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A Butterfly Flaps Its Wings In China: An Interview with Alexander de Laiglesia

by Jason Louv

If there was any doubt about the interconnectedness of the world and its markets, the current economic crisis should put an end to it. Today we are witnessing the first financial disaster that is truly global in scope. Here, to shed some light on the interconnectedness of today's markets and its consequences is Alexander de Laiglesia, currently Managing Director at *Banco Santander's* Asia-Pacific headquarters in Hong Kong.

How do the global financial markets interconnect?

Countries started interconnecting centuries ago as a consequence of cross-border trade and investment activity. This interconnectivity became increasingly global and complex over time and over the past months the world has become aware of just how markets that were previously considered to be totally independent can actually have a great impact on each other. One example is the way the implosion of CDOs (collateralized debt obligations) packaged by Investment Banks in New York has halted the building of new schools and retirement homes in Narvik in Norway. The municipality of Narvik had "unwittingly" invested much of its funds into US sub-prime residential mortgages.

Increased deregulation has freed up the flow of money and credit around the world. This has facilitated the channeling of wealth from developed countries to fund much needed projects in other less developed parts of the world. However, as these flows became more global and the financing structures involved more complex, a gap emerged between the people originating the credit and those investing in it. It became increasingly difficult to evaluate the nature and level of risk actually being assumed by investors while the size and scope of the investor base expanded at break-neck speed all over the world ranging from the most sophisticated Wall Street financial institutions to housewives in Tokyo and Bucharest.

A sustainable world requires efficient global economic and financial systems that take into account and adequately manage the ever-growing interrelationships between nations. In order to ensure that global financial markets work efficiently, it is essential that they are managed at a global level and in a transparent manner. This requires close co-operation between governments to ensure effective global market oversight. This oversight should focus on active supervision rather than excessive regulation since, as long as markets are truly transparent and properly supervised, they will tend to work efficiently.

Why should consumers in America care about the collapse of Iceland? What can it tell us about the way things are going to turn in the rest of the world?

The collapse of Iceland originated in 2001 when, following deregulation, local banks embarked on an unbridled loan fest both at home and overseas. The crisis unfolded when banks became unable to refinance their debts. The situation was exacerbated by the fact that Icelandic consumers also joined the party by borrowing excessively. Ring any bells? This led to inflation which required the government to raise interest rates into double digits which in turn attracted overseas investors who indulged in the carry trade phenomenon whereby one borrowed in a low interest bearing currency and invested the proceeds in a high yielding currency such as the Icelandic Krone.

The impact, when this particular financial bubble burst, extended far beyond the shores of this remote island and affected both unsuspecting individuals as well as well informed institutions. Relative to the size of its economy, Iceland's banking collapse is the largest suffered by any country in economic history. SO FAR! However, the Icelandic crisis also led to a run on deposits in the UK and one German Bank has had to seek help from the German federal government due to losses arising from its investments in Iceland. Over half a million depositors outside Iceland (far more than the population of Iceland) have been affected.

Why should consumers in America care about this? Because what happened in Iceland has been happening throughout the world and if other countries do not avoid making the same mistakes

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that took place in Iceland they will surely follow in the same footsteps; both governments and consumers alike. In an increasingly interrelated world, there are many common factors that affect us all so we must take heed and learn from what happens elsewhere. Iceland is one example but there are many more such as Japan´s “lost decade”, following the collapse of the financial bubble at the beginning of the 90’s, during which toxic loans and deflation prevented economic growth and prosperity for many years. The problem is that the world never really seems to learn from its mistakes or at least manages to quickly forget the lessons learnt.

What does collapse in America mean for the rest of the world? How much is the rest of the world really tied to American trade?

Since the end of the Second World War, the US’s political, economic and financial influence globally has grown to such an extent that any kind of crisis in the US normally has a clear impact on the rest of the world. If a country the size of Iceland could affect over half a million people outside that country, it is not surprising to find that the sub-prime loan crisis that originated in the US has effectively led to a global recession.

The growth of the so-called BRIC economies (Brazil, Russia, India, China) during this decade, particularly China, probably led to the false impression that the world no longer relied so much on America and this clearly contributed to an unsustainable global boom. The fact is that the world and China in particular still relies heavily on the US market. It is clear that

when America sneezes, the rest of the world is likely to catch pneumonia. This places a great deal of responsibility on the US Government and the American people since their actions not only affect their own country but also all those other countries that they share this earth with.

Do you see new financial models on the horizon? How do we get out of this mess?

Rather than finding new models at this moment in time it is more a question of ensuring that the current ones work more efficiently and effectively going forward. Capitalism is well suited to human behavior as it thrives on the dynamic impulses of fear and greed that have shaped the modern world as we know it. However, it is also clear that such impulses need careful restraint to avoid the injustice and hardship that prolonged or pronounced economic boom and bust cycles can entail. The trillion dollar question right now is how much and to what extent is government support and intervention needed to get the financial markets and the economy on a sound footing again without stifling the economy and markets so much that the lack of oxygen results in permanent paralysis. This requires a high level of cooperation and coordination between governments, market regulators and the private sector on a global level. We are all, quite literally, in this mess together and it will need a concerted effort by all of us to get us out of it.

Many financial institutions will need to re-invent themselves as they face a new world that will redefine how they are able to succeed in the future. Banks will need to become much more focused on their core markets, built on strong customer relationships and funded predominantly from their own deposit bases. They will also need to focus more on the kind of responsible lending that carefully evaluates and monitors the risk that both the bank and its customers are taking on, as well as providing value adding financial products and services that truly meet the needs of their customers.

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