OBSERVATIONS: *Light macro week; the Fed, and banks in focus again*

- Funding strains, continued regional bank concerns, and fresh European bank concerns now with Deutsche Bank have driven bond yields lower as bond markets have rallied. The 2-Yr US Treasury yield reached 3.76% last Friday, a drop of nearly -25bps on the week and down -125bps since March 8, 2023. [1]
- Existing home sales reversed a 12-month slide by increasing in February to 4.58 million annualized-rate—about +14% higher than January's existing home sales.[1] Existing home sales increased on a month-over-month rate in each of the four US regions, Northeast, South, Midwest and West.[1]
- New single-family home sales were +1.1% higher in February than January, but overall home sales came in below expectations and are -19.0% below the level of sales from Feb-2022.[1]
- Inflation in the UK remains stubborn, rising +10.4% (higher than all estimates) in February on a year-over-year (YoY) basis from January's reading of +10.1% YoY. Meanwhile, the Bank of England raised rates as expected by +25bps to 4.25% last Thursday. [1]
- Adding to intraday volatility? Zero day to expiry options (aka ODTE options are options contracts with less than a day before expiration) now account for over 40% of options trading in the S&P 500. Pre-Covid ODTE accounted for around 10% of all S&P 500 option activity.[1]
- Durable goods orders came in below expectations declining -0.1% in February from January. Excluding the more volatile transport goods segment, there was no change in durable goods orders from January to February.[1]

EXPECTATIONS

- The Fed raised the Fed Funds rate by +25bps to a new target range of 4.75% to 5.00%, reaching what many think will be the 'terminal rate.' Futures markets are currently pricing in only a 20% chance of any further rate hikes this year. A notable change in the Fed's statement was shifting language describing the future path of rates from anticipating "ongoing increases" to "some additional policy firming may be appropriate." Chair Powell also noted the Fed was prepared to "use all of our tools" to ensure the banking system remains safe.[1]
- US Treasury officials are evaluating whether it has sufficient authority to temporarily insure deposits greater than $250k without having to rely on Congress in the event of a more systemic crisis. Since the FDIC's formation in 1934, deposit insurability limits have been changed seven times from $2,500 in 1934 to the most recent increase in 2008 which took the limit from $100k to $250k—any change has to be authorized through new legislature (see One More thought).[2]

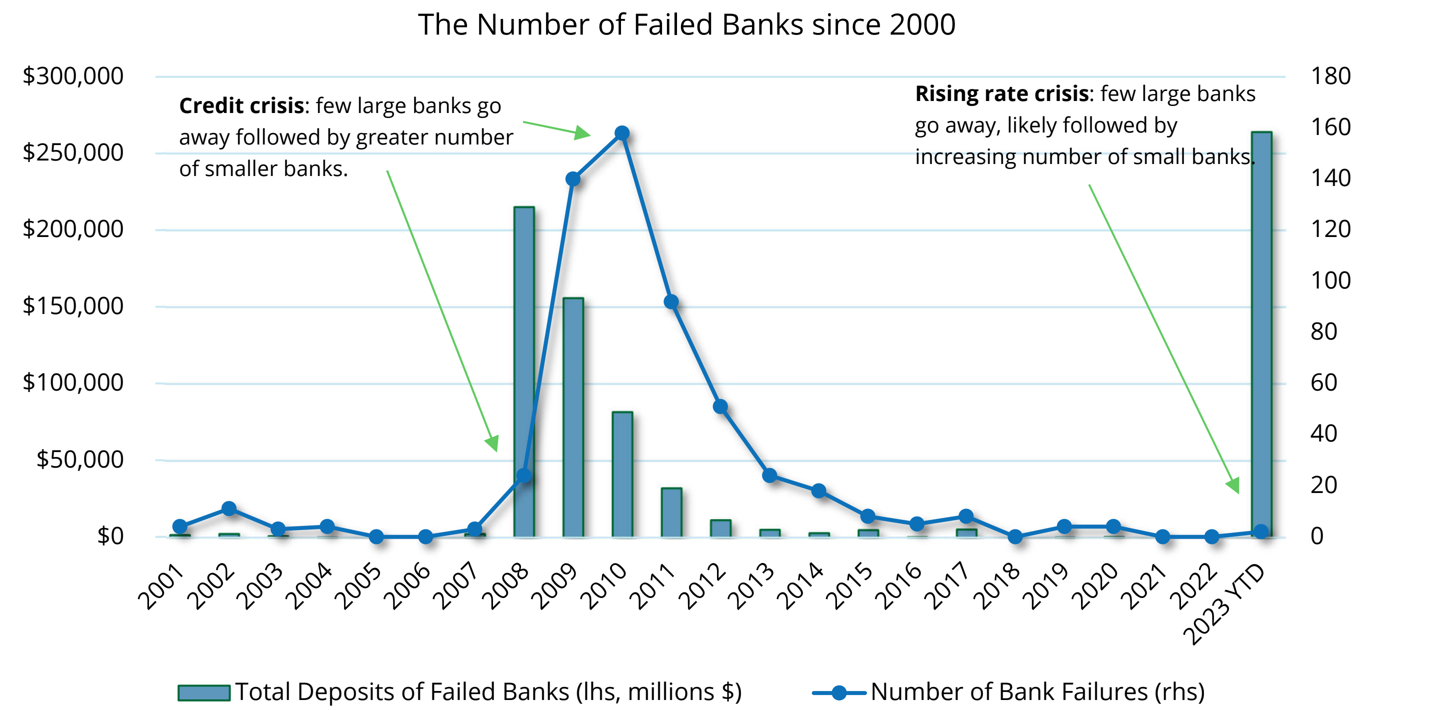
ONE MORE THOUGHT: *Bank failures and the Systemic Risk Exception*[3]

