Markus’ Academy Webinar with Bill Dudley
Unedited Transcript
03/30/2023

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00:05:09.220 --> 00:05:16.560
Markus Brunnermeier: Welcome back everybody to another. Webinar organized for Princeton, for everyone worldwide. They were happy to have Bill Dudley with us. I, Bill

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00:05:17.090 --> 00:05:17.810
Bill Dudley: Hi.

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00:05:18.610 --> 00:05:29.500
Markus Brunnermeier: Bill Dudley is a former president of the New York Fed, and is now colleague at Princeton, and very happy to have him with us. He's one of the foremost experts on bank regulation, central banking.

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00:05:29.650 --> 00:05:44.490
Markus Brunnermeier: and many more things in economics. And I'm. Also grateful to all of you for answering the poll questions. And before we start. Let's go through the poor questions. The first question: what if you look at the current banking crisis 2023,

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00:05:44.590 --> 00:05:49.910
Markus Brunnermeier: he said, similar to the snl Guys 19 eighties. That's what 44% thought

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00:05:49.990 --> 00:05:56.660
Markus Brunnermeier: similar to the Scandinavian crisis. 19 nineties, 3% thought this way similar to L to Cm.

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00:05:56.800 --> 00:06:00.440
Markus Brunnermeier: In 1,998. That's 10%

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00:06:00.670 --> 00:06:10.270
Markus Brunnermeier: and similar to 2,008. The global financial crisis, only 2% of this way, and none of the above thought. 41%, Perhaps I've missed some

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00:06:10.880 --> 00:06:18.550
Markus Brunnermeier: Continental or something like that, or it's a totally new type of crisis. The second question was about.

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00:06:18.650 --> 00:06:28.420
Markus Brunnermeier: You know the current state of the crisis. Is it more like a Lima moment? So the worst is happening now. It's the first, and you know the Lehman moment is still coming.

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00:06:28.460 --> 00:06:38.430
Markus Brunnermeier: Was it a slowly rolling crisis which will drag on, and the on the sperm 3% 19% and 77%?

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00:06:38.510 --> 00:06:50.940
Markus Brunnermeier: So that's that's surprising that you know. Most of you thought this will keep on rolling on. It will be ongoing for a while similar to the sml crisis I guess, which hold on for many years.

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00:06:51.910 --> 00:07:00.630
Markus Brunnermeier: So what banks are mostly affected with that, or what part of the financial sectors smaller mid-sized banks that's for 65% thought

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00:07:00.850 --> 00:07:03.030
Markus Brunnermeier: all banks, 10%,

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00:07:03.360 --> 00:07:15.140
Markus Brunnermeier: including the large ones. That's only 10% thought this way. And thanks, and shadow banks that's, actually what 25% thought. So Most of the audience thinks it's mostly smit-sized banks and small banks

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00:07:15.660 --> 00:07:33.500
Markus Brunnermeier: so how should we react to that. Should we have just tight the regulation. Should we find you in the regulation we have? Or should we just think of a total redesign and overhaul of the financial sector, like having Nero Banks, Cbdc. Which pays interest to other more Radical, that we design elements

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00:07:33.570 --> 00:07:43.130
Markus Brunnermeier: and the answers for that was 55. Let's find you in the regulation 45% thought. Let's overhaul organically. So it's almost 50 50.

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00:07:43.550 --> 00:08:00.160
Markus Brunnermeier: And finally financial dominance. You know to what extent this financial instability does it make an interest rate hike in

the future, or fighting inflation in the future. Less likely the same, or more likely, when the answer was, 63% thought it was make it less likely

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00:08:01.220 --> 00:08:07.350
Markus Brunnermeier: 29% thought it would be the same, and 9% thought it would be

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00:08:08.570 --> 00:08:21.200
Markus Brunnermeier: more likely to fight even stronger against inflation. So With this I would like to move on to Bill, so we will have a 5 side chat style today, and we go through the various

21
00:08:21.870 --> 00:08:40.760
Markus Brunnermeier: aspects we start with. You know what triggered the crisis, what are the policy conclusions from that? And so it also to some lessons we focus very much on the Us. Suspects. But we might also go to Europe. So we created Swiss and other aspects as well to have a global footprint

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00:08:40.830 --> 00:08:42.110
Markus Brunnermeier: on top of it.

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00:08:42.409 --> 00:08:49.880
Markus Brunnermeier: So let me let me pass on the microphone to to Bill, and then we will talk back and forth.

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00:08:49.880 --> 00:09:02.790
Markus Brunnermeier: But perhaps you can outline what's in your view? What really went wrong at the Silicon Valley Bank, perhaps all the signature, Bank, and other banks. What! You? What are the challenges, and how can we find you an improve on that.

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00:09:03.430 --> 00:09:14.170
Bill Dudley: So what went wrong with Silicon Valley Bank? Well, a couple of things went wrong. Number one. They they stretch for yield, so we got a lot of deposit growth in 2,02021, 22,

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00:09:14.240 --> 00:09:22.310
Bill Dudley: and rather than just dump those deposits into short term assets, they decided to buy long data treasuries and agency mortgage back securities

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00:09:22.560 --> 00:09:34.980

Bill Dudley: which would have been fine if interest rates it stayed. Low but when interest rates rose very sharply in 2022 they got, they they they develop very large mark to market losses in their securities. Book

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00:09:35.270 --> 00:09:42.290
Bill Dudley: The problem for them was that this curious book was funded by largely unsure deposits.

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00:09:42.410 --> 00:09:50.380
Bill Dudley: and they were more vulnerable because the deposit base was highly concentrated in in a, you know, relatively a few hands.

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00:09:50.400 --> 00:09:58.450
Bill Dudley: you know, some people really have hundreds of millions of dollars in posit at Silicon Valley Bank more than what they needed to actually conduct their day to day banking business.

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00:09:58.780 --> 00:10:07.940
Bill Dudley: Now Silicon Valley Banks plan was to sell off some of their that some of these, as as long dated securities, take a loss.

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00:10:08.100 --> 00:10:12.750
Bill Dudley: and then fill that capital whole by issuing new capital.

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00:10:12.990 --> 00:10:20.020
Bill Dudley: The problem is that they basically took the loss. They sold a bunch of security to Coleman sacks before they actually

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00:10:20.040 --> 00:10:28.080
Bill Dudley: accomplished the capital raise. and the situation moved so fast that the capital rays couldn't actually be completed.

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00:10:28.220 --> 00:10:30.330
Bill Dudley: The this is probably the

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00:10:30.400 --> 00:10:40.390
Bill Dudley: fastest bank run in history. you know literally, you know, tens and tens of billions of dollars flowing out of the bank. you know, on a date on a daily basis.

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00:10:40.450 --> 00:10:43.680
and while Silicon Valley Bank still had quite a bit of collateral.

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00:10:43.700 --> 00:10:51.090
Bill Dudley: According to the news report, they couldn't move the collateral to the Federal homeland banks for advances, or to the fed just got one too fast enough

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00:10:51.160 --> 00:10:56.060
Bill Dudley: to come up with the sufficient cash to meet their depositor withdrawal. So

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00:10:56.070 --> 00:11:05.870
Bill Dudley: they basically ran out of liquidity. They didn't have the cash to honor their withdrawals. And so the bank was closed by the fdic as a as as a consequence of that.

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00:11:06.160 --> 00:11:16.440
Bill Dudley: So the panic spread, because, you know, whenever something like this happens, it's a big surprise to people in the markets, right? And everyone then says, Wow! See, there's more risk in the market than I thought.

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00:11:16.570 --> 00:11:21.130
Bill Dudley: Let's look at other banks that that look like a Silicon Valley bank.

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00:11:21.190 --> 00:11:28.430
Bill Dudley: Large proportion of uninsured depositors large mark to market losses on their securities. Portfolio or loan perform from that matter.

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00:11:28.550 --> 00:11:38.280
Bill Dudley: and those banks that then also became under stress. So that's the Signature Bank. First re bubble. We per firstly public bank, and a few other regional banks.

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00:11:39.440 --> 00:11:52.600
Bill Dudley: So the so, the so the run spread, and you know the run in some ways it's pretty rational once it gets started. you know, back. No back in essentially meet all its liquid demands if they're all presented, you know, simultaneously.

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00:11:52.640 --> 00:11:59.960
Bill Dudley: No, no; they can liquify all of their assets instantaneously. So you know the cost of running is very low.

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00:12:00.110 --> 00:12:12.320

Bill Dudley: rather the cost of of staying put if you're wrong, and the bank runs out liquidity. So once it starts the incentives to run and and and do your evaluation and ask your tough questions later.

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00:12:12.560 --> 00:12:13.450
Bill Dudley: So

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00:12:13.460 --> 00:12:30.180
Bill Dudley: that's that's really what happened. Credentials also failed. But for other reasons, you know, you can think of this just as a the final straw and the camel's back that caused people to lose confidence in credit suites. But, Prince, we' in under under undergrade to rest, for

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00:12:30.260 --> 00:12:31.910
Bill Dudley: you know many, many months.

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00:12:32.100 --> 00:12:45.750
Bill Dudley: and in the fourth quarter of this year. They had a lot of depositor and customer outflows before things stabilized early early this year. So so the policy response was to try to, you know, stabilize things

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00:12:45.790 --> 00:12:48.400
Bill Dudley: by basically making clear that

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00:12:49.470 --> 00:12:51.000
Bill Dudley: unsure deposits

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00:12:51.270 --> 00:13:06.340
Markus Brunnermeier: deposit are actually going to be a protected. So what the ftic, the fed and the Treasury decided to do is what's called this, so can I can ask you before you go into the policy. So you mentioned the new. It was very fast. It was much faster, but than previous bank runs.

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00:13:06.340 --> 00:13:25.530
Bill Dudley: So that's also why they're probably close to the bank on Friday morning about and waiting for the weekend for the Silicon Valley Bank. Yeah, they couldn't. They couldn't. They couldn't wait to the weekend because there was no money left to pay off people so like. So it's care comparison to the case of Silicon Valley Bank to create suites. Chris. We've got a big liquidity life with National Bank.

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00:13:25.660 --> 00:13:43.820
Bill Dudley: And now the equity line. Essentially, what's the bridge to the weekend that got credits to the weekend. And so then, Chris, we've

the Swiss authorities. You've all got together to figure out all right. What we're going to do over the weekend, and and a deal with enough, you know, on on on Sunday Silicon Valley Bank. There wasn't the ability to get through the weekend.

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00:13:44.270 --> 00:13:57.950
Markus Brunnermeier: So that's that's also unusual. And this speed I I would like to understand the speed element, because the different reasons for this. You mentioned that you know the deposit of base was very particular in a very big deposit, very alert customer base.

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00:13:58.510 --> 00:14:09.030
Markus Brunnermeier: That was because it was the online component. But you know, in the 2,008 we had online banking already. So you touched to the new technology. And the third argument is that

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00:14:09.260 --> 00:14:13.960
Markus Brunnermeier: this deposit base was very vocal on media, social media and all that, and that figured out us to run.

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00:14:14.130 --> 00:14:22.760
Bill Dudley: Yeah, I think that's part of it that the you know, the the this, this deposit base. They knew each other, they tweeted to each other, and so

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00:14:22.780 --> 00:14:30.880
Bill Dudley: you know they weren't very. They they were pretty homogeneous, and so. you know, if one was going to move then, so was the the next one, and so on.

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00:14:30.930 --> 00:14:41.620
Bill Dudley: So that's one aspect of it. But the other aspect of it was just that the the amount of uninsured deposits in this particular bank was, you know, over 90% of the I'm Sure, that's very unusual.

63
00:14:41.740 --> 00:14:47.050
Bill Dudley: You know most banks, you know. If you have a if you have even 30% of your posits are insured.

