



FEDERAL RESERVE BANK *of* NEW YORK

## Session 3: China's Real Estate Market and Financial Stability

Speakers: Tao Zha and Daofu Chen

*Commentator: Jeff Dawson*

The Ninth Annual International Conference on the Chinese Economy  
China's Real Estate Market and Implications for Economic and Financial Stability  
Hong Kong Monetary Authority, January 18-19, 2018

Views expressed are those of the author and do not necessarily reflect the position of the Federal Reserve Bank of New York or the Federal Reserve System.

# Overview of comments

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- Important and useful contributions – both highlight concerns the Chinese real estate market could pose for financial stability *via the credit channel*
- Zha focuses on housing market speculation reflected in mortgage borrowing; Chen highlights broader concerns related to property-related lending
- Comments
  1. *There are good reasons to be attentive to the rise in mortgage borrowing and household debt*
  2. *Associated risks still appear manageable*
  3. *Some direct and indirect risks stand out and bear close monitoring*
  4. *What is the outlook for household debt and mortgage borrowing?*
  5. *Interpreting the impact of macroprudential policies can be tricky*

# Summary – Zha et al

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- Focus on speculation in residential housing market
  - Portion of mortgage originations (or amounts) for second (or more) homes at the city level (i.e., high/low “exposures”)
- Speculation played an important role in the Chinese housing market boom after the relaxation of macroprudential policies in 2014 and 2015
- Some evidence supporting the linkage between past house prices and non-fundamental growth in mortgage loans

# Summary – Chen

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- Highlights three stages of development of the Chinese real estate market
  1. “Honeymoon period”: benefits of institutional reform and insufficient supply leads to development in the real estate industry, spurs investment in related industries
  2. Real estate development begins to crowd out growth in other sectors of the real economy
  3. The real estate boom becomes a “bubble”
- Details recent trends in property-related lending as the main driver of credit expansion in China in recent years
- Notes the differentiation in various prices in China

# Comment 1

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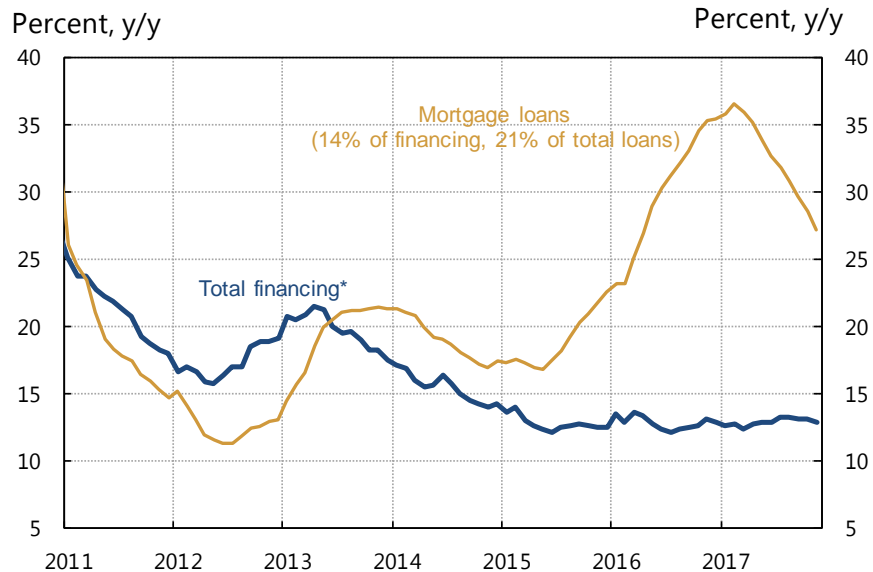
*There are good reasons to be attentive to the rise in mortgage borrowing and household debt*

- Both Zha and Chen highlight areas of concern with respect to growing credit risk among household borrowers
  - Speculation appeared to drive a surge in loan-to-value ratios on 2<sup>nd</sup> + mortgages in 2014-2016 (Zha)
  - Run-up in aggregate property-related lending (Chen)
- Housing assets and mortgages are the dominant part of household debt in China
  - High ownership levels (90% of households own property, which accounts for roughly 2/3<sup>rds</sup> of household balance sheets)

# Comment 1

- Household borrowing has been growing rapidly
  - Growth in mortgage lending has averaged 25% annually over past five years
  - Over half of new bank lending in 2016 went to mortgage lending

