

Selected extracts from the April issue of Forum

The share market bubble?

JYOTI RAHMAN

AFTER bringing uncomfortable memories of 1996 to many minds over the last few months, the bull run in Dhaka Stock Exchange (DSE) seems to be in abeyance, at least for now. At the time of writing, DSE had fallen by about 1 per cent since the end of February.

While there have been reports of angry reactions of retail investors expecting sharp price rises, a modest price correction is a preferable outcome than continuing froth in the market eventually ending in a more severe bust.

Of course, such a bust is still very much possible. We are by no means out of the woods yet. But with luck, we will have avoided a collapse. Either way, focus should now turn to factors that fuel these episodes, and what, if any, can policy do to avoid them.

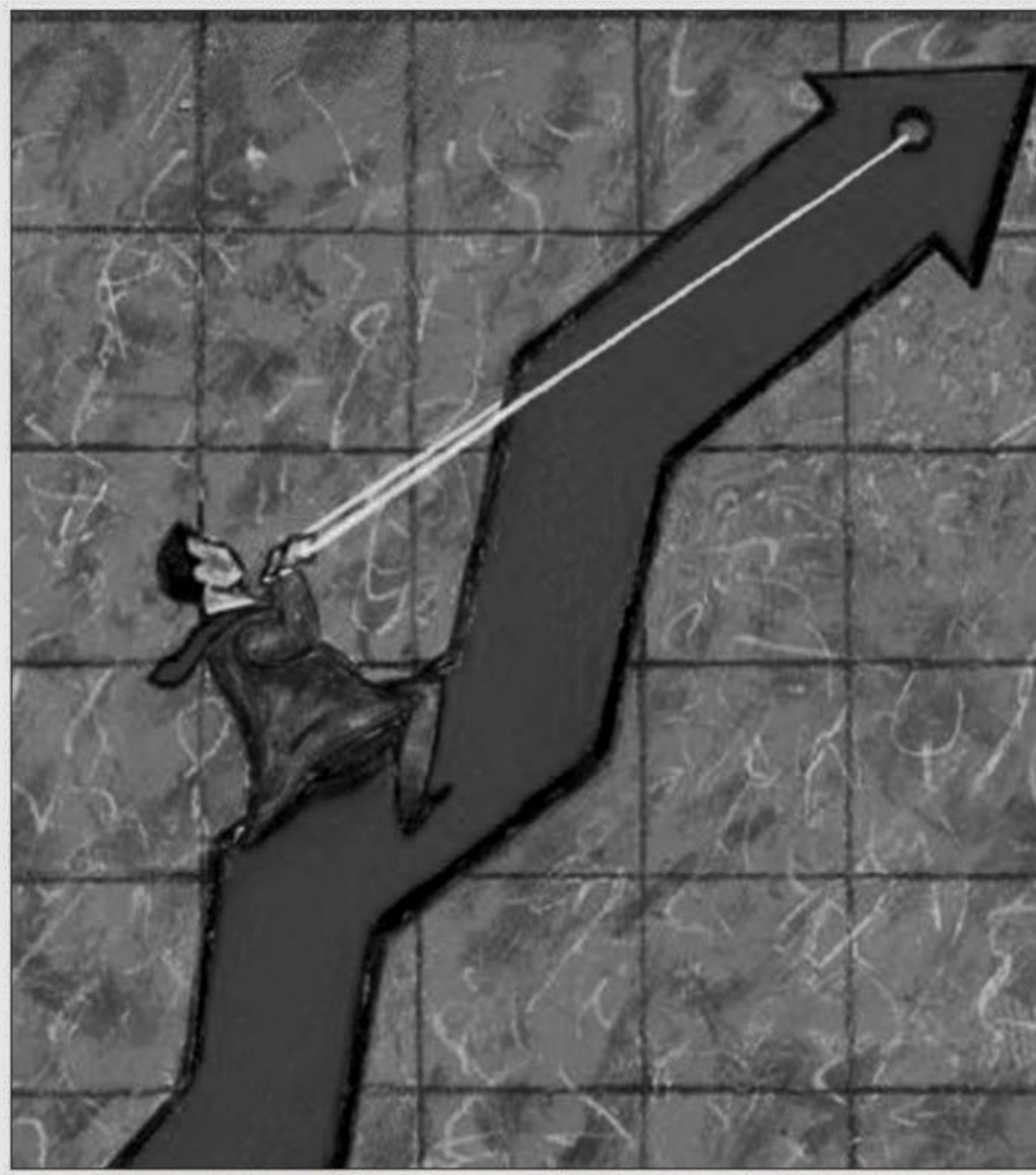
How does the recent stock market boom compare with that of 1996?

