

Echoes of the past

21 October 2025

Recent strains in the US banking sector have revived memories of past crises, highlighting the importance of distinguishing short-term setbacks from systemic risks.

Don't worry – I'm not embarking on another Pink Floyd-themed commentary. When there is a lot of uncertainty in the air, as there is now, despite global equities hovering close to all-time highs, investors often look to history as an indicator of what might happen next. Given that we are talking about periods of uncertainty, the focus tends to land on unfavourable past outcomes. I have observed previously that while this approach has some merit in evaluating potential risks, it can also overlook the differences. Perhaps I could have invoked the aphorism attributed to Mark Twain: "History may not repeat itself but it often rhymes."

Pest control

Last week we saw an outbreak of nerves in the US banking sector. Despite bumper financial market-related profits and a relatively benign bad-loan experience, the leaders of many major banks felt compelled to warn of impending doom. Jamie Dimon, CEO of JPMorgan, made the most impact with his comment that there is always "more than one cockroach". This referred to the bankruptcies of two private companies, First Brands and Tricolor.

The former appears to be a case of outright fraud, with the company – a manufacturer of automotive parts – allegedly pledging the same inventory and

Quick take

- US corporate and banking problems have reignited discussion about financial stability, but the evidence so far points to isolated cases of fraud and weak lending standards rather than the start of a wider crisis.
- The Federal Reserve continues to balance the need to contain inflation with its commitment to supporting growth and employment, and markets still expect two further rate cuts before the end of the year.
- While some comparisons are being drawn with past crises, today's lending environment is very different, with stronger balance sheets, tighter regulation and a more responsive policy framework helping to limit systemic risk.

customer invoices to more than one provider of credit. It was no doubt tempted to do this because of deteriorating cash flow and other liabilities, possibly exacerbated by tariff disruption and weakness in parts of the market it serves. There are also claims that more than \$2bn has simply disappeared. Whenever allegations of fraud arise, minds inevitably turn back to the bust that followed the technology boom at the turn of the century, with Enron the poster child for accounting misdeeds of that era.

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The case of Tricolor smells more of incompetence. It is a car dealer and also provided auto loans – sometimes, it seems, selling vehicles to people without a driving licence. Its situation was worsened by lending primarily to immigrants, many of whom have returned to, for example, Mexico, taking their cars with them and leaving the outstanding liabilities behind.

The concern is that both failures stem from a period of excessively low interest rates and insufficiently rigorous lending standards. The situation was exacerbated by a release from Zions Bank, a regional lender, which pre-reported a net charge of around \$50mn related to commercial real estate – around 5% of earnings. Fraud was alleged in this case too, as it was in another report of credit loss at Western Alliance Bank.

So, are these isolated, idiosyncratic events or harbingers of something worse to come? The market initially feared the latter but then stabilised as stronger results arrived from other banks. The sell-off was probably worsened by record selling of

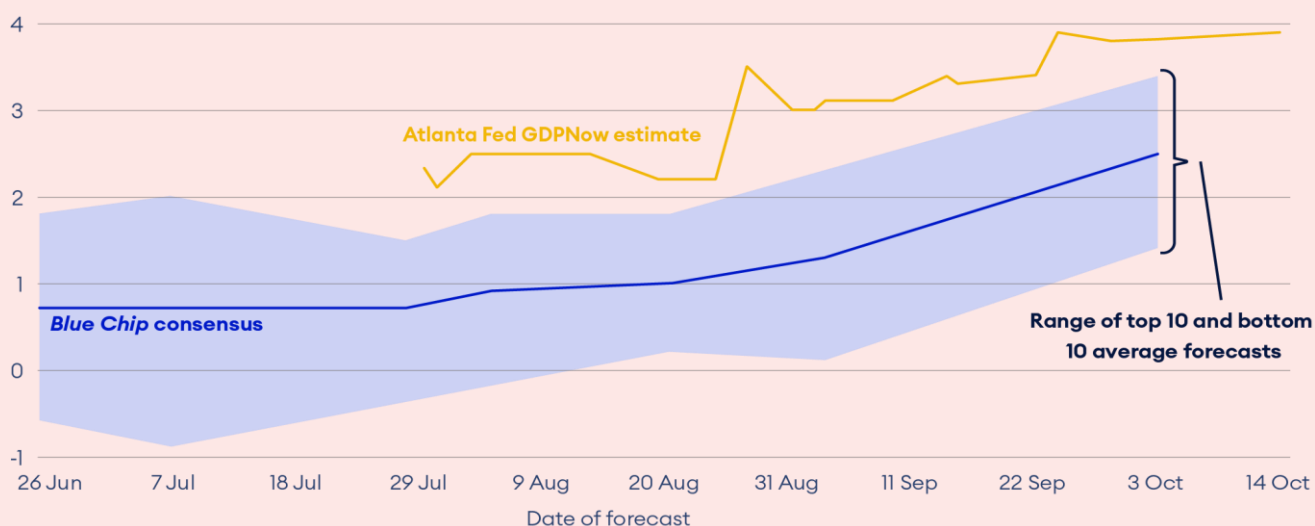
a regional bank ETF, amounting to \$500mn on Thursday.

