

The Role of Credit Regulation in Ensuring a Sustainable Property Industry: A Commentary

Rahah Ismail, Ph.D.
Research Programme, INSPEN
Valuation and Property Services Department

Received: June 1998

Revised: October 1998

Abstract

The property sector is an important sector of the economy. It has strong linkages to more than 130 local industries. A sustainable property industry is, therefore, of great importance to the economy. However, sustainability in the property industry requires some degree of price stability. Most of the 1990s were characterised by excessive lending by financial institution to the property sector. Such a large exposure not only causes distortion in property prices but also poses a threat to its own sustainability. This paper discusses the need for credit regulation in ensuring a sustainable property market.

Keywords: Credit regulation, asset inflation, sustainable property industry, non-performing loan, price stability

Introduction

Credit growth and property prices are somewhat linked. In a study by Bank of Japan (Bank of Japan, 1990, cited in Hutchinson, 1994, pp.62), which investigated the rise of land prices in the 1980s it was concluded that, "a higher growth in money supply under relaxed monetary conditions has usually been a source of land price increase". Bank of International Settlement (The Banks for International Settlement, 1993 cited in Hutchinson, 1994, pp.62) draws a connection between monetary policy and asset price movement through credit channels. It established that "easy monetary policy played a crucial part in the rapid credit

growth during the asset upswing, particularly in some of the countries experiencing the largest price cycles". The excess liquidity is vented through asset inflation. Asset inflation, however, is not supportable and a crash is inevitable. When this happens, it has a far-reaching impact on the rest of the economy. In particular, if the banking sector is over exposed to the property sector, it will cause instability to the financial system.

In Malaysia, most of the 1990s were characterised by excessive lending by financial institutions to the property sector. This was against the background of rapid

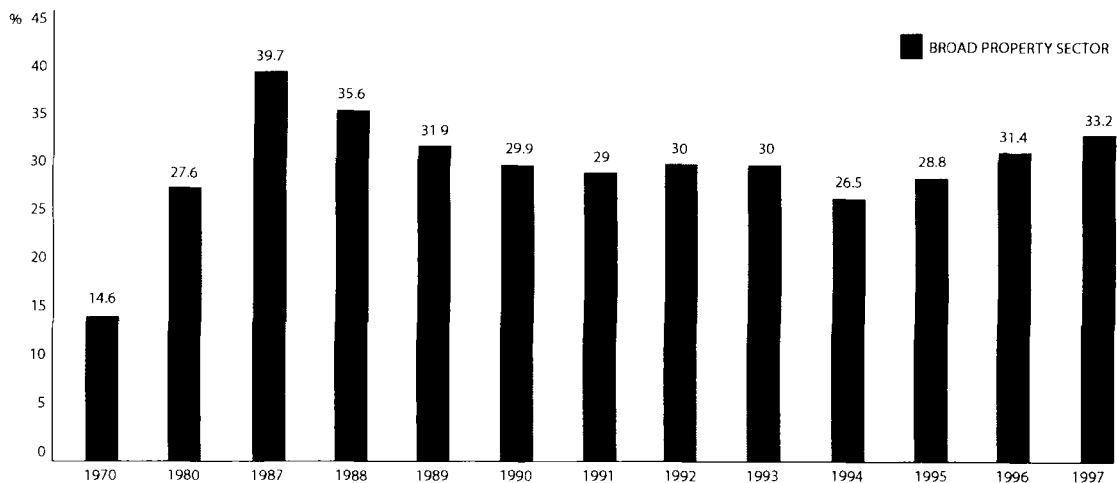
economic growth and rising levels of income, which translated into greater spending power for most people and property were much sought after. Banks driven by the profitability factor were only too willing to give credit to the lucrative property sector as returns were good. Supported by the borrowing from banks, there were vigorous investments in properties. As at the end of 1997, loans to the broad property sector made up more than a third of their total loans. Such large exposure to property, not only causes distortion in the flow of funds in the economy but also distortion in property prices.

Asset inflation during this period raises concern about affordability, as property prices, especially the residential properties, have moved to unrealistic levels. It has become unaffordable for most, as the upward movements in property prices do not match the movement in the level of income. It reduces the prospect for home ownership and is disruptive to the general economy.

Speculative activities supported by readily available credit facility are known to fuel the inflationary trend. This has led Bank Negara to take regulatory measures to curb asset inflation. As early as 1995, measures were introduced to curb exposure to this volatile sector of the economy. This was reinforced in March 1997 when Bank Negara introduced lending curbs to certain categories of the property sector and the share market. In 1998 the monetary restraints continue.

This paper attempts to give commentary on the credit regulation and its role in ensuring a sustainable property market. The first part of the paper highlights the extent of credit expansion into the property sector. The second part discusses how credit expansion in the property sector promotes the acquisition of properties and its impact on property values. The third and final part discuss the lending policies to the broad property sector and its implications.

