

# USING PAST EXPERIENCES TO DEVELOP AN EARLY WARNING SYSTEM FOR THAILAND'S PROPERTY MARKET

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## ABSTRACT

*This paper has a two-fold purpose. First, it analyzes the causes, effects and consequences of speculative bubbles, and Thailand's past real estate crises. The role of excessive credit extended by financial institutions is discussed as the main cause of real estate bubbles. Excessive credit is also believed to have been the major cause of pass-through financial imbalances and economic instability. Second, an early warning system for predicting a property-market crisis is created using two approaches: signal analysis and probability analysis. It shows that there are two leading indicators; the "ratio of post-finance to bank loans" and the "percentage increases in the price of construction materials", that currently exceed the threshold level are signaling a future real estate crisis. However, the interest rate, which the models reveal as the most significant indicator of a crisis, is still far below the threshold level. Moreover, many financial institutions are currently offering competitive incentives for fixed-rate loans of, say, 1-3 years, to buyers of houses. For all these reasons, the probability of a real estate crisis in Thailand is quite low for the next 1-2 years, i.e., 2005-2007. However, neither model treats the potential impact of other incidents, such as restructuring of the financial system, proper bank monitoring and new urban planning, all of which could change the overall structure of the economy.*

**Keywords:** Real Estate Bubbles, Real Estate Crisis, Early Warning System

## INTRODUCTION

Financial crises always lead to tremendous shocks and adverse effects wherever they occur. The major causes of this type of crisis are regularly investigated. Such inquiries reveal variations in market structure, timing and degree of vulnerability to the crises. In the case of Thailand, this investigation shows the conditions under which the real estate sector became a major source of vulnerability in a rapidly growing economy during the boom decade: 1986-1996. It then proceeds to show how the fundamentals of rapid economic growth originally started a genuine real estate boom that eventually turned into