Godsey & Gibb Associates
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Banking Crises: Historical Perspectives, Economic Consequences and Portfolio Impacts

In October, the ongoing financial crisis entered its most acute phase with record volatility in financial markets, declining equity prices and an unprecedented response from policy markers. Given the current environment, Godsey & Gibb Associates believes that an evaluation of past banking crises along with the future economic impacts are important determinants to consider when positioning portfolios.

While the current situation is no doubt severe, financial crises are not as rare as many might imagine. A recently released paper from the International Monetary Fund (IMF) analyzes 124 banking crises that occurred over the past 27 years in 37 different countries. Moreover, according to historian John Steel Gordon, financial panics occur roughly every 20 years in the U.S. including 1819, 1836, 1873, 1893, 1907, 1929, 1987, and now 2008. To varying degrees, the characteristics of these past episodes are useful in analyzing the current situation.

The IMF paper concludes that governments have employed a broad range of policies to deal with past financial crises. Intervention nearly always takes place, with bank restructuring agencies and asset management companies set up. Recapitalizations of the banking sector by governments are also common. Once emergency measures have been put into place, the long-run challenge of crisis resolution entails the resumption of a functioning credit system.

In the current environment, U.S. and global policy makers have consulted and cooperated in unprecedented ways in an attempt to reduce the impacts of the current crisis. For example, the U.S. Treasury recently announced equity stakes ranging from $2 billion to $25 billion in the nine largest banks. The Federal Reserve announced that it would begin purchasing short-term corporate debt known as commercial paper, and the Federal Deposit Insurance Corporation introduced guarantees for certain non-interest bearing accounts and certain medium-term debt with maturities of up to 3 years by banks.

While these recently announced measures address many problems in the current crisis and the global nature of the policy response is commendable, a significant economic slowdown appears unavoidable. Economic consequences from the crisis indicate that global developed economies will be in or close to recession in the second half of 2008 and early 2009, and that the anticipated recovery period will be gradual by past standards. With the most acute phase of the financial crisis hopefully behind us, we believe it is important to continue to position portfolios for the economic slowdown. Banks will have to adjust to a more regulated, conservative environment and housing, which has been an intense drag on economic growth, will also need to recover. Systematic risks from derivatives will also need to be addressed. As such, we remain defensive and overweight cash.

Write-downs and Credit Losses vs. Capital Raised

Region/Firm	Total Losses	Capital Raised
Worldwide	$647.4 billion	$615.0 billion
Wachovia Corp.	$96.7 billion	$11.0 billion
Citigroup Inc.	$61.0 billion	$74.0 billion
Merrill Lynch & Co.	$52.2 billion	$29.9 billion
Washington Mutual Inc.	$45.6 billion	$12.1 billion
UBS AG	$44.2 billion	$27.0 billion
HSBC Holdings Plc	$27.4 billion	$5 1billion
Bank of America Corp.	$27.4 billion	$55.7 billion
J.P. Morgan Chase	$20.5 billion	$44.7 billion
Wells Fargo	$17.7 billion	$30.8 billion
Morgan Stanley	$15.7 billion	$24.6 billion

Source: Bloomberg

The Costs of Past Banking Crises In GDP & Output

Source: The Wall Street Journal

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