

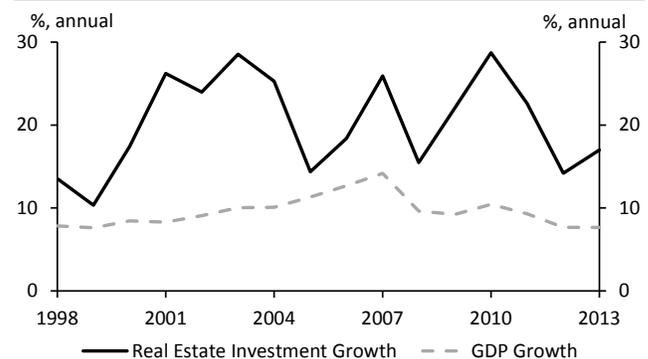
China's Slowing Housing Market and GDP Growth

By Jun Nie and Guangye Cao

The slowdown in China's real estate sector poses a risk to the country's near-term GDP growth. To achieve the 7.5 percent growth target for 2014, additional policy stimulus from both the central and local governments will likely be needed.

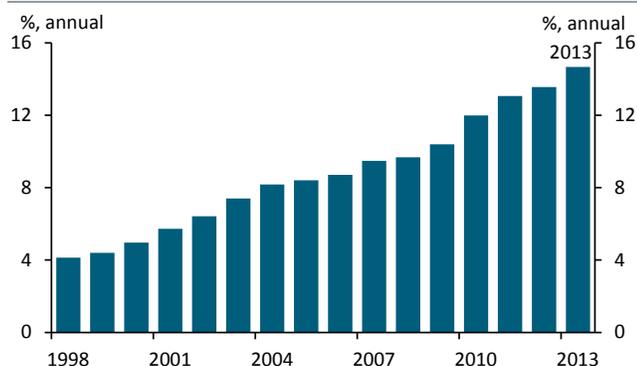
The Chinese economy has grown at an average annual rate of 9.5 percent since 1978, when the country began transitioning from a centrally-planned economy to a market-oriented one. One important contributor to growth has been the real estate sector. As Chart 1 shows, real estate investment has grown at an average annual rate of 20.2 percent since the 1998 housing reform, about twice as high as overall GDP growth.¹ Prior to the reform, most urban Chinese households lived in condos provided by the government, whereas households had to purchase their own residences after 1998. As a result, real estate investment increased steadily from about 4 percent of GDP in 1998 to about 15 percent of GDP in 2013 (Chart 2).

Chart 1: High growth in real estate investment



Sources: China National Bureau of Statistics, authors' calculations.

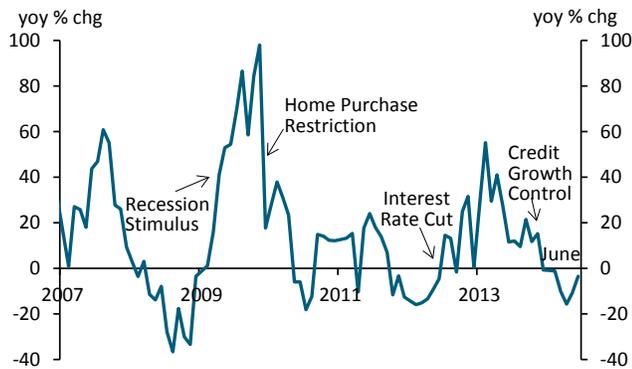
Chart 2: Real estate investment as share of GDP



Sources: China National Bureau of Statistics, authors' calculations.

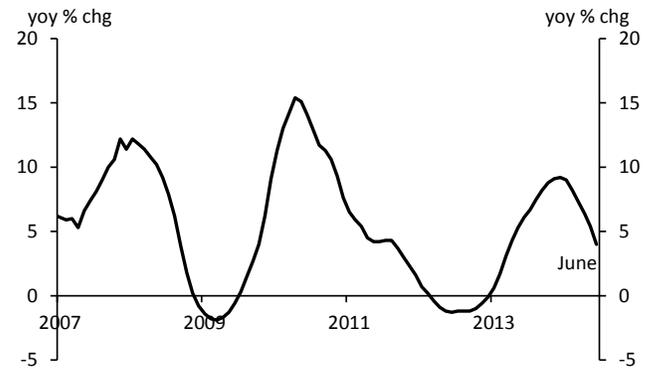
Recent data from China, however, indicate the expansion of the real estate sector has slowed significantly. Both housing starts and home sales decreased in the first six months of 2014. In particular, home sales decreased by 8 percent compared with the same period in 2013 (Chart 3), while housing starts, a more forward-looking measure, plunged 20 percent in the same period. Home price growth has also slowed significantly. Chart 4 shows that year-over-year growth declined from 9.1 percent in November 2013 to 4 percent in June 2014. The declines are relatively broad across cities. For example, of the 70 large and mid-sized cities, 55 had declining home prices in June, compared with 4 in March.² Reflecting weak home sales and housing starts, the year-over-year growth of real estate investment declined by 6 percentage points, from 17 percent in 2013 to 11 percent in the first half of this year. Real estate investment growth remained positive due to continued construction and completion. However, the decline in housing starts suggests weaker future growth in construction activity, thus leading to potentially softer real estate investment in the coming months.

