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Fed rate hike follows theory that banking crisis will ebb soon

Article

The news: Two top US economic policymakers say they're focused on finding out why **Silicon Valley Bank** failed and determining what changes to federal regulation and oversight might be necessary to prevent further bank runs.

An aberration that requires a post-mortem: In a press conference after the Federal Open Market Committee (FOMC) announcement of a quarter-point interest rate increase, **Jay Powell**, chair of the Federal Reserve, admitted that **SVB's sudden collapse had left top officials asking themselves, "How did this happen?"** But his remarks repeatedly suggested that **policymakers saw this failure as an anomaly.**

What Powell said about the banking crisis:

- He thinks the **banking system "is sound and it's resilient** with strong capital and liquidity"—but he noted that there's heightened uncertainty over how the aftermath of SVB's collapse could impact the economy. He also stated that "**We have the tools to protect depositors when there's a serious threat to the economy.**"
- He reiterated that **the Fed plans to investigate what led to SVB's collapse,** with the central bank's vice chair for supervision, Michael Barr, leading the probe. **That would include an internal review of how the Fed supervised and regulated SVB.** The Justice Department and Securities and Exchange Commission also have launched investigations, and Powell said he would welcome outside scrutiny as well.
- He acknowledged that **the recent bank failures will lead to "some tightening credit conditions for businesses and households"** that will likely affect the labor market and inflation. **He believes that impact will be similar to what the Fed could accomplish through rate tightening:** "As a matter of fact, you can think of it as being the equivalent of a rate hike, or more than that."
- **He "did consider" a pause in rate hikes** in the days leading up to the FOMC meeting. But recent economic data showed inflation abating slightly in February while the economy added 311,000 jobs. The hot labor market and slower but still-high price increases convinced Powell that there's still more work to be done to get inflation levels back down to the pre-pandemic 2% goal.

Yellen echoes Powell's address: A few hours later, Treasury Secretary Janet Yellen spoke before a Senate hearing, **quashing hopes that the Biden administration was considering a move to broaden deposit insurance.** "I have not considered or discussed anything to do with blanket insurance or guarantees of deposits," Yellen said.

- Yellen agreed with Powell that a post-mortem was in order. "I absolutely think that it's appropriate to conduct a very thorough review of what factors were responsible for the failure of these banks," she said. "Certainly **we should be reconsidering what we need to shore up regulation to prevent this.**"

- Yellen and Powell both noted the speed of the SVB collapse, with Yellen saying it might make sense to **update stress test models and bank liquidity requirements** because bank runs "may more readily happen now."

Our take: Everyone supports an investigation into what went wrong and why. But resistance to new financial regulations is mounting within Congress and the banking industry. Lawmakers are speaking and moving cautiously, using what Yellen referred to as "the tools at our disposal" to stabilize the situation. But they still appear reactive, and what they'll do if additional banks collapse remains unclear.