

Box A

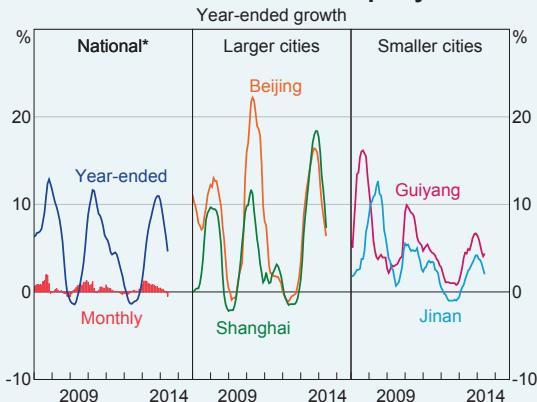
The Chinese Residential Property Market

Conditions in the Chinese residential property market softened noticeably over the course of 2013 and the first half of 2014. Over this period, there has been a broad-based slowing in the growth of residential property prices, although it has been most pronounced in the very large eastern urban centres (Graph A1). The volume of property sales has declined since late 2013, and prices have fallen in most cities for which data are available in the past couple of months. These trends have coincided with widespread reports of elevated vacancy rates for residential property, especially in smaller cities.

The easing of property market conditions follows policy measures introduced in early 2013 to slow the rapid growth in housing prices. The growth in prices over that earlier period was also strongest in the very large eastern cities, such as Beijing and Shanghai, which recorded year-ended growth in new property prices of over 15 per cent.¹

A number of price cycles have occurred in China's residential property market over the past decade. These cycles have coincided with changes in government policies, which have typically sought to constrain demand when prices have been rising rapidly and to promote demand when price growth has weakened. The Chinese Government has used a wide range of measures to influence residential property prices, such as tax policies, restrictions on the number of properties that households can purchase, and changes in the cost and availability of finance.² In times of rapid price growth, the government has also endeavoured to boost the

Graph A1
China – New Residential Property Prices



* Weighted average of price indices for 35 major cities
Sources: CEIC Data; RBA

supply of social housing to help absorb pent-up demand in urban areas.

In early 2013, the State Council, China's central legislative body, directed local governments to implement housing market policies intended to moderate price growth and reduce speculative investment.³ Provinces introduced a range of measures, including adjustments to property-related taxes in some areas and stricter checks on eligibility to purchase housing. In some locations, minimum interest rates for mortgages were increased, and existing restrictions on mortgage finance were tightened, including larger down payments for second home purchases and bans on additional mortgages for certain property owners. Across the country, efforts to increase the supply of subsidised housing were strengthened.

1 Comprehensive official data on housing market conditions are only available for China's larger cities, and activity in small cities and rural areas are only available as regional aggregates.

2 See RBA (2012), 'Box A: China's Residential Property Market', *Statement on Monetary Policy*, February, pp 14–16.

3 State Council (2013), 'Document No 17: Notice on Continuing to Follow Through with Property Market Controls'. Available at <http://www.gov.cn/zwgk/2013-03/01/content_2342885.htm>.

Residential property investment represents a sizeable share of China's economic activity and hence weaker conditions in the housing market have the potential to weigh on overall growth.⁴ In the medium to long term, however, demand for residential housing is likely to continue to be supported by rural-urban migration. Urban housing space per capita has grown steadily for more than 20 years, and China's urbanisation rate has risen from 42 per cent to 54 per cent in the past decade, a trend that is likely to continue given the government's commitment to facilitate further urbanisation.⁵

Housing market conditions also affect conditions in important segments of the financial sector. The direct exposure of the banking sector to the real estate market is moderate, with household mortgages and loans to property developers accounting for about 14 per cent and 7 per cent of banks' lending, respectively. Mortgages have generally been relatively safe assets for banks, as the central government requires maximum loan-to-valuation ratios of 70 per cent for first homes and 40 per cent for second homes, and the rate of non-performing loans is relatively low. In addition to accessing bank funding, property developers raise sizeable funds outside the banking sector, including through trust companies, entrusted lending (bank-intermediated intercompany finance), the bond market and informal lending channels.⁶ To the extent that regulatory supervision and internal risk assessment is weaker for some of these funding channels than for the formal banking sector, there is a greater chance of financial losses in the event of a sharp negative correction in the housing market. As the banks are ultimately funding much of this lending they are also exposed to this risk indirectly.

⁴ Real estate accounts for more than one-quarter of Chinese fixed asset investment.

