GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Stress Among US Regional Banks: Recent Market Developments and Risks to Financial Stability

TUESDAY, MAY 9, 2023

US REGIONAL BANKS FACED A BRUTAL SELLOFF LAST WEEK

Several US regional banks came under renewed pressure in equity market last week after JPMC's acquisition of First Republic Bank (FRC) failed to reassure investors that the worst of the US banking turmoil was over. News that PacWest Bancorp and Western Alliance are exploring "strategic options"—the latter have denied doing so—prompted the regional bank KBW index to fall by as much as 7% intraday on Thursday before rebounding by Friday. PacWest[1], Western Alliance, and Metropolitan Bank have lost over 50% year-to-date amid extremely heavy short-selling volume (relative to outstanding liquidity) triggering stock trading volatility halts (Figure 1). Notably, the market perceives thematic contagion in the market, even though these banks had significantly more upbeat first quarter results than FRC, disclosed available liquidity, and noted that deposits remained stable in April.

WHAT HAS DRIVEN THE SELL-OFF OF BANK-STOCKS?

The failures of SVB and Signature exposed the structural challenge facing the business models of regional banks. Market sentiment remains extremely negative towards regional banks amid large stock price declines, which can become self-fulfilling as it leads to deposit outflows which further feeds into the negative sentiment (Figure 2) and a differentiation among US regional banks is taking shape – small vs. large banks

Recent stress reflects concerns about the ability of smaller lenders to cope with a higher rates environment, along four dimensions: 1) deposit outflows, due to a lack of confidence in regional banks and to higher-rate alternatives like money market funds, 2) the reliance on uninsured deposits as a source of funding, and the share of uninsured deposits to total deposits, 3) the amount of unrealized losses in AFS/HTM portfolios, and 4) lending concentration to commercial real estate. In addition, there appears to be increasing scrutiny on banks' utilization of liquidity facilities (BTFP, DW, FHLB advances), which is interpretated as an indication of liquidity stress, as well as banks' business models that are more likely to experience medium-term earnings challenges as funding costs increase, especially for those specializing in real estate and transactional banking. (Figures 3 and 4, Table 1). Investor sentiment have also been made more fragile by negative news headlines that quickly spread through social media (Table 1). Market participants also point to speculative short sellers that likely exacerbated the price actions. Reuters reported that the US authorities are assessing possible market manipulation regarding bank shares.

IS STRESS CONTAINED?

So far, bank stress remains limited to US regional banks as European and EM bank stocks have remained relatively stable (Figure 5). Within the sample of banks included in the KBW index, there is a skewed tail of strongly underperforming banks (Figure 6). Markets have proved sensitive to bank communications that can signal liquidity stress, such as potential sales of assets, updated information about deposit trends, and M&A options.

Market participants expect the pressure on the small reginal banks to persist. Borrowing from the Fed backstop facilities has been substantial since the SVB failure (Figure 7). However, last week the take-up has dropped drastically to $81bn this week from $155bn previously (Figure 8). This is the smallest amount since the banking turmoil started in March. This fall is mainly driven by the sharp decline at the discount window ($6.8bn) related to the resolution of FRC. However, the BTFP amount remains elevated at $75bn. Market sentiment could remain glum and there could be further stress in the coming weeks as market participants expect the borrowing from the emergency facilities to remain high.

WHAT COULD HAPPEN NEXT?

Investors appear to want further support from authorities to regional banks, particularly as the Fed stays the course in bringing down stubbornly high inflation. Investors pointed to the risk of an acceleration of the deposit flight from regional banks to large banks and money market funds. Some market participants were disappointed that the Federal Deposit Insurance Corporation (FDIC) did not raise the deposit insurance cap[2]. Others believe that the FOMC decision on Wednesday to raise fed funds target rates by 25 bps will further exacerbate the profitability pressure on regional banks. While the FDIC made use of its systemic risk exception for SVB and Signature Bank, markets now seem to be testing the FDIC's resolve going forward given the current shortfall on the deposit insurance funds. While takeovers by well-capitalized banks and non-banks could provide a market solution, potential buyers might have the incentive to wait until banks actually fail to obtain stronger concessions and for the FDIC to share losses. This approach could drive up market fear.

[1] After market closed on Friday, PacWest announced to cut quarterly dividend and reiterated that the bank remains fundamentally sound.
[2] The FDIC discussed 3 options to overhaul deposit insurance funds. Targeted increase in deposit coverage for business account is viewed as the best option for financial stability. Other options include maintaining the status quo or full coverage for all deposits.

