

The History of China's Real Estate Market and The Risks It Faces

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Abstract. Today, China's real estate market is facing various crises, and the development of real estate market contributed a lot to the growth of China's economy. Therefore, it is crucial to understand the Chinese real estate market and the problems it faces today. This paper briefly analyzes the history of China's real estate market and positively affirms the contribution of the real estate market to China's economy by analyzing the data. In addition, this paper also analyzes the dangers faced by China's real estate market based on the current market conditions in China and discusses possible solutions. Based on these analyses, this paper suggest that people need to pay more attention to the real estate market and highlights the significance of real estate market to the Chinese economy.

Keywords: China's real estate market, Contribution, Challenges, History.

1. Introduction

The economy of China has maintained rapid growth in the past few decades, and now it has become the second largest economy in the world and is very likely to surpass the U.S. become the world's largest economy in the foreseeing future. In the growth of China's economy, the flourish of real estate has always been a main force. But today's high housing prices, which are not in line with people's incomes, have made housing affordability one of the biggest economic and social issues right now. In this paper, I will review the history of China's real estate market, its important contribution to China's economic growth, and discuss the affordability and some risks of the real estate market today. At last, what did the government do to stabilize the market.

2. The History of China's Real Estate Market

China's real estate system, like China's economic system, changes over time and at different phases of development. In general, we can divide the history of China's real estate market into five phases.

Phase 1, 1949-1978. After the founding of the People's Republic of China in 1949, it inherited the real estate system of the Soviet Union: the welfare housing system. This welfare housing system is not a market economy behavior, and real estate has not been privatized. Under this welfare housing system, all properties belong to government agencies, the state, or collective enterprises. It provides rental services to people through low-cost rentals. Therefore, at this stage, real estate in China is not yet a market behavior, and there is no private ownership. The ownership of the property belongs to the government, the state, or the collective.

Phase 2, 1978-1987. A new real estate model emerged at this stage: the one-third model. Under this model, government-owned enterprises, the government and individuals each bear 1/3 of the construction and maintenance fee of new houses. At this stage, China's real estate system has not changed substantially.

Phase 3, 1987-1991. At this phase, China's real estate has just begun to market. Some provinces and cities were allowed to conduct land transactions and in 1988 passed a constitutional amendment that allowed the transfer of land use rights but the state retained ownership. Moreover, according to Hung-Gay Fung and his colleagues, "In addition, the housing Public Accumulation Fund (PAF), contributed to by employees and aimed to relieve the financial burdens of employers, was launched in Shanghai and gradually spread to other parts of China." (Hung-Gay Fung et al.73) This also marks the further improvement of China's housing system.

Phase 4, 1992-1997. China's real estate market is developing rapidly. After 1992, many areas in China were divided into economic development zones, the restrictions on land use were relaxed, and a large number of corresponding real estate service companies were established, such as property management companies, real estate brokerage companies, and so on.

Phase 5, 1998-present. The government abolished the welfare housing system, and employers turned this "welfare" into a housing economic subsidy. After the abolition of the welfare housing system, the housing Public Accumulation Fund, housing subsidies, etc., which has made China's real estate market take off. After 1998, China's real estate prices and assets ushered in rapid growth. The boom in the real estate market has also contributed to the scale of China's economy today.

3. The contribution of the real estate market

From 1949 to 1998, China gradually completed the process of marketization of real estate, and China's real estate market entered the era of unprecedented prosperity. The strong economic growth of China in recent decades is inseparable from the prosperity of China's real estate market.

