# China Real Estate Outlook: International Experience

**Alicia Garcia Herrero**

**Chief Economist for Emerging Markets BBVA**

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# Analysis of international experience for two issues of high relevance for China

Section I

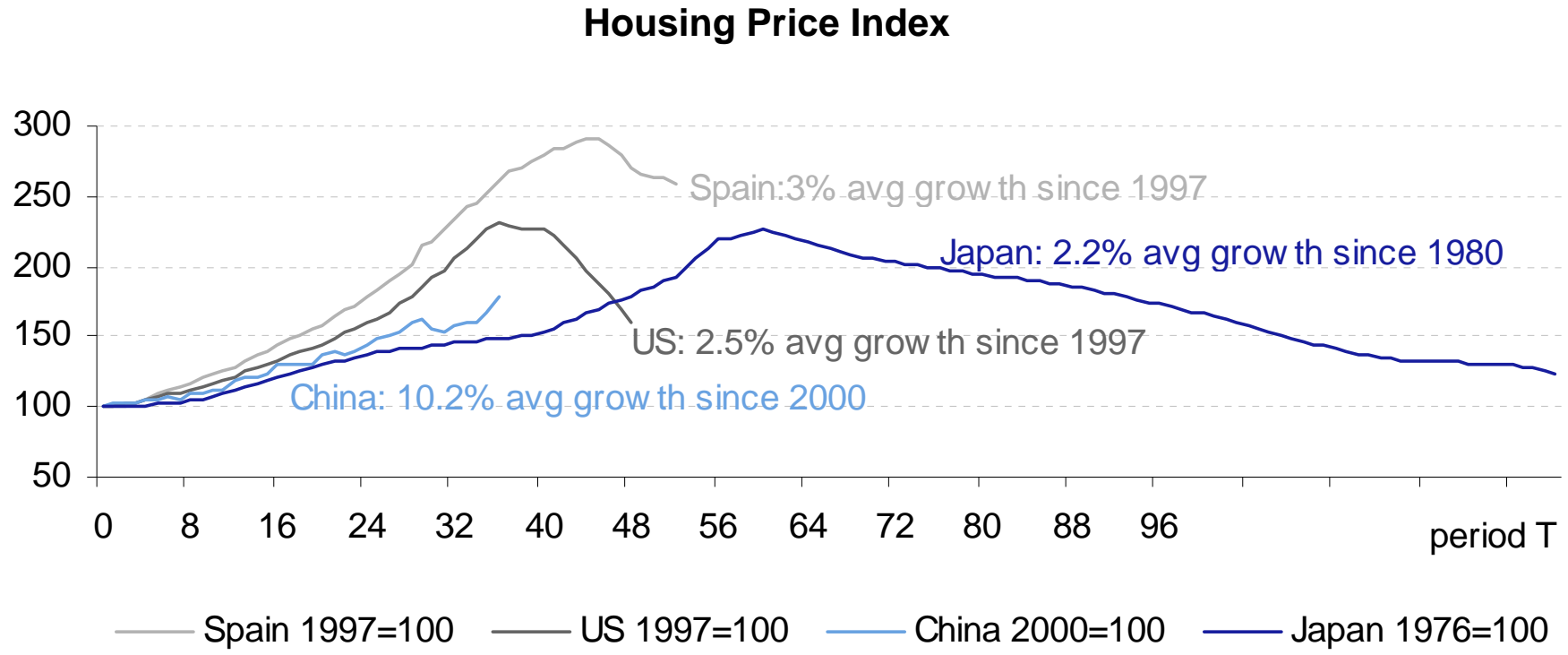## Housing bubbles

Section II

## Affordable housing

## Analysis of international experience

Section I
# Housing bubbles

# The run-up in China's housing prices doesn't seem all that large

**Housing Price Index**



Spain:3% avg growth since 1997

Japan: 2.2% avg growth since 1980

US: 2.5% avg growth since 1997

China: 10.2% avg growth since 2000

Legend: Spain 1997=100 — US 1997=100 — China 2000=100 — Japan 1976=100