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Figure 1: Options Volume in US Regional Banks Under Stress

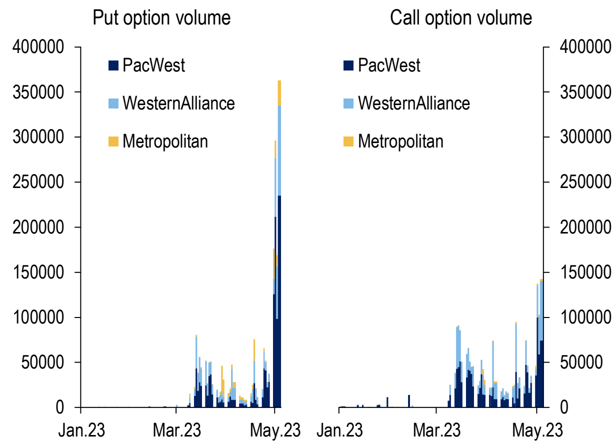


Figure 2: Regional banks facing a self-fulfilling prophecy

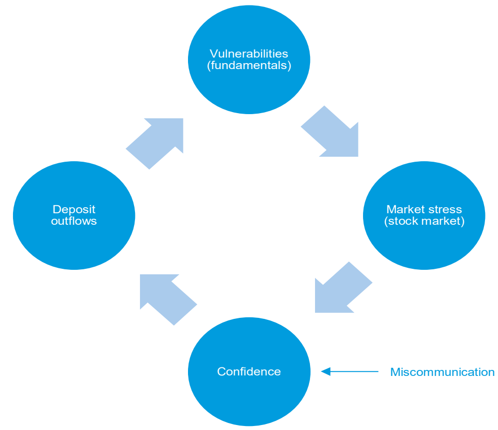


Figure 3

Bank stock performance and deposit outflows

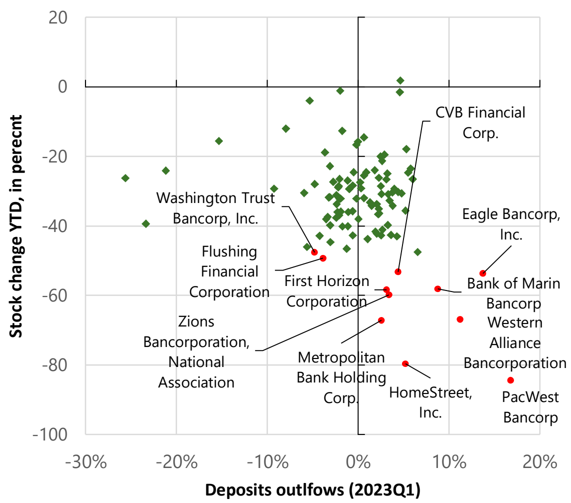


Figure 4

Bank stock performance and FHLB advances

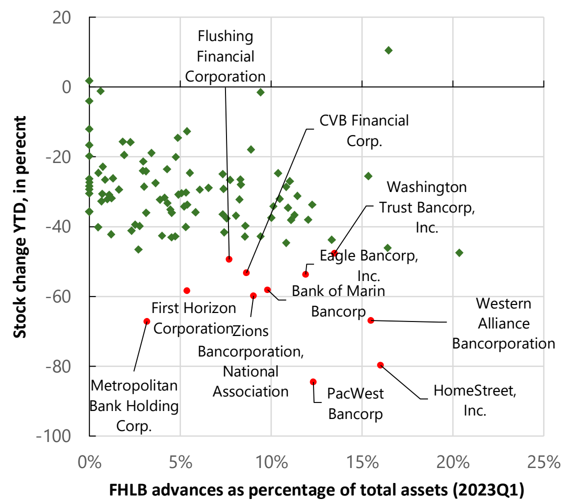


Figure 5

Bank Stock Price (Index to Feb 1)

