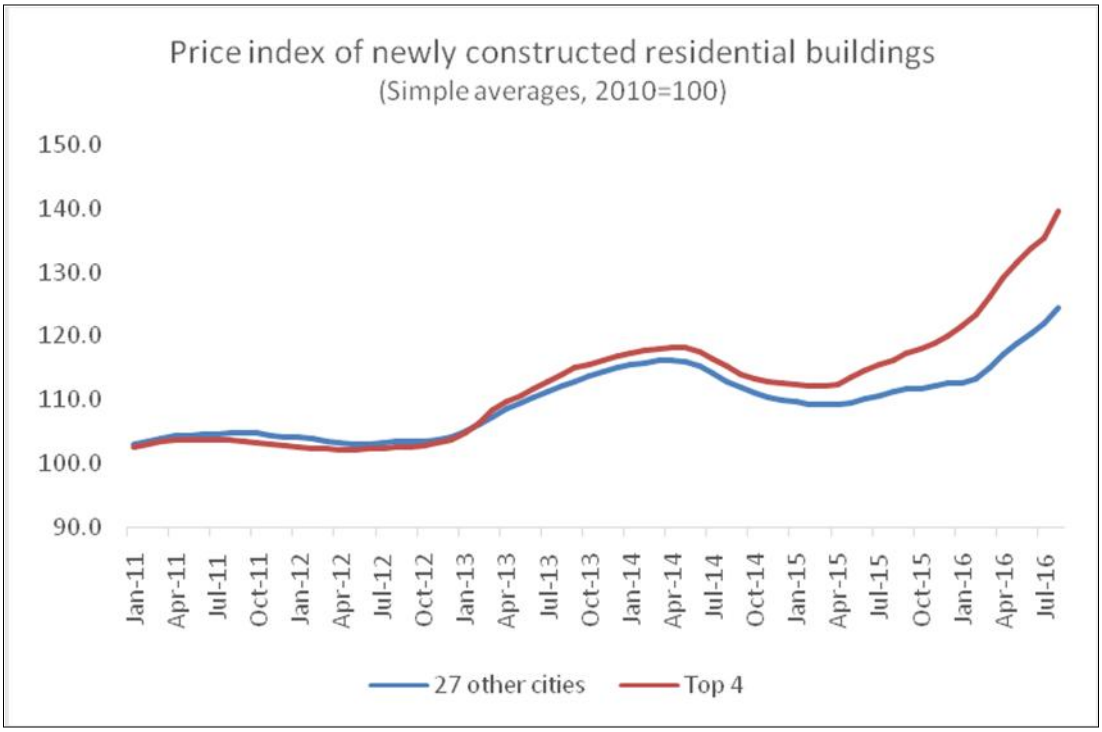
Housing Market Frenzy in China*

C.P. Chandrasekhar and Jayati Ghosh

What exactly is going on in the Chinese housing market? Over the past year, there has been a dramatic rise in prices of residential property in many cities, and especially in some of the large metros. This comes after a period just before, when everyone was talking about the "softening" of the Chinese real estate market as the authorities sought to clamp down on what they believed was speculative activity that was leading to excessively high prices and making housing unaffordable for many ordinary Chinese. But since then – and really from early 2015, as Chart 1 shows – prices seem to have gone completely berserk, increasing at unprecedented rates.

The biggest increases were in the Top 4 metros (Beijing, Shanghai, Tianjin and Chongqing) but many other cities have also showed very rapid increases. Chart 1 shows the simple averages of the price index for the Top 4 and 27 other cities: this indicates that from April 2015 to August 2016 (16 months) average prices in the Top 4 metros increased by 24 per cent and those in 27 other cities increased by 14 per cent.

Chart 1:



This certainly suggests something approaching a bubble, especially as house prices were already seen by many as being far too high even before the recent surge. According to official data, the house price to average income ratio was 9.2 at the end of 2015; and since then prices have increased even more dramatically than before, as Chart 1 indicates.

However, not all cities show the same trend, and even among the Top 4 metros there have been significant differences. The most dramatic increase in prices has occurred in Shanghai, as Chart 2 indicates, with new house prices there going up by more than 40 per cent in the 16 months to August 2016. Beijing follows with a 30 per cent increase, but the increase in Tianjin has been more moderate at 21 per cent. Most remarkably, prices in Chongqing have barely increased at all over this period, despite the apparent frenzy in residential real estate markets in general.

Chart 2:

Clearly, it is not only macroeconomic policies such as interest rates, banking and financial regulations and so on, that are at play here. Such sharp regional variations suggest that there are specific factors affecting particular cities more than others, and that authorities in some municipalities have been better able to control residential prices even through this more generalised bubble.

Indeed, in recent weeks, some other local governments in other cities have moved to institute regulations to curb house prices. The municipality of Hangzhou this week brought in rules that require purchasers of high-priced land at auctions to pay the entire amount within a month, so as to reduce speculative activity by developers and others. Nanjing in Jiangsu Province became the fourth city to limit those without residence permits to a single ownership and disallow more than two properties even for those with resident status.

Interestingly for a country ruled by a Communist Party, the home ownership ratio in China is now one of the highest in the world, at nearly 90 per cent compared to around 64 per cent in the US and the UK, for example. This is largely because the Communist Party allowed residents to buy their homes at prices that were steeply discounted relative to market value. Thereafter, there has emerged a flourishing market particularly for urban real estate and particularly for residential housing. Most of this relates to apartments rather than standalone homes (or “villas” as they are referred to in China), and the market is still generally driven by those who wish to reside in their own homes, mostly in newly constructed apartment buildings.

