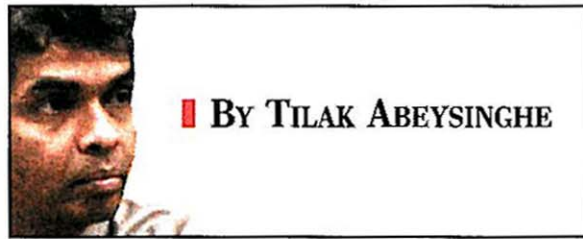


ASK: NUS ECONOMISTS

Both property price cycles and price trends matter



■ *With more than 90 per cent home ownership (both public and private), why should there be any concern about property price increases if higher prices mean higher wealth for Singaporeans?*

THIS is a very legitimate question, especially when the Government is trying to get a grip on runaway residential property prices.

There is no question that higher prices mean higher housing stock value. However, how this higher value impacts the aggregate economy is not clear, for what is beneficial to an individual may not necessarily be good for the whole economy.

What is of concern is price escalations, not price increases per se, that tend to create two obvious undesirable effects: one, large price cycles; and two, steep price trends that are unmatched by income trends. These tend to create negative effects on the aggregate economy.

Large price cycles and therefore price expectations create large demand-supply imbalances in the property market because of gestation lags on the supply side. These imbalances tend to create self-generating price cycles of long duration unless they are brought under control. In the Singapore context, data shows that price cycles in the private market spill over into the HDB market, not the other way around. House rentals also tend to move with price cycles.

Past price escalations, despite subsequent price collapses, have pushed the long-term price trend of residential properties well above that of per capita disposable income. The question here is whether the wealth effect generated by higher house prices outweighs these negative price effects.

When house prices go up, the wealth effect on consumption expenditure may operate through various channels:

One, people may feel rich and may spend more out of their disposable income on consumption.

Two, realised capital gains by selling the property may be channelled into higher consumption.

And three, equity loans using the house as a collateral may be used to boost consumption expenditures.

In the case of Singapore, we observe that the wealth effect of house prices on aggregate consumption expenditure is very much absent. This emanates from the lack of avenues to materialise the increased value of housing.

Instead of the wealth effect, two negative price effects seem to be present. First, there seems to be a negative effect on consumption as a result of higher down payments and mortgage payments.

Even if the wealth effect is present for those who have paid off their mortgages, the negative price effect seems to dominate at the aggregate level. With the 99-year lease system, even the bequest value of higher property prices is likely to be dominated by the negative price effect. This explains the falling consumption to income ratios at different income levels.

One little examined aspect of steep property price trends is the effect it has on fertility. In an interesting recent article published in *Economic Inquiry*, authors Junjian Yi and Junsen Zhang found a strong negative relationship between fertility and residential property prices in Hong Kong. They estimated that house price inflation can account for about 65 per cent of the fertility decline in Hong Kong over the past four decades.

It is worth investigating if a similar relationship holds for Singapore too. Our tentative calculations indicate it does. Fertility declines have been observed in every developed country. But in some of these countries, property prices may not be a constraining factor in family size decisions. In places where it matters, it seems to precipitate the decline in fertility.

What is in operation here is a powerful force called relative income, which mainstream economists tend to ignore because it involves interpersonal utility comparisons. In short, what relative income means is that what matters most is not an individual's own income but his or her income relative to others' or to a desired standard of living.

A house is an important part of the desired standard of living. As house prices increase, and given the desire to upgrade to more expensive housing, young couples find their relative income falling and decide to settle for a smaller family size.

Therefore, while trying to bring property price cycles under control, it is also important to have a desirable price trend and to consider more avenues for housing wealth to be realised.

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