China's Overheating Real Estate Market and its Relation to Economic Development

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ABSTRACT. *China's real estate economy and land economy, with aspects of the environment, law, business finance and resource management, has experienced continuous growth since 2002. Additionally, the fact that China's real estate market has experienced such changes in a brief period is of interest and even more so in terms of how this relates to the wider Chinese economy. China's surplus monetary liquidity has also become a catalyst for increases in housing prices. Real estate investment provides an ideal opportunity for investors to counter-balance high inflation and uncertainty. It is also a diversified form of investment, offering higher and stable returns. While investors and some owners benefit from such wealth, implications for others such as financial instability and the overheating of prices must be acknowledged. Negative consequences could be alleviated though the use of government regulations, but the unpredicatable nature of real estates makes the implementation of public polcies an even tougher task.*

KEYWORDS: *China, land economy, estate economy*

1. Introduction

The economy of China, specified by its socialism with Chinese characteristics, is one of the world's fastest growing economies. State-owned enterprises, as well as other domestic and foreign businesses play a considerable role in the Chinese economy. One notable part of this is the real estate market.

China's real estate economy and land economy, with aspects of the environment, law, business finance and resource management, has experienced continuous growth since 2002. In 2000, real estate investment was an approximate 3311.98 hundred million Chinese yuan and it increased to 44319.50 hundred million Chinese yuan by 2011, around 13.38 times higher. Real estate investment has also been the fastest-growing aspect of fixed-asset investment during this period. In 2018, almost 17 percent of China's GDP was made up from acitivity in the real estate market, 3.34 percent more than in 2000. Both domestic and foreign investors have been attracted to this particular market, making it one of the most sought-after areas of investment in modern times. Additionally, the fact that China's real estate market has experienced such changes in a brief period is of interest and even more so in terms

ISSN 2616-5902 Vol. 2, Issue 7: 84-90, DOI: 10.25236/AJBM.2020.020710

of how this relates to the wider Chinese economy.

2. Review of Literature

This paper will analyse China's real estate market and its influence on the Chinese economy as a whole. Technological advancements and institutional change are often regarded as the most significant factors in maximising growth in this sector. Different from developed countries' liquidity, especially in the context of a depression, the application of loose monetary policies appears less favourable compared with China's surplus monetary liquidity which creates a positive relationship with real estate bubbles.

Ren's work on China's economy indicates that while fast-growing real estate markets make a considerable contribution to China's regional economic development, although it does result in an imbalance which has the potential of being detrimental. According to an estimation on the dynamic relevance between China's real estate and its economic growth from 1994 to 2020, economic growth appears stronger in the short-term whereas in the long-term a negative relationship presents itself. Xiaojing indicated that a real estate cycle does exist and that the so-called 'overheating' of real estate is a natural occurrence.

In short, this paper aims to answer two integral questions based on quantitative and qualitative findings relating to China's economic development: (1) What are the causes of real estate market bubbles in the 21st century? (2) How does the real estate market correlate to China's economy?

3. Methodology

The primary research method utilises both quantitative and qualitative analysis. Qualitative analysis includes interpretations of previous findings, in addition to research papers and journals that are appropriate for answering such questions about Chinese real estate markets. Quantitative analysis consists of accessible data from China's real estate market, including Shanghai's real estate price in 2008, data focusing on the 2008 financial crisis and rates of inflation as well as GDP. Based on this data and ensuing analysis, this paper serves to identify the reasons behind the aforementioned 'overheating' of China's real estate and how this relates to the wider Chinese economy.

4. Findings

In major cities, real estate prices have reached historically high levels. For example, Shanghai experienced a decline of two per cent in 2008 before soaring to a record high of 52% in 2009. However, fast-growing rates in terms of housing prices exceeded increases in that of income. Since the turn of the century, Shanghai's housing price have witnessed accumaltive growth of 270% which is almost twice as high than an income increase of 146%. While some real estate investors and householders have been fortunate enough to gain such wealth for the last two decades, unaffordable housing prices have placed much pressure on the lives of ordinary Chinese citizens.

China's economy has a strong relationship with its real estate market. Due to the fact that a large part of the Chinese economy consists of real estate sales, the 2008 global financial crisis caused serious damage on an even larger scale than would normally be expected. The trading value of first-hand households experienced a 40% depreciation compared to that in 2007. However, the implementation of certain regulations that focused on house-pricing mechanisms ensured that the real estate market did not collapse and made a somehat swift recovery. Without government control, the implications could have been far greater. One specific threat to the Chinese economy appeared in 2015, when real estate prices became out of control in the capital as well as Shanghai and Shenzhen. This had the pontential to restrict overall growth and jeopardise the stability of China's wider economy. Hence, the importance of a stable real estate market must not be underestimated.

