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Silicon Valley Bank collapses, the bailout has begun

written by Gary Wilson
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March 11 — Silicon Valley Bank, the 16th largest in the U.S., was shut down on March 10 and put under the control of the California Department of Financial Protection and Innovation.

“The fact that the FDIC took over the bank during the day — rather than Friday evening, which is the normal procedure — shows just how fast-moving and chaotic this situation, including a massive run on the bank, had become,” commented financial journalist [Wolf Richter](#).

SVB had \$175BN in deposits as of December 31. About \$151.5BN of the deposits are

uninsured. The collapse of SVB is the second largest (by assets) bank failure in U.S. history after Washington Mutual, which collapsed in 2008.

As the takeover of SVB was being executed, Treasury Secretary Janet Yellen said at a hearing before the U.S. House Ways & Means Committee that the department is monitoring “a few” banks amid issues at SVB.

“There are recent developments that concern a few banks that I’m monitoring very carefully and when banks experience financial losses, it is and should be a matter of concern,” Yellen said.

“The [SVB] collapse was a byproduct of the Federal Reserve’s hiking of interest rates by 1,700% in less than a year,” reports [Business Insider](#). “Once risk-free Treasuries started generating more attractive returns than what SVB was offering, people began withdrawing their money, and the bank needed a quick way to pay them. They were ultimately forced to sell their loan portfolio at a huge loss.”

[Christopher Whaler, Chairman of Whalen Global Advisors in New York, said](#): “There could be a bloodbath next week as banks are in trouble, the short sellers are out there, and they are going to attack every single bank, especially the smaller ones.

“I think [the fall of crypto bank] Silvergate started it. That one was the first pebble to go off the mountain and now we have a boulder and more are likely to follow.”

The collapse of crypto

Before SVB, two high-profile failures were attributed to the high interest rates.

The first was the collapse of the cryptocurrency market. Since the Fed started raising interest rates in March 2021, Bitcoin has plunged more than 65%. This contributed to the demise of the cryptocurrency exchange FTX, founded by Sam Bankman-Fried.

On March 8, crypto bank Silvergate went into liquidation. There's also been a double-digit decline in high-growth tech stocks over the same period.

Signature, one of the main crypto banks, was hit hard on March 10, with shares sinking 32% before trading was halted for volatility. CNBC reported that Signature's losses were almost 50% for the week. First Republic Bank, PacWest Bancorp, and Western Alliance Bancorp were among the other banks whose stock trading was halted for volatility.

[UPDATE: Signature Bank collapsed and was shut down on Sunday, March 12. This is the third-largest bank failure in U.S. history. Federal regulators have taken over.]

A bank run is the capitalist "free market" method of keeping the banking system solvent. During a bank run, many depositors lose confidence in the banking system, and seemingly all the depositors at the same time demand payment in cash.

During a general bank run, the banks scramble for cash. Commercial banks halt new loans to conserve cash, and existing loans are called in. A bank run causes credit to seize up throughout the economy. Businesses also are forced to scramble for cash as the banks and other creditors call in their debts. Forced to raise cash quickly, they dump their unsold commodities at considerable losses causing prices to fall sharply. Production, trade, and, most significantly, employment falls sharply.

The Banking Panic of 1933

The most famous bank run is known as the Banking Panic of 1933. In response, in 1934, the Federal Deposit Insurance Corporation was established, backed by the full credit of the U.S. government. Even if the Federal Deposit Insurance Fund were exhausted, the U.S. government would be charged with coming up with the money to pay off the depositors of failed banks, at least up to the insured limit.

The result, however, is that while the FDIC makes bank runs less likely in the short

run, it has made the solvency of the banking system erode over time.

Government-backed bank insurance creates what is called a “moral hazard.” When banks and their depositors fear runs, the managers are under pressure to use caution and avoid risks. But when the government deposit insurance “guarantees” deposits, bank managers figure there is little danger they will ever face a run. Therefore, they will pay less attention to maintaining reserves and take more risks to maximize profits for their shareholders, including the bank managers. That risk is the “moral hazard.”

Today, bank regulators cannot liquidate an insolvent bank as they did in the 1930s. In today’s credit-run world, even petty transactions like purchasing morning coffee are done with debit cards, credit cards, and smartphones.

The FDIC has already announced that “the main office and all branches of Silicon Valley Bank will reopen on Monday, March 13, 2023. ... Banking activities will [also] resume ... including online banking and other services. Silicon Valley Bank’s official checks will continue to clear.”

In the current crisis, the banks hold the government hostage. They demand anything and everything to bail us out, or we will take you down with us. As long as capitalism rules, the bankers are not lying when they say this.

On cue, Rep. Ro Khanna (D-Calif.), whose Silicon Valley district includes both the bank and many of its venture capital and startup clients, called on the White House and Treasury to do “whatever is legally permissible & appropriate to support the Bank which is central to the startup & tech economy,” in a tweet.

[UPDATE: On March 12, the Federal Reserve, Treasury Department and the Federal Deposit Insurance Corporation unveiled a plan to rescue uninsured depositors, Semafor reports.

Only customers with deposits \$250,000 and below are insured by the FDIC. But by invoking a “systemic risk exception,” they’ll now be able to cover larger accounts, which make up a much higher percentage of SVB’s deposits than most banks.

The Fed also announced a new “Bank Term Funding Program” with \$25 billion from its Exchange Stabilization Fund that would provide temporary loans to financial institutions as needed.

The bailout has begun.]

Interest rates

Unlike stock market price fluctuations that have little effect on the real economy, changes in long-term government bond interest rates have a big impact. This is because mortgage, auto, commercial and industrial loan interest rates are tied to those of long-term government bonds.

The Federal Reserve System and its Open Market Committee appear to be in command of the course of the capitalist economy. If the Fed lowers interest rates, it leads to inflation and a recession. If the Fed raises interest rates, the result is slow growth, bank failures, or outright recession with rising unemployment. A tight monetary policy (higher interest rates) can worsen an inevitable recession. No policy followed by the Federal Reserve can prevent a recession and mass unemployment from developing once capitalist overproduction has gotten to the point where it floods the market with unsold commodities, destroying profitability.

The COVID shutdown in 2020 resulted in capitalist underproduction. The economic boom that rose after the COVID shutdowns ended led to a wave of commodity hoarding, triggering overproduction. The Fed’s easy money policies (low interest rates) drove commodity prices higher in terms of dollars as well as gold.

As a result, overproduction was accelerated as unsold commodities tied up shipping

ports. Fearing that the suddenly overheated economy would crash unless promptly reined in, the Fed was forced to reverse course and drive up interest rates to restrain the boom.

The result can be seen in the fall of cryptocurrencies in 2022, the collapse of FTX and the crypto bank Silvergate, and now the collapse of Silicon Valley Banks.

Major corporations, including Amazon, Goldman Sachs, META (parent company of Facebook), and Twitter, among others, have announced major layoffs.

Average hourly earnings growth slowed greatly in February while the unemployment rate increased.

The Fed can't control the economy like controlling the water level in a bathtub.

Lowering interest rates will not revive business until excess inventories — overproduction — have been liquidated. A period of overproduction must be followed by a period of underproduction. Only the inevitable recession — a period of underproduction and mass unemployment liquidating overproduction — can reverse the capitalist bust.

