The Bursting of the Asian Housing Bubble*

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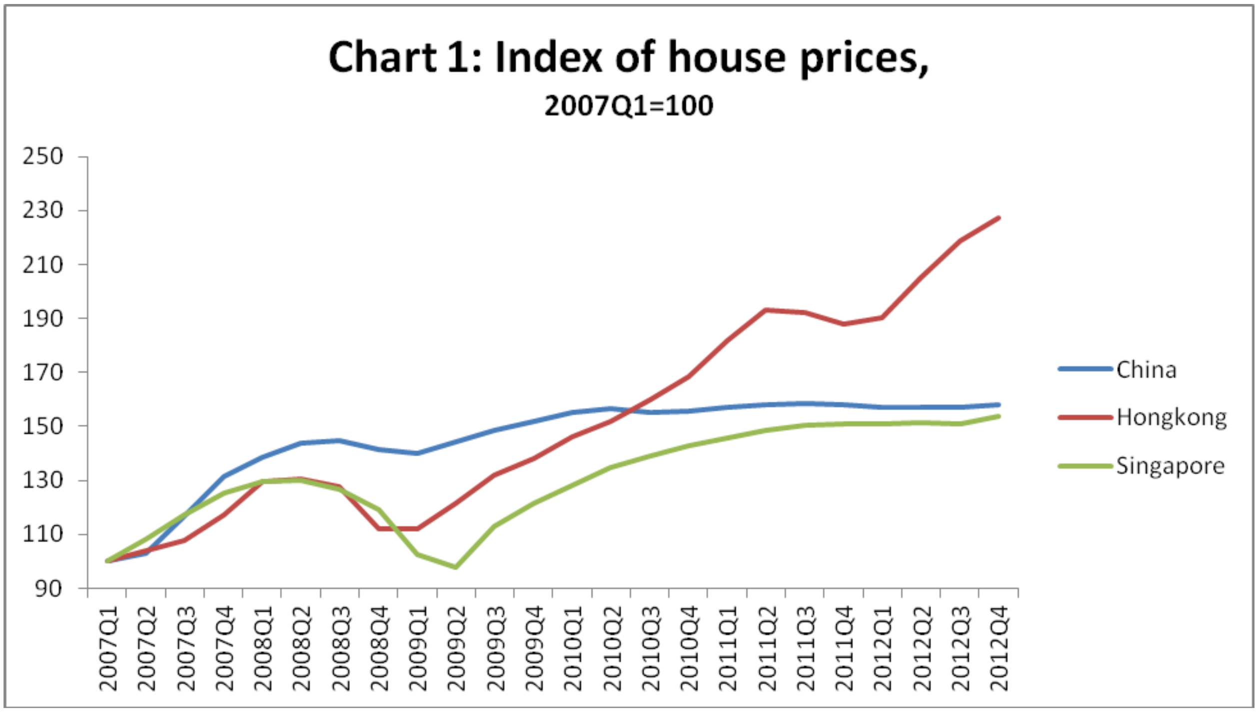
Everyone knows the role played by housing bubbles in the pre-crisis booms that ended in spectacular crashes in the United States in 2008, as well as in other countries like the UK and Ireland, and then Spain. But many commentators still persist in seeing this as more of a developed economy problem, which is less likely to become a concern in developing countries where excess demand for housing remains an issue.

In fact, however, it is just as possible for debt-driven private consumption bubbles to burst in developing countries - and several developing country financial crises have resulted from precisely that in the past. The experience of the Asian financial crisis in 1997-98, in which excess private indebtedness played a big role in causing the crisis in South Korea and Thailand, had provided a salutary lesson to most of developing Asia in the subsequent decade.

So it could have been expected that allowing excessive private credit expansion, especially for private retail credit for housing, automobiles and other consumption, is something that would be anathema to Asian countries, especially those that had already gone through one round of devastating financial crises. Yet, in the aftermath of the Great Recession of 2008, many Asian developing countries actually encouraged the growth of consumer credit bubbles as a means to more rapid recovery, accentuating a process that had already been eased by financial liberalisation from 1999 onwards.

The result has been an explosion in heavily leveraged consumption as well as in residential real estate activity, even in economies where wage incomes have not increased that much, such as the Republic of Korea. And the impact has been most strongly felt in the housing market. From early 2009, as Charts 1 and 2 show, residential prices in several Asian economies soared dramatically for at least two years.