Figure 1: Credit Growth in the Property Sector 1970 – 1997



Source: Bank Negara Malaysia, Annual Report 1970 – 1997

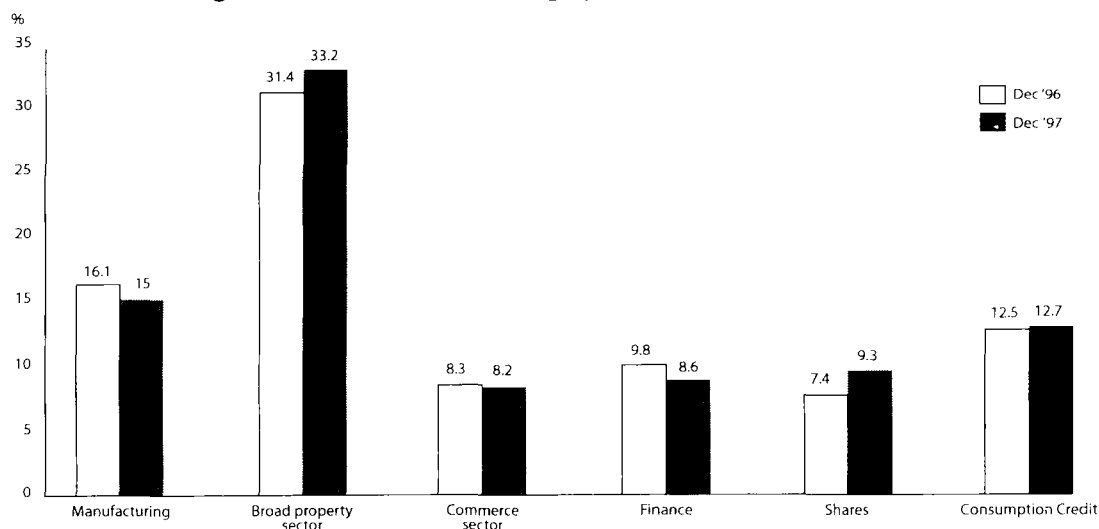
Credit Expansion in the Property Sector

From 1957 to 1996, except for the brief recession in the mid-1980s, Malaysia experienced relatively uninterrupted growth. Between 1960 to 1984, the real GDP grew at an average rate of over 6 per cent. After the recession of the mid 1980s, the economy rebounded, with a strong growth of an average rate of over 8 per cent. In 1996, the real GDP growth was 8.5 per cent. However, in 1997, in the wake of the regional economic crisis, the real GDP moderated to 7.8 per cent.

In line with the remarkable economic growth is the strong in money supply reflected in the high credit growth. In April 1996 the credit growth peak to 31.6 per cent. At end of March 1997 in spite of signs of overheating in the economy, the credit growth was still high at 30.5 per cent exceeding the credit plan target of 25 per cent (Bank Negara Malaysia, 1997). In terms of credit distribution, the broad property sector consumes the most share of the credit.

The credit expansion in the broad property sector is phenomenal. Prior to 1970, loans extended to the broad property sector (real estate, construction and housing projects) by the commercial banks were scarce. The World Bank (1989) described loans to this sector by the commercial banking sector as non-existent at that time. It was only after the introduction of the New Economic Policy (in line with the Government's objectives of promoting home ownership) that loans to property sector, in particular housing loans, began to expand. The expansion also coincided with the rapid industrialization and urbanization of the country and the growth of new households (Bank Negara Malaysia, 1989). As owning a property is every man's dream, with improved economic performance, banks see real estate as having good prospects to the bank's lending business. Banks readily channelled funds into this sector and were enthusiastic in lending to this sector. In less than three decades, loans to the property sector by commercial banks had expanded to more than 30 per cent in 1997.

Figure 2: Direction of Lending by Commercial Banks in 1997



Source: Bank Negara Malaysia, Annual Report 1970 - 1997

As mentioned above, loans to the broad property sector comprise the largest slice of the commercial bank's advances. As shown in Figure 2, in 1997, other sectors like manufacturing and services that propel the economy were not allocated as much funds as the property sector. This raised the question of whether the funds were properly allocated and channelled for macroeconomic growth and stability. Growth in such sectors contributes to job creation and ensures that the standard of living, employment and wages do not stagnate.

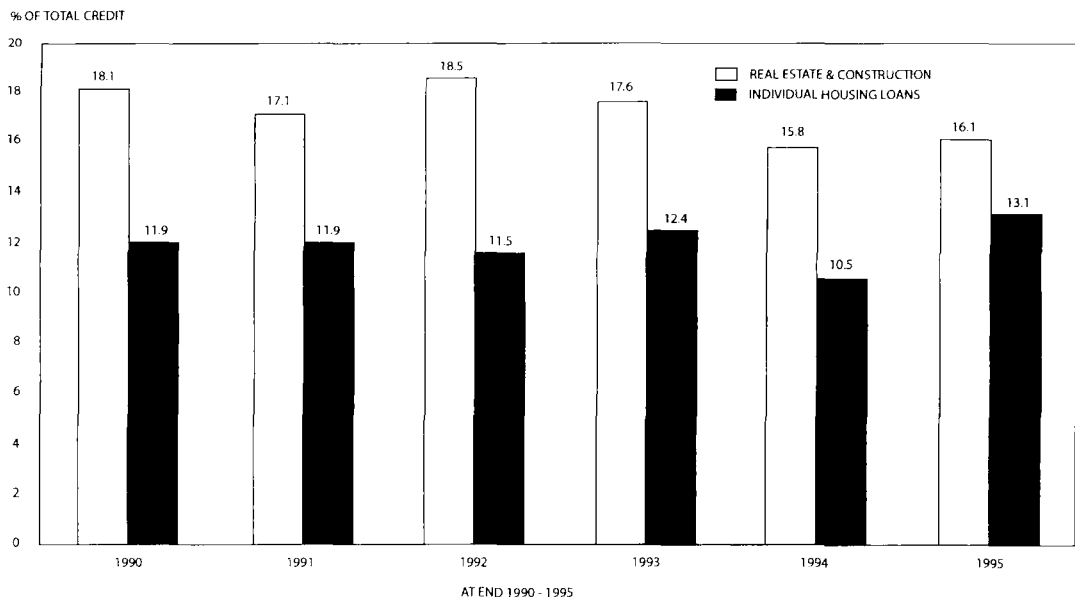
In the broad property sector, housing consumes the most credit. As shown in Figure 3, the housing loan sub-sector absorbs a significant proportion of loans to the broad property sector. This is in line with the government's home ownership objectives. In addition to credit supplied by the commercial banks, the Government also provides its own

housing loan, thereby adding the supply of credit for house purchases. Although the main objective is to encourage home ownership, there is no way to determine whether the purchase is purely for owner occupation or for speculative purposes.

Supply of Property Finance and Property Values

In line with the remarkable economic growth in Malaysia, the property industry and in particular, the housing industry flourished. The growing population and the increasing disposable income coupled with easy access to finance have led to a high demand for housing. Residential development has taken place at a rapid pace in response to demand. In Klang Valley, for example, the total supply of new housing for the period 1990-1993 was 151,966 units with an average increase of 145 per cent.

