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UOB Investment Insights

Thinking Ahead

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Making sense of global events: Silicon Valley Bank's fall and the China National People's Congress

- Last Friday, Silicon Valley Bank (SVB) became the second-largest retail bank to fail in United States (US) history, and the largest since Washington Mutual during the Global Financial Crisis in 2008. This triggered concerns about possible contagion across wider markets.
- Meanwhile, the National People's Congress (NPC), China's top legislative body, has just concluded its annual meeting. Besides setting a surprisingly low growth target of 5% for 2023, Chinese lawmakers also announced a slew of measures that offer valuable insights about the nation's priorities.

Silicon Valley Bank's fall: What happened and why?

- SVB's business model was unique and not representative of the industry.
    - SVB relied heavily on deposits from the tech sector, which is facing lower cash reserves and venture capital funding. Tech start-ups have had to withdraw bank deposits to fund business operations as rising interest rates and a slowing economy weakened finances.
    - Meanwhile, SVB had invested too much of its assets in long-term US Treasuries and other government-related debt, which had fallen in value as interest rates rose. When customers started withdrawing their deposits, SVB had no choice but to sell their investments at a loss.
    - SVB's attempt to raise USD 2.25 billion via a stock sale failed as withdrawals increased, resulting in a run on the bank and regulators shutting it down.

Contagion risk is low

- Risk of full-blown contagion to the US banking sector is low. Over the weekend, the Federal Deposit Insurance Corporation (FDIC), Federal Reserve (Fed) and Treasury Department moved quickly to prevent an erosion of confidence in the banking sector by protecting all depositors exposed to SVB and Signature Bank, a New York-based bank that had similarly collapsed.
    - This is not a bailout for SVB or Signature Bank, as shareholders and certain unsecured debtholders will not be protected. However, risk of further bank runs is lowered.
- The Dodd-Frank Act enacted in 2010 after the Global Financial Crisis means bigger US banks have robust fundamentals and are well-capitalised with enough short-term liquidity.
    - The 10-largest US banks have more diversified business models than SVB, with 57% of total deposits from retail accounts and 34% from corporate accounts.

- Larger US banks also have better risk management and are more liquid, with Liquidity Coverage Ratios (LCR) well above regulatory levels.
    - Bigger US banks are subject to stringent stress tests annually, which lower the likelihood of unforeseen shocks.
- Smaller banks can address liquidity issues by offering higher-yielding certificates of deposits (CDs), borrowing from the Federal Home Loan Banks or tapping on new initiatives by the Fed to provide short-term loans to banks.

Removing US Financials from our list of Top Ideas

- While US banking sector fundamentals remain sound, there is still the possibility of a confidence crisis as similar issues may surface for other smaller banks (such as First Republic Bank, PacWest Bancorp and Western Alliance Bancorp) in the short term.
- Cost of funding may also rise for banks in the near term, but this should affect smaller regional banks more than the biggest banks with more diverse funding sources.
- Nonetheless, this raises the risk of downward earnings revisions for bank stocks.

China National People's Congress meeting: New targets and priorities

- Important developments include President Xi Jinping securing an unprecedented third term and the government setting a surprisingly low growth target of 5% for the year. However, investors should also pay attention to Beijing's other announcements that offer hints about the nation's priorities moving forward, as well as industries that may benefit from government support.

1. Economic growth

- China's government surprised many by setting its lowest-ever growth target of "around 5%" for the year. This is lower than the 5.5% target for 2022 but higher than last year's actual growth of 3%.
- This implies the government could rely less on fiscal and monetary policy and more on the natural dynamics of the country's reopening to boost the economy. The government is likely to step in with targeted measures only if recovery disappoints.
- This is provided China does not experience another COVID wave. Stabilisation of the housing market and improving consumer confidence could also lead to economic growth exceeding expectations.
- Our **UOB house view** is for China's GDP to grow 5.2% in 2023.

2. Domestic consumption

- Amid tensions with the West and slowing economic growth across Developed Markets, China is expected to prioritise domestic consumption to support its economy. Consumer-focused companies could emerge as key beneficiaries.
- Retail sales data should benefit from the low base in early 2022 but it may take a few months before we see a conclusive increase in consumer spending. Latest data reflect increased

spending on services, travel and dining but weaker spending on big-ticket items such as cars and homes.

- While consumption may take time to recover, China's reopening and focus on domestic spending mean sentiment in the non-manufacturing sector should stay buoyant in the coming months.
- The question now is how well the economy withstands headwinds, such as elevated interest rates and slowing growth in Developed Markets that will likely weaken global demand.

3. Key industries
   - China is placing increasing emphasis on self-reliance in its technology sector, amid mounting trade sanctions imposed by the US. This includes limits on sales of new semiconductors to China announced by US President Joe Biden in October 2022.
   - In addition, high-end manufacturing is likely to see greater government support, to counter the trend of global companies shifting production operations away from China.
   - Mainland telcos, software firms and internet data centre-related companies are among sectors that may benefit.

4. Property sector
   - China faces a delicate balance between reviving its property market, which is crucial to economic recovery, and lowering risks posed by property developers that have borrowed heavily.
   - The government is likely to introduce targeted support measures, including helping high-quality state-owned and private property companies shore up their balance sheets and meet financing requirements.

5. Monetary policy
   - The ongoing economic recovery has lowered the need for China's central bank, the People's Bank of China (PBoC), to introduce "flood-like" stimulus, in PBoC governor Yi Gang's words. While policy rate cuts appear to be off the table for now, markets are still expecting some targeted policy easing in the months ahead to encourage lending.
   - If the economy rebounds faster than expected, the PBoC could shift to a neutral policy stance.

What you can do

- Although contagion risk from SVB's collapse is unlikely, US banks may face increasing scrutiny ahead.
  - We expect more volatility for US bank stocks in the short term. Review your portfolio if you hold investments in US Financials or oversized allocations in Tactical solutions.
  - At the same time, consider lower-risk Core solutions that pay dividends while you wait out this volatility.

  - On the other hand, China remains one of our Top Ideas for those with risk appetite to capture Tactical market opportunities.
  - Valuations compared to historical levels are attractive as many investors have yet to fully factor in the Chinese economy returning to normal.
  - Chinese stocks offer investors useful diversification as the Chinese market has low correlation with Developed Markets. In addition, the country's ongoing reopening serves as a buffer against slowing economic growth elsewhere in the world.
- Most importantly, build a diversified portfolio with both Core and Tactical solutions to meet long-term financial goals, and avoid concentrating risk in any one country or industry.
- Speak to your UOB Advisor to find out more.

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