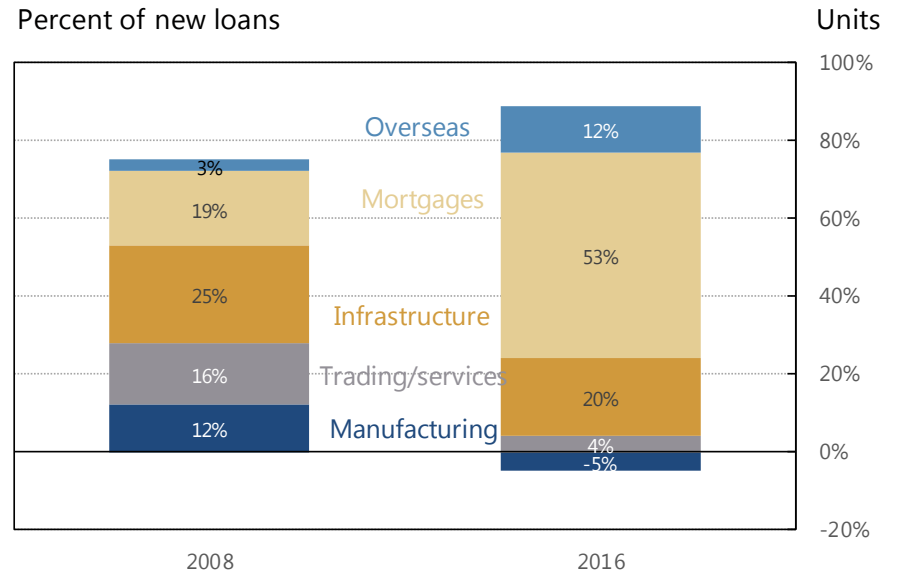
**China: Total financing growth**



Source: CEIC, PBOC

\* Total financing includes off-balance sheet financing, trust loans and net corp debt/equity issuance.

**China: Net new lending by segment**



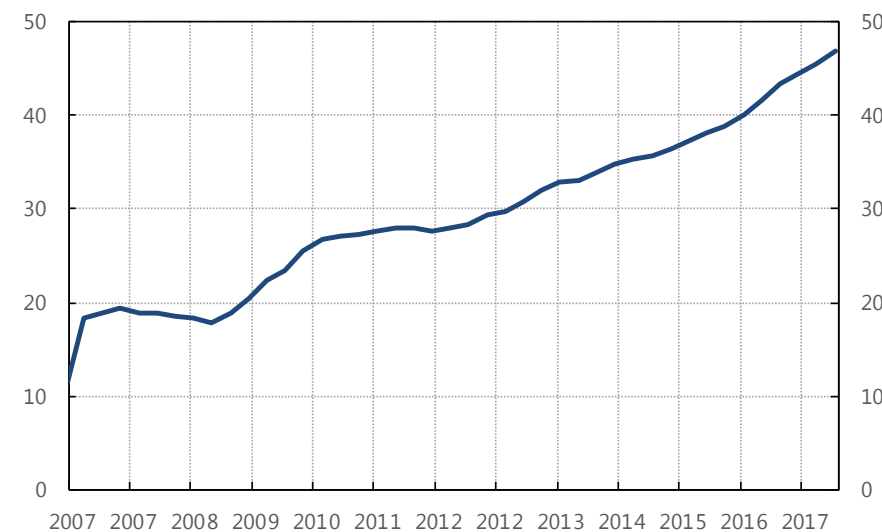
Source: Company reports

# Comment 1

- Rapid growth has pushed up the stock of household debt and share of property-related bank assets
  - Household debt to GDP has doubled over last ten years
  - Share of property-related bank assets has increased five fold

