

# International Conference on Commercial Property Price Indicators

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## Role of property prices - A central bank perspective

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*Views expressed are personal and not of the Reserve Bank of India*

# Structure of Presentation

- Some characteristics of property prices
- Asset prices and central banks
- Initiatives in development of property price indicators in India
- Trends in property prices and financing of property markets
- Macro-prudential measures used by RBI
- Summing up

# Some characteristics of property markets

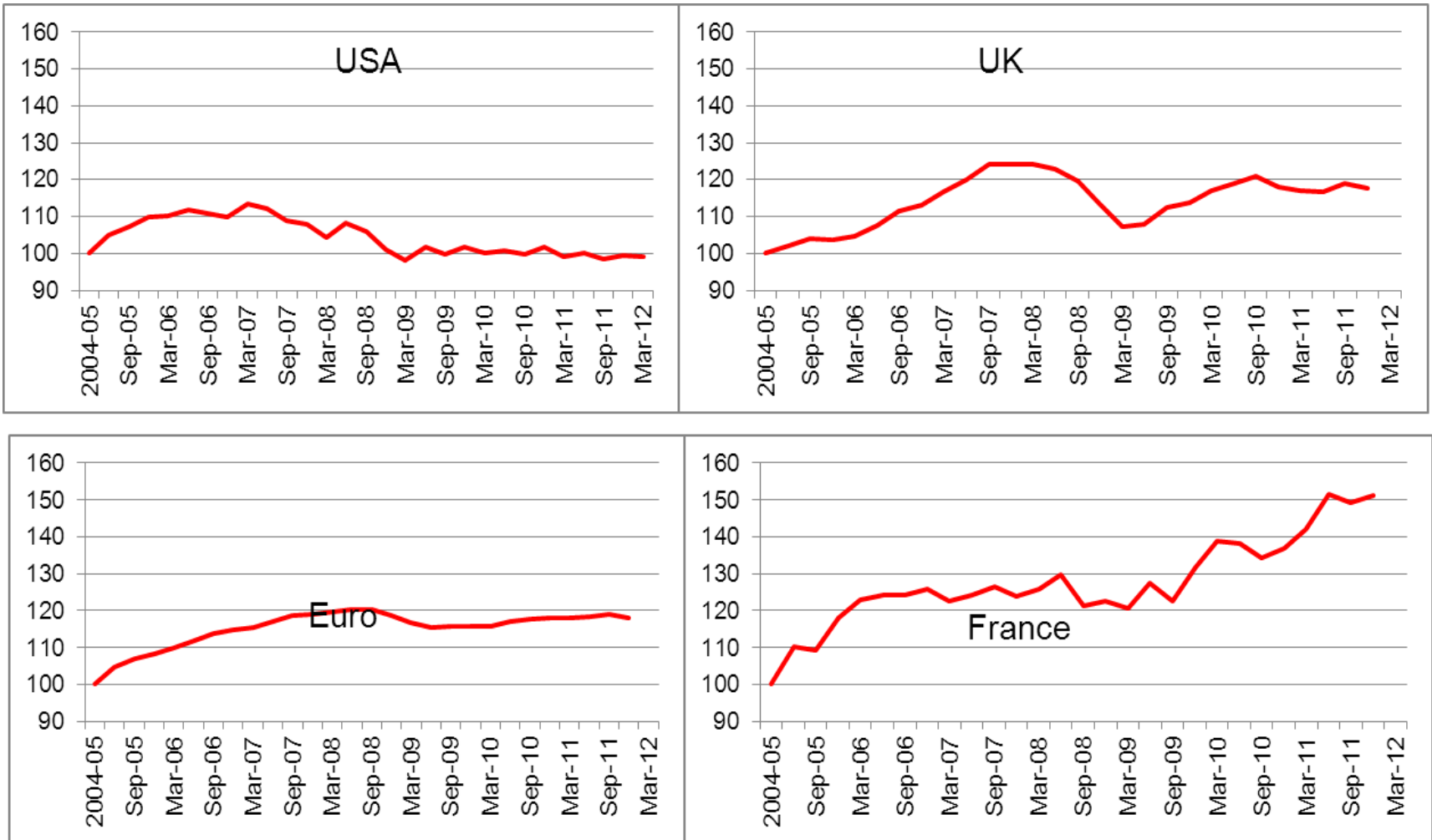
- In keeping with the Basel II terminology, commercial property generally means income producing real estate such as office buildings; retail space; multi-purpose commercial premises; multi-family residential buildings; multi-tenanted commercial premises; industrial or warehouse space; hotels; land acquisition, development and construction; etc.
- Commercial property is primarily produced and transacted as an investment, often with speculative motives and as such should reflect the risk profile of the asset class considered.
- On the other hand, residential property is primarily meant to be used for residing although sale/purchase of residential houses for investment purposes is quite common and significant.
- In the wake of the recent global crisis, some of the definitional criteria of properties (e.g. income producing asset) may be called into question. For practical purposes, it is more important to focus on development of property price indices for some fairly well identified class of properties rather than debating on conceptual issues.