period T

**Source: CEIC and BBVA Research**

It appears that the bubble in China –if we can use that word– has not yet reached the peak levels of other countries
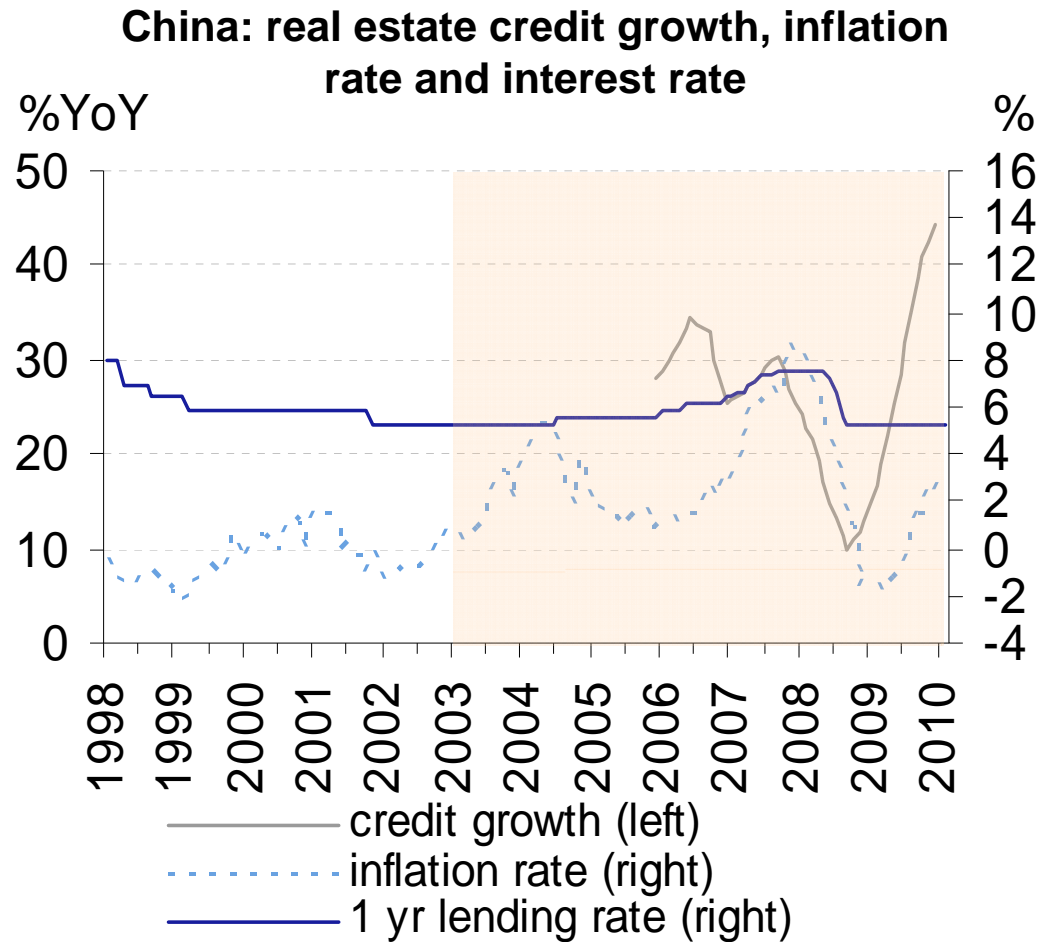
# Nevertheless in some China's large cities housing affordability has become a big issue

Housing affordability, as measured by median price-income ratio, is worse in Chinese cities than in US ones (even if the US case looks more of a bubble).

| China | | United States | |
|---|---|---|---|
| City | Price/Income | City | Price/Income |
| Beijing | 22.3 | Los Angeles | 10.0 |
| Shanghai | 19.3 | San Francisco | 9.8 |
| Shenzhen | 22.1 | San Diego | 9.5 |
| Guangzhou | 14.7 | New York, NY | 7.1 |

