Daiwa's View

UBS agrees to acquire Credit Suisse

➢ A quick response to head off the contagion of financial instability

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A quick response to head off the contagion of financial instability

UBS announced yesterday that it would take over the embattled Credit Suisse Group and the Swiss government published a Q&A regarding the rescue. The acquisition would be done through an exchange of shares at an acquisition price of 3.0bn Swiss francs, well below the market price. This move is expected to deter the contagion of financial instability that began with the failure of Silicon Valley Bank (SVB). Without this quickly orchestrated and unprecedented deal, the Fed would have been tasked with deciding monetary policy at this week's FOMC at a time when global markets were facing peak financial instability.

The published Q&A noted that "FINMA has been provided with a clearer legal basis so that part of Credit Suisse's regulatory capital can be written off (private creditors are to share in the exposures to the tune of around CHF 17bn)," indicating that the bailout drama will include writing off AT1 bonds (the market was already anticipating this, evidenced by the price of Credit Suisse 9.75 perpetual bonds, which were trading at around $30 on Friday). If shareholders' losses are limited to the market value portion and the AT1 bonds are put into a hard default, this deal will likely make it harder for G-SIBs to raise loss-absorbing regulatory capital in the future.

The Q&A noted that the first CHF 5.0bn of losses that arise in the process of integrating Credit Suisse would be borne by UBS, the next CHF 9.0bn would be borne by the Swiss government, and UBS would have to cover any further losses. In other words, those additional losses for UBS will depend in part on the upcoming integration process, and there is also a possibility that losses related to that process will increase if the economy or financial conditions worsen as a result of unnecessary rate hikes by the central bank. This will require the world's central banks to be that much more cautious and make it less likely that the rate hike outlook will return to levels prior to the SVB failure, but the suppression of inflation is a critical task for Western central banks, which are already behind the curve, and there is still a possibility that the Fed, like the ECB, will take the risk of destabilizing markets. Although the near-term peak of financial instability may have passed as a result of yesterday's deal, it is difficult to say whether markets will completely settle down.

In the press release it issued today, "Coordinated Central Bank Action to Enhance the Provision of US Dollar Liquidity," the BOJ announced that six central banks, the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, the Federal Reserve, and the Swiss National Bank, have agreed to increase the frequency of 7-day maturity operations for enhancing the supply of USD liquidity from weekly to daily. This confirms that the Swiss National Bank is not acting alone and that the major central banks are working together to prevent financial crisis contagion.

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