China Economic Update June 2024

China steps up support for the property sector – but will it be effective?

NAB Group Economics

In mid-May, Chinese authorities unveiled a range of measures aimed at stabilising the property sector, following almost four years from the implementation of the Three Red Lines policy, almost three years of slumping construction starts and property sales, over two years of falling residential property prices and the collapse of several major real estate developers. The precise goals of these policies are unclear; a return to pre-Three Red Lines trends would not be appropriate. We long argued that activity in China's property market was unsustainable prior to 2020 and it may take several years for the sector to find a suitable equilibrium, particularly given longer term demographic trends.

Lack of transparency following bubble burst

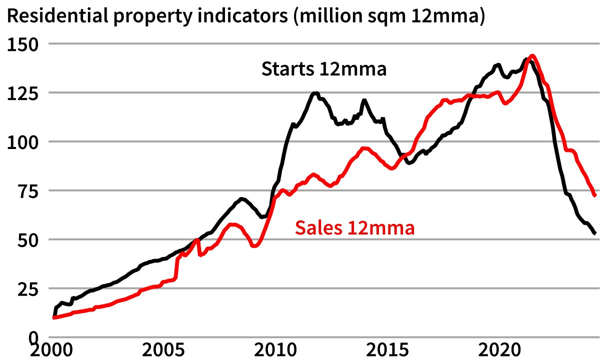
Prior to August 2020, China's property market experienced a long running bubble, as various government and financial policies led to excess investment in the sector. Price-to-income ratios rose rapidly – far above the levels seen in most advanced economies – while property developers took on vast debt to purchase land from local governments and undertake new projects (while regularly leaving construction unfinished).

Various factors contributed to the bursting of this bubble. The Three Red Lines policy in August 2020 restricted access to funding for property developers – leading to high profile collapses. The failure of many developers to complete projects led to a mortgage strike starting in 2022. New property sales and construction starts plunged, investment in real estate contracted and house prices across the country began to fall in 2021.

The excesses of this period led to an increasing number of unsold properties, however there is limited transparency around the scale of the problem. In its monthly release detailing investment in real estate development, the National Bureau of Statistics provides the area of floor space of residential buildings for sale, which it defines as unsold or unleased buildings where construction has been completed. In April 2024, this totalled around 391 million square metres, equivalent to around 4.3 million individual apartments (assuming a typical 90 square metre unit).

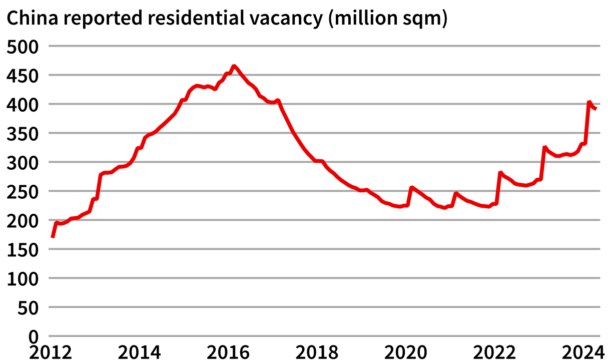
China property indicators

New sales and construction starts have plunged since Three Red Lines



China unsold property

Official data shows an uptick, but may understate the stock



However, there are various caveats around this statistic – most notably that it excludes second-hand houses that are available for sale – meaning that the NBS measure

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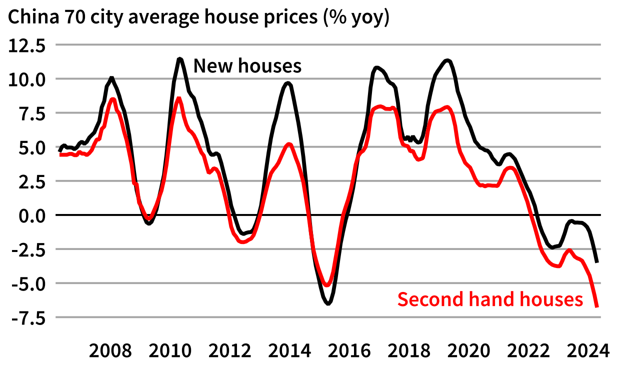
Data sources: IEA, Macrobond, NAB Economics likely under-represents the total. A recent report by Reuters put the floor space figure at the equivalent of around 7.2 million apartments (although we note that they may have included non-residential buildings), while another piece by Nikkei, which produced an estimate based on cumulative construction completions and sales since 2000, suggested that there could be 50 million unsold apartments. The sheer scale of the divergence in these estimates highlights the uncertainty around the property overhang.

Given the weakness in demand and scale of oversupply, property prices in China have been falling. Across 70 major cities, prices for new and second-hand houses have fallen year-on-year since April 2022 and February 2022 respectively. New house prices fell by 3.5% yoy in April 2024, while second hand prices fell by 6.8% yoy – the steepest decline in the latter on record (back to April 2006).

China property prices

Second hand property prices falling at a record pace



Chinese authorities seek to boost the property sector

In mid-May, Chinese authorities announced a range of policy measures intended to provide support to the property sector. These included policies to underpin housing demand as well as a program to absorb excess stock and increase the supply of affordable housing.

