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Between property boom and bust

Are property prices in China excessively high and is there a lot of leverage in the market?

The answers are "no" and "not quite" respectively, argues **Jonathan Anderson**, a speaker at the recent SuperReturn Asia investment conference in Hong Kong and Managing Director, Global Emerging Market Economist at UBS.

Compared to the US in the last 10 years – where mortgages financed nearly 100 per cent of new housing sales on average – just between 25 per cent and 30 per cent of new housing sales in China were financed by mortgages over the same period. Where homeowners took out mortgages, they usually borrowed 50 per cent of their home equity.

"So not a lot of leverage," says Anderson.

And while property prices in China soared by an average of 135 per cent in the last decade, nationwide incomes grew by 146 per cent over the same period.

"As a result, price-to-income ratios have been falling in China. They have been falling virtually every year, with a few exceptions," says Anderson.

"You have not seen a trend increase in housing prices relative to incomes over the last decade in China. We've got no leverage, we've got no price increases and we have inventory levels, as best as we can measure, that have been falling like a stone since 2005."

Nevertheless, the evidence is clear that China's property sector is heating up, notwithstanding Beijing's efforts to constrain what many see as a growing property bubble.

September saw a relatively quick rebound in property prices and sales following a four-month slump driven by tighter government policies. According to the National Bureau of Statistics, China's national property-price index rose 0.5 per cent in September from the previous month, and rose 9.1 per cent from the same period a year ago. The index covers 70 large and medium-sized cities.

Nationwide property sales in terms of floor space also rose 16.6 per cent from a year ago in September, following a 10.1 per cent fall in August, according to the bureau.

The leading cause of the robust buoyancy of China's property sector, says **Paul Schulte**, Global Head of Financial Strategy at China Construction Bank International, is China's economic stimulus package of nearly US$600 billion in 2009.

Speaking to INSEAD Knowledge on the sidelines of the SuperReturn conference, Schulte says that about 45 per cent of the stimulus package was injected into infrastructure construction, which accounted for "a very big part of the growth" in the last four financial quarters.

"That's coming down very dramatically as this money gets spent out," says Schulte. "And so the larger portion of the growth rate starting about now in 2011 is becoming more from consumption and less for investment."

In any case, China's economic outlook for the next few years is "quite robust", says **Ben Simpfendorfer**, Chief China Economist for RBS and the author of 'The New Silk Road'. Simpfendorfer, a speaker at the conference, expects China's economy to grow at an annual clip of around 10 per cent in the next couple of years. However, he worries that the property sector "could be in some trouble" in the next two to five years, with inflation trending "dangerously higher".

Simpfendorfer, who views the property sector as China's leading economic driver, also reckons that the housing-related manufacturing sector ¬¬– including producers of steel, copper pipes, furniture and home electronics – will be dragged into a downturn when the property sector eventually declines.

"If the property sector were to correct, if you're going to see a few years of very weak investment spending in this sector, the impact on the manufacturing sector would be enormous," he says.

Inflation though does not pose a major threat in the near term because neither non-food prices nor food prices are rising quickly, says Simpfendorfer. But inflation is a "major threat" in the medium term, because China faces structural inflationary pressures from wages, land prices and raw materials prices.

But is China's speedy growth propelling the country towards an economic disaster, as some investors argue?

Jonathan Anderson of UBS points out that some China observers are bearish on China's economic outlook because they see the country as being awash in massive excess capital and capacity creation. Furthermore, China's domestic investment-to-GDP ratio has surged to nearly 50 per cent currently from 35-40 per cent of GDP in the 1990s.

However, much of the investment has gone into the property sector. As such, China has not been significantly expanding the economic share of its non-property related manufacturing base – including industrial factories and shipbuilding – from what it was 10 to 15 years ago, says Anderson.

Indeed, the Chinese yearning for property ownership has resulted in personal consumption falling to about 30 per cent of household spending currently from about 50 per cent in the 1990s, according to Anderson.

"China is not seeing household spending fall apart and domestic demand fall apart," says Anderson. "The only thing that's happening in China is that there has been a big re-allocation spending to property."

"The only thing that China is building more of today is property," says Anderson.

"And the property story has been massive. But there is no massive excess capital creation process in China.

"What there is, is a big property boom. That's where the household spending has gone, that's where the investment spending has gone. If you get the property story right in China, you get the China story right."

This article was written by Kevin Tan based on interviews for INSEAD Knowledge and conference sessions at SuperReturn Asia in Hong Kong.

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