



By: *Emre Alkin*

# The Bankruptcy of the Silicon Valley Bank - Is the Perfect Storm Coming?



For the last couple of years, in my articles, I've been trying to highlight a theory of mine: "If a financial crisis breaks out, developed countries will be the epicentre, not the developing ones", which I base it upon the following arguments:

The "Long-Term Trends in Public Finances in the G-7 Economies" published by the IMF in 2010 offers an interesting projection: "Under the current and future pressures on public finances, public debt would spiral out of control in the absence of fiscal adjustment. Under unchanged policies, the net debt-to-GDP ratio of the G-7 economies would reach 440% by 2050."

This is an alarming debt stock that cannot be sustained. However, the report also mentions a miracle. If the world's seven largest economies increase their growth rates by 1% each year by 2050, this ratio will decline by 256 points to 185%. If this report, which was issued before the pandemic, were issued today, it would be pointing to some frightening levels. First of all, it seems almost impossible for the G-7 economies to increase their growth by 1% higher than anticipated each year. But let's think for a moment that this has happened. When it does, will they still be able to pay off this debt?

To see whether they really could or not, we should take a look at the current debt rates. Japan's current debt-to-GDP ratio is 239%, followed by Greece with 181%, Lebanon with 149%, Italy 132%, Portugal 130%, and the US with 125%. Of course, some experts also examine these economies' debt-to-total-assets ratio as well as their debt-to-GDP ratio. The former data tell us that countries, except for Japan, are indeed trapped in a debt spiral. A country with a debt-to-GDP ratio surpassing 100% needs to keep its growth rate constantly high, which can cause some serious side effects such as high inflation and financial crises: even worse complications.

As you may remember, after summoning several banks to negotiate financing for the reorganisation of Lehman Brothers, which filed for bankruptcy protection in 2008 involving more than US\$ 600 billion in assets,

the Federal Reserve finally decided that the firm was beyond saving, so the Government used the funds to save other firms struck by the subprime mortgage crisis. This was the most prominent event of the George W. Bush era, as well as the herald of so-called "state capitalism", under which the government would support any company it chose, while sacrificing others. Especially in relation to that approach, the wrong decisions of the Bush Administration caused the Republican McCain to lose to Obama.

In the EU, 80% of companies are funded by banks, but in the United States, only 18% can benefit from bank credit. Almost all US companies issue bonds or debentures to the private debt market. Obviously, companies with high credit ratings can borrow with maturities much longer than one year. As for companies below the BBB-rating, there is a "risky" borrowing market, almost bigger than the US economy itself, from which these companies can borrow with maturities less than one year or a little longer.

**The domino effect of a distress that may occur in this market could lead to a worse outcome than that of the 2008 financial crisis**

According to many reliable fund managers, the domino effect of a distress that may occur in this market could lead to a worse outcome than that of the 2008 financial crisis. The Fed supports the debt securities of strong companies, but its power to intervene in such a colossal "junk" market would be obviously limited. Today's debt stock has become so enormous compared to 2008 that no central bank or insurance fund is powerful enough to bear such a huge burden. If anything goes wrong, ordinary investors will have to deal alone with the outcome of their own investment decisions.

**The bankruptcy of the Silicon Valley Bank (SVB) has also been caused by wrong decisions**

Similarly, the bankruptcy of the Silicon Valley Bank (SVB) has also been caused by wrong decisions. Having ploughed billions into US government bonds when interest rates were near-zero, the bank has recently become unable to repay its debt, unable to pay their depositors, and eventually collapsed. Naturally, there are now concerns whether this situation would affect other banks in the US or in Turkey. We know that most of the available money, which is bank money by the way, consists mainly of deposits that can be transferred by means of paper orders or electronically as opposed to the fact that there is only a small amount of printed money.

The world might face a serious crisis, if, in the event of a banking bankruptcy, depositors who would want to withdraw their money in panic or want to transfer it to other banks, as they did in the case of SVB, are not calmed down. Such a crisis would be incomparably greater than that of 2008. Governments can only overcome such a danger by looking to strong and convincing people to trust in them. As the weekend is over, we can learn today about the effects of the recent developments in the US on the world markets. The Great Depression (1929–1939) was triggered by the failure of a small bank to pay its depositors. Of course, the causes of the Great Depression were not the same as the reasons that lead to financial disturbances in the modern world. If the United States, which is still struggling with high inflation, is hit by a liquidity crisis worse than that of 2008, we could face problems that cannot be solved by means and knowledge.

