Fears of a downturn in China's real estate market are growing

SHOHEI TAKASE
ECONOMIC RESEARCH OFFICE

MUFG Bank, Ltd.
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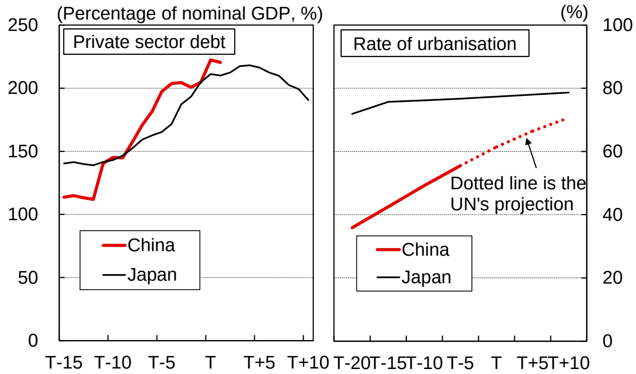
Attention has increasingly been drawn to China's real estate and financial markets due to concerns about the deterioration of the business and cash flow of Evergrande – one of China's largest real estate developers. The sharp rise in real estate prices and the resulting accumulation of debt in China up until now are perceived as large causes for concern; total outstanding debt for the private sector now stands at 220.5% of nominal GDP. This may partly reflect the impact from the COVID-19 pandemic, but it should be noted that this number exceeds the level of debt in Japan (211.1%) just before the bubble burst in December 1990 (Chart 1, left). In addition, current population growth in China is decelerating significantly and is slower than that of Japan in 1990. In a few years, China's population is forecast to start to decrease. In light of this, there are fears that in the future China will end up in the same situation Japan faced when its bubble burst.

On the other hand, there are some differences when present-day China is compared with Japan of the 1990s. In response to the overheating of the economy and soaring real estate prices, Japan raised its official discount rate by a large amount and implemented regulations for total loans that would ensure the growth of real estate lending did not exceed that of total loans (Table 1). In contrast, China is maintaining its loan prime rate – the benchmark lending rate – at its lowest ever level and lowered its reserve requirement ratio in July. Although regulations for real estate lending are being tightened, such as the introduction of "three red lines" related to debt in August last year, these regulations are focused on corporations whose debt has worsened significantly, and the People's Bank of China is ensuring the stable and healthy development of the real estate market. Furthermore, when it comes to the capacity for economic growth, the level of China's current urbanisation rate is lower than Japan's was in 1990, and demand for investment in real estate is forecast to increase by a sufficient amount (Chart 1, right).

In light of the above, it appears unlikely that Evergrande's issues will trigger a change in China's real estate market – like the one that occurred in Japan in the 1990s – that would lead to sluggish long-term growth of the economy. This view is supported by the Chinese government's deep awareness of the importance of balancing debt reduction with keeping the economy afloat, instead of focusing exclusively on deleveraging. However, it is necessary to keep an eye on the risk that solving the debt problem will be pushed back.

Chart 1: China and Japan's Private Sector Debt and Rate of Urbanisation



Note: 1. For China, T = 2020; for Japan, T = 1990

2. China's "private sector debt" is total as of end March 2021

Source: BIS, UN Population, MUFG Bank Economic Research Office

Table 1: Comparison of Japan during its Bubble Period and Present-Day China

	Japan	China
Demographics	・Growth of total population and working-age population in 1990 was 0.3% YoY and 0.5% YoY respectively	・Growth of total population and working-age population in 2020 was 0.1% YoY and -2.2% YoY respectively
Potential growth rate	・Potential growth rate in the first half of the 1990s (average) was around 2.0% YoY (Bank of Japan data)	・In September, the Governor of the People's Bank of China forecast the potential growth rate will be between 5.0% YoY and 6.0% YoY
Policy rate	・Official discount rate was raised from 2.5% as of April 1989 to 6.0% in August 1990	・Loan prime rate has remained at its lowest ever level of 3.85% since April 2020 ・Reserve requirement ratio lowered in July
Regulations on lending	・Ministry of Finance said it would keep the growth rate for real estate financing below that of total lending	・Although it introduced "three red lines" related to debt in August 2020, the People's Bank of China is ensuring the stable and healthy development of the real estate market

Source: National statistics of each country, MUFG Bank Economic Research Office

Translated by Elizabeth Foster

For further details, please contact the Economic Research Office, MUFG Bank

Managing Director, Rei Tsuruta Tel: +81-(0)3-3240-3204

Written by Shohei Takase <Shiyouhei_takase@mufg.jp>