March 29, 2023

# Tightening Credit Does Not Equal a Pause in Interest Rate Hikes

## Introduction

This week's Federal Open Market Committee (FOMC) meeting occurred as normal, but the circumstances leading up to the meeting were anything but. With the fall of Silicon Valley Bank (SVB) earlier this month, largely driven by losses in their interest rate-sensitive portfolio, concerns about the FOMC's decision to raise interest rates prompted many questions about where interest rates will go from here, and whether there is a risk of contagion in the banking system. Using our proprietary Tactical Behavior Assessment® (TBA) methodology, we examined FOMC Chair Jerome Powell's statements during the March 22, 2023 press conference where he announced the Committee's decision. **Our analysis leads BIA to conclude that, even though they have softened guidance on future rate increases, the FOMC lacks confidence that credit tightening in the banking sector will be enough to pause in interest rate increases, and that they are prepared to continue to raise them more readily than implied if necessary. Also, based on our analysis, it is BIA's opinion that there is more risk of contagion in the banking system than Chair Powell is willing to acknowledge.** Below is what we discovered.

## A pause in interest rate hikes is not imminent.

Chair Powell was asked many questions about the direction of interest rates: Will the FOMC cut rates? Will the Committee increase rates from here? Why not pause given the trouble it caused for SVB? His responses suggest to BIA that the Committee is not considering rate cuts at the moment, although it *will* raise rates if they feel they have to. Behaviors also indicate a lack of confidence that credit tightening will be sufficient to allow a pause in rate increases.

Chair Powell is asked twice about the potential for interest rate cuts. He states that, based on current assumptions, "participants don't see rate cuts this year. They just don't," and "rate cuts are not in our base case." He makes these statements without exhibiting BIA indicators, therefore providing no behavioral evidence to lead BIA to the opinion that the FOMC would cut rates. Similarly, when asked about the potential to increase rates, given that the Committee has previously signaled that rate hikes were coming to an end, Chair Powell says, "No, absolutely not. No, if we need to raise hike, raise rates higher, we will," without exhibiting behavioral evidence to suggest otherwise. This leads BIA to the opinion that Chair Powell believes the collective mindset of the Committee is more inclined than not to raise rates if necessary. That said, the FOMC's decision to change their guidance for future rate hikes from "ongoing rate increases will be appropriate" in February's guidance, to "we now anticipate that some additional policy firming may be appropriate" in the latest statement, hinges on the expectation that banks will tighten credit as a result of events stemming from the collapse of SVB. This would allow the Committee to pause rate hikes in upcoming months; however, BIA Indicators suggest Chair Powell and other members of the Committee lack confidence this will be the case.

> **"I'll tell you what I heard."**
> **- Chair Powell**

Chair Powell repeatedly reminds his audience that it is "too soon" to determine the extent of the effect of credit tightening, and how monetary policy should respond. Yet, there are behavioral clues that suggest there is some level of doubt that goes beyond mere uncertainty. For example, when asked to what extent members of the Committee incorporated *material* credit tightening into their forecasts, Chair Powell is non-committal, saying, "I'll tell you what I heard," and "what I heard was a significant number of people saying that they anticipated there would be some tightening of credit conditions." He also states that "some people did reflect that" in their forecasts. This gives the impression that the vast majority of committee members expect a tightening of credit, but the phrase committee members anticipated "some" tightening falls short of confirming that tightening will be material. Furthermore, the phrase "some" people reflected credit tightening in their forecasts is at odds with the statement that a "significant number of people" on the Committee say they anticipate credit tightening. This suggests to BIA that confidence in such a scenario is not as broad-based or strong across the Committee as implied. Also, Chair Powell characterizes future credit tightening as a “possibility” to offset the need to raise interest rates, which further **signals to BIA that Committee members are not fully confident that credit conditions will tighten sufficiently to allow for a pause in interest rate increases in upcoming FOMC meetings.**

