

The China housing market: recent developments, outlook, and perspectives from international experience—comments by Louis Kuijs, World Bank Office Beijing

I thank BBVA and CITIC Bank for inviting me to attend and comment at this important presentation.

I liked the report a lot. It has an appropriate focus, asks important questions, looks at the right issues with regard to the property market, and tries to answer the questions using data and on the ground information. With data on China's property market far from optimal, it is hard to be sure about conclusions from empirical studies. But the results and conclusions from this report seem sensible and they are rightly put in context.

The key conclusion of the report on the valuation of property prices and a possible bubble are that, overall, there is some overvaluation, but not a lot. It points to the fundamental drivers behind price increases: urbanization, income growth, liquidity. Price increases are not that intimidating, compared to the evolution of the fundamentals. The study also suggests that it is not easy, and maybe not desirable, to stop housing prices from rising.

I agree with the report that in the face of overvaluation, China could either witness a downward correction or a period of low price increases, although in reality we don't often notice smooth adjustment.

With regard to the risks of a negative correction in prices, taking into account what are typically the key factors in a housing bubble burst, one suggestion looking forward is to look more at different forms of leverage.

Again, I find the conclusions plausible. There are risks with regard to China's property market, though, and these are not just about prices but also about volumes.

- There is tension between the underlying upward housing price pressure and the policy objective to contain price rises. Because of this tension, interaction between the market and policy measures could lead to a more abrupt than planned downturn in the real estate market.
- Risks are heightened by the widespread use of property as investment vehicle and the role of local governments. Property construction is an important part of the economy, directly and in terms of impact on large sectors such as steel and cement. Thus, shocks to the property sector that would slow down construction significantly could have a large impact on the economy and on bank balance sheets, taking into account bank exposure to construction and other sectors dependent on the real estate market.
- Moreover, a property downturn could affect the finances of local governments, which do a lot of the infrastructure investment and are important clients of the banking system.

There are a few reasons to be cautious in interpreting the results. Most of these are not specific to this paper—they apply to all such studies. The report sensibly stresses the “suggestive” nature of the valuation assessment.

- Some remarks on the data
 - The NBS property price data has been criticized heavily, domestically. One issue is that it is not adjusted for location or quality. Since the majority of sales are new properties that over time tend to be built further and further away from city centers, the official price data does not capture well how house prices rise over time. The team could consider to also look at other data, such as that from Centaline on the secondary market. This suggests that average prices in large cities have grown much faster than indicated by official housing price data for these cities. Another source is from Soufun.com.
 - Government behavior over the cycle: if government wants to see prices contained it changes the composition of apartments sold by encouraging the sale of cheaper ones and discouraging the sale of higher end ones.
 - On affordability ratios, the official data tends to under-estimate household income, especially the incomes of higher income population; and the average household that buys a home is not a household with an average income.

- On the model and the estimates; these seems broadly sensible to me.
 - Is the price a real one? It should be, right?
 - It is good to have a variable in the model that captures expected future income growth. The assumption of 10 % real income growth may be on the high side (in a way, it is not too surprising that equilibrium prices continue to rise if urbanization and income growth continue strongly). The team could consider, as bad case scenario, a simulation with real income growth of 4 % for 3 years.

Some comments on policy

With regard to housing prices, and whether or not they are too high, two separate issues are often mixed together in China. This has, in my view, at times led to suboptimal policies.

One issue is whether prices are right from the market perspective. The other is that of affordability, a social issue. The macro and financial risks on the property market require macroeconomic measures and reforms. Social concerns require a different policy response.

- Macro and financial policy is supposed to prevent different types of risks from building up and make the economy and the financial system robust to a possible property downturn. If housing prices are considered systematically too high from a market perspective, it makes sense to use macroeconomic levers to “lean against the wind”. Indeed, such macroeconomic levers are more obvious than administrative measures, especially locally administered ones.

- On the other hand, if the issue is more a social one, about affordability, it is better not to use macro and financial policies to contain overall housing prices. If the objective is to make housing more affordable for targeted groups it would be better to use a sustainable rules-based arrangement, almost unavoidably explicitly subsidized by the government.

- Thus, in this connection, the scaling up of social housing is in the right direction. However, as the report rightly says, finding a transparent, rules based financing model is key. Successful, sustainable social housing requires strong institutions and clear rules, including on a sustainable financing model and the funding of the subsidy element. Local governments have so far typically not had strong incentives or means to build a lot of social housing. This time the increased prominence of the plans and the central government's emphasis provide an incentive. However, the large scale and time pressure, and already stretched finances of some local governments, suggests that the execution may not be straightforward. In the government's plans, of the RMB 1.4 trillion in overall investment required this year, RMB 800 bln would come from the owners (end users or companies involved in shantytown renovation) and around RMB 100 bln from the central government. The rest will need to be generated by local governments via various channels, including land revenues, housing provident funds, and bank lending. The exact structuring of the financing will be hugely important for sustainability and efficiency.

Other measures that could improve the functioning of the property market:

- Increase the costs of holding a house, to make it less attractive to buy a house and just keep it empty.
- Increase attractiveness and availability of alternative financial vehicles. This calls for financial market reform.
- Reform intergovernmental fiscal relations to reduce dependence of local governments on land sales
 - A more widespread property tax. This probably calls for the central government to take the lead.
 - Other stable local revenue sources.
 - Consolidate land sales revenues fully into overall budget

Wrapping up, in all, I very much liked the report. I look forward to next year's. Thanks for inviting me.