# Some characteristics of property markets

- Separate measurement and monitoring of residential and commercial property price movements are necessary as their dynamics could often be different.
- There could be country specific features and both geographical and socio-economic heterogeneity could contribute to the complexity in property price movements, especially in an emerging country like India.
- Real estate markets have significant linkages with the financial system, especially the banks in view of the exposures of the financial market to the real estate and as such volatility in real estate market could transmit considerable shock to the financial system. The role of real estate (asset) prices in amplifying the business cycles has been at the forefront of policy debates in recent years.
- In this context, the issue of precise measurement of property prices is of critical importance to central banks in view of their role in financial stability.

# Residential Property Prices – International Experience I

(Source: BIS)

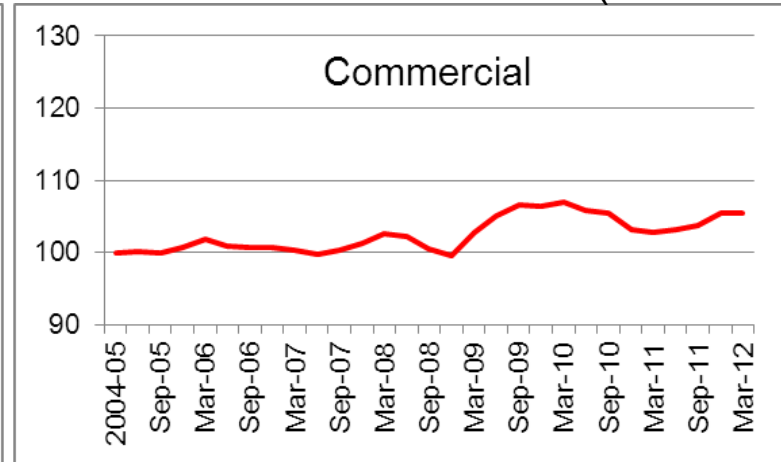
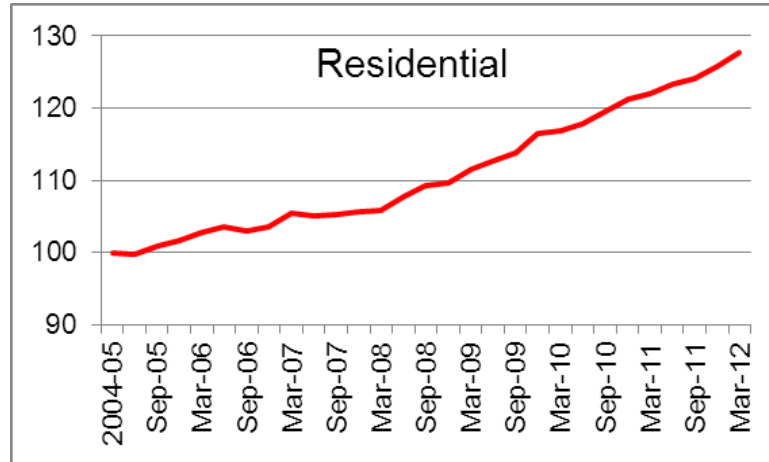


Post-crisis, marginal recovery in residential property prices in Europe, while the same in US remained flat.

