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Analysis of the Real Estate Market in China's Past and Present

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Abstract: The real estate sector, which plays a significant role in land financing and is a foundational sector of the Chinese economy, is very important. By primarily examining data from the China Statistics Bureau, the China Statistical Yearbook, and real estate-related statistics, this paper examines the present growth pattern of China's real estate business and highlights possible concerns in the current real estate industry. The real estate market is clearly in a downturn right now, but there are also hidden risks of overinvestment that might undermine the stability of the financial system. This is what this paper's data investigation reveals. As a result, the economic growth model that relies heavily on land financing cannot continue, and appropriate regulatory changes are needed to lower the risks associated with potential hidden hazards in real estate. Finally, it is recommended that the government carefully regulate the real estate market and, in the future, promote high-tech companies and financial industries to lessen the country's reliance on land financing.

Keywords: real estate, land finance, Chinese economy

1. Introduction

China's local economy is highly dependent on land finance, and most of the region's economic development is driven by the real estate sector. After the global financial crisis broke out in 2008, China adopted expansionary policies to stimulate the economy. While this has contributed to sustained economic growth, it has also resulted in a rapid increase in the leverage ratio of various sectors and the macro leverage ratio. The high debt of real estate enterprises has also become more and more prominent, which hides a large risk potential.

To prevent the debt risk of real estate enterprises from spreading to the entire financial system, China introduced the "three red lines" and the "centralized management system for real estate enterprise loans" in 2020, to strictly prevent funds from flowing into the real estate market in violation of the law [1]. China's supervision of real estate enterprises to become more stringent effectively curbed the real estate enterprise leverage rate continued to climb, the real estate enterprise gearing ratio in 2021 fell by 0.38 percentage points [1], but also caused Evergrande Group as the representative of the part of the real estate enterprise cash flow difficulties, real estate enterprises have appeared in the event of default on debt, the real estate market and the relevant financial institutions have brought about a greater impact. The real estate market as well as the related financial institutions have been greatly impacted. In the past two years, China's real estate prices, in general, appeared

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downward in the background, real estate enterprises' high leverage to China's economy is the hidden danger that caused great concern.

This paper will examine the development history, current situation, and possible pitfalls of China's real estate in the past few years, and give some insights and suggestions.

The purpose of this paper is to study and analyze the sustainability of the government's implementation of an economic development approach that is highly dependent on land finance, and to provide corresponding insights and recommendations.

This paper will first introduce the development history of China's real estate industry, explaining how the real estate industry has been an important part of China's economic development and the relationship between the real estate industry and China's economy. Secondly, it will introduce the current situation of real estate and its hidden dangers. Finally, some suggestions will be given and the article will be summarized.

2. History of China's Real Estate Industry

2.1. Economics of Local Governments' Development Model Centered on Land Finance

After the reform of the tax-sharing system in 1994, part of the financial power of local governments was transferred to the central government, while the power of affairs remained almost unchanged, which led to the excessive responsibility of local governments and a huge gap between fiscal revenues and expenditures. In order to maintain the normal operation of local governments and the continuous development of the local economy, it is not enough to rely only on the local government's own income and transfer payments from the central government, so local governments at all levels actively look for financial resources. At this time, the land as a resource in the hands of the local government could be freely disposed of, and its huge economic value gradually appeared, local governments at all levels through "land sales" to obtain a huge amount of income, this part of the huge income can solve the situation of the local financial resources shortage. Therefore, local governments will naturally produce dependence on "land finance" [2].