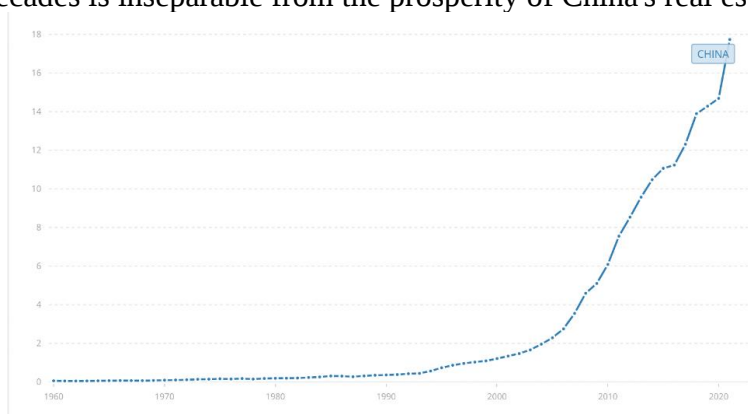


Fig. 1 China's GDP from 1960-2021 (In Trillion USD)

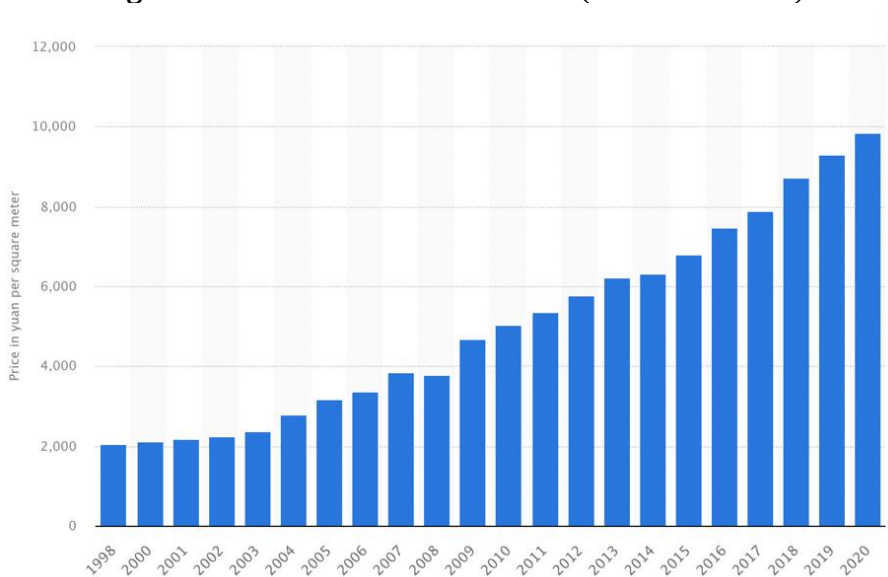


Fig. 2 Average real estate sale price in China between 1998 and 2020 (in yuan per square meter)

In fig.1 and fig.2, it shows China's GDP since 1960 to the present, and the average sales price of real estate in China between 1998 to 2020. From the figures, we can see that China's GDP has grown rapidly since 1998, and China's housing prices have also ushered in rapid growth since 1998. The timing of the rapid growth of China's GDP coincides perfectly with the rapid growth of the real estate market, which shows the contribution of the prosperity of the real estate market to China's economic development.

The contribution of real estate to China's economic growth is mainly in two aspects. The first is to make up for insufficient consumption through real estate investment. We know that the lack of consumption power has always been a major problem in China's economy. According to the data from Statista, we can know that China's consumption accounts for less than 40% of GDP. However, the major developed countries in the West have very high consumption power. For example, US consumption accounts for 65-68% of GDP. Therefore, real estate investment has become important in driving domestic GDP growth.

Table 1. Real Estate Development and Economic Growth, 1997-2005

Year	GDP (RMB billion)	Real estate capital (RMB billion)	Ratio of real estate to GDP	Construction and installation projects (C&I) (RMB billion)	Urban fixed assets investments (UFAI) (RMB billion)	Ratio of C&I to UFAI
1997	8,166	2,997	36.7%	1,163	1,919	60.6%
1998	8,653	3,131	36.2%	1,374	2,249	61.1%
1999	9,096	3,295	36.2%	1,516	2,373	63.9%
2000	9,875	3,484	35.3%	1,634	2,622	62.3%
2001	10,897	3,977	36.5%	1,875	3,000	62.5%
2002	12,035	4,557	37.9%	2,197	3,549	61.9%
2003	13,640	5,596	41.0%	2,770	4,518	61.3%
2004	16,028	6,917	43.2%	3,654	5,903	61.9%
2005	18,670	7,956	42.6%	4,618	7,510	61.5%
Compound growth rate	10.9%	13.0%		18.8%	18.6%	

