ing, stories of price-earning ratios reaching 70 or higher suggest nothing but "irrational exuberance."

Considering various factors, one major market commentary optimistically noted last November: "The relative resilience of the other issues in the marketplace is encouraging and DSE 5,000 from the current level of 4,169 seems a realisable target by mid-2010."

DSE crossed 5,500 in February, and was still around then at the time of writing. Returning to 5,000 by middle of the year would require a correction of 9 per cent or so over the next quarter -- a modest adjustment all things considered. If we are lucky, we will avoid a bust this time round. But unless a range of regulatory, monetary, supply-side and socio-cultural issues are addressed, we will soon see another frothing episode. And we may not be lucky next time.

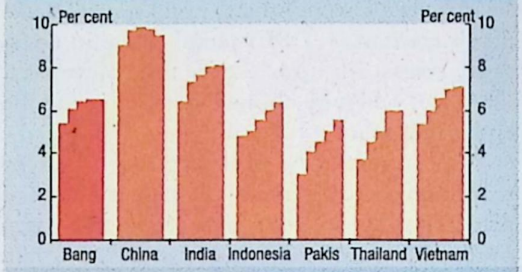
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Are there regulatory failures here? Have there been insider trading and other such efforts to drive up the market to unrealistic heights?

The Security and Exchange Commission is the agency in charge of regulating, and preventing illicit manipulation of, the share market. The SEC has taken steps to calm the market -- for example, conditions for margin loans have been tightened. However, it is vitally important that the SEC is seen as a credible and competent institution. And that credibility has been tarnished recently when this technocratic institution has been used to achieve partisan political ends in the DSE election.

While restoring the credibility of the SEC is

Chart 3: Forecast economic growth, 2009-14 (Bangladesh vs neighbours)



Source: IMF World Economic Outlook, October 2009. Regional growth outlook has been revised upward since then, but detailed country forecasts won't be available until later in April.

crucial, there may well be other factors at play here. Mansur and Haque (2009) eloquently point to the excess liquidity that may be fuelling up an asset price bubble:

Obviously when there is a lot of liquidity in the system, and money being fungible, there is no way to prevent people from borrowing on one account (for the officially stated purpose of trading, housing, agriculture and other uses) and investing in the stock market. As surging flood water cannot be contained by a putting a small/weak dam downstream and water simply bypasses or overwhelms/washes away the barrier, money keeps pouring into the stock market ignoring the SEC signals lured by quick capital gains.

While much has been made of the strong remittance flows during the global recession, it is not clear whether we understand why remittance held up in 2009. Similarly, we may not fully appreciate the unintended consequence of the strong remittance inflows. Strong remittance inflow underpins capital inflow into the country that is putting upward pressure on taka. If the taka is allowed to appreciate, it may hurt the manufacturing sector (exports-oriented or imports-competing) in a classic "Dutch disease" manner. But by pegging taka to the dollar, and thus allowing it to depreciate against the Indian rupee, the Bangladesh Bank may be inadvertently fuelling food price inflation.

And the dollar peg at an undervalued rate means the central bank is accumulating foreign reserves. Unless the surplus reserve is "sterilised" by the central bank selling instruments, money supply will rise. Money supply has been rising at an annual rate of around 20 per cent for the past year and a half -- the longest period of that rate of growth in the past quarter century (Chart 4). If there is excess liquidity in the economy, the impact should be visible in the