CHAPTER 2
THE PROPERTY MARKET AND INFLATION IN MALAYSIA

2.1 THE MALAYSIAN PROPERTY MARKET

Property is an important component of the economy as a large proportion of the national wealth constitutes property. This is evident where property transactions in terms of value constitute up to 20 - 22% of the total Gross National Product during the peak years of 1996 – 1997 (Usilappan 2002). Data from Bank Negara’s Annual Reports (various issues) show that almost 36% of all lending by banks is to the broad property sector, which includes real estate, construction, residential and non-residential property. The proportion of this lending for the purchase of residential properties alone for the period 1988 – 2000 was about 12 - 15%. In 2001 this amount increased to 27.1% (Bank Negara Malaysia, various annual reports). Figures 2.1 and 2.2 below chart the amount of lending to the residential sector and the broad property sector.
The market for residential property can be observed by analysing the market performance of this sector over the period of 1988 – 2001.
The proportion of residential property transactions to that of the total transactions over the period from 1988 until 2001 was about 65% (Ministry of Finance, Property Market Report 1988 - 2001). It is evident from Figure 2.3, that the residential property market is the most active property sector.

**Figure 2.3: Volume of Transactions in All Property Sectors and Residential Sector (1990 – 2001)**

Hence it is not surprising to note that in terms of value, the residential sector alone accounts for 50% of the total value transacted during the period of study. This is depicted in Figure 2.4 below.
Figure 2.4: Value of Transactions in All Property Sectors and Residential Sector (1990 – 2001)

Figure 2.5 below shows graphically the percentage change of the volume and value of property transactions in the country and particularly the residential sector over the period from 1991 to 2001. Data on residential transactions are not available for the period before 1990 (Ministry of Finance, Property Market Report 1990 - 2001).
2.1.1 PRE 1988 (BUST YEARS)

Prior to 1988, there was the 1984-1987 debacle where the major reasons for the poor property market as mentioned by Dass (1988) was the result of bankers lending too much money into property, the absence of market studies, everybody jumped into the bandwagon and the general faith that property prices would never fall and continue to rise was the philosophy of the day.
2.1.2 1988 – 1989 (GROWTH YEARS)

Overall, the initial signs of recovery observed in late 1987 improved considerably in 1988. It was evident that the increase in the number of properties transacted was not confined to lower priced properties and that the price slide which characterised the property market in the recessionary period had tapered off (Ministry of Finance, 1988). The amendments to the National Land Code which relaxed restrictions on foreign ownership of landed property and amendments to the Real Property Gains Tax (RPGT) Act which placed non-residents in the same position as residents in respect of this tax, coupled with the lower value of the Ringgit, had significant and far reaching effects on the property market. The repeal of the Share (Land Based Company) Transfer Tax and the 5% reduction in Corporate Tax, both introduced in 1988 also played a part in improving the market. The residential property market was boosted by the increased liquidity position of banks and lower interest rates.

Bank Negara fixed the interest rates for housing below RM100,000 at 1.75% above the base lending rate. Interest rates for government housing loans were also reduced and state governments began to encourage more housing developments by cutting red tape, reducing time to process applications, simplifying procedures and reducing charges. The improved situation continued into 1988 with increased property transactions. The RPGT rates were reduced for foreigners and Property Trusts were launched in 1989. The property sector in general was invigorated by the improved economic situation, higher domestic incomes, higher lending by commercial banks with
lower interest. Coupled with the action of the Employees Provident Fund releasing more money, the property sector augured well and the volume and value of transactions increased in tandem.

2.1.3 1990 -1994 (GROWTH AND CONSOLIDATION YEARS)

The property market grew stronger during this period resulting from the improved Malaysian economy and the effective demand caused by the greater prosperity. Price gains were significant in all property sectors. The directive issued by Bank Negara in November 1990 to restrict foreign access to local funds resulted in a significant impact on properties purchased by foreigners in the country. The number of transactions in the residential sector rose by 27% from 1989 (Ministry of Finance, Property Market Report 1990). The relatively low interest rates, easy availability of loans, increased supply of affordable houses, relaxation of Government housing loan regulations and higher disposable incomes contributed to the growth in the residential sector. The government also set up the Abandoned Housing Project Fund to assist in the revival of abandoned housing schemes.