Table 1 shows the relationship between real estate market and the economic growth in China from 1997-2005. As we can see, the ratio of real estate to GDP raised from 36.7% in 1997 to 42.6% in 2005. Therefore, the boom of the real estate industry has made up for the insufficient domestic consumption capacity in China, which has enabled the rapid development of China's economy. Moreover, Chinese people have a cultural urge to purchase real estate, and the ownership of properties could directly influence people's social status in China. Juwai explained this phenomenon in his report "Why are Chinese so obsessed with buying a property?" He said that "Owning a home of their own is unspoken, but the well-known aspiration of most Chinese. Even in 2010, China's National Bureau of Statistics reported that 90% of mainland Chinese owned their own home."

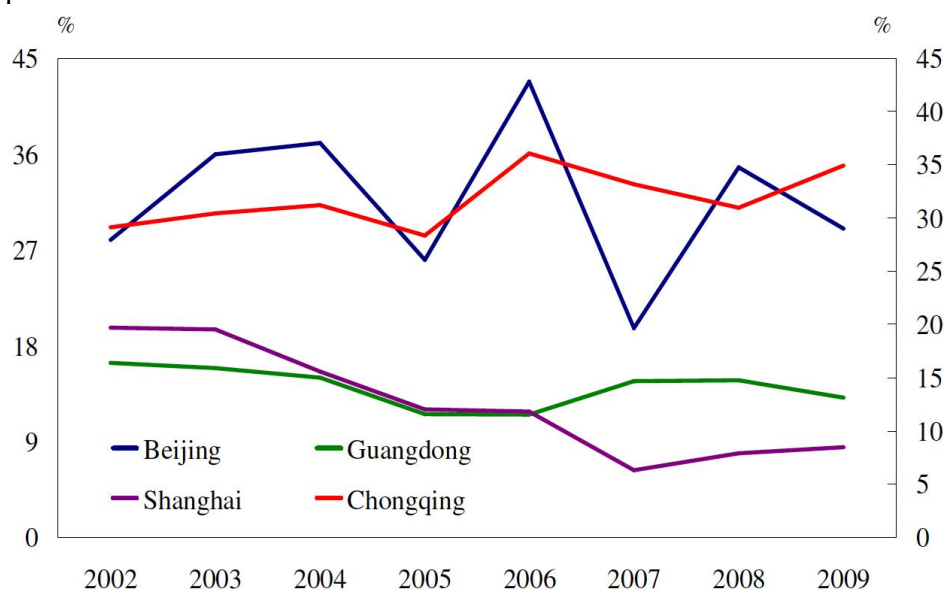


Fig. 3 Land sales as a percentage of local government general revenue

The second aspect is that local governments can rapidly increase their fiscal revenue through income from land sales, and use these fiscal revenues to invest in infrastructure construction and other areas conducive to economic development. Fig.3 shows the proportion of land sales revenue to fiscal revenue in four major cities in China. As can be seen from the figure, the Beijing Municipal Government's land sales revenue once accounted for more than 40% of the fiscal revenue around 2006. From the data of these four major cities in China, we can see that the fiscal revenue of various local governments in China is very dependent on land sales. Therefore, the rapid development of the real estate market in the past years has also greatly increased the fiscal revenue of the local government, and the government can reinvest these fiscal revenues to maximize the effect of economic growth.

