# China Economic Update May 2023

## Reports of a property rebound appear premature

## NAB Group Economics

A range of media reports in the early months of 2023 have touted an apparent rebound in China's property sector. Recent years have been particularly challenging for the industry – facing the negative impacts of regulatory changes and COVID-19 constraints – culminating in a sharp slowing in property sales, construction activity and the collapse of several property developers. While there are signs that property sales are stabilising and prices are rising in some locations, it is too early to suggest that property will shift from being the headwind to growth of recent years to being a tailwind in the near-term.

## Policy constraints stalled China's property sector

China's broader property sector has long represented an outsized share of its economy (when compared with advanced economies). At various times over the past two decades, Chinese authorities have adjusted policies around the property sector – including guidance to banks on mortgage lending, altering the size of down payments for purchases and purchase restrictions in different locations– to either stimulate or cool the broader economy. In addition, local governments have been highly dependent on land sales to generate revenue – particularly in lower income provinces – providing an incentive to keep the property sector flourishing.

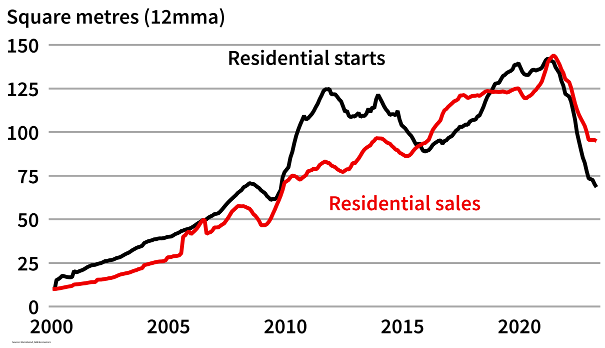
However, concerns over the excesses of property developers and their high debt levels led to the implementation of the Three Red Lines policy in August 2020 – a series of debt ratios that firms had to exceed to be eligible for further bank funding. These measures severely restricted credit to the sector – leading to the high-profile collapse of deeply indebted developer Evergrande, along with a range of smaller firms. According to Bloomberg, China's property developers defaulted on over 140 bonds in 2022, with missed payments totalling around US$63.7 billion (a record high, compared with around US$9 billion in 2021).

In addition, COVID-19 had a negative impact on property demand – with household incomes constrained by a lack of fiscal transfers (when compared with other countries), while zero-COVID policies encouraged an increase in savings and negatively impacted consumer confidence. This was exacerbated by property developers' long running tendencies to abandon construction projects when funding was exhausted – leaving them unfinished – which led to a mortgage strike (where purchasers of unfinished properties refused to pay their mortgages) that as of late 2022 remained unresolved.

The combined effect of these factors was a steep downturn in the property sector – with residential sales volumes falling rapidly along with new construction starts. Monthly data is highly volatile, meaning that it is often necessary to smooth it to reveal underlying trends. In April 2023, the twelve-month moving average for residential property sales (in square metres) was over a third lower than its peak in June 2021, while new residential construction starts were around half the peak of March 2021.

### Real estate sales and starts

#### Construction starts cut in half as developers debt access was limited




## Authorities take the foot off the brake

Rumours that China would ease some of the restrictive property policy measures – including the Three Red Lines – began to emerge in late 2022. Changes were confirmed in mid-January, when the PBoC announced an easing in the debt limits for thirty well-performing property developers considered systematically important to the sector. Banks were also instructed to extend repayment deadlines for housing construction and cut mortgage rates to encourage borrowing – although reports suggest that the latter measure has instead encouraged existing borrowers to repay mortgages faster, rather than spur a rebound in activity.

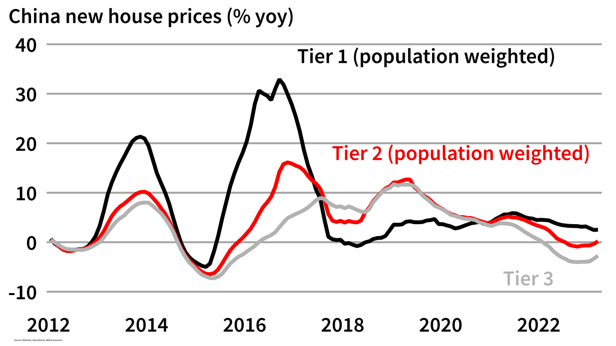
A range of headlines have touted the increase in sales values in the first four months – up 11.8% yoy according to unrevised data from the National Bureau of Statistics (NBS) – albeit this followed a 32% fall over the same period in 2022 – meaning that it remains well below earlier peaks. In contrast, the volume of sales over this period rose by just 2.7% yoy. It is also worth noting that there is inconsistency between the reported growth rate and the reported levels data (in RMB and square metre terms). Using the latter, the volume of sales contracted by 2.2% yoy in the first four months, with a larger decline in the month of April (down 9.5% yoy) – despite Shanghai and a range of other locations facing severe COVID-19 measures during April 2022.

Taking the reported growth rates for sales values and volumes would imply that there have been sizeable increases in property prices in early 2023 – however this is not consistent with the NBS's property price statistics – where even the increases in the largest tier 1 cities (the only locations recording anything more than minimal growth) fall well short of the implied price growth based on sales data.

Trends in residential property prices have differed widely across the country, with aggregate prices for the country's largest tier 1 cities (weighted by population) continuing to grow through the COVID-19 pandemic and into the post-zero-COVID phase. That said, price gains were modest when compared with pre-pandemic growth and were heavily weighted towards Beijing and Shanghai, with falling prices more recently in Shenzhen and Guangzhou. In contrast, prices in tier 2 and tier 3 cities peaked in late 2021 and subsequently declined. Outside the top tier cities, price trends have been consistently weaker for existing properties than new builds.

## China new house prices

### Little growth outside China's largest cities



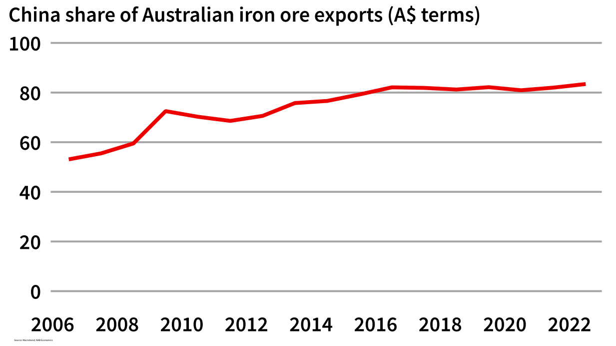

## Conclusions

Although property sales data appear to be stabilising at a considerably lower level than the previous peaks, new construction activity remains relatively weak. Property developers may prove cautious – particularly given the collapses of several firms in recent years – waiting for a clear turn around in sales before committing to new projects.

From an Australian perspective, this would be a negative trend, as residential construction is a key consumer of steel, an industry fed by Australian iron ore exports.

## Australian iron ore exports

### Dependency on China has risen

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