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## No Housing Bubble in China

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By John Derrick, Director of Research, U.S. Global Investors

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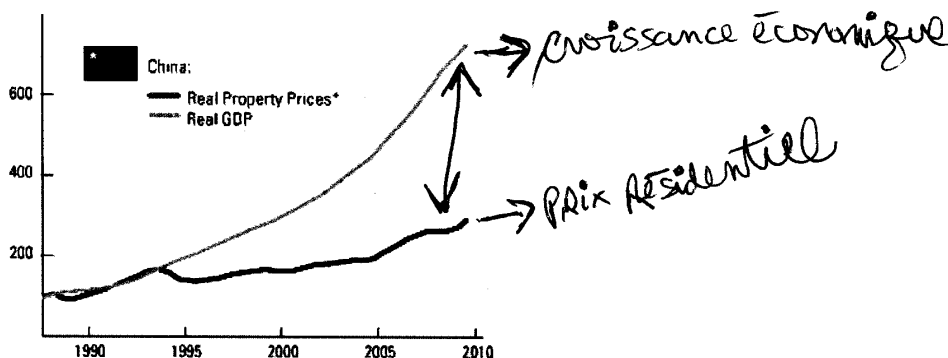
China's housing market is hot, but it's not a bubble on the verge of bursting, as many contend.

Before we can discuss why it's not a bubble, a little background on the Chinese housing market is needed.

Prior to the early 1990s, urban dwellers in China were provided an apartment by their employers or the government, with rent set at less than 5 percent of their salary (utilities included). Starting in the early 1990s, the government began to privatize housing by selling apartments to their residents at a low price. Almost overnight it created a private home ownership rate of about 70 percent.

This policy change was also a vast redistribution of wealth from the government to the people – those apartments typically occupied prime downtown locations, and thus are worth at least the price of a new luxury apartment.

### Do Rising Property Prices Equal a Bubble?



Note: Both series are rebased to May 1988 = 100  
\* Deflated by CPI and shown as a 12-month moving average

Source: BCA Research

The price of housing in China has risen as the economy has expanded, but the chart from BCA Research shows that housing price growth has been significantly slower than GDP growth since the late 1980s.

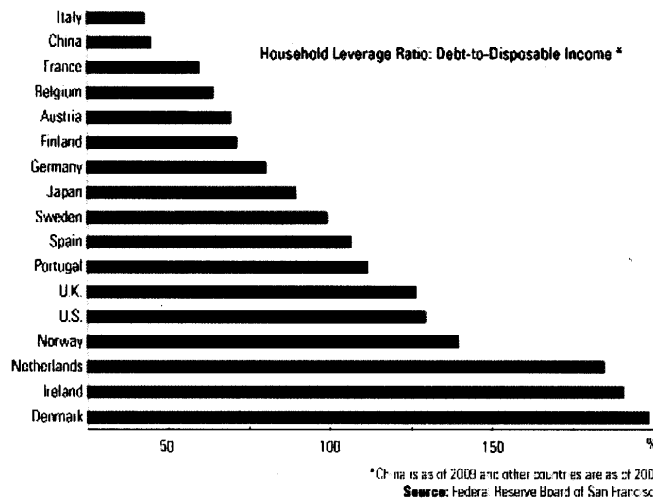
The price of housing has roughly doubled since the late 1990s, but it's important to remember that China's prices have risen from a much lower base than in the developed countries (among them, Britain, Ireland and Spain) in which bubbles were created. It's also relevant to point out that household disposable income in China more than doubled during the period. The rise of the Chinese middle class is a major global economic phenomenon – tens of millions of people are added each year.

Leverage is also an important indicator in judging how susceptible a housing market is to growing into a bubble. The chart below, also from BCA Research, shows debt as a percentage of disposable income in China and in a number of developed-market countries. More than half of the developed countries had debt in excess of income, with Denmark and Ireland pushing 200 percent.

<http://advisoranalyst.com/glablog/2010/04/10/no-housing-bubble-in-china/print>

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**China's Household Leverage is Low Relative to Income**

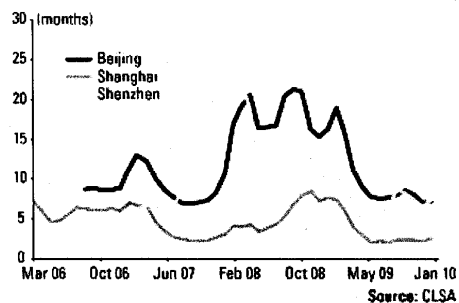


China is at the far other end, with debt totaling just 44 percent of disposable income. Furthermore, homebuyers in China put down at least 20 percent as a down payment (30 percent for a first-time buyer and 40 percent for a second-home buyer to damp down speculation). These buyers rarely fall behind on their mortgage payments.

It's obviously true that there has been rapid price appreciation in major cities like Shanghai and Beijing. Prices have risen above the affordability level for most families in these cities, and that is why the government is acting to let some air out of those markets before dangerous bubbles form.

For example, the government's "second mortgage rule" requiring much higher down payments is having some effect - in January, price appreciation rose less than 1 percent month-over-month, down from a 2.1 percent jump in December. The government has also ordered that developers build more economical homes.

**Residential Property Inventories: Number of Months to Clear Inventory (3 Month Moving Average)**



Where does the China housing market go from here? Home inventories are low in major cities - at the current sales pace, there are only a few months worth of inventory in Shanghai, and the situation isn't much better in Beijing or Shenzhen (see chart below).

But demand is still strong. A recent survey by the Hong Kong-based brokerage CLSA found that 56 percent of China's middle-class families are considering buying a new home - despite the higher prices many families can pay a 30 percent down payment because of their higher savings.

Our own research shows that property developers, coming off a good 2009, are expanding into second- and third-tier cities, where housing markets are also growing and prices are more affordable.

This widening of opportunity, combined with the government's early recognition that decisive measures were needed, together will raise the probability that it will achieve its goal of slowing down home price increases without causing the market to collapse.

*Senior China analyst Michael Ding contributed to this commentary.*

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