Roles of a Central Bank in Monitoring Real Estate Market

Ruja Adisornkanj
Economist
Economic Intelligence Team
Monetary Policy Group

Real estate sector grew significantly last year, reaching historical record in the last 13 years thanks to various positive factors; economic growth and low interest rate. Moreover, the government realized the important role of the real estate sector as an economic driving force due to its high linkage with other economic sectors. Thus, the real estate stimulus measure had been imposed and was one of contributing factors for last year's remarkable real estate growth. This development on real estate sector was closely monitored by policy makers including the Bank of Thailand (BOT). As a central bank, the BOT also monitor factors contributing to real estate stability as parts of policy formulation. To make accurate assessment, comprehensive information and indicators are necessary.

One of the most important indicators used to indicate real estate imbalance is "price". As continual increasing in house price represents a "thermometer" for measuring bubble in the real estate market. Like the US's experience, its house price, prior to the subprime crisis, had increased approximately 10% annually for more than 10 consecutive years before the bubble burst. Realized the essential role of this indicator, the BOT continues to develop the house price indices by selecting suitable variables with a statistically significant number of observations. The new house price indices are expected to be released to the public soon.

These new house price indices are classified into 3 indices - single detached house with land, townhouse with land, and condominium. The indices are aimed to measure house price movement associated with demand pressures. They can be monitored in order to identify imbalance in overall housing market but not appropriately be used as early warning indicators.

As for the methodology, the most reliable means to measure house price movement is repeated sales method used by countries where second-hand housing market is large and the database is reliable. The repeated sales pricing technique allows us to measure price movement of the same house recorded on each transaction. However, in case of Thailand, the limitation of data collection system causes difficulty in construction of house price indices via this methodology. Therefore, hedonic regression methodology is employed as an alternative way to construct the indices.

In general, movement of house price consists of 2 parts. The first part is the price movement caused by changes in characteristics of the house itself such as age, number of floor, location etc. The latter part is the price movement caused by anything else. Importantly, a change in demand is one of contributing factor we focus on in this latter part. It depends on changes in demography, incomes, taste, and investment appetite, etc. Movement of the hedonic house price indices represents a change in price of the house with similar characteristics over time, thus they measure price change associated from the latter part.

Nevertheless, factors contributed to change in house price other than its characteristics may depend on many factors including change in demand and production cost which cannot be differentiated by the hedonic method. Consequently, the new house price indices should be utilized with caution. For instance, if hiked house price is observed, it should not jump into conclusion that adverse speculation happens and will definitely cause damage to the economy. Analysis on length and magnitude as well as root causes of the increased house price should be further investigated together with assessment on other indicators such as mortgage loan and delinquency ratio. As in the real world no single indicator can be considered a magical mirror that foretells the future correctly. These house price indices alone, therefore, cannot be relied completely on by policy maker in order to make policy decisions. But they are other indicators used to assess imbalances in real estate market.

Besides the assessment on price and other real estate indicators, dialogues with real estate entrepreneurs, consumers, and financial institutions also provides valuable information, for macroeconomic policy formulation that help facilitate or, at least, avoid hampering business activities.

(The views expressed in this column are the writer's own.)

Published in The Nation on Monday, July 25, 2011