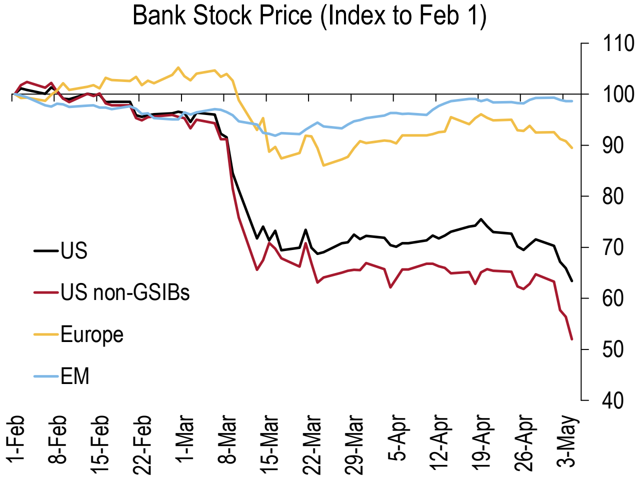


Figure 6

US bank stock returns

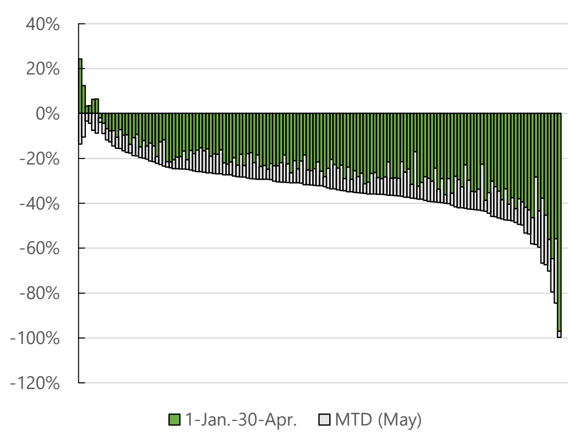


Figure 7

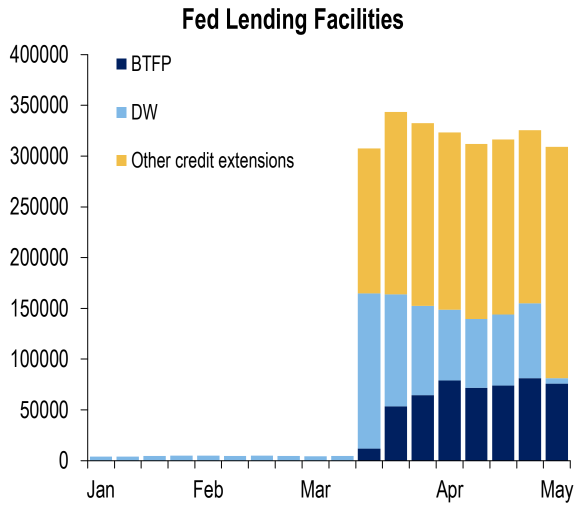
Bank Term Funding Program borrowings at select US banks

Ranked by the largest BTFP balance

Company (ticker)	As of date	BTFP balance ($M)	BTFP balance: Proportion of total liabilities (%)[1]	March 31, 2023, total deposits ($B)
First Republic Bank (FRCB)[2]	03/31/23	13,844.0	6.4	104.47
PacWest Bancorp (PACW)	03/31/23	4,910.0	11.8	28.19
East West Bancorp Inc. (EWBC)	03/31/23	4,500.0	7.4	54.74
Glacier Bancorp Inc. (GBCI)	03/31/23	2,740.0	11.0	20.15
Hope Bancorp Inc. (HOPE)	03/31/23	1,400.0	7.6	15.83
Western Alliance Bancorp. (WAL)	04/14/23	1,300.0	2.0	47.59
W.T.B. Financial Corporation (WTBF.B)	03/31/23	850.0	8.8	8.33
Eagle Bancorp Inc. (EGBN)	03/31/23	800.0	8.1	7.46
Associated Banc-Corp (ASB)	04/19/23	644.3	1.8	30.33
First National Bank Alaska (FBAK)	03/31/23	350.0	6.9	3.99
Business First Bancshares Inc. (BFST)	03/31/23	310.0	5.4	4.81
Southside Bancshares Inc. (SBSI)	03/31/23	198.4	2.8	5.84
Equity Bancshares Inc. (EQBK)	03/31/23	140.0	3.0	4.29
Northfield Bancorp Inc. (NFBK)	03/31/23	134.5	2.7	3.85
Avidbank Holdings Inc. (AVBH)	03/31/23	94.0	4.7	1.62
Ames National Corp. (ATLO)	03/31/23	75.0	3.7	1.90
Franklin Financial Services Corp. (FRAF)	03/31/23	50.0	3.1	1.50
1st Capital Bancorp (FISB)	03/31/23	40.0	4.5	0.82
Truxton Corp. (TRUX)	03/31/23	40.0	4.7	0.77