Figure 3: Distribution of Credit in the Property Sector



Source: Bank Negara Malaysia, Annual Report, Various Years

Development lands were very much sought after there were increasing amounts of plantation land being converted for mixed development (VPSD, 1994).

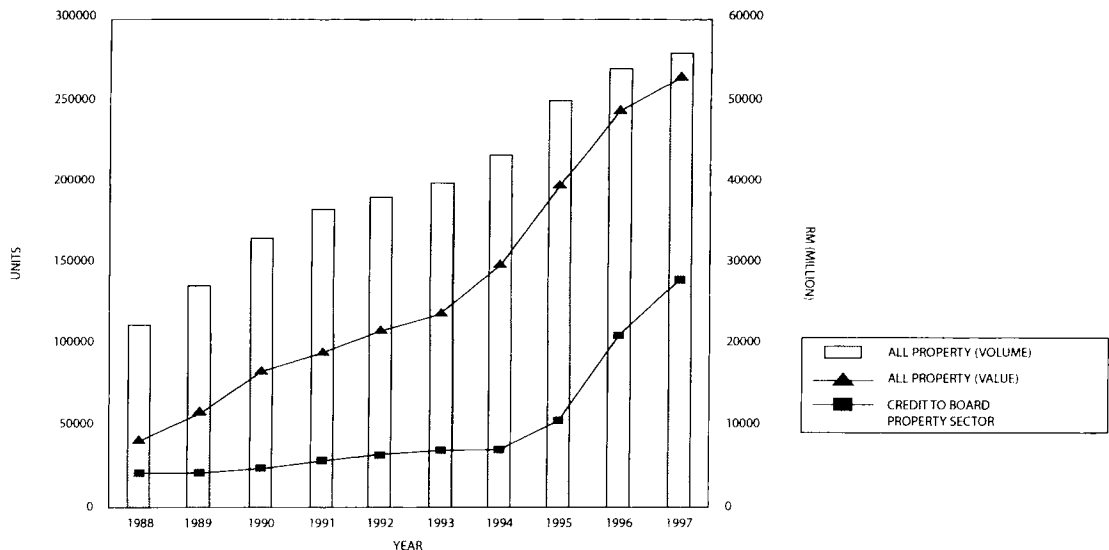
Encourage by the thriving growth of the property industry, many public-listed companies ventured into property development. In 1970s there were only about four public-listed companies involved in property development (Johnstone, 1982) In early 1990s the number grew to almost 40 (Ismail, 1997).

By virtue of being public-listed companies, these companies are required by the Securities Commission to hold sufficient land banks at strategic locations in growth areas to support development for a period exceeding five years^{1,2}. Supported by loan syndication from financial institutions, most public companies

expanded their land acquisition to meet this requirement. Thus, these corporations have vast land banks. For example, between 1990-1994, Dynamic Management Sdn Bhd, subsidiary of IOI and Lam Soon Huat had a 1000-acre site in Puchong to be developed as Bandar Puchong with 13,500 units of mixed development. Austral Enterprise, a subsidiary of Island and Peninsular Berhad, owns 1,990 acres of rubber land in Puchong. It has been given approval for supply of 20,000 units. Shah Alam Properties Berhad has a 1,000-acre site to be developed into Bandar Baru Selayang (Ismail, 1997). Land dealings in major towns became more active and land prices rose dramatically.

The quantitative expansion of credit into the property sector further stimulated demand for land and encouraged price speculation. Figure 4 illustrates the influence of credit

Figure 4: Property Finance, Volume and Value of Transactions



Source: 1. Valuation and Property Services Department, Property Market Report, Various Years
2. Bank Negara Malaysia, Annual Report, Various Years

expansion on the volume and value of property transactions.

As more funds were allocated for the property sector, the volume and value of transactions increased.

Ironically, with the escalation of property prices, property transactions do not contract in response to the sharp increase in prices, but instead the volume of transactions increases. First, this may be due to the general perception of the people that if property is not bought now, the price is going to increase further. Second, it

is driven by speculative criteria rather than in investment fundamentals. This can be easily proven as price has little or no relationship to the rental income. For examples, in the case of a residential property, taking into account of the acquisition price and the holding costs, i.e. mortgage rates and annual outgoings, rental income certainly does not appear to be the investment consideration. As illustrated in Table 1, the total annual costs far exceeded the annual rental income. Property is bought not for rental income but the anticipation of capital growth.

Table 1: Income and Costs Analyses of A Double Storey Terraced Houses in Kuala Lumpur

Average Price (RM)	Annual Rental Income (RM)	Yearly Sum of Mortgage Instalment at 70% of Purchase Price (RM)	Annual Costs		
			Annual Equivalent of Balance of 30% of Purchase Price (RM)	Annual Outgoings (RM)	Total Annual Costs (RM)
1	2	3	4	5	6
455,000	24,000	43,452.24	11,978	2,400	57,830.24

(1) Average Price of Double Storey Terraced House in Taman Bangsar Baru in 1997 (Valuation and Property Services Department, 1997)

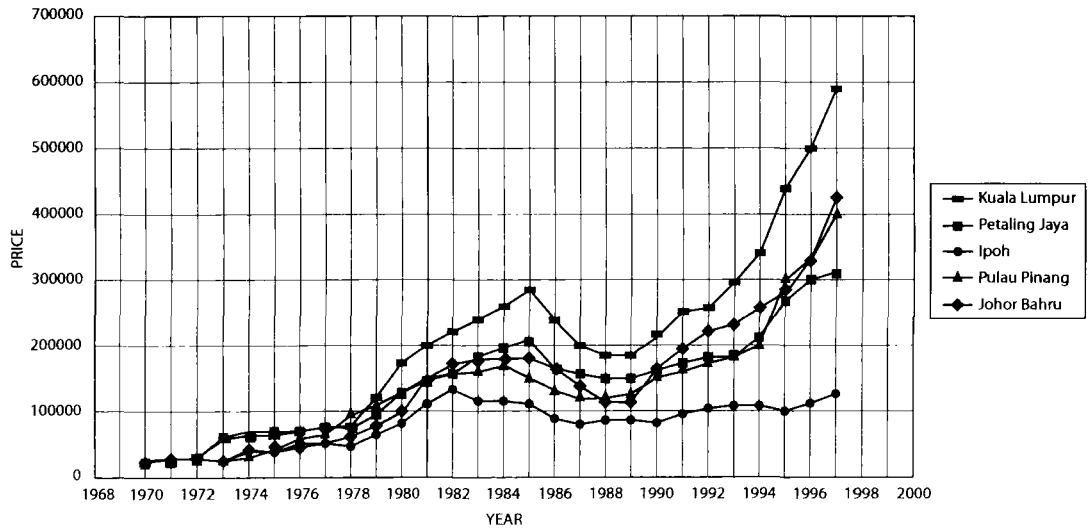
(2) Average Annual Rental Income for Double Storey House in Taman Bangsar Baru in 1997 (Valuation and Property Services Department, 1997)

(3) Interest Rate is taken at 13 per cent and repayment period is taken to be 25 years.

