

The reckless pursuit of ever higher returns is setting up China's property market for a painful fall, writes Shujie Yao

# House of cards

**A**s policymakers attempt to gently let air out of a swollen mainland property bubble, warnings abound. Cool the market too hastily and economic growth will be stunted; move too cautiously and soaring prices will threaten social stability.

But the truth is that the role of the government is limited; there has been a gross overestimation of the government's capacity to bend the market to its will. It is the behaviour of investors and buyers that will determine the development and bursting of the market bubble.

House prices will continue to rise in mainland cities over the coming months, particularly in the small and medium-sized cities as they catch up with the country's major urban centres. The bubble looks set to burst within two years, erecting a sizeable stumbling block on China's path to urbanisation.

Demand for housing will remain high as rapid urbanisation continues apace. The urban population is rising by about 3.5 per cent a year as rural workers flock to the metropolises, creating lopsided

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urbanisation patterns and exhausting limited supplies of affordable housing.

The supply of affordable housing is estimated at only one-fifth of total demand. The proportion of investment in low-cost housing to total residential buildings has tumbled over the past decade. In 1998, it was more than 13 per cent but fell to an average of 4.3 per cent in 2008 despite government pledges to remedy the situation – it was a meagre 0.38 per cent in Guangdong.

The government has repeatedly warned developers to build low-cost apartments of less than 80 square metres. But the average size of residential properties sold on the market in 2008 was 92 square metres, far beyond the reach of low-income households.

Developers and local governments are guilty of manipulating government quotas by constructing affordable housing at the end of roads to nowhere. The lack of supporting facilities, like schools,

hospitals and shops in these remote suburbs ensures that these new developments lie empty.

Developers are now trying to slow construction to maintain high prices. In Shanghai, 67 sites were supposed to be under way this year, but only 17 have been started and the asking prices for new apartments under construction are 14 per cent higher than last year.

Demand is also linked to the Chinese psyche. There is a great reluctance to rent housing, reflected in the fact that private home ownership in China was among the highest in the world, at 82 per cent in 2003, compared with 41 per cent in Germany and 69 per cent in the United States.

Household structure on the mainland has also changed significantly in the past decade. The old thinking that four generations can live happily under one roof has dissipated. In 2008, the average number of people living in one household was 3.16, down from 3.42 in 2001. Such a decrease may not seem noteworthy but, when you consider China's huge population base, it is clear that this trend is inspiring a marked increase in housing demand.

Added to these demand factors is the sheer greed that is rife among the rich. Chinese investors take a highly irrational approach to money-making: they are envious, avaricious and speculative.

Lessons from the 2007 stock market bubble, and the subsequent fallout, have not been heeded. It is these people who are inflating the housing bubble as they seek more attractive returns than those offered by low-interest saving accounts.

Local government officials and profit-driven developers will not change their modus operandi overnight. Local authorities have long acted to bid up land sale prices and accelerate farmland transformation to boost revenue. Around 40 per cent of local government revenue comes from land sales.

Evidence of underhand dealing is glaring. In 2006, land purchased by developers dropped by 4.4 per cent year on year but the land used for development rose by 20 per cent, suggesting that a significant amount of land had been hoarded for future development when prices rose.

The consequences of a property crash will be far greater than those that followed the stock market collapse.

Real estate has become a pillar industry for China's economic growth. Investment in property development accounted for 18.7 per cent of total fixed asset investment last year. Combined, the real estate and construction industries contribute more than 10 per cent of gross domestic product each year. By the end of 2008, more than

2.1 million people were employed in the real estate industry.

Possible solutions include the development of a comprehensive, commercialised house-renting system to overturn traditional thinking that affordable housing can only be sold but not rented.

Closer central government supervision of how local governments implement wide-ranging, low-cost housing programmes is necessary to avoid a repeat of past corruption. Collusion between local officials and developers is not going to disappear overnight.

And I have long argued for a progressive tax policy to be applied to three categories of housing based on floor space. Owners of apartments of less than 80 square metres would not be required to pay taxes and would enjoy a low deposit requirement,

while owners of luxury houses would face heavy taxes and punitive mortgage rates.

The fear is that these measures, even if implemented, will come too late. Rising prices will further exclude low- and medium-income households from the market, and Chinese society will become ever more polarised.

When the bubble bursts, the resulting political and social instability will jeopardise China's long-term sustainable growth prospects and prosperity. The reverberations will be felt both inside and outside Asia.

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