CHINA PROPERTY INDUSTRY:

TAKING LESSONS

FROM ASIA FINANCIAL TURMOIL

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According to the general information on the property market in China published by the State Statistics Bureau, China made the investment of 310.6 billion yuan in real estates in 1997, a drop of 3.4% from the previous year. Houses of 434.68 million sqm were built, declining by 0.3%. New projects in the year involved the area of 128.17 million sqm, and projects of 187.87 sqm were completed, rising by 12.6% and 6.5% respectively. Vacant houses reached 70.38 million sqm, a growth of 25.4%. Area sold amounted to 79.14 sqm, a gain of 15.7%. Such information suggested, the property market in China witnessed a stable growth in 1997, the macro-economic control measures continued to play roles, and the government policy to adjust market structure and stimulate housing demand began to see fruits and had laid down foundation for the slow recovery of the market in the future.

Vacant buildings reached 70.38 million sqm, further climbing 25.4% from those of 66 million sqm in 1996. Assumed each sqm cost 1500 yuan, the funds of more than one hundred billion yuan were frozen. The Southeast Asia financial crisis started from July
1997 has developed into Asia financial turmoil threatening the financial markets and the economies in Asia and the world as a whole. Asia financial turmoil, triggered by international speculations, was the results of the problems and contradictions accumulated in the long-term rapid growth of some countries in Southeast Asia. Specifically, investment swelling and the burst of property bubbles were one of the causes that cannot be overlooked. It was reported that one of the direct causes for the financial crisis in Thailand was the overheated real estate market. Enormous newly built houses were left idle without any buyers. As many as 850 thousand flats were unsold. Vacancy of newly built houses reached more than 20% (18% in Indonesia, 15-20% in Philippines...). Even though the price of houses dropped under half of the price when the bubbles were blown, no one seemed to be interested. Half of the property developments in Thailand were financed by the financial institutions. Foreign debt of Thailand accounted for as high as 46% of its GDP (Source: World Bank) due to excessive borrowing. And the problem was large part of foreign capital and bank loans went to the property and securities sectors, resulting in an unreasonable investment structure. Excessive speculations and over supply in real estate market had led to large number of unsold
houses, the swelling of bad assets of banks and finally serious bad debts for the banking sector (The ratio of bank bad debts in Thailand reached 10% in 1996, much higher than other Southeast Asian countries). Bad debts from real estates amounted to as high as $5.5 billion US dollars and bad assets of banks reached more than 8%. When the real estate bubbles burst, accompanied by the attack by international speculators, the fragile financial system was stricken hard. Overdue loans became bad debts, and the financial crisis broke out inevitably. Japan, South Korea, Indonesia and other countries almost shared the same story.

China property industry surged by more than 100% each year from 1992 to 1995, compared with 50% in Southeast Asian countries. Especially from 1992 and 1993, such growth even reached 198%, and a record high of 500% in some regions. This is more or less the same story with Japan before its bubbles burst. The property industry in China has gone beyond the actual demand (rendered as irrational development and abnormal growth by the author at that time). Commercial houses were overstocked in sluggish market. Consequently project and material costs were unable to be duly paid and triangle debts rolled bigger and bigger. With huge amount of funds of almost one hundred billion yuan frozen in the projects, property developers failed to repay their loans. Obviously bad debts for banks were not small figures. Even after the central government imposed austerity macro control over the property industry, investment was not curtailed in many provinces and cities. Investment was further expanded even the market was sluggish. Worsening overstocking of commercial houses (32.43
million sqm in 1994, 50.31 million sqm in 1995, 66.24 million in 1996 and 70.38 million sqm in 1997) resulted in bad debts and frozen funds. Nobody could tell how much capital was tracked in property projects in the whole country. But only in Guangdong, funds of 200 billion yuan were tracked in property development during the eighth five-year plan. If such bad debts occurred in any Southeast Asian country, crisis will be inevitable. The bubbles in the property industry and phenomenon of financial crisis in China at the time of property boom were not less than the Southeast Asian countries in some aspects. However China is fortunate enough not to have withdrawal rush, bankruptcy of mass companies and banks and devaluation of national currency, thanks to the fact that the reform of our financial system and state-owned enterprises has not been fully completed. Most investment in property development came from state-run banks and enterprises, and crisis is resolved internally. Losses are borne by the enterprises and the government, while profits go to individuals. Another reason is that our financial market has not been opened, foreign short-term funds are restricted to enter into China market for speculations. The Chinese government took resolute action to tighten macro control and stop property development from further heating. Twin austerity policies to control land licensing and loans were also adopted to press the bubbles and stop the situation from further worsening. Unlike the abrupt and external explosion of the financial crisis in Southeast Asian countries, the consequences of the problems of the property industry in China took another form, a sustained and internal consumption. But the waste and destruction of social and
economic resources are no different. The sequel of the property overheating for two years has too much impact. The vacant houses will not be fully sold until early next century.

