Major dip in China's property market

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China's property market is experiencing its biggest slump since records began to be collected in 2005, giving rise to concerns that if not halted it could cause significant problems, both for the financial system and the broader economy.

The National Bureau of Statistics reported that home prices fell in 64 of the 70 cities surveyed in July from their levels a month earlier, sending a tremor through financial circles. As recently as April, prices were falling in only 10 of the surveyed cities, and in major centres they were up by nearly 20 percent. After three straight months of declines, however, home prices are only up by 2.5 percent for the past year, according to calculations by Reuters.

Other figures show that residential property sales fell by almost 18 percent in July from a year ago, while developers' holdings of unsold properties increased by 25 percent over the same period.

The research director at Centaline Property Research, Liu Yuan, told the *Australian Financial Review:* "I think it is the worst slump we have ever seen. The market is not very good, as sellers need to offer big discounts to get a deal done."

If it continues, the property market slide could bankrupt financial companies that have invested heavily in real estate, even threatening the banks that often stand behind them.

Commenting on the figures to the London-based *Financial Times*, Stephen Green, head of macro research at Standard Chartered in Hong Kong, said: "The next six months are make or break for China's property market. The stresses leading to defaults among financial trust companies and lower tier developers are growing."

Daniel Kowalczyk, the senior economist at Credit Agricole in Hong Kong, used stronger language. In an e-mailed note he said official and private data pointed to "a steep correction in residential real estate prices whose depth begins to match that in the Lehman crisis. We expect new measures to stimulate the economy in a targeted way to be announced in the near term."

The property market data followed figures published last week showing that aggregate credit in China increased by only 273 billion renminbi in July, the lowest level since the start of the global financial crisis in October 2008, and only 18 percent of the level that had been expected. This trend could accelerate if financial companies decide that the property boom is over and it is time to pull back.

Such a move would have a major impact on the broader Chinese economy. Last year the property sector contributed 15 percent to the country's gross domestic product.

For the past six years, the Chinese economy has been sustained by an infrastructure and real estate boom promoted by government stimulus measures and a rapid expansion of credit. Fearful of the consequences of a bursting bubble, the government has been trying to pull in the reins.

However tighter credit policies threaten the solvency of weaker investments, raising the possibility of a snowballing effect through the financial system.

Speaking to the Australian Broadcasting Corporation's "World Today" program on Monday, Columbia University professor Patrick Chovanec warned of "systemic risks" in the Chinese financial system.

"They announced all these reforms last year but what they found is that the moment they introduced real economic risk into the system … these risks come to a head and they're afraid of what might happen and so they pull back from reform," he said.

When it was put to him that with a growth rate expected to be above 7 percent, the Chinese economy was still "relatively healthy," Chovanec replied: "Healthy is the key word. No, it's not healthy because

… a lot of the growth is coming from an investment boom that really has long passed its sell by date."

Chovanec also cast doubt on whether the 7 percent growth rate was accurate, noting that in the first half of the year the amount of freight transported by rail in China declined, a phenomenon not normally seen in a growing economy. Some important sectors of the economy, he said, were "actually in contraction."

The mounting problems in the Chinese economy have been underscored by figures released by the Ministry of Commerce showing that foreign direct investment in July was down by 17 percent from the levels of a year ago.

In its latest review of the Chinese economy, published last month, the International Monetary Fund (IMF) started with an upbeat tone, stating that growth was expected to be in line with the official target of around 7.5 percent.

Yet the main body of the assessment pointed to the increased risks, with the word "vulnerabilities" used three times in the space of a two-page press release.

The IMF noted that heavy reliance on capital spending and credit expansion had provided a lift to the global economy but that now "declining efficiency of investment, a significant build-up of debt and environmental costs are threatening growth prospects."

The IMF said financial vulnerabilities had "risen to the point that containing them is a priority" and a broad-based stimulus to the economy should only be undertaken if there were a risk of the growth rate falling significantly below the official target.

A significant slowdown in the Chinese economy, either sparked by, or leading to, a financial crisis, will have major implications for the world economy, and especially for countries such as Australia that have become increasingly dependent on the Chinese market.

The growing nervousness in Australian ruling circles over Chinese economic trends was reflected in the rush by political and business leaders to denounce an anti-China outburst on Monday evening by billionaire businessman Clive Palmer, the leader of the Palmer United Party, which effectively holds the balance of power in the Australian Senate.

Devoting an editorial to the subject, today's *Australian Financial Review* noted that if Chinese housing still looked "rocky" in six months it was hard to see how the economy could continue its modest recovery. China, the editorial continued, "contains more risk of shocks for Australia for some time" and was "no longer the guarantor of uninterrupted growth."