

After the Stock Market Crash-Real Estate Next?

By Dr. Mohamed A. Ramady

Arab News, Monday Nov 6, 2006

With Saudi and other Gulf stock prices in a free-fall - the Saudi index breaking below the psychological 10,000 level to reach a low of 8,300, the same levels as eighteen months ago, the time is right to ask whether Saudi and regional real estate markets will follow suit. The Saudi stock market has shed around 48% since January 2006, a much higher loss than the 23% two day loss in the now infamous 1987 Black Monday stock market crash. The fact that Saudi and Gulf markets have been retreating in an erratic fashion, with daily falls limited to the maximum allowable by the regulatory authorities has tended to cushion the magnitude of the falls. Understanding the causes of such tumultuous market movements, provides us with a better understanding of the markets as a whole, and especially if the contagion will spread to other seemingly “safer” investments such as real estate.

The current Saudi and Gulf stock market falls cannot defy all logic, nor did they occur just spontaneously. There were a collection of causes, some psychological, some due to market structure or to events peculiar to the region. The problem with psychological explanations is that they reside deep in the mind of investors and are therefore, difficult to access. Sometimes it is quite irrational to see massive self-offs of good investment grade safe stocks with excellent long term growth prospects, except attribute such sales to a “panic herd” mentality. Once set in motion, this is the most difficult to stop, either on the way up or down. By all accounts the Gulf economies are in a better fiscal shape than many previous years, economic profits are being undertaken to diversify their oil-based economies, the labor markets are being strengthened through educational reforms and market led graduate output and, despite recent wobbly oil prices, national financial reserves have been built up. And yet the crashes continue.

It was only a few weeks ago that the Saudi Arabian Monetary Agency’s Governor robustly denied rumours of a revaluation of the Saudi Riyal because of large Saudi surpluses. Instead of rallying the markets, the local index continued to fall. This is a far cry from 1987, when the U.S. dollar had been declining prior to Black October events, and the bond market had experienced one of its worst declines in history. There were worries then (and now) in the USA about record budget and trade deficits, and yet the Dow Jones Index is not the one that is currently experiencing erratic daily movements, but the Saudi and Gulf stock markets.

Once again investor education is the salvation to a long term rational stock market emerging. A long way has gone towards ensuring better market data and financial transparency, as well as limiting the ability of insider dealing to manipulate prices. The abolition of the two- shift trading day will, over time, limit the ability of professional intra-day speculators to stage manage price movements to the disadvantage of the smaller, unsophisticated investors. One reason for the current Saudi stock price falls could be due to massive profit-taking on positions held by professional traders, in the knowledge that dealing information and intent will now be more difficult to hide in an all

day session. One negative side effect of this unification however, is that employee productivity could fall further, as staff become glued to their internets and broker contacts during the opening sessions while still at work. This compared with the trading, or more appropriately, speculating, during the previous after- work afternoon sessions. Again, investor education and taking long term investment decisions will reduce current volatility.

Are there underlying symptoms for a parallel real estate crash in the Gulf? Can one really argue that the real estate market in the Gulf, or in any of the GCC countries, is so unified and homogeneous that a crash in one real estate sector will affect the others? Yet this is precisely what is happening in stock market dealing, where “blue chip” companies are being dragged down by more risky stocks. A real estate crash could be possible if current stock market investors had mortgaged real estate holdings to borrow from banks to speculate in the seemingly lucrative share market. Conversely, there will be those that bought real estate on the premise that prices will go up due to real estate’s attractiveness to those who had made money on the stock market. With current stock price falls, this investor segment could be reluctant to buy at inflated real estate prices, thus forcing prices down.

Once again, one must caution that not all real estate investments are the same. Some are based on solid commercial long term assumptions, while others are get-rich quick schemes that are sold while still on the drawing board to gullible investors. In Saudi Arabia, the real estate market is now at a more mature stage, compared to the earlier 1970’s oil boom era when raw real estate was traded. Today, a real estate investor has a wider choice through the emerging special economic cities and zones that are being planned or under construction all over the Kingdom. Such economic cities will have a core fundamental and economic business rationale supporting it, making the real estate investment viable, but long term patience is still required. In the short term however, it is unfortunate, yet again, that Saudi and local investors might be hit by some speculative selling and buying of real estate projects which could feed into the more solid blue chip real estate sector.

Dr. Mohamed Ramady is Visiting Associate Professor, Department of Finance and Economics, King Fahd University of Petroleum and Minerals, Dhahran, Saudi Arabia.