

CENTRAL BANKS COMMENTARY

Pro Take: The Fed Hits Inflation With Ninth Rate Hike as Banks Reel

A ‘small number of banks’ have problems but the U.S. banking system is ‘sound and resilient,’ Fed Chair Jerome Powell says



Fed Chair Jerome Powell said at his press conference that ‘depositors should assume that their deposits are safe.’

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By Bob Fernandez

Updated March 23, 2023 12:35 pm ET | **WSJ Pro**

The Federal Reserve on Wednesday stuck with its inflation fight as banks and regulators sort out the Silicon Valley Bank mess that has spread fear throughout the banking sector.

Its quarter-percentage-point interest-rate increase, though smaller than most of the hikes seen over the last year, feels like it packs more of a punch amid worries about the health of banks. But Fed Chairman Jerome Powell made clear that the Fed, even though it considered a pause, isn’t bowing out of its inflation battle.

Raising rates might have been necessary to work toward price stability, but it didn’t help calm fears about financial stability.

Bank stocks fell Wednesday after the Fed's interest-rate announcement and Mr. Powell's press conference. The Fed's rate hike, though small, is expected to put more upward pressure on the interest rates that helped trigger the banking crisis in the U.S. and Europe.

Silicon Valley Bank collapsed when the fair-market value of its long-term investments fell because of Fed rate hikes, leading customers and venture funds to fear for the bank's solvency and electronically withdraw uninsured deposits in a panic.

"It does nothing for the banks," Farrokh Langdana, a finance and economics professor at Rutgers Business School, said of the Fed's Wednesday rate increase.

Regional bank stocks have plunged in the wake of SVB's seizure by federal regulators.

First Republic Bank stock is down 88% since March 8. Last week, 11 big banks banded together to deposit \$30 billion in First Republic in an effort to restore confidence in the lender, and JPMorgan & Co. Chief Executive Jamie Dimon is leading discussions with the CEOs of other big banks about fresh efforts to stabilize troubled First Republic, The Wall Street Journal reported this week.

Zions Bancorporation stock has fallen 35% since March 8. Western Alliance shares are down 55%. The broad KBW Nasdaq Bank Index of 24 financial institutions including large and regional banks has shed 28% this month.

Referencing the SVB crisis, Mr. Powell said a "small number of banks" have problems but the U.S. banking system is "sound and resilient."

The Fed—which also regulates banks—was reviewing its actions at SVB, Mr. Powell said. "The speed of the [bank] run was very different than what we have seen in the past," he said. SVB "management failed badly," Mr. Powell said, adding that "we need to strengthen regulation."

On Tuesday, Treasury Secretary Janet Yellen said the U.S. government could rescue depositors whose funds exceeded the \$250,000 Federal Deposit Insurance Corp. protection threshold as it did for depositors at Silicon Valley Bank—which could stop a future run.

Mr. Powell reiterated the point in his press conference, saying that "depositors should assume that their deposits are safe."

University of Chicago assistant professor Dave Schabes said investors have to know more before they can make decisions on the health of individual banks. “What will really drive the behavior beyond today’s [Fed] announcement will be when people get more information about bank holdings because right now it’s pretty much a black box,” Mr. Schabes said.

Does Mr. Schabes think most banks are safe?

“I expect so. You don’t know. Many of them are private so they don’t issue public information. The regulators know,” he said.

As for the inflation fight, Mr. Powell suggested the banking crisis itself might lend a hand to the Fed, as banks, fearing being weakened, could tighten credit on consumers and businesses and slow the economy as a Fed rate increase would.

“We’re just going to have to watch,” Mr. Powell said.