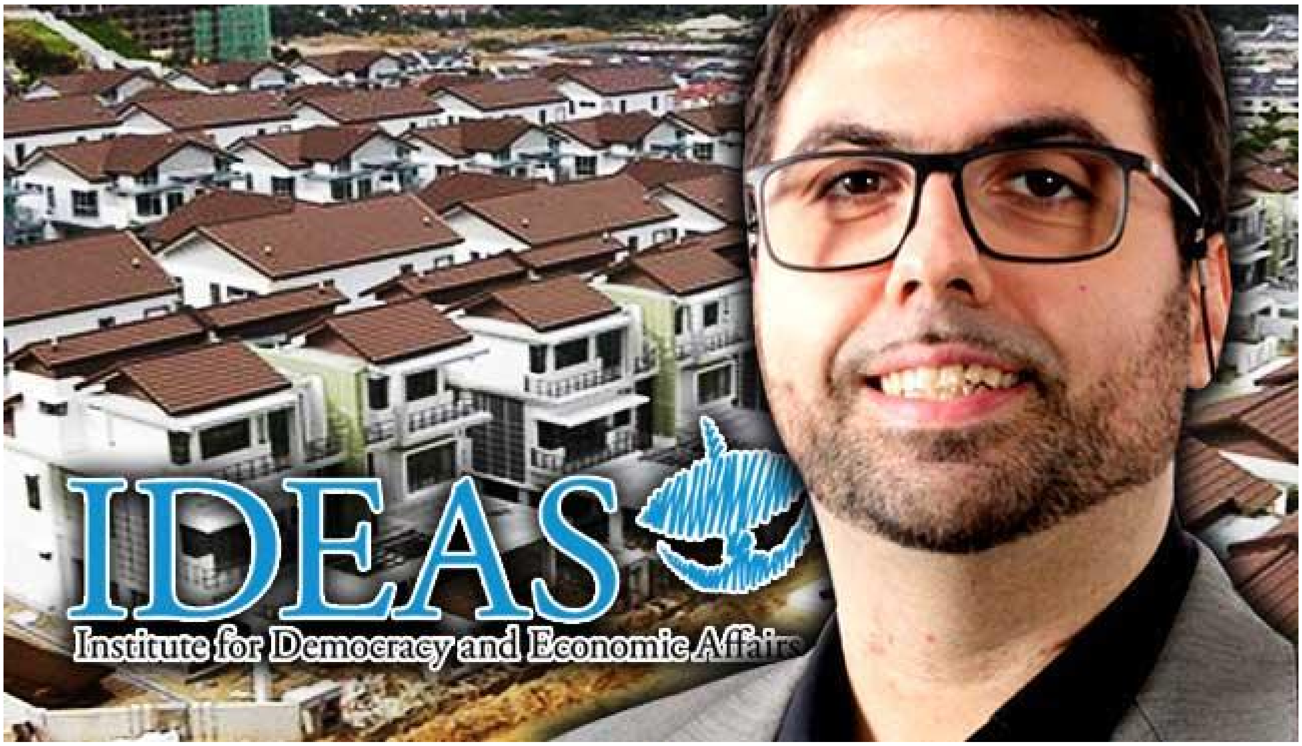
Property market bubble set to burst, says think tank

Robin Augustin | August 20, 2017

Economist says high number of unsold properties suggests property market close to crashing.



PETALING JAYA: The property bubble in Malaysia is set to burst, but the government must resist the temptation to intervene and allow market forces to coordinate supply and demand, says a think tank.

In an interview with FMT, the Institute for Democracy and Economic Affairs' (IDEAS) senior fellow, Carmelo Ferlito explained the two "economic dynamics" which have resulted in the current property situation in the country, where the prices of homes are beyond the reach of most and the oversupply of such homes, has led to many being left unsold.

Figures from the National Property Information Centre (Napic) have indicated that as of the first quarter of 2017, some RM10.08 billion worth of residential units are unsold in Malaysia. This figure does not include serviced apartments, which have since 2015, been classified as commercial properties.

For some time now, the discourse over unsold properties in the market has focused on two key contributing factors – the prices of homes that are too high and the difficulty buyers have in obtaining bank loans.

What hasn't really been explained, says Ferlito, was why the prices of property in the country are as high as they are.

"Malaysia is undoubtedly experiencing a housing bubble and the unsold properties are a natural consequence of this bubble.

"This bubble is due to two specific economic dynamics. The first is the natural business cycle, and the second is the intervention by the authorities," Ferlito said.

Expanding on what he meant by the natural business cycle, Ferlito said it began when the property market was expected to boom after the end of the 2008 global financial crisis.

"When an industry is expected to boom it attracts investors, such as developers and usually, it is the first wave of investors who really benefit from the boom.

"This in turn attracts new investors, which in this case, are the speculators who are looking to make a quick profit. They further contribute to the property market boom."

He added that the property market boom had a positive impact on related industries, such as the construction sector and businesses involved in the supply of raw materials.

"A direct result of this demand has seen property prices rising, and the ensuing growth in the need for more resources has seen prices on the production side of the equation, such as labour and materials, also increasing."

He said this inflationary expansion was reflected in the selling prices, and that the second wave of investments only made the situation "hotter".

"So when there is a boom, there is this very positive feeling in the market and it moves consumers towards 'desiring' new properties which furthers the inflation."

A case of intervention amplifying inflation

On the intervention by authorities, Ferlito said that while the natural business cycle was unavoidable, the resulting inflation was made worse by external intervention, particularly the low interest rates set by Bank Negara Malaysia (BNM).

"Essentially, all central banks fix base lending rates (BLR) on the assumption of knowing what the appropriate level is.

"However, when central banks set the interest rates, it is sending 'wrong signals' to the market.

"If banks were free to set the interest rates based on what free market proponents are pushing for, you would see interest rates that better reflect the relationship between supply and demand."

Ferlito said problems arise when the BLR is lower than an interest rate that would have been derived from the relationship between supply and demand.

"This means that the BLR may be artificially lower than what it should be. This makes it easier to borrow money and so people may invest in properties because it is 'cheaper' rather than because they want to purchase a property".

Ferlito explained that this could lead to higher inflation and wouldn't be sustainable simply because there is a mismatch between supply and demand.

"So the prices keep going up even though they aren't reflective of the relationship between supply and demand. At a certain point, to stop the inflation, central banks will raise the BLR."

Avoid intervention when market crashes

When the banks raise the BLR, the property bubble is bound to burst and this will affect developers, who are in the midst of developing new properties, and speculators.

"If the BLR increases, then developers who took loans to build new projects may not be able to repay those loans and their projects could be abandoned.

"As for the speculators, with the increase in interest rates and a lack of demand to meet their supply, they will have little choice but to either slash their rent or selling prices for their units."

Ferlito said the number of unsold properties was a sign that the property bubble may have reached its final stage and that the property market was close to crashing.

"But the property market crashing can be seen positively if we're looking at the goal of reducing housing prices.

"In a situation where there is over-supply and high prices, we should let supply and demand do its job and let the market affect prices to the levels they should be."

Ferlito said it would be crucial for Bank Negara to refrain from supporting the property industry by then lowering interests rates or the government bailing out developers.

"Intervention will only result in a longer and more painful crisis with prices kept artificially high by the central bank when the market is demanding for lower prices."

Last year, economist Hoo Ke Ping predicted that Malaysia would be hit by a recession in 2018, resulting in among others, the prices of medium and high-end properties dropping.

Previously, property expert Ernest Cheong, warned that the glut of unsold luxury properties could result in a financial crisis.