Chart 1: As the Hong Kong housing bubble grows, China and Singapore taper off

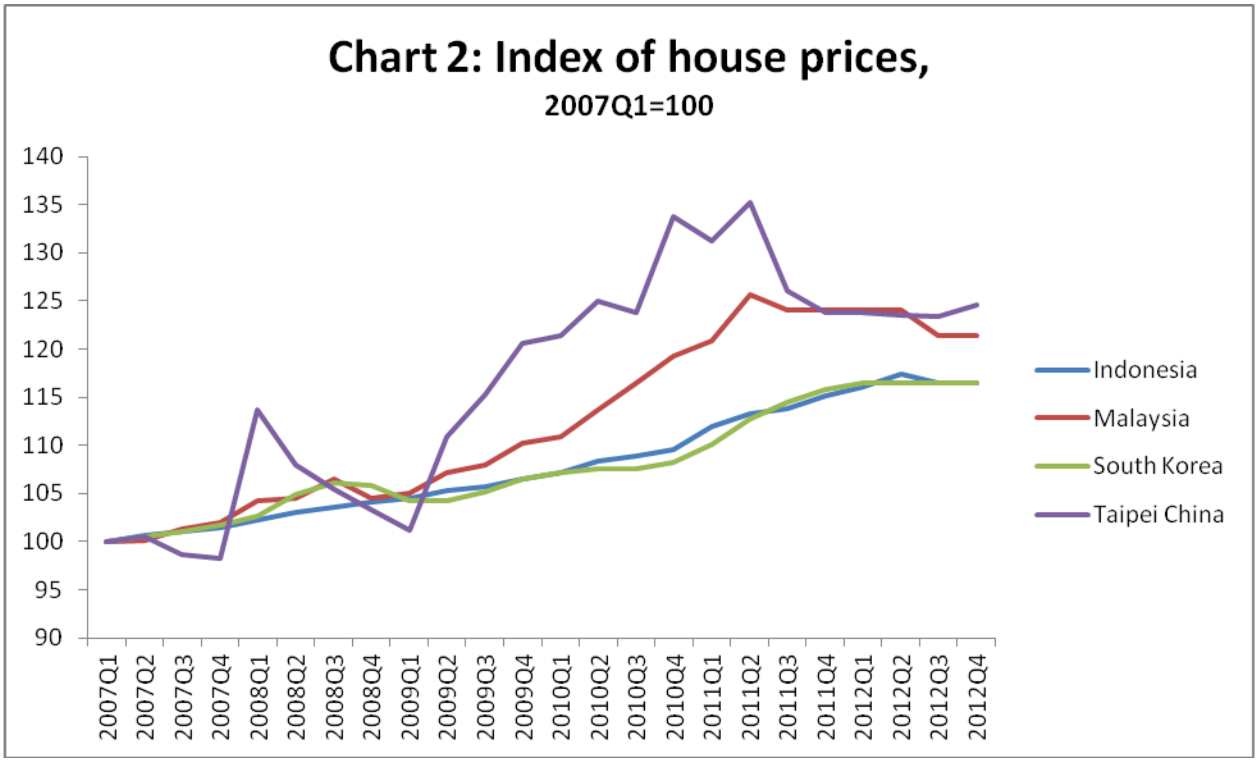


Source: http://www.globalpropertyguide.com/real-estate-house-prices/

This has been most evident in Hong Kong, where house prices have more than doubled since early 2009. In 2012, when global residential real estate prices increased by around 4 per cent, prices in Hong Kong rose by 24 per cent. It is now the most expensive place on earth, with property prices significantly higher than in New York, London or Shanghai. Of course, Hong Kong house prices are substantially affected by non-resident purchases (by mainland Chinese as well as expatriate westerners), so they do not reflect the same internal factors that are shaping real estate markets elsewhere in the region. That may be why house prices here have continued to increase even when the rest of the East Asian region shows signs of slowing down and why it has remained impervious to various policy measures designed to cool the overheated market.

By contrast, the authorities in China have been working to quell the forthy housing market ever since early 2010, and to some extent they seem to have succeeded, as average house prices have remained largely flat for the past two years.