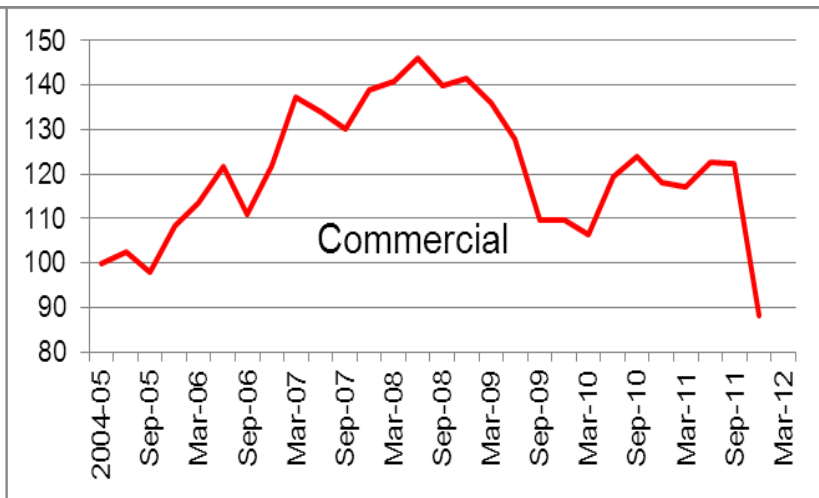
# Residential and Commercial Property Prices – International Experience II

## Switzerland

(Source: BIS)



## Denmark

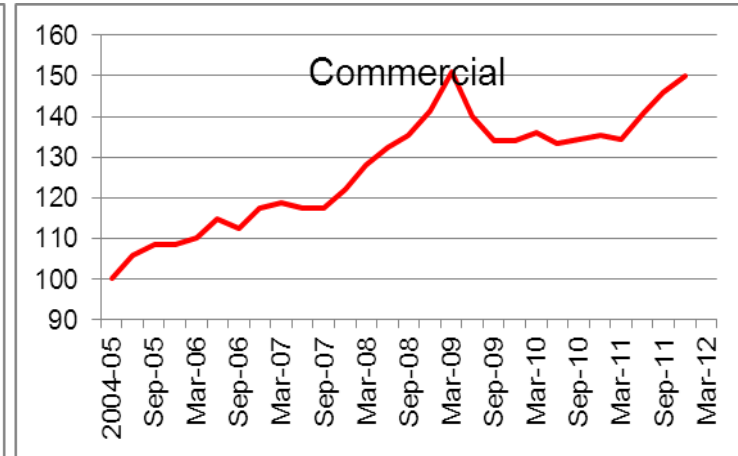
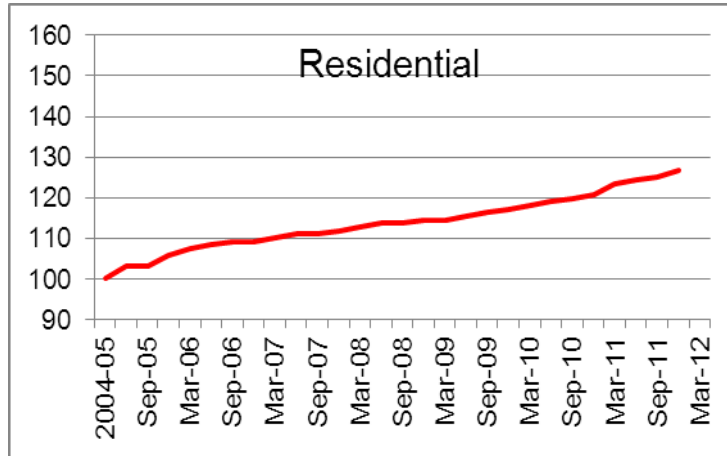


In select European countries, residential property prices were more resilient than commercial property prices.