**Source: Asian Development Bank, April 2010, available at**
**http://www.adb.org/Documents/Working-Papers/2010/Economics-WP198.pdf**

# China's housing price increased clearly fueled by real state credit

**China: real estate credit growth, inflation rate and interest rate**



%YoY

%

- credit growth (left)
- inflation rate (right)
- 1 yr lending rate (right)

Very low inflation rates (even negative) has given more room for monetary policy to be very loose/ strong credit growth to finance the huge fiscal stimulus
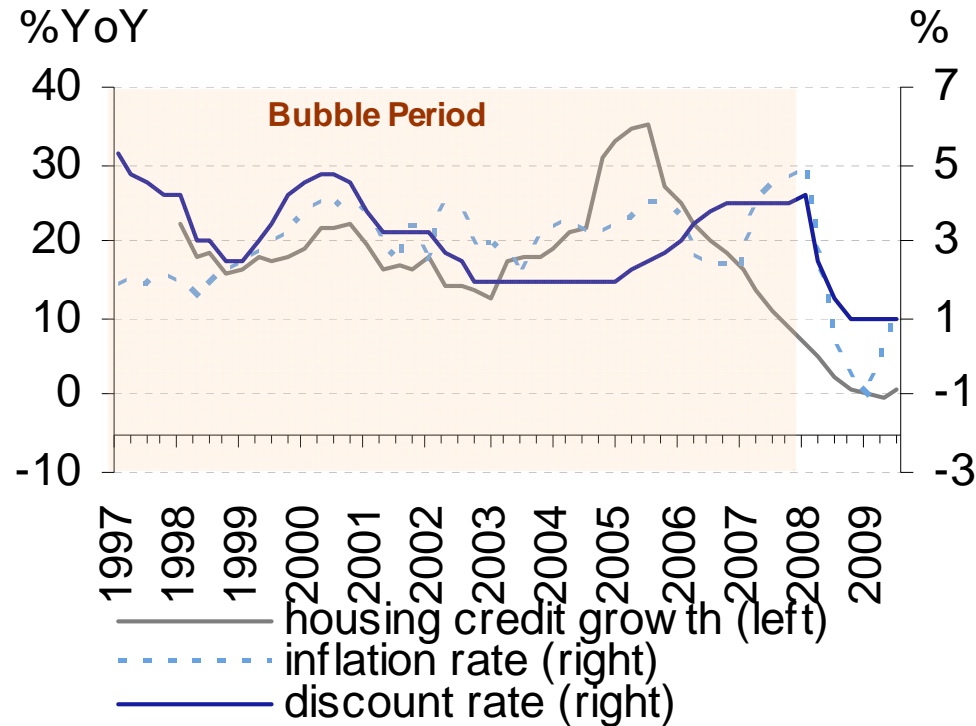
# However, housing lending more focused on developers than elsewhere

