

China Economics

The Politburo: Preventing a Property Market Spiral

This week, the Chinese Communist Party's top decision-making body signaled its strongest inclination yet of a more accommodative stance towards the property sector.

Property Emerges as the Foremost Risk

Significantly, the latest Politburo meeting's assessment of top areas of economic risk has changed since April. There has been a reordering of risks, with real estate front and centre, with risks skewed to the downside.

No End in Sight to Falling Home Sales

China's property market is one of the few sectors that appear to be in significantly worse shape than a year ago. Property sales, construction starts and resale prices are down by 28%, 31% and 3% respectively year-on-year in June. Real estate is linked to many facets of the real economy and financial system. If not managed well, the adverse effects of a continued downward spiral can spill over to other parts of the economy, and weigh on China's consumption-led recovery.

Soft Landing Needed to Avoid Disorderly Spillovers

Amid sluggish macro data and limited macro policy room, the Chinese authorities' commitment towards engineering a soft landing for the property market is especially important. This is not just to support GDP growth, but also to avert disorderly spillovers. Real estate-related activity is estimated to account for around 29% of GDP. We expect differentiated tweaks to housing purchase restrictions, in accordance with the principle of "tailoring policies to suit each city's circumstances" (因城施策). There is scope for easing mortgage restrictions, as households' debt-to-GDP ratio stands at 63%, well below many other countries.

Large-scale Macro Stimulus is not Likely

Given the prognosis, we expect the authorities to implement a wide range of measures to delicately stabilize the property market in the coming months, but not a large-enough stimulus to fuel a real estate boom. Measures will likely be targeted at arresting the slide in housing demand, support a healthy level of real estate activity and shore up the resilience of real estate players—and not much more. In H2 2023, China's policymakers are not likely engage in a large-scale monetary stimulus, given the divergence in domestic and global rates.

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Property Emerges as the Foremost Risk

This week, China's political leadership and financial policymakers met at two pivotal gatherings set to steer the course of its economy in the second half of the year. The first was the Chinese Communist Party's Politburo meeting on economic developments and the related work priorities. The second was the China Securities Regulatory Commission's (CSRC's) mid-year workplan seminar. Both meetings conveyed an emphasis on restoring certainty in market expectations.

At the scheduled Politburo meeting chaired by President Xi Jinping on 24th July, the Party's top decision-making body signaled its strongest inclination yet of a more accommodative stance towards the property sector. It also signaled its commitment to "revitalise the capital market and bolster investor confidence".

The July Politburo gathering is important, as it customarily sets the direction for macroeconomic and financial policies for the rest of the year. Specific measures by national and local authorities will then flow from the direction that was mapped out.

The read-out from the meeting highlighted that "economic activity is facing new difficulties and challenges, primarily a shortfall in domestic demand". In particular, it noted that some companies were having a difficult time, and that "hidden risks in key areas have increased".

While the statement alluded to a strengthening of counter-cyclical adjustments and policy readiness, there was no mention of a large-scale monetary or fiscal stimulus in the offing.

A Reordering of Key Macro Risks

Significantly, the latest Politburo meeting's assessment of top areas of economic risk has changed since the April gathering. There has been a reordering of risks, with real estate front and centre, and with risks skewed to the downside.

At this July meeting, real estate has become the foremost risk, followed by local government debt, and lastly, small and mid-sized FIs. Back in April, the Politburo's prime concern was smaller and mid-sized banks, and non-bank financial institutions. Second was real estate, and the third was local government debt.

Delving deeper, we note that the Politburo statement in April alluded to both upside and downside risks to the real estate sector. It began with the oft-repeated admonition to "hold firm in the position that houses are for living, not speculation", before moving on to thrusts to ensure the smooth functioning of the property and construction sectors. But by July, the statement on real estate risks has become focused squarely on downside risks. It pledged to "refine and optimise real estate policies in a timely manner", amid "profound changes" in the balance between property supply and demand.

