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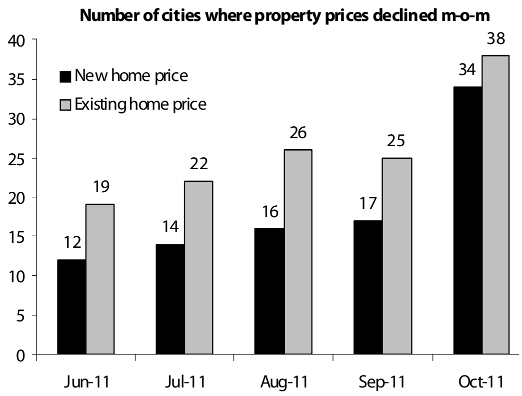
China: The pace of property price increase is expected to fall further, undermining investment growth

- China's property prices fell for a second consecutive month in October on a monthly basis, as a result of persistent tightening measures by the government to slow down property price increases.
- Property sales point to further deceleration of the pace of property price increase in the coming months.
- The correction in property prices is likely to undermine investment growth, while its negative impact on China's private consumption seems limited.
- Given that the correction in home prices is policy induced, the government could simply reverse its tightening measures, if there is a significant negative impact on the economy.

Property prices fell for second month in October on a monthly basis…

China's residential property prices fell for a second consecutive month in October 2011 in an increasing number of cities compared with the previous month. According to the National Bureau of Statistics, home prices in newly constructed residential buildings declined on a monthly basis in 34 of 70 cities, double the number of September (Figure 1). In addition, new home prices rose in 16 cities and remained unchanged in 20 cities in October, compared with 24 and 29 cities, respectively, in September. A similar trend is witnessed in the sales prices of second-hand residential buildings. Comparing with the previous month, existing home prices decreased in 38 cities, 15 more than in September (Figure 1). On y-o-y terms, according to the NBS 70-city property price index, property prices increased 2.8% in October, almost half the rate witnessed in the beginning of the year. Indeed, the pace of property price increases has started to decelerate gradually since April 2010, when prices reached their peak of 12.8% y-o-y (figure 2).

Figure 1



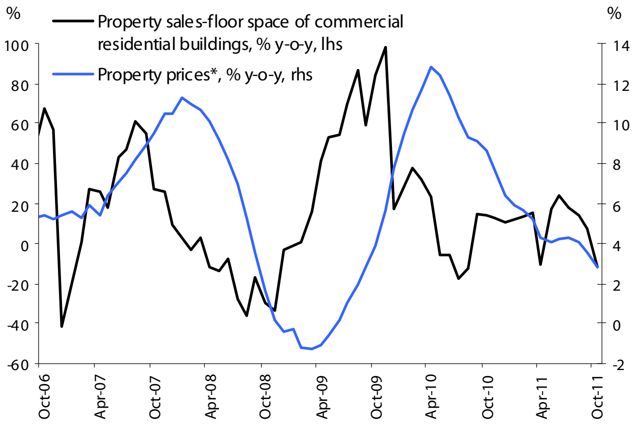
Source: National Bureau of Statistics of China

The correction in property prices is a result of persistent tightening measures by the government to slow down property price increases, and thus, limit the risk of a bubble in the housing market and keep housing affordable. Indeed, the government plans to maintain its control over the market even as it seeks to "fine tune" other economic policies. However, given that the property market is a key driver of economic growth in China, the government could simply reverse these measures, if there is a significant negative impact on the economy.

…with property sales pointing to further easing of property price increases in the coming months

Should we look at property sales, the data indicate that the pace of property price increases is due to decelerate further in the coming months. As figure 2 depicts, changes in property sales usually lead changes in home prices. This indicates that the key trigger for easing property price increases is developers being forced to cut prices in order to boost property sales and maintain cash flows, after the government's housing curbs that led to a sharp rise in financing costs. Property sales posted negative growth in October. Growth of commercial buildings sales in value terms dropped 11.1% y-o-y from 10.0% growth in September. Additionally, residential housing sales in value terms as well dropped 14.0% y-o-y from 5.6% growth in September.