The People's Bank of China (PBoC) announced that it would scrap the regulated floor for mortgage rates. Mortgages are priced off the PBoC's 5 year Loan Prime Rate, with the previous floor allowing commercial banks to offer mortgage rates at 20 basis points below the benchmark, while for second homes it was 20 basis points above. The removal of this policy will allow local branches of the central bank to determine the lower limit, based on conditions in these markets.

In addition, the PBoC trimmed the downpayment requirements for home purchases, with first home buyers requiring a 15% deposit and second (or above) requiring 25% (in each case a 50 basis point cut from the previous requirements). Various major cities that had their own requirements have eased policies as well – including easier purchases for those lacking a household registration (or hukou) in some localities.

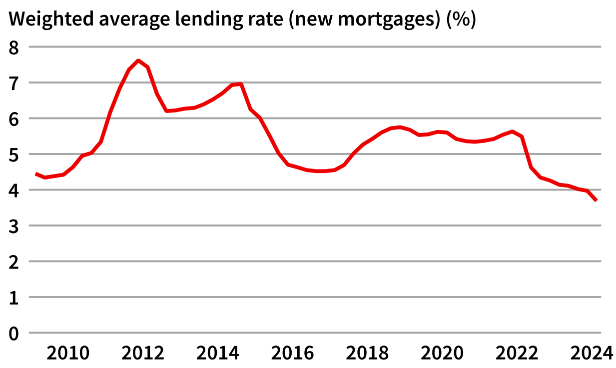
At the same time, Chinese Vice Premier He Lifeng announced a plan to address unfinished construction projects and de-stock the housing market. The centrepiece of this strategy is a RMB 300 billion relending facility from the PBoC that will provide 60% of the principal for banks loans directed to local state-owned enterprises (as selected by local governments) to purchase unsold property from developers. These sales – described as being purchased "at reasonable prices" – should then provide property developers with funds to complete unfinished projects, while the SOEs will offer the purchased properties for rent as affordable housing.

Conclusions – how effective can these policies be?

At a high level, the changes around the mortgage floor and downpayment requirements appear relatively small, particularly in an environment where weak demand for property has seen housing prices trend downwards since the second half of 2021. In addition, these measures represent a continuation of easing policy – the PBoC lowered the mortgage floor in 2022 and has cut the 5 year Loan Prime Rate by 70 basis points since the start of 2022. The weighted average lending rate for new mortgages has fallen even further – down by 180 basis points over the same period – with rates in Q1 2024 at the lowest on record (dating back to 2009). Overall, this implies that housing affordability has improved since 2022, however housing sales have continued to fall.

China mortgage rates

New mortgages at their lowest rate ahead of policy easing



This highlights the critical importance of confidence among purchasers. Housing has been a key asset class for Chinese investors over the past two decades – in part reflecting a limited range of other investment options. Such properties were often left vacant (in part due to a limited rental market for properties in China), relying on price increases to generate capital gains. This segment of the demand side is unlikely to return to any significant degree while prices are falling, and would require confidence that there is a viable potential for returns on investment.

Demographic trends could also have a negative impact on property demand – particularly in the longer term. China's population peaked in 2021, however its working age population – those most able to service a mortgage – peaked in 2013 and has declined ever since. This may place a cap on how large any recovery in property market activity could sustainably be.

There are a range of concerns with respect to the second part of the strategy – with local SOEs absorbing unsold properties. First, the scale of the package (at RMB 500 billion, with 60% of this total provided by the PBoC's relending facility) is relatively small. Using the lower end estimate of unsold properties and the average price for properties sold in April 2024 values this stock at around RMB 3.9 trillion. Bringing this measure back to pre-COVID trend levels would cost in excess of RMB 1.5 trillion at current prices. This cost would increase if the higher estimates of the number of unsold properties were more accurate.

Second is the use of local SOEs as the buyers of these unsold properties. A 2022 study of SOEs by S&P Global showed that local SOEs accounted for almost three-quarters of total SOE debt, but less than half of the sector's earnings, with a debt-to-EBITDA ratio of 12 (a ratio below 3 is generally considered to be sustainable). This policy would add additional debts to local SOEs, while it is far from clear that the affordable housing assets would provide sufficient revenue streams to service this debt. As a result, this policy may merely shift risk from one sector of the economy to another, and not necessarily to a sector better able to manage the risk.

SOE debt

Average ratio for local SOEs is highly unsustainable

SOE	Adjusted debt (US$ trillion)	EBITDA (US$ trillion)	Adjusted debt /EBITDA
Central	2.3	0.71	3.3
Local	7.3	0.61	12.0
Total	9.6	1.32	7.4

Source: S&P Global

This is particularly a risk if there is a mismatch between the location of unsold properties and where affordable housing is required. Major cities with large migrant worker populations are likely to be where affordable housing is most necessary, however there is anecdotal evidence to suggest that excess property is more common in lower tier cities.

Overall, the modest scope of this plan – when compared with the possible scale of the problem – may mean it is insufficient to stabilise conditions in the property sector.

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