In general, the rapid development of the real estate market has been the foundation of China's economic development. Relying on the flourish of the real estate market, the government has quickly completed the accumulation of capital and reinvested this capital into infrastructures. However, due to the rapid development of the real estate market, the transaction price of real estate is also rising. Today, in some major Chinese cities, such as Beijing, Shanghai, Guangzhou, and Shenzhen, housing prices are far beyond what most people can afford. The housing bubble gradually became a concern.

4. Challenges and opportunities

Today, the problem of high real estate prices in China is not just a single economic problem, it has become a social problem. Although the development of the real estate market has made an important contribution to China's economic development, the real estate dilemma we are currently facing is undeniable. Just like EDDIE CHI-MAN HUI, and his colleagues pointed out in their article, "The performance of the housing market, causing a strong wealth effect, has had marvelous effects for the entire society. Housing price bubbles in different Chinese cities have been explored and reported in the last few years." (EDDIE CHI-MAN HUI et al. 951)

Affordability of real estate has become a very serious problem, and this problem is also a major crisis facing the real estate market. The following two graphs are the housing price growth graph and the per capita income graph of some major cities in China.

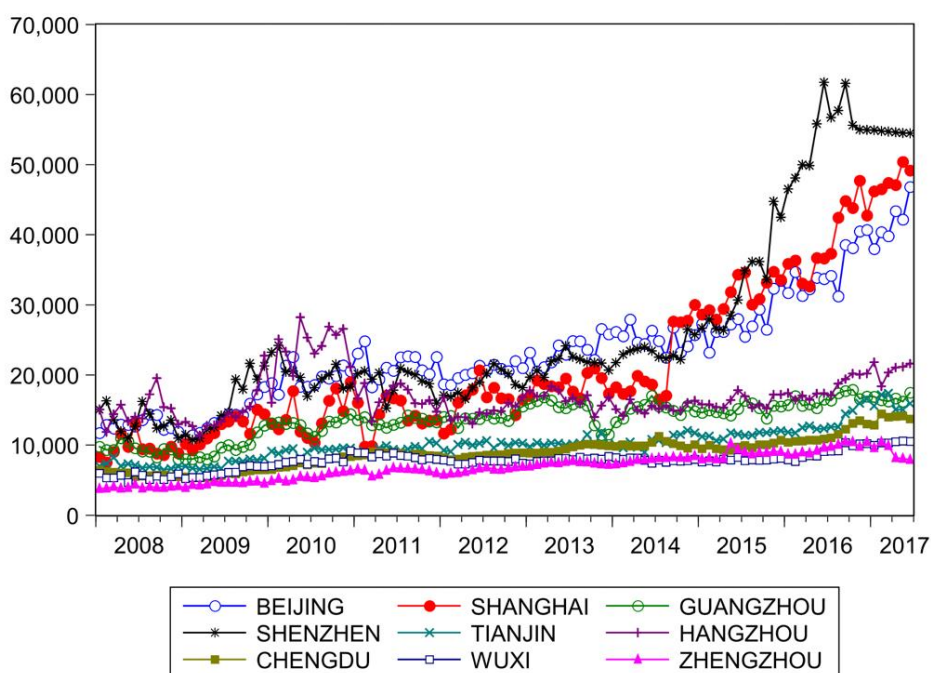


Fig. 4 Residential real estate prices (Yuan/m²) in China from Jan/2008 to Jun/2017