64
00:14:47.090 --> 00:14:58.190
Bill Dudley: then you have enough collateral to raise liquidity to to fund off a a all your on it through the brothers. The Silicon Valley Bank was very unusual in the in the high proportion of unsure deposit that they that they had.

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00:14:58.900 --> 00:15:10.250
Bill Dudley: So what happened was the systemic risk? Reception was evoked by the by, the by, the Regulators and the Us. Treasury. And what that basically is that says that we think this is systemic.

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00:15:10.540 --> 00:15:25.720
Bill Dudley: We have the ability to not do the lowest cost resolution to the Fdic, we can actually say, Look, there's gonna be other consequences of this that we want to avoid. And so in this case they basically said, we're gonna protect all the depositors for Silicon Valley Bank and signature today.

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00:15:26.040 --> 00:15:34.410
Bill Dudley: The problem with the systemic risk of session reception, though, is it? It's only done on an exposed base basis on a case by case basis.

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00:15:34.540 --> 00:15:37.580
So the the regulatory authorities right now are trying to like.

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00:15:37.770 --> 00:15:44.990
Bill Dudley: sort of can communicate to the people that if another bank were to feel we would probably do the systemic risk reception again.

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00:15:45.060 --> 00:15:55.130
Bill Dudley: But they can't promise it, because it's got to be done on a case by case basis, with majority vote of the Ftic and the Federal Reserve Board, so they can't sort of pre commit to it.

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00:15:55.150 --> 00:16:00.950
Bill Dudley: so that we've had this interesting dance by J. Paul and and Treasury Secretary Yellen to try to

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00:16:01.650 --> 00:16:06.420
Bill Dudley: intimate that all the depositors will be protected without being able to make that really ironclad

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00:16:07.370 --> 00:16:21.050
Bill Dudley: so legally. That's not possible to really extend the blanket. You could do something AD hoc. I mean the Treasury could take some of the money from their exchange stabilization fund. And basically say, this is available to backstop uninsured deposits.

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00:16:21.090 --> 00:16:36.740

Bill Dudley: But I think you know, in this case I think their strategy is just. We're just gonna make it very clear that we we stand behind the banking system and hope that people hear that as we will evoke the systemic risk perception whenever it's necessary, and in this case it's probably necessary

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00:16:36.940 --> 00:16:38.200
Bill Dudley: all the time right

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00:16:38.250 --> 00:16:49.560
Bill Dudley: Now the good news of all at all, in terms of what's happened is things in the United States very definitely seem to be stabilizing, and you know, the reality is the number of banks that really were sort of being picked on

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00:16:49.580 --> 00:16:57.250
Bill Dudley: is a very small proportion of the total number of banks in the Us. And a relatively quite quite a small portion of us banking assets.

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00:16:57.360 --> 00:17:06.589
Bill Dudley: That's why you know your poll. I think it's more like, you know kind of Illinois type of situation than it than the great financial crisis.

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00:17:06.880 --> 00:17:23.280
Bill Dudley: The savings long crisis is relevant in terms of like what's what's the cause of the initial problem? You know it's an interest rate like as a liability mismatch. That's why the the the the snl's got in trouble, but the snl crisis is very different, because most snl's.

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00:17:23.420 --> 00:17:32.870
Bill Dudley: you know, had very small proportion of one and sure deposits. Yes, and else we're able to operate even when they were in solvent, because they can continue to track deposits.

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00:17:33.050 --> 00:17:51.240
Bill Dudley: And what we saw in this snl crisis is that because of that they took a lot of risk, because the sort of heads we went to the the government loses, and so the fact they could operate with on it. With it was insured deposits, even even though, when when they were in solve, it May meant that they actually took more risk and generate even bigger losses

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00:17:51.240 --> 00:17:54.160
Bill Dudley: for the Federal Government when they were finally wound up.

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00:17:55.490 --> 00:17:56.850
Markus Brunnermeier: But if you say

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00:17:56.950 --> 00:18:01.940
Markus Brunnermeier: so, nevertheless you think it's very isolated, those very specific things. But nevertheless

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00:18:02.170 --> 00:18:21.610
Markus Brunnermeier: it's started to spread, and continually, I know you would say your was spreading tools, or you you essentially needed a blanket guarantee, or it was advisable to him, and have any express an implicit plank at them. Team. Well, you know, every situation is is different, but I mean, I think the key point is, once one bank goes, everyone looks for the next week. It's bank.

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00:18:21.610 --> 00:18:23.150
Bill Dudley: and if you don't sort of.

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00:18:23.830 --> 00:18:35.930
Bill Dudley: Make it clear that you're building a firewall between that first bank that fails in the next one, and it's going to tend to keep going, because people's risk. Aversion goes up dramatically after the first bank is failed.

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00:18:36.190 --> 00:18:40.320
Bill Dudley: So that's why you have to. It requires ever a greater force

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00:18:40.530 --> 00:18:45.500
Bill Dudley: to prevent the contagion from spreading. What's the first domino falls?

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00:18:46.780 --> 00:18:56.810
Markus Brunnermeier: So many people focused on the Us. Treasury. So when this Silicon Valley bank was holding, so this of them that was, you know, very much, not mark the market.

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00:18:56.810 --> 00:19:07.980
Markus Brunnermeier: but they also a lot of mortgages Banks are holding. So if you were to mark the market, the mortgages. You know that extended more just to 2.8% into set for 30 years. There must be huge losses on the mortgage books.

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00:19:08.010 --> 00:19:19.470

Bill Dudley: No, there are. There are a lot of losses embedded in the entire banking business, but it's important to, and people argue that the losses are, you know, a a pretty large proportion of total banking equity.

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00:19:19.610 --> 00:19:23.550
but it's really important to understand that that's not the only part of the story.

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00:19:23.560 --> 00:19:26.900
Bill Dudley: A lot of banks have deposits that are very sticky.

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00:19:26.930 --> 00:19:34.700
Bill Dudley: and they don't need to pay market rates of interest on those deposits to continue to have those deposits as part of their banking business.

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00:19:34.790 --> 00:19:43.580
Bill Dudley: So you know, as interest rates go up. There's losses on the security portfolio, but the retail deposits become more and more valuable.

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00:19:43.580 --> 00:19:54.970
Bill Dudley: And so you really have to net those 2 things together. The second thing is, you know, banks do have franchise value. They make profits off their customer base, and it also has to be taken into consideration.

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00:19:55.130 --> 00:19:57.120
So yeah, I think that you know.

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00:19:57.170 --> 00:20:03.170
Bill Dudley: you know, banks that interest margins are probably gonna, you know, come under a bit of pressure as we go forward.

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00:20:03.190 --> 00:20:12.730
Bill Dudley: You know what's interesting in the fourth quarter most banks so interest that interest margins actually wide. because what happened was the fed was raising rates very quickly.

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00:20:12.790 --> 00:20:26.350
Bill Dudley: and banks were being slow to raise the rates that they pay on deposits. Now I think what will happen over in the fullness of time. Banks will have to pay more for deposits, and so eventually that that interest, margin widening will probably come back down

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00:20:26.390 --> 00:20:30.130
Bill Dudley: the big beneficiary of what we're seeing right now is the money center banks.

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00:20:30.240 --> 00:20:46.020
Bill Dudley: because the deposits are flowing to the money center banks so that'll allow them to be even less aggressive about paying interest on the but so you're gonna see, I think, in the for you know, first quarter and that interest margin for the money center banks that can contain the wide and I think will be very interesting to see

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00:20:46.250 --> 00:20:53.620
Bill Dudley: is what happens to the net interest margin of some of these regional banks. So we're going to get first quarter earnings from. You know most of these banks in the next month.

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00:20:53.790 --> 00:21:01.740
Bill Dudley: and it could be very interesting to peruse those earning reports and those balance sheet statements to see what's happened to their net interest margin. So I think

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00:21:01.750 --> 00:21:04.580
Bill Dudley: I think the risk is mostly passed.

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00:21:04.850 --> 00:21:11.430
Bill Dudley: But i'm going to be very interested to see you know what they report in the first quarter, what their balance sheet looks like.

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00:21:11.610 --> 00:21:14.430
Bill Dudley: and whether that passes muster

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00:21:14.450 --> 00:21:23.070
Bill Dudley: with investors and depositors. If we can get through that, you know that evaluation over the next month, then I think the worst of this has passed.

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00:21:23.650 --> 00:21:28.980
Markus Brunnermeier: So during the global financial crisis, the live OS, where it was actually the variable to look at

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00:21:29.120 --> 00:21:40.370
Markus Brunnermeier: what we're able to look at the kernel crisis, saying, Well, that's you just mentioned, or getting it. Interest margins.

What would you look at in particular? You know some price and volume data. What's what's really the to look out for.

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00:21:40.910 --> 00:21:59.560
Bill Dudley: Well, I think you know I I mean, you want to look at a number of things. So your one number one you're looking at how it's dressed. Our banks actually going through. So one thing you want to look at is how much money are they borrowing from the Federal Home own bank system. Which money are they borrowing from the Federal Reserve either the discount window or this new special facility? The set is a set up to lend against

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00:21:59.560 --> 00:22:03.110
treasuries and agents agency more automatic security. So you want to look at

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00:22:03.170 --> 00:22:16.920
Bill Dudley: How much are they dependent on that Federal homo banks and the fed for funding. That's number one. Number 2. You want to look at the net interest marks is that being squeezed? Number 3, You want to look at this loaned a lot, mark the market losses in terms of their portfolio.

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00:22:17.110 --> 00:22:23.980
Bill Dudley: and you know those other things. And then, last thing you want to look at, and I think this is more about thinking about what's the impact of this on the economy

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00:22:24.000 --> 00:22:36.530
Bill Dudley: you want to look at? What's having to the bank lending. You know what what what people are concerned about. This is that this yeah turmoil and the banking sector is going to cause Banks to pull back on lending.

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00:22:36.550 --> 00:22:38.890
Bill Dudley: And then that's gonna hurt the economy.

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00:22:39.210 --> 00:22:44.380
Bill Dudley: My own view is that I'm. Somewhat skeptical that this is a very powerful channel, because

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00:22:44.490 --> 00:23:03.880
Bill Dudley: the problem for the banks is not that they have a credit problem. They have an interest, rate, mismatch problem. So it seems to me that the solution to an interest rate mismatch problem is to take less interest rate risk. It's not to pull back on landing. Now, if you thought

that this was sufficient to cause the economy to go into a much worse trajectory.

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00:23:03.880 --> 00:23:20.790
Bill Dudley: and that maybe would be a reason to pull back on lending. But if you think the effects of this on the economy. First order and the economy are pretty mild, which I I I think they don't really see this having a huge effect on the banks going to land. If I if i'm a bank, and the economic outlook has not changed in the fundamental way.

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00:23:20.820 --> 00:23:30.980
Bill Dudley: why should I be altering my lending decisions? If If it's a good loan. I think it's a good loan. Given the outlook for the economy then, before that, I should be want to make the same loan today.

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00:23:31.100 --> 00:23:34.260
Markus Brunnermeier: but perhaps you have less equity to, or less capital to.

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00:23:34.400 --> 00:23:35.550
Markus Brunnermeier: Well.

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00:23:35.700 --> 00:23:38.280
Bill Dudley: yeah, I mean the capital. You know the capital

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00:23:38.470 --> 00:23:58.390
Bill Dudley: is only depleted to the extent that the mark to market losses are occurring in the whole to maturity, part of the portfolio. Otherwise you know, in that hold them in in the whole majority part of the before it doesn't flow through capital. So there's no immediate regulatory capital. No; but do you think when banks make the kind of decisions or some hurdle of Aids decisions

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00:23:58.390 --> 00:24:08.950
Bill Dudley: to focus more on the regulatory capital, or more on the economic capital, too. That's a good question. That's a good question. I, I, I I I I would imagine they would be. They focus on both. But end of the day.