The government applied strict regulations after witnessing the previously mentioned increase of housing prices. Following a government announcement of such a policy, called 'Hujiutiao' or more specifically 'the nine policies of Shanghai', these real estate markets began to stabilise. With this policy, families who had taken out a mortgage were required to make a 50% down payment for residential housing and 70% for non-residential dwelligns. Government regulation serve to influence the market in a positive sense by limiting the number of transactions taking place, although housing price did remain at a relatively high level compared with other cities.

The development of land market is attributed to China's special land ownership system, which is monopolized by local authorities. Since China's land property rights system attributed all the lands to the state, with only a few collectively owned lands. The development of this land market could be described in three stages: inception, expansion, and maturity. With land market emerges in some coastal cities in the first stage, land usage right sales expand in the second stage, and land usage right sales directed by national authorities. The development of land market accelerates land price inflation, and therefore boost real estate bubbles.

Moving on, a particularly important part of China's economy is its surplus monetary liquidity and its externally dependent economic structure which explains real estate bubbles to some degree. Lijian's work tested the relationship between surplus monetary liquidity and real estate bubbles. An indicator of surplus monetary liquidity is a resident's private savings with banks. The test period was from 2004 to 2005 through monthly data acquired from China's 28 provinces. The results showed that surplus monetary liquidity boosted housing prices to some degree during this period. Other than this, government policies and restrictions on banks providing loans gave the impression of a stringent economic environment for business. Therefore, financial institutions began to pursue high-return assets such as granting loans for the purschase of housing.

ISSN 2616-5902 Vol. 2, Issue 7: 84-90, DOI: 10.25236/AJBM.2020.020710

Low interest rates have been an important point of reference when explaining the reasons for China's real estate success. What China faces today is a high level of inflation and low interest rates. While cash is likely to depreciate in value, Chinese citizens are becoming eager to invest in real estat even if this leads to a decrease in quality oif life. The root of such behavior is in no small part because of increases in the cost of education, health insurance and future uncertainty relating to external factors. Based on prior knowledge, the real estate market has been and will no doubt continue to be one of the most valuable investments. Statistics showed that there were several high inflation points in the 21st century: around five per cent in 2005, nine per cent in 2008, seven per cent in 2011 and a further seven per cent in early 2020. While high rates inflation places immense pressure on Chinese citizens, the belief that fixed assets are more secure still prevails.

Despite the real estate bubble, such markets have a positive correlation with Chinese economic output and activity within specific industries. Demand from the real estate market ultimately enhances growth in industrial production and the need for raw materials creates employment. Growth in the real estate market has been incredibly beneficial for the Chinese economy a whole, due to the previously mentioned results of high-level economic activity. In short, it has guarenteed the survival numerous industries. However, fluctuations in the price of raw material is likely to have a negative impact on the real estate market and an eventual increase of construction costs will inevtiably leading to higher premiums. From 2017 to 2020, the price of cement has been growing at an average rate of three per cent. It is almost certain that the increase in project costs will increase housing price, particularly if no government regulation is forthcoming.

Studies in Asia, the US and Europe suggest that residential real estate returns correlate to GDP growth by 60% to 95%. Over long-term periods, the correlation is both positive and high. Compared with developed countries, real estate prices in Asia have not levelled with GDP growth rates although the economic conditions are different in fundamental ways. With this evidence, it is still probable that the value of Asia’s real estate market will eventually increase in line with GDP but this will require continued observation into the future. In China, the strong correlation between GDP and real estate prices suggests that the market is vital to economic growth whilst being a sign of security for Chinese citizens.

Studies have measured the real estate cycle based on a number of factors, such as the ratio of real estate investments to total investment, the return rate and also pricing to measure the cycle developmentally. As established previously, the so-called ‘overheating’ of housing is one of the phases in this cycle. However, the formation of such a cycle and the necessary time period is difficult to define because the driving factors are subject to constant fluctuation. Demand for real estate investment is affected by the global stock and capital markets. While investors are unable to foresee high returns on other investments, the real estate market naturally becomes a sensible target. Economic growth is of course one of the main driving forces. With rapid economic growth in China, people have an increased level of disposable income and demand for housing and investments follows. Rapid increases in population levels is also a major concern, leading to even greater

ISSN 2616-5902 Vol. 2, Issue 7: 84-90, DOI: 10.25236/AJBM.2020.020710

demand for housing. The real estate cycle could also be affected by government policy. Expansionist monetary policies in China have increased demand and economic growth, while simultaneously raising house prices to an all-time high.

5. Conclusion

China's economic development is positively correlated to the real estate market. While the real estate market boosts economic growth, this inevtiably leads to higher demand for investments that result from increase levels of disposable income. Growth in the real estate market also correlates positively to GDP and activity within other industries. China's surplus monetary liquidity has also become a catalyst for increases in housing prices. Real estate investment provides an ideal opportunity for investors to counter-balance high inflation and uncertainty. It is also a diversified form of investment, offering higher and stable returns. While investors and some owners benefit from such wealth, implications for others such as financial instability and the overheating of prices must be acknowledged. Negative consequences could be alleviated though the use of government regulations, but the unpredicatable nature of real estates makes the implementation of public polcies an even tougher task.

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