Fear of property speculation grips Chinese leadership

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The Chinese government is increasingly concerned about soaring property prices and the potential for banks to incur massive bad loans once the present bubble bursts. It has taken a series of steps in a bid to rein in speculation.

The State Council, China's cabinet, announced measures on April 15 to curb speculative activities by making it more difficult to buy a second house. The deposit for a second home has been increased to 50 percent of its value—up from 40 percent. Mortgage rates for a second home were also lifted. Days later, the State Council took further steps to allow banks to refuse additional mortgages for those who own two or more properties.

The State Council warned: "Overly high housing prices and overly fast price growth have increased the difficulty for people seeking housing through markets. It also increased financial risks, which aren't beneficial to balanced social development."

The changes came after data showed property prices in 70 large and medium cities in China rose 11.7 percent in March compared to a year earlier—the fastest pace since Beijing began releasing housing statistics in 2005. The GDP grew at an annualised 11.3 percent in the first quarter of 2010, raising fears that the economy was overheating, driven by a 35 percent year-on-year increase in property investment and annualised 170 percent rise in land prices.

Since April 15, Beijing has announced new anti-speculation measures on virtually a daily basis. The *Financial Times* commented that the government is "trying to convince would-be investors that they are really serious," but also pointed to the danger that the measures "will work too well and that once prices start to fall, it will be difficult to stop them". Already some analysts are forecasting a 20 percent drop in property prices in major cities.

Beijing faces a dilemma. It is trying to cool speculative investment without precipitating a collapse of the property bubble and a financial meltdown. At the same time, amid continuing weak exports, the economy is dependent on the property boom to boost the steel, cement and construction industries. Local government finance is heavily reliant on land sales, which jumped more than 40 percent last year to provide 1.4 trillion yuan ($US205 billion) in fiscal revenues.

Despite calls at the recent National Peoples Congress to restrain property prices, the opposite is taking place. Economist Andy Xie wrote in the *South China Morning Post* on April 20: "Speculators lost their fear, while the fear of inflation seized savers. No one believed the government would let property prices fall. As a result, people have been withdrawing their saving and borrowing as much as possible to buy property, regardless of the price. This is all similar to the final frenzy in financial mania. If the experiences from the other countries are anything to go by, this frenzy could expand the size of the bubble dramatically. The consequences may well be catastrophic—as Japan showed 20 years ago, Southeast Asia 10 years ago, and the US is demonstrating now."

Xie warned that if bank lending were not slowed, a property price collapse could see the banks saddled with huge non-performing loans. When the last bubble burst in 1998, bad loans reached 40 percent of the total. Xie estimated if current prices collapse, the ratio would reach 20 percent and more. The extent of lending, however, is much larger than in 1998.

China Construction Bank, the country's largest lender for mortgage and infrastructure projects, had its mortgage book expand by 41.1 percent in 2009. Of its $225.6 billion in infrastructure loans, more than one fifth were made last year.

The magnitude of China's property bubble is generating concern in international financial circles. In remarks cited in the *Wall Street Journal* last month, James Chanos, a New York hedge fund manager, commented: "China is a world-class, if not the world-class, property bubble." His hedge fund is betting on a decline in share values for Hong Kong-listed Chinese property developers and companies exporting products like cement and copper to China.

Chinese real estate companies have expanded aggressively and borrowed heavily, often on international capital markets, making them vulnerable to global financial instability. When European and American share markets tumbled last week, after rating agencies downgraded Greek bonds to "junk" status, Chinese steel and real estate companies were particularly hard hit.

On the surface, the Chinese government does not face the debt crisis that is impacting on European countries. The reality is somewhat different, however. The *Financial Times* warned in late March that most of China's large stimulus measures did not come from conventional fiscal spending, but from state bank loans. In 2009, new loans doubled to 9.6 trillion yuan ($1.4 trillion) or equivalent to nearly one third of GDP.

Local governments are borrowing heavily to finance infrastructure projects as well as real estate development, often using state land as collateral. While banking regulators put the local government debt at 6 trillion yuan, academic Victor Shih told the *Financial Times* that actual debt was close to 11.4 trillion yuan, with another 12.7 trillion yuan over the next five years. He estimated that China's debt-to-GDP ratio was 71 percent by the end of 2009 and would reach 96 percent by 2011.

Rising government debt in China means that the working class will face a similar assault on living standards as is taking place in Europe, the US and other countries. In the March budget, social spending was already slowed significantly.

Confronting a mountain of bad debt in the late 1990s, partly due to the Asian financial crisis, the Chinese regime unleashed far-reaching attacks on living standards. Tens of millions of workers were retrenched from state enterprises and the health and education systems were put on a "user-pays" basis. The latter measure forced many working families to save as much as they could to prepare for illness and other emergencies. The savings in turn provided another source of cheap credit for business.

Peking University professor Michael Pettis explained in the *Financial Times* on April 21 that Beijing's response to the last loan crisis overloaded the burden onto working people. "It is perhaps not surprising, then, that during the period of the bail-out household income, already a relatively low share of gross domestic product, declined to alarming levels," he wrote.

Pettis pointed out that the present imbalance between low levels of consumption and huge overcapacities would be further exacerbated by another loans crisis. With weak and even falling global demand and rising protectionism, the only way out for China is to expand the domestic market. However, to clean up new mountains of bad debt means to put more pressure on households. Pettis warned China could end up like Japan after the collapse of its share and property bubbles in the early 1990s. While a Japanese banking collapse was averted through massive bailouts, it resulted in two decades of economic stagnation.

The collapse of the property bubble in China will have drastic consequences for the Chinese and global economy. It will also further exacerbate social tensions inside China. While a relatively small layer has profitted from rising property and share prices, the overwhelming majority of working people continue to face the prospect of worsening unemployment and poverty.