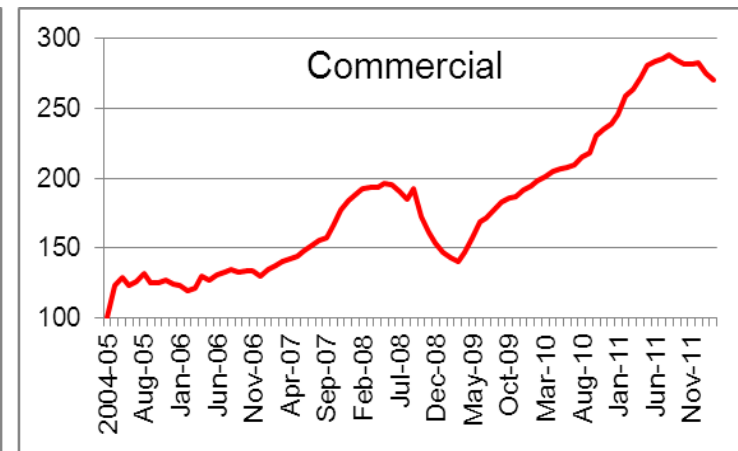
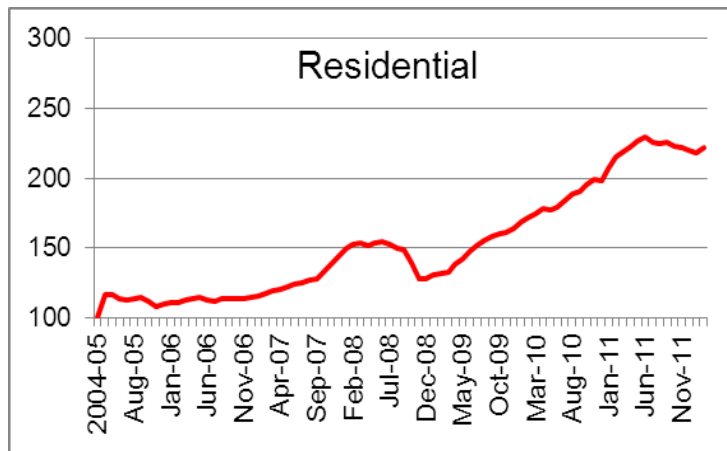
# Residential and Commercial Property Prices – International Experience (Asia)

## Indonesia

(Source: BIS)



## Hong Kong



In select Asian countries, increase in commercial property price is faster than residential property price

# Asset prices and central banks

- Should central banks bother about or respond to real estate prices?
- In the aftermath of the global financial crisis, the movements in asset prices and their implications for the financial stability and monetary policy have been explicitly recognized and the emerging view is that central banks cannot remain indifferent to asset price bubbles.
- The more relevant question is how; when; to which component of the asset prices; and with what instruments.
- Broadly, the basic need is to have reliable time series data on property prices – both for residential housing and commercial property.
- The next issue is early identification of build-up of asset bubbles, which is perhaps the most difficult and most debated. It not only calls for an appropriate analytical framework incorporating the real sector, financial sector and property market variables, but can pose considerable difficulty and ambiguity in decomposing the property prices into fundamentals, cyclical and bubble components.
- As regards the means, there is an increasing consensus to entrust the task to a host of macro-prudential tools, which is the essence of Base III.



