Market Flash

ASEAN+3 Markets Weather Credit Suisse and SVB Storms – but Risks Remain [1]

March 29, 2023

Bottom Line

- *The recent banking stresses have clearly triggered a sharp increase in risk aversion. While the initial reaction of ASEAN+3 markets has been more muted compared with those in US and European markets, volatilities in the markets remain high.*

- *Our network analysis suggests that while the Silicon Valley Bank (SVB)'s top contagion interconnections are concentrated in the US, CS appears to have more interconnected nodes with financial institutions in the ASEAN+3 economies, including banks and insurance companies from China, the Philippines, Korea, Indonesia, Malaysia, and Hong Kong.*

- *Thus far, we do not envisage an imminent systemic financial crisis thanks to swift actions by the authorities in the US and Switzerland, which have curbed the spillovers and provided some support to the markets. In addition, banks in the region and elsewhere have built up significant buffers including robust liquidity, capital and funding standards, following the implementation of stricter global banking regulatory standards since the Global Financial Crisis.*

- *That said, the risk of second and third order effects on regional banks could not be ruled out, especially if the situation around CS, which is a G-SIB, worsens.*

1. **Market concerns over the banking sector are on the rise recently.** The concerns were initially triggered by negative news flow around the shutdown of three US regional banks (SVB, Signature Bank and Silvergate). This week, stress rose further due to the concerns over the health of Credit Suisse (CS) whose share prices fell by 24% on March 15, 2023 at the SIX Swiss exchange. While the US regional banks catered to a narrow segment of customers, CS is one of the Global Systemically Important Banks (G-SIBs).

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What has triggered the CS stress?

2. **The fall was triggered by the refusal of Saudi National Bank (SaNB, which is the largest investor of CS) to provide CS with more financial injection,** citing additional regulatory requirements, which will kick in if it owns more than 10% stake at CS.

- While the SaNB expressed satisfaction with CS's turnaround plan and does not expect that CS would need more capital, it also said that its investments in CS are opportunistic and will be unwound once CS shares acquire proper value.

- The SaNB had bought the 9.88% stake (CHF1.4bn) in CS during October 2022 after CS announced that it will "radically restructure" its investment arm to significantly cut exposures to risk-weighted assets.

3. **More fundamentally, CS has been grappling with multiple issues over the past couple of years.** In fact, the share price has been in a continuous downtrend since the Archegos Capital Management incident in March 2021. CS shares lost 22% of its value in 2021, 67% in 2022 and 39% in 2023 (year-to-date). Some underlying problems around CS include:

- Issues with risk management and internal controls: CS in its 2022 annual report acknowledged that it had identified "material weakness" in its internal controls over financial reporting. The report said that the "management did not design and maintain effective risk assessment process to identify and analyze the risk of material misstatement in its financial statements". Reportedly, the issues were first identified by its auditor PwC and the SEC intervened last week to double-check if these issues had impacted the financial results.

- Financial and reputational losses: The bank took financial and reputational losses due to various incidents such as the collapse of Archegos Capital Management, supervisory breach in relationship with Lex Greensill, misleading authorities on spying on employees and Mozambique corruption case, and massive client data leak.

- Severe losses and poor outlook: CS reported the biggest loss in 2022 (CHF7.3bn) since the GFC (2008) and is expected to make substantial loss in 2023 as it absorbs restructuring costs. The bank reported a severe outflow of deposits in Q4 2022 indicating a loss of confidence among customers. A large-scale restructuring plan was announced in October 2022, which included cutting workforce, spinning off its investment bank, and narrowing the focus of business. However, it failed to improve investor and customer confidence.

What are the differences between the SVB and CS stress episodes?

4. **Both stress episodes materialized against the backdrop of falling deposits, but for different reasons:**

- In the case of SVB, the slowdown in tech sector and losses in securities investment led to a fall in deposits while in the case of CS, it was an outcome of falling customer and investor confidence amid financial and reputational loss.

- More generally, SVB collapsed after a bank run and failure to raise funds (which was triggered by realized losses on its securities portfolio) while CS faced a further deterioration of investor confidence after gaps in risk management were exposed.

How did the Swiss central bank rescue CS?

5. **The Swiss National Bank (SNB) stated that it stands ready to provide liquidity to CS and, along with Swiss Financial Regulator FINMA, and gave assurance that CS meets the higher capital and liquidity requirements applicable to systemically important banks.**

- CS tapped in the liquidity facility and borrowed CHF50bn from the SNB and also announced a repurchase of CHF3bn of senior debt securities while reiterating its commitment to "move forward rapidly to deliver a simpler and more focused bank".

- SNB and FINMA's joint statement helped shore up some confidence and CS ADR recovered to close lower by 14% by the end of US session. The stock surged as much as 40%, the most of on record, at the open in Zurich before paring gains.

What are the risks of spillovers to ASEAN+3 markets?