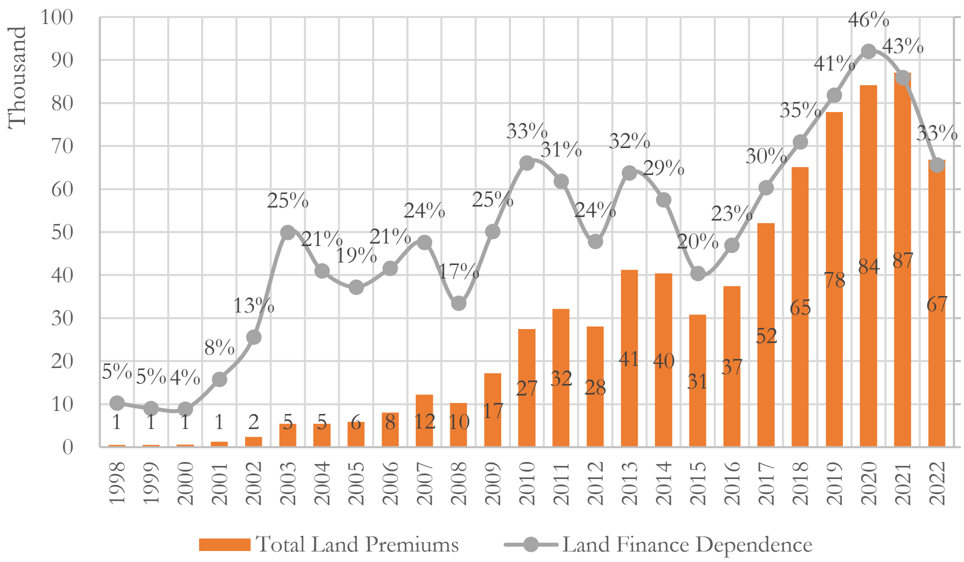

Figure 1: Revenues from land finance and their share of fiscal revenues.

Data source: National Bureau of Statistics

Photo credit: Original

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As can be seen in Figure 1, China's dependence on land finance has been increasing since the housing reform in 1998, and especially in 2015-2020, China's dependence on land finance continues to increase dramatically, reaching nearly half of the public budget revenue in 2020.

The reason why the government relies on land finance is that land finance can quickly pry local development: firstly, the government through the allocation and agreement to transfer land and other ways to attract investment to promote the manufacturing industry, real estate industry and the construction industry extraordinary development, access to high sales tax, corporate income tax, and other local taxes, and with the land concessions, the government will continue to increase the periphery of the other project inputs, which will lead to the whole region urbanization and Economic growth; Secondly, the government through the recruitment, auction, hanging and other ways to collect land premiums, and the right to use the land and the right to obtain the land financing, so as to drive the local economic development; Finally, the government can use the land for bank mortgages to obtain the urban infrastructure funds, to promote the construction of urban infrastructure [3]. In this way, land finance has become an indispensable part of local governments to build cities.

2.2. Relationship Between the Chinese Real Estate Market and Economy

Land finance and the real estate market are tightly linked through land acquisition fees, and higher house prices can bring higher land finance revenues to the government, thus further boosting the local urbanization process. Therefore, one of the consequences of relying heavily on land finance is to push up local housing prices and to further deepen the link between the real estate sector and the Chinese economy.

The direct contribution of the real estate industry to China's GDP in 2020 is more than 12% (value added share), of which 7.3% comes from real estate services and 4.8% from real estate construction [4]. In addition, according to the 2017 China Input-Output Table, it is expected that the indirect contribution of the real estate industry to GDP through inter-industry supply chain transmission may also be above 12%. Overall, the real estate sector's pull on China's GDP growth could be around 25%, i.e. if real estate activity falls by 10% overall, the combined direct and indirect drag on GDP growth (including multiple rounds of transmission) could be around 2.5 percentage points. At the same time, the economic situation will also affect the real estate industry in the direction of economic growth on real estate investment is greater than the impact of real estate investment on economic growth, which means that once the economic downturn fluctuations will lead to dramatic fluctuations in real estate investment [5].

Overall, the real estate industry is inextricably linked to the Chinese economy.

3. Current Situation of Real Estate in China

3.1. Concerns About the Viability of the Real Estate-Centric Strategy of Economic Development

Whether China's real estate industry is still in a golden period should mainly depend on the main indicators such as the scale of investment, the scale of sales, the number of employees, and the rate of increase.