Data compiled May 2, 2023.
BTFP = Bank Term Funding Program.
Analysis limited to select US public banks that disclosed Bank Term Funding Program balances from 8k filings, earnings releases and press releases. Data is collected on a best-efforts basis.
[1] Represents Bank Term Funding Program balance as a percentage of total liabilies as of March 31, 2023.
[2] JPMorgan Chase & Co. assumed substantially all of the deposits and purchased substantially all of the assets of First Republic Bank on May 1, 2023.
Source: S&P Global Market Intelligence.

Figure 8



Sources: Bloomberg Finance L.P.; SNL Financials; and IMF staff calculations.

Table 1. Key Metrics for the Top 20 Worse Performing Banks year-to-date

	Uninsured Deposits (% of Total Deposits)	Change in Deposits in Q1 (% of 4Q22 deposits)	FHLB advances (% of Total Liabilities) 2023Q1	Estimated CET1 impact of M2M losses (bps)	CRE exposure (% of Total Assets)	RRE exposure (% of Total Assets)	Net negative tweets ratio (since 1 Apr 23)	Stock price (MTD, %)	Stock price (YTD, %)	Total assets (USD bn)
PACWEST BANCORP	28.3	-16.8	13.2	226	8.4	13.1	8.3	-41.9	-73.2	44.3
HOMESTREET INC	14.3	-5.2	17.4	123	11.1	16.3	1.3	-37.1	-77.6	9.9
METROPOLITAN BANK HOLDING	30.4	-2.6	3.5	107	48.8	1.9	8.4	-29.9	-61.1	6.3
WESTERN ALLIANCE BANCORP	32.4	-11.3	16.9	108	15.3	23.7	3.4	-25.8	-53.5	71.0
ZIONS BANCORP NA	45.3	-3.4	9.6	404	18.8	12.8	1.2	-13.4	-50.9	88.6
FIRST HORIZON CORP	44.2	-3.1	6.0	124	20.3	16.3	4.8	-38.7	-55.8	80.5
BANK OF MARIN BANCORP/CA	32.6	-8.8	10.9	228	32.6	5.8	0.9	-20.6	-56.3	4.1
EAGLE BANCORP INC	42.6	-13.8	13.4	188	32.2	2.5	2.0	-21.0	-54.4	11.0
CVB FINANCIAL CORP	64.6	-4.4	9.8	292	35.9	3.1	5.0	-20.9	-53.3	16.3
INDEPENDENT BANK GROUP IN	49.6	-7.1	11.2	120	37.5	8.7	0.7	-15.3	-48.3	18.8
FLUSHING FINANCIAL CORP	34.7	3.8	8.6	89	31.1	9.4	1.0	-15.1	-45.9	8.5
HERITAGE FINANCIAL CORP	34.9	-2.3	6.0	161	29.4	8.2	1.3	-10.9	-48.0	7.2
WASHINGTON TRUST BANCORP	26.4	4.8	14.5	235	23.2	38.8	1.0	-13.0	-47.2	6.9
BANKUNITED INC	49.9	-6.6	22.1	165	16.0	23.7	1.4	-22.3	-47.4	37.1
PREMIER FINANCIAL CORP	32.3	-2.0	8.7	174	22.2	23.2	2.7	-15.7	-47.0	8.5
HERITAGE COMMERCE CORP	57.2	1.3	3.1	24	30.9	12.1	0.4	-17.1	-44.7	5.5
BROOKLINE BANCORP INC	33.9	2.0	12.9	103	33.0	14.1	0.5	-17.1	-43.4	3.3
HORIZON BANCORP INC/IN	38.4	-2.6	8.6	171	15.5	14.7	6.5	-22.0	-44.5	7.9
DIME COMMUNITY BANCSHARE	50.2	3.0	12.0	95	32.6	5.8	0.3	-14.2	-43.6	13.8
VERITEX HOLDINGS INC	39.0	-1.0	15.4	55	24.9	7.1	0.5	-3.9	-41.3	12.6

Source: FRY-9C consolidated data is unavailable so Call Report data was used for the most relevant IDI for each institution. Data as of 8 May 2023 13:00
Note: Mark to market losses are based on unrealized losses for AFS and HTM securities from AOCI schedule in Call Report.