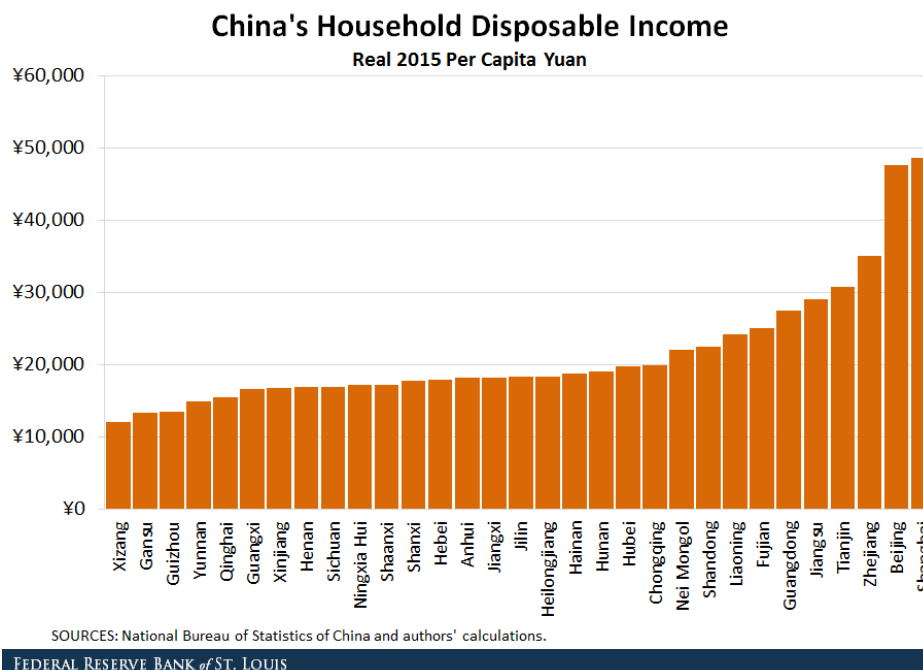


Fig. 5 China's Household Disposable Income Per Capita Yuan, 2015

We use 2015 Shanghai data to estimate. According to the above data, the per capita household disposable income in Shanghai in 2015 was around 49,000 RMB. The housing price in Shanghai in 2015 was around RMB 35,000 per square meter. Based on these two data, we can roughly estimate that it takes about 71 years for a family in Shanghai to afford a house of 100 square meters. This staggering statistic shows that some of China's big cities have had serious housing affordability problems. Excessive housing prices are a serious blow to the sustainability of the housing market. Excessive housing prices will inevitably lead to weakness on the consumer side. The vast majority of Chinese still have a very strong demand for housing, but because of the high housing prices, people have to give up buying real estate. At this time, the price of real estate will decrease due to the decrease in demand side. The decline in real estate prices will inevitably trigger a series of chain reactions. First, real estate companies may flee the housing market or cause a severe debt crisis. Due to the fall in real estate prices, the profits of the real estate market will decline, which will cause real estate companies to lose confidence in the real estate market and reduce land purchases, which will lead to the reduction of local government revenue and financial problems. Second, China's GDP growth may slow down. As I said above, the prosperity of the real estate market is a strong driving force for China's economic growth, and the weakening of the consumption side caused by excessive housing prices will cause the Chinese economy to lose its growth momentum. Third, whether the high real estate prices will lead to China's transformation of the economy from substantial to fictitious. The ultra-high profits in the real estate market may cause Chinese enterprises to shift from the real economy to the virtual economy, which will have a long-term impact on the Chinese economy. China's manufacturing industry is still lagging behind that of western developed countries. If the profits of the real estate market are too high, more companies will turn to the real estate financial market, which will lead to the slowdown or even regression of the development of China's real economy. Excessive prices and profits in the real estate market are also extremely unfavorable to the development and transformation of China's manufacturing industry.

Last, will the real estate bubble burst? Whether there will be a national or even world financial crisis like the 2008 financial crisis. Hongyu Zhan and his colleagues also discussed the problem of the real estate bubble in China in their article "How big is China's real estate bubble and why hasn't it burst yet?" They developed a diagram to show how will the bubble Lead to Financial Crisis and Macroeconomic Recession.