Overheated investment in property development and excessively prosperous property market are one of the important causes for the financial turmoil in Asia. At present the once over lending Southeast Asian banks have made corrections. Not a single bank is ready to lend to any property developer, investor even genuine buyer of houses. However the mass destructive financial turmoil in Asia did not strike China economy directly, as one of the leaders of the central government says, he financial crisis did not have much direct impact on the economy of China mainland, but we do not underestimate its future impact.* Actually the reason for why we have escaped such disaster and maintained economic and financial stability is that the government has adopted effective macro control policies and measures, effectively brought economic over-expansion under control, and taken comparatively prudent financial policies. In fact the Asian financial turmoil has produced direct and indirect impact and pressure on China. The devaluation of Southeast Asian currencies has reduced the competitiveness of China exported commodities. And foreign investment to China will probably be reduced. Other impacts will come out one after another in the future. As the financial crisis is the reality, we have to face up to it, and take lessons from it.

In the world of economic and financial integration and
globalization, there is no country that can close itself completely. China is the important part of the international community, and the international community is the background of reality for China social development. China is the important part of the international market, and the international market is the pre-requisite condition for China economic development. The historical progress of the integration of the world economy has led the Chinese nation into an era when China socialist modernization cannot be realized outside the international community and international market and when China social development and economic prosperity rely on its integration with the international community and international market. Economic depression and financial crisis in any part of the world will pass on to other parts like epidemics. Therefore Asia financial crisis will strike China with no exception. Under new international environment and challenge, we not only have to defend ourselves from the strike of foreign financial turmoil, but also have to stop domestic financial crisis from happening. In developing property industry, we have to be more careful.

Based on the analysis on Asian financial crisis and the experience of the development of the property industry in China, the followings are the lessons we should keep in mind:

Development of national economy in planned and balanced way is the rule we should strictly observe in the economic operation. Otherwise unbalanced investment
and economy as well as financial crisis will take place. The history of the People Republic of China for several decades can prove this point adequately. Any country against this rule will be punished by the rules. We should insist in the policy of further reform, speeding up adjustment and seeking both progress and stability*, further adjust industrial structure and maintain the stable and sustained growth of the national economy.

We should beware of and prevent overheating of property development. The development of real estates should be included into the plan of fixed asset investment of the whole country so that its development, maintaining an appropriate proportion, will suit the development of national economy. Because property investment requires enormous and long-term capital, pell-mell development and over supply will not only cause losses for the property industry and the banks, but also will affect the healthy development of the national economy as a whole.

The development of property in China should be oriented by market demand. Investment structure should also be improved. The way of extensive growth of high speed, high input, low quality and low efficiency should be changed. Property development should be focused on economic and functional commercial houses badly needed by residents. More efforts should be made in quality of houses and management of property, so that people can get more benefits.

The reform of financial system should be accelerated to ensure the healthy running of the financial system. The system reform of
state-enterprises should also be speeded up so that property developers can operate themselves in the real market, adjust their strategies and fix flexible prices according to the market changes. Property developers should not be confined to the limit of appraising their operational results in the form of growth of net assets and realization of pre-set profit target.

Governments of all levels, property developers and professionals should attach importance to the problem of overstocking of commercial houses. Solving the problem of overstocking of commercial houses is a systematic project, and should be acknowledged as part of the large system of the national economy. The sources of problems should be identified instead of just solving superficial problems. More and more vacant houses have exposed the problems of backward housing reform and the inadequate measures to stimulate housing demand. The stock of vacant houses cannot be sold out unless breakthrough is made in the formulation of policies and measures.

Since the happening of the Asian financial turmoil, the economy and finance of China has run normally. The economy continues to maintain the momentum of high growth and low inflation. In 1997 the economy grew by 9.7%, indicating the financial sector of China was not affected by foreign financial turmoil. This year (7hins fixes its economic growth rate at around 8%, representing the policy of seeking both stability and progress. At present China has foreign reserves of around 140 billion US dollars (and Hong Kong has 96 billion US dollars). Funds at home are becoming richer and richer. The saving rate was
1.2% higher than investment rate during the eighth five-year plan. The difference of saving and lending reached as high as 700 billion yuan at the end of 1997. Such financial strength and satisfactory economic running provides a bright future for the development of the property industry. I believe, with the painful lessons from the property overheating in 1992 and 1993, and several years of experience in macro control and structural adjustment since 1993, as well as the important lessons from Asian financial turmoil, the property industry in China will develop in healthy and orderly manner if the economy continues to enjoy rapid growth.

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