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MARKET WRAP

by SPEX Analysts

The Fed's New Balancing Act

The banking crisis' effect on monetary policy

by Evan Juarez

On Wednesday, the Federal Reserve unanimously voted to increase the interest rate by a quarter percentage point. Fed Chair Jerome Powell stated that the central bank considered forgoing a rate hike as it grew concerned with the stress in the banking sector but ultimately decided to raise rates. Now confronted with the banking system's stress and inflation, the Fed's monetary policy faces opposing pressures when determining rates.

While inflation requires a rate hike, the banking crisis might need a rate cut. Increasing interest rates lowers the yield of long-term Treasury bonds, which comprise a significant portion of banks' balance sheets as they are deemed risk-free assets. If the loss in the value of Treasuries is great enough, banks can go insolvent. The Fed must balance these pressures when considering the overall interest of the US economy.

Suppose the losses are substantial enough that a bank has less capital than what its customers deposited. Uninsured depositors, customers who are only insured up to $250,000, can be especially skittish. In that case, the customers may grow concerned they will not get their money back and perform a run on the bank, quickly withdrawing their funds en masse, causing the bank to go insolvent.

Mr. Powell said that the Federal Open Market Committee might temporarily pause rate increases, depending on the extent of the decrease in lending. If the banking sector grows too panicked, banks will refuse to lend to each other not know who could be the next to go insolvent. The result is a freezing in lending.

Depositors at other banks can also panic about contagion and withdraw their money at an unprecedented speed due to the ease of withdrawals through digital banking. The result is a rapid, system-wide funds outflow and credit crunch, jeopardizing the entire financial system.

Additionally, the Fed cannot set the benchmark rate too low. High inflation will persist, causing increasing inflation expectations to make it harder to bring inflation down eventually. "Powell has fought so hard to gain credibility as the inflation fighter," said Ellen Meade, a former senior adviser at the Fed. "To not do anything just seems wrong to me in that context, especially given the data." If the central bank grows too sensitive to the banking sector, causing financial dominance to occur, the Fed will produce harmful monetary policy.

The banking crisis can also provide an opportunity for the Fed if addressed correctly. The recent tightening in lending can assist the central bank in cooling the economy. Discussing the change in lending conditions, Mr. Powell stated, "in a way, that substitutes for rate hikes." Economists at Goldman Sachs estimate the tightening in lending is equivalent to a 25 or 50 bps hike in the fed-fund rate.

If the banking sector's health further diminishes and forces the Fed to delay its rate hikes, the higher, more obstinate inflation will require the Fed to tighten even further. Higher rates will put the banking sector at even greater risk and lower the chances of a "soft landing" for the overall economy.

Meanwhile, if future inflation readings increase unexpectedly, the Fed may have to hike rates to a level detrimental to the vulnerable banking sector, endangering the financial system. A new round of rate hikes would further aggravate the problems banks are having on their balance sheets.

Confronted by opposing monetary pressures, increased urgency from the banking sector or inflation can be the tipping point that sends the economy into crisis and recession. However, if stress in the banking sector remains contained and inflation decreases, the Fed will have performed a successful balancing act.

– EJ

LATER ON:

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A Looming Indictment

Has Trump's day of reckoning finally come?

by Sachin Sundar

On Saturday, former President Donald Trump announced on his social media platform Truth Social that he expected to be arrested on Tuesday. A Manhattan grand jury has been hearing testimony about Trump's alleged payment to porn star Stormy Daniels. The charges against Trump specifically concern whether the Trump Organization reimbursed Michael Cohen for his payment to Daniels and classified the reimbursement as legal expenses. Under New York state law, the falsification of business records with an intent to defraud is a felony and legal experts speculate that New York District Attorney Alvin Bragg will build a criminal case against Trump on that charge.

Trump greets fans as he arrives at the NCAA Division I Wrestling Championships

While it is likely that the Manhattan grand jury will vote on Trump's indictment soon, it is unlikely that any significant proceedings will take place this week. Reports from law enforcement sources indicate that the Manhattan grand jury did not meet on Wednesday but did reconvene on Thursday. New York City authorities increased law enforcement presence around the Manhattan Criminal Court and have discussed expanding Bragg's security detail. Trump has capitalized on the NYPD's response to his possible arrest, using photos of police barricades in New York City to raise nearly $1.5 million in grassroots funding for his 2024 campaign. Trump has planned a rally in Waco, Texas for Saturday, March 25.

Manhattan DA Alvin Bragg

The media and law enforcement response to Trump's announcement of his arrest has certainly garnered a frenzy, but it would be wise for both Trump's critics and supporters to temper their expectations. First, it is unlikely that the public will witness Trump's perp-walk. Following a potential indictment, prosecutors would begin negotiations with Trump's defense attorneys over his surrender, which could take several days. If Trump surrendered, he would be flown to New York for his arraignment, after which he would likely be released since he would be facing nonviolent charges. It is even unlikely that prosecutors would be able to request any bail from Trump.

