The Collapse of US Banks*

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There is nothing mysterious about the reasons for the collapse of the Silicon Valley Bank and the Signature Bank in the United States. There is also nothing mysterious about why the entire banking system of the capitalist world has come under a cloud: once some part of the system collapses, the other parts of it get saddled with "toxic" assets, which are nothing else but the liabilities of the collapsed part of the system, and hence become subject to a "domino effect". The real issue is: how did US capitalism get into a situation where its banking system came under such severe strain? Since the collapse of these banks, especially of the SVB, is not an internal phenomenon but is reflective of a systemic contradiction, what exactly is this contradiction?

The obvious proximate factor behind the collapse of both banks is the rise in interest rates. We shall however confine ourselves here to the case of the SVB alone, since it highlights the systemic contradiction more clearly: the case of the Signature Bank is rather atypical since it was dealing with crypto-currencies that are notoriously unstable.

Any rise in interest rates ipso facto lowers bond prices: the price of a bond is simply the stream of its earnings over its life-time, discounted at the going interest rate; and if the going interest rate rises then the same nominal stream of earnings gives a lower price for the bond. Now, all banks hold a range of assets among which bonds are quite prominent. A rise in interest rates therefore, by lowering bond prices, reduces the value of a bank's assets relative to its liabilities, which puts the bank under strain.

Any effort made by the bank to overcome this strain amounts to an open admission before the world that it is under strain, and acts as a signal for the public to desert that bank; the value of its equity falls and this in turn makes depositors panicky who then withdraw their funds from it. This is what causes a run on the bank and brings about its collapse. The thing to note is that when a bank comes under such strain, it faces bleak prospects, no matter what it does: if it does not attempt any corrective measures then it is in effect opting to face a collapse; and if it does attempt some corrective measures then too there are strong chances that it may face a collapse. Its collapse under such circumstances therefore cannot be laid at the door of the bank itself; it has to be explained by macroeconomic factors external to it.

The foregoing argument may suggest that any rise in interest rates would trigger a bank collapse, but this obviously is not true. Interest rate movements decreed by the Central Bank normally occur as small changes at the margin; and in case of a small rise in the interest rate the strain on the banks is manageable. Banks can manage this strain without creating much panic in the "market". But when the interest rate decreed by the Central Bank is suddenly increased by a substantial margin, then banks are denied the opportunity to manage any asset-liability mismatch in a quiet and orderly manner.

And the US interest rate has been jacked up quite substantially of late. The Federal Funds Rate increased from 0.25 per cent in February 2022 to 4.75 per cent in February 2023. Such a massive increase in such a short time makes it impossible for

banks to manage their balance sheets smoothly. The real question therefore is: why has the Federal Reserve Board (the equivalent of the US central bank) been jacking up interest rates in this manner?

The basic answer is that under neoliberalism, the only weapon available for State intervention in the economy is monetary policy. Fiscal policy which for a long period after the Second World War was the primary instrument of intervention, recedes to the background under neoliberalism. Governments are forced by globally mobile finance capital to put a ceiling on their fiscal deficits relative to the GDP; and since any taxation of capitalists and the rich in general is taboo for the same reason, namely that it incurs the displeasure of globally mobile finance capital, the effort to stimulate activity in the economy takes the form exclusively of lowering interest rates.

True, the US has no "fiscal responsibility" legislation and is not constrained, either legally or because of any practical fear of a financial flight (for such a flight can scarcely occur from a safe base like the US), to keep its fiscal deficit in check; but, for the US to increase its fiscal deficit to stimulate activity amounts to creating jobs abroad (since a good part of domestic US expenditure "leaks" out as demand for goods and services produced abroad), while increasing its foreign debt. The US did of course enlarge its fiscal deficit massively during the pandemic, a fact to which some attribute the current US inflation; but that was only under the shadow of a pandemic. For a very long period after the collapse of the housing bubble, the primary instrument used for stimulating the economy was the pushing down of the interest rate to exceedingly low levels, in fact to levels close to zero.

The housing bubble collapsed in 2008. From late 2009, right until 2022, it remained stuck more or less at 0.25 per cent other than a brief interlude between 2016 and 2020 when the Federal Funds Rate was increased by stages to a maximum of about 2 per cent. This extraordinarily long period of extraordinarily cheap money, by reducing the risks for the US oligopolists of raising profit-margin and prices, certainly contributed to the current inflation; but it still did not push the US economy anywhere close to a high enough level of employment. True, the official US unemployment rate fell to a low of 4 per cent, but there was simultaneously a reduction in the labour force participation rate; the unemployment rate calculated by assuming that the labour force participation rate continued at the same level as in mid-2008, remained high throughout the period after 2008. And when inflation struck, the interest rate was jacked up hugely all of a sudden. The reason for this apparently irrational fluctuation in monetary policy, this yo-yo movement in the interest rate, lies therefore in the fact that under the hegemony of globally mobile finance, there is scarcely any alternative. In short, this apparent irrationality arises not because of any whimsicality on the part of the government; it arises because of the hegemony of global finance.

The adverse impact of such wild fluctuations is aggravated by a second factor. When the interest rate falls and bond prices increase, whether or not this has any stimulating impact on the economy, it does not at least pose any threat to the banking system. An increase in the value of a bank's assets does not undermine it in any way. But when the interest rate rises and bond prices fall, the value of a bank's assets falls relative to the value of its liabilities; this triggers reactions in the "market" that may push the bank into unviability. This asymmetry between the effect on a bank of a fall in the interest rate and that of a rise, acts further to undermine the banking system.

It is not just the American banking system but the banking system of the entire capitalist world that is threatened by the sharp increase in the interest rate that is occurring everywhere as the official policy response to inflation. Even such a well-known bank as Credit Suisse has also of late faced a collapse in its equity prices and is being taken over by its rival UBS.

What is more, the threat to the banking system of the capitalist world has by no means reached a plateau. The Federal Reserve Board was planning earlier to raise interest rates even further for countering inflation; it may go a bit slower now because of the collapse of the two US banks. But it has no option other than raising interest rates as inflation continues to persist, since the only way that inflation is fought under capitalism is by generating unemployment; and this is typically effected these days by a rise in interest rates. As capitalism flounders in crisis, demonstrations by workers all over Europe are further underscoring the dead-end that it has reached in its neoliberal phase.

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