6. **The impact of these stresses has been less severe in ASEAN+3 than in advanced markets in the US or Europe.**

- The impact has been severe on global equity markets, especially banking stocks. The impact on US, European and Swiss broad equity indices has been much larger and the financial sector stocks have seen more weakness.

- However, the impact on ASEAN+3 markets has been more muted and, in most cases, financial sector stocks have not lagged too far behind the broad equity indices. There is a clear underperformance of financial index (as compared with the broad index) only for Japan (Figure 1). The financial indices in the region have underperformed a bit more around the events of CS than during the SVB episode, which highlights the importance of CS as a G-SIB.

  That said, investors will try to identify banks which may have issues similar to SVB and CS such as trends in deposits, concentration of customers, interest rate sensitivity of portfolio investments, and robustness of risk management.

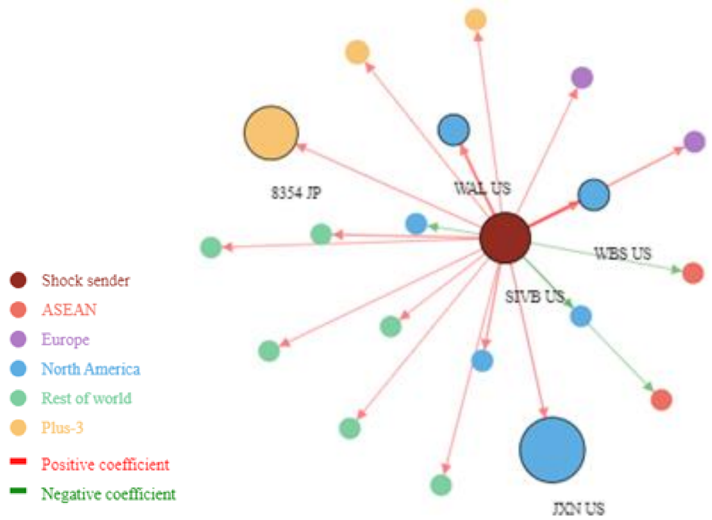
Figure 1. Performance of Selected DM and ASEAN+3 Markets Around Recent Banking Sector Stress Episodes
(Percent)

	US	Europe	Switzerland	Japan	China	Hong Kong, China	Korea	Indonesia	Malaysia	Philippines	Singapore	Thailand	US, EU, CH (average)	Plus-3 (average)	ASEAN average
Change since March 3, 2023															
Broad index	-2.3	-4.7	-3.7	-4.2	-4.7	-5.9	-2.0	-2.3	-4.1	-3.5	0.0	-2.7	-3.6	-4.2	-2.5
Financial Index	-11.4	-11.1	-11.5	-12.0	-3.8	-9.1	-5.3	-1.3	-5.6	-4.2	-3.3	-5.4	-11.3	-7.6	-3.9
Change around SVB (and other US regional banks) events															
Broad index	-3.4	-3.8	-3.5	-2.3	-1.0	-2.8	-1.9	0.8	-2.5	-2.6	-4.1	-2.5	-3.6	-2.0	-2.2
Financial Index	-10.3	-8.1	-8.8	-6.6	-2.7	-2.9	-1.3	1.0	-2.8	-3.1	-3.8	-6.2	-9.1	-3.4	-3.0
Change around CS events															
Broad index	-0.7	-2.9	-1.8	-1.1	-1.4	-2.3	-0.1	-0.3	-0.7	-0.8	0.1	-0.5	-1.8	-1.2	-0.4
Financial Index	-2.8	-5.9	-6.6	-3.6	-0.7	-3.8	-2.0	-0.2	-0.9	-1.9	-1.0	-0.7	-5.1	-2.5	-0.9

Note: The MSCI equity indices are used for calculations across countries to ensure consistent definitions across markets.
Sources: Bloomberg Finance L.P.; and AMRO staff calculations.

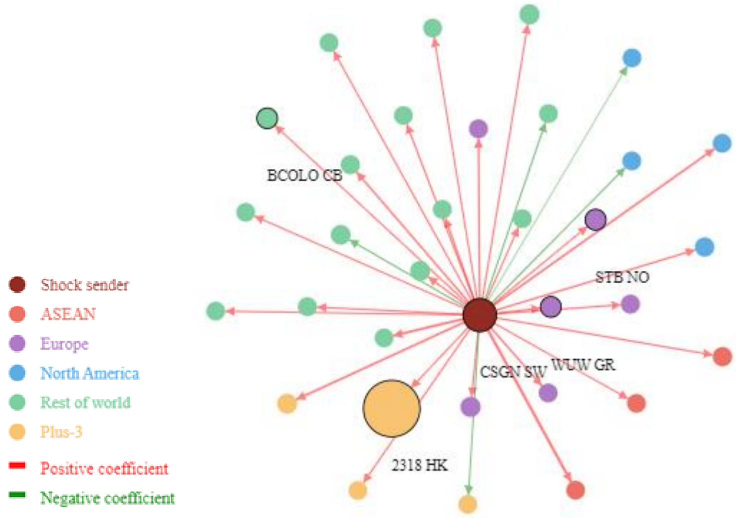
7. **Based on network analysis, CS has greater linkages with ASEAN+3 than does SVB.** To estimate the possible direct spillover effects of SVB and CS's to the ASEAN+3 region, we utilize Systemic Network of World Expected-Losses of Institutions ("SuNWEI"). From the depicted financial networks, SVB's top contagion interconnections are concentrated in the US (Figure 2). CS appears to have more interconnected nodes with financial institutions in the ASEAN and Plus-3 economies, including banks and insurance companies from China, the Philippines, Korea, Indonesia, Malaysia, and Hong Kong, China (Figure 3).