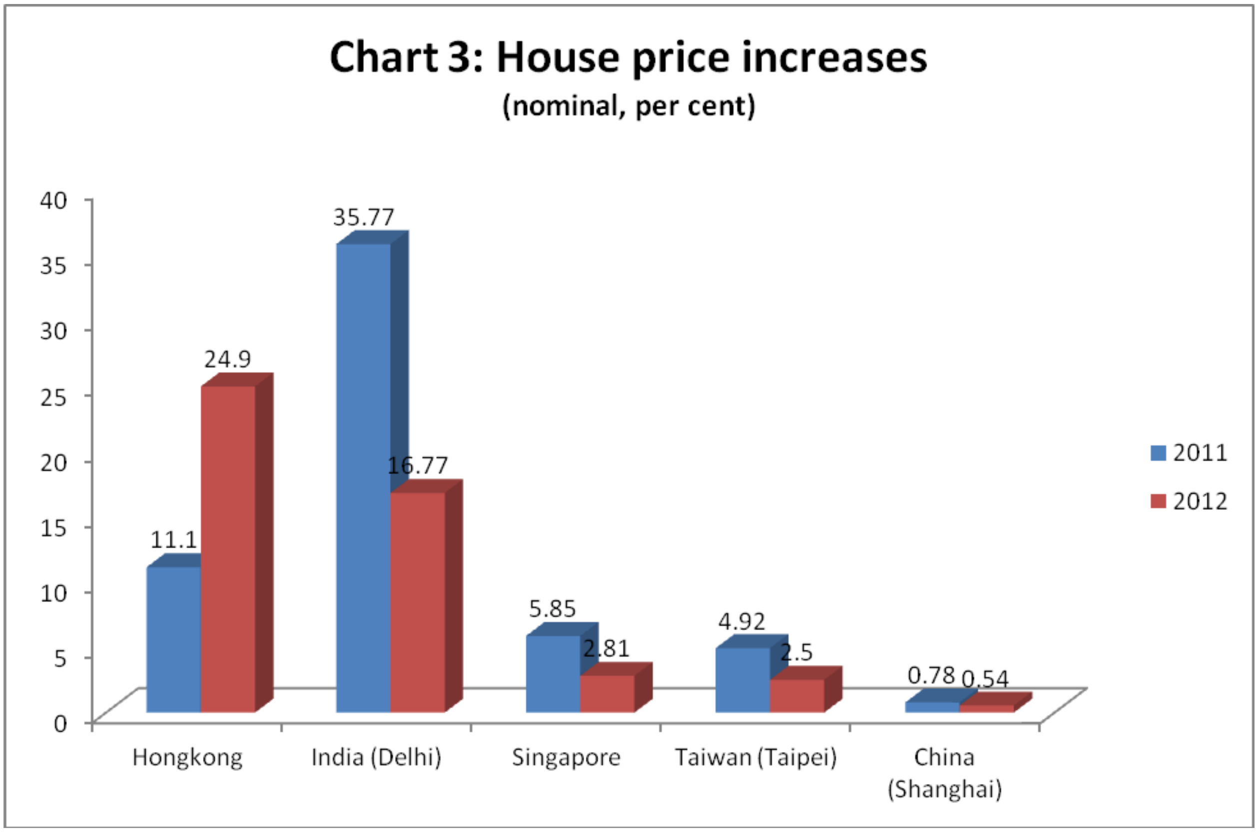
Chart 2: Some housing markets in East Asia are already declining



Source: http://www.globalpropertyguide.com/real-estate-house-prices/

In some other countries in East Asia, house prices have tapered off or even started declining, independent of any policy nudging, but simply because the bubble has finally burst. This is clearly evident for Taipei China and Malaysia (Chart 2), but even in South Korea and Indonesia, the rate of increase has come down significantly. As Chart 3 suggests, only in Hong Kong did the rate of increase further accelerate. Elsewhere, even in places where the prices continued to increase, they did so at a slower rate, including in India's Mumbai, where the rate of increase was still quite high.