Chart 1 explores this. In this chart, the horizontal axis shows number of months since the beginning of the bull run, while the vertical axis shows the DSE indexed to that beginning. Back then, DSE started rising from January 1996. In November 1996 (that is, 11th month of the run), DSE peaked at 395 per cent of its January value. Now, the market is indexed to March 2009, when the global asset markets reached the post global financial crisis trough. Since then, DSE had risen by nearly 125 per cent by February 2010 (that is, the 12th month of the bull run).

Chart 2 compares DSE with other regional markets. While DSE's performance was relatively modest compared to those of our neighbours for much of the past half decade, DSE far outpaced other regional markets in the closing months of 2009.

Both these charts show that while the recent bull run may have had the hallmark of bubble in its acceleration, the price rises have not been as stratospheric as those witnessed in 1996, or what Ho Chi Minh City experienced in 2006 or Shanghai went through in 2007.

There are two reasons why Bangladeshi stocks



might be attractive for global investors seeking emerging market bargains. First, with only a small proportion of stocks held by foreigners, Bangladesh remains a hidden opportunity for international investors. And second, Bangladesh weathered the global financial crisis relatively well, with respectable growth expected

in the next half decade.

Regional growth outlook has been revised upward since then, but detailed country forecasts won't be available until later in April.

Industry level price-earning ratios can provide further insight. All else equal, a high price-earning ratio means the stock has a high growth

potential. But if price-earning ratio rises very quickly in the absence of any new information, then that might point to a bubble. Four industries -- cement, information technology, services and real estate, and textiles -- have seen price-earning ratio sky-rocket during the bull run.

There are anecdotes of an emerging housing boom that might be driving the real estate stocks. A housing boom, along with the expectation of an infrastructure boom in the coming period, may be driving the cement stocks. Over the past decade, per capita cement consumption has trebled, further buoying the sector's medium-term outlook. One can argue that various "Digital Bangladesh" initiatives may well have been boosting IT stocks. And textiles may have benefited from the resilience shown by the export sector.

But these positive outlooks notwithstanding, 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.

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

For the full version of this article please read this month's Forum, available free with The Daily Star on April 5.

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Who is the greatest of them all?



REHMAN SOBHAN

SITTING in the lounge of the Fulbari resort in Pokhara, Nepal, overlooked by the magnificent Annapurna mountain range, we watched Sachin Tendulkar, on a widescreen TV put the South African attack to the sword, en route to his record breaking unbeaten double century.

Our watching was unfortunately episodic, as we were in Pokhara to attend a board meeting of the South Asia Centre for Policy Studies, and our chairman, rather unhistorically, demanded a more regular attendance from us at the meeting. We, however, saw enough of Tendulkar, in full cry, to inspire me to revisit the age-old question amongst cricket lovers: Who is the greatest batsman of them all?

The Bradman Legend

To the cricket aficionado this may seem a rather redundant question. Sir Donald Bradman, the Don, was without question the greatest batsman of all time. He scored a record 29 centuries in test cricket in 52 matches and retired at the end of the fifth test at the Oval in the summer of 1948 with a test average of 99.94.

He had needed just four runs, when he went into bat in his last test at the Oval, to attain the magical average of 100. But as luck would have it, Eric Hollies, a rather mediocre leg spinner, who played for Warwickshire, bowled him for a duck. The Don could have redressed this joke on history in the second innings but the all-conquering Australians won the match against England by an innings, bringing to an end their historic tour of England with an unbeaten record.

Many have rated the 1948 Australia test team, led by the Don, as the greatest Australian team of all time. Other batting greats such as Sid Barnes and Arthur Morris, the opening pair, Lindsay Hassett and the brilliant left hander Neil Harvey who at 18 was making his debut in test cricket, backed up the Don at the crease.

This formidable batting line up was followed by the dashing and handsome Keith Miller, perhaps one of the greatest all rounders of all time, who could score a century as fast as he could bowl in partnership with one of the all time great fast bowlers, Ray Lindwall. I rate Miller who was also a brilliant slip fielder, as a superior version of Ian Botham, who was perhaps the leading all rounder of his generation.

