CIO Special

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China: strong support for the property sector

01 Weak property sector warrants more pro-active policy support

02 Local governments to help with unsold property inventory

03 Incentivise home purchases with lower mortgage rates

04 Equity market sentiment improving on the back of the property market

Key takeaways

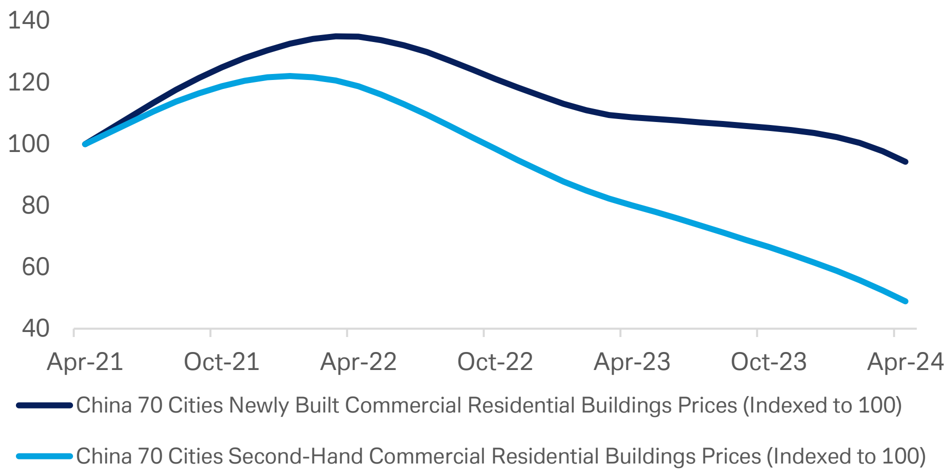
- In response to the deterioration of China's property sector over recent months the regulators announced significant support measures last week.
- These measures include providing bank lending facilities for local governments to buy unsold inventories and lowering the mortgage rates for households.
- Equity market sentiment was bolstered by the announced measures, but their actual implementation remains the key.

01 Weak property sector warrants more pro-active policy support

China announced more measures to support the property sector at a national government meeting on May 17. The stimulus measures come at a time when China's property sector continues to weaken with price declines and lower transaction volumes. The focus of the measures is to support housing demand, by lowering mortgage rates and getting local government to buy the unsold property inventories. Equity market sentiment improved significantly after the announcement of these measures.

China's property sector has deteriorated in recent months. The 70-city home prices showed faster declines in April. New home prices declined 3.5% YoY and secondary home prices declined 6.8% YoY, compared to the declines of 2.7% YoY and 5.9% YoY respectively in March. Among the 70 cities, new home prices declined in 64 cities in April compared to 57 cities in March, while new home prices increased in only 6 cities (compared to 11 in March). Property prices across tier-1, tier-2 and tier 3 cities continued their downward spiral accompanied by weak sentiment in the market.

Figure 1: Home prices in 70 major cities



Source: Bloomberg, Deutsche Bank AG. Data as of May 21, 2024

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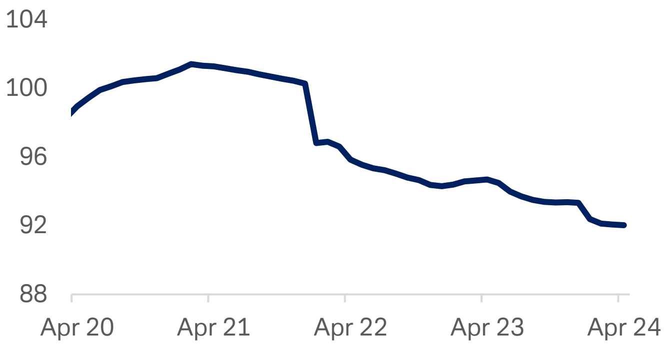
The property sector remains the weakest link in the economy, and it has been in decline for nearly three years. New home prices in 70 major cities have declined 5.8% since peaking in August 2021 while secondary home prices have fallen by an ever steeper 11.5%. According to the National Bureau of Statistics in China, the real estate climate index declined to 92.0 points – its lowest level in over 20 years – in April 2024, down from a high of 101.4 points in February 2021.

Figure 2: China Real Estate Climate Index



Source: Bloomberg, Deutsche Bank AG. Data as of May 21, 2024

Declining property prices have not only affected the related construction materials and service sectors but have also prompted negative wealth effects on household consumption. This increased the need for policymakers to respond with supportive measures.

02 Local governments to help with unsold property inventory

One of the key measures announced last week was that local governments would be tasked to buy unsold homes from developers and convert them into affordable housing. PBoC deputy governor Tao Ling said that they would create a CNY300bn re-lending facility to support local governments in their affordable housing efforts. The interest rates on the loans would be as low as 1.75% and they would be renewable for five years. Banks are also encouraged to support SOEs in their affordable housing efforts, so the total funding support could reach CNY500bn.