In 1991, confidence returned to the market with the ending of the Gulf War. The property sector was active and demands coupled with expectations were bullish as a result of the high growth rate in the economy, the Sixth Malaysia Plan, and the National Development Plans, which charted Malaysia’s transition to, developed status by the year 2020. Human resource shortage and deficiencies in the country’s infrastructural networks caused costs and
wages to increase. In February 1991 Bank Negara freed the Base Lending Rate (BLR), which subsequently caused it to increase. In 1992, BLRs of leading commercial banks were pegged at 9.5% resulting in high interest rates and constricted credit facilities for housing. This contributed to a respite in demand for higher priced housing. The National Land Code was amended to restrict foreigners from buying properties and uncertainties by the Foreign Investment Committee (FIC) guidelines affected market sentiments.

The property market improved marginally in 1993 and the BLR was reduced to 8.5%. The share market skyrocketed in 1993 and the excess liquidity went into the property market. The 'Highland Towers' tragedy induced the government's stance of restudying the structural soundness of buildings in hill slopes and this dampened the high rise building activity.

In 1994, the excess profits from the share markets were channelled into the property sector. Foreign funds entered the equity market and new liquidity was created. The Government increased the statutory reserve requirement to 11.5% in July 1994 and issued Government bonds to mop up RM3.2 billion from the market. In the later part of 1994 the market experienced a slowdown (Bank Negara Malaysia, Annual Report 1994).

2.1.4 1995-1996 (BOOM YEARS)

The robust economy coupled with low inflationary growth caused demand to increase exhibiting strong growth for property. The Government increased
domestic interest rates and encouraged savings. Other measures included the FIC increasing the minimum purchase price of houses for foreigners to RM250,000. Bank Negara in October 1995, allowed only 60% lending to investment properties above RM150,000 for residential and RM300,000 for commercial. A levy of RM100,000 was introduced for foreigners in the 1996 Budget and RPGT was raised from 5% to 10% subject to the disposal date and a flat 30% tax on disposal by foreigners. These measures helped to stabilise the property market.

In 1996, the property market expanded at a more sustainable pace and there were increased activity and price movements. Although concerns were expressed with regard to 'overheating' and the potential 'bursting bubble', the property market continued on its upward movement unabatedly. To control inflation and reduce overheating of the economy, the government tightened its monetary policies to dampen domestic demand. The banking system was faced with excess liquidity, due to higher disposable incomes and inflows of foreign short-term capital to take advantage of interest differentials. Bank Negara raised the statutory reserve requirement twice in 1996 to mop up the excess liquidity and this led to firmer interest rates which helped to buoy up the property sector.

Although there was a discernable drop in the construction of new houses, prices of second hand houses moved upward. The volume and value of transactions showed an increasing trend during the period from 156,913 to
175,682 and from RM15.81 billion to RM21.61 billion respectively (Ministry of Finance, Property Market Report 1995 & 1996).

2.1.5 **1997-1998 (BUST YEARS)**

The first half of 1997 was a boost to the property sector as the value and volume of transactions continued to rise and matched record levels. However the currency crisis, the stock market slump and the collapse of regional economies drastically affected the country. As a result, tight fiscal and monetary policies were introduced. Bank Negara classified property as non-productive and controlled the flow of credit to this sector. Non-performing loans were on the rise. Major banks reported massive losses and the share market was considerably affected. Mega projects were postponed causing a slowdown in the construction sector. To ensure foreign and local investors' confidence in the property market, the 1998 Budget reduced corporate tax from 30% to 20%, lifted the RM100,000 levy and allowed foreigners to purchase more than two units of houses, increased the quota from 30% to 50% for foreign nationals wishing to purchase condominiums priced more than RM250,000 and relaxed the RPGT provisions for foreign disposals from the previous 30% flat rate to a minimum rate of 5% after a period of five years. However these measures were not in time to prevent the recession.

By the end of 1997, investors lost confidence and the property market was affected although the volume and value of transactions were still high. What begun in 1997 became worse in 1998 until the counter cyclical fiscal and
monetary policies were put in place. In September 1998, the economy and the property sector went into a recession. Outstanding loans to the property sector were high at 35.3% and loans to the property sector were reduced. New rules regulating the currency and stock markets were introduced and an asset management company, Danaharta was established to take over the banks' non-performing loans, which led to the amendment of the National Land Code to expedite property loan recovery, by Danaharta.

The poor sentiment in the economy affected the property sector. Developers were cautious to launch new schemes and investors were too cautious to buy. The volume and value of transactions in 1998 plunged by 32.3% and 47.8% respectively reaching the lowest level since 1991 (Ministry of Finance, Property Market Report 1998). However compared to the other sectors, the residential sector was seen as the least affected by the recession.

