Global banking direct impact to US
By Lisa Weinberger • Bankrate.com

Questions are floating around about how or if the economy will turn around, and if so, when we can expect to see the change. We asked John Moore, associate professor of finance at Walsh College, his thoughts about the global economy and how it directly impacts the U.S. He discusses the history of global economic downturns and the impact it has had on the American banks.

Q: Regarding the crisis in Greece and the eurozone, do U.S. banks have anything to worry about?

A: There is definitely cause for American banks to be concerned about financial crises throughout the world, particularly in the eurozone. Our financial marketplace is a global marketplace, and all of the separate parts impact everything else to some degree.

If we look at historical examples, it was the collapse of (the bank) Credit-Anstalt in Austria in 1931 that had a domino effect upon global financial markets and hastened the Great Depression. In fact, we can go as far back as 1819 to see where adverse financial conditions in Europe impacted the United States, leading to the Panic of 1819.

Today's financial marketplace is as globally integrated as it has ever been. The impact of events outside America's borders will directly impact us. If there is a loss of investor confidence arising from any catastrophic financial event in Europe, the impact upon American banks, investors, and the overall domestic economy will be swift and significant.

Q: Do you see any common thread among the Asian financial crisis in the mid-'90s, the financial crisis of 2008 and what's going on in Europe now?

A: There are some comparisons but also some distinct differences. Certainly, the Asian crisis and the American crisis in 2008 both involve the basic characteristics of a boom-bust event. In these cases easy credit, much of it tied to real estate, and an overly optimistic private sector combined to create a boom that would inevitably lead to a bust outcome. Investor expectations were simply too aggressive, and when reality became apparent, financial markets corrected themselves.

The current situation in Europe is somewhat different, and I believe that it is more dangerous. The signing of the Maastricht Treaty in 1992, and eventual creation of a common currency (the euro) with parameters for each nation's monetary policy, was a major accomplishment. The core problem, though, is that Maastricht never addressed sovereign fiscal policy parameters and, as a consequence, the various European nations are free to pursue "nonaligned" fiscal policies. So long as countries such as Greece, Portugal and others can run up massive debt through the use of aggressive and unsustainable fiscal measures while other EU nations, such as Germany, are more restrained, the possibility of national debt defaults is both possible and potentially catastrophic. The EU does not have a solution in place on the issue of nonaligned fiscal policy. Until they address this fundamental problem, there is cause for concern.
Q: What do you think of Operation Twist, the Fed’s plan to sell short-term Treasuries to buy long-term Treasuries in a bid to reduce long-term interest rates?

A: The underlying goal of Operation Twist is to reduce the cost of funds and provide the incentive for private sector entrepreneurs to access debt capital to expand their businesses and create jobs. This is a fine and admirable goal, but I don't see any positive outcomes resulting from this attempt. At the end of the day, the private sector will assess risk, and the positive benefits from a dozen or two (dozen) basis points on debt capital will simply not be sufficient to overcome present concerns about regulation and health care costs. Japan tried using similar strategies to make the cost of debt capital close to zero in the 1990s in order to spur economic activity without success.

Also keep in mind that markets impact long-term interest rates more than the Fed does. If, at some point, capital markets become truly concerned about inflation, the long end of the yield curve will rise regardless of Fed tactics such as Operation Twist.

In the end, I have serious doubts that it will accomplish its goals. The private sector will still see risk in the marketplace arising from other factors, and this program will not change their minds.

Q: How can central banks and the international banking system work to reduce the severity of future banking crises?

A: First, the central banking system needs to step in and provide the resources to avert a financial disaster. The IMF (International Monetary Fund) and central bankers provided that in the case of Asia in the 1990s, and they appear to be doing the same in Europe at the present time. However, the only way in which we can lower our exposure to both the frequency and severity of financial crises is to curb the behavior of financially irresponsible nations whose fiscal policies result in unsustainable debt loads. As painful as it is, and we see this playing out in Greece, the consequence of a fiscal policy "binge" is the pain of an austerity "hangover."

There is no magical elixir that avoids the pain of a financial crisis. Political leaders, bankers, investors and citizens all need to realize there are consequences to actions.

We would like to thank John Moore, associate professor of finance at Walsh College and a certified public accountant for offering his insights. Questions for this interview contributed by Holden Lewis, assistant managing editor for Bankrate.com.