Much will depend on the overall economy. The Atlanta Fed's GDPNow tracker puts third quarter US GDP growth close to 4% on an annualised basis (figure 1). Even if that is being boosted by AI-related capital expenditure, consumption seems resilient. But there are signs of a fork in the economy, with lower-income households feeling a greater squeeze on real incomes from lingering inflation and tariff effects – the so-called 'K-shaped' economy. This could worsen once the effects of the One Big Beautiful Bill Act are felt in January. Meanwhile, higher-income households continue to float on a feather bed of rising equity markets and the prospect of tax cuts in the New Year.

This is definitely not a one-size-fits-all economy when it comes to Federal Reserve monetary policy, but it suggests the Fed will lean towards supporting employment if needed. That was how markets interpreted Chairman Jerome Powell's comments last week, and futures markets are pricing in two more quarter-point rate cuts this year.

Figure 1: US growth stays strong through Q3

The Atlanta Fed's GDPNow estimate for third-quarter annualised growth remains well above the Blue Chip consensus, highlighting continued economic resilience.



Source: Federal Reserve Bank of Atlanta, Rathbones

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A bear-shaped canary

It never hurts to recall Warren Buffett's line: "You only find out who is swimming naked when the tide goes out." There will no doubt be a few more failures, but so far there is little evidence of systemic risk building, and predictions of an imminent financial crisis still look misplaced.

Nevertheless, some commentators are drawing parallels with the failure of two hedge funds run by the soon-to-be defunct investment bank Bear Stearns in July 2007 – more than a year before the global financial crisis erupted. Those funds had invested in sub-prime mortgage-backed securities that were fast losing value as borrowers defaulted. The investments were highly leveraged, piling borrowing upon borrowing. One fund failed completely and the other required a liquidity injection from the bank. Bear's reputation was damaged, and as the underlying assets continued to lose value, margin calls mounted, liquidity dried up and the bank had to be rescued by JPMorgan in March 2008.

Does this mean we are a year or so away from a financial crisis? Again, we cannot definitively say no, but there is limited evidence to support that claim. We are well aware of the rise of private credit lending, which is more opaque and less regulated than bank lending, but we don't believe it involves the same level of repackaging of bad loans seen in the 2000s. The mortgage origination model of that era – rewarding volume without retaining credit risk – does not really apply today. Some private credit funds may make poor lending decisions, but we do not see this as widespread. We would take a more cautious view only if the economy weakened sharply.

Into the valley?

Unsurprisingly, memories of the collapse of Silicon Valley Bank (SVB) in 2023 have been rekindled, but it is worth noting this was a very different situation. SVB had a huge mismatch between the duration of its assets and liabilities, having parked short-term deposits in long-term bonds that were losing value. This triggered a run on deposits as its balance sheet came under pressure. What we are seeing now are more run-of-the-mill loan losses, fraudulent or otherwise. They could worsen as the refinancing cycle progresses or if the economy

takes a turn for the worse, but that's not our current view.

The Fed's response to banking stress – especially where liquidity is at risk – is now almost instantaneous. When SVB failed, the Fed effectively guaranteed all deposits, even those above the \$250,000 limit. That cap had been raised temporarily in October 2008 from \$100,000 to encourage households to keep money in the system as the crisis unfolded. When made permanent in 2010, it was done so retrospectively, allowing depositors to claim the extra coverage where applicable.