Figure 2



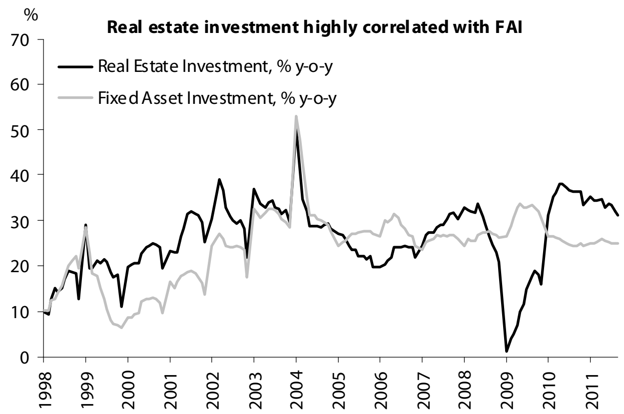
** Since January 2011, the National Bureau of Statistics started to implement "Survey Program on Sales Price of Residential Building". The new program made considerable adjustments on data resources, indicator selecting, calculation methods and other factors that may have an impact on the calculation of the price index. As a result, the data starting from 31/1/2011 are not comparable with historical data.*

Source: National Bureau of Statistics of China, Ecowin

The correction in property prices is likely to affect negatively investment growth…

The correction in property prices is likely to directly affect negatively fixed asset investment (FAI) and, consequently, real GDP growth. Indeed, the deceleration in the pace of property price increases will undermine property investment and construction activity, which together account for about 25% of total fixed asset investment (Figure 3). Property price changes can also affect total investment indirectly by affecting demand for investment in related sectors, such as construction machinery, cement, steel and transportation. Based on panel data at provincial level of 1994-2008, Ahuja et al. (2010)[1] show the overall impact of property price changes on China's investment would be significant, with a 10 percent drop in property prices likely to decrease investment by about 4%.

Figure 3



Source: Ecowin

…but its negative impact on private consumption seems limited

In contrast, the risk of a strong negative impact of the correction in property prices on China's private consumption seems limited for several reasons. First, the debt level of the household sector is relatively low. According to China's latest financial stability report[2], the household liability-to-asset ratio is 18.4% in China compared to 31.7% in US, 37.3% in UK, 33.8% in Germany and 26.0% in Japan. Second, income from properties including rental income and gains from property transactions does not appear to be considerable in total household income. Property income accounts for 2.3% of China's total per capita income in both urban and rural areas (Figure 4). According to Ahuja et al. (2010) [1], the overall impact of property price changes on China's private consumption would be insignificant, with a 10% drop in property prices likely to induce a fall in private consumption of 0.7%. In fact, we expect the government's ongoing policy reforms, aiming

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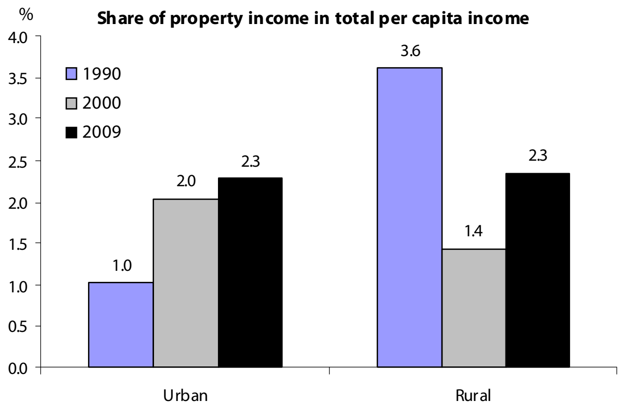
[1] *Ahuja, Ashvin, Lillian Cheung, Gaofeng Han, Nathan Porter, and Wenlang Zhang (2010). Are house prices rising too fast in China? IMF Working Paper, WP/10/274. Dec 2010.*

[2] *PBoC Financial Stability report 2010, Chapter VI.*

at rebalancing the economy, to support steady improvement in private consumption, offsetting any negative impact from falling property prices.

Figure 4



Source: China Statistical Yearbook 2010, National Bureau of Statistics

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