

# Two Bumps for Current Chinese Economy

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## China Buzzing with "Property Bubbles"

At least for the past 4 years, forbiddingly high housing prices and the obscene profits of the developers, corrupt officials, and reckless speculators have been the NATIONAL concern and resentment.

Now the property bubbles in China show up big in international media.

Some, like Marc Faber, even "predict" an imminent crash of the market and the economy.



# Major Players

- Local governments for new and needed revenues: from land
- Developers for obscene profits
- Speculator, a new area where millions and billions of yuan, could be made easily if you are daring enough: capital
- Investors: housing much better than stocks and bonds, and assured return against inflation: capital
- Banks: housing collateral better than other loans
- Beijing, apart from indirect taxes and fees, see a fast GDP  
Booster: consent and pampering

All based on ever growing housing prices.

More than a dozen trillion yuan stimulus money add oil on the fire.



# How Much Correction Coming?

Almost anybody' guess.

Different interest groups with  
different wishes

10%?

30%?

40%?

Beijing' s wisdom and  
determination should be more  
important. Hopefully the  
correction comes gradual and  
fairly controlled.



# Banks Must Not Fall

If the bubbles all pop, the Chinese commercial banks can't go unscathed. 2010 Q1, new bank loans remainder 2.6 trillion cny, of which property related 854.7 billion cny. 31%. Also 22% of all loans.

2010 May 10 report of property

**NPLs: stress test: maximum price drop a bank could stand: generally 30-40%**

**ICBC: so far 60% of loans/mortgage principal and interest already recovered.?**



# Pricking Bubbles Is

- Highly risky business.
- Predicting what may happen is highly hypothetical.
- My personal view:
- Housing prices fall: developers and speculators suffer. But almost all of them have deep pockets. Bankruptcy may not be too bad.
- Land prices fall: local governments (and land speculators, nearly all big SOEs) will suffer. Beijing will come to their rescue.



# Beijing Not Hesitant in Bail Out

For example, “muni-bonds”, disguised revenue sharing.

More locally sponsored, bank supported projects.

No bank runs imaginable.

Beijing will dance minuet. Ready to hold up or even reverse a bit when big danger looms.

When housing prices fall, sales go up, with profit margin narrowed.  
(Demand remains high.)



It will be bad, but may not be too bad.

- General fall of housing prices will push capital elsewhere needed.
- It may also help reduce inflation, and to unknown extent the overseas demand for RMB, as interest rate hike less likely.
- Politically popular.
- Walking across thin ice covered bond.



RMB



# RMB: To Appreciate or Not

Domestically, One finds many reasons for RMB not to appreciate and almost as many arguments for RMB to appreciate.

They all seem to sound reasonable and patriotic.

( Such patriots eager to thrust their US dollars into state banks!)

Different interest groups!



## However, Appreciation Inevitable

A general rule for emerging economies, esp. for the fast economic growers: productivity!

China hardly an exception.

What may happen if China sticks to the pegging?

Shy to admit pegging led accumulation of hard currency reserves has been and still is one major trouble for China.

What if China allows de-pegging?



# However, RMB Appreciation

Constitutes no “silver bullet” to help developed economies, and some emerging economy out of the difficulties.

Some even argue: drastic appreciation against the USD, as trumpeted by American senators, will hurt both China and USA.



Guess what is Going On in Beijing?

- ???



# Proposal from a Humble Scholar

- First year +1.5%
- Next 4 years +1% each year
- While watch the market and make timely readjustment (Euro).
- The sky won' t fall if reasonably small appreciation (or flexibility move) takes place.



Thanks for Your  
Attention!



## Land Price Inflation in Some Other Countries

Japan 1885 - 1990 serious

USA 1985 - 1989 medium

Sweden 1985 - 1991 serious

Norway 1986 - 1989 serious

Finland 1985 - 1987 serious

Germany 1990 - 1998 light



# If the Bubbles Burst

Developers lose and existing housing holders lose: some pension/savings wiped out

The related industries, like steel and cement, nose-dive

Banks suffer enormous bad loans.

The listed developers stocks crash.

Other listed companies with investment in property/land hit hard

Economic growth gets stalled if economy does not crash



# One Vacancy Report

From Chinese media: “China’s State Grid Corporation, the world’s largest electricity transmission and distribution company, reported in early April 2010 that it had not collected revenues from over 65 million apartments in 660 cities during the preceding 6 months, because the electricity meter had not moved (which was believed to be an indication of non-occupancy). “



# China and the United States

Ironically, both have big housing market troubles  
but for different reasons.

Difference:

China has little Sub-prime mortgage and related  
poisonous securities;

Many Chinese still have savings;

Beijing bent on providing subsidized housing;

The economy and urbanization still on the growth.

The authoritarian government can exercise  
considerable influence over markets and the  
behavior of local governments through  
political and administrative channels., if  
needed



# Shanghai Housing Vacancy

- Shanghai Municipal Statistics Bureau: by end of Feb., 2009, commercial housing vacancy reached 12.1175 million squ. meters from 7.3546 million squ. meters at end of 2008, almost doubled.
- Out of 7.3546 million squ. meters, 5.5407 million squ. meters were commercial residential housing.
- Estimated vacancy well over 16 million squ. meters in mid May, 2010.
- Shanghai has been a sellers' market, more demand than supply.



