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Credit Suisse: Liquidity support after share price turbulence

Erste AM Investment Division / Erste AM Communications

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Following the turbulence at several US regional banks, the major Swiss bank Credit Suisse (CS) also came under pressure in midweek. The bank had already been in the focus of market participants in recent months as it underwent a large-scale restructuring of its business model.

Uncertainty among investors

This week, the pressure increased significantly after Credit Suisse announced problems with previous years' balance sheets and Saudi National Bank, a major shareholder of CS, made it clear that it would not make any further investments in the bank.

This caused uncertainty among investors, and the bank's shares and bonds sold off sharply. The stock lost more than 24% during the day and credit default swaps, which are used to hedge against a bank default, traded at higher levels than during the great financial crisis of 2008.

The negative sentiment spilled over to the rest of the financial markets. The EuroStoxx 600 closed down 2.9% and safe havens (government bonds) were in strong demand. The yield on 10-year government bonds from the USA fell from 3.7% to 3.5% and that on German bonds from 2.4% to 2.1%.

Quelle: Bloomberg, Data as of 16.03.2023
Note: Past performance is not a reliable indicator for future performance.

What are CDS?
A credit default swap is a credit derivative entered into between two parties that enables trading in the default risks of bonds, loans or debtors. The protection buyer pays a premium (swap) to the protection seller and receives a compensation payment from the protection seller if the debtor is unable to settle its debt.

Swiss National Bank Grants Liquidity Assistance

In the evening of yesterday, Wednesday, the Swiss National Bank then announced that it would grant liquidity assistance to Credit Suisse. In doing so, the bank will

1) borrow up to 50 billion Swiss francs from the central bank and
2) buy back about SFr. 3 billion in debt,

in order to strengthen its liquidity position on the one hand and to reassure market participants on the other.

In early trading in Europe, these measures also had an effect. Futures contracts on European equity indices are noticeably up and the Credit Suisse share gained more than 20% at times.

How do we assess the current situation?

We continue to believe that the European and US banking systems are fundamentally sound. This is especially true for the global systemically important banks, which have been heavily regulated since the 2008 financial crisis to ensure that they have excess assets over liabilities even in economic stress scenarios (*=bank failure*).

Central banks in the US and Switzerland have also shown in recent days that they are stand by to support the liquidity situation of banks in the event of a crisis (*=bank liquidity*).

In principle, a central bank has three functions:

1. Low inflation
2. Financial market stability and
3. Full employment.

In our view, at least in the short term, the hierarchy of priorities has shifted from 1) to 2). But even if financial market stability remains guaranteed, and the rapid intervention of central banks speaks in favor of this, a more restrictive credit environment could remain as a lasting effect. This would put pressure on economic growth.

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