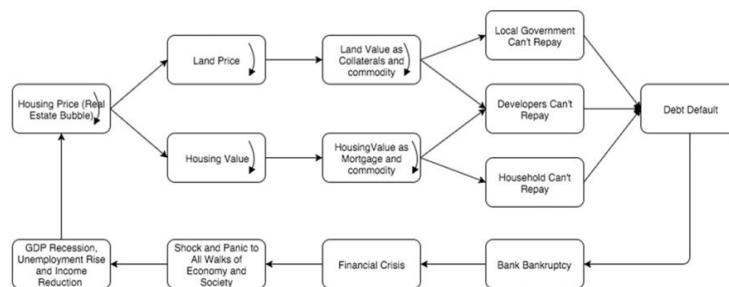


Fig. 6 How China's Real Estate Bubble Leads to Financial Crisis and Macroeconomic Recession

This picture clearly expresses a series of chain reactions and a heavy blow to the Chinese economy if the real estate bubble bursts. If the real estate bubble bursts, real estate prices and land prices will plummet, causing local governments, real estate developers, and home buyers to rapidly reduce their assets and eventually become insolvent and unable to pay their debts. At this time, all people face the problem of debt default and falling into a debt crisis. Banks will also be hit hard, as the market faces a debt crisis and cannot repay their debts, and banks will also be in trouble. A large amount of liquidity cannot be recovered, leading to bank failures and triggering a financial crisis and a general recession of the macroeconomy. Unemployment soars and stock prices decline. The whole society is in panic. Therefore, the stability of the real estate market is very important.

The Chinese government has also enacted some policies to stabilize the housing price. One of the policies is called the "Three Red Lines" policy that published by the central government in August 2020. The three red lines are: Liability to asset ratio (excl. advance receipts) of less than 70%; net gearing ratio of less than 100%; cash to short-term debt ratio of more than 1.

There are several reasons why the Central Chinese Government enacted this three-read-line policy. According to a report from UBS, there are 5 reasons. First of all, to control the price of houses. In the past decades, housing prices in China have risen rapidly. It has far exceeded the affordability of most Chinese, so stabilizing and controlling housing prices is a top priority. Second, manage the land market. Soaring land prices are one of the reasons for the higher housing prices, with many real estate developers buying large amounts of land at low prices and driving up land prices. Therefore, managing the land market and stabilizing land prices are also necessary means to stabilize housing prices. Third, to ration credit to the real estate sector: The real estate market absorbs a lot of money. Through macro-control, the government diverts some of the funds absorbed by real estate to industries with more production value, thereby promoting economic growth. Fourth, To lower cyclicity. Stabilize the real estate market through a "long-term mechanism for the real estate market". Finally, the real estate market plays an indispensable role in China's economy, so the government needs to ensure the sustainable development of China's real estate market through stricter policies and management methods. It can be seen that the Chinese government is also actively solving the problems currently faced by the real estate market.

5. Conclusion

China's real estate market has gone through decades of development since the founding of the People's Republic of China and has fully completed its market-oriented reforms. Since 1988, the real estate market has developed rapidly and has driven China's economy into a stage of rapid development. Local governments also increased fiscal revenue through land sales and reinvested in economic development. Therefore, this paper praises the contribution of the development of the real estate market to the Chinese economy.

However, after experiencing the rapid development of the real estate market, the real estate bubble has still become a problem worth worrying about. Based on the analysis of data from major Chinese cities and taking Shanghai as an example, this paper finds that a family in Shanghai needs 71 years of income to buy a 100-square-meter apartment. This shows that the problem of real estate prices in China is already very serious. In addition, the excessively high prices in the real estate market will

also cause a series of economic and industrial problems, such as the problem of Chinese enterprises' deviating from the real and into the virtual.

The three red lines policy is a reflection of the Chinese government's confidence in stabilizing the real estate market. The introduction of this policy also demonstrates the sensitivity of the Chinese government to market changes. And use its powerful administrative ability and high decision-making efficiency to quickly make the correct deployment for market changes.

This paper affirms the prosperity of China's real estate market to China's economy by analyzing history and data from the macro level, and reflects the irreplaceable position of the real estate market in China. This paper describes the current problems faced by China's real estate market, and describes the past and present of China's real estate market from an objective perspective. It believes that we must first recognize the historical contribution of the real estate market and urge the government to strengthen the management of the real estate market.

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