Chart 3: Home sales have decreased



Sources: China National Bureau of Statistics, authors' calculations.

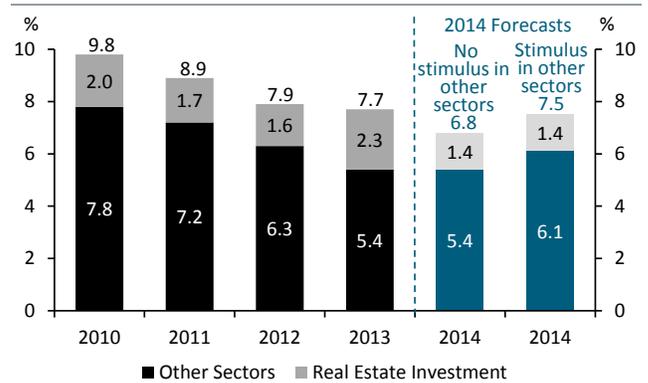
Chart 4: Home price growth has slowed



Sources: China National Bureau of Statistics, authors' calculations.

The real estate sector's recent cooling poses a downside risk to China's near-term GDP growth. For example, suppose real estate investment growth slows from 17 percent in 2013 to 11 percent in 2014, its pace in the first half of this year.³ As real estate investment represented about 15 percent of Chinese GDP in 2013, this 6-percentage-point decline in real estate investment growth suggests a 0.9-percentage-point drag on overall growth. This means that, all else equal, China's GDP growth could decline from 7.7 percent in 2013 to 6.8 percent in 2014, well below the government's 7.5 percent target, and the first time China's growth fell short of its target since 2000 (Chart 5). Recognizing this risk, however, the Chinese government has implemented a series of so-called "mini-stimulus" programs to boost activities in other sectors, such as railroad construction and trade. These stimulus policies appear to be effective, as the economy has expanded at an annual rate of 7.5 percent in the first half of this year. Therefore, if these policies continue to offset the weakness in the housing sector, the government may still be able to achieve the 7.5 percent target this year.

Chart 5: GDP growth and sector contributions



Sources: China National Bureau of Statistics, authors' calculations.

The near-term outlook for the real estate sector depends on the government's policy response to the recent slowdown. Chart 3 shows that government intervention has been effective in influencing this sector's performance in the past. Policy responses could include removing restrictions on buying second or third homes, which were introduced in 2010 to control rapidly rising home prices. The People's Bank of China could also cut interest rates or increase credit availability to the housing sector. However, there is little sign the central government will adopt such policies, as they would spur growth in home prices and credit—growth policymakers have tried to dampen in recent years. Efforts to support housing activity in the near term, then, will likely come from local governments. These governments have strong incentives to modify the central

government's property tightening policy, because their fiscal budgets rely heavily on property income tax and land sales revenue. Though the central government has not announced any loosening of home purchase restrictions, the local governments of many cities that previously implemented such restrictions have already loosened their policies. This loosening can take various forms, such as allowing non-residents to buy a second home or narrowing the areas in which home purchase restrictions apply.

Looking further ahead, the real-estate sector will need to adapt to the inevitable decline in demand caused by demographic change. The share of China's population from 24 to 30 years old, the age group needing to purchase their first home, has declined from 13.4 percent in 2000 to 10.7 percent in 2010. The share of the working age population (15 to 59 year olds) has declined to 68.7 percent in 2013 after peaking at 70.1 percent in 2010, reversing the upward trend of the prior two decades.⁴ In addition, oversupply in the housing sector has raised some concerns. The average inventory-to-sales ratio—a measure of how many months it would take to sell all existing inventory at the current rate of sales—rose 50 percent in the past 12 months, from 12 months in June 2013 to 18 months in June 2014, a rate well above the United States' 5.8 months.⁵ Already, 21 percent of urban households in China own more than one residence, compared with around 7 percent for total U.S. households. The national home ownership rate stands around 90 percent, compared to 64.7 percent in the United States. These factors suggest there is modest scope for additional demand growth.⁶

Taking both the short- and long-term factors into account, the real estate sector's recent slowdown is likely to continue as housing activity stabilizes at a lower growth path. While this adjustment could provide certain long-term benefits, it will generate significant downward pressure on China's near-term growth.

¹ Real estate investment in China includes construction, renovation, land purchase, and land development. The real measure is calculated by deflating nominal real estate investment data by the Consumer Price Index of the residential sector.

² Based on the change in home prices from the previous month reported by China's National Bureau of Statistics.

³ In nominal terms, real estate investment growth rates were 20 percent in 2013 and 14 percent in the first half of 2014.

⁴ Demographic data are from UN Data at <http://data.un.org/>.

⁵ The inventory-to-sales ratio is from a June 2014 [report](#) by E-house China R&D Institute. It uses data on new homes for 35 major Chinese cities.

⁶ Chinese home ownership data is from a June 2014 report by the China Household Finance Survey.

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