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Teck move shows credit-market thawing, but raises asset bubble concerns

BY ALIA MCMULLEN, FINANCIAL POST MAY 5, 2009

Key borrowing rates between banks are now lower than they were before the recent credit boom and bust, fuelling speculation among some analysts that cheap overnight money and continued fiscal stimulus injections are setting the groundwork for another asset bubble.

The three-month U.S. dollar interbank lending rate, known as the London Interbank Offered Rate (LIBOR), dropped below 1% to a record low of 0.99% on Tuesday, signalling government and central bank stimuli are working to quell the credit crunch. Libor -- a key determinant of short-term corporate bond and mortgage rates -- peaked at 4.82% following the collapse of Lehman Brothers Holdings Inc. in September last year.

Indeed, fresh evidence of credit-market thawing arrived Tuesday as Teck Resources Ltd. dramatically raised the size of its high-yield bond issue to US$4.225-billion from about US$1-billion as orders flooded in. The notes, at five, seven and 10-year maturities, were being sold at different with coupons around 10%.

While economies remain in recession, early signs of improvement amid a raft of government spending have raised the question whether governments can hit the eject button before another asset bubble takes hold, or whether it is already too late.

"The key risks seems to be that the extraordinary degree of monetary accommodation will ultimately boost growth in the emerging markets and this will put significant upwards pressure on commodity prices, and oil in particular," Riccardo Barbieri, an economist at Bank of America Merrill Lynch in London, wrote in a note. "This could present the advanced economies with the unpalatable scenario of slow growth and rising inflation and complicate the task for central banks."

Richard Rahn, a senior fellow at the Cato Institute, a non-profit body with a free-market bent, said the drop in interest rates and Libor would likely cause asset prices, which are currently cheap, to bubble, burst and ultimately send the U.S. economy into a double-dip recession.

Mr. Rahn said the U.S. economy was in a similar situation to where it was six years ago, when Federal Reserve chairman Alan Greenspan cut the benchmark interest rate to 1% in June, 2003, and kept it there for one year -- a move many cite as the driver of the U.S. house price bubble that ignited the financial market crisis.

He said commodity prices would rise, with oil likely hitting US$100 a barrel again before the end of the year, pushing up inflation and causing central banks to hike rates at a time where unemployment would still be high.

But not all believe the market turbulence of the past two years is about to repeat itself. Don Drummond, chief economist at TD Bank Financial Group, said an asset bubble was unlikely because financial institutions continued to experience problems raising funds. He said spreads for medium- and longer-dated government and corporate bonds remained high.

Furthermore, he said, Libor would not likely fall much further.

"If it did, I would think that would be a signal for the central banks around the world to start to mop up the short-term liquidity," he said.

Even so, Mr. Drummond was concerned the lower Libor rates were beginning to cause some institutions to load up on short-term funding.

He said central banks would also be tested in determining the right time to put an end to the run of stimulus spending because it was difficult to know if a recovery is underway until after the fact.

"Surely it's gone down in everybody's mind that it was an error of Greenspan's to have left the 1% rate in place for as long as he did. Hopefully that makes people lean to acting a little bit sooner," he said.