Key Questions

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Will the Conflict in Ukraine Cause Another Banking Crisis in the US?

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It's not likely, however, ripple effects need to be monitored closely.

The Russian invasion of Ukraine has delivered images of both pure chaos and heroism from Ukrainian nationals and provided a recipe for global uncertainty in the financial markets. The spider web of financial institutions, the supply chain for commodity delivery, and global geopolitical relationships continue to shake under the weight of the conflict, producing an elevated degree of uncertainty. Sanctions imposed on Russia have been widespread and likely will take a toll on the country's economy in both the short and long term.

US banking sector exposure to Russia

We do not fully know how these financial repercussions will be digested by the world's markets. A resolution to the conflict feels like a distant ambition, but we are met with the question of how to evaluate our investments amid the current instability. Here, we focus on the US banking sector's exposure to Russia and Ukraine and how the markets are processing the unfolding events.

US banks have largely insulated themselves from volatility in the region and have either trimmed or outright exited the region following the resolution of the Crimean conflict in 2014. That episode resulted in a meaningful pullback of capital exposed to Russia and Ukraine, creating a near-exclusionary bubble around the zone. This conservative approach to the volatile region has proven to be prudent as the world watches pandemonium again rear its head.

Based on minimal allocations to the region, we foresee a negligible impact on the US banks with an international presence, both in terms of risk to balance sheet degradation as well as danger to revenue prospects.

The impact on money center banks

Among the large money center banks – banks whose borrowing and lending activities are with governments, large corporations, and regular banks – the most exposed firm possesses a modest 0.3 percent allocation to Russia as a percentage of its total assets, equating to its 20th largest country allocation. The remaining US money center banks that are international players do not list Russia or Ukraine as countries of exposure because allocations to their balance sheet fall below the reportable threshold. In short, Russia and Ukraine do not rise to the level of reportable geographies, signaling a muted impact to forward-looking financial conditions.

In reviewing financial statements of the large money center banks back to 2015, none list Russia or Ukraine as notable geographies of revenue generation or balance sheet exposure.

This speaks volumes as to the limited relationship between US money centers and the region and the exclusionary policies established by the firms.

Capital markets activity in Russia and Ukraine

Additionally, over the past three years, the activity of capital markets in the region has contributed a mere blended 0.50 percent for the five largest money center banks with international operations and 0.044 percent of total consolidated revenue. In a worst-case scenario, with Russian and Ukrainian exposures going to zero, the US banks have largely insulated themselves from revenue and balance sheet degradation. We also do not believe that substantial knock-on effects exist that would chip away at the large domestic banks' pristine capital levels, which have been developed and regulated coming out of the global financial crisis.

That said, European banks face greater risks, risks that are closer to home, and thus it is still important to monitor risk levels such as credit spreads and other measures of financial stress within the capital markets.

Key financial indicators

Corporate credit spreads (the additional compensation investors demand over benchmark US Treasuries) in the banking sector versus the Bloomberg US Corporate Bond Index, as a whole, have witnessed a negligible excess outward move relative to the composite index since the invasion of Ukraine on Feb. 24.

Date	Bloomberg US Corporate Bond Index Spread (credit spreads vs. US Treasuries – total corporate bonds universe) (basis points)	Change in spread (basis points)
12/31/21	92	--
2/23/22	120	+28
3/4/22	124	+32

Date	Spread US Banks (credit spreads US Treasuries – banking sector-specific) (basis points)	Change in spread (basis points)
12/31/21	78	--
2/23/22	109	+31
3/4/22	114	+36

As of March 4, the risk premium associated with banking issuers was 114 basis points. (A basis point is a unit of measure used to describe the percentage change in the value or rate of a financial instrument.) This compares to a level of 109 basis points on Feb. 23, and 78 basis points at the close of 2021, a year-to-date differential of plus 36 basis points.

Comparing this to the broader investment-grade corporate index we see a similar outward push in spreads. Using these same points in time, the index moved from 92 basis points at the end of 2021 to 120 basis points on Feb. 23, and a present level of 124, a year-to-date gain of 32 basis points. For reference, when we zoom out over a longer time horizon, 1997 through the end of 2021, the average spread of the Bloomberg US Corporate Bond Index has stood at a level of 133 basis points. The takeaway here is that we remain well within the bounds of a behaved corporate credit market, indicating that investors are not overly concerned about the health of the US banking sector.

Key takeaway

Despite the global uncertainty that has escalated because of the Russia and Ukraine conflict, US banks remain largely insulated from the mayhem. A conscious effort to reduce exposure to the region has allowed the banking sector to avoid excess volatility and orderly trading persists in the corporate credit markets. We retain a favorable view on corporate credit, relative to sovereign debt, and believe that an expected reduction in new issuance could be a strong technical factor to keep spreads relatively contained for the balance of the year.

For more information, please contact your advisor.

About the Author

As a Senior Research Analyst with the Equity & Fixed Income Research team Michael utilizes proprietary corporate debt evaluation techniques to achieve strong risk adjusted compensation in client portfolios. He works to understand a client's priorities to ensure recommended investment and risk management strategies are appropriate for each unique circumstance. Leveraging more than 14 years in the financial industry, Michael is responsible for evaluating the creditworthiness of individual investment grade corporate issuers. Michael graduated Cum Laude with a Bachelor of Arts degree in Finance and Economics from Otterbein University and has completed his MBA degree from Ashland University.

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