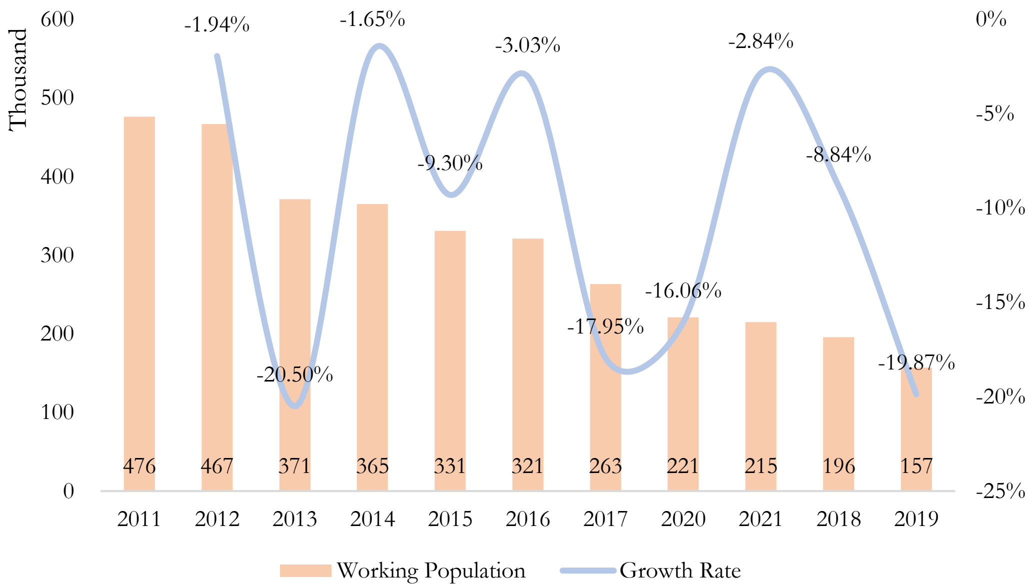

Figure 2: Employment in China's real estate industry.
Data source: China population and employment statistical yearbook
Photo credit: Original

Figure 2 shows that employment in the real estate sector has decreased over the past ten years, with all growth rates being negative.

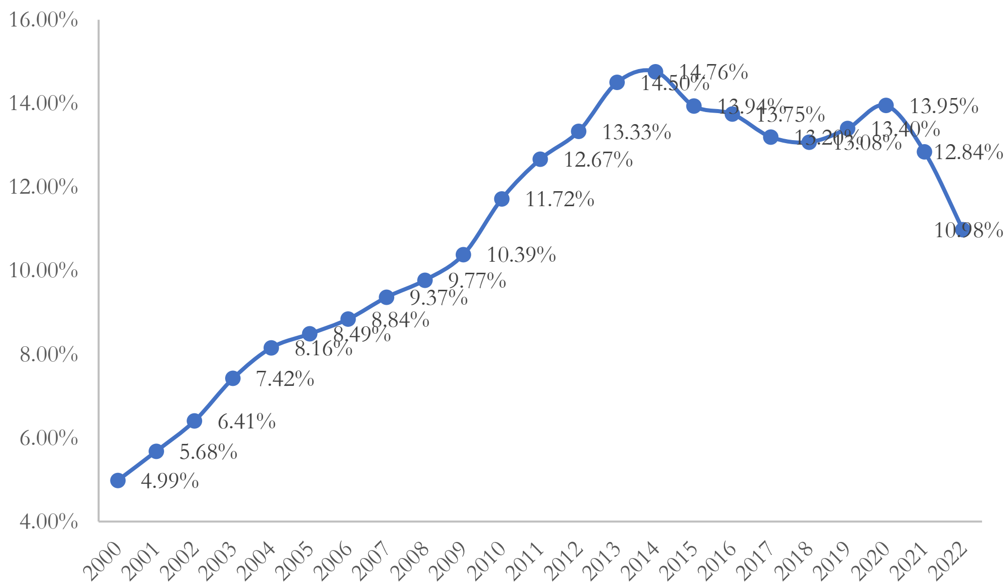

Figure 3: Real estate investment as a share of GDP.
Data source: National Bureau of Statistics
Photo credit: Original

As can be seen in Figure 3, the share of real estate investment in GDP peaked in 2014, and then gradually became a downward trend.