**China: Real Estate Loans**
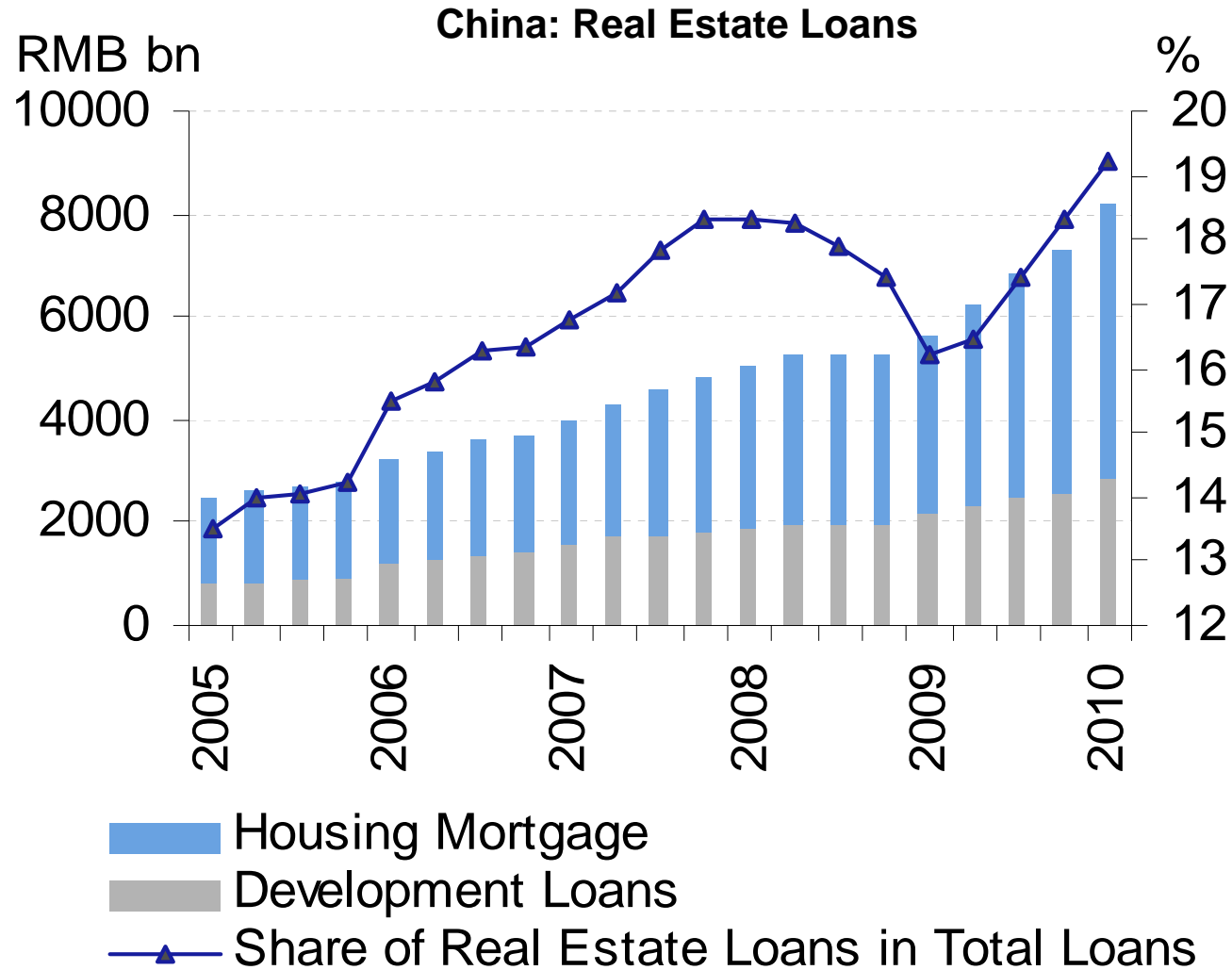


Source: CEIC and BBVA Research

# Spain housing bubble was ALSO supported by a credit boom

**Spain: housing credit growth, inflation rate and interest rate**



%YoY / %

Bubble Period

housing credit grow th (left)
inflation rate (right)
discount rate (right)

Too low interest rates also helped fuel the credit boom.

This was not so much Spain's decision (monetary policy was not a tool any longer within Monetary Union) but rather the fact that Spain was in a more expansionary cycle than the rest of Europe so interest rates were too low for Spain

