FOREWORD

In March 2023, banking stability was tested. Silicon Valley Bank (SVB) and Signature Bank of New York, US regional banks, failed after rapid depositor flight. One week later, Swiss authorities announced a state-supported merger of Credit Suisse with UBS following a loss of market confidence. This marked the first failure of a global systemically important bank since the global financial crisis. In March, US and European bank stock prices sold off significantly, by about 25 and 14 percent, respectively. At the same time, a flight to quality in sovereign bond markets and a reassessment of the global monetary policy path took place even as coordinated central bank action served to contain broader financial market stress.

Faced with a potential loss of confidence in the banking system, authorities took strong and rapid action. US authorities applied a rarely used "systemic risk exception" allowing the Federal Deposit Insurance Corporation to protect all depositors of the banks under stress, at higher cost to the deposit insurance fund. At the same time, the Federal Reserve created a new lending facility allowing all banks to borrow against high-quality securities at par value—which is generally higher than market values—to mitigate liquidity pressures on the banking system. For their part, Swiss authorities acted decisively through the state-supported merger, which included both liquidity support and a fiscal backstop. These quick and decisive actions contained the immediate threats to financial stability.

The recent events are powerful reminders of the challenges posed by the interaction between tighter monetary conditions and the vulnerabilities built up since the global financial crisis. After years of low interest rates, tighter monetary policy is challenging banks' effective risk management in securities portfolios and of loan exposures. With few signs of underlying inflation abating, most central banks are expected to continue tightening. Yet, the well-telegraphed and appropriate monetary tightening has created a challenging environment for bank and nonbank financial intermediaries that are poorly managed, as evident in the newfound focus on unrealized interest rate–driven losses in securities portfolios. Some institutions are simply unprepared for the higher rate environment. Previous *Global Financial Stability Reports* have consistently warned of risks to the financial system from rapid monetary tightening following the period of high liquidity and low rates. In addition, Financial Sector Assessment Programs have flagged country-specific gaps in supervision, regulation, and resolution.

Financial crises have often been preceded by monetary tightening, but the latest stress episode differs in important respects from the 2008 global financial crisis, the 1997 Asian financial crisis, and the 1980s US savings and loan crisis. While the current stress is squarely in the banking system, the 2008 crisis quickly spread from banks to nonbanks and off-balance sheet entities of banks. Furthermore, the 2008 crisis was triggered by credit losses due to housing market declines, while the current turmoil in part stems from unrealized losses in portfolios of safe, but falling-in-value, securities. Finally, bank capital and liquidity rules and crisis management frameworks were strengthened significantly after the global financial crisis, helping stem a broader loss of confidence and underpinning a swifter and better coordinated policy response. The current turmoil also differs from the Asian financial crisis, when current account deficits and heavy external borrowing exposed corporates and banks to exchange rate and funding risks. And it differs from the 1980s savings and loans crisis, which occurred outside of larger banks, in entities with significantly less capital and liquidity.

Stresses triggered by the tighter stance of monetary policy may result in further bouts of financial instability. Activities in riskier segments of capital markets such as leveraged loans and private credit markets have slowed. Concerns have also been growing about conditions in commercial real estate markets, which are heavily dependent on smaller banks. While banking stocks in advanced economies have undergone significant repricing, broad equity indices remain very stretched in many countries, having appreciated markedly since the beginning of the year. A more extensive loss of investor confidence or a spreading of the banking sector strains