Peru faces threat of housing bubble

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Peru's National Institute of Statistics and Information (INEI in Spanish) released statistics last month establishing that property prices in the country have risen faster than anywhere else in the world, ballooning by 121 percent between 2008 and 2012. This outstrips London (35 percent), Hong Kong (61 percent), China (64 percent) and Brazil (90 percent).

The difference between Peru and the other countries that have seen real estate prices climb sharply is that the Peru's was one of the few national economies to emerge virtually unscathed from the world financial crisis that erupted in 2008.

The foreign investor-friendly policies pursued by President Ollanta Humala—and his predecessor Alan Garcia—made Peru one of the very few countries that initially benefitted from the crisis. By branding Peru as an attractive and secure place to invest, they were able to attract foreign money that was pouring out from crisis-ridden nations. At the same time, the country's economy benefited from mining exports, with China as its largest partner. To do this, Humala quickly scrapped the minimal reformist promises of his "social inclusion" program, which won him the presidency with up to 80 percent of the vote in the poorest areas of the country.

For a few years now, construction, alongside mining, banking and emerging sectors like retail and agribusiness, has played a leading role in raising the average family income of millions above extreme poverty levels.

Recent economic developments, however, have proven that Peru is not immune to the capitalist world crisis. The economy this year is decelerating, affecting all sectors.

The rise of Peru's GDP in recent years can be quickly erased as the world economy faces further contractions, returning millions of Peruvians to conditions of extreme poverty.

What sustained the demand in housing is the rise of the emerging middle class and entrepreneurs—sections of the population not linked to the traditional bourgeoisie.

The fortunes of the new entrepreneurs are generally quite slim. They depend on Peru's position as a mineral export country and with China decelerating, their prospects can fizzle quickly.

According to US standards, "Property bubbles," the Peruvian financial web site SEMANAeconomica.com reports, "are usually measured by the price/rent ratio. This indicator shows the number of years you would have to rent a property to recover the purchase price. When there is a bubble, this ratio is usually higher than 25. In Lima this figure reaches 16 as measured by the Peruvian Reserve Central Bank (BCR in Spanish)." The 25 ratio obviously is a figure used to measure a housing bubble in a developed country like the US.

Opposing this analysis, SEMANAeconomic.com reports, "economic analyst Ricardo Lago, argues that the price/rent ratio should not focus on the number 25. Speaking to the *Daily Mail*, he noted that in the case of an illiquid asset such as a home, the ratio should be around 12, meaning there already is an economic bubble in many of the districts of Lima."

This argument is far stronger than the simple comparison of prices in different Latin American cities. According to Scotiabank-Peru, "still, so far Peru has one of the lowest prices per square meter (m2) built compared to other countries in the region. In Peru it is US$ 1,810 per m2, while in countries like Brazil it exceeds US$ 3,700, in Argentina and Chile US$ 2,800 and in Colombia US$ 2,300."

As the demand from sector A on the income scale—the richest—is almost fulfilled, banks have turned their attention to sectors D and E—the poorest and most vulnerable. One can only wonder what the mortgage interest rates would be for the most fragile sections of the Peruvian population. As a point of reference, credit card effective annual rates now surpass 100 percent.

The purpose of the SEMANAeconomic.com article is to warn the capitalists, and especially the banks, that Peru may actually be in a housing bubble and should demand that Humala enact policies before the bubble bursts. It is an endorsement of the tightening of mortgage credit that has already started.

"In Peru" says the web site, "rather, mortgages are slowing. Between August 2013 and August 2014, the stock of housing loans grew by 13 percent, while between 2012 and 2013 it grew by 24 percent. However, 90 percent of loans are intended to finance a first home, which would not have increased the risk of speculation. Dollarization in the credits is 41 percent."

In addition to higher prices in construction materials, Scotiabank-Peru warns, "there is another issue to consider: the increase in mortgage banking delinquency; which between late 2013 and August 2014 ... increased 55 percent."

One significant aspect of the housing boom and its slowdown that was not mentioned by SEMANAeconomica.com is the way in which it has fueled the corruption dominating the construction unions. With the slowdown, rival unions, the Apra-dominated CTP and the Stalinist-dominated CGTP, compete even more ferociously for new projects. In order to win the right to act as labor contractors, they stop at nothing. It has been widely reported that both unions have hired hit-men to get rid of the competition. So far, over a dozen union leaders have been murdered this year.