(4) The opportunity cost is calculated on the assumption that the balance of 30 per cent of purchase price can earn an average interest of 7.25 per cent from fixed deposit

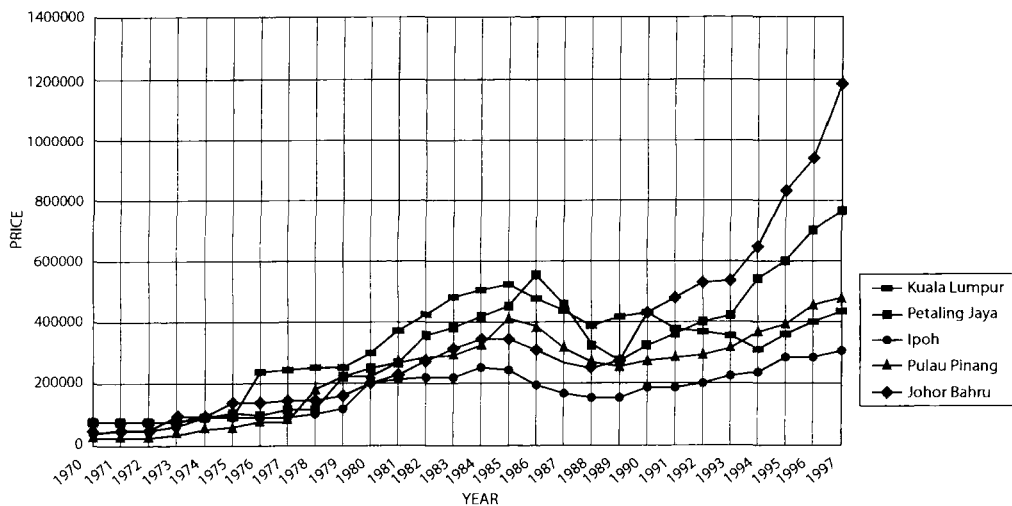
(5) Annual outgoings are estimated to be at 10 per cent of rental income. These include rates, quit rent and maintenance.

Figure 5: Price Movements of Double Storey Terraced House in Selected Housing Estates in Five Major Towns



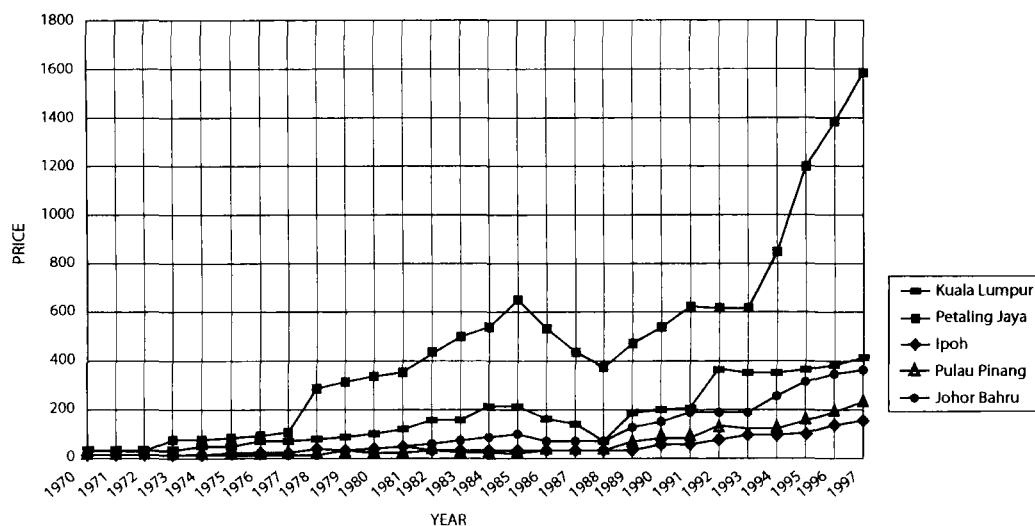
Source: Valuation and Property Services Department, Property Market Report - Various Years

Figure 6: Price Movements of Double Storey Shophouse in Selected Areas in Five Major Towns



Source: Valuation and Property Services Department, Property Market Report - Various Years

Figure 7: Price Movements of Industrial Plots in Selected Estates in Five Major Towns



Source: Valuation and Property Services Department, Property Market Report - Various Years

Thus, as the rush for houses continues, so does the upward movement in prices. Property acquisitions are made possible through bank borrowing. Unfortunately, this has contributed to the escalation of property prices. Figures 5, 6 and 7 show property prices have escalated in recent years in major towns. As mentioned earlier, all this took place against a background of high economic growth and prosperity.

The Danger of Over-Expansion of Credit to the Property Sector

The skewing of available funds to finance the property sector and share market can derail economic growth. This is because; first, financial institutions play a significant role in funding economic development. Inadequate channeling of funds to other productive sectors would impede economic growth, thus slowing the process of moving towards achieving a fully-developed nation status.

Second, it would impact the asset and general price level. Gan and Soh (1996) observe that a time lag, the impact of asset inflation will creep its way into goods and wage inflation. Wages and land prices increase are detrimental to the country, as it would impact on the international competitiveness of the country. Furthermore, asset inflation normally cannot sustain itself. When it happens, the rest of the economy will be affected and economic recession will prevail.