# Measurement of Property Prices in India

## **Reserve Bank of India (RBI) initiatives**

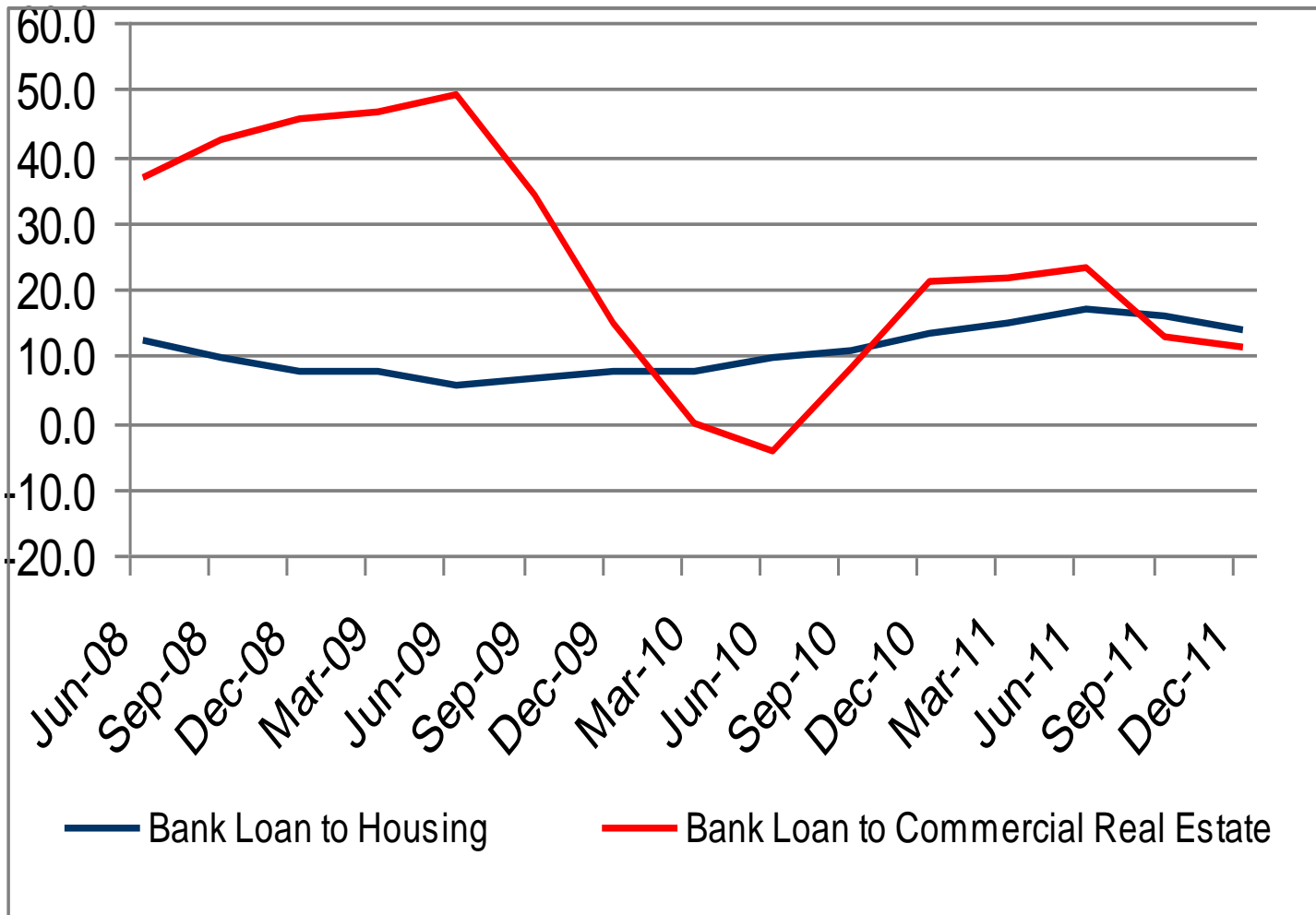
- The RBI Working Group on Surveys (2009) noted that in spite of several efforts towards building information on real estate prices in India, large data gaps exist. It recommended setting up of an asset price monitoring system to have comprehensive information on real estate prices.
- RBI has taken up development of residential house price index (HPI) and currently compiles a quarterly HPI for nine major cities. based on the official data on registration of property sale/purchase deed collected from the government registration departments.
- Initiatives are on to build an asset price monitoring system based on real estate loan data from banks, including both residential and commercial property prices.

## **Other initiatives**

- The National Housing Bank (NHB), has been compiling a residential house price index (RESIDEX) based on primary transactions data from real estate agents and housing loan based data from housing finance companies and banks. At present, RESIDEX is compiled quarterly for 15 cities in India.