Table 1: Politburo Statements on Main Economic Risks

Date of Meeting	Order of Risks	Key Excerpts
April 2023	Small and mid-sized FIsReal estateLocal government debt	"We must effectively guard against risks in key areas, carry out the work of reforming and <u>resolving risks in small and mid-sized banks, insurers and trusts.</u>
		We must hold firm in our position that houses are for living, not for speculation, tailor policies to suit each city's circumstances, support basic housing and upgrading needs, ensure the delivery of pre-sold properties, protect livelihoods and protect jobs, and promote the steady and healthy development of the real estate market
		We must <u>strengthen the management of local government debt</u> , and strictly prohibit new hidden debt. We must continue to work on Covid-control."
July 2023	 Real estate Local government debt Small and mid-sized FIs 	"We must effectively guard against risks in key areas, adapt to the new-reality of profound changes in the demand-supply relationship of our country's real estate market, tweak and optimise real estate policies in a timely manner, tailor policies to suit each city's circumstances and make good use of the policy toolbox , better meet residents' basic housing and upgrading needs, and promote the steady and healthy development of the real estate market
		We must <u>effectively resolve risks from local government debt</u> , and formulate and implement a series of solutions to reduce them. We must strengthen financial supervision, and <u>steadily push forth with small and mid-sized financial institution reforms and risk reduction</u> ."

Source: Official government statements, translation by Maybank Research

Why Has Property Emerged as the Top Concern?

Amid sluggish macro data and limited macro policy room, the Chinese authorities' commitment towards engineering a soft landing for the property market is especially important. This is not just to support GDP growth, but also to avert disorderly spillovers.

China's property market is one of the few sectors that appear to be in significantly worse shape currently than a year ago. Real estate fixed asset investment fell by 20.6% y-o-y in June this year, after dropping by 21.5% in May, which itself was the steepest contraction since Covid started.

Real estate sales volumes and prices have stayed soft. In June, floor space sold contracted by 28.1% compared to a year ago, the 24th straight month of decline. At the same time, real estate construction starts by floor space fell by 31.4%. In terms of residential property prices, new home prices have troughed in end-2022, but resale prices have yet to decisively recover, after reaching a peak in mid-2021.

Fig 1: Real Estate FAI, Property Sales & New Construction Starts Slumped in 2023

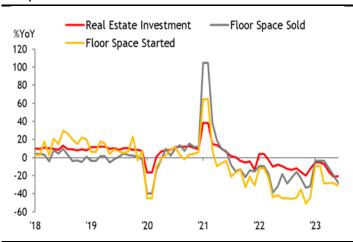


Fig 2: Property Prices Edged Up Slightly Recently But Remain Below their Peaks in Mid-2021



Source: CEIC

Source: CEIC

Scarring from the Covid era is evident in lacklustre housing demand. Back then, instances of property developers failing to complete the construction of pre-sold units have led to lingering concerns among homebuyers. Despite a 16-point package of measures in November 2022 to smooth the delivery of homes and ensure the solvency of real estate players, the sector has yet to regain a strong footing.

The authorities recognise the need to arrest the weakness in property demand, which can further hit the finances of real estate players, shake homebuyers' confidence and lead to a downward spiral. If not managed well, the adverse effects can spill over to other parts of the economy, and weigh on China's consumptionled recovery.

Large Swathes of the Economy and Financial System is Tied to Property Sector

<u>GDP growth</u>: China's real estate sector is tied to many facets of the real economy and financial system. First, its economic contribution is not limited to property development and construction. It extends to steel production, mining and financial services. In total, real estate-related activity is estimated to account for around 29% of GDP.

<u>Local government finances</u>: A flagging property sector would weigh on land sales proceeds, which contribute to a significant part of local government finances. With local governments under pressure to curb their borrowing, slow land sales would hurt their ability to fund public spending.

<u>Bank balance sheets</u>: About 24% of China's bank loans are related to the real estate sector. They comprise 18% in housing mortgages and 6% in loans to real estate developers. Although banks' real estate exposure has steadily come down from 29% in 2020, a rise in bad loans from the sector would still hurt banks' performance.

<u>Private consumption</u>: Real estate has become an investment asset of choice for many households, due to limited alternative investment avenues. An estimated 70% of household wealth is held in property. Hence, a continuing decline in resale prices can lead to negative wealth effects and jeopardise the fledgling recovery in private consumption, the main engine of China's growth this year.

China Real Estate-related Loans % of Total Real Estate Development Bank Loans Housing Mortgages 35 ---Total Real Estate Related Loans 30 25 20 15 10 5 4Q20 1Q21 2Q21 3Q21 4Q21 1Q22 2Q22 3Q22 4Q22 1Q23

Fig 3: Real Estate Related Loans Make Up 24% of All Bank Loans

Source: CEIC

Just Enough Support to Engineer a Soft Landing

Given the prognosis, we expect the authorities to implement a wide range of measures to delicately stabilise the property market in the coming months, but not a large-enough stimulus to fuel a real estate boom. Measures will likely be targeted at arresting the slide in housing demand, support a healthy level of real estate activity and shore up the resilience of real estate players—and not much more.