## There is more risk in the banking system than implied.

Chair Powell is also asked several questions about a possibility for contagion in the banking system, which he does not fully answer. First, he is asked what the Committee’s confidence level is that deposit flight at mid-sized banks has ceased. In response, he says, “I guess our view is the banking system is sound and it’s resilient, it’s got strong capital liquidity,” to convince his audience that deposit flight is not a risk. However, he characterizes deposit flows as having “stabilized” over the last week, which is not the same as saying deposit flight has ceased. This leaves open the possibility that there is still some level of deposit flight occurring in the banking sector. Chair Powell is also asked if the public can be confident that there isn’t any weakness elsewhere in the system, given that the SVB case was “missed.” Chair Powell fails to answer, resorting instead to a series of statements meant to give the impression that SVB was an outlier. However, he does not address in any way the possibility for weaknesses in other banks. Finally, when asked to address public concerns that commercial real estate (CRE) portfolios, which are held disproportionally by small regional banks, pose a similar risk as SVB’s VC exposure, Chair Powell is somewhat defensive. He states, “we’re well-aware of the concentrations people have in commercial real estate. I really don’t think it’s comparable” to SVB. This does not fully answer the question, and instead attempts to brush it off. Also, it is notable that Chair Powell says “we’re” fully aware of CRE concentrations, referring to the Committee, but says that “I” do not think is it is comparable to SVB. This change in language indicates to BIA that Chair Powell is aware that other members of the Committee do not agree with his opinion, and suggests that there is greater risk associated with regional bank CRE portfolios than he is willing to acknowledge. Based on his repeated failure to fully answer questions on the topic, **it is BIA’s opinion that Chair Powell suspects there is more risk throughout the banking system than he wants to admit.**

**Credit tightening is a “possibility.”**
**- Chair Powell**

## Not all deposits are safe.

On a final note, it is interesting to BIA that Treasury Secretary Janet Yellen said, during a Senate committee hearing, that the FDIC has “not considered or discussed having anything to do with a blanket insurance or guarantees of all deposits” in response to a question. Given that, in the press conference, Chair Powell repeatedly stated that all depositors’ savings in the banking system are safe, he is similarly asked if that means all savings are covered, and if the FOMC is promising to bail out all small bank depositors. Chair Powell does not answer, instead stating, “I’m not saying anything more than I’m saying…I’m saying you’ve seen that we have the tools to protect depositors…and we’re prepared to use those tools. And I think depositors should assume that their deposits are safe.” While the FOMC is only one part of the legal and regulatory framework that involves deposit guarantees, this carefully worded response falls far short of saying all deposits will be guaranteed, despite multiple assurances that deposits are safe. In BIA’s opinion, Chair Powell’s assurances are likely motivated by a desire to calm depositors’ fears, rather than to articulate a well-defined plan for comprehensive protection. This suggests to BIA that, despite his assurances, Chair Powell believes that, in some circumstances, some deposits will not be fully guaranteed.

**“We’re well-aware of the concentrations people have in commercial real estate. I really don’t think it’s comparable.”**
**- Chair Powell**

**Notice and Disclaimer:**
BIA does not make investment recommendations, and nothing contained in the BIA marketing content accessed via this link should be considered a recommendation to take any investment action with regard to any company referenced in any BIA analysis or sample report. By clicking the link and accessing the referenced material, you are acknowledging that you have read and understand that, while designed to illustrate the application of BIA's analytical methodology to corporate disclosure, the unpaid content may be considered investment research.

**About this Report:**
This report represents the application of BIA's Tactical Behavior Assessment® methodology and reflects BIA's assessment of the completeness and responsiveness of statements made during earnings conference calls, television interviews and other presentations. In each case, our assessment represents the opinion of BIA applying the Tactical Behavior Assessment® methodology and does not purport to indicate that any individual is in any specific instance being truthful or deceptive. BIA does not make stock recommendations. Under no circumstances is BIA's analysis intended to be a recommendation to buy or sell the securities of the company which is the subject of this report.

**About BIA:**
Business Intelligence Advisors (BIA) is the leading Intelligence Solutions research and advisory firm. Founded in 2001 on the principle that Intelligence techniques originally developed for the national intelligence community could be powerfully applied to the private sector, BIA has developed a ground-breaking suite of service offerings to provide clients with an edge in collecting and evaluating information critical to their success – whether that means making a more informed investment decision, identifying hidden risks, or enhancing due diligence efforts. BIA's services, which include proprietary Behavioral Intelligence Research, Expert Advisory, Investment Intelligence, and Learning & Development Solutions, are delivered by a team of in-house experts from the national intelligence and finance fields.

www.biadvisors.com