Higher US rates pose risks to emerging markets

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KUALA LUMPUR: The likelihood of rising interest rates in the US as the world's biggest economy starts to recover poses a major risk to many emerging economies, according to the head of research of the International Organisation of Securities Commission (IOSCO) Werner Bijkerk.

Besides the risk of the rising US interest rates in the US, Bijkerk also warns of a property bubble in emerging economies. He observes the signs of overheating real estate markets in these economies, including Malaysia, which could spread to the financial market through real estate-backed securities.

Bijkerk told The Edge Financial Daily in an interview that while financial centres in emerging markets are seeing huge demand for properties as strong economic growth attracts further investments and immigrations, some of the property projects don't really reflect the underlying demand of the market.

"So what you see is an overheating [property market], and what you see is that this is also going to spread to the financial securities market in the form of mutual funds, in the form of real estate investment trusts, and we are worried about that," he said.

However, he believes that Malaysia's capital market will be able to withstand the spillover effect of higher US interest rates. He also believes that the country's highly developed Islamic financial capital market and the deep bond market could act as a stabiliser to the overall health of the financial market.

"Malaysia is in particularly good shape due to a lot of reasons. One of them is its developed Islamic finance market, which is less correlated and less vulnerable with shocks coming from the Western world. So that will help, and we had seen that already in the previous crisis," said Bijkerk.

Malaysia has the largest Islamic bond market in the world, accounting for over 60% of the outstanding Islamic bonds, or sukuk, issued globally. As at last June, its outstanding sukuk stood at a whopping total of US$148 billion (RM488 billion).

The recovering US economy recently raised fears that the US Federal Reserve (US Fed), after years of maintaining a loose monetary policy, will start to increase interest rates. The US Fed will start raising rates if unemployment drops below 6.5%, while inflation stays under 2.5%.

The unemployment rate declined to 6.6% in January from 6.7% in the month before, the lowest since October 2008. A year earlier, the unemployment rate was at 7.9%. Inflation rate was at 1.6% in January and is expected to remain at the same level in February.

"One thing you can say with Malaysia having experienced the Asian financial crisis is that it is now better prepared. The structure of the economy and the financial market has much improved, and I think the quality of the regulation as well," said Bijkerk.

While the outflow of funds from emerging markets to developed markets has sent equities and bond prices down since June last year, Bijkerk said the affected financial markets have staged a rebound and have adapted to the situation relatively well.

The Indonesian rupiah, one of the worst battered currencies last year due to the outflow of foreign funds, has gradually regained some lost ground so far this year. The currency appreciated by 3.52% year-to-date to 11,740 against the US dollar.

Bijkerk said some policymakers in the emerging markets have been able to respond decisively when confronted with the outflow of funds. The improving economic climate in the developed markets has also strengthened the external positions of many Asian countries, as their products are more in demand.

“Countries around the world have taken strong policy actions by increasing interest rates and heavily intervened in the currency markets. Some economies are suffering, but some are virtually fine.

“The balance, we have yet to know, but it looks not too bad. If you look into the crystal ball, economic growth in the US and Europe has slightly recovered, which acts as a counterbalance to the external positions of the Asian countries,” he said. Bijkerk was here to attend the IOSCO board meeting held by the Securities Commission Malaysia last week. It was the first time the meeting was held in Asia.

The meeting discussed various key issues facing global financial markets and securities regulators, with issues pertaining to emerging markets deliberated extensively by the board.

According to IOSCO chairman Greg Medcraft, this meeting reinforced IOSCO’s role as the key global reference point for securities regulators, industry and policymakers in supporting the accelerating importance of market-based finance.

IOSCO is the leading international policy forum for securities regulators and is recognised as the global standard setter for securities regulation. The organisation’s membership regulated more than 95% of the world’s securities markets in more than 115 jurisdictions.