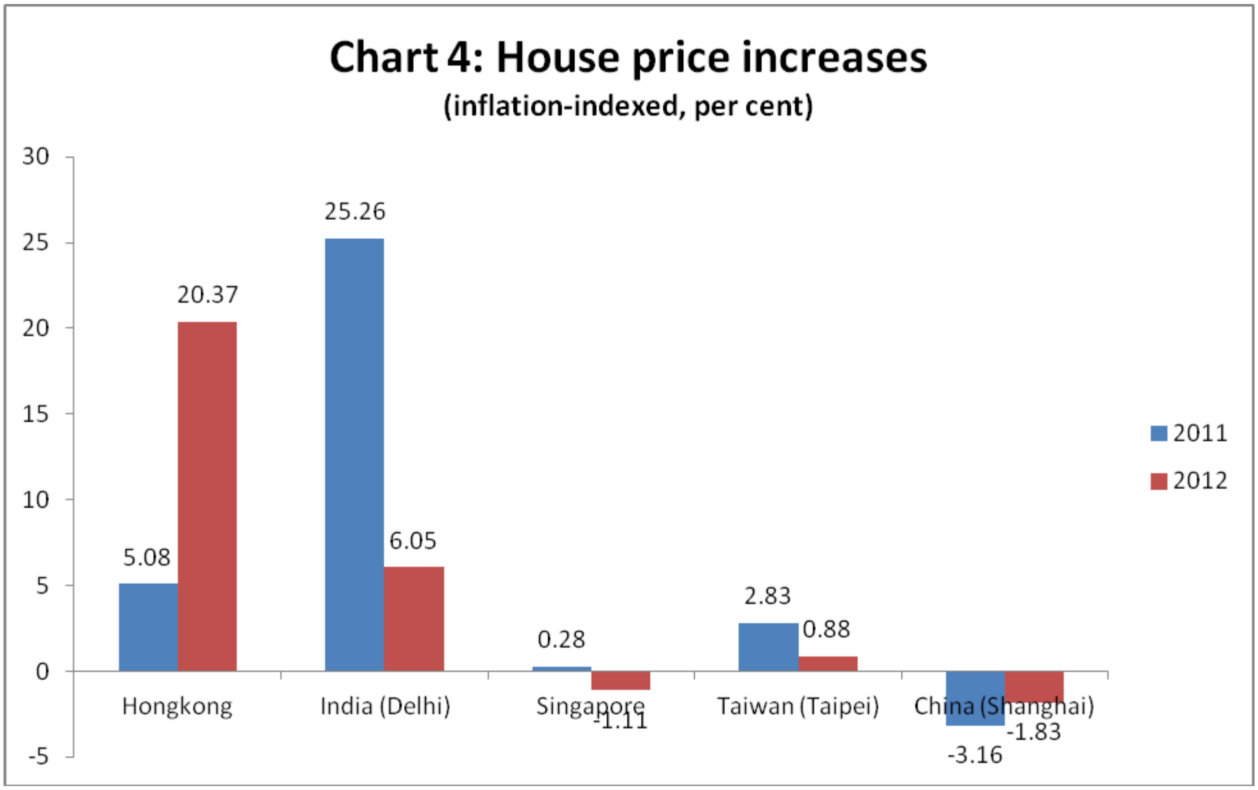
Chart 3: Last year house prices increased but a bit slower than before



Source: Knight Frank Global House Price Index, http://my.knightfrank.com/research-reports/global-house-price-index.aspx#

In fact, in the past year (as indicated in Chart 4) house prices in Shanghai and Singapore increased less than the general rate of inflation, so they declined in real terms. In other places like Taipei, they barely increased in real terms. The indicators for the first quarter of 2013 are that housing continues to increase in prices across much of Asia, but at significantly slower rates, and in some countries they have started declining.

Chart 4: Delhi and Hong Kong are still going strong, but in Shanghai house prices increased less than general inflation