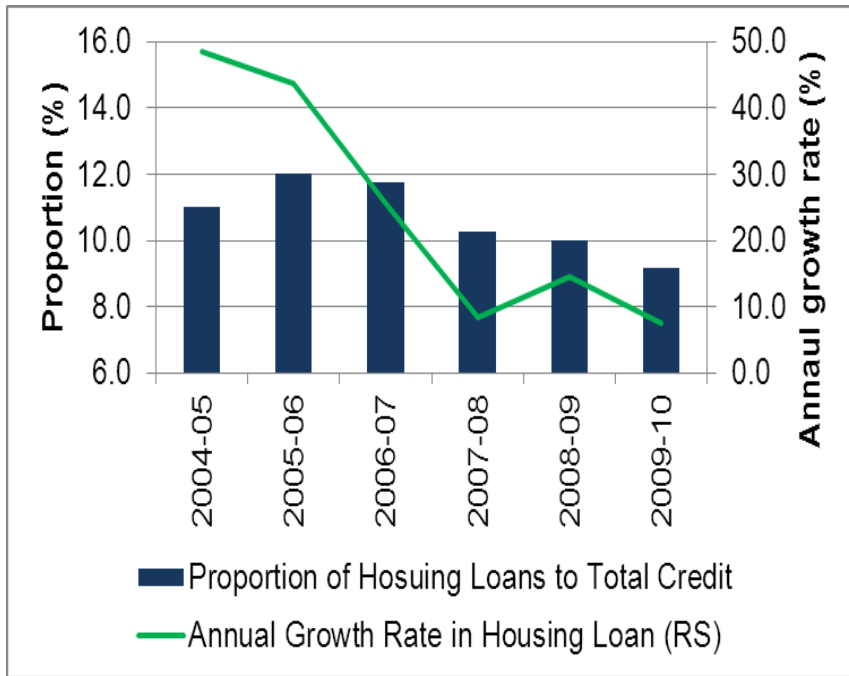
# Property Prices and Credit Market

## Annual Growth Rate



# Property Prices and Credit Market

## Housing Loan to Total Credit



## Proportion of Real Estate Loans to Non-Food credit

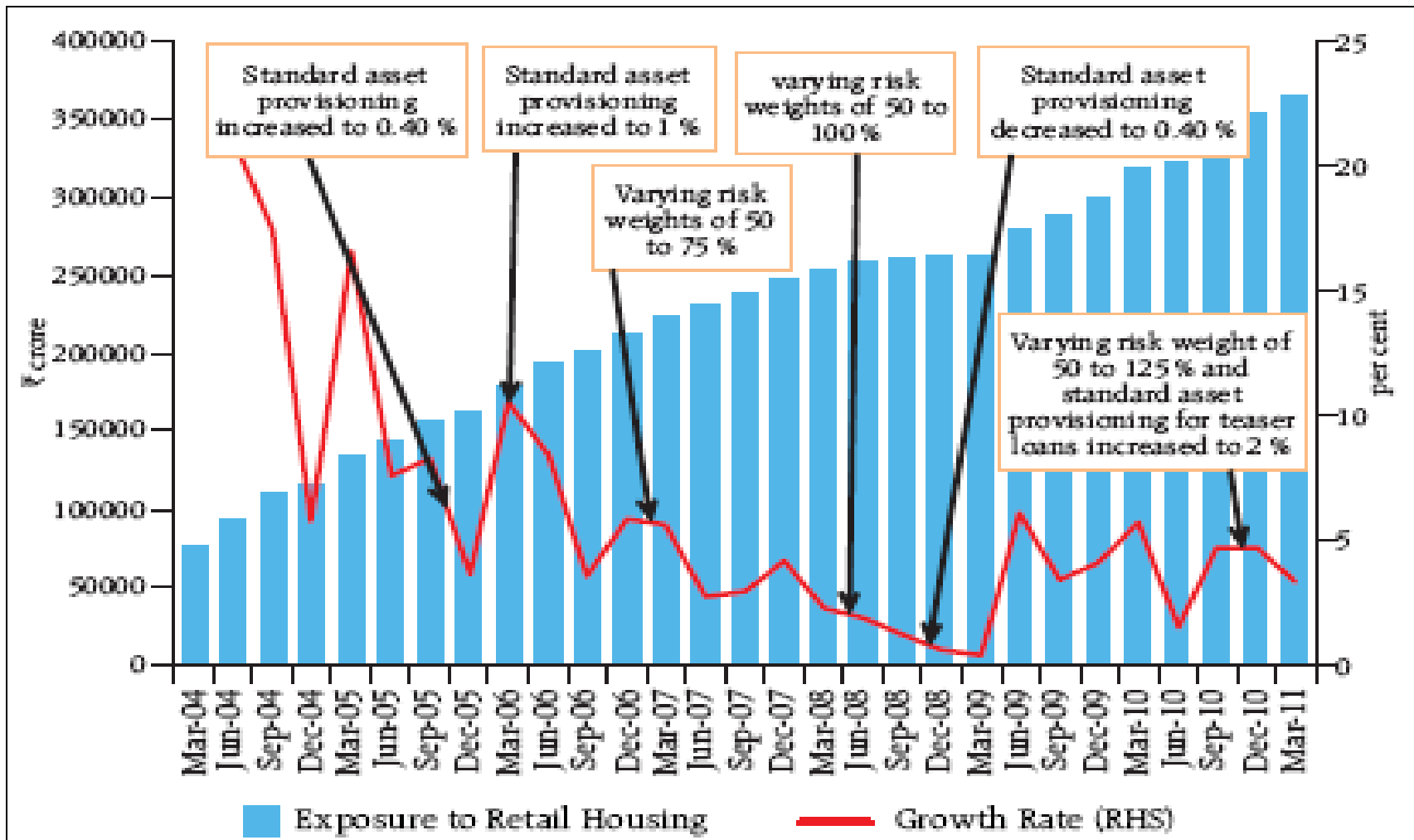


Source: RBI

# Monetary and Regulatory Policies: RBI experience

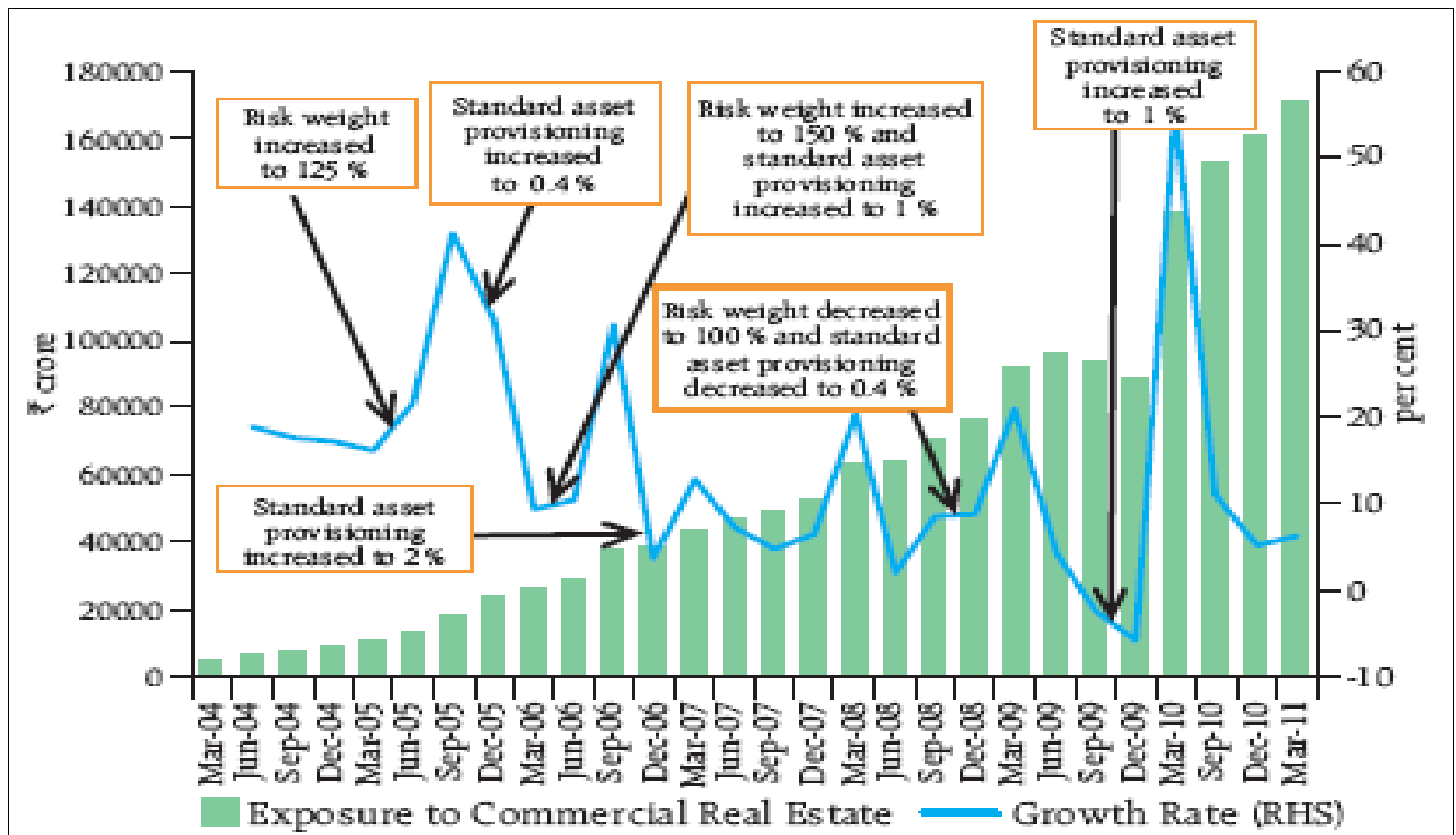
- The role and responsibilities of RBI include both monetary policy, banking regulation and supervision and also financial stability.
- RBI has been one of the early users of counter-cyclical macro-prudential tools.
- RBI has used sector specific risk weights and provisioning norms in respect of bank credit to sectors such as commercial real estate, housing loans, exposure to capital market, etc. to modulate credit growth to these sectors and preserve credit quality.
