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Asia Property

ARRESTED DEVELOPMENT - CHINA: POLICY RESPONSE – SUPPORT NOT STIMULUS

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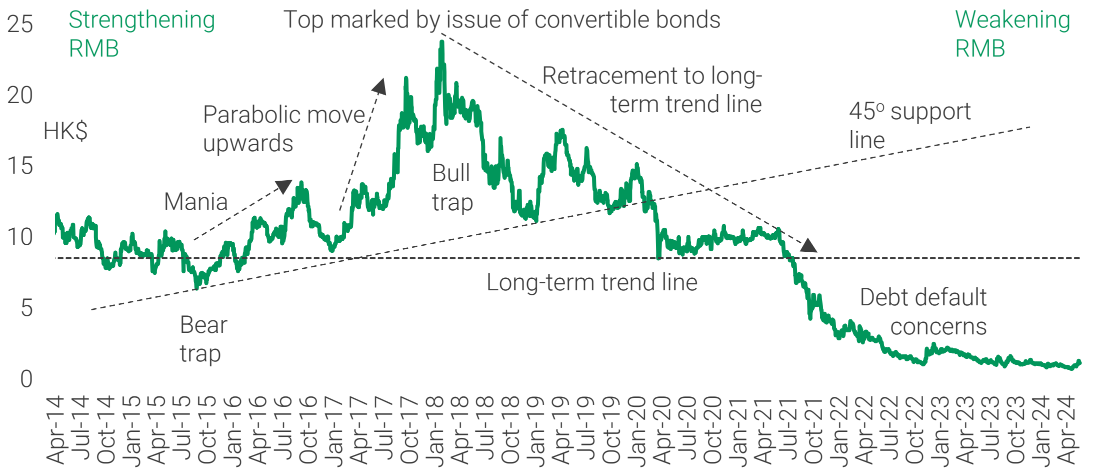
Beijing's policy announcement to allow banks to fund the purchase of uncompleted property by local governments and SOEs is a response to the continued falls in the volume and price of home sales. Insufficient to put a bottom into this housing cycle, this policy move is more about managing the downturn rather than an attempt to reflate the housing market. Falling volumes and prices continue to heap liquidity pressure on developers. More defaults are still to come.

"Missing the bottom on the way up won't cost you anything. It's missing the top on the way down that's always expensive." **Peter Lynch**

Fig. 1: R&F's share price



Source: Oculus Research, Bloomberg

- **Falling markets:** Beijing's policy measures are a response to an increasing fall in property sales volumes and prices; they do not mark a return to the old stimulus measures of reflating the housing market.
- **Secondary market:** New home sales fell 47% YoY in the first four months of the year, indicating the on-going pressure on developers' ability to meet their short-term liabilities. More developer defaults.
- **Bear markets:** Share prices jumped on the authorities' policy announcement: short covering rather than genuine buying demand. As cash flows deteriorate further, share prices should resume their falls.

Arrested Development

Continued negative news from China's property market has triggered a policy response from Beijing. Despite continued revisions in the base data, new home prices dropped at the fastest monthly rate in nine years in April, falling for an eleventh straight month, while those in the secondary market marked a full twelve-month decline. Sixty-four of the seventy cities covered by the NBS data reported declines in new home sales prices, rising from fifty-seven cities in March, while sixty-nine cities reported secondary house price declines.

Sales reported by the top 100 developers fell 47% in the first four months of the year compared with the same period in 2023. The new home sales market has now fallen nearly 50% in size from its peak of around 1.6 billion sqm GFA in 2021, to just over 820 million sqm – a recognition not only of the loss of faith in new home prices and developers' ability to complete developments, but also the extent to which credit-fuelled demand had overstated new home sale demand.

The PBoC also announced new financial incentives for people to buy homes. The most important are the scrapping of the mortgage interest rate floor for both new and second-hand homes and cutting the minimum down payment ratio for first-home buyers from 20% to 15% and for second-hand homes from 30% to 25% – the lowest down payment requirements since mortgages were introduced in 1992. This supports the scrapping of home-buying restrictions in almost all major cities and the lowering of local mortgage rates extended by many local governments.