In his time, when Bradman was invested with the accolade of the greatest batsman of all time, the distinction was challenged by the old timers, who spoke with reverence of W.G. Grace, who practiced his trade as a doctor and batsman in Gloucestershire in the late 19th century. Later this title was passed on to the Australian opening batsman, Victor Trumper, who was Neville Cardus' favourite. The mantle then fell on Jack Hobbs, the elegant opening batsman who was the mainstay of England's batting line up in the 1920s.

But at the end of the day, in the pre-World War II era, no one could remotely approach Bradman's capacity for accumulating runs against all types of bowlers, on all sorts of pitches, with such consistency and speed. Bradman, was not as handsome in his stroke play as Victor Trumper, Ranjitsinghi, or Hobbs. But Bradman could score fast and is the only batsman to score 300 runs in a single day of test cricket.

I have never had the privilege of watching Bradman bat, except in rather poor quality black and white videos of his career, where you can get a glimpse of his economical, yet efficient batting style. The first time we could hear if not see Bradman in action, was during England's tour of Australia in the winter of 1946-47. The English team, led by Walter Hammond, who was Bradman's closest rival in the 1930s to the title of leading batsman, had a strong batting side, with Len Hutton, his opening partner Cyril Washbrook, Dennis Compton, and Bill Edrich.

But their bowling line up was weak, with Alec Bedser, a medium fast seam bowler, as the only quality bowler. The English attack was slaughtered by the Australians, and the Don scored several centuries, including a double century, in an innings where he was partnered by Sid Barnes, who also scored a double century.

In those days, we listened to the matches on the radio where skilled commentators, gave us an accurate and exciting account of the state of play. But we did not have the visual pleasure of seeing the brilliant stroke play, or the movement of the ball off the pitch, all supported by action replays in slow motion, which makes the watching of cricket on the screen today no less exciting than seeing it live on the ground. I also heard the cricket commentary of the subsequent Indian tour of Australia in the winter of 1947-48, led by Lala Amarnath, who was also annihilated by the Australians led by Bradman, who continued to score centuries.

I finally recollect our religious presence, in the study of the headmaster of St. Paul's School, Darjeeling, where some of us were invited to come in after supper to listen to the live commentary of Don Bradman's last tour of England in 1948. The record of that tour was brilliantly captured by Jack Fingleton, who was an opening batsman for Australia in the 1930s but went on to be come a famous sportswriter, from where he wrote on that epic tour in his book, *Brightly Fades the Don*.

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Is the bull market sustainable?

AHSAN MANSUR

THE Dhaka Stock Exchange (DSE) is one of the best performing stock markets in the world in recent years. During the 4-year period since January 2006, the DSE general index has increased by more than four-fold to more than 5,800 in recent weeks.

The DSE gained further momentum with the Grameen Phone IPO in November 2009. Along with the price index, the market capitalisation has also increased rapidly, from \$3.4 billion in January 2006 to \$34.2 billion today.

The strong market performance also attracted an increasing number of small investors to the market, with the number of new Beneficiary Owners' (BO) accounts surging to high levels.

All these positive developments have opened up the potential for the stock market to become a real alternative to mobilise funds for investment, moving away from the traditional dependence on the banking system. However, while welcoming these developments, we also observe a number of disturbing phenomena, which, if unattended, may seriously undermine the sustainability of this positive trend.

Significance of healthy stock market

It is generally well accepted in economic and financial literature that both banking and stock

capital market, as reflected in terms of market capitalisation and turnover, has significantly changed this situation; the capital market is gaining its position as a sizable source of investment financing after the banking sector, which is a welcome development.

Market developments and sustainability depend on market fundamentals, and the fundamental strength of the market essentially comes from financial strength of the listed enterprises. Strong regulatory environment created and maintained by the regulatory bodies (like the SEC) and participation of institutional investors and professional market analysts help orderly market operations.

The problem comes when market prices overshoot fundamentals in a big way, transactions become speculative, and market becomes unstable in terms of prices, turnover, and volatility. Such developments are not new in Bangladesh; we experienced it in the boom and bust of 1996 (see box).