The pace of urbanisation has assisted in the continued demand for residential housing. While the sheer pace of price increase may appear to suggest a strong speculative element, it is not necessarily driven only by financial players and "land kings" who are real estate dealers interested in capital gains, but by individual buyers and potential occupiers. It has been estimated, based on data collected by sales managers across the country, that in the past three years less than ten per cent of buyers were investors. However, this does not rule out the speculative element, since individual buyers also see residential property as a secure investment (especially because of the various fiascos in the stock market since mid-2015). There are many instances of individuals and families holding multiple properties.

But the craze for new housing is doubtless being fed by speculators and real estate agents, such as those in Shanghai who brought on a spate of divorces by suggesting that new rules would exempt unmarried couples from higher down payment requirements.

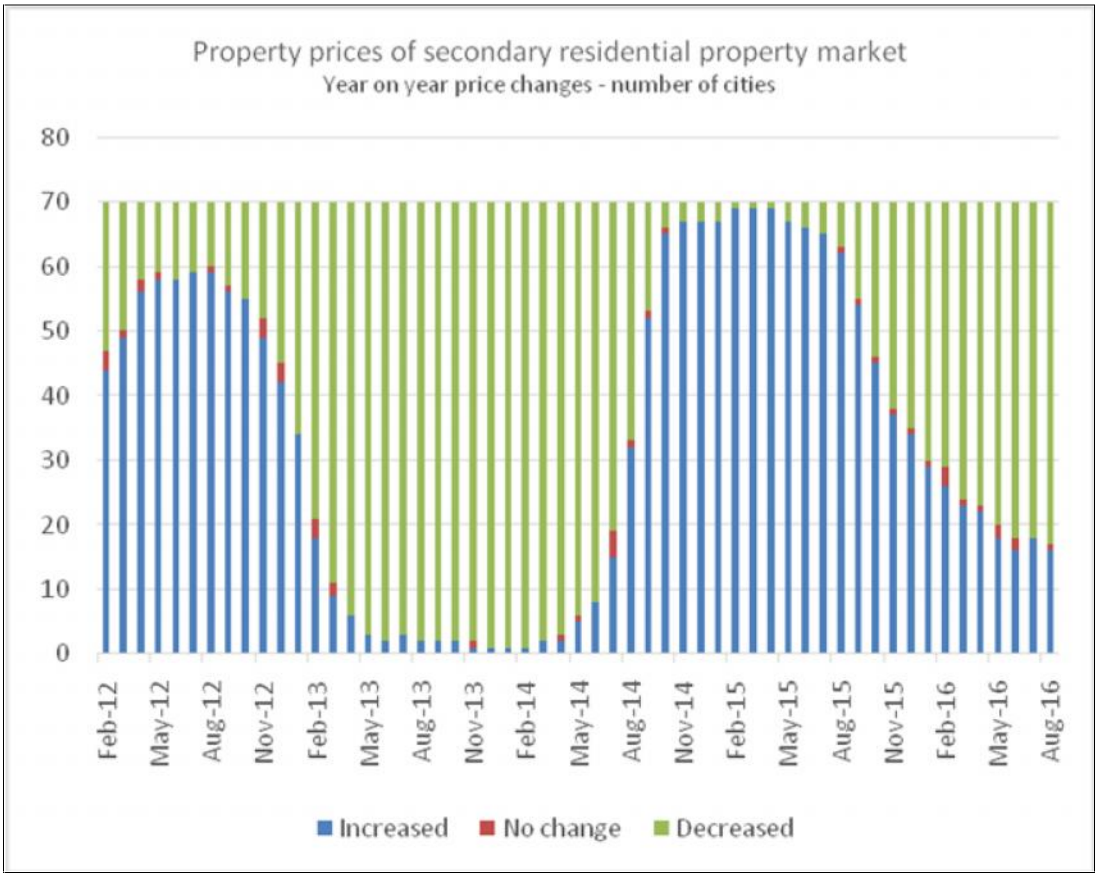
Obviously this bubble cannot continue to expand at the current rate for much longer, and house prices in many cities and towns must stabilise or come down eventually. The problem, as in most housing booms, is that house purchases are leveraged (albeit to a lesser extent in China than in other countries because of higher down payment requirements). The extent of debt flowing into housing has increased sharply in the current year. According to Bloomberg, outstanding housing mortgages in China increased by 31 percent just in the first half of 2016, three times more than the increase in overall lending. Loans to households increased to account for as much as 71 percent of total new lending in August 2016, compared to 24 percent in January. And this excludes the shadow banking activities that are also dominantly geared to real estate and construction lending.

This means that there is bound to be a knock-on effect on banks and other lenders, once the bubble bursts and house prices start coming down. The Chinese authorities are trying to walk the tightrope to bring stability and greater affordability into the housing market without simultaneously destabilising finance, but this is a difficult task. Indeed, the problem may be urgent, because in fact in many cities the downslide in house prices has already started – and indeed it is evident that in recent months the trend has got aggravated.

Charts 3 and 4 indicate the number of cities (including the top 4 metros, first tier cities and second tier cities) that showed rising, stagnant or falling prices (relative to the same month of the previous year) for new residential property and for the secondary market. They indicate that both for newly built homes and existing houses in the secondary market, there was a phase of several months when almost all the 70 cities in the dataset showed increasing year-on-year prices. But from September 2015 the number of cities showing falling prices has started increasing, to the point that in August 2016, as many as 62 cities experienced falling house prices and only 6 still had increasing prices (including Shanghai, Beijing and Tianjin) while 2 showed no change. The decrease is less widespread in the secondary housing market, but even here as many as 53 out of 70 cities showed declines.

Chart 3

Chart 4



The tightrope walk of regulating the housing market in China is clearly about to become more difficult.

* **This article was originally published in the Business Line on October 11, 2016.**