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00:24:08.990 --> 00:24:16.760
Bill Dudley: you know. if you're a bank, you have customers. You want to service your customers, and the customer comes to with a you know, a a request for a loan.

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00:24:17.060 --> 00:24:35.070

Bill Dudley: Are you gonna term? Turn them down. If you think their credit is good, it seems to me more likely that you would, basically you know, liquidate some of your portfolio securities portfolio. Use those proceeds to fund loans because you could reduce interest rate risk, and you also could improve your your your margins. Typically lending is going to have a higher margin.

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00:24:35.070 --> 00:24:44.420
Bill Dudley: then investing in treasuries or agency mortgage, back security. So I I just don't see the logic of pulling back on the on on on the wending side of the equation.

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00:24:44.950 --> 00:24:57.110
Markus Brunnermeier: So I wanted to ask you about, You know, modeling of the deposit side of the house stable, the deposits on how much market power. The banks have, you know we have a lot of sophisticated modeling and prepayment risk of mortgages.

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00:24:57.250 --> 00:25:13.360
Markus Brunnermeier: Do you have an do you have an idea? But the being, how sophisticated all is, all there in the modeling and managing the deposit stability is the a lot of innovation in the last few years which happen, or that we use for see or innovation in this.

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00:25:13.360 --> 00:25:31.120
Bill Dudley: Well, very, very biggest banks there is a regulatory acquired called the net stable funding ratio, and it basically, looks at different classes of deposits, and basically, you know, decides how you know runable they are likely to be. I mean, I think, for banks, you know, if you divide the the deposit, there's there are 3 buckets

133
00:25:31.310 --> 00:25:39.230
Bill Dudley: There's the ensure deposits that are remarkably stable. I mean, you basically can be broke, and this in your deposits will stay there.

134
00:25:39.440 --> 00:25:56.930
Bill Dudley: Then there's the uninsured deposits that are needed for corporation or other business to conduct their banking if their operations, so the deposits that are tied to payroll the Todd posit. They're tied to, you know, paying suppliers. Those deposits are pretty stable as well, because

135
00:25:56.930 --> 00:26:05.030
Bill Dudley: there's a big cost to a company, and moving their banking business from one back to another. And then there's a lot the large uninsured deposits

136
00:26:05.190 --> 00:26:06.960
that aren't really there

137
00:26:07.160 --> 00:26:24.710
Bill Dudley: to do banking business. I mean the best example of this in the case of Silicon Valley Bank is apparently a circle which is a a a crypto currency a purveyor. They have a a Us. Dollar a stable coin. They apparently had several 1 billiondollars on deposit at Silicon Valley Bank to backstop

138
00:26:24.720 --> 00:26:39.310
Bill Dudley: us dollar coin money didn't have to be at Silicon Valley Bank. It could be in Treasury bills. It could be in Treasury money market funds. It could be another bank, so that money was, you know, immediately movable, without any consequence at all. So it really depends.

139
00:26:39.510 --> 00:26:42.410
Bill Dudley: It's more of an art science, I think, at this stage.

140
00:26:42.620 --> 00:27:02.320
Markus Brunnermeier: I said. But do you think they are very interested? Sensitive in a sense, or is more the risk, sensitivity? What you know what I mean? I think you know, retail deposits, I mean probably have some interest Rates sensitivity, right? Because obviously, if the bank is paying you one anything you get 4 and a half percent from my market mutual fund. That's gonna affect your decision whether to keep the deposits there.

141
00:27:02.440 --> 00:27:07.690
Bill Dudley: Typically, though households have not been that alert or sensitive

142
00:27:07.750 --> 00:27:25.330
Bill Dudley: to the level of market rates, and that's why it was interest. Rates went up last year. The the retail free top deposits went from being very unattractive to to to banks when they have these big, you know, deposit branch networks. They have to pay for all these branches. Interest rates are 0.

143
00:27:25.330 --> 00:27:31.370
Bill Dudley: Those deposit branches are just a huge sinkle of cost. But when interest rates go up.

144
00:27:31.400 --> 00:27:36.210

Bill Dudley: those deposit branches have a lot of utility because they're producing a lot of low cost.

145
00:27:38.070 --> 00:27:47.670
Markus Brunnermeier: So let me come back when you compare it to the snl Guys, As you said, you know it's an Eric Isis. There was century, not the bank, and that by the Snell crisis direct on over almost 10 years.

146
00:27:47.900 --> 00:27:54.040
Markus Brunnermeier: So are you saying, actually having this bank run is shortening the the length of the total crisis.

147
00:27:54.230 --> 00:28:05.040
Bill Dudley: Well, I don't I don't know about that. I would just say it's a it's a different situation. I mean it's the crisis. We're typically smaller institutions, or we rely on retail insured deposits.

148
00:28:05.060 --> 00:28:20.560
Bill Dudley: And you know, during that period there are also a lot of broker deposits where you could, basically you know. Take, take, take, take a big chunk of money and divide it up into smaller size, ensure deposits and distribute them across the number of the depository institutions that you can still do that today.

149
00:28:20.640 --> 00:28:25.750
Bill Dudley: And so that allowed the snl to stay in business and continue to fund themselves, even when

150
00:28:25.780 --> 00:28:37.500
Bill Dudley: you know, if if at a liquidation basis they were broke, and we know they were broken on a liquidation basis, because we ultimately did close down a lot of snls, and it costs the Government something on the order of maybe 150 billiondollars.

151
00:28:39.230 --> 00:28:53.620
Markus Brunnermeier: So can you elaborate a little bit? You know what the role of at home loan bank plays in this context Also, in context, then you yeah, they're a lot more important than people think. And they're also really important during the great financial crisis.

152
00:28:53.720 --> 00:29:06.590
Bill Dudley: So the Federal Homeland Bank system there's now 11 Federal home banks in the country, and basically what they do is they issue a Federal Home Bank for Federal Hong Kong Bank obligations, you know, discount notes and

153
00:29:06.710 --> 00:29:20.110
Bill Dudley: and longer data coupons, and they use those procedures to basically give it loans to depository institutions. So the depository institutions pledge some of their assets to the Federal home banks

154
00:29:20.110 --> 00:29:31.550
Bill Dudley: in the Federal home at banks have that as collateral. They lend this money against again these advanced system, that a home on banks are really safe. So in terms of the where they sit in the hierarchy.

155
00:29:31.610 --> 00:29:40.460
Bill Dudley: because not only do they have the collateral that the pledge to them with haircuts, they're also senior to the Fdic. If the bag actually fails.

156
00:29:40.500 --> 00:29:51.020
Bill Dudley: So if if a bank that they've lent to actually fail, not only do they have the the collateral that they can liquidate, but they're also senior to the Fdic in terms of the claim. So

157
00:29:51.040 --> 00:30:05.740
Bill Dudley: the Federal home of banks are pretty safe in this whole process, and all during the great financial crisis, the Federal home banks, state and business we're able to fund and provide a source of liquidity. This source of liquid is actually more popular for banks than the discount window.

158
00:30:05.830 --> 00:30:14.660
Bill Dudley: because it doesn't have the stigma attached to it's the case that the discount window has to stick. Monday Fleming from the Federal and homeland banks does not.

159
00:30:15.150 --> 00:30:31.370
Bill Dudley: I think the I mean the discount window is a has statement for a couple of reasons why it's not it's it's it's it's. It's like penalty rate, so it's above what you can get from, or you know, in the Federal Fund market, from another bank, or what you can get doing a, you know, borrowing through the Repo market.

160
00:30:32.540 --> 00:30:51.670
Bill Dudley: So this discount window, you know. So if you go to the discount one, it's usually a sign that you either had a surprise at the end of the day, and some payment. Hit your account, and you weren't anticipating it. So you just need to borrow a little money from the Fed to tidy over to the next day, or a sign that you're in difficulty that

you're having trouble raising money from other banks, or from from your customers.

161
00:30:51.670 --> 00:30:57.550
Bill Dudley: So banks are pretty allergic to relying on the discount window very heavily, although you can see in this last

162
00:30:57.730 --> 00:31:07.850
Bill Dudley: episode discount, we know. Borrowing did go up quite dramatically. This is an example where you know, if you really don't have the money from any other source, you know, if your choices are to

163
00:31:07.900 --> 00:31:22.350
Bill Dudley: fail for power from the discount, when of course, you're gonna go, that goes to the discount when you're in the the Homeland bank is lending it to walk rate at the policy rate. It's basically you know, the cost of their advance plus a little bit of mark up. So you can think of the

164
00:31:22.390 --> 00:31:40.400
Bill Dudley: you know the Federal Home Loan banks are borrowing it. The Treasury market rate, plus it's just a small little premium above that. And then they're lending at a mark of above that. The other advantage of the Federal Bank is they can also advance you term lending. So it doesn't have to be an overnight loan. It could be a you know it could be a term.

165
00:31:40.610 --> 00:31:53.640
Bill Dudley: so so the banks are just much more comfortable with using the Federal Bank. This has been, you know they've been using a month for a regular basis, so that's something that they're pretty comfortable with. But as a deposit, I should become even more concerned because I'm actually junior.

166
00:31:54.000 --> 00:32:04.520
Bill Dudley: No, no, we but you're not. But the FDA is, is is is protecting you. So you don't need to worry about that. I mean the ft I see is backstop By Not only is it backstop by the fact that they can

167
00:32:04.880 --> 00:32:19.560
Bill Dudley: assess more insurance Premiums against the banking Industry, to to rebuild the reserve fund. They also have a line of Credit to the Us. Treasury. I cannot imagine a Circumstance, and which the Fdic Fund didn't make good on its its obligations.

168
00:32:20.020 --> 00:32:26.440

Markus Brunnermeier: So if you look at this new fed backstop liquidity facility, if there would not have land at the

169
00:32:26.590 --> 00:32:39.320
Bill Dudley: they would not have been able to compete with the Federal Home Loan banks.

170
00:32:39.350 --> 00:32:43.200
Bill Dudley: That's useful if you you know, if you if you have a shortage of collateral.

171
00:32:43.230 --> 00:32:55.850
Bill Dudley: But you know, most banks that have a large proportion of of of insured deposits have plenty of clarity. They don't have to collateralize their insure deposits. So let's imagine my bank. That's 50% sure deposits.

172
00:32:56.130 --> 00:33:12.580
Bill Dudley: I have a 100 sense of collateral to collateralize that 50% of unassured deposits so. Most banks that you know exist have plenty of collateral pledge. I mean the discount window takes a very wide array of collateral. The Federal home banks. It's it's it's it's it's narrower.

173
00:33:12.580 --> 00:33:17.800
Bill Dudley: But you know there's plenty of ability to liquefy your portfolio at the fed. If you need to

174
00:33:19.300 --> 00:33:22.320
Markus Brunnermeier: so, why is there no stigma attached to this facility

175
00:33:22.460 --> 00:33:24.380
Bill Dudley: compared to the discount

176
00:33:24.880 --> 00:33:31.670
Bill Dudley: I you know. I guess it's because it has some attractive features that I can borrow a dollar against, you know 85 cents or a c.

177
00:33:32.940 --> 00:33:49.050
Bill Dudley: So you know, I think you know things are not stigmatized and look like that that look attractive, right? So if I offer a facility that makes sense from a market perspective to use, then people are going to use it. I mean a good example of this is the reverse. Repo facility that money market funds use

178

00:33:49.060 --> 00:34:03.620
Bill Dudley: to take their cash, and the positive, you know they take their cat deposit with the repo with the fed. They do it because they're getting a better rate than if they did repo in the private market. So if the facility is attractive on the face of it. There's really no statement attached to it.