## China: Household debt to GDP

As percent of GDP

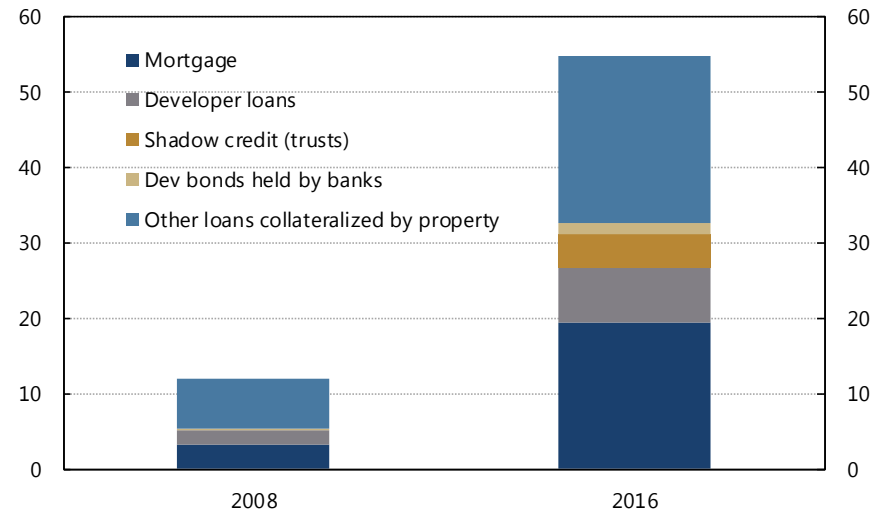


Source: BIS, CEIC

## China: Banks' total property exposure

RMB, tn

RMB, tn



Source: CEIC, Deutsche Bank

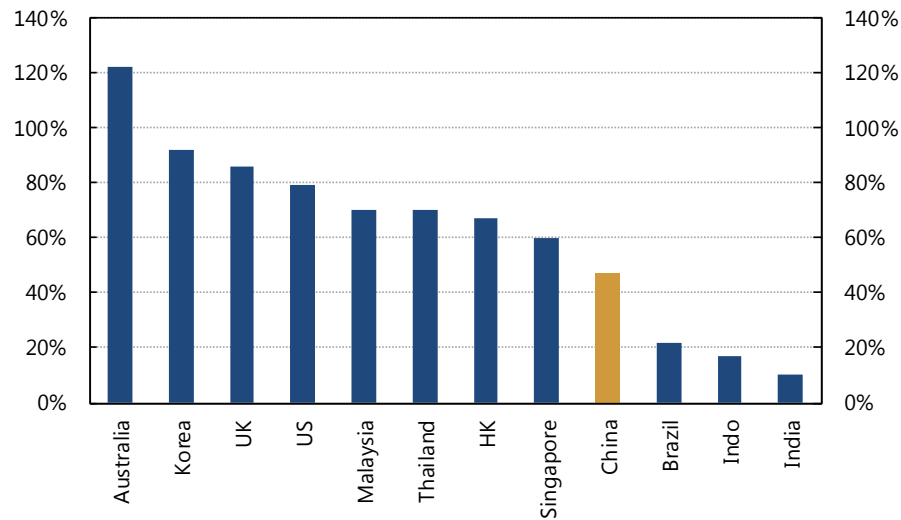
# Comment 2

## *Risk related to household debt still appear manageable*

- Mortgage debt to GDP in China is still low compared to advanced economies
- Loan-to-value ratios are increasing, although mortgage participation is still low
- Household savings rates are still among the highest in the world

### China: Household debt to GDP

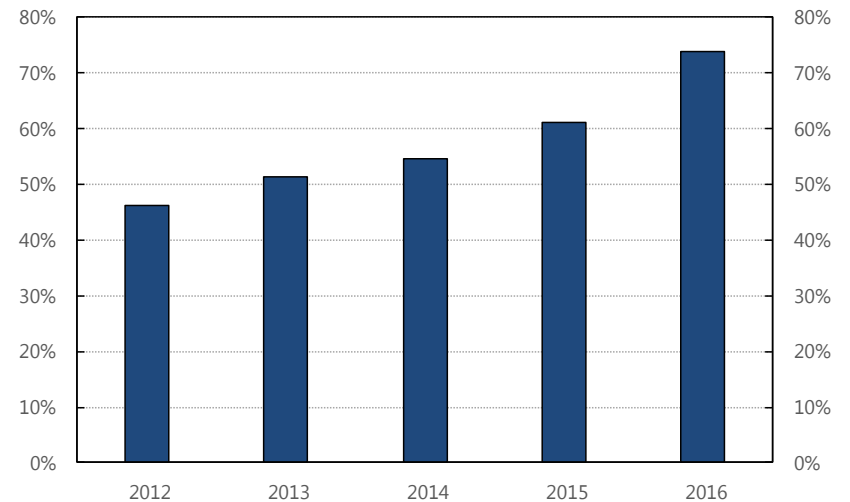
As a percent of GDP



Source: BIS, CEIC (most recent available)

