Canadian warns of economic bubble

William White one of few to predict 2008 market collapse

By Peter O'Neil, Canwest News Service January 13, 2010

Canadian William White, who is believed to be the only senior economist within the world of central bankers who warned publicly about pending economic disaster before the 2008 global meltdown, said Tuesday that new "bubbles" in the financial system are emerging -- and could burst.

White says he shares the dire concerns highlighted in this week's edition of the influential newsmagazine The Economist, which boldly declared on its cover: "Bubble Warning: Why Assets are Overvalued."

"I don't think it's alarmist or premature," he said.

White, a northern Ontario native who now lives in Switzerland, retired in 2008 from his role as chief economist at the Switzerland-based Bank for International Settlements, an international institution that advises the world's central bankers.

For more than a decade, White and one of his senior researchers warned in BIS annual reports and at public events that the global economy was facing growing risk because of speculative bubbles, particularly in areas such as the overpriced U.S. housing market.

While they weren't alone in expressing concern about weak government regulations covering the lending practices of financial institutions, they took the provocative position that central bankers should play a far more active role by raising interest rates to contain speculative excesses -- even during periods of low inflation.

Among those who dismissed White's concerns were Alan Greenspan -- the once-revered chairman of the U.S. Federal Reserve who held the position from 1987 to 2006 -- and current chair Ben Bernanke.

White says he agrees with The Economist's argument that the principal danger of speculative bubbles forming and exploding are in emerging economies such as China, where equity and housing asset prices are soaring.

White said equity prices in major industrialized countries, such as the U.S., appear overpriced by historical standards, though that factor isn't yet accompanied by two other factors associated with bubbles: a decline in savings rates and a rapid credit expansion.

"In a certain sense, all of that points in the direction of 'don't worry too much about the industrialized count-ries,'" he said.

But he expressed concern over estimates that the current equity market valuation in the U.S., while still well below its peak in 2007, remains at roughly the same level as two of the four valuation peaks of the last century -- those of 1901 and 1966.

He also questioned the health of financial institutions and pension funds that may have bet heavily on the current red-hot equities market, which could be on shaky ground if there's a price collapse.

"It's a variation of Warren Buffett's old line -- it's only when the tide goes out that you see who's swimming without a bathing suit," White said, referring to the billionaire American businessman. "When the asset prices go back down again because the fundamentals don't justify it, then we'll see who is swimming without a bathing suit."

White said he is reasonably satisfied with the regulatory reforms being brought in by governments to prevent a repeat of the global financial collapse, though he said too much attention is being paid to excessive bonuses, leading to the exclusion of more important issues.

For instance, he said governments have to consider stronger measures to prevent institutions from becoming "too big to fail."

He also disagrees with recent arguments from Bernanke, who delivered a speech earlier this month that took aim at critics like White.

Bernanke said a lax regulatory regime -- not central bankers' refusal to raise rates to cool speculative excesses -- was to blame for the U.S. housing market crisis. White said problems relating to poor supervision were a huge factor in the crisis.

But White said bubbles grew dangerously as a result of central bankers' willingness to continue a low-interest rate policy, which left the world awash in cheap money that in turn, fuelled the motivation to discover new and increasingly dangerous ways to invest it.

"The idea that the interest-rate environment had no role in fostering that kind of behaviour I think is just wholly implausible," White said.

Bernanke concluded his speech with a concession to his critics, saying the federal reserve would in fact consider using higher interest rates to deal with bubbles if regulations failed.

But White said central bankers should seriously consider the option of using monetary policy to "lean" systematically against excess credit growth that inflates asset prices and fuels excessive spending behaviour.