- Other pre-emptive actions mainly through macro-prudential policies include discretionary caps on loan-to-value (LTV), debt-to-income, loan-to-income ratios.

# Counter Cyclical Prudential Regulation: Retail Housing Loans



Source: Financial Stability Report, December 2011, RBI

# Counter Cyclical Prudential Regulation: Commercial Real Estate



# Summing up I

- Dynamics and data behaviour of commercial and residential property price can be different.
- Country specific features and both geographical and socio-economic heterogeneity contribute to the complexity in property price movements.
- Prominent measurement issues makes monitoring of real estate sector difficult.
- Real estate markets have significant linkages with the financial system, especially the banks in view of the exposures of the financial market to the real estate and as such volatility in real estate market could transmit considerable shock to the financial system.

# Summing up II

- Asset prices, especially property price developments, need to be taken into account and continuously monitored along with the macroeconomic and financial market variables by the central bank.
- There is a strong need for good quality residential and commercial property price indices available on a regular basis from the central bank perspective in view of the monetary policy, financial regulation and financial stability roles.
- A calibrated approach incorporating both monetary and macro-prudential policies based on a suitable analytical framework is an ingredient to address asset price bubbles.



## Select References

1. ECB Bulletin, February 2010 - Euro area commercial property markets and their impact on banks.
2. Financial Stability Report, December 2011 – RBI
3. Data Sources: Bank for International Settlements, RBI
4. Monetary Policy Dilemmas: Some RBI Perspectives, Sep, 2011 - Speech by D. Subbarao, Governor, RBI.

**THANK YOU**