Real estate bubble in china: the present and the future

Life

The concern over whether China is experiencing a real estate bubble has increased, especially after Dubai crisis happened. The construction area of both residential and commercial properties has increased by almost 6 times since year of 2000. China has enjoyed a sharp increase in property price since 2006. Especially, after 2009, due to the large stimulus package, majority of themoneywent to construction and real estate industry. It further pushed up the property price, leading to a lot families became the “ slave of the property” who were struggled to pay the mortgage.

Not only the high price has affected most people‘ s lives in China, it could also greatly affect Chinese economy and even the global economy. Domestically, the prosperity of real estate industry is fuelled by local investment and easy band loan. According to MSN Money, there is an increase of 38. 2% from 2010 in property market , mainly from developers and speculators. The scale of loans goes to property market is even more scary, up to $1. 3 trillion. People have compared the real estate bubble of China to the United States. The question is will Chinese property bubble has the similar effect?

Fortunately, the difference between China and the United States are quite striking. The factors lead to the collapse of property market in United States will unlikely to happen. In China, a country with high saving rate, people used to buy property in cash 4 or 5 years ago. Even in the heyday of residential mortgages, the loan is not as easy as in the U. S. Down payment amount is much higher than in the U. S. A decline of 20 to 30 % in prices will not let the bubble burst in China. In conclusion, the burst of real estate bubble is not easy in China and, if happened, will have limited effect to the world economy.

In this paper, I will try to present the whole picture of Chinese real estate market from the current situation to how it evolves, and will touch on the future as well. This will be achieved with the help of some data and the explanations of ratios. Section II: A Real Estate Bubble in China? The first question needs to be answered is that is there a real estate bubble in China? Since government tries to avoid this sensitive word “ bubble”, and data are not reliable. People have to figure them out and estimate how large the bubble is. Bubble is believed to exist in many major cities of China.

For example, in Beijing, real estate prices rose by 350% to 900 % only in 7 years from 2003 to 2010(Figure 1). Other indicators of real estate bubble have reached an alarming status in China in many major cities, including Beijing, Shanghai , Nanjing , Hangzhou and so on. The even striking fact in China is that you can hear stories about “ empty cities” very often. China has the second largest mall empty in southeast China, and modern empty city in Ordos. These are only the cases that you know and easy to identify. However, more empty streets or blocks are in the cities, waiting for people to move in.

Ghost City Ordos: the famous empty city in China is Ordos, which is located in the north part of China. Ordos is the second richest city in China, followed by Shanghai, even richer in term s of per capita than Beijing. The city is rich because of abundant natural resources. One –sixth of China‘ s coal reserve, one –third of it is natural gap reserves. The GDP has increased at 25% per year, much higher than the national level. With such a huge amount of money, local government wants to attract more people to stay in Ordos. This is how the empty city comes from.

The new city was designed to accommodate 300, 000 people, with a capacity of holding 1 million people. Currently, you can hardly see any people on the street, even though most of the properties have been sold out. Surprisingly, the city is still under construction. The local government still believes that they can fill in the new city soon. Unfortunately, the stories about empty cities have been repeated on and on in China. This has been interpreted as a sign of over investment and real estate bubble.

In the case, the apartments have all been sold out, even though nobody moves in. ecause most people believe that property will grow definitely. For investment purpose, most of them prefer to buy one. This kind of behavior has contributed to the high vacancy rate in China, High Vacancy Rate: since official data are not reliable, the concrete number of vacancy rate is not available from official sources. The reason for this has been that government officials said that, they don't know what vacancy rate means. Obviously, government is trying to avoid knowing the fact. Somehow, people have provided a rough estimate on the vacancy rate.

They are using how many electric meters that have no readings for 6 months as an indicator of vacancy rate. Overall, we got a number of 65. 4 million apartments. It is estimated that the vacancy rate is as high as 36%. With such a high vacancy rate, people are wondering how large the real estate bubble in China will be. James S. Chanos, one of the first foresee the collapse of Enron and earn large profit from hedge fund, gave the answer, it will be Dubai times 1000. A growing number of economists and hedge funds managers have been believed that Chinese economy is a big bubble.

Others argue that China is definitely not a bubble, the development is real. There is overheating in some area, but infrastructure construction is still necessary to a country like China with such a huge population. Still, a lot people live in area without roads. The demand of properties is still more than the supply of apartments, due to the urbanization and economic growth. The pent up demand from city dwellers for better living condition, in the future, will convert to real development in economy.

