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Need to stabilise house prices

WARNING SIGNS: **High house prices not only threaten the health of the global economy, but also have an impact on inequality**

By Mazlena Mazlan

EARLIER this month, Min Zhu, the deputy managing director of the International Monetary Fund (IMF), gave a speech at a conference in Germany, followed by a post on IMF's blog a week later, warning the world against a "benign neglect" of house price booms.

He made three important points. **FIRST**, while housing is an essential sector of the economy, it is also a major source of vulnerability. More than two-thirds of the economic crises of recent decades were preceded by boom-bust patterns in house prices.

SECOND, an overvaluation of the housing market is not easy to detect. A detailed look is necessary to tell whether a market is overheating and thus heading for an impending bust, rather than merely looking at broad measures such as price-to-rent ratio.

THIRD, despite the influence of the housing market in causing crises, the "policy toolkit" to contain housing booms is still under construction.

It has been more than a week since Zhu's blog post, yet the media worldwide is still picking up his statement. With the housing market strongly moving upwards everywhere, the continuing media attention demonstrates the mounting concerns that house prices are getting overstretched.

There is evidence supporting the concerns. The global house price index has seen seven consecutive quarters of growth. While in some markets, it is a sign of recovery from the financial crisis, in most it is a sign of a growing bubble waiting to burst. The IMF has begun to more actively monitor the housing market by recently establishing the Global Housing Watch. High house prices are important, not only because they pose a threat to the health of the global economy. It also has an important impact on inequality.

A booming housing market favours people who can borrow. Even when the authorities raise lending rates to cool down the market, the gap in the ability to borrow, and thus to own properties, will widen even further.

The IMF has released specific country reports focusing on the housing market as early as 2012. The report for Malaysia was released last April. It highlighted that our housing market has been in the upturn for 30 consecutive quarters, which is actually not news to Malaysians. But the report also highlighted three other salient points that may not be obvious.

FIRST, factors that historically determined Malaysia's house prices do not significantly explain the recent upturn. In simpler terms, there are new elements at play. The danger is that neither the IMF nor the Malaysian authorities know what these new variables are. A disease with unknown causes has no cure.

SECOND, the behaviour of residential loans does not seem to contribute to the recent price dynamics. This second point may be IMF's nice way to say that our macroprudential policies undertaken so far did not manage to dampen house prices, although it justifies this by acknowledging that these policies were intended to reduce lending for speculative purposes rather than to stabilise house prices.

THIRD, house prices are diverging further away from rents and incomes. The price-to-rent and price-to-income ratios for Malaysia have risen by more than 30 per cent since the last quarter of 2008.

The IMF country report for Malaysia highlighted ***that our housing market has been in the upturn for 30 consecutive quarters****, and that there are new elements at play in the recent upturn in house prices.*

Regardless of Zhu's view that these don't necessarily imply overheating, the divergence is still inherently unsustainable.

What are the implications of the IMF findings to our efforts to contain house prices?

FIRST, the IMF findings suggest we have taken a trial-and-error approach in stabilising house prices. The Malaysian authorities have announced 10 rounds of cooling measures, the latest being an effort seen as curbing the operations of the "property investors' club".

Yet, the Malaysian House Price Index is more than 40 per cent higher than it was in 2010. Not exclusive to Malaysia, because other countries have also taken many rounds of cooling measures, only to see prices accelerate even further.

SECOND, there must be a carefully thought-out policy mix that takes into account the various clever outmanoeuvring, for example the collective buying by "investor's clubs" and "holding companies" to manipulate the tax and lending policies. Supply-side measures must be included, such as efforts to seek market-friendly ways to reduce constructions costs and encourage competition in the industry. Perhaps it is time for macroprudential policies to deliberately seek to reduce house prices.

THIRD, the rising price-to-rent ratio can mean good news. As of April, rents were only around eight per cent higher than they were in 2010, which means that people can still afford to rent. Nonetheless, the rental market is beginning to build its upward momentum. It may be a sign that instead of a correction in price, we may see rents rising to catch up with prices. Both scenarios would be painful.

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