



# How big is China's real estate bubble and why hasn't it burst yet?



Simon X.B. Zhao\*, Hongyu Zhan, Yanpeng Jiang, Wenjun Pan

Department of Geography and International Centre for China Development Studies, The University of Hong Kong, Hong Kong

## ARTICLE INFO

### Article history:

Received 29 July 2016

Received in revised form 17 February 2017

Accepted 18 February 2017

### Keywords:

China

Real estate bubble

World financial crises

## ABSTRACT

This paper represents an international, comparative, empirical study of the relationship between financial crises and real estate development, with a focus on China. We review recent major crises around the world from 1980 to 2014. We then discuss the ways real estate crises develop into financial crises (considering that most recent financial crises actually trace their origins to real estate bubbles). We also look at China's current economic situation, and identify potential threats to the country's economic development by comparing it with other countries' historical experiences. A comprehensive analysis of the relationship between real estate and finance predicts an upcoming burst in China's bubble economy. We explore the deep-seated underlying Chinese systemic causes and characteristics that explain why China's economic bubble has yet to burst and the possible financial consequences of the real estate bubble in China. Our findings suggest that a financial crisis often emerges from a weak financial system which is too closely linked to the country's real estate sector. These linkages allow real estate crises to mushroom into financial crises. In turn, these financial crises balloon into macroeconomic crises. China's current situation is extremely alarming, though the country shows remarkable resilience to crisis as the government seems to possess the tools and capacity to avoid a hard landing. The findings of this research advance our understanding of the consequences of China's real estate bubble and sound a clear warning to China's policymakers.

© 2017 Elsevier Ltd. All rights reserved.

## 1. Introduction

After the gradual establishment of the modern financial system (around 1720) and throughout numerous major financial crises, real estate sectors globally have developed strong links with financial sectors, and thus affect entire macroeconomies at home and abroad (The Economist, 2014). This paper shows how real estate crises have historically triggered a large portion of the major financial crises occurring over the past two decades. These financial crises subsequently spread to other sectors, stifling economic development as a whole. A recent scholarly study of housing prices, credit and outstanding mortgage debt data from 40 countries from 2000 to 2009 shows that over 87 percent of the countries that experienced a real estate boom (and 91% of the countries experiencing both a real estate boom and a credit market boom) ended up suffering from a financial crisis or a severe drop in GDP growth (Crowe et al., 2013). China has experienced both remarkable real estate and credit market booms in the past decade. Yet, China still defies

the odds—having so far avoided serious financial crisis and an economic hard landing. What makes China's case different from that of other countries? To answer this question, we need to understand the causes of financial crises.

Studies conducted on the linkages between the real estate sector and overall economic conditions have a long history. The real estate sector incredible represents an integral component of the overall economy and forms close connections with financial markets (Ermisch, 1990). Economic peaks and troughs correlate closely with fluctuations in property prices (Quigley, 1999). However, the majority of studies in this area focus on how financial crises affect the real estate sector—rather than the other way around (DiPasquale and Wheaton, 1996; Case and Shiller, 1998). Few studies explore causality between real estate crises and financial sector crises, which in turn cause macroeconomic crises.

Three different types of models attempt to explain the causes of financial crises (Renaud, 2000). The first type focuses on fiscal, monetary and exchange rate policy explanations for financial crises—for example, looking at the role played by large budget deficits, inflationary monetary policy or pegged exchange rates in these financial crises (Krugman, 1979, 1999). The second type of model centres on the logic of bank runs. These models show how (rational) expectations of future crises can lead to crises today (Obstfeld, 1981).

\* Corresponding author. Present address: Department of Geography, The Jockey Club Tower, The University of Hong Kong, Pokfulam Road, Hong Kong.

E-mail addresses: [sxzhao@hku.hk](mailto:sxzhao@hku.hk) (S.X.B. Zhao), [fossilzhy@gmail.com](mailto:fossilzhy@gmail.com) (H. Zhan), [ypjiang@hku.hk](mailto:ypjiang@hku.hk) (Y. Jiang), [briseispwj@gmail.com](mailto:briseispwj@gmail.com) (W. Pan).

These models stress the need for credible policy and adequate capitalisation (of the central bank or financial institutions depending on the exact model discussed). The third type of model focuses on structural and institutional problems inherent in the design of financial institutions themselves. These models look at the effects that collateral requirements, lending regulation and supervision, and other factors have on economic incentives. The misalignment of incentives and economic fundamentals invariably (in these models) lead to financial crises—often as the result of developing asset–price “bubbles” (Velasco, 1999). Such bubbles represent significant misalignment of nominal asset prices from fundamentals, and may rationally occur as economic actors’ short-term incentives diverge from their long-term interests.

However, none of the models (or other existing studies) describe the direct causal relationship between real estate crises and financial crises (which we will discuss in Section 2 of our paper). In Section 3, Our paper will demonstrate China’s systematic real estate bubble through the perspective of property prices, the supply of cash M2 (Broad money: the amount of money) and vacancy rates (for residential housing) and the linkage between real estate markets and financial sector performance during crises in China. We compare and contrast various aspects of these crises across time and major countries that have experienced a real estate boom and bust. We also discuss the causal relationship between real estate crises and financial crises. We show how real estate crises explode into financial crises and negatively impact on the entire economy. In Section 4, we further identify and describe the fundamental causes and mechanisms that explain why Chinese investors can leverage real estate investments so heavily—and yet avoid a hard landing (so far). We draw parallels between other nations and China—providing a warning to Chinese policymakers about the pent-up risks which threaten to make China another crisis case study. The final section provides conclusions and three possible scenarios for the likely outcomes facing China’s over-leveraged economy in the near and mid-term future.

