

Over 1,000 Executives Participate in Live Web Discussion

Examining the Causes of the Crisis

"We are in the midst of a global financial crisis which has, in turn, triggered a crisis in consumer confidence." These were the stark words of Prof. Antonio Argandoña at a special Continuous Education Program titled "The Economic Crisis: In the Eye of the Hurricane," held on IESE's Barcelona campus on October 7.

IESE Profs. Eduardo Martínez Abascal, Núria Mas and Sanjay Peters also provided input, along with Prof. Argandoña. Prof. Pedro Videla, director of the Department of Economics, chaired the event.

The event was repeated two days later on IESE's Madrid campus, where Profs. Juan J. Toribio, José L. Suárez and Javier Díaz Giménez made up the panel. Prof. José R. Pin moderated the discussion on the roots of the crisis and the best route out of it.

Concerning the roots of the crisis, Prof. José L. Suárez related an anecdote of the late Prof. Rafael Termes concerning the flourishing black market in the Spanish economy after the country's Civil War.

"People bought and sold canned sardines and earned a little money in the process. Now and again, somebody dared to open the can. If they complained that the sardines were rotten, people said: 'How ignorant you are! They are for buying and selling, not for opening and eating,'" the late professor used to say.

In the same way, subprime mortgages were sold above their true value. But at the Barcelona event, Prof. Martínez Abascal said that financial instruments linked to U.S. subprime mortgages were only part of the cause of the current crisis. "The more serious problem has been the underlying performance of the U.S. real-estate and mortgage market in general," he said.

Confidence knocked

A second crucial factor was the sharp fall in inter-bank confidence. "Banks' increasing reluctance to lend to each other created a significant contraction in liquidity, which, in turn, has prompted defaults," said Martínez Abascal. Prof. Suárez added that this situation significantly damaged investors' confidence, creating "an enor-

mous mistrust of the markets that has led to the current situation."

The economists discussed measures taken by national governments to staunch the crisis, such as the U.S. government's bailout plan, the U.K. government's recapitalization plan and the de facto nationalization of a number of banks in the United States, the United Kingdom, the Netherlands, Belgium, France and Germany through government bailouts.

In Barcelona, Prof. Peters viewed the U.S. bailout plan as absolutely essential. "We could not afford not to approve the plan," he said. Prof. Toribio concurred in the Madrid session. "We are facing a solvency problem: if there is no liquidity in the market, no one can lend to anyone," he said.

The economists and financial experts discussed the logic behind the bank bailouts. "The theory says that you have to save solvent institutions that are going through short-term liquidity difficulties. And what we are seeing now are institutions with a solvency that disappears overnight ... as a consequence of another institution's problems," Prof. Argandoña noted. "But it is not clear if the governments are going to pull out later," Prof. Toribio said.

The fact is that, for the man and woman on the street, neither rate cuts nor liquidity injections have been effective because banks are not interested in increasing their loan capacity to borrowers. They need the liquidity provided by the former "lenders of last resort," the central bank-



ers, to cover their own needs, as inter-bank loans and investors have vanished.

Emerging problems

Despite interest rate cuts, bank rescues and the bailout plan's swift passage through Congress, Prof. Argandoña predicted that the United States would not sidestep negative growth and that the crisis would contaminate many regions, including emerging countries. "Countries like China, India and Brazil will have to respond rigorously to continue growing as many Western countries enter deep recession."

However, even if the BRICs do outperform their Western peers during the downturn, the professor does not foresee any movement of the financial market's tectonic

plates. "The financial center of the world will still remain anchored in the West for the foreseeable future," he said.

At the Madrid event, Prof. Díaz Giménez pointed out that the slump in global commodity markets will be particularly hard felt in emerging countries. "For a while now, some of these countries have benefited from high raw material-prices... Emerging economies are going to be weakened by the crisis." Yet Prof. Suárez felt confident that China and some other Asian economies would suffer less.

Pain in Spain

In terms of contagion from the U.S. crisis, Prof. Martínez Abascal highlighted the atmosphere of uncertainty in Spain that has little basis in reality. "Spanish banks are solid," he said. "They do not lend money to anyone who does not inspire trust." Liquidity is there, albeit hidden. He concludes, therefore, that it is highly unlikely that Spanish banks will collapse.

Although the Spanish banking system is essentially sound, the crisis has pierced the housing bubble. This will have harsh consequences for Spain, which, according to *The Economist*, was building more homes than France, Germany and Italy combined when the crisis first surfaced in August 2008.

Prof. Suárez said that real-estate developers quoted on the stock market reported a 67 percent fall in sales in the first half of 2008, compared to 2007, with prices dropping 13 percent including inflation. "And there is still scope for prices to fall further in real terms," he said.

In conclusion, Toribio, along with his peers Profs. Díaz Giménez and Suárez, highlighted the need for investors, bankers and families to abandon the short-term outlook that has characterized markets and society in the last few years. And the economists were confident that, through innovation, the market would be able to re-establish the financial system.

Over 1,000 alumni attended the session, which was broadcast live for the first time to all alumni members via **Cisco Systems'** WEBEX meeting manager.

agenda

IESE has responded to the financial crisis by organizing a series of special Continuous Education Sessions to discuss the topic across the globe. Look out for upcoming events.

London

April 11, 2008

Current Global Economic Turbulence
Prof. José M. Campa

Toronto

Oct. 16, 2008

Will the Emerging Markets Save the Day After Black Monday?
Prof. Bernardo Villegas

Brussels

Nov. 3, 2008

The Implications of the Global Financial Crisis: Regime Shifts?
Prof. Sanjay Peters

Moscow

Dec. 1, 2008

From a Liquidity Tsunami to a Global Recession: Any Good News Lately?

Munich

Dec. 3, 2008

The Current Financial Crisis: Analysis, Reasons, Solutions, Lessons Learned.
Prof. E. Martínez Abascal

London

Dec. 11, 2008

Managing our Careers, from the Headhunter's Point of View.
Prof. Mike Rosenberg

New Delhi

Dec. 12, 2008

Financial Crisis and Corporate Governance
Dean Jordi Canals

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Prof. Pascual Berrone
- Is Monetary Policy Becoming Less Effective?
Prof. Javier Gómez Biscarri