# US housing bubble ALSO fueled by easy credit/ loose monetary conditions

**US: housing credit growth, inflation rate and interest rate**
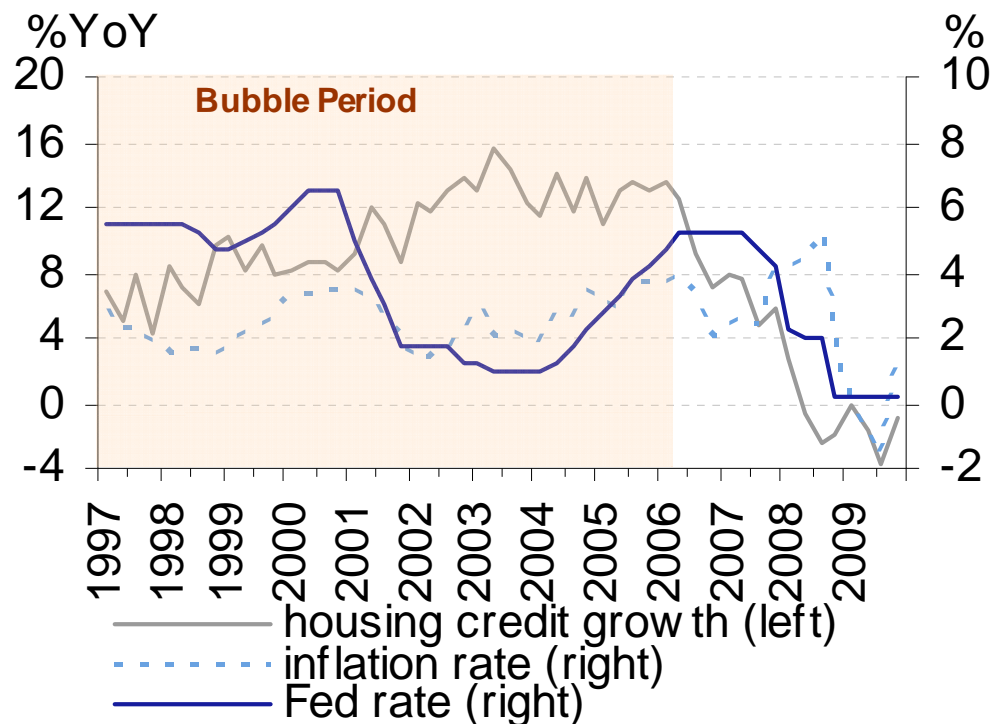


Such loose monetary policy was supported by very low inflation

However, the prevailing idea of "great moderation" faded away starting in 2006 and ended up in the summer of 2007 with the burst of the subprime crisis.

# Japan is the clearest case of how monetary policy can lead to credit and housing price boom (and bust)

**Japan: real estate credit growth, inflation rate and interest rate**

%YoY

Bubble Period

———— real estate credit grow th (left)
·········· inflation rate (right)
———— discount rate (right)
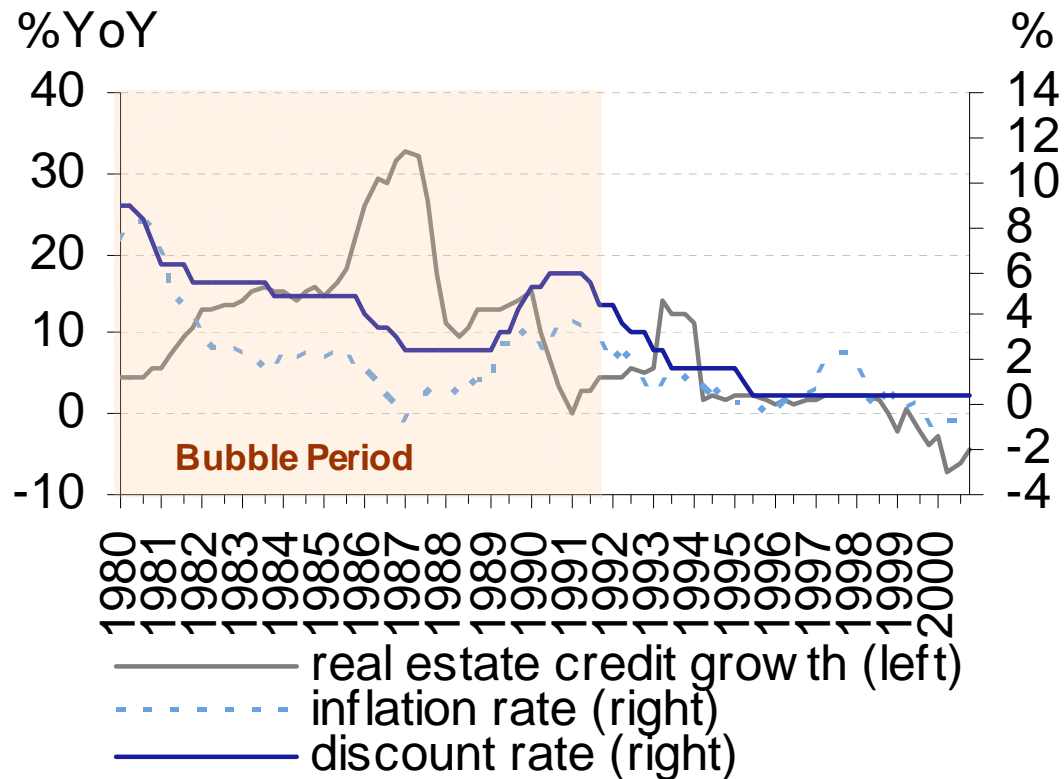
Again, very low inflation also contributed to the bubble (in as far as it did not give any worries to the central bank to discontinue its lax policy)