## 2. A review of financial crises

Among the dozen or so financial crises that occurred prior to 1980, five severe crises stand above the rest (The Economist, 2014). The first of these crises, the panic of 1792, occurred in the United States. The panic resulted from speculators cornering the federal bond market. Reforms brought about as a result of the panic laid the foundation for the establishment of the New York Stock Exchange and modern finance as we know it (Sylla et al., 2009). The second crisis, the 1825 Latin American crisis, represented essentially the first emerging markets crisis. The crisis—as we will see again and again—resulted from information asymmetries between investors and the people who managed their money (Neal, 1998). Perhaps the first global financial crisis, the panic of 1857, resulted from a wave of financial innovations and fierce competition which resulted in highly-leveraged risk-taking (Calomiris and Schweikart, 1991). Once again, financial innovation (in the form of minimally regulated trust companies), combined with highly leveraged shady market speculation, triggered the panic of 1907. That panic led to the establishment of the modern Federal Reserve Bank in the United States (Bruner and Carr, 2007). Finally, the fifth and worst of them all took place from 1929 to 1933. The Great Depression emerged from the contest between government and markets, often since repeated (Kindleberger, 1986). In general, the majority of all crises occurring during the pre-1980s era of modern global capitalism (with some noteworthy exceptions) represented “pure” financial crises.

Once since the 1980s has the real estate sector played a significant role in the global economy—and its financial sector crises.

The Japanese asset bubble that occurred in the late 1980s and into the early 1990s dealt a crushing blow to Japan’s economy, not only in terms of its magnitude but also in terms of its lingering effects. Even today, Japan’s actual GDP growth falls far short of the potential GDP growth Japan would have had if the crisis caused by the bubble not occurred. Many observers blame Japan’s property asset bubble (and the ensuing crash) on poor monetary policy (in the form of excessively low interest rates) and the interrelationship between the Japanese stock markets and land markets (Stone and Ziemba, 1993). Several mistakes made by the government, in the form of monetary policy when the bubble reached its peak, produced the long-lasting aftermath—in the form of an economic recession lasting from late 1989 to today (Quigley, 1999). Much of the literature focuses on the Japanese asset bubble resulting from over-heated speculation in Japan’s real estate markets. Such speculation, in turn, emerged from inadequately regulated Japanese financial markets and Japanese fiscal policies. Miyao (1991) argues that serious problems already existed in the “prosperity” of the Japanese land sector before the bubble burst. These problems consisted of “inefficient land use, inadequate public infrastructure and an increasing disparity between the haves and the have-nots due to land-price escalation.” In addition, he points to excessive regulations over land use and transactions and a need for reform of the land-tax system. However, few studies have addressed whether or not the problems in the real estate sector represented one of the direct causes of massive economic recession. These studies also fail to address whether the government had played a role in the mismanagement of real estate sector policies which finally resulted in the asset price bubble bursting.

The academic literature about the 1997 Asian financial crisis focuses more on national financial systems than the broader perspective which would correctly identify the pivotal role played by real estate bubbles. Quigley (2001) finds that, in the case of Hong Kong, real estate markets contributed significantly to the Asian financial crisis. Property prices in Hong Kong rose to historical heights just before the crisis. Fu (2000) finds that high land prices contributed to the economic inefficiencies that led to financial instability. Scholars like Corsetti et al. (1999) point the finger at Hong Kong’s vulnerable financial system of the time. Fu (2000) points to criticisms made against the Hong Kong government for its use of improper monetary policies. Few scholars correctly point to Hong Kong’s real estate sector—and the lack of prudential policies—as the reason why the Asian financial crisis affected Hong Kong to the degree it did.

The story of the Asian financial crisis starts about 50 years ago. From the late 1980s to the early 1990s, several Asian countries—particularly Thailand, Malaysia, Singapore and South Korea—recorded annual GDP growth rates of approximately 10%. Rapid development led to plenty of investment opportunities (and thus large capital financing needs). To meet these needs (which domestic savings alone could not cover), companies in South-east Asia turned to large amounts of portfolio investment from around the world. Several countries chose to close financing gaps by printing money. In the meantime, Japan—as the region’s former investment hot spot—continued in economic recession.

The usual accounts of the Asian financial crisis focus on the devaluation episodes brought about by misaligned currency pegs. As several International Monetary Fund missions at the time highlighted, many Southeast Asian currencies’ real exchange rates depreciated rapidly in the face of capital flight...and other factors (McKinnon and Schnabl, 2004). Speculators saw the significant undervaluation of real exchange rates in the area—compared with their official, fixed nominal values—and started selling in the hopes of buying back later at lower, post-devaluation exchange rates. Speculators first targeted the Thai baht, and then quickly expanded selling to other Asian currencies. Devaluation brought an end to

متن کامل مقاله

دریافت فوری ←

**ISI**Articles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات