China's real estate market reform and development path

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Abstract. China's real estate market has made an important contribution to economic and social development and has attracted widespread attention. The real estate market is not only concerned with housing problems, but also closely related to finance, residents and public services, and has become an important factor affecting economic and social development. This paper analyzes the main reasons driving the development of China's real estate market and discusses the possible problems. The results show that China's real estate market is in urgent need of reform and innovation to solve some existing contradictions, so as to promote high-quality economic development. Finally, this paper provides some suggestions for real estate development.

Keywords: Real estate market; Development path; China.

1. Introduction

The housing market in China is in a slump due to the defaults of debts by major property developers. According to the Global House Price Index released by the International Monetary Fund (IMF) in 2021, housing costs in China are growing faster than incomes in recent years and most countries have the similar pattern worldwide. As 70% of the Chinese citizens’ wealth is in real estate market, investing in real estate may yield greater returns than investing in other industries (Lau, 2021). In the last two decades, China’s housing prices have approximately tripled, especially in first-tier cities such as Beijing, Shanghai, and Guangzhou, which exhibit higher growth rates (Yu, 2022). This article aims to analyse the reasons behind the housing crisis in China and the potential solutions to cope with this peril.

From an economic standpoint, there was an increase in demand with limited supply, which resulted in a surge in housing prices in the market. Following this market pattern, the housing prices would have been returned to the market equilibrium price once the demand were accommodated and people secured their own real estate. Since the 1998 Housing Reforms in China, there has been a constant growth in the construction of residential properties. It is expected that the number of houses will be able to satisfy 3.4 billion people (Bloomberg, 2016). This means that, with about 1.4 billion populations in China, each citizen can acquire more than two houses on average. However, this is not the whole story. Inflation also contributed to the increase in the housing price. Furthermore, Feng et al also suggested that the spatial-temporal interaction effect may also play a positive role in the rise of the housing prices in China (Feng, 2021).

Similar to the global housing crisis, China’s housing crisis is rooted in predictive error about the consequence of inflation. Builders started building infrastructure excessively as the misjudgement on inflation. They overestimated the housing demand. When demand for real estate property increases, supply goes up, then the increase of demand is further fuelled by speculators investing in the market. When the demand was achieved but supply continues to rise, it resulted in a plummet in housing prices and a collapse (Sundaram, 2021). However, the situation of China is relatively better than other countries. China’s property market is deteriorating with a decline of 1.3% in housing prices following with a fall of 5.0% in property investment and a drop of 25.0% in property sales in H1 of 2022 (Gao & Woo, 2022).

One the other hand, the Land-use policy stipulations are also responsible for continuously rising housing prices in China rather than land shortage, which faced by the globe (Sheng, 2021). The expensive price of land in China has been an important cost factor to boost up the asking price of the house in China. Contrary to western countries, where industrialisation drive urbanisation, China’s own developing path for its economy is reversed. Urbanisation is the driving factor for industrialisation. As hundreds of millions of people migrate to the major cities, the real estate market
in China has indeed associated with all aspects of industries. For instance, the development of infrastructural and medical service provided in communities have contributed to the high housing prices in China. The rapid development in the past two decades cannot be dismantled by real estate, where it is not even an industrialised country, but its urbanisation reversely, brings up the industrialisation process, and this contributed a lot to the economic development of the country.

2. China's real estate market reform

The rapid expansion of China's economy over the past few years has significantly increased housing demand. The cost of apartments and houses has skyrocketed as more and more individuals relocate to cities. Urbanisation in China brings up a wide variety of sectors with the increase of living standards of people. From building materials to household appliances, from underground to high-speed railway. In general, high housing prices have been a result of higher education quality, better markets around houses, and an increase in employment rate as well as the higher wage level in the society. Due to the high employment rate, the higher wage, and the presence of infrastructure with adequate medical services, these factors have encouraged cities to develop at a rapid pace and their housing prices surge correspondently (Ding et al, 2017).

China's housing crisis is mostly a result of the accelerated expansion of its economy. Although China has enough land for use, its residents and developers blindly believed that there is a shortage given the high population density. In addition, the social norm of Chinese is that the primary choice for investment is to purchase housing to get the sense of stable (Farrer, 2021). Besides, during the COVID-19 shock, the strict quarantine policies of the country significantly reduced people's enthusiasm for buying houses (Bayoumi & Zhao, 2021). Previous study indicated that COVID-19 shock has impacts on the housing price in China (Qian et al, 2021). Individuals are more cautious when buying real estate because they are worried about the precarious situation caused by the pandemic. Thus, they prefer more cash in hands. The fact that China was already experiencing a slump in the housing industry prior to the release of COVID-19 has exacerbated the adverse effects of the virus on home values. Because of this, there is an extremely high surplus of housing, resulting in downward pressure on property prices.