While it is generally postulated that banks play a crucial role in the growth of a sector, excessive credit to the property sector poses a danger to the banking system itself. It is a potential source of instability to the financial system. This is evident from lessons from other countries that during an economic downturn, overexposure to the property sector caused banks to be badly hit (Bangkok Bank PCL, 1997). As the property prices plunged, so did the value of the collateral. During this time,

the ability to pay back the loan by borrowers was also reduced. Borrowers cannot easily trade off their properties to pay off the loan because, first, banks will tighten up their lending policy and potential buyers will have difficulty in financing the purchase. Second, due to the falling property prices, borrowers may find that they are in negative equity, i.e. their value of the loan is greater than the value of their property. Incidence of arrears and non-performing loans increases. Loans made to real estate ventures cannot be covered in full. Recovery of capital in cases of non-performing loans is difficult. Overexposure to the property sector, therefore, can cripple the financial sector. This held back the economy and stagnated a large part of the real estate market (Cargill *et al*, 1996).

At the end of 1997 the total non-performing loans (NPLs) of commercial banks were close to RM 13 billion (Bank Negara, 1998). This represented about per cent of the total loans. Of this, the NPLs in the broad property sector alone were RM4.8 billion or 40 per cent of

the NPLs. Table 2 shows the level of NPLs in broad property sector, by the quarter, over a one year period, from March 1997 to March 1998, which is consistently high. The table shows that the residential property sub-sector has the highest level of non-performing loans, averaging at 33 per cent. In March 1998, the total NPLs have increased to RM22.3 billion and the NPLs in the broad property sector have increased to RM8.2 billion, which is almost double the figure in December 1997. The non-performing loans by the broad property sector are expected to increase by the end of 1998. The level of non-performing loans attributable to the broad property sector is indeed high in relation to its proportion to total loans. As argued above, the recovery of loans in the case of loans default can be difficult and this can be treated as bad debt. This situation if not controlled can undermine the financial system. For example, in Japan, Korea and Thailand, over exposure to the property sector by the financial institutions caused them to experience financial instability.

Table 2: Non-Performing Loans in the Broad Property Sector

ALL COMMERCIAL BANKS

TOTAL NPL NPL in BPS	31 Mar 97		30 Jun 97		30 Sep 97		31 Dec 97		31 Mar 98	
	7,846,624 NPL in sub-sector RM '000 %		9,233,226		8,926,310		12,953,781		22,227,618	
Residential property	1,112,530	35.37	1,092,429	29.20	1,114,059	33.72	1,628,409	34.00	2,454,709	29.85
Non-residential property	497,361	15.81	654,250	17.49	450,267	13.63	904,032	18.88	1,328,897	16.16
Construction	941,076	29.92	1,063,454	28.43	876,615	26.53	1,324,466	27.66	3,002,077	36.51
Real Estate	594,723	18.91	930,818	24.88	863,391	26.13	932,281	19.47	1,437,488	17.48
Total NPL in BPS	3,145,690	100	3,740,951	100	3,304,332	100	4,789,188	100	8,223,171	100
Share of NPL in BPS (%)	40.09		40.52		37.02		36.97		37.00	

Source: Bank Negara Malaysia, 1998

NPL - non performing loans

BPS - broad property sector

Another repercussion on the oversupply of property finance is that it tends to create an oversupply situation or glut in the property market. With easy access to finance, property developers in their eagerness to reap profits tend to overbuild, ignoring the supply situation. For example in 1997, the supply of retail space in shopping complexes in the Klang Valley over the next three years would almost be one and a half times more than the existing space (VPSD, 1997). Glut often results in poor take-up rate and poor occupancy rates. Such a situation affects the return of a property and hence the demand for it. In the event of an economic downturn the problem of oversupply worsens. Developers would face cash flow problems and this would affect the banks. Further deterioration of the situation will result in non-performing loans. This will undermine the confidence in the industry.

The escalation of property prices caused by excessive supply of property finance can retard the attainment of the various government's social objectives viz. promoting home ownership, encouraging the growth of small-medium industries as well as the growth of Bumiputera business community. When the escalation of prices does not match the income levels, the prospect of ownership would be remote for most people as the property have become unaffordable.

The Need for Credit Regulation

The property sector is an important sector of the economy. In 1997, the construction sub-sector alone contributed about 11 per cent to the GDP. In addition this sector has strong linkages to more than 130 related local industries. A sustainable property industry is, therefore, of great importance to the economy. However, sustainability

in the property industry requires some degree of price stability. Price stability means that it does not undergo a series of chronic fluctuations of price levels. It is also generally accepted that the term price stability is consistent with at least some positive rate of inflation measures (Kenny, 1997). It is often compared to a consumer price index. The Malaysian Consumer Price Index has remained relatively low and stable. Quite commonly, speculative criteria surpass investment fundamentals in the decision making of investors. Eager to capitalism on the flourishing property market, banks tend to overland to the property sector. This drives up to the prices to an unrealistic level. Price stability, however, may be achieved by monetary policy through money supply via credit control and manipulation of interest rates as well as through fiscal measures.

Banks have a duty to protect the interest of investors and depositors. Often, financial institutions, in their pursuit of rapid expansion of their credit business, tend to lower their guard, relax their lending criteria and give high debt to price rations. Profitability factors have driven banks to be engaged in the riskier activities. The danger of overexposure to the property sector must not be under estimated. Lending to property is in itself a high risk. It is risky because the value of the collateral is affected by the state of the market and full capital recovery in the event of foreclosure is unlikely. Property is also illiquid, i.e. cannot be turned into cash readily because it is expensive. In addition, the market is imperfect and the process of getting a buyer with adequate means to buy takes time. Furthermore, over-enthusiastic lending to the property sector can create an oversupply situation which may in turn affect the property prices hence the price of the collateral. As property investment is capital

intensive, in the event of high incidences of non-performing loans it can be crippling to the financial institutions and affect its stability. It is, therefore, in the interest of the public that financial institutions need to be regulated from over lending to the property sector.