179
00:34:04.170 --> 00:34:18.780
Markus Brunnermeier: So is there some risk for the fad? Essentially, because of some people? Arg. You know, if there's before. Let's pose this collapse. It takes it for 100 cents to the dollar, and then just it's on it till it matures.

180
00:34:18.780 --> 00:34:33.100
Bill Dudley: Well, there's a little bit of risk, and the fed has recourse to the to the up to the lender of, you know. Borrow power, and they also have a a bunch of Treasury money that's been given to them from the Exchange Stable Organization Fund as they first

181
00:34:33.219 --> 00:34:34.320
Bill Dudley: lost piece.

182
00:34:34.420 --> 00:34:39.580
Bill Dudley: So basically, what? What what has to happen is a bank would have to fail.

183
00:34:39.659 --> 00:34:56.739
Bill Dudley: The fed would then have some walk potentially have some losses on. Yeah, because the cloud will be worth less than what the fed lent to them, and then the change Stabilization Fund, Equity Tranche would make the fit whole. So that's why that's why this is a 13 3 Sicily. That's why the Treasury was involved.

184
00:34:56.739 --> 00:35:01.040
Bill Dudley: and that's why the Treasury made the equity contribution. So the fact that actually take this risk.

185
00:35:01.220 --> 00:35:20.650
Markus Brunnermeier: Perhaps you can explain to the audience. What's thirteen-three facilities, or almost eliminated doing? Dot Frank, that was one of the so 13 3 facilities are introduced only after the said deterrence that we're in a situation of unusual and exigen circumstances.

186
00:35:20.720 --> 00:35:21.860
And when

187
00:35:21.930 --> 00:35:25.840
Bill Dudley: certain class the borrowers can't get funding from any other source.

188
00:35:25.960 --> 00:35:45.100
Bill Dudley: and in those circumstances, with the you know, agreement of the Treasury. The Fed is allowed to set up broad, base facilities to to to support support. You know the financial system. What was taken away with that, Frank is the ability to offer a facility

189
00:35:45.100 --> 00:35:58.660
Bill Dudley: to support a single institution, so the fact can no longer have a facility to support, for example, Aig. So it has to be broad based, and that's what's different. That's what was taken away from the fit by the dot Frank act.

190
00:35:58.990 --> 00:36:03.400
Markus Brunnermeier: And how big is this exchange debilitation fund? And somebody asks in the audience.

191
00:36:03.620 --> 00:36:12.500
Bill Dudley: Yeah, i'm not sure the what the limit is. I mean, I can't remember the exact amount that the exchange civilization from pledge. I think it was something I there were maybe 25 billion

192
00:36:12.580 --> 00:36:21.990
Bill Dudley: you know I you, know. I I think you know the fed has to make a judgment of You know how much equity can that support safely? And so I imagine it's probably pretty elastic.

193
00:36:22.730 --> 00:36:25.530
Bill Dudley: I'm not worried about the fed running out of capacity there.

194
00:36:26.640 --> 00:36:33.920
Markus Brunnermeier: So is this, you know. If you take all of this discount window at home on banks, this new facility.

195
00:36:34.330 --> 00:36:36.910
Markus Brunnermeier: Think there's important pieces missing?

196
00:36:38.150 --> 00:36:45.050
Bill Dudley: Well, I mean, yeah, the the the the main struggle that the you know, both the Treasury and the fed have had and

197
00:36:45.090 --> 00:36:56.680
Bill Dudley: is to are the uninsured deposits protected Ex. Ante. And yeah, they've been saying things like we think all deposits the banking system to save all the the the banking system will be safe.

198
00:36:56.920 --> 00:37:04.110
Bill Dudley: but they can't be quite as explicit as they'd like to be, because, to be truly explicit, you have to basically say

199
00:37:04.120 --> 00:37:07.710
Bill Dudley: that the systemic risk perception would be invoked in every case.

200
00:37:08.060 --> 00:37:19.960
Bill Dudley: and they're just not quite comfortable, you know. moving that far. Now, I mean, you know Treasury Sector yelling has been very clear that this things got worse will escalate. So that's another way of reassuring people.

201
00:37:20.060 --> 00:37:39.870
Bill Dudley: So I you know. I have no doubt that if you know things were to get worse we we would see more action by the Treasury and the fed. I don't expect things to get worse, so I don't so I don't expect that kind of if you ever were to extend the blanket guarantee, would you then only for

202
00:37:39.880 --> 00:37:53.370
Markus Brunnermeier: limited timeframe extended, or what do you specify the timeframe, or what you say? You know there's an explicit blanket guarantee what would have to be done by Congress Congress would have to enact it. That's that's that's the catch right now.

203
00:37:53.480 --> 00:38:03.370
Bill Dudley: and Congress doesn't seem to have the functional ability to agree on much of anything at this point, so I can't imagine that kind of coming forward I mean

204
00:38:03.510 --> 00:38:17.010
Bill Dudley: from Congress at this point. But you know the Treasury still has the Exchange stabilization fund monies, and that could still be used. The fed still has the ability to escalate in terms of the discount window They could off return funding. They could do

205
00:38:17.010 --> 00:38:26.490

Bill Dudley: you know, a term auction facility like they did during the great financial crisis. So there's still there's still definitely escalation options available. The the toolkits not empty at this point.

206
00:38:27.170 --> 00:38:44.530
Markus Brunnermeier: Give me up and a little bit the mobile hazard considerations. If you extend the blanket to guarantee, do you think all the debt will then convert to deposits. Essentially, you know well it it it does create a lot of issues. So if you, if you were to be very explicit that all of the are protected.

207
00:38:44.550 --> 00:38:46.640
Bill Dudley: Then you're creating a

208
00:38:46.650 --> 00:38:55.880
Bill Dudley: much bigger pool of safe assets that that's that's elastic that people can float towards. And so that's going to dissipate this disadvantage.

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00:38:56.150 --> 00:38:57.670
Bill Dudley: You know. Assets that are.

210
00:38:57.870 --> 00:39:16.220
Bill Dudley: you know, Don't have that protection like Think about. You know a one P. One commercial paper so presumably what would happen is the the spread between a. When when commercial paper and ensure the positive, uninsured deposit rates would probably widen a bit. So yeah, you have to be a little bit cautious about when you make these kind of blanket guarantees, because you are going to

211
00:39:16.220 --> 00:39:22.680
Bill Dudley: create, you know, boundary issues in terms of what's Where's the boundary between what's insured? And then what's the next thing?

212
00:39:24.260 --> 00:39:35.110
Markus Brunnermeier: So let me talk a little bit about the the interaction among the banks, because what you see you see fund outflows deposit outflows from the small and the original banks towards the big banks.

213
00:39:35.180 --> 00:39:41.560
Markus Brunnermeier: Of course, if you have a well-functioning banking system. The big banks could just re-channel it back to the regional banks.

214

00:39:42.020 --> 00:39:53.370
Markus Brunnermeier: And then this the funding situation will be resolved, and we saw it to some extent, You know, the Jp. Morgan and Bank of American City Bank actually channeled back to first the public bank.

215
00:39:53.410 --> 00:39:58.190
Markus Brunnermeier: of course, at the much higher interest rate than the initial deposits probably were charging.

216
00:39:59.090 --> 00:40:09.510
Markus Brunnermeier: Do you think that there's if the banks themselves could stabilize themselves much more by you know channeling it bank. If or do you think the Internet market is working well in this regard?

217
00:40:09.640 --> 00:40:16.570
Bill Dudley: Well, I think one of the constraints here is the supplemental leverage ratio which basically puts a limit on.

218
00:40:16.600 --> 00:40:22.030
Bill Dudley: you know, the ratio of total assets in a bank and its equity capital. And so

219
00:40:22.410 --> 00:40:34.430
Bill Dudley: you know, to the extent that more deposits move to money, center banks, and they lend out those deposit and expand their balance sheet. Then there's risk that the supplemental leverage ratio becomes binding for those banks.

220
00:40:34.680 --> 00:40:42.710
Bill Dudley: you know, and the banks also may not, you know, always feel comfortable with the counterparty risk of having large exposures to banks that

221
00:40:42.740 --> 00:40:49.040
Bill Dudley: you know, in you know, could potentially be a at at at at risk. So it's not that.

222
00:40:49.040 --> 00:41:04.720
Bill Dudley: Not the greatest recycling that is another problem we have compared to, you know, 10 years ago it used to be that the money market funds played a lot of this recycling mechanism. We had very large prime money market funds that invested in Bank Cds and Banks commercial paper.

223
00:41:04.910 --> 00:41:24.740

Bill Dudley: And when we reform the money market fund industry by introducing floating any of these for institutional prime money market funds that basically made that whole industry go away. And so the prime money market fund industry today is much smaller than it was.

224
00:41:24.740 --> 00:41:31.230
Bill Dudley: You know, a a decade ago, and so that's not available as easily as a recycling mechanism.

225
00:41:31.940 --> 00:41:43.650
Bill Dudley: Who should be he? Think the regulation? Do you know? No, definitely not. You know the money, mark we we we've had a couple of episodes of money market fun, turmoil. I don't think we want to go go back to that.

226
00:41:44.690 --> 00:41:45.390
Markus Brunnermeier: Okay.

227
00:41:46.150 --> 00:41:55.590
Markus Brunnermeier: Good. So perhaps you can go to further policy measures. Then we talked to touched already on many of these and all of the implications for monetary policy.

228
00:41:56.220 --> 00:42:10.360
Bill Dudley: Yeah. And i'm not your policy side. If I may think that the big issue here is going to be the question of how much do these banking most actually restrain economic growth. You know the fed, you know, prior to the Silicon Valley Bank problems, the Fed was basically

229
00:42:11.940 --> 00:42:29.370
Bill Dudley: determining that interest rates were not sufficiently high enough to restrain the economy fast enough to get inflation back down to 2% in a timely way. I mean when Chairman Palm means that maybe we need to consider moving back to 50 base when Great Ike was really because of the economy in the first quarter.

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00:42:29.370 --> 00:42:34.600
Bill Dudley: look to be considerably stronger than what the fed had anticipated. And so the Fed was

231
00:42:34.610 --> 00:42:54.210
Bill Dudley: rethinking what monitor orders restrictive, met in terms of the level of interest rates consistent with with monitor really restricted. Now, what's changed is we now have these banking system problems which are going to exert some restraint on growth. And so. Now the Federal Reserve is essentially has to estimate. How much does this re

232
00:42:54.210 --> 00:43:04.960
Bill Dudley: place or substitute for further rate hikes? And the answer at this point is, we just don't know if the you know. If the contagion ends, and it's all just a few banks.

233
00:43:05.030 --> 00:43:09.140
Bill Dudley: then the effects on the economy are likely to be very, very modest.

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00:43:09.240 --> 00:43:20.730
Bill Dudley: and then the Federal Reserve is probably going to have to return to raising interest rates further in contrast to banks, you know, to, you know, respond to the shock by pulling back credit availability in a in a significant way.

235
00:43:20.760 --> 00:43:25.460
Bill Dudley: Then the Fed Reserve might be done, and that reality is we don't we just don't know.

236
00:43:25.550 --> 00:43:36.800
Bill Dudley: So what we're supposed to look at. Well, i'm going to be looking at loans outstanding. I'm going to look at the this this year Loan Officer Survey, which talks about the you know credit standards.

237
00:43:36.910 --> 00:43:47.170
Bill Dudley: And then we look at the real like it on date, in terms of seeing what's happening to economic activity. You know the last fed has a. Has a fed now Gdp. As a. As a Gdp now forecast, and

238
00:43:47.270 --> 00:44:00.340
Bill Dudley: i'm not sure where it is today, but I looked earlier in the weekend. It's it's 3.2 for the first quarter, I mean the fed situation fed is still in the same place. They've been it for a while. Economy is too strong. Labor markets too tight. Inflation is too high.