### China: Household debt to income

Percent of estimated disposable income



Source: NBS, PBOC, CEIC, FRBNY estimates

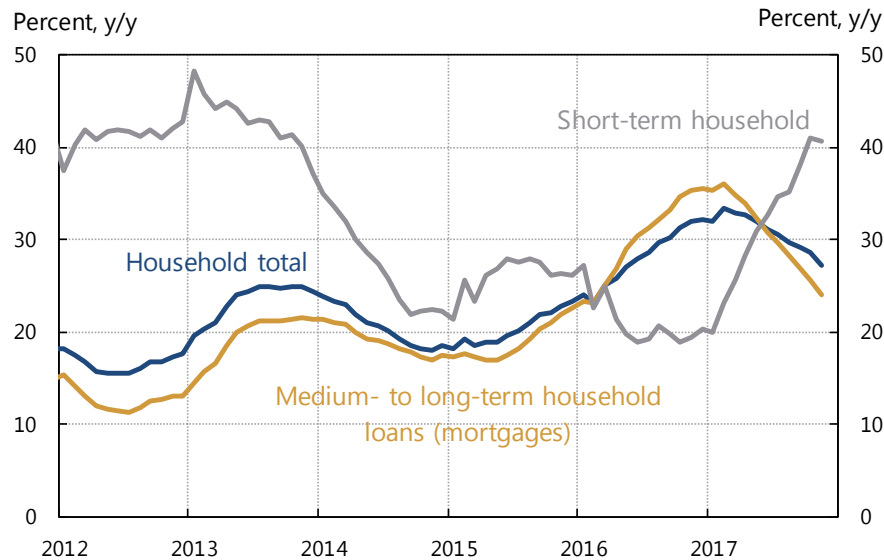


# Comment 3

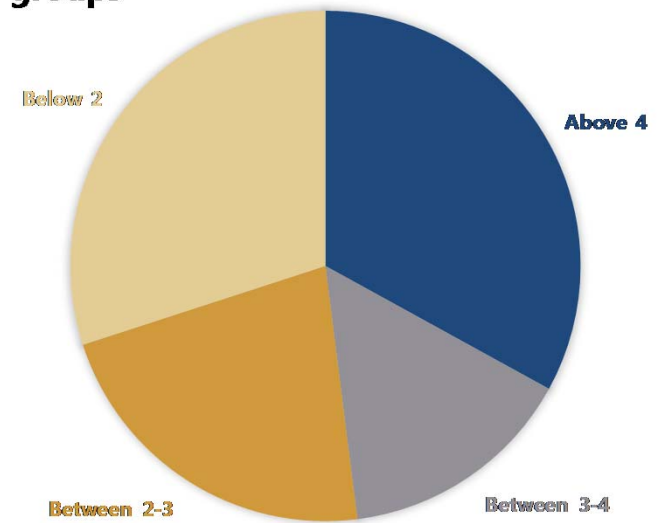
*Some direct and indirect risks stand out and bear close monitoring*

- Non-mortgage household lending has surged recently
- Mortgage servicing costs have gone up and may be weighing on consumption
- A third of household debt is held by highly-indebted households