Figure 2. First-order contagion: SVB Financial Group



Note: AMRO's SunWEI tool was used to estimate the expected costs to the wider financial system from shocks to listed financial institutions. In the networks depicted above, each node denotes a unique financial institution. The size of the node represents the financial institution's total liabilities, and the color its country of domicile. Two nodes are connected by a directional arrow, whose thickness represents the extent to which the Probability of Default (PD) of the "risk sender" affects that of the "risk receiver". A positive coefficient indicates positive co-movements of PDs, which are used to estimate financial interconnectedness.
Sources: Credit Research Initiative of the National University of Singapore; and authors' calculations.

Figure 3. First-order contagion: Credit Suisse



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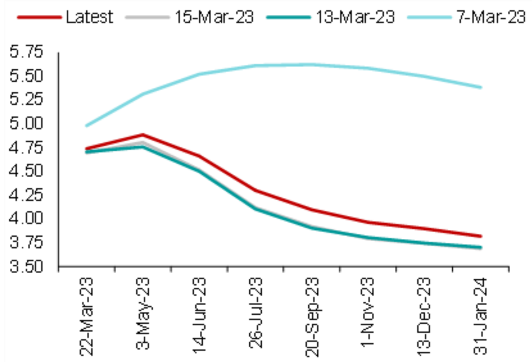
What is the impact on market's pricing of Fed and ECB policy path?

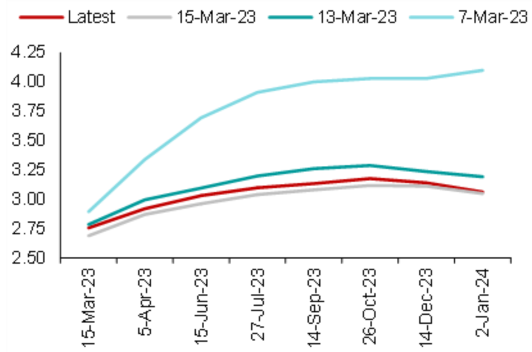
8. **In the immediate aftermath of the recent banking turmoil, markets are pricing in less hawkish stances for Fed and the ECB (Figures 4 and 5) in order to preserve financial stability.** In a scenario where the Fed and ECB ease their hawkish stance and the banking sector stresses are effectively contained, the backdrop for risk assets will improve significantly. The risk assets can perform strongly in this scenario once volatility in the markets subsides.

Figure 4. Change in Fed Pricing
(Percent)



Sources: Bloomberg; and AMRO Staff calculations.
Note: Latest data as of March 16, 2023.

Figure 5. Change in ECB Pricing
(Percent)



Sources: Bloomberg; and AMRO Staff calculations.
Note: Latest data as of March 16, 2023.

Conclusion

9. **Financial stability risks have risen amid a global monetary tightening environment, with the failure of SVB triggering a sharp increase in risk aversion, which was further aggravated by the worries over CS's health.** While the initial reaction of ASEAN+3 markets has been more muted compared with those in US and European markets, volatilities in the markets remain high.

10. **Thus far, imminent systemic risks seem contained, thanks to the swift actions of the authorities in the US and Switzerland.** Furthermore, banks in the region as well as many jurisdictions elsewhere have built up significant buffers including robust liquidity, capital and funding standards, following the implementation of stricter global banking regulatory standards since the Global Financial Crisis. These buffers will prove critical in withstanding any global financial stability risks.

- That said, the SVB incident has shown that there is a risk that pockets of vulnerabilities exist in the banking sector which can face more stress than others in adverse conditions.

- While based on preliminary analysis, the direct exposure of ASEAN+3 banks do seem limited. However, we cannot rule out the risk of second and third order effects on regional banks, which could be significant, especially if the situation around CS, which is a G-SIB, were to worsen.

- Any further shock from the banking system or otherwise could amplify the negative effects on markets, given the already fragile risk backdrop. In such a scenario, backstops provided by authorities—especially in jurisdictions of the source of the shock—will be critical in mitigating the spillovers to other markets.