AMSA

The Chinese Property Market

Global Markets Department – April 2022

Tom Behrends

AMSA

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1 Introduction

The Chinese property market has seen tumultuous months since the introduction of its three red line policy. The government has promised a loosening of borrowing restrictions, but markets and currencies are contracting amid growth concerns.

2 General Description

Three red lines

The 'three red lines policy' was outlined by Chinese authorities, back in August 2020. The aim of these policies was to define thresholds on borrowing, and encompassed, "a liability-to-asset ratio excluding advance receipts of less than 70 per cent, a net debt-to-equity ratio of less than 100 per cent and a cash to short-term debt ratio of one" (Liu, 2022, para. unknown).

Property developers, inter alia, Evergrande have come under immense pressure since the imposition of these restrictions, putting an end to the extravagant borrowing in the sector.

The real estate sector, in the world's second-largest economy has been hit by a liquidity crunch, with a slump in property sales. As of mid-April 2022, 17 firms have defaulted on offshore bonds since authorities began combatting excessive borrowing and speculation (Tan & Cheng, 2022).

Changes in the Chinese property sector have far reaching implications for its economy, given that the real estate and related sectors amount to approximately 25% of the country's GDP, (Tan & Cheng, as cited in Moody's, 2022). Also, important to note is the significant portion of global GDP growth China contributes. The countries contribution was more than threefold that of the US throughout the 2010s, at over 30% (Yu & Mitchell, 2022).

Recent Covid concerns and restrictions have amplified pressure to economic growth that was already slowing. According to Asia-Pacific economist Gary Ng at Natixis, "[t]he measures may have been too tight. Now we see this fine tuning of the policy […] [t]he worst time is over basically for those developers who are broadly in line with the current regulatory target or framework" (Tan & Cheng, 2022, para. 11)

2 Financial Description

The effects of struggles in the Chinese property sector are reflected, amongst others, in the valuation of the national currency. The renminbi is on track to achieve its steepest monthly fall on record, with the Chinese currency having depreciated by over 4% to around 6.6 renminbi per dollar (Lockett, 2022). This trend and selling of Chinese assets are driven by the aggregation of a struggling housing market, strict Covid restrictions and the anticipation of the US Federal Reserve raising interest rates.

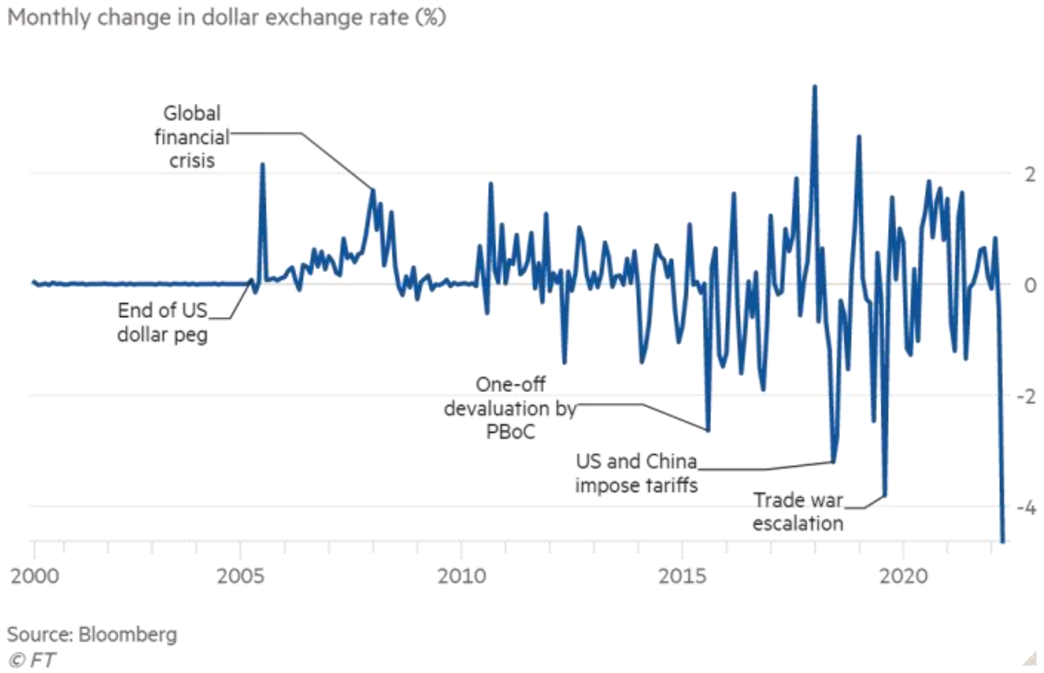

Figure 1: Renminbi takes record tumble

Source: Lockett, 2022.

The rate of selling was accelerated by Xi Jinping who announced extensive spending packages on infrastructure to alleviate pressure from Covid restrictions. The announcement signalled that the government would have to take more action than anticipated to achieve its target growth rate of 5.5% for the year. Additional announcements were made that pledged measures to stabilise the economy, the property market, and China's currency. These series of announcements had little effect on currencies, nonetheless, stocks rallied with the benchmark CSI 300 index gaining over 2% (Lockett, 2022).

Figure 2: CSI 300 Index, dollar terms

Source: WSJ, 2022.

According to Steve Cochrane, chief Asia-Pacific economist at Moody's, "a weakening renminbi will be positive for the export-based economy and that may be partly behind the lack of further policy moves to try and rein in the exchange rate" (Lockett, 2022, para. 8). Also, important to note is that US dollar debt eclipsed those on renminbi bonds for the first time in 12 years in April; the yield advantage had been a main driver for inflows to the debt market in past years. Foreign exchange strategists predict that downward pressure on the renminbi may persist (Lockett, 2022).

3 Outlook

The worst seems to have been overcome, nonetheless the short-term outlook is bleak, with many foreign investors leaving the country. According to HSBC Holdings Plc, the largest foreign bank in China, further defaults may be on the horizon as the Covid situation is worsening. Local governments have implemented additional measures in March; however, policy disagreements remain, highlighting the difficultly of striking the right balance between facilitating economic growth and enforcing a strict zero-Covid policy. The housing market has continued its downward trend, while heavily indebted property developers are struggling. A "sharp sell-off in Chinese stocks threaten to sap consumer confidence and further erode property sales" (Wee, & Wilson, 2022, para. 5).

Chinese Developers, inter alia, Evergrande, many of which have defaulted on their international bonds and are preparing to restructure are attempting to revive home sales by rolling out price discounts. "Some Chinese property developers are heading into the May Golden Week holiday with a blitz of promotions, hoping to jump-start apartment sales after authorities across the country made it easier for people to purchase homes and obtain mortgages" (Wee, & Wilson, 2022, para. 1). The Evergrande Group alone is promoting purchasing incentives for 413 projects, totalling 10,000 apartments.

From a long-term standpoint, high growth in the Chinese property market may be changed forever. According to S&P Global Ratings "China's policy crackdown on its residential housing market has 'bottomed', but that it will take several quarters for markets to feel the effects of the regulatory easing" (Tan & Cheng, 2022, para. 4). This is reflected in China's economic outlook, that has deteriorated in recent weeks. Economists estimate growth to slow to 5% in 2022, below the government's target of about 5.5% (Lockett, 2022).

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