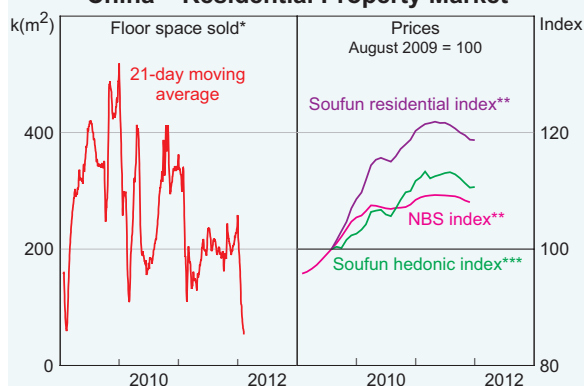


Box A

China's Residential Property Market

Over the past year, conditions in China's residential property market have eased significantly. Transaction volumes have been lower than in previous years, and property prices have fallen modestly in a number of first- and second-tier cities (Graph A1). In part, these developments reflect policy measures that were introduced in 2010 to contain the property market, and they are currently contributing to the moderation of growth in the overall Chinese economy.

Graph A1
China – Residential Property Market



* Aggregate floor space sold for Beijing, Chengdu, Chongqing, Guangzhou, Hangzhou, Nanjing, Shanghai, Shenzhen, Tianjin and Wuhan
 ** Based on average property prices per square metre
 *** Prices adjusted for location and other housing characteristics
 Sources: CEIC; China Index Academy; National Bureau of Statistics; RBA

At the onset of the global financial crisis, the Chinese Government implemented a number of policies to stimulate activity in the residential property market. In particular, it reduced down payment requirements on the purchase of properties, lowered minimum interest rates for mortgages, and reduced the minimum holding period for a property to qualify for an exemption from capital gains tax. These measures were accompanied by a

very rapid expansion in housing mortgage credit, with the result that turnover and property prices increased significantly during 2009 and early 2010. While official indices of nationwide property prices recorded a peak rate of growth of around 13 per cent over the year to April 2010, other data suggested that property prices were increasing at a much faster rate.

The increases in property prices raised concerns in many quarters about housing affordability, prompting the central government to introduce policies to curb speculative activity in residential property. Starting in early 2010, the central government unwound many of its earlier stimulatory policies and banned new mortgages for those who already owned multiple properties; this latter measure was coupled with stricter enforcement by banks to ensure loans were used for their intended purpose. At the urging of the central government, local governments in around 50 cities also introduced limits on the number of properties people could purchase based on their existing holdings; in some cities, purchases by non-residents were banned altogether. The authorities also announced that apartments designated as affordable would no longer be able to be sublet, left empty, or sold by individuals on the secondary property market.

These measures were accompanied by policies aimed at boosting the supply of affordable housing. The authorities granted favourable access to credit and expanded the range of subsidies to those developers engaged in the construction of low-income housing, including providing free land. In 2011, development began on more than 10 million affordable apartments, and construction of an additional 7 million is expected to begin in 2012. The

government also instituted audits of developers' land holdings to ensure land was not left idle; the government has reserved the right to confiscate land that is left unused for too long.

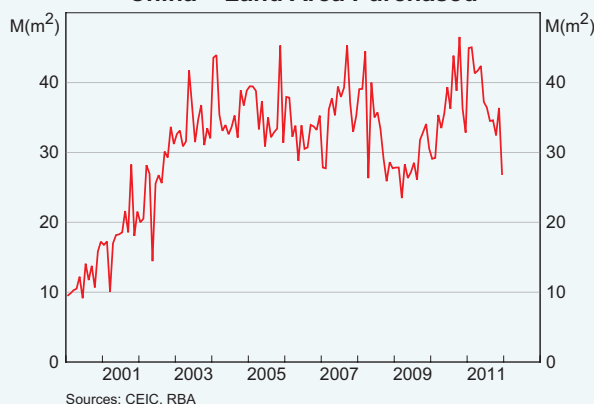
The effects of these measures have become apparent over the past year. Attitudes towards buying property have changed considerably; the Urban Depositor Survey by the People's Bank of China reported that between the December quarters of 2010 and 2011, the share of respondents expressing a preference to invest in real estate had fallen significantly, and the share of respondents expecting to purchase an apartment within three months of the survey dropped to levels not seen since 2008. Confidence of developers has also been affected by lower sales revenue and expectations of lower property prices; the Business Climate Index for real estate has decreased towards global financial crisis levels, reflecting the tighter financial conditions many property developers have been experiencing (Graph A2). Many developers have been scaling down their construction plans and reducing their purchases of land (Graph A3).

As developers revise their construction plans for the coming year, slowing residential construction activity will have direct and indirect effects on GDP growth. Dwelling investment has become an important source of demand in China, with its share of GDP having increased from about 5½ per cent in 2004 to approximately 9 per cent in 2011. Although the rate of growth in dwelling investment was strong in 2011 as a whole, residential building activity slowed noticeably in the second half of 2011, which contributed to the moderation in economic growth over the same period. The slowing in housing investment is also likely to have an indirect effect on growth as local governments rein in spending in response to weaker revenues – roughly 20 per cent of taxes collected by local governments are related to land, and land sales

Graph A2
China – Real Estate Business Climate Index



Graph A3
China – Land Area Purchased



generate an amount equivalent to around 35 per cent of local governments' current expenditure.

The easing in conditions in the residential property market also has implications for the financial sector. Overall, the stock of loans to the real estate sector (including commercial real estate) is roughly 20 per cent of outstanding loans (although this ratio is around 30 per cent for the five largest banks). Nearly two-thirds of these loans are residential mortgages, although most analysts consider that the risks this lending poses are limited; mortgages

typically have relatively low loan-to-valuation ratios, with down payments around 40 per cent of the value of a property on average.¹ The main risks from the property market emanate from loans to property developers and, to a lesser extent, loans to local government financing vehicles. While loans to property developers are roughly 7 per cent of total loans outstanding (with a maximum loan-to-valuation ratio of 75 per cent), financial institutions also have exposure to property developers through bond and equity holdings. Slowing land-related revenues could also create financial strains for local governments, although should this occur, it is likely that assistance from the central government would be forthcoming.

The central government's plans to expand the supply of affordable housing will provide some support to construction activity over the year ahead and, so far, there has been very little evidence that infrastructure projects are being shelved by local governments because of revenue shortfalls. Official statements suggest that the main goal of the residential property controls has been to improve housing affordability and to reduce the likelihood that developments in the property sector lead to overheating in the broader economy. Should the property market turn out to be weaker than expected, central and local governments are likely to relax some of these controls in order to support activity in the sector, and economic activity more broadly.

¹ A 2007 PBC survey in the 20 biggest cities suggested that the average down payment was 37½ per cent, although some reports have suggested somewhat higher ratios.