239
00:44:00.550 --> 00:44:04.480
Bill Dudley: and in some ways they're actually in a worse situation. And now.

240
00:44:04.620 --> 00:44:08.090
Bill Dudley: because they're a they have a lot more uncertainty about

241
00:44:08.180 --> 00:44:24.380

Bill Dudley: the trajectory of growth because of these banking system woes. And so there, this is going to make it harder for them to determine. What's the appropriate approach? The best. I think the situation is not much more nonlinear like, you know, we can't control that. It might be jumping.

242
00:44:24.380 --> 00:44:38.000
Bill Dudley: But all the things smoothly going down is your time. Yeah, I think it's yeah. It could be. I mean, obviously banking system, you know, stresses can go from while to fast, very, very quickly. But I I also think it's just like

243
00:44:38.180 --> 00:44:42.080
Bill Dudley: you don't really know how big the impact of this is going to be. And so

244
00:44:42.140 --> 00:44:56.600
Bill Dudley: you know, whatever you thought before you, you're the uncertainty badge around what you thought before it just gotten a lot wider. So think of it As the before. The fed was sort of conducting policy with a well functioning backing system. They sort of knew how the transmission mechanism launch our policy works.

245
00:44:56.610 --> 00:44:57.810
Bill Dudley: Now they have

246
00:44:57.860 --> 00:45:05.560
Bill Dudley: a slightly impaired transmission mechanism, and they're not really sure how impaired it is. And so what? What? The consequences of that are going to be for the real economy? So

247
00:45:05.590 --> 00:45:06.400
Bill Dudley: they're just

248
00:45:06.550 --> 00:45:17.870
Bill Dudley: a little bit, you know. There, before it was sunny out now it's raining, and they so it's driving through the rain. And so they're a little bit less certain about. You know where they're going, and how fast they can they can drive there

249
00:45:18.190 --> 00:45:25.170
Markus Brunnermeier: when the other thing you saw, even though the fair Titan but 25 basis points, still, long end of the gradually yield came down.

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00:45:26.550 --> 00:45:32.330
Markus Brunnermeier: and I don't know what the mortgages market did. It probably came down a little bit, too, so it's not really a tightening on the long end.

251
00:45:32.440 --> 00:45:38.630
Bill Dudley: Yeah, although in the last few days the the long end is going back up. I mean what's essentially been happening

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00:45:38.710 --> 00:45:52.610
Bill Dudley: as as sentiment about the banks has improved. People are now starting to Price back in more monetary policy, tightening, and as a consequence of that long-term rates are also moving up again, so

253
00:45:52.710 --> 00:46:00.620
Bill Dudley: you know, right now I mean I look just before we got on. It looks like the market sort of 50 50 in terms of a 25 base point. I get the main meeting.

254
00:46:00.640 --> 00:46:09.970
Bill Dudley: you know. So you know, if the banking system improves, people will assume that there's less restraint if they assume there's less restraint, and there's more for the fed to do so we'll see.

255
00:46:11.170 --> 00:46:20.620
Markus Brunnermeier: So you know the president of the Ecp. You can actually separate totally liquidity tools on financial stability, and monitor the policy tools to do inflation.

256
00:46:20.770 --> 00:46:32.760
Markus Brunnermeier: Do you believe that you can totally separate these 2 things? They can be, you know, very accommodative for financial stability, but a very restrictive in monetary policy terms. Or do you think these 2?

257
00:46:32.840 --> 00:46:33.650
Markus Brunnermeier: I

258
00:46:33.740 --> 00:46:47.860
Bill Dudley: I think it's largely too true. I think it's largely true that you can separate them. I mean you. You basically have liquidity tools to deal with, finance, disability issues, and then you have the interest rate tool to deal with. You know strength of the economy inflation.

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00:46:48.080 --> 00:46:50.190
Bill Dudley: But there's a there is a but

260
00:46:50.310 --> 00:47:02.260
Bill Dudley: the higher you push short-term interest rate. The more stress you are putting on the banking system, and the more you know, risk you have in the financials away from. So the 2 you have tools to address each of these pieces.

261
00:47:02.270 --> 00:47:10.880
Bill Dudley: but the pieces are not completely separate. The voluntary policy I pursue will affect the degree of financial stress. I'm. Putting on the banking system, so they're not going to be really separable.

262
00:47:11.710 --> 00:47:23.340
Bill Dudley: So do you think it's a level of the interstate which causes the problems, or is the speed of day. I think I think it's probably both. But you know clearly, if the Fed had tightened sooner

263
00:47:23.610 --> 00:47:42.730
Bill Dudley: and it's been more gradual, I think we would have less stress. And this is one of the most, you know, rapid tightening and fed history, you know. They raised rates by 4 and a half to 4 and 3 quarters in in in in 9 months, and and you know I was a little surprised as we went through that process that we want to see more signs of stress.

264
00:47:42.860 --> 00:47:57.060
Bill Dudley: because last time we did this in 1990, for you know Orange County went bankrupt, so I was expecting to be other, you know, sort of, you know, casualties. And there basically were no casualties of note until Silicon Valley, back

265
00:47:57.190 --> 00:48:00.290
Bill Dudley: and Silicon Valley Bank ironically, was completely avoidable.

266
00:48:00.320 --> 00:48:05.280
Bill Dudley: All they had to do is not take the interest rate risk in the first place, or, if they took it.

267
00:48:05.860 --> 00:48:07.780
Bill Dudley: raise the capital first.

268
00:48:08.050 --> 00:48:25.370

Bill Dudley: and then, and then sell off the securities. So they they. you know. I I know the Regulators are getting a lot of fl for what happened at Silicon Valley Bank, and I think it's fair to say that the Regulators probably should have moved more forcibly, and forcing the bank to deal with their interest rate risk.

269
00:48:25.520 --> 00:48:30.830
Bill Dudley: But at the end of the day the the number one corporate here is the management of Silicon Valley Bank.

270
00:48:30.880 --> 00:48:42.450
Bill Dudley: They didn't need to do this to be a viable bank. They had a good franchise, and they blew it up because they were greedy. They were trying to stretch for a little bit more yield because they want a little bit more profits, because they want a little bit stronger. Stock price.

271
00:48:42.580 --> 00:48:45.080
Bill Dudley: and that greed, you know, cost in their bank.

272
00:48:46.450 --> 00:48:57.610
Markus Brunnermeier: So can we talk briefly about the interest that swap market? So typically it's a case that you know it's smaller and regional banks. They are by protection from the big banks on the inter side swap market.

273
00:48:57.850 --> 00:49:10.200
Markus Brunnermeier: Didn't they didn't buy enough this time around, or what went wrong on the swap market or not on Why didn't they make use of it? But it this way.

274
00:49:10.360 --> 00:49:14.620
Bill Dudley: you know. Reverse your your your interest rate exposure.

275
00:49:14.700 --> 00:49:23.910
Bill Dudley: then you're also eliminate the profits from the from that exposure. Right? Because you're You're essentially swapping Long did fixed assets back into into floating rate.

276
00:49:23.990 --> 00:49:29.410
Bill Dudley: So Silicon Valley Bank could have had their risk. They could have p to risk they chose not to.

277
00:49:29.530 --> 00:49:48.270
Bill Dudley: and because they chose not to. That's why they had such a big exposure. So that was a choice they made. But clearly there's plenty

of tools out there that allow you to hedge your industry at risk, both by using squabs, but also by using swaps you can take off, you know you. You can also buy, you know, a O. Out of the money protection.

278
00:49:48.270 --> 00:49:58.050
Bill Dudley: So you know the problem with the you know the the the distance center to doing so is that using those things does cost you, you know, profit margin in the short term.

279
00:49:58.990 --> 00:50:03.310
Markus Brunnermeier: So what do you say, actually what we observe that typically or an ideal world.

280
00:50:03.380 --> 00:50:15.130
Markus Brunnermeier: the smaller and the regional bank spy protection against inter sket movements from the big banks makes sense, because the big banks have this too big to fail. Benefit that the you know the deposits fly into the big banks.

281
00:50:15.130 --> 00:50:25.770
Bill Dudley: and this way they can easily provide this into that insurance. Well, I don't know that they, you know they have to buy it from the bang, and they just have to buy it in the capital markets, and there's a lot of people that make that that sell interest rates, flops.

282
00:50:25.790 --> 00:50:32.100
Bill Dudley: So I don't, you know it's really. It's really a more of a security business than a banking business.

283
00:50:32.130 --> 00:50:35.370
Bill Dudley: Look, I don't think I don't think the big banks you know.

284
00:50:35.650 --> 00:50:51.420
Bill Dudley: Think about. Oh, we're just we're gonna. We're gonna just sort of sell these off to the smaller bank. You know it's it's it's a market for swaps. There's a you know, big deep liquid market for swaps, and you know the big banks are participants and medium size banks or participants. But I wouldn't. I wouldn't view it as place. So when one group of

285
00:50:51.540 --> 00:50:56.190
Bill Dudley: players that selling to another group player, it's going lots of different directions.

286
00:50:56.420 --> 00:51:11.570

Bill Dudley: I mean, there's there's some research which shows about money to be. It's easy, Martin Jennifer shows that actually the big things sell into the protection to the smaller banks. I think the I think the you know. I think what? What, what, what what happens in the banking market is the the big banks.

287
00:51:11.810 --> 00:51:13.920
Bill Dudley: Their their business model

288
00:51:14.160 --> 00:51:31.290
Bill Dudley: leads to less interest rate exposure in terms of asset versus liabilities. They have less interest rate, risk, just by pursuit of their business. You know. A lot of their business is, you know, business lending floating rate business lending, and they have, and so they don't have a lot of I mean generally

289
00:51:31.370 --> 00:51:36.530
Bill Dudley: generally higher interest. Rates for money-centered banks is typically a good thing, not a bad thing.

290
00:51:36.640 --> 00:51:43.850
Bill Dudley: but for regional banks they have more of a consumer business, and so they often have, and they also

291
00:51:43.850 --> 00:52:02.710
Bill Dudley: sometimes have a a, a, a abundance of deposits. And so what do we do with the excess extra posits where we make loans with some of them? But then, what we do with the rest. Well, they can dump that into longer data securities because they hope to earn a higher return over time. Now the problem with long data securities over the last decade, as you know, Marcus is.

292
00:52:02.730 --> 00:52:04.140
there's been no

293
00:52:04.240 --> 00:52:11.930
Bill Dudley: positive risk for him from holding a long-term security versus a and short, dated obligation. So you really haven't been paid

294
00:52:12.030 --> 00:52:18.960
Bill Dudley: to invest in longer dated assets, and i'm surprised that Banks haven't sort of reflected that in their as of liability management.

295
00:52:20.140 --> 00:52:29.610

Markus Brunnermeier: So can I ask you something you right now for this? So for the Silicon Valley Bank, Essentially the FDA. C. Made some losses. No, some significant losses.

296
00:52:29.880 --> 00:52:33.180
Markus Brunnermeier: Can you explain to us? You know how these lost will be spread?

297
00:52:33.200 --> 00:52:46.250
Bill Dudley: The Fdic probably will increase the fees on the rest of the banking sector. Yeah, that's exactly what happened. I mean what we what this is Just another example of a bank. A lot is worth a lot more than a bank did.

298
00:52:46.440 --> 00:52:57.390
Bill Dudley: Once a bank fails. you know the franchise value gets eroded. A lot of the value of the bank in terms of it, You know, software technology becomes outmoded.