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Secondly, according to the National Bureau of Statistics, in 2022, China's real estate industry, the area of new housing construction decreased by 39.4% compared to 2021, the area of housing sales decreased by 24.3% compared to 2021, and the market supply of new housing decreased, and the listing of second-hand housing continued to improve [6].

Taken together, the number of real estate-related employees in China is also decreasing, while the supply of real estate has shrunk, suggesting that real estate is shrinking in size.

In addition to this, changes in population size and age structure are long-term factors driving the real estate market. Changes in the demographic structure make it difficult to support rigid demand in the real estate market. This contains two factors, the first factor is the population growth rate and its structural changes, a long-term factor driving the development of the real estate market [7]. The second is the number of marriages, marriage, and home ownership has been one of the main components of consumer demand for commercial real estate in China.

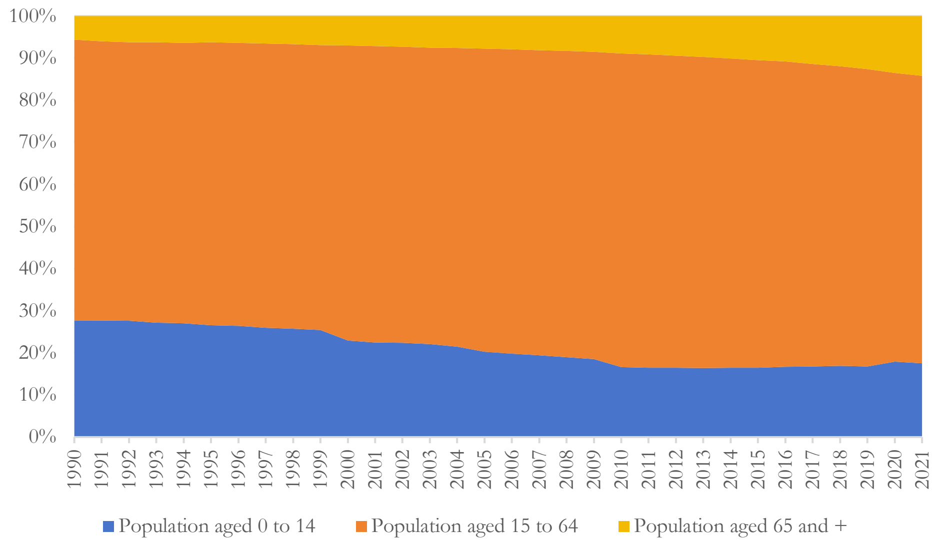

Figure 4: Population Structure.

Data source: National Bureau of Statistics

Photo credit: Original

According to Figure 4, China's population is undergoing structural changes, the 65+ population is increasing, while the population under 14 years old is decreasing. The population growth rate has declined to less than 1.5% after 1990, and the current population growth rate is about 0.5%, it is expected that the population growth rate will still decline in the future. Secondly, the number of marriages has been growing negatively since 2015 [7]. Marriage and home ownership are one of the main components of consumer demand for commercial properties. However, from the Civil Affairs Bureau published data on new marriages in previous years, it is expected that the number of newly married pairs in the country will decline from 13.5 million pairs in 2013 to 8 million pairs in 2020 year by year, with an average annual growth rate of -7%, which can be seen that the demand for marriage and home ownership is declining year by year in the next five years [7]. The impact of demographic factors on the real estate industry is complex and may lead to changes in market supply and demand, fluctuations in price trends, and strategic adjustments by developers. The current population decline means that the demand for property will plummet and house prices will fall, leading to a further contraction in the size of real estate.

