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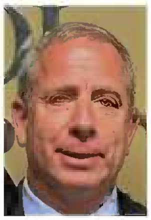
Bank panic could undermine Fed's fight against inflation

MICHAEL MARTZ
Richmond Times-Dispatch

Bank stocks rebounded in the market on Tuesday, but the damage already may be done to the Federal Reserve Board's ability to raise interest rates to control inflation.


Engelke

The collapse of two regional banks over the weekend sparked a panic that prompted President Joe Biden to intervene by guaranteeing the security of all bank deposits, regardless of whether they were covered by federal deposit insurance. The Federal Reserve and U.S. Treasury also expanded a one-year lending program for banks, struggling in part because of interest rates that have risen to dampen economic growth and slow inflation.

Now, the Fed's Open Market Committee faces a tougher decision next week on whether to raise interest rates again, and if so by how much, to control inflation that rose slightly higher last month.

"The Fed has to do something," said Kent Engelke, chief economic strategist and managing director at Capitol Securities Management, Inc., in Richmond. "Otherwise, they lose credibility."

Engelke blames social media for inciting a market panic that raised doubts over the stability of the country's financial system and forced Biden to intervene.

"The whole thing is undermining what the Fed ultimately is trying to do," he said.

The saga began on Friday, when California regulators shut down Silicon Valley Bank after a run on deposits left it underwater. It intensified on Sunday, when New York regulators shuttered Signature Bank and the Biden administration stepped in to ensure protection of bank customers, even those with deposits above the $250,000 cap set by the Federal Deposit Insurance Corp.

"I believe you had incessant fear-mongering over the weekend," Engelke said.

In Virginia, banking officials and regulators said the two bank failures had nothing to do with state banks and everything to do with the risks that Silicon Valley and Signature took in courting specific industries, such as start-up technology firms and cryptocurrency investors, respectively.

"Things are good here in Virginia," Bruce Whitehurst, president and CEO of the Virginia Bankers Association, said after bank stocks rose on Tuesday.

"The fact that bank stocks are up today is a very positive sign that the market is adjusting to the reality that those two bank failures represented a very unique set of circumstances and were not representative of a broader problem in the industry," Whitehurst said.

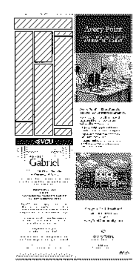
But between the market bloodbath and resurrection, the Consumer Price Index showed Tuesday morning that prices rose slightly more than expected in February, although they were 6% higher on an annualized basis, compared with 6.4% in January and 9.1% in June.

The Federal Reserve Board's inflation target is 2%, which is why the open market committee appeared to be considering an additional increase in the benchmark interest rate of 0.5% at its meeting scheduled on Wednesday. The Fed has raised the rate eight times since March, moving from zero to a range of 4.5 to 4.75%, which has increased the cost of borrowing for consumers, banks and a wide range of other businesses in order to slow the economy and tamp down prices.

Engelke fretted that the Biden administration's guarantee of all bank deposits and expansion of the short-term bank loan program is "allowing a massive easing of financial conditions" that will make it harder for the Fed to control inflation.

But he expects the open market committee to raise the rate by 0.25%, which would signal its commitment to controlling inflation.

The recovery of the market, and specifically bank stocks, sent a signal on Tuesday that "they believe the worst is over," Engelke said. "People are stepping back and taking a deep breath."



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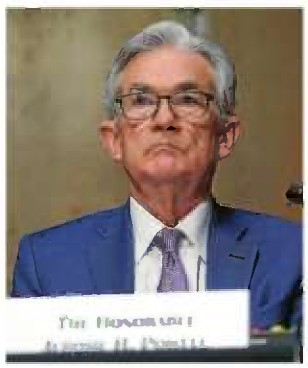

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Federal Reserve Chair Jerome Powell has raised interest rates eight times since last March.