Chinese real estate sector: slow and steady

From its liberalisation in the 1990s up until the sharp correction experienced by the sector in 2021, China's real estate market was one of the driving forces of the country's economy. After years of strong growth, in 2016 the famous phrase «housing is for living, not for speculation» began to flood the headlines, reflecting the growing concern among policymakers for the sector's sustainability. Thus, following a first attempt in 2017, in August 2020 regulators intervened in the market with the famous «three red lines», which were restrictive policies that sought to control the excessive indebtedness of property developers.[1] It was in the context of these regulations that the high levels of debt of the major developers ended up leading to the problems encountered by Evergrande in mid-2021,[2] an event which triggered contagion among other developers and gave way to a phase marked by a correction in home sales and prices.

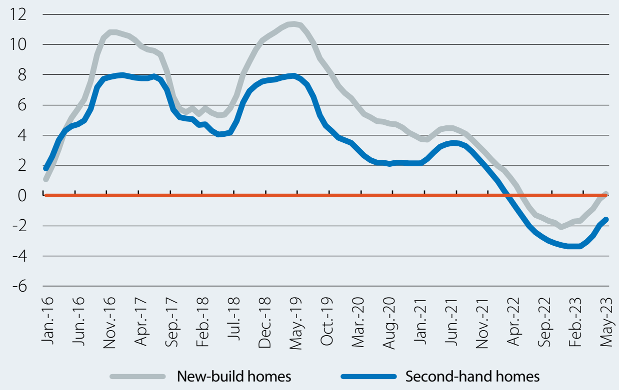
In an attempt to correct the situation, in early 2022 the country's main regulators announced an action plan to soften the restrictive measures taken in 2020 and alleviate the liquidity shortage for developers that Beijing considers «good quality». At this juncture, below we analyse the recent evolution of the real estate sector, focusing on home prices, sales and the financial health of the agents involved.[3]

The correction of the real estate sector

The benchmark used to assess Chinese real estate prices is the average price of new housing in the country's top 70 cities. This measure registered exceptional growth rates during the period between 2016 and 2019, reaching a peak of more than 11% in year-on-year terms in April

China: average price of housing in the 70 most important cities

Year-on-year change (%)



Source: *CaixaBank Research, based on data from the National Bureau of Statistics of China.*

2019. Since then, new home prices have suffered a correction, with negative rates for most of 2022 and bottoming out in October, at which point they began to register a gradual recovery. According to the latest data, the average price of new-build homes rose slightly in May 2023 (+0.1% year-on-year vs. –0.2 in April and –0.8% in March), the first increase in the last 13 months.

However, the readings have become increasingly disparate, reflecting the divergent performance of the real estate market between different types of cities, classified as tier 1, tier 2 and tier 3 and below.[4] While the first two are now registering an increase in prices compared to 2022, the cities of the third tier and below continue to show substantial declines. The same goes for existing home prices.

The number of home sales, meanwhile, began to fall across the board in early 2022, although the growth rate had been flattening out since mid-2021. The maximum contraction was reached in May 2022, with a fall of more than 34% year-on-year. Recently, and after the abandonment of the zero-COVID policies, the sector began to show the first signs of recovery, with a rebound in sales this March. Following this initial rebound, which was mainly driven by the release of pent-up demand following the COVID-19 pandemic, since April the indicators have weakened somewhat, especially in the case of home sales initiated and residential land sales. The number of completed new-build homes was the exception, with year-on-year rates exceeding 30%, mostly thanks to policies that seek to guarantee the delivery of pre-sold homes.

1. They included a 70% limit on the liabilities-to-assets ratio, a 100% limit on the net leverage ratio and a minimum liquidity ratio (relative to short-term debt) of 1. Depending on how many «red lines» property developers fail to comply with, they face different limits to the growth of their debt and in extreme cases can lose access to credit.
2. Evergrande is the largest real estate developer in China and in the world in terms of assets. With liabilities of more than 300 billion dollars, in 2021 it defaulted on its bonds. After failing to meet its financial obligations, Evergrande found itself in cross default, whereby its failure to service one creditor's debt was sufficient for others to demand repayment of their loans. Its shares in Hong Kong were frozen, and it is estimated that the company has lost around 90% of its value since that year. In recent years, suppliers and creditors have demanded hundreds of billions of dollars in outstanding bills.
3. On the one hand, households have maintained relatively low mortgage debts, due to the high initial payments required to access a mortgage. However, mortgage debt has increased in recent years and the official figures do not include the portion of debt in the shadow banking sector. On the other hand, the major property developers continue to experience solvency problems. See the Focus: «China's real estate sector (part II): emergency landing or low-altitude flight?» in the MR03/2022 for further information on the financial situation, credit rating and debt structure of China's biggest property developers.

4. Tier 1 comprises the four most economically developed cities; tier 2, the next 15, and tier 3, the rest.

Current situation

The current phase of the real estate cycle is different from those we could have found in the past, as the authorities are now adopting a much more cautious attitude when it comes to choosing and implementing expansionary measures to revive the real estate sector, prioritising a sustainable recovery that is free of imbalances. In addition, the outlook for the growth of housing demand has been revised, as it is now expected to be lower than previously projected.[5] Furthermore, the authorities are choosing to prioritise the allocation of resources to more strategic sectors, such as innovation and technological development.

Nevertheless, measures aimed at increasing flexibility in the sector have been adopted, although they are much more specific in nature. For instance, credit conditions for new home buyers have been relaxed (in April 2023, the average mortgage rate for new buyers was almost 160 bps lower than in October 2021), additional financial support has been given to property developers to ensure the delivery of pre-sold housing,[6] and greater political support has been given to urbanisation and public housing, among other measures. In addition, the recent round of interest rate cuts implemented by the People's Bank of China offers the sector some breathing room.

In short, the recent evolution of home prices and sales, as well as other more advanced indicators (such as the PMIs),[7] suggest that the real estate sector has initiated a recovery in 2023, albeit a gradual one. After an initially strong rebound, spurred on by pent-up demand following the pandemic, in the coming months the sector will receive more selective support from the authorities as the country seeks a more sustainable form of growth.

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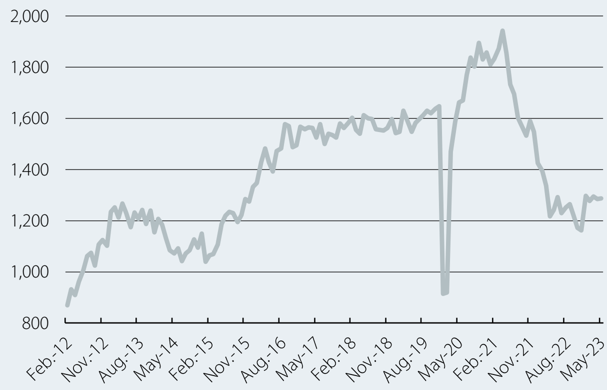
China: sale of new housing

*(Millions of m²) **



***Note:** * Seasonally adjusted and annualised.*
***Source:** CaixaBank Research, based on data from CEIC, Wind and Capital Economics.*

5. In particular, this decline in the outlook reflects the ageing of China's population (aggravated by the one-child policy in force from 1982 until 2015) and a lower rate of migration from rural to urban areas.
6. These measures include quantitative credit growth targets, bond-guarantee schemes, and non-performing loan grants for select developers. In addition, pre-sale collateral deposit requirements for eligible developers were also relaxed and the real estate loan concentration limits for banks were postponed.
7. The construction index produced by the National Bureau of Statistics of China has shown some very promising figures in the first five months of the year, and reached its peak (65.6 points) in March.