



IMPACT OF FINANCIAL CRISIS ON REAL ESTATE BUBBLE IN INDIA

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Abstract: This paper sheds light on the impact of financial crisis of 2008 which occurred in the United States and India and how the effects can still be seen in today's real estate market. The cause for the financial crisis that occurred in the United States has been mainly discussed as the subprime crisis which is linked to the real estate sector. The relationship between this financial crisis and the real estate sector which leads to the formation of a bubble has been looked into. The topic of real estate bubble and whether the bubble will burst in Bangalore has also been discussed.

Keywords: Financial crisis, Subprime loans, Real estate bubble.

1. INTRODUCTION

A financial bubble refers to a situation where a high level of trading activity can be seen on a particular asset class at price levels that are much higher than their innate value. A housing bubble is a not a permanent condition and it is caused by speculation that is unjustified in the housing market. This leads to rapid increase in real estate prices. Speculation is when investors buy something and expect to make money off of the price rises in the future. As they buy more houses to make money from price increases, they are in fact pushing up the price of houses by increasing the demand. This price increase attracts more speculators to invest in houses and the cycle continues. Eventually, this bubble has to pop (Kenton, 2019).

The increasing price reaches a point where it is no more sustainable and the economy starts to slow down and many people find it hard to repay their mortgages. There is an excess demand for houses since there is the perception that the real estate market is doing well. People want to invest in houses as they are of the opinion that the real estate market is the only stable market. Due to this excess demand and less supply, the prices of these houses shoot up even more and there are many more loans and mortgages taken by the people in order to just invest in this

market. These mortgages are sometimes taken up on the same property and the credit rating agencies overlook many aspects of prospective home owners. This phenomenon was what caused the financial crisis of 2008 in the US economy. This study focusses on how such crises affects the Indian market and will also speak about whether there is an impending bubble in the Bangalore real estate market.

2. LITERATURE REVIEW

The research paper studies the impact of permanent shocks to housing prices ascribed to monetary variables and income growth and it also attempts to identify the speculative price bubbles in the housing market. It states that although income growth is a factor contributing to the variations in housing prices, the probability of any possible untoward selection in bank financing of the housing sector cannot be ruled out (Joshi, 2006).

One of the research papers studies the speculative bubble behaviour in the Indian real estate market and the author uses various econometric tools like variance bound tests, stationarity and co-integration tests, and regime switching models to test the presence of bubbles in the Indian real estate market (Vijay Kumar Vishwakarma, 2012).

The Indian real estate market could not remain unaffected by the global recession. This study focussed on how the implications and impacts of this global recession played a major role in the fall of demand in almost every sector, most importantly the real estate sector (Dr. D.D. Chaturvedi, 2013).

The author has studied the impact of financial crisis and has stated that India has seen a boom in the real estate sector. He has also stated how the consequences of a bubble must not be underestimated (Vedpursiwar, 2013).

The findings suggest India has witnessed rise in demand for housing since the year 2001 which can be connected to increase in levels of income, younger earning age group, rapid urbanisation and nuclearization of families. It also points towards existing incomplete information in Indian housing market is inadequate. It is said so because these data lack sufficient information about mortgages, transparent transactions, proper laws and indices (Singh, 2013).

According to the researchers, the financial crisis not only affected the United States, but also the European Union, UK and Asia. They have also stated that the effect of this crisis could not be fully quantified in India but certain sectors like real estate would be seen (A. Prasad, 2017).

The financial crisis of 2007-2008 has brought back to life the interest of scholars and academicians in price bubbles. Shiller is known to have created a graph which depicts prices of homes in the United States over the century. This graph shows that prices have relatively been stable during the 20th century but have witnessed doubling over the decade after 1996 which then resulted to collapse and the crisis of 2008. Recovery was seen only after the year 2011 (Pedro Bordalo, 2018).

3. RESEARCH METHODOLOGY

3.1. Problem Statement

The demand for houses due to many people shifting to Bangalore has increased manifold. This ought to have an impact on the prices of the houses as many people are on the lookout for properties to invest even though the prices are increasing. The real estate market was once perceived to be a stable one but after the financial crisis of 2008, people are realising that it has always been a volatile market and investing in it does not always assure safety. It is perceived by many that the boom in the housing market is good for the economy but the problem is that perception has led to the increase in prices and eventually the housing market became just a superficial bubble which will result in many investors losing their money. Many of the investors say that this boom is a sham and this impacts them in a negative manner.

3.2. Objectives of the Study

1. To find out the implications of the financial crisis in today's real estate market.
2. To decipher whether Bangalore will be having a real estate bubble in the near future.

3.3. Research Design

The study is descriptive in nature and has been done with the use of secondary data. Analysis of various papers relating to financial crisis of 2008 and real estate bubble been performed.

4. IMPACT OF FINANCIAL CRISIS IN INDIA

The global financial crisis of 2008 has been mentioned as the most severe financial crisis that the world has ever faced since the Great Depression of the 1930's. The financial crisis is characterized by reduced liquidity in the global credit and housing market which is triggered by the failure of mortgage companies, investment banks and government institutions which had invested excessively in subprime loans.