On the supply side, the central government announced its support for local governments to purchase unsold properties and unused residential land. In support, the PBoC announced the creation of a new RMB 300 billion relending facility for local state-owned enterprises to purchase unsold properties. The PBoC said it expects the move to result in banks extending an additional RMB 500 billion in credit to the scheme, adding to other measures, including the 'Whitelist' and 'old-for-new' trade-in schemes.

Will this be enough?

Market estimates suggest that there are some 3bn sq. m of pre-sold but uncompleted homes in the primary housing market. Of this supply, it is estimated that at least 40% is from developers that are already in financial difficulty. The cost to fund the delivery of this pre-sold property has been estimated at RMB2–3 trillion, such is the funding problem facing developers.

Even if the full RMB500bn in credit lending is achieved – and this is a big if, given that, as the Whitelist shows, banks have been reluctant to lend on all but the best projects – the amount is still too small to reflate the primary housing market. Not only would the buying of suitable property take a significant time to implement, but it would also do little for second- and third-tier cities where much of the oversupply is concentrated and where governments have limited fiscal room to deal with additional debt.

This is not to decry the government's measures, but to recognize that this is a policy response aimed at arresting the rate of house price decline – managing the on-going structural adjustment – rather than a return to the old stimulus measures of reflating the housing market. Wringing out excess speculation from house prices and leaving a greater market share in the hands of state-owned developers remains the authorities' aim. Suggestions that this is a pro-growth stimulus are misplaced; more money printing by the central bank is RMB negative.

Part of the concern for the authorities must also relate to the potential fallout from the property market on smaller banks and the risk of internal capital flight. As smaller banks come under scrutiny, depositors turn to the big banks, which then refuse to on-lend to anyone but the Central Bank, causing wider solvency problems. Selling uncompleted developments, many of which must now effectively be in the hands of their lenders, is at least one route to lowering the banking system's NPLs.

Secondary market

The shift in home buyers from the primary to the secondary market is significant: secondary home sales volumes are now higher than new home sales for the first time since the start of the housing reform programme in 1998. This reflects the end of the twenty-year boom in property sales and the extent of hidden supply that is still to come to the market as the previous credit-driven hoarding of property is unwound. It is also a part of the housing market that is subject to less significant control by the authorities.

Unlike developers, secondary market sellers are not restricted by the authorities in making deep cuts to their asking prices. This explains why anecdotal evidence suggests that secondary prices have now fallen some 50%, whereas the primary market is down only some 30% from the peak. Buyers now favour secondary homes not only because they do not trust developers to complete new projects, but also because secondary home prices are increasingly attractive.

The secondary market is still going through price and volume adjustments. Secondary sales volumes remain positive, but the growth in sales has slowed as homebuyers are simply not in a rush to buy. Yet given the increasing substitution of secondary for primary housing – increasing levels of available secondary stock for sale, attractive prices, completed units etc. – it is difficult to see how the primary market can find a bottom without stability in secondary market prices. The secondary market is now leading this cycle.

Unfortunately, demand-side measures implemented in a falling market always tend to have the unintended consequence of encouraging a greater supply than demand response. We expect the government's latest mortgage measures to encourage more secondary homeowners to list their investment properties for sale and so put further downward pressure on home prices.

Supportive

The government's announced measures may encourage a short-term boost to sales, but they are insufficient to cause a bottom in the housing cycle. They reflect Beijing's challenge to manage the downturn in property sales and prices, while addressing the widespread debt problems across the financial system and property market. In reality, structural reforms are badly needed in politically tricky areas such as developer funding, social welfare spending, the restructuring of debt-laden local governments and the overall tax system. No structural measure has yet been forthcoming.

The shares of private developers may have jumped on the news of the government's measures, but this was largely the result of short covering rather than genuine buying interest. Stock prices should soon resume their falls as declining sales (47% YoY in first four months of the year) and mounting repayment schedules cause more developer defaults. Bear markets in property are characterized by weeks of hope and months of despair.

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