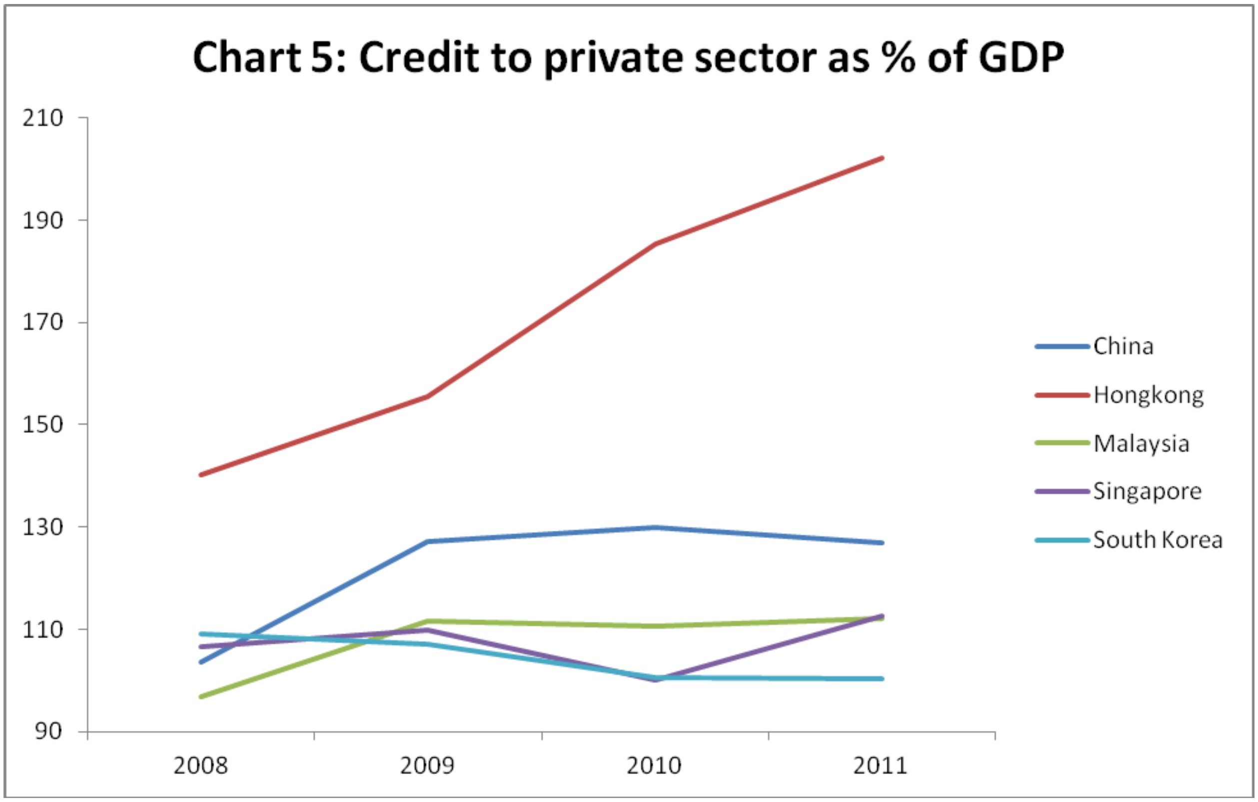


Source: Knight Frank Global House Price Index, http://my.knightfrank.com/research-reports/global-house-price-index.aspx#

But while the rapid increase in residential real estate prices clearly suggested housing bubbles in many Asian countries, the bursting of the bubble need not be good news, and can have painful conseqences. As in the US housing market before 2007, most of the increase in real estate prices in these Asian economies was debt-driven, resulting from the rapid expansion of retail credit to households, which in turn dominated in total personal debt. As Chart 5 shows, credit to the private sector increased dramatically in many of these economies.

The most substantial increase has been in Hong Kong, which is also home to the frothiest property market of them all. But all the countries shown in Chart 5 have private credit to GDP ratios in excess of 100 per cent, which has usually meant an inevitable day of reckoning at some point, usually with unpleasant implications. Indeed, the household sector is already facing personal debt crises in several countries, notably South Korea, Malaysia and Thailand. And this is turn is already acting as a drag on the economy, as households that increasingly find it difficult to service their debts are forced to deleverage and cut consumption.