# Boost Consumption

- 1) Consumption volume
- 2) Consumption rate
- 3) Government directed consumption growth, limited
- 4) Invest less in manufacturing and construction/property
- 5) Expend more on social programs
- 6) The market will work it out
- 7) American style ???



# Don' t You Believe this?

Apartment sells at 30,000 cny (almost \$5000) per square meter In much Beijing and downtown Shanghai!

A couple of very highly paid white collar workers make 200,000 cny a year. For a modest apartment of 100 square meters, plus 20 yrs mortgage, related taxes and fees and internal furniture/appliances, etc., it would come to 5 millions cny or more. 25 times of their yearly income. (International standard ratio 4-6)

Often their parents and other relatives give their life savings to help for the down payment. One apartment purchase destroys 3 middle class families.

Not to say about the smaller income families!



# Post Crisis Chinese Economy

“The composition of growth in gross domestic product in the first quarter was: consumption 52% (or 6.2 percentage points of the overall 11.9% growth rate), capital formation 57.9%, (6.9 percentage points of growth), and trade -9.9% (which subtracted 1.2 percentage points from growth).”



# Discussion

Housing situation in the USA

Where outside the USA, do you like best its the housing market?

Housing just another commodity in the market?

Your idea in dealing with the housing problem.



One of Many Manipulation Tricks: housing almost sold out: 123 million m<sup>2</sup> vacant 2007





WEEK  
on UKE

1



# China's Property Bubble not the Same as Japan's in the late 1980s

- China is still relatively poor and its economy is likely to grow fast for many years.
- Japan was already rich and fully urbanized in the late 1980s.
- Japan's population had already stabilized; China's will be growing for 2-3 more decades.
- China's demand for residential urban housing will remain very strong for many years – its urban population may grow by 200 million over next 2 decades.
- China's government has more (administrative) tools to deal with bubbles than Japan had and is not afraid to use them.



## From Dan. Rosen, April 23, WSJ

- “China's economic data for the first quarter of 2010 brought long-simmering worries about overheating to a boil, and was quickly followed by tougher-than-expected measures to restrain property speculation from the State Council, the nation's highest government body.
- The latest measures drove down shares in real estate developers and related companies, and crystallized fears about the aftermath to the strongest stimulus-led recovery in the world.”



# Chinese Housing Desire Stronger Than Any

Those living in government provided housing were offered the ownership of the rooms/apartment at price lower than market value, with 3-5 years' moratorium of resale. Soon the pent up desire for better housing aided by mortgage, led to a fast expanding housing market, and prices soared, despite supply of new construction.



# The Iron Rule of Sandwich Press

- Japan and many Asean nations went through an export boom and then found: domestic costs went up while export prices drop. Pressed in between.

Housing development market provides the “way out”, which soon leads to bubbles.

China is not immune.



# Beijing Leadership Tested

- After years of hesitance and lip service, is Beijing this time determined to control the property bubble. The central bank has begun to tighten monetary policy, but cautiously, so as not to kill recovery in the broader economy. Around the middle of April 2010 the State Council (China's Cabinet) in April, 2010 announced tough administrative measures to curb property speculation and increase housing supply. More effective measures have to come out to avoid traditional “retaliatory bouncing back” of the prices. Property tax, for example.



# Another “Hollowing” Effect

Property development and speculation has become **dangerously lucrative** ( with a ratio of 1: 12?) that it sucks in capital and other resource **in acceleration**.

SOEs, private business and individuals, and foreign capital deserting other industrial and service investment, rush for quick and easy profits, and **the “hollowing” threatens to distort China’s economic structure**. Sort of tsunami preparation like “sophisticated” financial securities did in 2007 and 2008 in the USA?

A test for Beijing to fight the “vested interests” (China’s Property Wall Street) to keep the fast growing economy to steer clear of the giant sucking whirlpools.



# Who Fights Against Who

- Fuzzy Battle Line
- Beijing and tough opponents  
(the rich and powerful)
- Hesitance and half mind in the past leave people doubtful of positive results
- Developers with deep pockets and strong “connections” and tricks
- Banks’ questionable positions



## Two Markets and Two Attitudes

- Popular anger against the high housing prices also comes from the comparison between the stock market price ups and downs and the housing market ups and downs. Whenever, the stock market index went high, the government and their mouthpieces get busy to talk it down, with deep corrections, while nothing of that happened to the housing market. The rationale from the people is the money lost in the stock market is mostly their own money of the stock buyers (many of them are poor and small) while the money in the housing market is money of the state banks and the speculators.



# Classic Tulip Bulbs Mania Repeated

Anxiety and anger even spread to students  
about to graduate from colleges.

Prices too high lead to high vacancies  
and speculating enthusiasm.



# Retrace the Path of Housing Changes

Nationalization through political campaigns, resulting in 95% urban residents living in government owned, controlled, and poorly serviced and crowded housing. Government and “work units” housing managers acted like old England bad landlords. Rent was cheap.

All this until late 1990s, when urban housing reform/privatization began and mortgage soon followed.