More importantly, any criminal charges that Bragg could bring against Trump regarding his alleged hush-money payment to Stormy Daniels would be highly unprecedented. According to election law experts, the New York state government has never prosecuted an election law case involving a federal campaign. Moreover, in order to convict Trump on felony charges, Bragg and his team would not only have to prove that the Trump Organization falsified business records but also that Trump knew about this falsification and did it with an "intent to defraud." Defenders of Trump have claimed that the money paid to Stormy Daniels was not a campaign donation but rather an extortion payment to prevent public embarrassment to Trump. At any point after Trump's potential indictment, there is the possibility of the court simply throwing out the case.

Even if Bragg and his team could overcome all of these potential hurdles and convict Trump on felony charges, there is no reason to believe that it would significantly hinder him as a political force. It is still likely that Trump would secure the Republican nomination for president as he has been leading in the polls and even his potential primary rivals, such as former vice-president Mike Pence, have decried the prospect of Trump's arrest. If Trump was convicted, he could still legally run for president and have his name appear on the ballot.

This would not be historically unprecedented: labor leader Eugene Debs ran for president from a prison cell in 1920 (his supporters even wore a campaign button that read "For President Convict No. 9653"). And while a president pardoning themselves is technically legally uncharted territory, it would be no surprise if a convicted President Trump moved to do so in 2025.

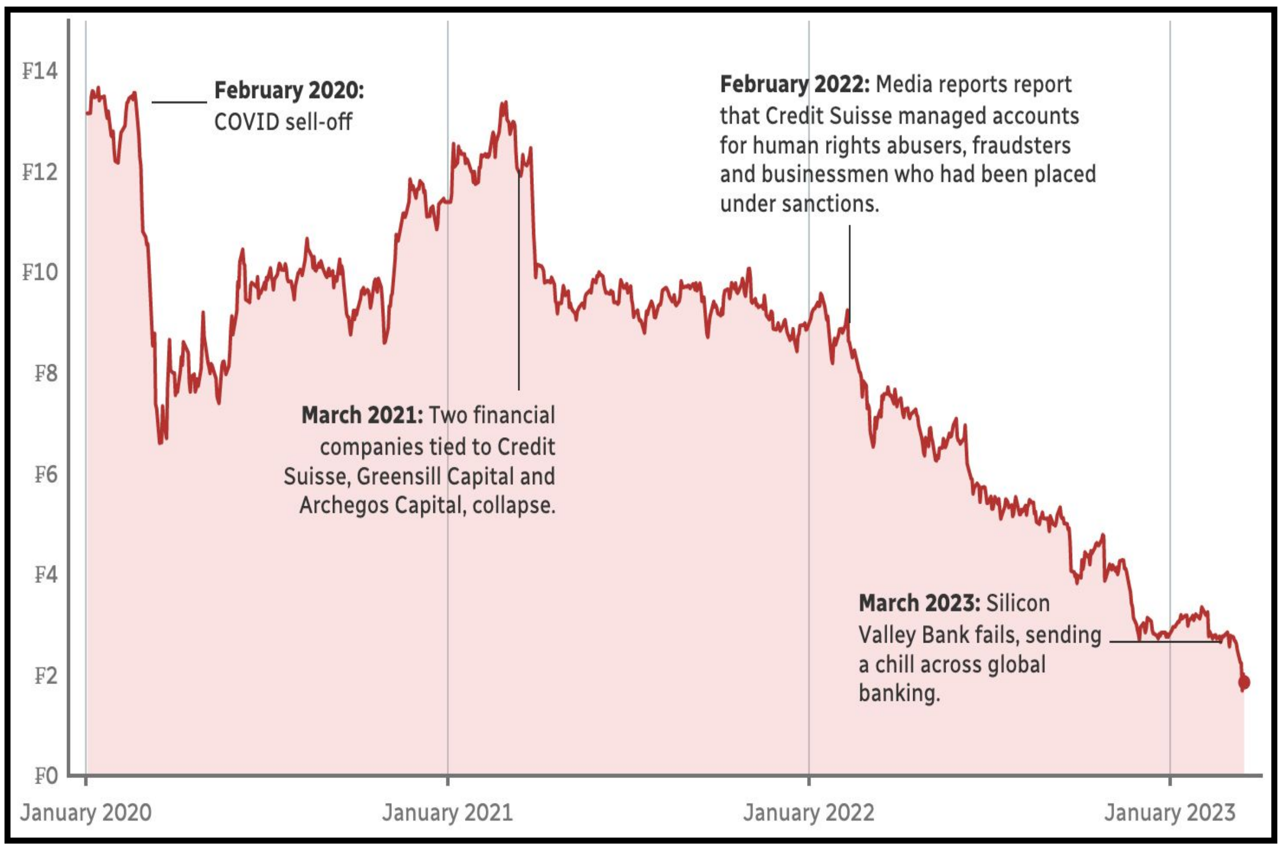
This is not to claim that the indictment and arrest of Trump would not be monumental. It would be the first time in American political history that a former president has been indicted, which is certainly significant. Undoubtedly, an indictment of Trump would affect his prospects in a general election.

