

The Real Estate Sector and Thailand's Economic Stability

The importance of the real estate sector to the Thai economy extends beyond its shares to GDP and employment of 8 and 6-7 per cent, respectively. To a significant degree, the sector's performance has implications on economic stability, through linkages with financial stability and household wealth - with the latter helping to determine aggregate consumption and investment. Pre-crisis over-investment in the real estate sector brought about considerable non-performing loans (NPLs) that threatened the soundness of the commercial banking system and its ability to extend credits in the ensuing years. Today, loans extended to the real estate sector account for 15 per cent of total commercial bank loans, of which a higher portion goes to residential mortgages whereas a lower portion goes to property developers compared to the pre-crisis level.

Table 1 Relevant statistics of the real estate sector

	1996	1997	1998	2001	2002	2003		
						Q1	Q2	Q3
Investment in the construction sector/GDP (%)	11.9	6.2	3.5	3.2	3.6	3.8	4.1	4.4
Employment (% of total)	5.8	6.0	5.2	5.8	5.8	8.4	7.2	6.7
Loans to real estate sector/total loans (%)	17.8	15.5	17.7	13.9	14.1	14.3	14.7	15.1
- Residential loans	8.9	7.4	7.9	8.3	8.7	8.8	9.2	9.6
- Loans to property developers	8.9	8.1	9.8	5.7	5.5	5.4	5.5	5.5
Commercial bank loans to real estate sector/GDP (%)	18.7	19.8	20.1	11.7	12.0	11.5	11.8	12.1

Source: Compiled by the Bank of Thailand

Changes in property prices affect the economy in various ways, namely through: (1) the bank credit channel to private investment, the magnitude of which depends in general on both households' and firms' initial balance sheets and the exposure of the financial sector to the real estate industry. The credit channel effect can be quite substantial in Thailand, particularly because bank loans constitute a principal source of funding for households and firms. Indeed, total commercial bank assets, a large portion of which is bank loans, exceed Thailand's GDP - a noticeably large ratio; (2) the effects on inflation, which are twofold - indirectly via aggregate demand and directly through households' housing-related expenditure, which, at 25.8 per cent of the CPI basket and largely in the form of rent, can be sizable albeit with considerable adjustment lag; (3) the impact on fiscal condition through property tax, which amounted to approximately 5.2 billion baht during the first 9 months of 2003; and (4) the indirect wealth effect on private consumption and inflation. However, the last channel is not expected to be sizable for Thailand, given the relatively low rate of home ownership of Thai households and the limited size of the second-hand housing market. In fact, according to a National Statistical Office's (NSO) survey, only 53 per cent of Bangkok households are homeowners, compared with 70 per cent of households in the UK and the US.

Property price and monetary policy

In recent years, asset price inflation has occurred under a low consumer price inflation environment in several industrial economies. These experiences have given rise to a debate over the role of monetary policy.

Most central banks agree that asset prices are too volatile to be an additional target but should be used as indicators to aid the forecasting process. The MPC views the property price cycles as a fixture of the economy. Nevertheless, not every boom and bust has to lead to a financial crisis. The consequences on the real economy depend on the wealth effect and the role of bank credits in the economy. As property price tends to lead inflation and react to interest rate changes, a monetary regime that promotes price stability such as inflation targeting can help moderate the asset price cycles to some degree. Without the pressure on the general price level, however, monetary policy only plays an indirect role, while the central policy elements rest with the promotion of financial system resiliency.

Understanding the BOT's preventive measures

In the past 2-3 years, the real estate sector has continued its recovery. Although prices have not risen much, the exception being condominiums in the central business district (CBD), as an exception, the BOT has taken preventive anti-speculation measures and plays its part in promoting good corporate governance by stipulating that financial institutions: (1) lower the post-construction loan-to-value ratio to 70 per cent for residential property with the transaction price exceeding 10 million baht; (2) extend credit to property developers only when the projects are legal; and (3) report to the BOT on new real estate loans made over 100 million baht on a quarterly basis. Aiming to monitor real estate credit and financial stability, measures (1) and (2) took effect on 1 December 2003 while (3) became effective as of 9 December 2003.

Table 2 The necessary indicators of the real estate sector

High priority indicators	Other indicators
1. Housing price index	4. Housing quantity demanded
2. Land price index	5. Housing completion
3. Housing starts	6. Housing quantity supplied
	7. Transaction values of land and houses, according to classified by types
	8. Property credits
	9. Commercial real estate price index
	10. Cost of production e.g. construction material price index

Source: Surveyed by the Bank of Thailand

On the data front, Thailand still lacks a systematic set of property sector indicators. The existing collection of data is compiled by several agencies for their own specific purposes. Being aware of the important role the real estate sector played in the economy, the MPC requested that the BOT initiate the construction of the housing price index and cooperate with relevant agencies to bring about a systematic set of indicators, both from the perspectives of demand and supply. A conference convened by the BOT and participated by developers, banks, valuation and other state and non-state agencies was unanimous in their opinions that 10 property sector indicators were deemed necessary, 3 of which should take priority. They are the housing price index, the land price index and housing starts. The BOT has taken responsibility in the construction of the housing and land price indices while the rest of the indicators will be put together by the agencies directly responsible for the relevant data. Moreover, the BOT will coordinate with these agencies to monitor progress periodically.