Financial Stability in a Time of Macro Uncertainty
Panel: Financial Institutions

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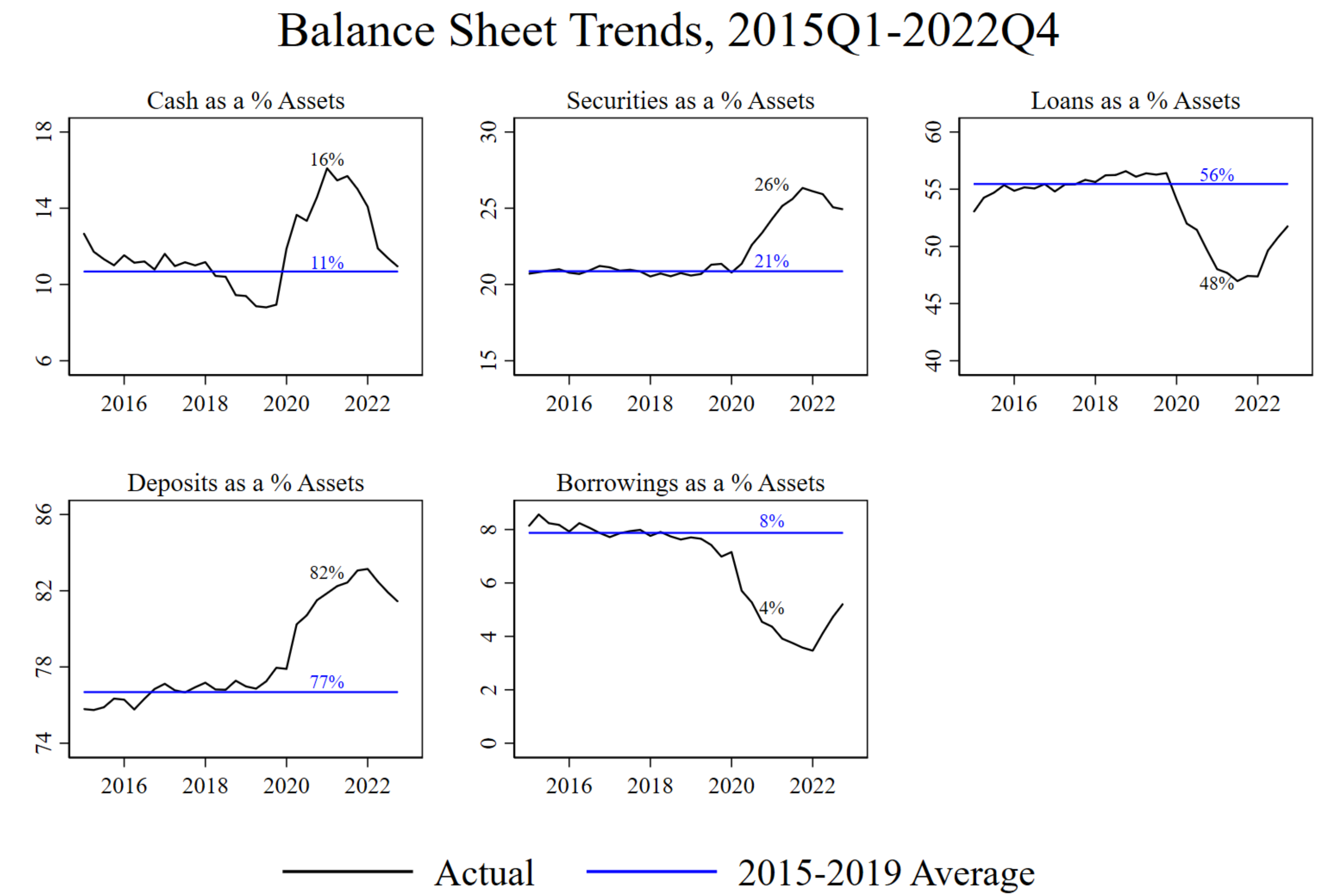
Balance Sheet Trends 2015-2022



Note: Values in each panel represent (rounded) 2021Q1 figures.

Bank Balance Sheet and Interest Rates

Assets	Liabilities
Fixed Rate Assets (~65%)	Deposits (90%)
Duration 4.5 years	reprice slowly
Variable Rate Assets (~35%)	Equity (10%)
Reprice in 3 mos.	