From Figure 2, it is evident that the expansion of bank credit to the property sector is disproportionate. Loans to the property sector doubled the loans to the manufacturing sector. Funds, therefore, need to be redirected to the productive sectors like manufacturing and services sectors which have been earmarked as vital growth sectors of the economy.

Policy Measures

Excessive credit growth in the property sector means high potential risks which have adverse effects on the property market, financial stability and rest of the economy. Therefore, the strong credit growth in the property sector must be moderated. As early as 1995, Bank Negara began to tighten its monetary policy aimed at breaking the inflationary trend and stabilizing the property market. In this case the monetary or credit policy has to work through the banking institutions. The measures taken included "lowering the margin of financing to 60 per cent of the purchase price of houses and apartments costing above RM150,000 and of shop house costing above RM300,000." (Bank Negara Malaysia, 1996). This measure, however, was not applicable where the property was for owner occupation or for the conduct of own business (*ibid*).

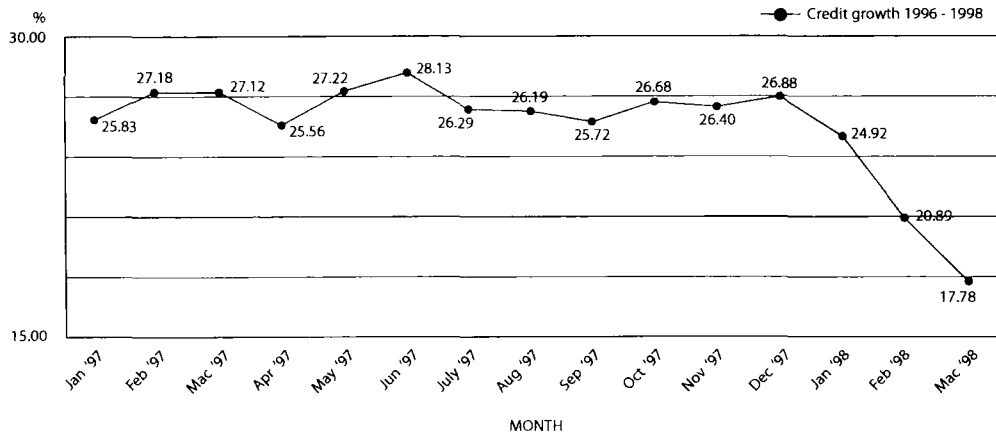
In early 1997, measures to curb the banking system's exposure to the property market and restrain asset inflation were reinforced. The property sector was classified as a 'less productive' sector. Hence, new guidelines

were introduced to restrict banks' lending to the broad property sector not to exceed 20 per cent of the total loans of the banking institutions. The guidelines, however, exempted loans to houses costing below RM 150,000 as well as for infrastructure projects. The guidelines also prevented excessive lending to finance purchases of stocks and shares. The guidelines were aimed at containing asset inflation and over-speculation in the stock market. The property and the share market are somewhat related. Those who make money from the stock market tend to buy properties which they subsequently charge to financial institutions to obtain more credit to enter the stock market again. The new guidelines are aimed at reducing the exposure of financial institutions to a possible bubble-like economy. The final objective is to steer away funds being channelled into areas that are less productive.

In December 1997 further guidelines were issued by Bank Negara to the banking institutions regarding loans to the property sector. First, project financing should not be provided where construction has not started. This includes the construction of low and medium-cost residential properties costing RM150,000 and below. Second, in cases where construction had started, banking institutions should assess the viability of such projects under the changing economic conditions. The loans towards construction and the purchase of residential properties costing RM150,000 can only be extended under strict criteria.

In March 1998, the measures introduced remained tight, consistent with the objectives of restraining asset inflation and reducing the speculative activities and stabilising the property prices. Initially, Bank Negara had directed credit growth in the country to

Figure 8: Credit Contraction



be checked at 15 per cent from a growth of 25 per cent in 1997. However, by the third quarter of 1998, loan growth has deteriorated sharply, that the target is reset at an annual minimum loan growth of only 8 per cent (The Star, 1998).

Policy Implications

As a result of the tight monetary policy, annual monetary supply growth and annual credit growth declined rapidly. At the end of March 1998, credit growth moderated to 17.8 per cent from a high of 28.1 per cent in June 1997. As shown in Figure 8, the rate of contraction was rather rapid within a few months. In fact it contracted at much faster rate than expected and had hit hard on the property sector.

With the introduction of the monetary measures, a noticeable slowdown in new loan approvals was reported. Bridging finance for construction became scarce. In spite of the fact that banks were free to provide financing for the construction and purchase of residential houses and apartments costing up to

RM150,000 per unit, subject to the business assessment of the viability of the projects, banks were very selective in giving out loans. There were complaints and allegations made by the Housing Developers Association that banks were reluctant even to provide finance for the construction and purchase of houses below RM150,000 (New Straits Time, 1998). The hardest hits were those developers who have started their projects and found that there were not enough buyers or those who need subsequent financing for their projects. Banks became overly cautious in their lending to the property sector. Lending policies were more stringent.

As a result of the reduced financing, construction activities were reduced. It was also reported that financing for the manufacturing or constructions related products like tiles was subsequently reduced. Job losses were inevitable. In the constructions sector, the housing sub-sector supports 500,000 workers who were directly involved in construction works (The Sun, 1998). The number employed by the broad property industry is certainly higher. Thus,

the number of unemployment generated by this sector can be substantial.

The Malaysian property market has hit a slowdown. The volume of property transactions has declined close to 30 per cent during the first half of 1998 as compared to the previous period (VPSD, 1998). Properties were difficult to dispose off due to difficulty in financing the purchase. There are instances where individuals put a deposit on a house but end forfeiting it because it is becoming harder to get loans. There were reports that those banks that do provide loans, normally put a lower than market price for a property and approve loans of 60 per cent of the assessed value. Commercial, retail and luxury condominiums had been worst hit. The signs show the property industry is heading for a difficult time.