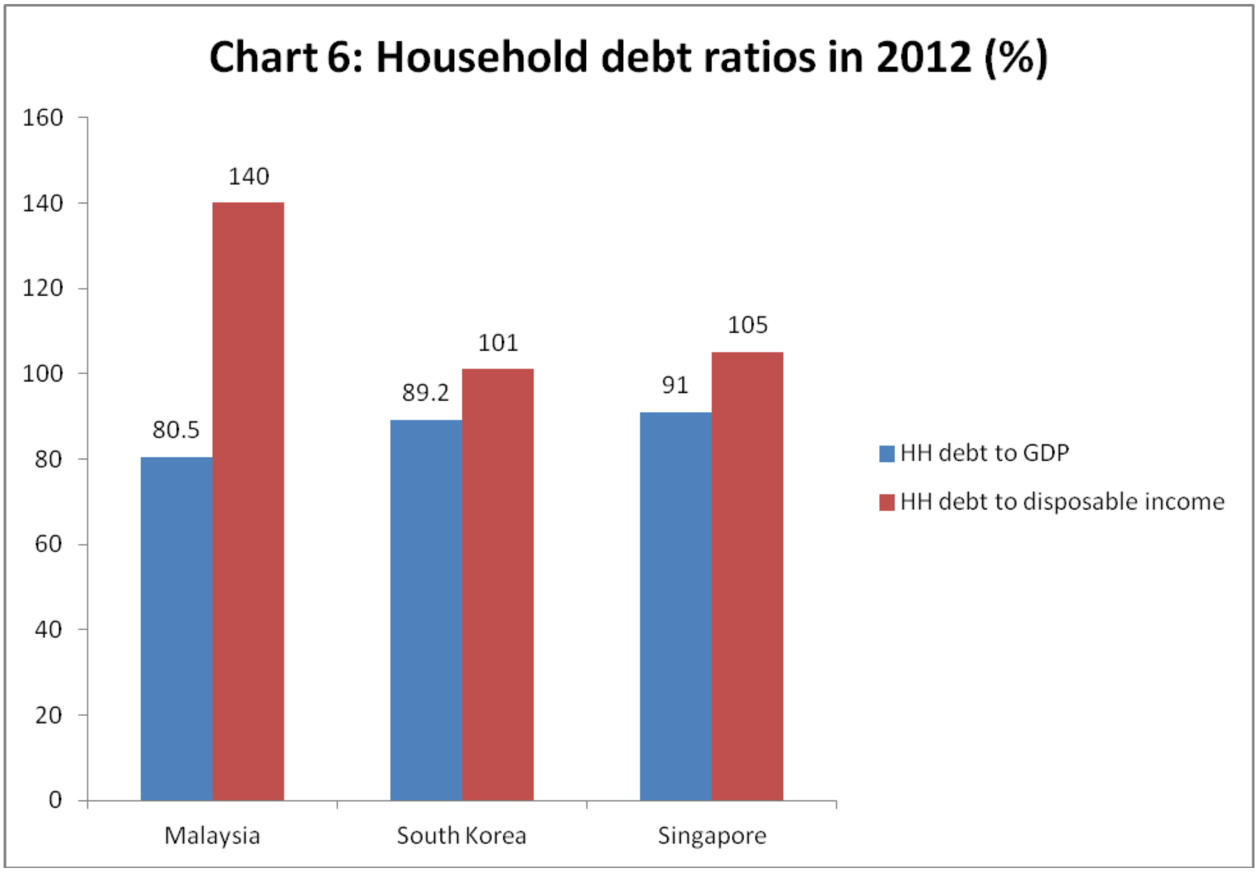
Chart 5: House prices are strongly related to credit increases to the privatesector



Source: World Bank World Development Indicators online

Chart 6 shows that household debt has very clearly reached crisis levels in some economies. In Malaysia, total household debt in 2012 amounted to more than 80 per cent of GDP and a shocking 140 per cent of personal disposable income - clearly therefore an unsustainable level that will have to be reduced sooner or later. In South Korea and Singapore, the corresponding ratios in 2012 were around 90 per cent and more than 100 per cent - once again suggesting that this state of affairs is not likely to be able to persist for long. In South Korea, total indebtedness of the government, companies and households is currrently 283 per cent - significantly more than the 227 per cent that existed just prior to the Asian Financial Crisis in 2007.

Chart 6: In some economies, household debt is reaching crisis levels



So this is a bubble - or rather, a set of bubbles - waiting to burst. Indeed, some are already in the process of bursting. Debt levels across the economy are rising beyond the ability of the various debtors to service them. Housing debt is just one of the problem areas. In the case of other forms of personal debt - such as credit card debt, debt to finance purchases of vehicles and student debt - there are similar and growing concerns about the capacity of borrowers to repay.

As these factors cause consumer spending to slow down, this is already affecting companies, and causing their debt to become more difficult to service. The corporate bond market, which had become incredibly buoyant in emerging Asia in the recent past, is also becoming a cause for worry.

All this makes the East Asian region's economies ever more vulnerable to external shocks. But with these levels of indebtedness, the shocks that cause the next round of damage may even come from within.

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