

The Bubble of Real Estate An Obstacle to Development

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In recent months, the realty market has been frozen. Transactions of houses in the inner city fell by some 65%, the market price by some 30%, most transactions were for small houses, and trade in apartments was in the doldrums. These facts make many people think of a bubble that is going to burst, especially in provinces with high foreign investment, such as Hà Nội, HCMC, Đà Nẵng, Cần Thơ and Đồng Nai.

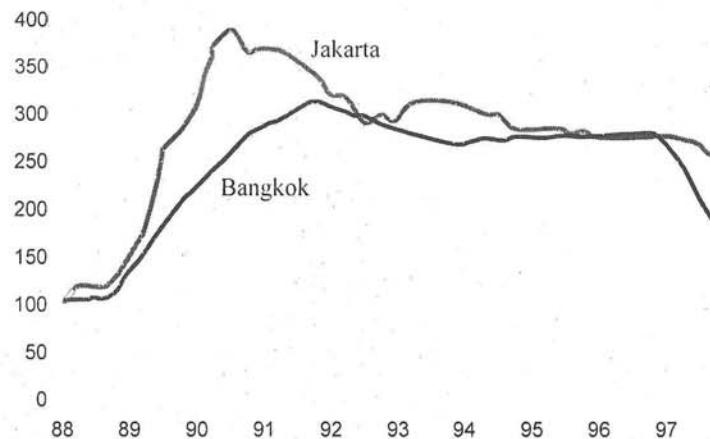
1. Facts about relations between expectations and the realty bubble

The bubble of real estate has been experienced in Japan and, more recently, in East Asia, and considered by many economists as one of causes of the 1997 financial crisis in Asia. At that time, East Asia was flooded with short-term loans from the U.S., Japan and the EU when these suppliers of credit adopted an easy monetary policy while many Asian countries, after a decade of high growth rates (9% to 10%) and profitability, became a promised land for foreign investment.

With support and guarantee from governments and their banking system, most foreign loans secured by finance companies were put in the profitable but risky realty market by local investors. The figure 1 shows that in Bangkok and Jakarta from 1988 to 1991, prices of office buildings rose considerably because of increases in the market demand. Facing the price fever, groups kept borrowing from banks to invest in the realty market and banks were ready to supply because they believed in the government's support and increasing prices of mortgaged estates.

The bubble of real estate finally burst because of risk involved in short-term loans and the close relation between high-ranking officials, state-run banks and state-owned groups of companies. When foreign investors realized troubles with these unhealthy relations and got disillusioned with the Asian miracle, they started withdrawing their capital when short-term loans became

Figure 1: Index of price of office building in Thailand and Indonesia



Sources: Marcus Miller & Pongsak Luangaram (1998)

due. Real estate speculators became insolvent and they had to sell estates and houses at cut prices. The realty market was frozen for several years and the price started to fall.

Banks, once believed in the increasing value of mortgaged estates, felt terrified when the price fell and they started to demand repayment from investors who could not sell their mortgaged assets to repay debts. The whole banking system became insolvent when foreign investors wanted to take their money back. As a result, the financial crisis broke out in Thailand in 1997 and spread over many countries. Up to now, many office buildings in Bangkok are still left empty although the rental is much lower than one charged in Vietnam.

2. Vietnamese realty market and the hypothesis about realty bubble

There have been signs of excessive speculation in real estates. The building of Trans-Asian Highway and East-West Highway, the establishment of industrial parks in several provinces, increases in both foreign and domestic investment, and unreasonable formation of trading centers have boosted the market demand for real estates and office buildings and encouraged investors

to plunge into this market at any price. When the infrastructure is poorly developed, the population is on the increase and personal income is still low, the high demand for housing is only a result of speculation. The price of real estate is too high to accept when it is higher than that of Tokyo and the personal income equals only a fortieth of the Japanese one.

Many people are of the opinion that the price of real estate in Vietnam is unreal but some others believe in the reserve because estates are still traded. According to a reliable estimate, only 5% of buyers have real demand for housing and the rest are speculators. An average apartment in the inner city is worth some VND500 million but it could be sold at a billion in other cities and get cash payment while American citizens usually pay for their houses in 30 years. Plans to build apartment houses for low-income earners still meet with great difficulties because the lack of a suitable mechanism. In other words, the price of real estate in recent years has been decided by speculators who expect it will keep rising.

Is there something wrong here? In my opinion, the price is really determined by speculators but the gov-



Photo by Huynh The

overnment intervention is strong enough to prevent it from causing a shock to the economy because lessons from the Asian financial crisis have provided a warning that made Vietnam try its best to maintain stability in order to attract foreign investment and ensure sustainable development. The Government and the National Assembly realize clearly the fever in the realty market and its inadequacies. The government has intervened strongly in the market with Decree 182, removal of pending planning, struggle against the sales of land without carrying out construction as required, priorities for residents whose houses are included in infrastructure projects, and many other decisions that aim at stabilizing the market. It's worth remembering that the realty market has no fault because it operates according to the market forces.

3. Inadequacies and obstacles

Theoretically, when capital and land are not invested in production of goods and services, they can be put in real estate as a means of strong value, which affects unfavorably the sustainable development because wealth and resources are left unproductive instead of being used for producing added value. In addition, from social aspect, peasants face shortage of land caused by urbanization; low-income earners have no chance to buy a house in their lives; and a lot of hospitals, schools and parks could not be built as planned because of lack of land. All of these are prob-

lems to solve as the economy develops.

A new philosophy of economic growth maintains that the economic development must be linked with human happiness. If peasants have no time and conditions to move to industrial and services sectors, they will become a burden for society and an obstacle to the economic development. If workers and wage-earners have no chance to buy and own houses or apartments, the economic growth will lose its meaning. As the economy develops, the failure to control income of ordinary people and speculators, along with social evils, such as corruption, smuggling, money laundering, etc. will provide speculators with chances to pour their money to the realty market causing harmful damage to the economic growth in the long run. If public works needed for the good of communities couldn't be built because of the shortage of land, citizens will suffer stress and bad health even they make more money. Lack of schools, hospitals and necessary institutions will lead to poor quality of life. All of these facts could be disastrous consequences of the large-scale speculation in real estate.

4. What are suggestions for the realty market?

Speculating in the real estate with legitimate income is not as bad as we think. The problem is how the government intervenes in the market on time to ensure a healthy environment for all businesspersons and

speculators within the long-term plans for development.

The development plan, whatever philosophy it aims at, should make the best use of existing resources for the good of the community and at the same time, ensure balance between the economic growth and better quality of life. In this article, I want to present some suggestions:

- Controlling the inflation rate in order to orient idle money towards production of goods and services instead of buying real estates in an effort to preserve the wealth.

- Developing other channels of investment, such as the stock exchange: It's worth noting that bank savings accounts are only suitable to small savers while the stock exchange is a business opportunity for speculator savers.

- Making the realty market more transparent by publicizing long-term town planning results and keeping the balance between land for production and for the good of the community.

- Controlling and preventing illegal sources of capital generated by corruption, money laundering and embezzlement by introducing laws on land and trade in real estate; and imposing heavy taxes on income from the trade in real estates.

When everybody has equal chances to make their money productive and buy houses from the market and when the speculation in real market is not much more profitable than other investments, the danger of the bubble of real estate will be well under control. ■