Prior to 1978, Malaysia adopted a flexible administered interest rate regime whereby the minimum lending rate and the ceiling on deposits rate fixed by Bank Negara after consultation with commercial banks. In 1978, this practice was abolished and banks were allowed to fix their own interest rate on deposits and the minimum lending rate charged to their prime customers. This move appeared to be disadvantageous to the borrowers. This led Bank Negara to step in, and in 1983 it required that the interest rates to be pegged to base lending rates (BLR). BLR is calculated based on banks' cost of funds. In 1991, Bank Negara adopted a free interest rate regime and BLR of banking institutions was completely free from the administrative control. However, in order to ensure that borrowers are not exposed to high interest rates, the margin between BLR and lending rates was allowed to be fixed at a maximum of 4 per cent (See, 1994; Bank Negara Malaysia, 1994).

With the recent measures to mop up the excess liquidity, money supply was reduced, the costs of funds increased and interest rates went up. At the end of May 1998, the three month Kuala Lumpur Inter Bank Offered Rates (Klibor) was pegged at 11 per cent, which translated into BLR ceiling of about 12 to 13 per cent. This means that the effective rate charged by commercial banks would be 14 to 15 per cent (The Sun, 1998; New Straits Time, 1998). The cost of borrowing has become very costly to borrowers and thus hinders development. The high interest rates hurt the Malaysian economy and proved to be damaging to the economy.

The measures to curb the banking system's overexposure to property almost resulted in a credit crunch and the industry came close to a standstill. However, immediate actions were taken to increase liquidity in order to revitalize the property sector. First, an initiative to provide a Housing Developer's Credit Facility amounting to RM2 billion to ensure housing projects continue to receive financing was introduced. Under this scheme the interest rate to be imposed shall not exceed 10 per cent annually and the fund is to be allocated to areas where there is high demand for houses (Bank Negara Malaysia, April, June, 1998). Second, Pengurusan Danaharta Bhd., an asset management company, was set up to buy over banks' property-based NPLs. This is expected to provide more money to banks for their lending business and at the same time it is expected to ease pressure on the soft property market by avoiding the auction process, which is the remedy for NPLs (The Star, 1998; The Sun, 1998). However, Danaharta is only recently fully operational on 1 October 1998. Third,

Bank Negara has moved to reduce the cost of funds. This included the move to reduce the statutory requirement (SRR) by 2 per cent in June 1998 as an effort to increase liquidity (The Sun, 1998). With the reduction of SRR, about RM8 billion were injected into the banking system. However, the banks were slow to respond to this. This led Bank Negara to move away from the free interest rate regime and the BLR is instead calculated based on Bank Negara intervention rate while the administrative margin is fixed at 2.25 per cent (The Star, 1998). A low intervention rate would result in a low BLR. To further impact on the interest rate, in September the SRR was further reduced by 2 per cent releasing another RM8 billion into the system (The Star, 1998; Bank Negara Malaysia, 1998). The intervention rate is reduced to 8 per cent and the impact can be seen when it brings down the interest rate (Star, 1998).

Regardless of the measures taken, the credit situation remains tight in the property sector and there is a threat of stagnant economy. Banks are further urged to lend to the property sector. The 20 per cent cap on lending limit to residential properties costing below RM250,000 was lifted and there were calls for the banking sector to relax the conditions for extension of credit to this sector (Bank Negara Malaysia, 1998). Realising the importance of a robust property sector to revitalise the economy, a National Economic Recovery Plan (NERP), which was launched on 26 July 1998 has reclassified the property sector as a priority sector, as the property industry has strong linkages to with the other economic sectors. Banks were also urged to relax the conditions for the extension of credit for construction and property development. The prices for affordable housing in the Klang Valley, Johor Bahru and Pulau Pinang, were recommended

to be in the range of RM200,000. Such efforts were deemed necessary to prevent the economy from suffering a growth seizure (Prime Ministers Department, 1998).

Conclusion

Undoubtedly, immediate measures need to be taken to prop up the property industry. The National Economic Action Council (NEAC) move to upgrade the status of the property sector from non-productive to priority sector may be viewed as a logical effort to revive the property industry as well as the economy. The property sector has linkages with more than 130 related industries locally. By reclassifying property as a priority sector, banks are urged to lend to this sector. Further, the move to lift the 20 per cent cap on lending limit to residential properties costing RM250,000 and below and the call for the relaxation of conditions for extension of credit to this sector would mean reactivating the related industries hence inducing the generation of productive workforce. It is also anticipated that this move can bring about significant income and employment multiplier effects in the economy. The argument, while theoretically sound, casts a shadow of doubt. Under normal circumstances, property development and construction activities may produce the desired results. However, under the present depressed circumstances given the inflation factor, the rising costs of living due currency crisis, the pay cuts, jobs losses which translate into lower disposable income for households and lower credit worthiness of the prospective borrowers, such moves may not produce the desired multiplier effects. Instead the loans extended may turn into NPLs. As shown in Table 7, the NPLs in the residential sector are the second highest after construction. Such action to resuscitate the economy will only

further overexpose the banking system to the property sector thus endangering the stability of the financial sector.

The Housing Developers' Credit Facility is the government's direct involvement in the provision of finance to affordable housing projects. It not only provides cheaper costs of funds to developers but also reduces banks' risks. In time like this what developers need is some form of concession to reduce their risks and cost of funds. At the same time such measures would not burden the banking sector which is floundering. Perhaps other initiatives similar to the Housing Developers' Facility provided by the Government. Would prove useful to jump-start the industry. In the past, the Government has also played a more direct role by setting up a revolving fund to provide concessionary bridging finance to developers at an interest rate of two per cent for the construction of low-cost houses (Bank Negara Malaysia, 1994). This fund was channeled by Bank Negara to the participating banks and developers obtained loan from these banks. Such move did not only reduce the costs of funds to developers but also reduced banks' risks.