# In any event, many countries have experienced a housing price bust lately…

## Change in House Prices, 2009:01
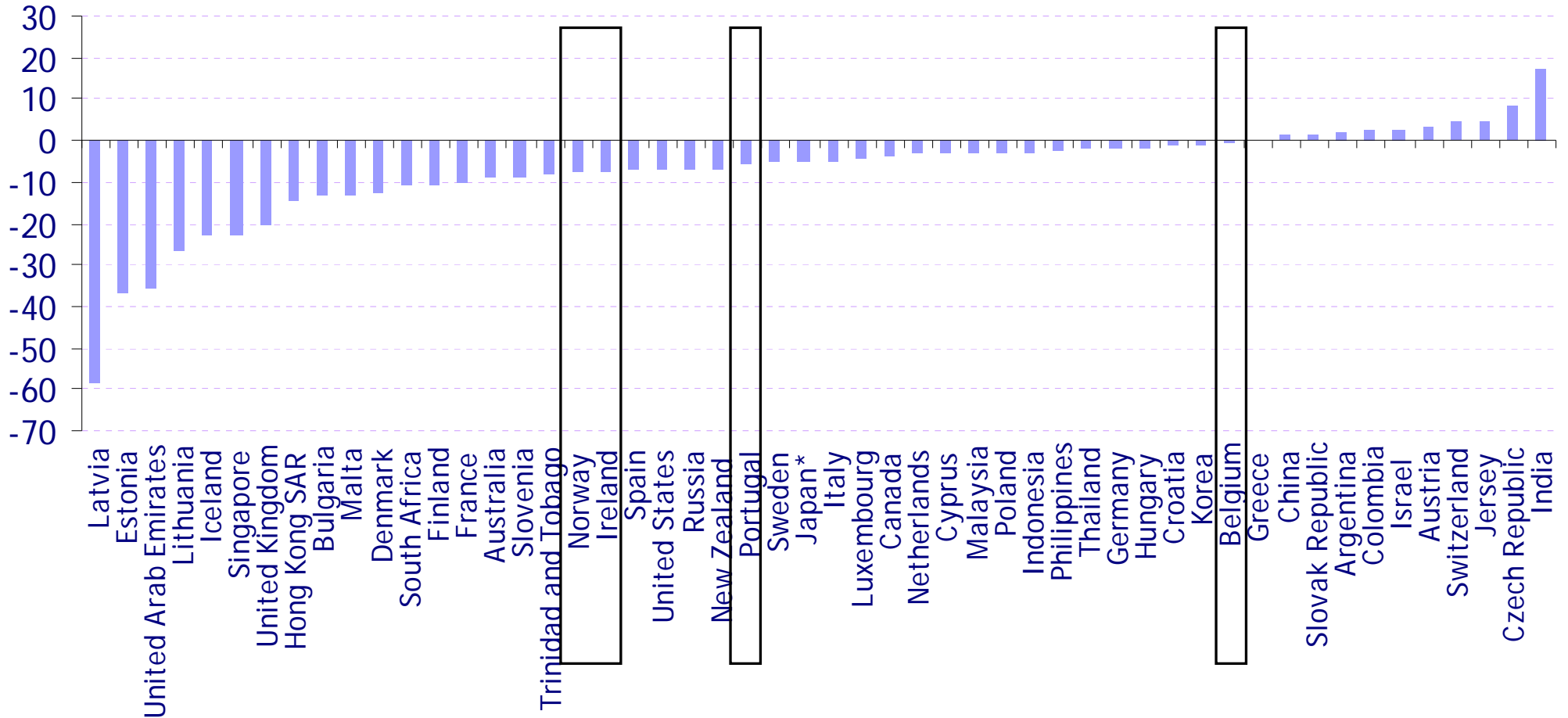


Source: Global Propery Guide; national sources; Organization for Economic Cooperation and Development; and IMF staff calculations. Data for Argentina, Belgium, Colombia, Croatia, Czech Republic, Greece, Hungary, India, Korea, Lithuania, Luexembourg, Malaysia, and Slovak Republic are as of 2008:Q4. Data for Japan is as of 1991 to now.

