Wealth management insights from Stifel's CIO Office

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WASHINGTON POLICY STRATEGY

Potomac Perspective

Beyond the immediate impact on the banking industry, the current situation could impact policy and markets in numerous ways. The debt ceiling debate, the future of the Federal Reserve (Fed), coordination among global banking regulators, and the 2024 election are all intertwined and affected by events in the banking system.

OTHER FALLOUT FROM THE BANKING CRISIS

The banking crisis could have ripple effects impacting several other policy areas of concern to investors.

Debt Ceiling Implications

The banking crisis interacts with the debt ceiling debate in several ways and the combination could fuel market volatility especially as the X-date (the day when Treasury exhausts its extraordinary measures) approaches.

The combination of the situation in the banking industry plus the debt ceiling debate **heightens the risk to the economy and the financial markets**. Prior to the banking crisis, it was already assumed that a failure to raise the debt limit in a timely way could pose a risk to the markets as investors would likely become increasingly cautious ahead of a possible showdown. **If Congress fails to raise the debt ceiling by X-date the economic damage, coupled with constrained credit from banks due to the current situation, could heighten risks to the economy and increase the political risks confronting investors this summer.**

Since the debt ceiling will be a "must pass" bill, it could be an attractive vehicle to attach other legislation that might not otherwise pass on its own. **Depending on the situation later this summer, the debt ceiling bill could become a vehicle for a deposit insurance/banking bill**. Lawmakers from both parties will be looking for concessions from the other side, and a banking bill could push Republicans to support a bill in return for spending concessions or other policy changes. It is too early to confidently handicap whether a banking bill might be included in a debt ceiling bill, but banking industry participants should be on the watch.

The Federal Reserve

Beyond the impact the banking crisis could have on monetary policy, **the political pressure on the Fed could increase**. Lawmakers on both parties have been critical of the Fed for its handling of monetary policy. That criticism will extend to the Fed's role as the primary federal banking regulator of Silicon Valley Bank. Add to that the recent scandal involving securities trading by some Federal Reserve Bank presidents, and it is possible that **calls to break-up the Fed or audit the Fed could reemerge**. Those efforts will likely fail, but given the rise of populism among Republican lawmakers and the increased influence of Progressives among Democrats, a new, larger, bipartisan group of anti-Fed lawmakers could emerge on Capitol Hill.

Also, given the timing of recent events, there will be increased pressure on the Biden administration to nominate a Federal Reserve Vice Chairman who can withstand political scolding during Senate confirmation hearings.

International Coordination

According to the *Financial Times*, European banking regulators are angry at American banking regulators for insuring all deposits at Silicon Valley and disregarding the post-Great Financial Crisis playbook on how to deal with financial crises – a playbook that was written by American regulators. Tempers might cool off in the coming months, but the U.S. situation could damage relations

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between U.S. regulators and their international counterparts, which in turn could impact future work on coordinating global financial regulation.

2024 Election Impact
The 2024 election is still 20 months away, however, the current situation could have implications for the election.

Even if the banking crisis stabilizes and does not deteriorate materially, it could still put **downward pressure on the economy which in turn could negatively impact President Joe Biden's reelection chances**. A president typically gets the blame or credit (rightly or wrongly) for the economy, and if the U.S. economy slows and tips into recession, it is likely that President Biden's reelection chances would suffer. **A weakened incumbent could have negative down-ballot effects on other Democrats in 2024.**

If the banking crisis deteriorates and Congress is pressured into expanding deposit insurance and potentially other measures, **the political mood could shift into anti-incumbency and "throw the bums out" regardless of party**. Lawmakers realize this, which is why any vote to expand deposit insurance will be politically difficult. Most Democrats will likely follow the lead of the White House, but Republicans might feel the same pressure they did in 2008 to avoid voting for anything that might be described as a bailout. For Republican lawmakers who support a large increase in deposit insurance (for example beyond $1 million per account), a primary challenge could loom. **The fear of 2024 repercussions will be a big factor in any future debate over deposit insurance.**

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