Much attention has been drawn to the removal of the phrase "houses are for living, not for speculation" in July's Politburo statement on property market risks. However, since it was first coined at a Central Economic Work Conference in 2016, the "living, not speculation" phrase has been omitted from official economic priority statements in 2017 and 2018 when real estate market expansion was more moderate. The phrase was then reinstated when property market sentiment improved.

In a nutshell, the authorities are unlikely to strongly boost real estate prices, as this would undo years of concerted efforts aimed at reducing market froth. Over the medium term, after prices stabilise, China will likely stay the course in maintaining steady growth in the real estate market.

Tailored Policies for Each City's Circumstances

We expect differentiated tweaks to housing purchase restrictions, in accordance with the principle of "tailoring policies to suit each city's circumstances"(因城施策). There are currently different sets of restrictions targeted at different homebuyers, with conditions most favourable for first-time homebuyers. Easing measures can include higher loan-to-value limits for first and subsequent properties, and more favourable mortgage rates. At present, the first-homebuyer minimum down-payment ratio for Tier 1 cities such as Beijing and Shanghai stands at 35%, while that for Guangzhou and Shenzhen is around 30%. Selected cities are expected to tweak the definition for first-time homebuyers, with those who have paid off their mortgages considered anew as "first homebuyers."

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Last year, the People's Bank of China lowered the floor of mortgage rates for first-time home buyers below the loan prime rate (LPR) of the same maturity. It followed up by giving local governments the leeway to relax or scrap such floors for their localities. This flexibility will continue to come in useful in the current context.

There is scope for easing mortgage restrictions, as households' debt-to-GDP ratio stands at 63%. While it has climbed in the years leading up to Covid, the ratio is not as high as Asian economies such as South Korea, which stood at more than 100% of GDP.

Fig 4: Minimum Down-payment Ratios by City

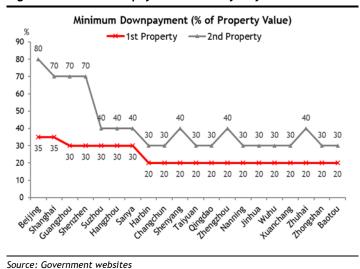
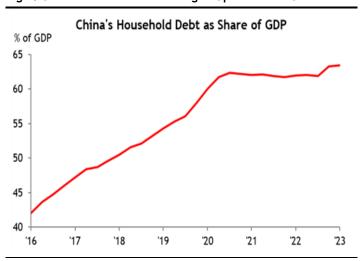


Fig 5: China's Household Debt Edged Up to 63% of GDP

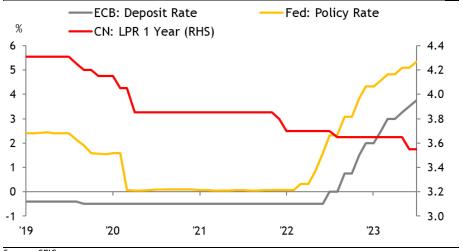


Source: CEIC

Large-scale Macro Stimulus is not Likely

China's policymakers are not likely engage in a large-scale monetary stimulus in the second half of 2023. The PBOC would not be comfortable with easing sharply, given the widening divergence of domestic with global rates, due to worries about capital outflow pressures. This is especially pertinent with the Fed signaling its openness to further rate hikes. Similarly, massive pump-priming is also not expected this year, as the pressure to de-risk local government debt is still present.

Fig 6: China's LPR 1 Year Has Edged Down Since Covid Started, Contrasting with Upward Trend of Global Rates



Source: CEIC

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CSRC Mid-Year Workplan: Stable Policies, Stable Expectations.

We expect the CSRC to prioritise policy predictability in matters relating to the capital markets. This will contribute to domestic and global investors' confidence in Chinese assets, after a period of uncertainty. At the CSRC's mid-year workplan seminar on 24^{th} and 25^{th} July, the financial regulatory body echoed the Politburo's direction of revitalising the capital market and bolstering investor confidence. In particular, the securities regulator's stated top priority was to "further emphasis stability". It pledged to "promote stability in expectations via stability in markets, stability in functions, stability in policy" (坚持以市场稳、功能稳、政策稳、促进预期稳).

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