# Impact on the real economy more dependent on how the price bust affects investment in construction: Japan a case in point

## Investment in Residential and Nonresidential Construction



Gross fixed capital formation in residential construction
Gross fixed capital formation in nonresidential construction
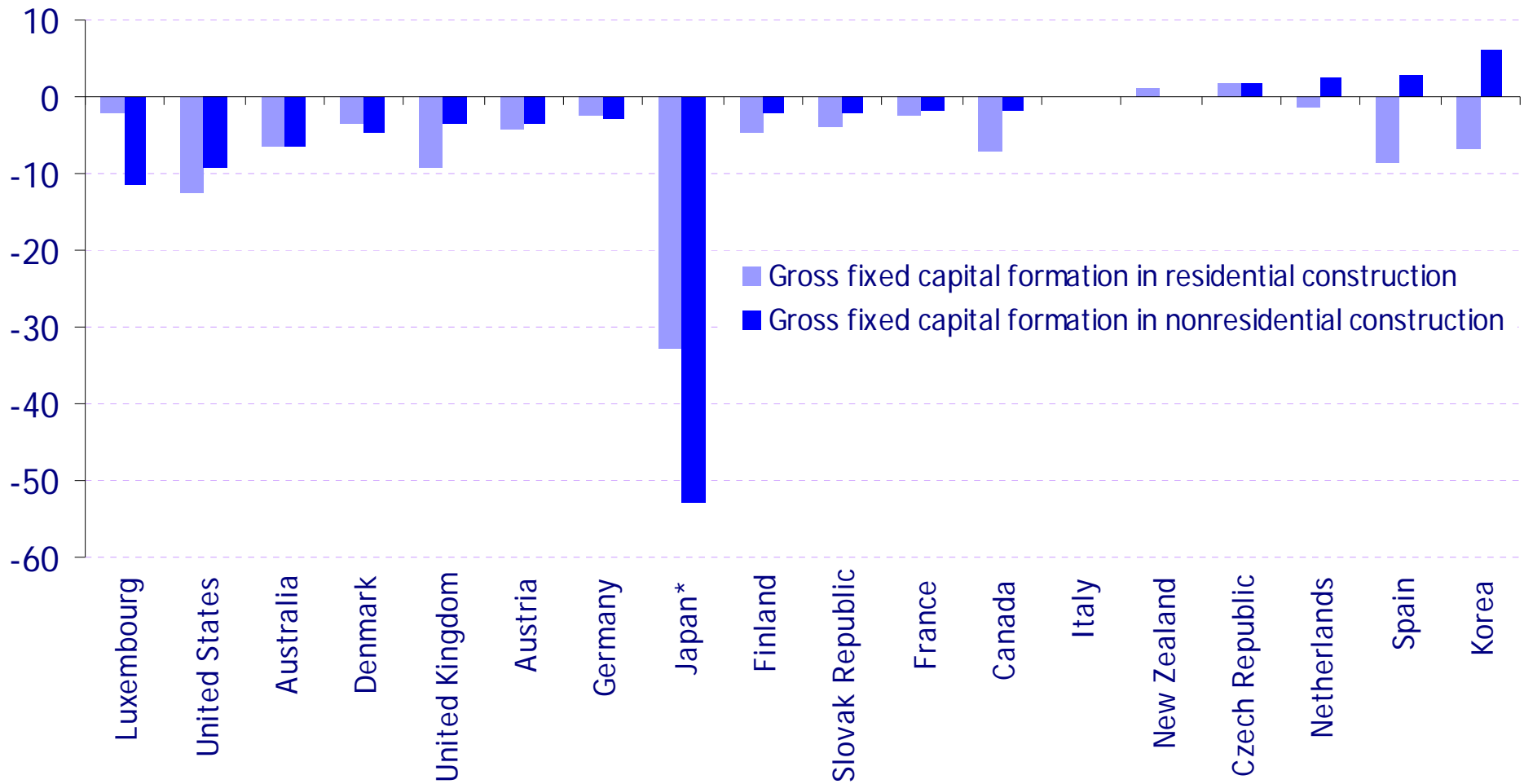
Source: OECD; IMF staff calculations; and BBVA Research. Data for Japan is as of 1991 to now.