## Banking and Finance Are Not Exactly the Same

Banking is an activity of trust, but naturally, it is sometimes described as a purely financial activity because it directly involves money. When this is the case, the attentive behaviour of the banks, which act as an intermediary between the supplier of funds and the user of funds in the said activity, their prudence in risk management, and the fact that bank managers think of the depositors' money

rather than their own profits, are often overlooked. And sometimes, in some situations, good intentions may lead to unintended consequences. Like the road to hell, as the saying goes, is paved with good intentions, right? Perhaps one of the most important commercial achievements of the 21st century was the fact that start-ups, which promised to provide technological and digital solutions, reached billions of dollars in value, after being funded first by angel investors and then large corporations. The market value of solution providers such as WhatsApp, Uber, and Airbnb, as well as video game companies have reached billions of dollars. In Israel's incubator ecosystem, investors provide funds to, let's say, 10 start-ups. Even if 3 out of 10 new companies become a success, these investors do make a profit.

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In the meantime, if the gap between the capital invested and the value that the company has reached has widened so much that many investors start to pray for the success of at least one of the companies they have invested in, that's when their investments eventually turn into a daring journey. The astronomical profits drove investors to become more and more enthusiastic about investing in a start-up. The amount of money they lost was so small compared to the money they made that their audacity grew with every new investment. Regardless of whether they were small or large investors, the interest rates, which remained at very low levels during the pandemic, also spurred their search for yield. The fact that they have been capable of immediately exiting from the capital markets increased their appetite. Let's remember that subprime lending contributed to the 2008 crisis. Disaster was inevitable when audit agencies made a habit of not actually performing their duties, yet receiving money for their services. It was revealed that bank

and financial institution managers turned a blind eye to subprime lending so as they could get their share, in cash, from the profits on paper, which was in fact achieved by inflating the number of assets. So, it was just another form of greed.

**Today, we are faced with a problem created by supposedly wise people who approve low-interest loans without paying attention to the risk parameters**

Today, we are faced with a problem created by supposedly wise people who approve low-interest loans without paying attention to the risk parameters. Bewitched by the colourful world of crypto assets and start-ups, some people have invested the money borrowed from individuals and institutions in risky undertakings. After all, the reports said that there was only a small chance of risk. Just like in 2008. But this time, a new problem might be on the way: a possible crisis of trust in both the investment and the investor ecosystem. Once bitten, twice shy, investors can keep away from the start-up ecosystem for a while. Such ecosystems operate through a constant inflow and outflow of money; therefore, they will quite probably be disrupting the harmony in the money and capital markets that move with them.

**There is one fact that everyone misses: the increasing US Treasury yields, the US Private Bond Market being constantly under risk, sharp fluctuations in crypto**

However, there is one fact that everyone misses: the increasing US Treasury yields, the US Private Bond Market being constantly under risk, sharp fluctuations in crypto. Values, the measures to combat inflation, and bank collapses can unfortunately speed up the arrival of the “perfect storm“: a financial crisis where no one can find a tangible instrument to invest in. Even if it seems quite unlikely, I can't

say that it won't happen. I should also mention a possible summer attack by the Russians on Ukraine and the possibility of a new pandemic wave.

**As in every crisis, people who can maintain the cash/asset balance will win**

Should these possibilities come to pass, depositors would not be able to withdraw their money from banks due to the ratio of cash in circulation to bank deposits; where the latter is greater than the former, governments would impose a transfer limit from bank to bank so that the risk does not become contagious, and that foreign exchange transactions would be restricted in developing countries. Such a liquidity crisis would put serious pressure on loans; thus, interest rates should be expected to go up very rapidly. In such a scenario, there would be an increase in the value of assets which can be quickly converted into cash, but there may also be a serious decline in the value of tangible assets, primarily real estate. Those who have cash might acquire assets they would never have dreamed of being able to acquire.

As in every crisis, people who can maintain the cash/asset balance will win. As well as the “goods-money“ exchange, we might also witness a “goods-money- quickly convertible value“ exchange. The question here is whether a person who wants to sell an asset, which price has increased quite highly, will have the chance to invest in another, of similar value or not. Perhaps tangible assets acquired through conjunctural gains will help their owners make big money in the future. Here's a list of dos and don'ts I share with the audience in every conference I have been attending since 2012:

- Never invest all of your money. Always keep some cash aside;
- Make assets out of rare, timeless and easily convertible items;
- Invest only a slight amount of your money in popular money-making instruments that you don't know much about;
- Take out loans to put some money aside

when the interest is low, and wait for opportunities;

- Favour more flexible real estate investments, such as buying land, rather than houses or buildings;
- Have a digital cockpit that will help you control risks from a single platform at all times;
- Use powerful market intelligence to gain valuable market insights.

An investor who is incapable of getting the pulse of the market can only buy and sell, whereas in fact, accessing critical information is as important as investing. A set of analysis that points to rising opportunities, warns of upcoming risks, even crises, in the fastest way possible is necessary not only for individual investors but also for corporations. After the SVB collapse, US President Biden said, "Americans can have confidence that the banking system is safe. Your deposits will be there when you need them", promising new regulations and penal sanctions to the responsible parties. His statement helped ease the tensions in the markets and showed that American citizens will not pay the price for this crisis.