2.1.6 1999 – 2001 (GROWTH YEARS)

In 1999, the overhang in the property sector was a cause for concern and banking institutions were instructed to no longer fund developments on new residential properties and shop houses costing above RM250,000 per unit. However, end financing was not affected and as a result, demand was not adversely affected. Home ownership campaigns were held to sell off existing stock of houses with some government perks thrown into the package.
With the stimulus, the property market improved and there were increases in the volume and value of transactions. Prices of houses seemed to move upwards and more housing schemes were launched. Interest rates were reduced to an all time low. The stock market also performed better and helped sustain the property sector.

Although the general economy fell in 2000, it began to pick up in the year 2001. The nationwide efforts to steer the property market back to its pre-crisis level through liberalised access to housing loans, home ownership drives and other policy instruments produced some positive impacts to the residential sector. The measures included a lowering of the ceiling rate of ad-valorem stamp duty on property transfers from 4% to 3%. Housing loan eligibility for public sector employees was raised and upgrading to better and higher priced properties was allowed. The Employees Provident Fund also relaxed its policies to permit contributors to make withdrawals towards the purchase of a second house. These measures contributed positively to the residential sector of the market, which saw growth in the volume of transactions by 3.1% as compared to the previous year (Ministry of Finance, Property Market Report 2000).

Overall the property market on the whole was on an increasing trend and prices chalked up to modest gains. In the Klang Valley, prices reached pre-recession levels and were beginning to throw off the sluggishness that had set in the residential sector.
2.2 THE INFLATION SCENARIO

Malaysia has gone through various periods of inflationary experiences; the economy had experienced high inflation regimes during the periods of 1973 - 1974 and 1980 -1981 and low inflation regime throughout the period of 1985 - 1987. The country was able to contain a low and stable inflation during the high economic growth regime based on the effective policy mix of the Malaysian government. Since the sharp depreciation of the Ringgit in 1997, inflation has once again become an important issue and the focus of the government in macroeconomic management (Cheng & Tan, 2002).

Overall the inflation rate has remained between 1.4% to a maximum of 5.3% during the period 1988 – 2001 (Bank Negara Malaysia, various Annual Reports). Figure 2.6 below charts the inflation scenario in Malaysia over the period of study.
2.2.1 PRE 1988

During the early 1980s, the severity of the international economic recession imposed considerable constraints on the growth and development of the country. As a result of tight liquidity position and moderate increases in demand under conditions of increased under-utilisation of capacity of plants and manpower prices increased at a slower rate. The inflation in Malaysia decelerated, in tandem with world inflation. The CPI registered less than one percent rates of growth for three consecutive years from 1985 to 1987. The deceleration in the rate of increase in the CPI reflected to a large extent the influence of weakening demand conditions, following the protracted world economic recession which significantly decreased import earnings and
consequently private sector incomes as a whole (Ministry of Finance, various reports).

2.2.2 1988 –1996

The economy registered a significant growth with more than 8% for three consecutive years and in 1990, it strengthened further despite the growth slowdown in the industrial countries. The Gulf war, which began on 2nd August, 1990, as a result of the Iraqi invasion of Kuwait, set off a round of oil price increases by 50% in October 1990. The immediate impact of this third oil crisis resulted in an increase of inflationary pressure in both the industrial and developing countries (Ministry of Finance, 1990). In Malaysia, the effect of the increase in oil price was felt after a time lag of one year of the outbreak of Gulf war, from 2.61% in 1990 to 4.39% and 4.75% in 1991 and 1992 respectively.

The government stepped up efforts to curb inflation in the country by launching a 'zero inflation campaign' in June 1995.

2.2.3 1997 – 2001

The recent financial crisis in Asia which started in July 1997 caused an increase in interest rates, fuel prices and prices of goods and services in the country. Strong foreign demand as a result of the depreciation of the Malaysian Ringgit of over 40% has resulted in a strong and powerful inflationary pressure and escalated the price level in the country. However,
the prudent and immediate action taken by the government on 2nd September 1998 to effectively peg the nation's currency to the US dollar at US$1 = RM3.80 has had some controlling effect on inflation. As a result there was an increase in import prices, especially prices for intermediate and capital goods.

The problem of inflation in Malaysia was relatively well controlled during the recent financial crisis period as compared to the neighbouring countries. After experiencing an economic downturn for approximately two years since mid 1997 due to the financial shocks, the Malaysian economy began to pick up again from the third quarter of 1999 and the pressure on the consumer prices has therefore been subdued to a substantial extent. The inflation rate for the first quarter of 2000 registered at a level that was compatible with the pre-crisis rate of less than 3%. By late 2001, the inflation rate was contained at 1.4% (Bank Negara Malaysia, various reports).