299
00:52:57.570 --> 00:53:00.480
Bill Dudley: And so yeah, there's a big

300
00:53:00.690 --> 00:53:11.080
Bill Dudley: jump in the duration of value when a bank fails. Now, in the case of Silicon Valley Bank, that jump was probably exacerbated by the fact that they had a pretty unique banking model.

301
00:53:11.260 --> 00:53:15.450
Bill Dudley: and there probably weren't a lot of banks that were comfortable, you know.

302
00:53:15.680 --> 00:53:19.060
Bill Dudley: taking on board that different banking model.

303
00:53:19.080 --> 00:53:29.140
Bill Dudley: The other thing that I think made it a little bit more difficult for the fdsc. In this, in this cycle is. The large banks have much less appetite to buy smaller banks now than before.

304
00:53:29.240 --> 00:53:39.440
Bill Dudley: for For 3 reasons. Number one and the Regulators don't want the big banks to get bigger number 2. The big banks, when they bought firms that failed last time.

305

00:53:39.720 --> 00:53:49.520
Bill Dudley: assumed a lot of legal liabilities that they didn't anticipate, and they had very bad experiences doing so, you know, as Dame Jamie Diam, for example, about how he feels about his acquisition of bears, turns, and

306
00:53:49.530 --> 00:53:57.100
Bill Dudley: Washington mutual, you know he would never do either of those again. and the last reason why large banks don't want to buy a smaller entities

307
00:53:57.180 --> 00:54:13.290
Bill Dudley: is, is is the way their capital is is a regime works. They there's buckets for what's called the Sifi Search our systemically important financial institutions for charging capital, and he get bigger and more complex, you move into a bigger Sifi surcharge bucket.

308
00:54:13.330 --> 00:54:32.110
Bill Dudley: and that increment of capital doesn't apply just to the assets that you just acquired. It applies to your entire book of business. So let's imagine Jv. Morgan. 2 trillion dollar bank buys a 200 billiondollars, makes the 200 billiondollar acquisition, and it has to pay, and it has, and it that pushes them into a hierarchy bucket of a half a percent

309
00:54:32.140 --> 00:54:54.860
Bill Dudley: that half a percent additional capital charge applies not to the 200 billionbut to the 2.2 billionso very, very expensive for for them. So there's a huge distance set up to get pushed into the next Sifi bucket. So this time you didn't see the big banks do the acquisitions? That's another. So that so I think the you know, the the the pool of potential buyers for Silicon Valley Bank

310
00:54:54.940 --> 00:54:57.150
Bill Dudley: was much smaller.

311
00:54:57.350 --> 00:55:00.750
Bill Dudley: and that's why for Citizens Bank.

312
00:55:00.950 --> 00:55:07.310
Bill Dudley: It looks like they got a very good deal on the on on their acquisition, because you can see what what the market assessment was

313
00:55:07.390 --> 00:55:13.110
Bill Dudley: after it was announced. Sip persistent Banks stock. Price went up very sharply.

314
00:55:14.800 --> 00:55:20.450
Markus Brunnermeier: I see, so perhaps it can go a little bit. You know. How should we change the regulatory framework now?

315
00:55:20.470 --> 00:55:23.430
Markus Brunnermeier: And the supervision given. you know.

316
00:55:24.070 --> 00:55:31.500
Markus Brunnermeier: should we really have some different rules and interest rate risk, and you know the banks to be faster and more aggressive.

317
00:55:31.920 --> 00:55:35.140
Markus Brunnermeier: Well, I think you are in this management approach.

318
00:55:35.240 --> 00:55:48.920
Bill Dudley: I think there's a number of things. So this whole hold of maturity idea of security right now, if you, if you can, you can basically claim that. Given about a series that you hold, or in the whole maturity bucket

319
00:55:49.190 --> 00:55:58.050
Bill Dudley: and the whole inventory bucket means that you that mark to market losses. Just sit there. They don't flow through your equity. Capital! They don't affect your rings

320
00:55:58.140 --> 00:56:06.000
Bill Dudley: so, and that's independent of how you're funding those assets. So you need to have a better linkage between

321
00:56:06.680 --> 00:56:12.580
Bill Dudley: the hold, the majority assets, and how they're funded. So that's number one. So the asset you have to look at both sides of the balance sheet

322
00:56:12.720 --> 00:56:31.660
Bill Dudley: Number 2. I think you just have to look at what's what's the interest? Rate exposure of the bank. If interest rates go up a lot, what's going to happen to the bank in terms of they're not interest margin in terms of the capital losses that they're going to be booking either on their whole maturity book or they're available for sale assets. So I think that's gonna happen. The second thing I think is gonna happen is

323
00:56:31.700 --> 00:56:49.720
Bill Dudley: the Regulators, you know, I think, need to move faster and more aggressively when they identify problems. So, according to Michael Barr's testimony to Congress this week. He made it very clear that the the Fed Examiners were on the case in Silicon Valley Bank. They had identified, you know, some of the interest rate mismatch issues.

324
00:56:49.720 --> 00:56:54.030
Bill Dudley: And they had, basically, you know, told the man that you got to fix these.

325
00:56:54.360 --> 00:57:07.130
Bill Dudley: But the problem is is that Typically, what happens is the regulars give the bank some time to do so. and the bank can drag its feet, and that, and there can be multiple iterations before the Fe gets

326
00:57:07.130 --> 00:57:24.760
Bill Dudley: angry enough it was it to San Francisco, fed in charge on? Can who decide? So the ultimate threat point is to close down the bank. But if you you can do things you can do things less punitive that you can. You can issue enforcement orders. You can force the bank to raise more capital.

327
00:57:24.830 --> 00:57:31.150
Bill Dudley: So I just think that the Regulators are probably going to have to look at. You know, when we see something that we really don't like

328
00:57:31.180 --> 00:57:32.250
Bill Dudley: we need to.

329
00:57:32.460 --> 00:57:43.260
Bill Dudley: you know, increase not just the the the size of the penalty in the bank, but also the the the tempo we have to. We have to move to, to, to be more aggressive. A quicker

330
00:57:43.260 --> 00:57:59.190
Bill Dudley: third thing that's gonna happen is the Fed almost certainly is going to move back down and make that threshold for tighter. Look at regulation 100 billionSo what happened in in 2,018? When trump administration passed the the it passed legislation. We basically raised the threshold

331
00:57:59.190 --> 00:58:09.470

Bill Dudley: for for for systemic bank regulation from 50 billionto 250 billionand at the same time. This the the the new legislation, basically said the Fed had the discretion

332
00:58:09.620 --> 00:58:27.210
Bill Dudley: to have higher standards all the way down to 100 billionin the fed, said, No, no, we're not going to do that. We'll we'll we'll we'll just be at 250 billionThen we'll now use that discretion. I'm all certain that 100 billionwill be the new threshold fruit. So no law changes required for that.

333
00:58:27.210 --> 00:58:33.850
Bill Dudley: Another thing that I think will happen is systemic risk testing will be a little bit more

334
00:58:35.050 --> 00:58:35.950
Bill Dudley: varied.

335
00:58:36.010 --> 00:58:46.670
Bill Dudley: So one of the complaints of the fed so stress test that they use for the what's called C car process where they're accessing banks. Capital accuracy under stress was the stress test. This year was

336
00:58:46.760 --> 00:58:54.180
Bill Dudley: interest. Rates stay low for a very extended period. The comedy is really weak. Well, that wasn't a very good description of what actually happened.

337
00:58:54.330 --> 00:58:57.560
Bill Dudley: And so the stress test is very ill suited

338
00:58:57.760 --> 00:59:03.710
Bill Dudley: to identifying capital weakness in the case of a bank like Silicon Valley. So I think we're going to need to have

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00:59:03.790 --> 00:59:10.480
Bill Dudley: stress. Test it. you know. Compass a a broader array of possible. you know, surprises

340
00:59:10.520 --> 00:59:30.020
Bill Dudley: inside the they'll be coming, you know, for more than one stress scenario. So you Exactly. Exactly. Yeah, the unassure deposits is is is is tricky, right? The current regime is pretty inefficient, right, you know, to to to to basically ensure the deposits after. The fact

341
00:59:30.300 --> 00:59:45.010
Bill Dudley: is, you know, responding after the you know the horses left the bar, and it's also a bit arbitrary and unfair, because, you know, some banks will have the their unsure deposits protected and potentially other banks might not.

342
00:59:45.260 --> 00:59:49.200
So that might cause you to say, Well, let's just ensure all the deposits.

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00:59:49.380 --> 00:59:56.390
Bill Dudley: But if you ensure all the deposits, then you're gonna have all sorts of moral hazard issues just like we saw with this with the savings and loans.

344
00:59:56.420 --> 01:00:07.990
Bill Dudley: So the question is, is there a middle ground, and I think there probably is, I can imagine, protecting all the uninsured depositors. but only with constraints on the bankings book of business.

345
01:00:08.140 --> 01:00:24.990
Bill Dudley: If you look at the banks to get in trouble. The banks that get in trouble typically are fast growers with sort of pretty unique business models and concentration of exposures. So let's imagine we sort of had a regime, and said, we'll protect all deposits. Depositors as long as you're not growing really fast.

346
01:00:25.090 --> 01:00:35.880
Bill Dudley: and as long as you don't have, you know, big mark to market losses. You know i'm booking a whole host of the criteria. You could probably do it in a way that you, basically

347
01:00:36.000 --> 01:00:44.000
Bill Dudley: you know, build in like 95% of the banking institutions. And you created incentives for the 5% that we're outside to behave

348
01:00:44.020 --> 01:00:48.090
Bill Dudley: in a better manner. So there might be, You know it. It doesn't have to be, either.

349
01:00:48.320 --> 01:00:58.980
Bill Dudley: you know, uninsured deposits have to persist, or all the poses have to be ensured. There might be a middle around here. I think this needs to be explored because I I I do think this idea of doing it on a exposed basis

350
01:00:59.040 --> 01:01:03.520
Bill Dudley: is really messy and and potentially unfair.

351
01:01:04.100 --> 01:01:20.610
Markus Brunnermeier: But you, you're fine with making it more complicated and complex because it's all this conditioning. It will be a more complicated regulatory for embark to

352
01:01:20.610 --> 01:01:37.480
Bill Dudley: all your unsure deposits, and I know what would happen is Banks just wouldn't go past that threshold anymore. So it's sort of sorry you sort of like put speed limits in on bank behavior, and you know you look at Silicon Valley Bank. They more than double their asset size in a couple of years. So let's imagine Silicon Valley Bank just had to grow a lot more slowly.

353
01:01:37.480 --> 01:01:55.150
Bill Dudley: Would they have all the access that they were going to jump in this long day to the Treasury Agency. More effect security. They probably wouldn't have the assets, and so they want to take another interest rate risk. So they want to got in trouble in the first place. So I think you know some sort. Yeah, you'd have to do a lot, you know, Careful study. This is basically think about like what causes Banks to get into trouble.

354
01:01:55.180 --> 01:02:03.710
Bill Dudley: And so what do we want to do to prevent those kind of behaviors in it, and we prevent those. But here the other thing i'd like to see is change. How we compensate bank. Ceos.

355
01:02:03.870 --> 01:02:16.320
Bill Dudley: Right now. We pay them with cash and equity. and I think paying them with equity encourage his more risk taking. I'd love to pay them with subordinated debt that goes away. If they fail.

356
01:02:16.380 --> 01:02:26.100
Bill Dudley: I think, if you know, they were paid in compensation that they had to hold for many years that vanished. If the bank failed, I think they would take a lot less risk.

357
01:02:26.140 --> 01:02:28.540
Bill Dudley: So I think there's also some.