From 1934 to 1981 the US averaged about 15 bank failures per year. From 1980 through 1991 nearly 1,300 banks failed. In 1991, the Federal Deposit Insurance Corporation Improvement Act (FDICIA) was passed in response to the Savings and Loans crisis which ultimately cost taxpayers over $100 billion. The FDICIA has two significant provisions when dealing with troubled banks; (1) prompt corrective action and (2) least cost resolution – meant to reduce the

[1] *Bloomberg LP*
[2] *Bloomberg LP, https://www.fdic.gov/about/history/timeline/2000s.html*
[3] *https://www.atlantafed.org/-/media/documents/research/publications/economic-review/2002/vol87no1_eisenbeis-wall.pdf, https://www.federalreservehistory.org/essays/fdicia, https://crsreports.congress.gov/product/pdf/R/R47026, FDIC.gov, https://www.fdic.gov/bank/historical/crisis/chap2.pdf, https://www.fdic.gov/bank/historical/crisis/podcasts/-episode4, https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2022dec/qbp.pdf#page=1*

impact to taxpayers in the event of bank failure(s). It has been generally understood that the provisions limit the FDIC's ability to take losses that would normally be assumed by uninsured depositors and non-deposit creditors. *Pre FDICIA passage, the FDIC had protected uninsured depositors through other supporting measures, though not mandated by law to do so.* This is really where the moral hazard starts. Depositors are lenders to banks and current insurance provisions for depositors are set at $250,000 by law. Beyond that statutory limit, there is no legal precedent to protect uninsured depositors, yet as noted, the ongoing assumption is that an implicit protection exists—despite the potential consequences to taxpayers (though rightfully so when systemic risks are involved). One of the more direct effects of the assumed protection is that it has greatly reduced uninsured depositor discipline in the assessment of banking relationships, and we observe that even today as uninsured depositors deem themselves as 'ringfenced' from any potential bank problem. *To be sure, weak regulatory oversight shares in the blame for recent problems.* Importantly, part of the FDICIA's 'least cost resolution' provision calls for systemic risk exceptions (SRE) which may require protection for uninsured depositors on the basis of systemic risk considerations (i.e., too big to fail). The SRE had never been used until the Great Financial Crisis, when it was used with Wachovia, Citigroup, and the Temporary Liquidity Guarantee Program (TLGP)—which in the case of the TLGP meant that for the first time, the FDIC would be covering something other than deposits. The SRE is the framework that the FDIC, in conjunction the Federal Reserve, and US Treasury, relied on with regards to the uninsured depositors of Silicon Valley and Signature Bank as deposit flights from these banks were assumed to lead to broader systemic concerns. From here on, it is not clear how uninsured deposits—which account for an estimated 43% of the $18 trillion in total deposits at FDIC insured institutions— will be handled though government officials, notably US treasury Secretary Janet Yellen recently noted that "similar actions could be warranted if smaller institutions suffer deposit runs that pose the risk of contagion." *Note: The Deposit Insurance Fund currently has a balance of $128 billion.* Despite increased pressure on lifting the cap for insured deposits, legislative movement here is not likely in the near term. In the meantime, the recently announced Bank Term Funding Program and the assurances made by the Federal Reserve and the US Treasury have helped to promote an increased confidence for depositors. In the worst case of systemic scenarios, the TLGP or a similar construct would likely be implemented to protect uninsured depositors but not the stock or bond holders of troubled institutions.

CHART OF THE WEEK



Source: Clearstead, FDIC.gov

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