

Domino Effect

Overnight, the world was in the grip of a banking crisis. Within a few hours, after failing to raise enough funding to fill the budget gap, Silicon Valley Bank was imploded and shut down at the behest of the regulatory authorities.

It didn't take long for the financial markets to wake up to another collapse and the closure of Signature Bank, a cryptocurrency lender.

Under these hard circumstances, many economic crises have been recalled, which were linked in one way or another to a term known as the "domino effect".

- **What is meant by the "Domino Effect"?**

This term refers to how a problem affects an organization or a related company in the same sector. When one domino is hit, it will not only fall by itself, but will affect everyone who stands in its way.

In economics, the domino theory is often used to explain how an economic problem in one country can spread like a contagion or domino effect to similar countries and firms.

For instance, Silicon Valley Bank in particular, like other banks, has benefited from the environment of cheap financing in conjunction with the zero-interest policies adopted by the US Federal and other central banks for a long time.

However, in 2022, the US Federal had implemented an intense monetary tightening policy in order to control rising inflation by withdrawing liquidity from markets and controlling demand.

It didn't take long for the banks to feel the harshness of this policy. When the US Federal began to raise interest rates, the yield on bonds owned by Silicon Valley and others increased, causing the value of those bonds to fall.

Thus, liquidity was necessary for the bank to cover the gap in its budget, and it went to the financing markets on Wednesday, March 8, 2023, offering bonds and stocks, but it failed to raise the needed and targeted funding of \$2.25 billion.

As a result of this failure, the bank's share fell sharply, trading on it was halted, and the banking authorities decided to close its branches fearing that their customers would rush to withdraw their deposits, which is exactly what happened.

Someone might say, this is a Silicon Valley crisis alone, so why did it affect other banks? Taking into consideration that Silicon Valley is linked to other banking activities in the market, and it also has deposits for emerging technology companies that want to get their money. Therefore, it makes sense that the crisis will affect other banks.

It is worth noting that the Silicon Valley crisis has caused concerns among depositors in various Silicon Valley branches outside the US, especially in small banks, where they have withdrawn money from them and went to larger and safer banks.

A domino effect resulted from these seemingly planned actions, leading to the closure of Signature Bank and a liquidity crisis at the Swiss Credit Suisse bank.

- **Domino effect examples that happened in the past**

1. The most well-known example of an economic domino effect was the debt crisis of 2012 and 2013, when government bond yields in Greece increased, leading to higher bond yields in other eurozone economies.
2. Additionally, the financial crisis of 2007 and 2008, in which the funding rates decreased in the United States, thus, spreading around the world and in all banks.
3. Furthermore, by focusing on the debt crisis in the eurozone, we can notice that market sentiment had changed in 2011 when investors realized that Greece was on the verge of bankruptcy and that bonds were at risk of default.
 - a. Initially, investors sold Greek bonds, causing yields to rise dramatically, and this shift in market sentiment and loss of confidence caused investors to lose faith in other Eurozone debt markets.
 - b. Previously, investors believed that Euro bonds were excessively safe. Nevertheless, when they realized the eurozone countries were not immune, they started demanding higher bond yields.

Source:

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