CHINA ECONOMIC UPDATE MARCH 2022

China's outsized property sector presents a major drag for growth in 2022

NAB Group Economics

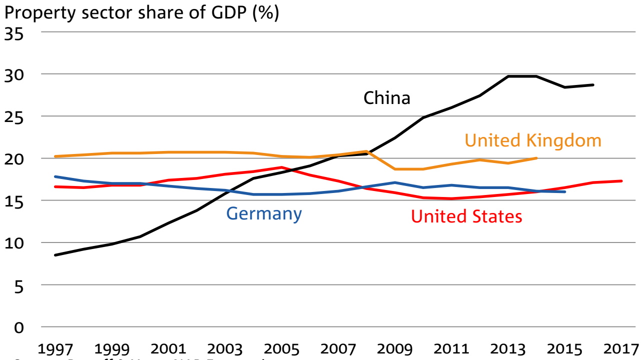
China's broad property sector has come under renewed focus over the past year, as the long slow collapse of major developer Evergrande highlighted imbalances in an industry that has an outsized share of the country's economy. Chinese authorities face a delicate balancing act in managing the sector's imbalances while attempting to minimise the impact on overall economic growth.

PROPERTY'S HISTORICALLY IMPORTANCE TO CHINA'S ECONOMY

The property sector has been a major contributor to China's overall economic growth over the past two decades. Estimates (based on input/output tables) of the total size of the broad sector – comprising construction and property related services (such as buying, selling, renting and managing property) – suggest it could be as large as 29% of China's economy – well in excess of other major economies. In addition, there are related sectors both upstream and downstream – such as the manufacturing of construction materials (such as steel, glass and cement) and financial services to support property transactions.

PROPERTY'S SHARE OF GDP

China's share far exceeds other major economies



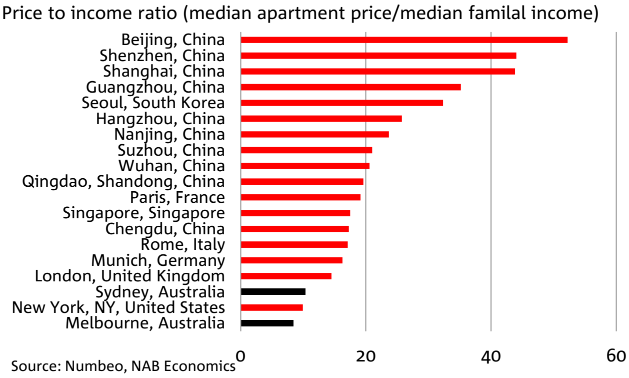
Source: Rogoff & Yang, NAB Economics

Home ownership rates are also high by international standards. Various studies in recent years, typically building off residential surveys, estimate that at least 80% of Chinese households own their home (with some studies suggesting more than 90%), while more than 20% of households own multiple homes. In comparison, the US Census Bureau reported home ownership rate of 65.5% in late 2021. It is worth noting that these data are not directly comparable, due to differing societal norms around family sizes and intergenerational cohabitation mean that there could be considerable differences in what constitutes a household in each country.

The importance of the property sector to the overall economy creates some significant challenges for Chinese authorities, particularly if there were a major shift in housing prices. The long running boom in housing markets has seen prices rise substantially – particularly in the country's largest cities. This has generated considerable wealth for some households – particularly early entrants to the market – (contributing to the significant wealth inequality in the country) but also made housing extremely unaffordable by international standards.

HOUSING AFFORDABILITY

Long boom has made China's housing comparatively expensive



Source: Numbeo, NAB Economics

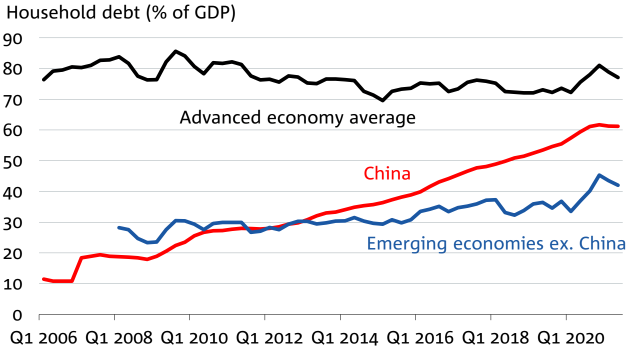
The long running boom in China's housing sector has been partially fuelled by debt. Between early 2009

Date **March 2022** | Author **Gerard Burg** – Senior Economist – International

and the end of 2021, household debt in China (as a share of GDP) rose from under 20% to over 60% – in stark contrast to a declining trend in advanced economies (at least until the start of the COVID-19 pandemic).

HOUSEHOLD DEBT

China's debt has accelerated over the past decade



Source: BIS, NAB Economics

Given the narrower range of investment options for Chinese households (when compared with most advanced economies), it is unsurprising that property represents an outsized share of China's household wealth. Surveys of China's household wealth suggest that real estate accounts for over 70% of total assets, compared with around 35% in the United States (Rogoff & Yang). This suggests that household consumption in China would be more vulnerable to house price declines than the United States.

GOVERNMENT POLICY TURNS AGAINST THE HOUSING BOOM

Over the past few decades, government policies have generally been supportive of property construction and real estate. In part, this reflects the importance of land sales to local government revenues – accounting for almost 46% of the total in 2020 – but also reflects previous stimulus of the property sector used to underpin growth – such as in 2016, when authorities eased property purchase restrictions, encouraged banks to expand lending and provided fiscal support, warding off fears of a hard landing for China's economy.