Perhaps the move to raise the ceiling price of affordable houses to RM200,000 in areas like Penang, Johor Bahru and the Klang Valley requires some consideration. The redefinition is critical in view of the institutional responses that it may generate. For the banks, it draws the line for loan priority. For the developers, it means being able to shift the focus from concentrating on projects costing below RM150,000 to those houses costing RM200,000. Is there a need for the price of affordable houses to be redefined in these areas? In fact, the total number of transactions showed a drop of 27.7 per cent in the first six months of the years as compared to the previous' period. The house price index for those growth

regions also shows a drop in the range of 12.1 per cent to 21.7 per cent (VPSD, 1998). While developers may be happy with the new price definition, it is equally important that when directives of the Bank Negara are implemented it must be viable for both developers and banks. One must not permit a situation where when loan is extended, there would be arrears in repayment, or projects abandoned due to poor sales.

The move from a free interest rate regime and reduction of SRR to 4 per cent, which released RM16 billion into the banking system, has managed to bring down the interest rate, thus reducing the cost of capital to the firms, a prerequisite for the economy to rebound. While such measures are necessary to revitalise the economy, it may also threaten the economy with further inflation. Bank Negara would have a tough battle to control price stability. The move has raised concerns from banks for Bank Negara to ensure that intervention rates adopted are realistic and reflect the administrative costs (The Star, 1998). While such measures have increased liquidity in the banking system, bankers are wary of the property sector. Credit for this sector is still very tight. In fact, the current contraction in credit is so fast that there are fears that it might be turning into a growth seizure.

As evident from lessons from other countries as well as from past experiences, banks, over exposure to the property industry caused instability. Therefore, precautionary measures to prevent this must always be incorporated in the banking system. The so-called pre-emptive measures taken by Bank Negara to prevent asset inflation are more of a corrective measure in response to the spiralling up of property prices since the early 1990s. Control should not only be taken when there are signs of overheating.

Perhaps, as a precautionary measure, Bank Negara should impose a fix ratio for loans to be channelled to the property sector. There must be close supervision to ensure that the guidelines are followed thus preventing banks from over lending to this sector during the goods times. The present experience is certainly a lesson to be learned. Regulations on property finance and strict supervision are necessary at all times to prevent over lending to this sector, thus ensuring a sustainable property industry.

Endnote

1. Policy and Guidelines on Issue/Offer of Securities, December, 1995.
2. Securities Commission was formerly known as Capital Issues Committee (CIC). CIC guidelines require property development companies to hold 1,000 acres land as their asset.

References:

- Bangkok Bank PCL, (1997), *Financial Institution Crisis: From Japan, Korea to Thailand*, http://www.bbl.co_th/research/jun_prl.htm
- Bank Negara Malaysia, (1989), *Money and Banking in Malaysia*, 30th Anniversary Edition.
- _____ (1994), *Money and Banking in Malaysia*, 35th Anniversary Edition.
- _____ (1995), *Annual Report 1994*, Kuala Lumpur: Bank Negara.
- _____ (1996), *Annual Report 1995*, Kuala Lumpur: Bank Negara.
- _____ (1997), *Annual Report 1996*, Kuala Lumpur: Bank Negara.
- _____ (1998), *Annual Report 1997*, Kuala Lumpur: Bank Negara.
- _____ (1998), *Press Release: Housing Developer's Facility*, www.Bnm.gov.my. 27 April.
- _____ (1998), Letter to Institut Penilaian Negara dated 18 June 1998.
- _____ (1998), *Press Release: Interest-Rate Policy*, www.bnm.gov.my. June 1.
- _____ (1998), *Press Release: Statutory Reserve Requirements of Banking Institutions*, www.bnm.gov.my. 7 September.
- _____ (1998), *Press Release: Lending to the Construction and Property Sectors*, September 7.
- Cargill T., Hutchinson M. Takatoshi, I. (1997), *Japanese Deregulation You Should know*, JIAP, <http://www.nmjc.org/jiap/dereg/papers/deregcon/hutchison.html>
- Gan, W. B and Soh, C.C. (1996), *Asset Market Inflation in Malaysia*, paper presented at MIER 1996 National Outlook Conference, Kuala Lumpur 3-4 December 1996.
- Hutchinson, M. (1994), "Asset Price Fluctuations in Japan: What Role for Monetary Policy?" *BOJ Monetary and Economic Studies*, Vol. 12 No. 2, Dec pp 61-83.

- Ismail, R. (1997), A Comparative Study of Private Sector Housing Finance and Development in Britain and Malaysia, Unpublished Doctoral Thesis, University of the West of England, U.K.
- Johnstone, M. (1982), "Residential Construction and Financial Institution in the Periphery: A case Study from Malaysia" in Ismail Ahmad and Jamaludin Jani (eds.) *Geography and the Third World*, Bangi: Universiti Kebangsaan Malaysia, pp 156-176.
- Kenny, G. "Low Inflation or Price Stability? A look at the issues" *Irish Banking Review*, winter (1997), pp 3-16.
- Prime Minister's Department, (1998), *National Economic Recovery Plan*, Kuala Lumpur: Percetakan Nasional Berhad.
- New Straits Time*, (1998), Bank 'still lending to property Developers', 19 February.
- New Straits Time*, (1998), Analysts back Daim's views on tight credit, 30 May.
- See, Y.L. (1994), "The current state of the Malaysian financial system, with special reference to capital market developments", in *Pacific-Basin Finance Journal* Vol. 2 pp. 113-118.
- The Star*, (1998), New Measures to ease liquidity unveiled, August 28.
- The Star*, (1998), Banking Institutions must have minimum annual loan growth of 8 per cent, September 10.
- The Star*, (1998), Danaharta will ease property market, says HDA, July 18.
- The Star*, (1998), Interest rates down sharply in two months, 12 September.
- The Sun*, (1998), Analysts echo Daim's views on interest rates, tight credit, 30 May.
- The Sun*, (1998), Bank Reserve Requirement Cut by 2 per cent, June 27.
- The Sun*, (1998), Builders want non-performing loans acquired, July 18.
- Valuation and property Services Department (VPSD), (1994), *Property Market Report 1993*.
- _____ (1998), *Property Market Report 1997*.
- _____ (1998), *Indeks Harga Rumah Malaysia, January-June*.
- World Bank, (1989), *The Housing Sector Getting the Incentives Right*, World Bank Regional Centre, Report no. 7279-MA