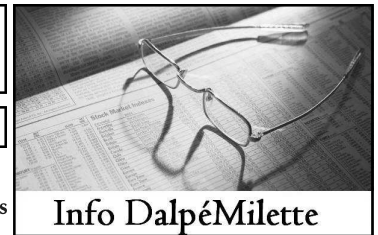


Sujet: L'immobilier résidentiel en Chine /
More on Chinese real estate market

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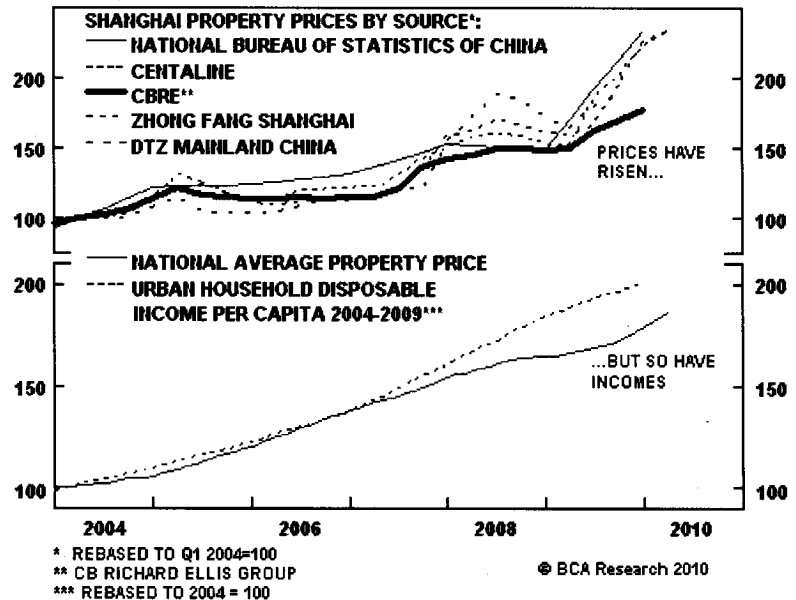
(Part I) Chinese Property: A Reality Check

Our China Investment Strategy service published a Special Report on the property market in China: Prices still reflect underlying fundamentals.

Chinese policymakers issued harsh administrative measures last week in an aggressive move to cool off the country's red-hot property market.

Homebuyers are now required to pay down 30% and 50% respectively for their first and second homes, and banks are "advised" to stop lending to third-home buyers in cities with high-flying prices. The near-term impact of

these new policies is clearly negative for property prices. Already there are reports about a sharp reduction in property transactions, and the market situation needs to be closely monitored. However, a more important issue is the structural outlook of China's property market. A massive property "bubble" and the risk of an imminent crash have been a major concern of some China bears. Official statistics show that the national average selling price has increased by about 100% since 2004 (roughly 12% per annum), although property prices jumped significantly last year. The national average price increased by about 20% and 60% in Shanghai, which indeed is frothy and unsustainable –the very reason behind the authorities' most recent policy actions. The longer term average however, does not appear excessive compared to China's rapid income growth. Moreover, increasing financial intermediation has further improved housing affordability: Increasing accessibility to mortgage borrowing has significantly improved households' ability to buy homes. Nonetheless, if prices continue to appreciate, the risk of a major boom/bust scenario cannot be ruled out. Please see the next *Insight*.



(Part II) Chinese Property: A Reality Check

Chinese economic growth will obviously suffer if house prices undergo a bust.

Three sectors would directly feel the pinch from falling property prices. The first would be the consumer sector:

Households' balance sheets would be damaged in a fashion similar to how American families were hit in the aftermath of the U.S. housing bubble.

The key difference, though, is Chinese consumers' have a much lower leverage ratio. In turn, falling home values may have a negative wealth

effect on households, but direct implications on their expenditures and ability to honor loans is unlikely to be significant. The second sector to be damaged is the banking system, but the damage here is also likely to be contained, given Chinese banks' extremely conservative mortgage lending practices. Bank lending to developers has been even more conservative. The average loan-to-value ratio for land mortgages to developers is 50%. Finally, the most direct risk to overall growth is probably on capital spending and construction activity. However, unless policymakers engineer a draconian credit squeeze on developers similar to that in late 2007 and early 2008, we suspect overall capital spending should not suffer much. Bottom line: The Chinese authorities may be rightly concerned about speculative froth in some localities, and are taking measures to slow down overall property price increases. Still, the structural case behind property prices remains compelling.