**China: Household loan growth**



**China: Distribution of household debt by debt-to-income groups**



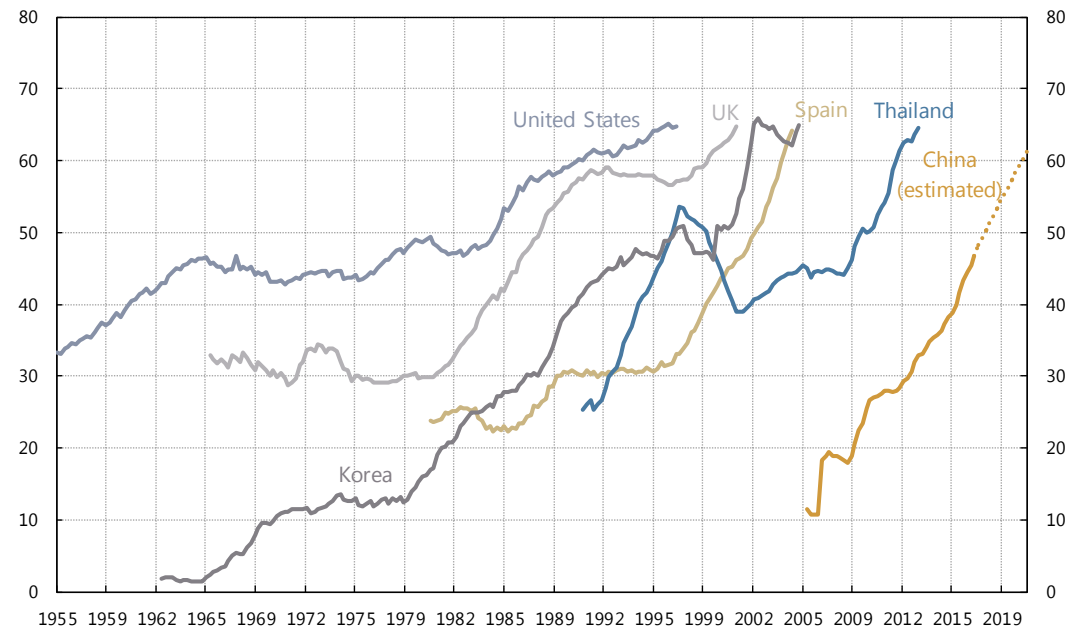
# Comment 4

*What is the outlook for household debt in China?*

- HH debt to GDP tends to become a drag on long-run growth when it exceeds 60%
- China's debt-to-GDP is on pace to reach 60-65% by 2020

## Household Debt to GDP

Percent of GDP



Source: BIS, CEIC, JPM, Deutsche Bank

# Comment 4

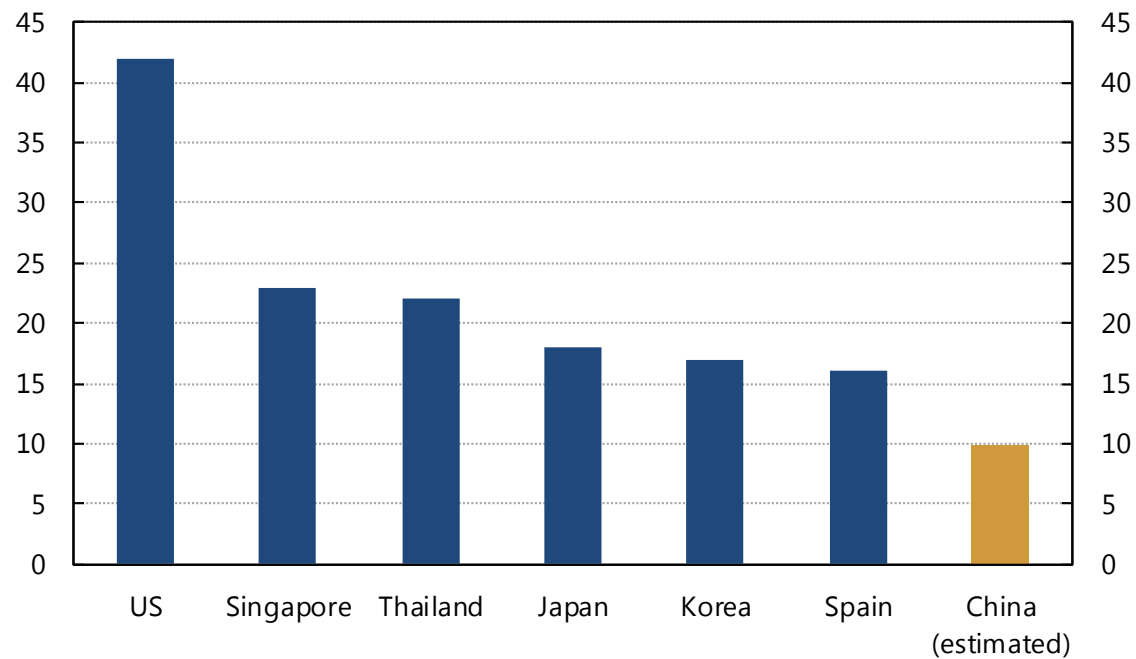
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*What is the outlook for household debt in China?*

- Rate of change of debt rather than the absolute amount that can lead to problems

## **China: Household debt**

Number of years for HH debt to rise from 25% of GDP to 60%



Source: BIS, CEIC, JPM, Deutsche Bank

# Comment 5

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*Interpreting the impact of macroprudential policies can be tricky*

- In most cases, monetary tightening/loosening occurs at roughly the same time as the use of prudential instruments, making it hard to isolate which policy tool had the greatest impact
- Recent work suggests loan-targeted macroprudential tightening measures successfully reduce credit growth, particularly in emerging economies (Alter, Narita, 2017)

# Comment 5

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- Several other factors at play in 2014-2016
  - PBOC also cut benchmark interest rates; mortgage rates fell by roughly 125 bps
  - Additional channels for disposable income disappeared
    - Domestic stock market collapsed in mid-2015
    - Capital account closed in 2016
- Still the relaxation of housing market restriction appears to be a compelling factor contributing to the surge in exposure