The global landscape is also littered with such boom and bust episodes, the recent ones being: the crash of the US stock markets in 2000 (NASDAQ tumbling from 5,100 to less than 1,600); Japanese stock market crash of 1989 with Nikkei tumbling from 31,000 to less than 10,000; the crash of GCC (Saudi Arabia, UAE, Kuwait, and Qatar in particular) stock markets in 2005; and more recently the crash of Chinese stock markets



market developments play important roles in output expansion, capital formation, and productivity gains, even after controlling for many other factors associated with long-run economic performance of an economy. Beyond the macro-economic relationship, even micro-economic studies of finance and growth, and firm-level data also find that financial development disproportionately boosts the growth performance of industries that are naturally heavy users external finance.

The banking sector, which dominates the financial sector in Bangladesh, has served the economy very well, and its coverage is broadly comparable with other developing countries. However, equity markets which generally serve as the second most important pillar of the financial sector, have significantly lagged behind in Bangladesh. The recent increase in investor interest in the Bangladesh

in 2007.

We must keep in mind that a sharp rise in stock prices does not necessarily mean formation of a bubble. Sometimes stock prices may rise sharply across the board when some things change fundamentally in the economy or in the economic outlook, as happened in the case of Spanish and Irish stock markets on the eve of their joining the EU. Several East European (former Soviet Bloc) countries also experienced surges in their stock markets because of their anticipated integration with the EU. Furthermore, no two bubble episodes are exactly the same across countries or across time. Each episode had its own features and unique background.

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Share the wealth

IFTY ISLAM

WITH the successful IPO of Grameenphone (GP), market capitalisation has risen to \$32.9 billion (30 per cent of GDP) versus \$3.2 billion and 6 per cent just 5 years ago. Turnover has increased by a factor of 30 times over the same period, averaging around \$140 million daily. While foreign participation in the equity market remains low at around 1 per cent, this lack of effective integration into global financial markets was undoubtedly a blessing in disguise in shielding Bangladesh from the bulk of the spillover from the global financial crisis.

However, there have been growing concerns from a number of capital markets observers that the Bangladesh stock market is becoming a "bubble." This might be defined either as a market where price levels are substantially in excess of fundamentally justified levels as a result of excess liquidity or potentially a speculative element whereby some investors are merely buying because prices are rising rather than by an assessment of fair value. Recently the finance minister has alluded to the "shallowness" of the market, whereby there is a growing demand/supply imbalance for stocks.

In this article we will be primarily focusing on how to increase the supply of equities, and deal with the issue of excess demand in a future

equity, it is worth taking a step back and looking at corporate financing considerations more broadly. Questions that have been analysed in the academic literature include: How do firms in developing countries choose between debt and equity? What role do domestic and international capital markets play in this choice? Is this choice influenced by the level of development of the stock market in a country?

Broadly speaking, economies can be characterised as being either stock market-oriented or bank-oriented. Traditionally, the UK and US economies have been regarded as being stock market-oriented while Japanese and German economies are regarded as being bank-oriented. In this framework, Bangladesh, like India and other countries in South Asia, can be considered a bank-oriented system.

Drawing on some of the work from Marvin Goodfriend, professor of economics at Carnegie Mellon University, one can characterise the evolution of corporate financing needs and strategy, and implicitly the growth of capital markets in developing economies, as follows: In the earliest stages of economic development, firms finance investment by building up savings from internally generated funds. Self-funding is supplemented by loans from close relatives, extended family members, friends in the community and the like. Such "inside" funding overcomes information and



piece of analysis. A combination of weak investment demand for capital investment from the corporate sector and strong remittance inflows has left the banking system with excess liquidity of up to Tk 35,000 crore at its peak.

This excess liquidity has manifested itself in asset price inflation in both equities and real estate markets. Clearly one solution to the supply/demand imbalance is for Bangladesh Bank to mop up excess liquidity through its money market operations. However, this should be done in conjunction with increasing the supply of new stocks coming to the market place. We will focus on measures to improve the supply side in the balance of this article.

Corporate financing decisions

Before we come back to assessing the prospects for Bangladeshi corporates to issue more

credibility problems, and provides an incentive for owners to use the funds energetically, as promised. The borrower is bonded by its close relationship to family and community. Indeed, close relationships monitor the borrower's behaviour and can enforce discipline on the borrower if need be.

As an economy develops, self-funding and inside funding become insufficient to finance firms that must manage complex production processes and serve broader markets. Firms must attract additional financing from external sources.

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