Lower securities valuations have reduced banks’ liquidity and capital, potentially dampening loan growth.

Interest rates have risen across the yield curve since the Federal Open Market Committee began tightening monetary policy in March 2022. After amassing securities during the pandemic, commercial banks saw rising interest rates erode the value of their securities portfolios by nearly $600 billion, or about 30 percent of their capital holdings. In some cases, declines in valuation of securities holdings in response to interest rate changes—known as “unrealized losses”—can mechanically reduce key regulatory capital and liquidity ratios. Should banks need to sell the securities to generate income when their valuations are low, the realized losses could erode capital buffers and threaten the banks’ solvency.

W. Blake Marsh and Brendan Laliberte investigate how recent interest rate changes and banks’ associated unrealized losses have affected bank decision-making. They find four channels through which unrealized losses have reduced bank liquidity and capital, potentially dampening loan growth. These channels highlight that unrealized losses can affect all types of banks irrespective of size, regulatory treatment, or funding access.

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