First Republic a Fourth Failure as Credit Crunch Claims Another Victim

Another regional bank falls, but the markets are seeing the forest from the trees as challenges appear contained.

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What's happening?

First Republic Bank (ticker: FRC) has been seized by regulators and its deposits and assets sold to JPMorgan Chase & Co., ending a month of speculation about the bank's potential insolvency. Last week, the company reported it had lost over $100 billion in deposits in March following the collapse of Silicon Valley Bank. Its pursuit of "strategic options" ultimately fell through, and by the end of the week, the FDIC was working with large banks to facilitate a sale. FRC is the second-largest bank failure in U.S. history, behind Washington Mutual in 2008.

Although some First Republic clients may be wondering if their checks still work[1], markets are taking the news in stride. In contrast to 2008, the banking system today is better capitalized, has greater liquidity, and employs less leverage. Regulators have also moved with great speed and force to shore up confidence among depositors. As a result, the risk appears contained to a few regional banks that mismanaged duration risk and assumed deposits would be sticky. In fact, shares of other regional banks have been resilient, as broader deposits rebounded in April and have since stabilized following withdrawals in March.

What does it mean?

As we noted in our recent CIO letter, A Volatile Journey to a Better Place, credit has become significantly less available and more costly over the past year. The challenges at Silicon Valley Bank, Signature Bank, Silvergate Bank and First Republic Bank have simply exacerbated this trend. Last week's Fed testimony about recent bank failures sent a strong message that stricter enforcement and additional rules are forthcoming. Tighter credit could affect spending and hiring, potentially curbing growth. Other risks include longer-term effects of higher financing costs and questions about the resiliency of household balance sheets.

However, stricter lending standards also have the same effect as rate increases. As key inflation signals show signs of cooling, the Fed is likely to be less aggressive than it was at the start of 2023. Our base case is that the economy can continue to slow without going into a deep recession. That said, the collapse of First Republic shows that the fallout from higher interest rates isn't over, and investors must prepare for a variety of scenarios.

The volatility that markets have experienced is a necessary part of moving away from zero-bound rates and crisis-era stimulus policies. Although that may be uncomfortable at times, volatility should be a lot easier to bear when you're moving toward a healthier, more balanced economy and a sustainable rate structure.

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1. Clients will receive uninterrupted service according to a statement by JPMorgan Chase.

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