

Bubble trouble: Policy makers strike warning note

IMF, World Bank advise caution over risks posed by emerging equity, property and commodity markets

BY BRIAN MILNER

The once-distant warning bells of new financial bubbles in the making in Asia and elsewhere are getting louder.

The International Monetary Fund, the World Bank and the Hong Kong Stock Exchange, Asia's biggest listed stock exchange by market capitalization, yesterday added their voices to the growing chorus lamenting the risks posed by excessive liquidity sloshing around emerging equity, property and commodity markets.

Rising bubbles can actually aid in the global recovery in the short term. It's what happens when they inevitably burst that strikes fear in the hearts of policy makers.

"In East Asia, if you start to get a strong rebound in growth, and you've got a lot of liquidity, there is the question of whether one could start to face asset bubbles in particular markets," World Bank president Robert Zoellick said in Singapore.

He cited the fear of bubbles in the region as one reason behind two recent interest rate hikes by the Australian central bank, but cautioned that governments have to be wary about tightening monetary policy and unwinding stimulus, because of the risk of curtailing economic growth.

"I think one of the questions here will be the timing of how they manage the interest rates and the risk that they could get some inflation and even asset bubbles, which, obviously, if they become a serious issue, could undermine confidence going forward," Mr. Zoellick told the Foreign Correspondents Association of

Singapore, where he is attending the Asia-Pacific Economic Co-operation meeting.

Emerging-market equities have been on a remarkable tear since the dark days of early March - with benchmark indexes up more than 85 per cent - dwarfing gains in developed markets. And property has zoomed back into bubble territory in China and Hong Kong, where a tidal wave of money from the mainland has flooded into the residential real estate market.

Speculators have plowed capital obtained at rock bottom interest rates into other hot asset classes, as well, as money rapidly flows from the relatively stagnant economies of the developed world to faster-growing emerging markets with the allure of higher returns.

"A whole lot of attention has been paid to the rebound in North American and European equities this year," said Douglas Porter, deputy chief economist with BMO Nesbitt Burns. "But what we're seeing there is chump change compared to the amazing rally we've seen almost up and down the emerging markets."

Another factor in the bubble-like conditions has been the revival of the carry trade. In its latest incarnation, traders have been borrowing U.S. dollars at near zero rates to snap up assets in other currencies with higher rates of return. This is one reason the greenback has taken such a pounding against a raft of currencies from Brazil to Australia.

"The persistent decline of the U.S. dollar in recent months is a confirming tell-tale of a funding currency being used

for global leverage," Wilfred Hahn, founder of Vancouver-based Hahn Investment Stewards, said in his latest note to clients.

The typical carry trades of recent years involved borrowing yen at what were then the world's lowest interest charges and acquiring higher-value assets elsewhere.

"We are seeing a return of the carry trade in a slightly different form," Mr. Porter said.

"That's at least partly a factor driving some of the commodity markets and emerging market equities higher."

Some emerging countries, notably Brazil, are trying to take the heat out of their currencies and asset markets by limiting the inflow of foreign capital.

But no government is abandoning large-scale fiscal stimulus measures, and only a handful are contemplating such other bubble-deflating measures as higher interest rates.

"The bottom line is this: If you get off stimulus, you're going to cause a slowdown. But if you don't, you're going to cause bubbles," said Vitaliy Katsnelson, director of research with Investment Management Associates in Denver, who has long warned about bubbles brewing in China.

"Identifying such bubbles is a lot easier than timing their collapse," he wrote in a note to clients.

"But as we've recently learned, you can defy the laws of financial gravity for only so long."