358
01:02:28.620 --> 01:02:45.410

Bill Dudley: Well just some more data. It's the you know it's the holy going. Well, the bank fails. It's coordinated. That goes to 0 in the story. So you know this is, you know. Think about how the old investment. Banking partnerships were, they had unlimited liability. The partners had unlimited liability. So if the partnership

359
01:02:45.430 --> 01:02:54.980
Bill Dudley: failed. the partners were on this on the hook for not only the capital to contribute to the partnership with their own net worth. so that made the partners a lot more

360
01:02:55.180 --> 01:03:08.240
Bill Dudley: risk, averse in terms of taking risk by, you know. We talked about looking at compensation after the Gfc. And then it just sort of died out in the United States, I think. Compensation. Another new, you know, an area to take another look at frankly.

361
01:03:08.410 --> 01:03:20.030
Bill Dudley: And the the final thing, I think it's interesting about this whole thing is this comes back more to print sweets and ebs. The Swiss authorities decided not to take credits with the resolution. They said it was just too big and complex.

362
01:03:20.180 --> 01:03:25.380
Bill Dudley: and the issue here is. if very large, systemically important, financial institutions

363
01:03:25.520 --> 01:03:28.930
Bill Dudley: are too big and complex to be resolved.

364
01:03:30.280 --> 01:03:35.690
Bill Dudley: is it? It raises? The question is, why do we have this whole resolution framework? If it's not workable.

365
01:03:35.790 --> 01:03:37.750
Bill Dudley: then living wills.

366
01:03:37.770 --> 01:03:48.280
Bill Dudley: and you know all the things that we built to to allow a large system of important bank to be resolved. But you know all that's called into questions. So I think

367
01:03:48.320 --> 01:04:06.930
Bill Dudley: you know. The decision of this was authorities to, you know, arrange a force merger between Ubs and Chris, Weis, you know, really

calls into question. Is this resolution framework really credible? And you know, if if you're if you're not wanting to use the resolution frame, or what what you're basically saying is that the biggest banks are still too big to feel.

368
01:04:07.150 --> 01:04:11.970
Bill Dudley: And you know right now. I mean, we're seeing a distortion in the banking system. Money is moving to the banks, and

369
01:04:11.990 --> 01:04:26.650
Bill Dudley: you know that's also not very desirable. Actually, you don't want the biggest banks getting bigger just because of you. It is too big to feel so. That's something. But these things to the whole debate, and you know about too big to fail. We Haven't resolved the issue essentially

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01:04:26.770 --> 01:04:29.250
Bill Dudley: doesn't seem like it yet, I mean.

371
01:04:29.400 --> 01:04:39.560
Bill Dudley: Now, perhaps the United States could take a big Sophia through resolution. But you know, the problem with these global banks is: they operate in many different geographies with many different regulators.

372
01:04:39.890 --> 01:04:44.750
Bill Dudley: And so re resolution is, you know, not straightforward.

373
01:04:44.970 --> 01:04:46.740
Bill Dudley: And you know typically

374
01:04:46.780 --> 01:04:57.160
Bill Dudley: typically when banks get into difficulty, you know there are other banks that are also weak. At the same time, you know, if a bank, you know, I mean, I think, resolution work for a bank that was completely idiosyncratic.

375
01:04:57.370 --> 01:05:07.530
Bill Dudley: you know there otherwise no bank look like it at all. But typically, when banks get into difficulty, there's usually other banks that have engaged in similar business practices. And so.

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01:05:07.960 --> 01:05:17.470
Bill Dudley: erez Agmoni, you know there, there's correlation across the banking system. So in Switzerland, you know, for care. It's W. To have to change the law in order to avoid a vote among the shareholders 150.

377
01:05:17.650 --> 01:05:27.580
Markus Brunnermeier: How is it in the Us. Is to some, from collective action that you can just essentially close down even a big bank if you wanted to without the vote of the shield.

378
01:05:28.440 --> 01:05:33.420
Bill Dudley: I I I i'm not sure actually the answer that that what? How legally it works.

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01:05:33.460 --> 01:05:40.100
Bill Dudley: I think it's very similar that the that the regular side, that the the bank is no longer viable.

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01:05:40.120 --> 01:05:57.110
Bill Dudley: and that, and then have the ability to put it into into resolution. The other thing which is discussed, the Charl. Or vote in this point in in the in which case is different. This is a murder right? So what was unusual was about having a merger without having the having to wait for the shareholder vote

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01:05:57.180 --> 01:06:04.830
Bill Dudley: in resolution. You don't have to have a shareholder vote. The bank is failed. So the shelters don't have anything to say about it at that point.

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01:06:06.080 --> 01:06:16.660
Markus Brunnermeier: and the fact, you know you use the Cocos normally the cocoa. There's a trigger, and then you convert them to equity, and then they will be treated like any other equity, and they decided to just

383
01:06:16.660 --> 01:06:31.730
Bill Dudley: something like a focus for the Us. Banks. It's not used in the United States. It's a European thing at all. It's a European. The the other thing here is, it is. People completely misunderstand what happened with the Prince Weis 81 capital.

384
01:06:31.950 --> 01:06:41.490
Bill Dudley: You can go to the credit. We we's website and read the terms and conditions about their 81 cocoa obligations, and what they say very clearly is that

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01:06:41.770 --> 01:06:51.600

Bill Dudley: if the regulars make a finding of nonviability, which is what the Regulators made. A finding of the cocoa is convert, not to equity, but to 0.

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01:06:51.880 --> 01:07:00.770
Bill Dudley: So the these, these, the every 81, it can be different. So a lot of 80 one's convert to equity. But these Cocos don't convert to equity they convert to

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01:07:00.790 --> 01:07:05.500
Bill Dudley: to 0. So I think what happened in this case was the 81 holders.

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01:07:05.590 --> 01:07:09.710
Bill Dudley: you know, thought that they were senior to the shareholders.

389
01:07:09.950 --> 01:07:13.550
Bill Dudley: but it turns out in one particular case they're not

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01:07:13.930 --> 01:07:17.550
Bill Dudley: when when they're they're not. When the firm is no longer viable.

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01:07:17.710 --> 01:07:24.760
Bill Dudley: and the government's re ranging a force merger, so it wasn't a a situation that was anticipated.

392
01:07:24.790 --> 01:07:27.150
Bill Dudley: but based on the

393
01:07:27.280 --> 01:07:43.370
Bill Dudley: you know language in the instruments. It seems like everything happened exactly where the way it was posted. So you don't anticipate a long lawsuit over years. Well, they may. They're gonna be a loss of. But my reading of the of the the instruments is they're very clear, very clear.

394
01:07:43.950 --> 01:07:47.340
Markus Brunnermeier: So typically what we see in the Us is actually a lot of

395
01:07:47.960 --> 01:07:58.770
Markus Brunnermeier: difficulties at smaller banks, and then the big banks that to pick to fail banks, benefits from capital. But here in

Switzerland you have a big bank. Do you see this between small and big banks, some shift.

396
01:07:58.960 --> 01:08:04.830
Markus Brunnermeier: And also there's some talk about Charles Schwab, and this to to think investment banks and

397
01:08:05.070 --> 01:08:18.870
Bill Dudley: to to the similar problems because of interest it moves. Or these are different problems. Yeah, I mean. Yeah, the interest rate risk really depends on the the specific institutions in terms of do they decide to invest? You know, surplus

398
01:08:18.870 --> 01:08:27.580
Bill Dudley: causes and long-dated fixed income assets, and they decide to edge that exposure or not as a choice. So there's nothing you know. There's nothing

399
01:08:28.390 --> 01:08:31.450
Bill Dudley: particular about. You know, Charles swab position that.

400
01:08:31.460 --> 01:08:35.050
you know, means that they're more vulnerable. They're more vulnerable if they make

401
01:08:35.279 --> 01:08:43.500
Bill Dudley: particular set of of of of of decisions that are that are there, that put them in more a a at at risk. So so I don't think there's anything

402
01:08:43.649 --> 01:08:55.020
Bill Dudley: I mean. I think the banks that are, you know, more vulnerable are the ones that just have a higher proportion of uninsured deposits because of the UN. Insure deposits, you know, are are at greater risk of, you know, of runs.

403
01:08:55.149 --> 01:09:01.180
Bill Dudley: So that's so, you know. So a small community bank that has mostly retails that you know there's no run risk. There.

404
01:09:02.569 --> 01:09:10.290
Markus Brunnermeier: We didn't talk about cross-border issues at all. Is there any implications for cross-border issues as well from the recent events? So

405
01:09:11.060 --> 01:09:21.609
Bill Dudley: Well, I mean, I think you know, I think, that the global authorities were pretty happy to see the Ubs credit suite merger take place, but that way.

406
01:09:21.740 --> 01:09:33.180
Bill Dudley: So I think there's I think there's close coordination, You know of the Swiss authorities with, you know, governments around the world telling you know, telling them what they're doing, why they were doing it.

407
01:09:33.250 --> 01:09:43.620
Bill Dudley: and I think generally. you know, regulators around the world were. you know, I think, probably happy to see it resolved in this way. I would, I would suspect

408
01:09:44.729 --> 01:09:53.229
Markus Brunnermeier: so. Perhaps we can, you know, come at the end what what we touched upon. It's already. You know that's good to stop. What's your outlook?

409
01:09:53.330 --> 01:09:59.480
Markus Brunnermeier: What you watch, and I think you have a very, you know, less pessimistic view. You hope that the

410
01:09:59.530 --> 01:10:16.190
Bill Dudley: it was this over by now. Yeah. Well, i'm. I'm gonna be very interested in in the first quarter earnings of some of these regional banks. Right? So in the next month we'll get first quarter earns reports, and so we'll be able to look at their net interest margin. We'll be able to look at how much money that are they borrow from the fed. We'll be able to look at. You know things like.

411
01:10:16.190 --> 01:10:26.650
Bill Dudley: you know, you know what's having to their long growth and their profitability. So I think the first quarter of herings of of, of of some of the banking mystery generally is going to give you a lot of scrutiny

412
01:10:26.650 --> 01:10:41.630
Bill Dudley: this quarter more scrutiny than that mid typical. So I think that you know the net interest. Margins are gonna be very, very important to watch if if they continue to widen, which is what's been heading for the money Center banks that's gonna make people feel. You know more comfortable that the banks.

413
01:10:41.630 --> 01:10:51.760
Bill Dudley: you know it's not just about, you know. Mark to market losses on the on the asset side. You have to also look at the benefit of having lots of retail deposits that you don't have to pay market rates for

414
01:10:51.960 --> 01:11:05.940
Bill Dudley: so certainly I'll see your loan officer to see how much tightening there is a credit conditions. And just to see how households and businesses Think about all this? Do they? Are they scared about what's happened in these banks? Or do they just view it as sort of a you know, isolated?

415
01:11:05.940 --> 01:11:23.090
Bill Dudley: Is that it doesn't affect their their their behavior. Yeah, you also have a a question in these kind of episodes. You know what what what happens to animal spirits. Do people get a nerve by this? And if they're unnerved by this, do they pull back, and then can that be just sort of a self reinforcing

416
01:11:23.090 --> 01:11:42.090
Bill Dudley: negative dynamic. I I i'm not plan to change my own behavior. I don't know about you, Marcus. So this doesn't have any effect on my spending decision. Yeah, yeah. Consumption investment. Yeah. So I You know, I I I wouldn't think that this is enough to really affect the business and household

417
01:11:42.090 --> 01:11:48.300
Bill Dudley: confidence in a way to affect what they're planning to do going forward. But you never know, because it is a shock.

418
01:11:49.550 --> 01:12:08.090
Markus Brunnermeier: So we talked a lot about the shocks. We didn't talk about commercial real estate. And are you worried about commercial real estate having some problems there, too? Or I? Yeah, sure. For sure, I think commercial real estate, I mean especially office buildings. And you know in big cities that you know that those office plans are not being utilized to the same degree as they were before.