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3.2. Problems That may Arise From the Crash of Real Estate Companies Represented by Evergrande

In 2021, Evergrande Group, the second-largest Chinese real estate developer in terms of comprehensive strength, had debt repayment problems. The endgame of the Evergrande case is not yet completely clear, but the spillover effects have begun to emerge. The real estate research team at UBS Securities believes that Evergrande's debt restructuring may be difficult to avoid in the coming weeks or months [4]. Possible ways for the spillover effects of the Evergrande incident include: 1) tightening financing conditions for other developers and suppliers; 2) impacting the project delivery capacity of real estate-related suppliers; 3) dragging down confidence in the real estate market as well as real estate sales and construction activities; and 4) dragging down the production and investment in real estate-related industries, especially building materials [4]. The UBS Bank research team did stress tests on the possible impact on bank loan quality under different scenarios, such as a default by Evergrande, defaults by more high-risk developers, and a significant downturn in real estate activity, and the main conclusion was that the overall risk exposure of bank loans is manageable. Of course, the impact could be even greater if banks' off-balance sheet exposures and indirect exposures from real estate-related sectors and local government debt are taken into account. In the most pessimistic scenario, the drag on economic growth will continue to be highlighted.

3.3. Pitfalls in the Real Estate Sector

The Chinese Academy of Social Sciences released the "2007 China's Social Situation Analysis and Forecast" Blue Book pointed out that the current "land finance" model of investment overheating risk and financial risk [8].

The Shell Research Institute released the "2022 Survey Report on Housing Vacancy Rate in Major Chinese Cities", which shows that the average housing vacancy rate in 28 large and medium-sized cities is 12% [9], which is relatively in a high range. This means that many houses are not fully utilized and there is a waste of land resources, which is also a reflection of overheated investment. The oversupply of housing may mean that there is a bubble in real estate assets, and the bursting of asset bubbles may trigger financial risks and economic instability, which in turn affects the long-term sustainable development of the economy.

Data released [10] by the China Index Research Institute shows that in 2022, a total of 606,000 foreclosed homes were listed for auction in China, an increase of 35.7% year-on-year, and the size of the nation's foreclosure market has increased to 1.4 trillion yuan. The surge in foreclosures means a rise in the risk of loan defaults, meaning that some borrowers are unable to repay their loans on time. This could lead to an increase in non-performing loans by banks and financial institutions, thus posing a threat to the stability of the financial system.

Pitfalls such as over-investment and impacts on the stability of the financial system may affect the long-term health of the economy, so the government should transition from a model that relies heavily on land finance to develop the economy.

4. Conclusion

As the cornerstone sector of China's economic development, real estate is under intense development pressure as a result of the real estate industry's abrupt move away from high-speed expansion in recent years.

This essay first describes China's approach to economic development, which is based on land finance, before going on to discuss the role that real estate plays in China's economic growth. It then examines the current state of real estate development and the potential risks. The market is in a slump, as seen by the drop in real estate employment and the percentage of real estate investment; however,

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by examining the vacancy rate of Chinese properties and the number of foreclosed properties, it is determined that there are potential risks associated with overinvesting in real estate. Finally, it offers pertinent advice from the government's perspective on how to keep China's economy growing sustainably and healthily.

The haphazard growth of the real estate sector in China should be tightly controlled, as should the leverage and debt-to-equity ratio of real estate companies. Second, the government should actively promote the reform of industrial institutions to further achieve tax growth, diversify fiscal revenues, and energetically create high-tech companies focused on research and technology. To draw more investment into the actual economy, it should also boost the financial market's innovation and openness. At the same time, the growth of the bond market and the capital market should lessen reliance on bank loans and the real estate market.

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