The Fed also addressed the losses in bond portfolios that felled SVB by introducing the Bank Term Funding Programme, which allowed it to lend to distressed banks at the face value of their bond holdings, avoiding forced sales at a loss. Loans could be repaid once liquidity improved or the bonds matured without crystallising losses. At its peak, outstanding loans reached \$168mn – not huge in the grand scheme, but enough to calm markets. Sometimes you just need a backstop, even if it is rarely used. Similar examples include the European Central Bank's "whatever it takes" pledge in 2012 and the Bank of England's gilt-buying intervention after the Liz Truss mini-Budget in 2022.

The "bezzle"

Economist John Kenneth Galbraith coined the term "bezzle" to describe a long-term pattern of bad faith in which the victim does not realise they have been deceived and may even feel better off – delusion sets in later.

In lending terms, the lender believes they have made a good loan, receiving regular interest and expecting repayment. Confidence abounds, encouraging further loans. Meanwhile, the borrower has the money and may spend it on operations, marketing or, in extreme cases, personal gain. The illusion of prosperity keeps the economic plates spinning – until momentum slows and the plates wobble and fall, revealing that much of the activity was unsustainable, though not necessarily illegal.

Galbraith suggested that the longer the cycle, the greater the eventual "bezzle". We invest in full awareness that these negative outcomes are

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possible, and aim to build portfolios resilient to downturns (and especially to fraud) yet still able to participate in future gains. It is a constant balancing act and lasting success rarely comes from taking extreme positions in either direction.

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Economic highlights

UK. The 0.1% month-on-month rise in GDP in August shows the economy is just 0.1% bigger than it was in March. The three-month growth rate, a good guide to the underlying trend, was also a lowly 0.3% in August, down from 0.7% in April. The annual growth rate declined from 1.5% to 1.3%. The business tax increases imposed in April this year are still restraining growth. The service sector was flat. Even though the hospitality sector performed strongly (growing by 1.2% m/m), other consumer-facing services contracted, and business services remained weak. This implies that households are willing to shift around spending, but still seem reluctant to raise it materially. Weak overseas demand is also a factor.

The 0.7% m/m rebound in manufacturing output only partially offset July's 1.1% m/m fall and left the three-month growth rate at 0.0%. As a result, manufacturing output is now no higher than it was in August 2023. The 0.3% m/m fall in construction output was also disappointing given above-average temperatures and below-average rainfall in August. There is little reason to think GDP growth will accelerate much from here. The disruption to the auto sector caused by the Jaguar Land Rover cyberattack probably means the economy shrank in September, with weak retail sales already in the bag owing to the wrong sort of weather. Sentiment is still weak, and taxes may rise further in the Budget on 26 November. But with inflation still high and rising, there is no space for the Bank of England to cut interest rates just now.

US. We are still lacking key US data owing to the federal government shutdown. Survey data is as good as it gets and it has been all over the place. The NFIB Small Business Survey undershot expectations, while the Empire Manufacturing Survey came in well above forecasts. Then the Philadelphia Fed Business Outlook was much weaker than projected. This is making it hard to form opinions in the short term. Even so, investors still see the Federal Reserve cutting rates twice more this year.

EU. Eurozone industrial production fell 1.2% m/m in August, but the headline index masks a much harsher reality. Excluding the 9.8% m/m increase in Ireland, the index dropped by 2.4%. Production shrank across all four major economies, notably in Germany and Italy, but the weakness was

widespread, with Austria and Greece also experiencing significant declines. Worryingly, the gap in industrial production that has opened since 2022 between Germany, Italy and the rest of the Eurozone keeps increasing. Weakness spread across the main industrial groupings, with only non-durable goods avoiding contraction. Capital and durable consumer goods showed the largest drops, down by 2.2% and 1.6%, respectively. We continue to expect past interest rate cuts and German fiscal expansion to feed through positively, but cannot deny that impatience is building. The US tariff situation is not helping either, with inventory management disrupting underlying growth trends.

China. China's economic growth slowed to the weakest pace in a year in the third quarter, as fragile domestic demand left it heavily reliant on exports, stoking concerns about deepening structural imbalances. While the 4.8% growth rate met expectations and kept China on track to reach its target of roughly 5% this year, the economy's dependence on external demand at a time of mounting trade tensions with Washington raises questions over whether that pace can be sustained.

More positively, industrial production (+6.5% y/y) was the standout feature. Oxford Economics attributes this to higher-value production of intermediate and capital goods for the emerging market supply chain, and a pivot away from lower-value final exports to developed market countries. The Fourth Party Plenum starts this week and there are the usual hopes for supportive measures to be announced in the 15th Five-Year Plan.

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