Even in 2009, when residential property prices enjoy a high fluctuation, the construction area has increased by 40. 7%, largely due to the central government‘ s stimulus financial package. Figure 4 Section III , What are the forces that push up the price? In China, it is more than market demand and supply that determine the price . Local government, individual investors, and central banks are also involved, which make the issue more complicated. Recent years’ increase in property price has created an impression that real estate market will keep growing in the future.

Unfortunately, this is also the belief in the U. S. real estate market which, ultimately, results in economic recession. Thus, almost everybody bet on the future of real estate market. In this section, I will analyze both the market reasons and social factors that contribute to present situation in China. In terms of market demand, the demand for property comes from two kinds of groups. One is from the new migrants from rural places in China. Another is from local residences who want better living condition. Due to the urbanization process and economic growth in recent years, the demand will increase in the long term.

This has been part of the reason why investors bet on the market growth. At the same time, governments and real estate developers have made an effort to supply enough apartments to meet the increasing demand. According to Macroeconomic principle , it seems that these have been enough to explain the fact. In an emerging country, political issues are unavoidable in any sense. Land sales have become an essential resource of local government's revenue which means high property price shares the burden of high land-use right. In China, people don't buy land instead they are renting land for a certain amount of time.

Normally, it is 70 years. In this sense, you are renting the land or buy the right to use the land for 70 years. Because of the conflict of interest, local governments are not enthusiastic in applying the central government's price control policies. In order to facilitate the transaction, local governments even requires very low upfront. Question concerning this will be further mentioned in the next part. It has shown that in Beijing and Hangzhou, land sales have accounted for more than 30% of tax revenue. Thus , local authority has less incentive to tackle the problem.

Only average home buyers bear the cost of high property price. Individual investors and state-owned companies made things worse as well. Since state-owned companies normally have much solid financial foundations than private companies, they are more likely to win the land sales bid. It was shown in Beijing that 82 % of land auctions are won by SOEs. These large firms are owned by central government, so in turn, if SOEs didn't win the auction or real estate market suffer a big crisis , both the SOEs and central authority will be affected. This has encourage local government to cooperate with SOEs.

For individuals, they store apartments, waiting for a moment when real estate price goes even higher. Earning quick money is all their purpose. High vacancy rate can explain the situation. Section IV, How Real Estate bubble will affect China’s economy? Unlike other industries, real estate industry affects not only the industry itself but also social safety, political stability and financial stability in China. There are mainly two types of risk that will threaten the development of China’s economy, namely, loose mortgage policy for individuals and corporate.

Mortgage loans are relatively new to Chinese residence. Most people pay cash to buy property instead of real estate loans. However, it grows almost 50% per year. The proportion of mortgage loans in nominal GDP has increased by 5 % in just one year. When big fluctuation of property price happens, it is likely that majority of property owners’ benefit will be affected from two perspectives. First of all, it will mean the shrink of the value of lifetime saving. As property is the largest investment of most families, the decline of price is also the shrink of their wealth.

Secondly, households will become more conservative in investing in the future. People will spend less money on consumption and put more money into banks instead. On the other hand, individual and corporate mortgage loans will also pose a threat to the banking system. For individuals, mortgage loans are relatively new. Chinese used to pay cash for their properties. Nowadays, mortgage loans have enjoyed a 50% increase in just one year. When property price declines, the majority of loan owners will have difficulty in paying the mortgage. When it comes in a large scale, private banks can go bankrupt.

Due to some negotiation between different groups, real estate developers don't need to pay the full amount of bidding price, instead they only need to pay a small portion to get the right to use the land. To be specific, if a firm wins a bid which worth 5 billion RMB, only one-tenth of the full amount need to be paid initially. What' s more, firm can get a loan from banks by using the land as a collateral at the amount of 2. 5 billion. It is clear that firms don't take as much risk as we thought and they can use the extra money to invest in biding for more land.

Whenever there is market fluctuation or crisis, these firms and banks will definitely have a difficult time. Conclusion: Opinion diverts in interpreting overheating in construction industry. Some believe that China has a real estate bubble and it will burst soon. Others disagree, thinking this is an exaggeration of the problem of overheating investment in real estate industry in some areas. Personally, with the evidence mentioned above, real estate bubble does exist in China. However, the real demand is there as well.

Most of the problems come from over investment in some areas. Resource misallocation leads to the unreasonable increase in property value. More market liberalization and less state-owned companies compete in the industry will help solve the problem. The importance of property even relates to marriage. There is an article in New York Times, titled" In China, Money can buy Love". Owning a property has become the condition for marrying to somebody. If property price jumps dramatically, not only the economy will be affected, but also social well-being.