When there was a housing bubble in the market, most of the sub-prime lenders failed to pay their mortgages after the teaser rates expired. In China, one of its largest embattled developers, Evergrande, is on debt default (Tan, 2021). Evergrande, as the world’s most indebted real estate developer which was gripped by solvency crisis, exhibited a threat to economic stability in China (Huang, 2022). The local governments’ revenue of China has relied heavily on the property development. Chinese banks’ lax lending assessment allowed investors to lend large amounts of money to purchase properties. Consequently, the house-purchase intention increased, driving up the prices even higher.

As a result of the housing crisis and the subsequent inflation, the aggregate demand for housing decreased and shifted towards the left due to the decrease in investment and consumption (Zhao et al, 2020). The rise of China's housing prices not only increases the cost of purchasing basic accommodations in the future, but also increases the transaction cost and the mental pressure of its residents. As a result of the abundance, rising housing costs often increase the social economic burdens and lead to higher inflation rate. Following the collapse of the housing market, many mortgages became virtually worthless, which in turn deteriorates the lenders' revenue (Han et al, 2019). Considering that about 27% of loans in China are associated with property and mortgages, plummeting house prices will lead to an economic downturn and risking the broader Chinese economy (Hsu, 2022).

Since the Evergrande had been proclaimed in default. The company owes money to nearly 170 home-grown banks and 121 financial organisations (Hoskin, 2021).

Accordingly, with fail of the key market player, there will be ramifications for the financial business. Despite Evergrande's obligation default last year, China's housing market continues to worsen. The pandemic caused an increase in unemployment in China, which has impacted the social
stability of China. People have lost their savings and are now prompt to buying insurance than real estate properties including houses, shops, lands etc., due to which a lot of new apartments are empty and construction companies are facing risk of default and rupture of their capital chain. A stoppage in the Chinese land area, which represents a critical extent of the country's financial situation. This could have expanding adverse influences on the worldwide development (Stevenson & Li, 2021).

The Chinese economy is on a vital pace to save its drooping real estate market and avoid a serious deterioration within the world's second-biggest economy. China must replace its property-led growth model to remain sustainable for its economic growth. Currently, the People's Bank of China cuts its five-year advance Loan Prime Rate (LPR) by fifteen premise focuses to 4%; This is the second decrease in the year and the biggest on record (Reuters, 2022). China's LPR is the rate at which banks lend to their best clients. Thus, the five-year development is primarily utilised as a source of perspective for contracts since it is the benchmark for elective credits. From a macroeconomic perspective, the country is trying to lower its loan rate to boost consumer spending and investing. However, this can spur excessive growth and subsequent inflation.

3. Conclusions and suggestions

To solve the housing crisis, it is important to create an affordable housing trust. As mentioned above, there is huge growth of new residential properties in last two decades for the country since its housing reform. This increases the affordability of housing for the citizens. China has performed well in supplying the houses but there is still lack of sufficient coordination between the local districts to its land resources cross-regionally (Sheng, 2022). Due to the traditional culture, owning houses is critical to many Chinese families, which results in many families chase to buy more than one house. Thus, China needs to guide the distribution of its land at national level.

Currently, the Chinese government has tried to increase investment in the housing sector and tightened lending standards. The banks are also fine-tuning their real-estate lending rules and bidding rules to tackle the housing crisis. The government has escalated its involvement in the real estate market, by dividing two categories: first-time buyer subsidies and new home building (Wang, 2022). However, this showed a focus on demand-side controls alone, which would buoy the citizens’ expectations of lowering housing prices. The government should introduce measures to try to increase the transparency of the housing market and regulate speculation. The country should address its demand-side and supply-side policies to reduce the imbalance of the market.

The country has planned for its policy realignment towards its supply-side and demand-side controls to include more regulation on the supply-side. Tighter loan restrictions on large property companies and renew systems for pricing property re-imposed (Gill, 2021). With its implementation of the stricter tax for second-home buyers (Reuters, 2013), the country is also planning to reduce the taxes impose on buyers, thus encouraging people to invest in the housing sector and revive the industry (CNBC, 2022). Nevertheless, the tax system has less of an impact on its implementation, so the Chinese government must work harder in dealing with the supply-side policies for reasonable land supply. More importantly, there should be a stronger monitoring and chasing on illegal real estate transactions.

In a nutshell, China is working on a number of schemes to try to rescue the failing housing market, both in the short and long term. The Chinese government has worked hard to supply rental properties at a lower rate. The relationship between real estate market and economy is inseparable. To make housing affordable for all 1.4 billion citizens of the country, the government should try to improve the social safety net other than those suggested above, so that the citizens will not face the problem of unaffordable housing. Thus, both the well-being (mental and physical) of the citizens and its stable economic growth are guaranteed.
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