However, official support for property has reversed. Growing concerns that property markets were overheated and the unsustainable financial position of many property developers led Chinese authorities to introduce the "three red lines" – a series of debt measures that companies had to meet or exceed to avoid restrictions on lending. According to Bloomberg analysis of company filings, around two-thirds of the top 30 property developers failed to meet at least one line in 2021, with Evergrande failing two, and three unidentified firms failing all three.

On the demand side, it appears that China's government has been attempting to discourage households from investing in property for some time. At the end of 2016, at the annual Central Economic Work Conference, President Xi emphasised the principle that "houses are for people to live in, not for speculation" – a phrase that has been regularly used since by Chinese officials.

In November 2021, Vice Premier Liu He reiterated this principle in an article in the People's Daily. It stated that local officials should focus on stabilising land and house prices as well as the public's expectations to ensure that they solve housing problems and support a healthy property development sector.

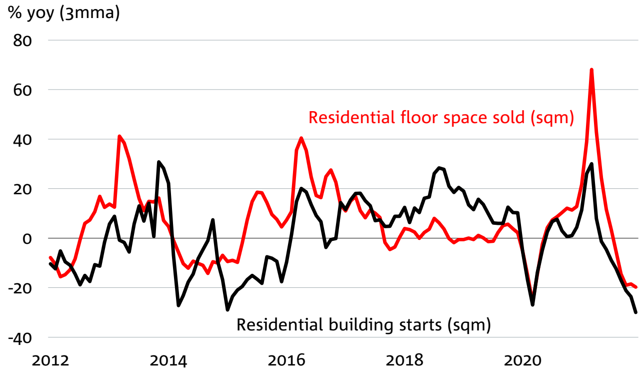
The scale of China's property sector means that any significant downturn will have a negative impact on the overall economy. Rogoff and Yang estimate that a 20% downturn in real estate activity could result in a 5 to 10% fall in GDP – with the potential for further declines through the financial sector – given the importance of mortgage lending and the use of property as collateral for other lending.

RECENT PROPERTY TRENDS

Various measures of activity in the property sector have deteriorated in recent months. For example, both residential property sales and construction starts (measures in square metres) surged at the start of 2021 – reflecting base effects due to the COVID-19 lockdown during the same period in 2020 – before starting to fall in year-on-year terms. Similarly, house price growth slowed across the second half of the year.

CHINA HOUSE SALES AND STARTS

Steep downturn in housing activity



Source: CEIC, NAB Economics

Despite the collapse of Evergrande, Chinese authorities have (so far) resisted any pressures to pull back on the "three red lines" policy – albeit they have indicated that selected state-owned enterprises may be permitted to exceed limits in acquiring assets from distressed private sector developers.

That said, the People's Bank of China (PBoC) has cut its primary policy rate in recent months and directed commercial banks to increase mortgage lending – likely in an effort to stabilise the market (in line with the views expressed by Vice Premier Liu).

CONCLUSIONS

At this stage, it appears likely that the weakness in property sector is set to continue. Authorities have allowed Evergrande – along with some smaller developers – to default on bonds, suggesting that they are unlikely to flood the sector with stimulus, despite the current softness in economic activity.

That said, the construction sector is likely to receive some support – focussed largely on infrastructure. The State Council is looking to accelerate progress on 102 major infrastructure projects outlined in the 2021-2025 Five Year Plan, while the Ministry of Finance allocated RMB 1.2 trillion of special purpose bonds to local governments in late December 2021, urging them to use these funds in the first quarter of this year.

Given the size of the broad property sector, it is clear that weakness in property presents downside risk to economic growth. In February, we lowered our forecast for China's economic growth to 5.1% in 2022. If there is no growth contribution from property, the rest of the economy would have to grow by just over 7% to reach this forecast.

Longer term adjustment to the property sector is extremely challenging. While property in many major cities is highly unaffordable, attempting to adjust prices lower would present sizeable risks to the financial sector as well as to households that are highly leveraged – potentially disrupting the efforts to boost domestic consumption.

CONTACT THE AUTHOR

Gerard Burg

Senior Economist – International

Gerard.Burg@nab.com.au

+61 477 723 768

Sources:

Rogoff, Kenneth, and Yuanchen Yang. 2021. "Has China's Housing Production Peaked?" China and the World Economy 21 (1): 1-31

Group Economics

Alan Oster
Group Chief Economist
+(61 0) 414 444 652

Jacqui Brand
Personal Assistant
+(61 0) 477 716 540

Dean Pearson
Head of Economics
+(61 0) 457 517 342

Australian Economics and Commodities

Gareth Spence
Senior Economist – Australia
+(61 0) 436 606 175

Brody Viney
Senior Economist
+(61 0) 452 673 400

Phin Ziebell
Senior Economist – Agribusiness
+(61 0) 475 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 0) 477 723 769

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 0) 455 052 520

Steven Wu
Economist – Behavioural & Industry Economics
+(61 0) 472 808 952

International Economics

Tony Kelly
Senior Economist
+(61 0) 477 746 237

Gerard Burg
Senior Economist – International
+(61 0) 477 723 768

Global Markets Research

Ivan Colhoun
Global Head of Research
+(61 2) 9237 1836