The International Monetary Fund (IMF) officials have stated that the losses due to real estate crisis amounted to \$945 billion only in the USA and when the losses of every country are compiled, it might run into trillions of dollars. There was a rise in the number of defaulters who had taken subprime loans. This crisis accelerated in the month of September, 2008 which eventually evolved into a global crisis. The fall of top investment firms such as Lehman Brothers, Bear Sterns etc., A few which were rescued by the government and American Investment Group (AIG) were Merrill Lynch, Citi Group and JP Morgan. The subprime loans are provided to people who do not qualify as prospective borrowers due to factors like low income level, number of down payments made, credit history, etc.

India took a long time to come out of the socialist belief of the Post-Independence era that houses were supposed to be provided by the government. The macroeconomic environment was also conducive. India's Gross Domestic Product (GDP) grew 8.4% in 2010-11. Banks were offering home loans to buyers and funds to developers without keeping the notion of leveraging the sector in mind.

It is challenging to point out the exact cause of the financial crisis, but more than a handful of experts are of the view that subprime loans in the housing sector was one of the most important cause of the financial crisis of 2008. The most important cause of the crisis is boom and burst in the housing market. The crisis started with the bursting of housing "bubble" which began in 2001 which continued to grow at a rapid rate until it reached its peak in the year 2005. The factors that contributed to the rapid increase in the demand for house price also include low interest rate and huge inflow of foreign capital from China, Japan and the U.K. Since subprime loans were provided without much verification, the rise of inflow of money in the economy also increased the demand for houses.

The crisis that was faced by the US market had hit the Indian real estate sector hard. The sector was already pressurized due to the increase in interest rates put into action by the Reserve Bank

of India (RBI) to contain inflation and also to restrict the flow of funds. According to consultants, the real estate prices will undergo a sharp correction in the short to medium term.

The financial crisis in the global market has affected the availability of funds for the domestic realty sector. Since the RBI has already put restrictions on Indian banks to fund real estate companies in the country, they are solely dependent on foreign funds through Foreign Direct Investment (FDI) and are forced to borrow from high net worth individuals at very high interest rates (Sutradhar).

4.1. Real Estate Bubble

Metropolitan cities in India are becoming a hub of industrial parks, high rises, residential complexes and commercial complexes, which are steadily transforming these cities' skyline. Many want to invest in the real estate as it is known to be one of the less risky sectors for investment, but the question of whether the rising prices and increase in performance of real estate sector is a farce, looms over us. The financial institutions lend loans to customers and mortgage the same property multiple times which led to the financial crisis in the United States in 2008. The crisis had a global impact and its effects could be seen on India's economy.

According to a representative of Century Real Estate, Bangalore - the real estate bubble in Bangalore is not as big as it seems. Investors are putting their money in residential deals rather than commercial ones. This situation has been raising fears of an immensely active economy which is making a lot of the scholars' minds dubious. The central banks have initiated a reduction in the number of lenders on the amounts sanctioned for real estate loans which led to an increase in the rates of interest and a decrease the attractiveness of home financing for consumers. This caused the cost of home and office rent including their purchase price reaching unprecedented highs. Since many real estate companies are privately held, their financial health is not disclosed to investors and buyers and often inability to read available information also causes grave concerns among the investors.

The representative states that, before a bubble bursts, prices begin to drop slowly and this has been evidenced across the country. The National Housing Bank's Residex tracks housing prices in 26 cities in India. This index showed that there was a fall seen in the housing prices of 22 cities. Mumbai and Delhi saw prices drop by 0.5% and 1.5% respectively. While properties in Chennai dropped by 2.3% and properties in Kolkata dropped by 4.1%. Properties in Bangalore

witnessed a drop by 2% which is comparatively less. When the nominal numbers were compared by analysts, housing prices were seen to have fallen in 11 out of 15 cities. The residents who have taken multiple loans might end up selling their properties for prices less than what the property is actually worth in order to repay their loans. At this point, the bubble bursts and prices might drop excessively straightaway.

An example of how devastating the impact of a real estate bubble can be was told by the representative. He stated that since the launch of BSE Realty Index in the year 2007, the Index had depreciated more than 80% in value, with a humungous 80% drop that happened just during the calendar year of 2008. The year 2008 is when the bubble occurred. If another such bubble were to occur, the same situation might be witnessed again (Tejas).

5. CONCLUSION

Land falling under the category of fixed assets gives the sector a high volume to leverage. It works on a model where businesses can be started by taking loans multiple times based on the value of underlying asset. Most developers have built their model based on the high value of the underlying asset and not the actual capability to execute. In Bangalore, although the indicators might look alarming, there is no indication that the real estate bubble will burst in the near future. Therefore, it would be safe to say that investing in real estate in Bangalore might still not be a bad decision for investors.

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