# Table of contents

Section II
## LATAM' experience in financing affordable housing

## Policies to finance affordable housing in China

- Since 1990 the Chinese government has been implementing various programs to foster supply of affordable housing for low income households

- The most important has been the *Jingji Shiyong Fang* (subsidized construction of affordable housing)

  1. Key subsidy is the allocation of land at no cost by local governments

     However, still compensation must be paid to existing land users

  2. Generally also reduction of fees paid by the developer to the local government are waved

  3. Targeted to first time buyers with an income below a certain benchmark and official registered (hukou).

     - Official registration makes it hard to target low and very low income

     - Also income benchmark quite high so not really for poor

  4. Benchmark price generally set by local government and developer profits also regulated (not above 3%) so hard to get developers involved!

# Policies to finance affordable housing in China (II)

*Jingji Shiyong Fang* considered relatively unsuccessful because not targeted enough and not enough supply (developers and local governments do not really have incentives to pursue it)

The 2008-2010 fiscal package followed a multilayer approach with a target number of new houses built by 2012

| Type of program | Target houses in million unit |
|---|---|
| Continue with the *jingji shiyong fang* but tightening the criteria for access | 1.3 |
| Fostering the *low-rent public housing program* | 1.8 |
| *Refurbishing existing low-quality housing* | 2.8 |

# Policies to finance affordable housing:
## the Latin American experience

We review the experience of Chile, Colombia, Peru and México in financing affordable housing and draw lessons of potential interest to China

a. Close coordination across institutions and long-term planning are essential

b. As regards incentives on the demand side:

- Interest rate reduction seems like a better option than lower down-payment requirements

- Too restrictive access criteria tend to be detrimental, specially on the downpayment

- Important to keep clear separation between the affordable market and the regular one: restrict conditions to second-hand sale of affordable housing is key

# Policies to finance affordable housing
## the Latin American experience (II)

c. As for incentives on the supply side:

- Enough supply of land needs to be ensured: key role of local governments

- Ensure developers' interest. Important to make sure that their margins in the affordable market are comparable with other markets (i.e., high-end):

  - Land subsidization key as well as the level of the regulated price

  - Tax incentives may be considered