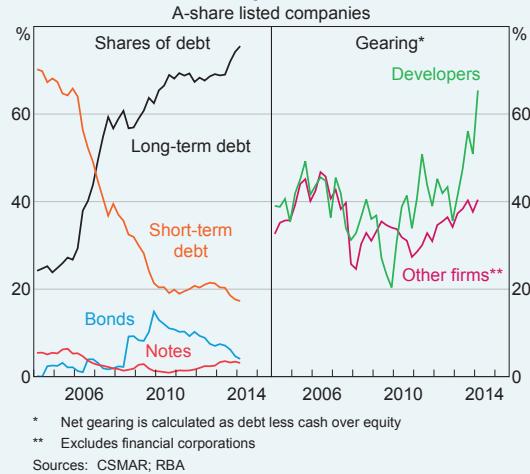
⁵ For further discussion, see Berkelmans L and H Wang (2012), 'Chinese Urban Residential Construction', RBA *Bulletin*, September, pp 21–26.

⁶ For example, trust loans to developers amounted to about CNY 1 trillion in 2013, compared with CNY 4.6 trillion worth of bank loans to property developers.

A more general risk to the financial system relates to the correlation between property prices and land values. For many of the cities in which housing prices are now recording falls or declining growth, the growth of land prices for residential projects has also moderated. To the extent that land is an important source of collateral for financing in China, and a significant source of revenue for local governments, widespread and sustained declines in land prices could have broader implications for financial stability.

The financial reports of listed property developers are one source of information about the health of the sector, although listed firms account for only around 11 per cent of total sales, and are likely to have more stable access to a diverse range of funding sources than some unlisted developers. The aggregate gearing of Chinese listed developers, at less than 70 per cent, is not excessive by international standards, being lower than private non-financial corporations in the euro area but somewhat higher than in the United States and Australia. Nevertheless, it has increased rapidly over the past two years to its highest level in at least a decade, and is now significantly higher than the gearing ratio for listed firms outside the real estate sector (Graph A2). This

Graph A2
China – Property Developers' Debt

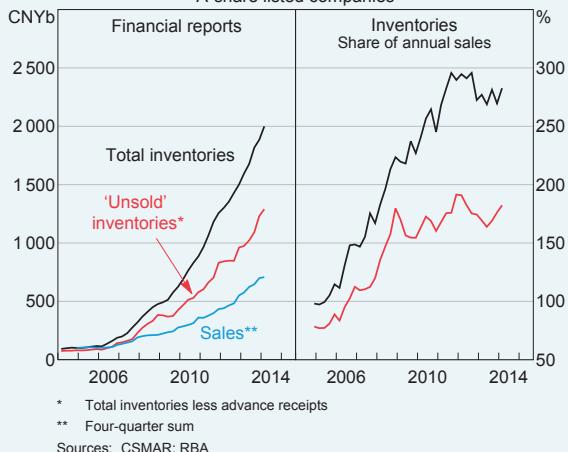


increase has largely been driven by rising long-term debt, which constitutes three-quarters of debt outstanding; the level of cash holdings remains high, but its growth has slowed. Other indicators of the financial health of listed companies, such as the ratio of current assets to current liabilities and the return on equity, appear relatively strong.

Consistent with reports of widespread vacancies and 'over-building' in Chinese cities, the value of listed developers' inventories has increased as a proportion of revenue over the past decade (Graph A3). Adjusting for pre-sales of residential property under construction (which account for a large share of new housing purchases), the ratio of 'unsold' inventories to sales has remained relatively stable since about 2008, although it has tended to rise during property downturns.

Graph A3
China – Property Developers' Inventories

A-share listed companies



Little information is available about the financial health of unlisted property developers, particularly the large number of smaller firms. However, restrictions on the quantity of bank lending to the real estate sector suggest that these firms are likely to be more reliant on non-bank sources of credit to finance operations. These sources of financing typically have much higher interest rates than bank loans, leaving developers more vulnerable to repayment risks. More broadly, a climate of slowing cash flows increases the likelihood of developers defaulting on their financial obligations, including credit provided by non-bank lenders. It is likely that the banking sector is indirectly exposed to this financing, in the sense that banks are the ultimate source of funding for many non-bank financial institutions.

The recent decline in residential property prices has led some cities to ease policies that have had the effect of restricting property transactions for both developers and buyers. These changes vary by locality and include tax breaks, less stringent requirements for access to local residence permits, and the removal of some purchase restrictions. Despite these changes, property market policies remain restrictive overall. With a few exceptions, such as efforts by the People's Bank of China to encourage bank lending to first home buyers, the central government has so far eschewed a nationwide response to weakening conditions. The restrictive stance of policy towards the property market leaves the authorities with further scope to support activity in the sector if required. ▶