Big banks slip into bear market territory as rates rise

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June 12, 2018

More than a dozen of the world's biggest banks have slipped into a bear market, highlighting risks to the global economy even as equity indices reach new highs and the Federal Reserve prepares to raise interest rates.

Investors on Tuesday sent the Nasdaq to a record close on the eve of a meeting at which the Fed is expected to lift rates for a seventh time since the end of 2015. But strategists note that beneath the bright economic data and rising benchmarks, strains have begun to emerge among a group of banks and insurers deemed to be critical to the health of the global financial system.

Among the 39 "Sifis", financial institutions considered systemically important by the Basel-based Financial Stability Board, 16 are down more than 20 per cent from their recent peaks in dollar terms, meeting the standard definition of a bear market.

They are Deutsche Bank, Nordea, ICBC, UniCredit, Crédit Agricole, ING, Santander, Société Générale, BNP Paribas, UBS, Agricultural Bank of China, AXA, Mitsubishi UFJ Financial Group, Bank of China, Credit Suisse and Prudential Financial.

The synchronised dips were a sign of global financial stress, said Ian Harnett, managing director of global strategy at Absolute Strategy Research in London, who this week used the data to send out his first "Black Swan" alert since 2009.

At some point, he said, central bankers might have to respond to bearish signals from almost half the global Sifis, rather than continuing to tighten monetary policy.

"The clue is in the name," he said. "If these banks are supposed to be systemically important then policymakers ought to be watching them to see what is happening."

The Fed's gradual interest rate increases — more recently coupled with shrinking its balance sheet by shedding bonds acquired in its crisis-fighting "quantitative easing" programme — have begun to ripple through financial markets, pushing up short-term borrowing costs for households, companies and banks.

The three-month Libor rate, the rate at which banks lend dollars to each other, climbed to a 10-year high of 2.37 per cent in May, and although the rate has since dipped slightly to 2.33 per cent, analysts say that the dollar funding market is noticeably tighter of late.

The spread between Libor and the "overnight index swap" rate, a gauge for the future expected level of the Fed's base interest rates, is another popular measure of stresses in the banking sector. Although the Libor-OIS spread has slipped from the highs touched in April — when US companies were repatriating dollars held overseas and depleting the available short-term funding for banks — it remains at about twice the post-crisis average.

What many of the harder-hit Sifi banks have in common, said Mr Harnett, was a heavy dependence on US-dollar funding, putting them at risk of a squeeze if US rates continue to rise and the dollar continues to strengthen. Banks in Canada, Australia and Sweden, in particular, came through the last crisis in relatively good shape, thanks largely to their exposures to China and a strong commodities market. But in the years since then, the banks had overextended, he said, trying to support rapid asset growth with wholesale funding, rather than traditional deposits.

The alert he put out on Monday was his first since a warning on inflationary risks in June 2009, as oil prices climbed higher. Mr Harnett drew parallels to another bearish note he wrote in March 2007, when European banks began to sink while non-banks marched higher.

There were 30 banks ranked as "GSIBs" — global systemically important banks — by the FSB last November, including JPMorgan Chase, the biggest US bank by assets. The nine insurers classed as critical to the world's financial system include AIG, Allianz, Ping An and Prudential of the UK. The big dips in the Sifis' stock prices were ominous, said Bert Ely, an adjunct scholar at the Cato Institute and a principal of Ely & Company. He noted bullish remarks from Jamie Dimon on CNBC last week, when the JPMorgan chief celebrated strong consumer and business sentiment and said he could find no "real potholes" in the outlook.

"The good news does not last for ever," he said. "Those kind of comments are usually just before things start heading down."