Hedging Income

- Banks hedge net interest *income*, less so the economic value of equity
- Even today, with large duration exposure from a rise in interest rates, banks are engaging in receive fixed/pay floating cash flow hedges
- Only makes sense if banks are hedging income against a decline in rates; opposite of what you would do if you're hedging duration risk.
- Why hedge income? Banks are focused on short-term ROE

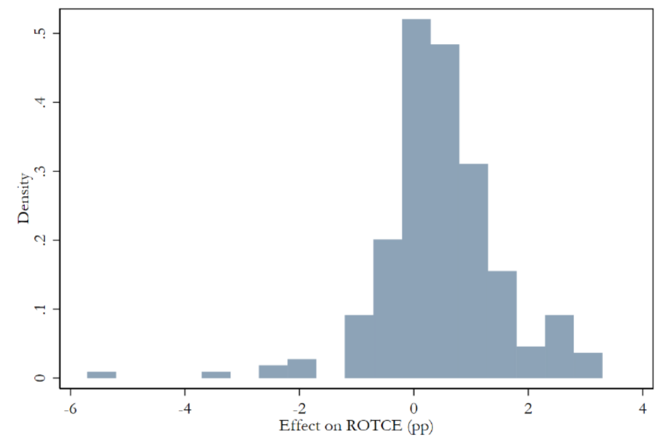
Short-term ROE and Risk-Taking

- Focus on income helps to explain why banks loaded up on securities as deposits flowed into the banking system.

- The alternative would have been to put excess deposits into reserves, which were yielding less than Treasuries and Agency MBS

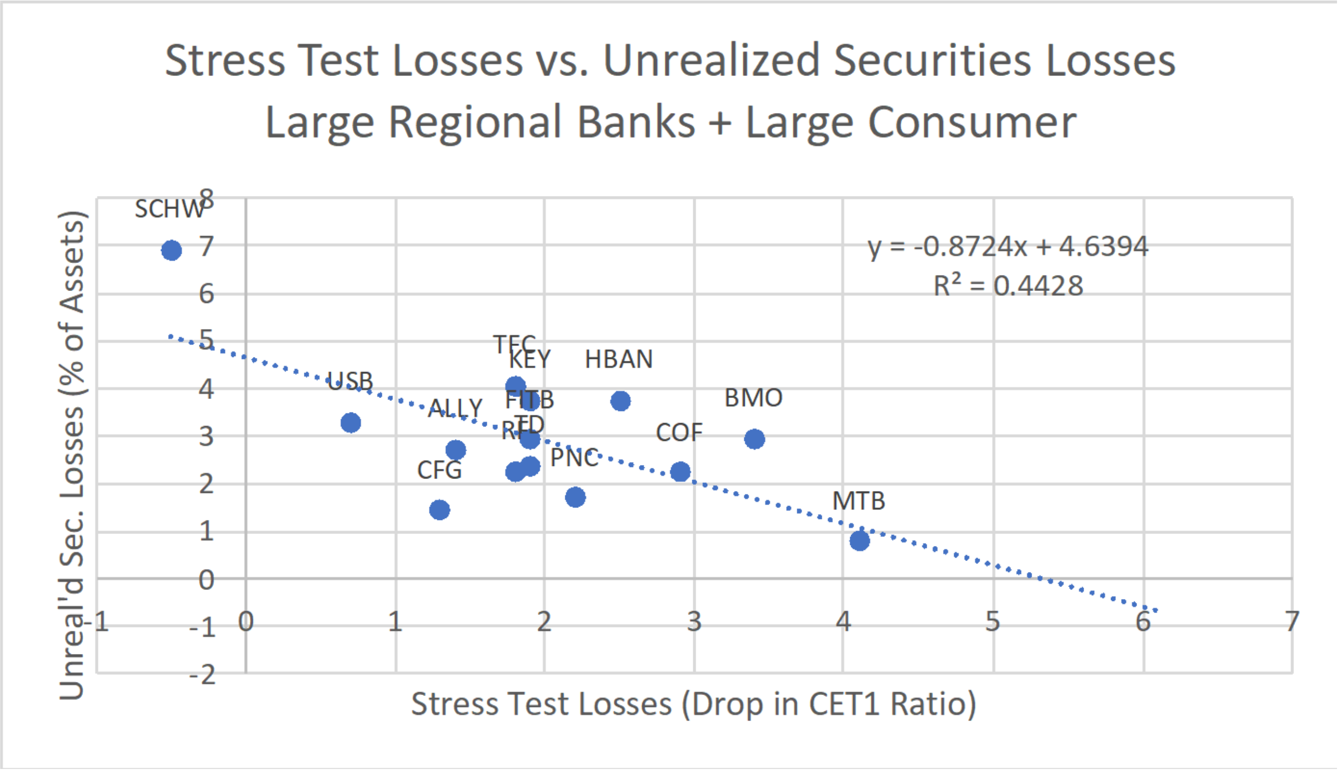
- Counterfactual effect of not increasing securities share of assets. My <u>rough</u> estimate is that ROTCE would have been lowered by:

Bank Size	Median Effect on ROTCE (pp)
$5-25 Billion	0.442
$25-100 Billion	0.453
More Than $100 Billion	0.139
Big Three	0.419
Silicon Valley Bank	3.232



Note: Figure represents the effect on ROTCE that would have realized in a counterfactual setting where commercial banks maintained their 2019Q4 securities/assets ratio through 2021Q4 and allocated incremental assets to reserves.

Implications for Stress Testing



Banks that did the worst on the stress tests just before SVB crisis, had the smallest losses in their securities portfolio