Regardless, the critics of Trump should temper their expectations about the effects of a possible indictment and recognize that Trump remains a force to be reckoned with. *-SS*

New Swiss Bank Superpower

Credit Suisse and UBS Merger

by Vihaan Hari



Continuous Decrease in Credit Suisse Stock Indicating Decrease in Popularity

Over the past years, Credit Suisse has been steadily losing the confidence of its investors. From illegally allowing U.S clients to evade taxes to an accounting scandal at Luckin Coffee to even the collapse of Archegos Capital, Credit Suisse has lost the trust of its clientele. However, with the recent news of the Silicon Valley Bank and Signature Bank collapsing, clients' lost their last bit of hope, causing them to abandon Credit Suisse and withdraw their savings. As a result of pressure from the Swiss National Bank, UBS was forced to merge and save the Swiss economy while bettering its own finances.

This merger between these two powerful banks will ultimately produce the long-term results and economic stability the Swiss National Bank hoped for. Firstly, investors' confidence levels in the banking systems will bounce back to normal after seeing how quickly UBS bought Credit Suisse after the fall of banks in the US. Knowing that the government was able to quickly take action and close a deal that consolidated the two banks reassures consumers that there is a safety net for their deposits. While confidence in banks increases, current investors suffer hefty losses due to Credit Suisse's primary reliance on AT1 bonds, which defaulted, indicating a short-term loss. However, the benefits of the merger outweigh the short-term losses as the benefits of the merger deal due to the prevention of further collapses.

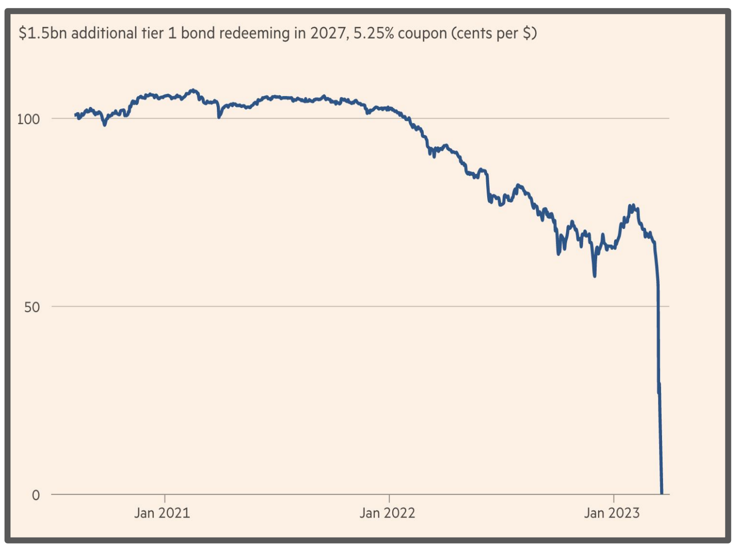
Unlike in 2008, when banks were falling one after another, UBS contained the problem by limiting the spread of collapses by merging with Credit Suisse. Individually, both banks are a part of the top 30 globally systemically important banks. Put together, this joint bank creates a single entity too big to fail, with its astounding amount of capital and funds. For UBS, this merger represents a long-term future filled with opportunity.

Being guaranteed a liquidity line of more than $100 billion, coupled with the complete write-off of AT1 bonds, means UBS possesses sheer amounts of money to lend.

As seen from the heavy pressures and influence from the Swiss National Bank, the government had strongly shaped the restructuring of banks. Because of their successes in containing the succession of bank collapses, it is likely for governmental intervention to become the norm when a banking crisis arises. In the Credit Suisse Merger, the trinity of the Swiss National Bank, regulator FINMA, and the Minister of Finance forced Credit Suisse to a merger with UBS; despite Blackrock showing signs of interest. When Credit Suisse did not initially agree, the government resorted to legal action by threatening to strip shareholders of the right to vote on the deal and even remove the Credit Suisse board.

In this situation, government intervention worked due to a boost in confidence in clients. Because the government rapidly ensured that clients' deposits would not be lost by backstopping the funds of the merged banks, clients did not feel the need to withdraw all of their money. Mirroring this course of action would be beneficial if and when another bank collapses. Because banks are so dependent on any changes in public opinion, designing governmental policies that support banks in the case of collapse is imperative to contain the domino effect that typically occurs when one bank collapses.

While governmental intervention will become the norm due to its ability to maintain economic stability, it must be acknowledged that the behaviors of banks will differ creating a moral hazard. Knowing a safety net exists, banks will choose to take on riskier investments. To counter this, governments can increase regulations to deter risky behavior by strengthening the risk standards in the form of increasing risk-based capital standards or risk-based deposit insurance premia. Taking this course of action will not only ensure banks limit the risks taken when investing but also provide a governmental backbone that restabilizes the economy in the event of a bank collapse. - *VH*



AT1 bond redemption dramatically decreases