419
01:12:08.350 --> 01:12:11.170
Bill Dudley: But the good news on commercial real estate is.

420
01:12:11.540 --> 01:12:24.810
Bill Dudley: the problem is really more when the loans come due and have to be refinanced, and the Billings are maybe no longer worth what the

what the original long amount was, or the bank wants more collateral than what the what the lender can present.

421
01:12:25.170 --> 01:12:28.290
Bill Dudley: There's not very many loans coming to over the next year.

422
01:12:28.450 --> 01:12:43.680
Bill Dudley: you know it's on it's it's it's on the you know, maybe a 100 billion 4,050,000,000,000dollars. So so the roll over risk is quite low. So it's very possible that some of the values on these commercial loans have come to out of it. Of course you real estate, have come down.

423
01:12:43.850 --> 01:12:45.650
Bill Dudley: but you know

424
01:12:46.070 --> 01:12:54.990
Bill Dudley: it's likely that people will stay per mostly current on their loans, and you know, if it's in, since they don't have to refiance the loans to any great degree this year.

425
01:12:55.210 --> 01:12:56.250
Bill Dudley: you know. I think it's

426
01:12:56.430 --> 01:13:04.550
Bill Dudley: yeah, it's not a it's not a positive for the banking system, but it doesn't seem to me to be something that's going to generate a real systemic shock in 2,023.

427
01:13:04.780 --> 01:13:15.050
Markus Brunnermeier: So I think commercial gonna stay is less for a problem because most of this loans are floating well, but also the majority. But the majority is is, you know.

428
01:13:15.080 --> 01:13:24.370
Bill Dudley: not coming due this year. You know it's it's really that that roll over a risk. So so let's say I. I I bought a building at 100. I borrowed $80 against it

429
01:13:25.510 --> 01:13:30.560
Bill Dudley: as long as the as long as the the rents cover my interest payment. I'm going to keep paying money on the loan

430
01:13:30.740 --> 01:13:43.000

Bill Dudley: when the loan comes to. Let's say the value of the building is 70. My loan is 80. The bank is now going to say i'm not going to give you 80 anymore. I'm going to give you, you know, 55 against so long, and then that. And then that's when you have a problem.

431
01:13:44.550 --> 01:14:03.260
Bill Dudley: So normally we start with on a. We stop with a positive note. But let me just ask one more question: what keeps you up at night? In a sense, is there anything particular to say? Okay, that's the debt limit ceiling case? We have a date. Yeah, I'm: Really, I'm really worried about that because

432
01:14:03.370 --> 01:14:06.540
Bill Dudley: the House Speaker, Kevin Mccarthy.

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01:14:06.680 --> 01:14:09.690
Bill Dudley: depends on remaining House Speaker

434
01:14:09.760 --> 01:14:12.440
Bill Dudley: on the basis of a few

435
01:14:12.700 --> 01:14:15.280
Bill Dudley: extremist House Republican votes.

436
01:14:15.310 --> 01:14:18.120
Bill Dudley: And so if he brings the floor

437
01:14:18.300 --> 01:14:27.400
Bill Dudley: legislation to raise that limit ceiling. I worry that. you know he'll be at risk of losing his speakership.

438
01:14:27.590 --> 01:14:37.970
Bill Dudley: and I worry As a consequence, he might not be willing to bring that to the floor in a timely fashion. So his vulnerability, his exposure as a as the speaker.

439
01:14:38.030 --> 01:14:42.220
Bill Dudley: makes me particularly worried about this particular debt limit situation.

440
01:14:42.700 --> 01:14:46.930
Markus Brunnermeier: and you don't think the fed can solve this with a platinum coin, or

441
01:14:46.980 --> 01:15:00.320
Bill Dudley: I. I don't think the Treasury. If the Treasury would be the trader's decision to do a platinum coin. What happens is the the the the mint issues of platinum coin to the Treasury, the treasury, the Us. The fed then gives the money to the meant.

442
01:15:00.330 --> 01:15:16.120
Bill Dudley: The men is allowed to turn over any extra money it has to us Treasury doesn't kind of get that limit. That's that's the loophole. But they're not going to do it. It's it's just it's it's it's a loophole. It's not the intent of Congress, I mean. I just be subject to litigation. Almost certainly they're not going to do that.

443
01:15:16.810 --> 01:15:28.960
Bill Dudley: So can you outland this scenario. So if this, what will happen, what would happen is it's 2 things the day of you know where the deadline actually became binding, binding.

444
01:15:30.020 --> 01:15:35.270
Bill Dudley: The government would run out of cash inflows to pay all its obligations.

445
01:15:35.310 --> 01:15:42.020
Bill Dudley: So the Government would. You know they essentially. We should be receiving, you know, 60 cents every day, and they'd have like a dollar of obligations.

446
01:15:42.210 --> 01:15:51.050
Bill Dudley: and it the Congressman's cellar. So so what they would, so what the treasure would almost certainly do is they would basically prioritize payments on interest and debt

447
01:15:51.130 --> 01:16:02.120
Bill Dudley: to avoid a government to fall. But they would not be able to pay a whole bunch of other things, because they just wouldn't have the money to do that, and so would be the immediate and sharp tightening of fiscal policy.

448
01:16:02.360 --> 01:16:11.600
Bill Dudley: probably to the 2 of 7 to 8% of Gdp. So it'd be a sudden stop in terms of the fiscal policy Number 2. It'd be a market cataclysm.

449
01:16:11.760 --> 01:16:22.830

Bill Dudley: because the markets are going to be expecting the debt limit ceiling to be averted at 1159 Pm. So if it doesn't happen, there'll be just a huge jump in people's assessment of risk.

450
01:16:22.860 --> 01:16:25.790
Bill Dudley: and markets will go down dramatically. So you'll have a

451
01:16:26.230 --> 01:16:29.340
Bill Dudley: You have 2 big problems market term, well and

452
01:16:30.140 --> 01:16:40.510
Bill Dudley: extraordinary fiscal timing. Not a good, not a good look. Now, I don't think you can live in that environment for very long, so I think eventually cooler as would prevail, and we'd raise the debt limit ceiling.

453
01:16:40.560 --> 01:16:46.160
Bill Dudley: but it'd be much better to raise it at 1159, or or even, maybe at 10 pm

454
01:16:46.750 --> 01:16:48.780
Markus Brunnermeier: What would it do to inflation?

455
01:16:49.620 --> 01:17:08.500
Bill Dudley: It'd be negative shock for the economy, for sure, I mean because you're you're you're it's going to be a stackflation, or do you think it would bring inflation shopping, but it depends what happens. The Us. Dollar I mean the the the the inflation impulse really comes through the Us. Dollar, I think not anywhere else. I think it's really just a very near term big contractionary for it on the account.

456
01:17:08.580 --> 01:17:15.230
Bill Dudley: but it's really just a mess. It's the way I would describe it. It's a and who you know. Who knows exactly what would happen?

457
01:17:15.560 --> 01:17:17.130
Bill Dudley: You don't want it. You don't want.

458
01:17:17.210 --> 01:17:20.800
You know people who in the house to say, Well, how do you know it would be bad?

459
01:17:21.160 --> 01:17:23.190
Bill Dudley: I don't want to test that proposition.

460
01:17:24.120 --> 01:17:39.440
Bill Dudley: but it it might be the same as in 2,008. If the market totally tanks, then Congress comes together just an hour. No, it could be. It could be like the of the first round of tarpa legislation, first round of type of legislation in pass. But that was not a pleasant experience, so I would prefer to avoid that.

461
01:17:40.420 --> 01:17:43.860
Markus Brunnermeier: So what's the positive note we are ending up with.

462
01:17:43.910 --> 01:17:58.900
Bill Dudley: Well, the positive note is that you know the the economy is still in pretty good shape. Fundamentally, you know, household business balance sheets are in pretty good shape. And so, even though the Fed still has some work to do in terms of tightening monetary policy, getting inflation under control.

463
01:17:59.260 --> 01:18:03.110
Bill Dudley: you know. once they achieve that objective.

464
01:18:03.230 --> 01:18:08.360
Bill Dudley: I think they have the ability to reduce rates, and the economy will come back pretty quickly.

465
01:18:08.410 --> 01:18:21.740
Bill Dudley: And what's different this time it's a fed has plenty of room to stimulate the economy. So you know this whole risk of being pinned at the 0 lower bound, you know, being stuck in a Japanese style Experience that risk is really, you know.

466
01:18:21.830 --> 01:18:31.350
Bill Dudley: fallen away considerably. So. So i'm thinking most likely a scenario in the next year we'll probably have a mild recession. And then, once that happens and

467
01:18:31.490 --> 01:18:43.670
Bill Dudley: inflation comes down the Federal relent. And but then we have a economic recovery. I think that's what the stock market senses. That's why the stock market is, I think, held up pretty well, even with a lot of bad inflation news. And even with this

468
01:18:43.940 --> 01:18:45.540
Bill Dudley: turmoil in the banking system.

469
01:18:46.200 --> 01:18:49.530
Markus Brunnermeier: and your inflation forecast in this scenario would be.

470
01:18:49.710 --> 01:18:56.860
Bill Dudley: I think it's gonna come down but slowly, you know. I'm. I'm sorry with i'm sorry with the fed. I think you know it's it's it's gonna take time.

471
01:18:56.990 --> 01:19:12.590
Bill Dudley: That's kind of generate more weakness in this in the labor market. It's gonna bring down wage installation. It's gonna bring down services inflation. It's it's laid out very clear clearly what they need to accomplish. It is a moderately restrictive monetary policy that generates slack in the labor market.

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01:19:12.630 --> 01:19:19.690
Bill Dudley: That slack in the labor market brings down wage inflation and brings down services sector inflation, and eventually we get back to 2%.

473
01:19:19.940 --> 01:19:23.590
Markus Brunnermeier: So if you assign a property within soft and hard landing.

474
01:19:23.830 --> 01:19:34.260
Bill Dudley: I think hard landing is, you know, more like mo. Much more likely, because every time the fed is generated at 1%, you know, half percent rise in the unemployment rate or more.

475
01:19:34.290 --> 01:19:43.310
Bill Dudley: We've always had a hard landing, 12 for 12. Since World War 2. The Fed has said that they think they need to generate a a rise and unemployment rate of at least one percentage point.

476
01:19:44.110 --> 01:19:49.280
Bill Dudley: We're also flying a little bit more blind. Now, with all this banking system, you know noise.

477
01:19:49.300 --> 01:19:57.440
Bill Dudley: so I think a hard landing is more likely than not, but probably not right away. I mean, the economy still is doing pretty well, I mean, you know.

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01:19:58.170 --> 01:20:02.600
Bill Dudley: just because we're going to have a hard landing most likely doesn't mean the hard learning has to happen soon.

479
01:20:03.130 --> 01:20:05.410
Bill Dudley: so it could be that hard laying is you know

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01:20:05.480 --> 01:20:10.340
Bill Dudley: late 23, early, 24 it doesn't have to necessarily happen immediately.

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01:20:12.430 --> 01:20:23.470
Markus Brunnermeier: Very good, thanks a lot, Bill. It was extremely insightful, and I learned a lot, and so did our audience be very good for all your statements, and

482
01:20:24.040 --> 01:20:30.210
Markus Brunnermeier: pointing out all the weakness and all the things we have to do. So thanks again. And I see you around.

483
01:20:30.490 --> 01:20:31.580
Bill Dudley: Okay, Thank you.

484
01:20:31.610 --> 01:20:36.110
Markus Brunnermeier: Thanks to everybody for joining us and hope to see you soon again. Bye, bye.