These are significant measures as they would directly address the demand-side issues of the unsold property inventory of developers. Local governments had previously purchased unsold new properties or secondary properties and converted them into affordable housing. However, these transactions were implemented in relatively small numbers and in only a few cities. Despite the announcement last week, we think a nationwide large-scale involvement of local governments in purchasing unsold properties is unlikely. For selected cities where affordable housing is in strong demand, local government may step in with the bank lending support. However, for some lower-tier cities where affordable housing is not in strong demand, the actual implementation of the policy could be in doubt given the limited financial resources of local governments, in our view.

03 Incentivise home purchases with lower mortgage rates

Last week, PBoC also announced more measures to incentivise households to purchase property, including 1) lowering the minimum mortgage downpayment requirement for property purchases to 15% (from 20% previously) for first homes and to 25% (from 30% previously) for second homes, 2) lowering mortgage interest rates by 25 bps from the housing provident fund programmes, and 3) removing mortgage floors for home purchases (previously LPR-20 bps for first homes and LPR+20bps for second homes).

These measures could significantly reduce the cost of buying properties for households. The minimum downpayment rate of 15% is already the lowest on the record. With the reduced mortgage rates from the housing provident fund and the removal of floor interest rates, coupled with the possible reductions in loan prime rates, purchasing a home is becoming much more cost-efficient in China. While these measures are unlikely to prompt a sudden improvement in household sentiment about the property sector, we think they may significantly support property purchases for actual use rather than for investment purposes, including from first-time buyers and buyers looking for larger properties/higher-quality housing.

Figure 3: China real estate sales

Source: Bloomberg, Deutsche Bank AG. Data as of May 21, 2024

In addition, the loosening and lifting of city-level purchase restrictions were significant measures. As discussed in our recent CIO Special (China: growth key to market upside, published on May 14, 2024), many tier-1 and tier-2 cities recently eased the purchase restrictions, including Nanjing, Chengdu, Changsha, Hangzhou, etc. Even in the tier-1 cities such as Beijing, Guangzhou and Shenzhen, purchase restrictions were relaxed in order to support transactions. Since late last month, anecdotal evidence indicates that transaction volumes in these cities increased visibly after the loosening of purchase restrictions.

04 Equity market sentiment improving on the back of the property market

As the market was expecting more pro-active support measures for China's property sector, equity market sentiment improved quite visibly. Hong Kong's property equity index was up nearly 5.0% last week. With better sentiment, the Hong Kong benchmark Hang Seng Index was up 3.1% and the Hong Kong Tech Index was up 3.8%. Last week was already the fourth consecutive week that Hong Kong equities recorded positive returns.

The recent property measures could support near-term property market transactions. In particular, the government's help on buying unsold inventory could provide relief to some of the cash-strapped developers. As local government may be short of financial resources, they may need to finance these purchases through bank lending or more bond issuances.

Just last week, China announced that it would sell CNY1tn (or USD138bn) of ultra-long-term treasury bonds to enhance the fiscal support to the economy. The government plans to use the funds to develop strategic areas in China, including technological innovation, coordinated regional development, ensuring energy security and high-quality population development. This bond issuance is equivalent to more than 1% of GDP and it would be a powerful fiscal stimulus tool for the economy. With the added fiscal support from central government, we think some financial resources may be shifted to local government for property-related purposes.

Having said that, we do not expect any quick turnaround of the downward price trends in property in most Chinese cities. The current macroeconomic recovery is still quite gradual, with slight improvements in exports and manufacturing. The labour market remains challenging and jobseeking is not easy especially for younger people. Therefore, with lower income expectations, the appetite to buy properties among Chinese households could stay low in the near term. In addition, on Monday, the PBoC kept the Loan Prime Rate unchanged for this month at 3.45% for 1Y and 3.95% for 5Y. The rates are still relatively high compared to the rental yield of the properties which is around 2%. Households will therefore still have to live with negative carry and are likely to feel incentivised to repay their mortgages instead of extending them, let alone investing again, in our view. We only expect the PBoC to make a small rate cut of 15 bps to the 1Y Loan Prime Rate to 3.3% by March 2025.

Having said that, with the likely improving growth recovery in China in the second half of this year, we believe consumer sentiment may improve together with an upturn in the labour market. On Chinese equites, we think the ongoing re-evaluation of China by investors supports our expectations of a broad and sustained recovery in Chinese equities in H2 (please refer to CIO Special on China – growth key to market upside).

Glossary

CNY is the currency code for the Chinese yuan.

The Consumer Price Index (CPI) measures the overall change in consumer prices based on a representative basket of goods and services over time.

The China Securities Regulatory Commission (CSRC) is a government agency directly under the State Council of the People's Republic of China. It is the national regulatory body that oversees the securities and futures industry in China.

Foreign direct investment (FDI) is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy.

GRE refers to Government-related entities in China.

Gross domestic product (GDP) is the standard measure of the value added created through the production of goods and services in a country during a certain period.

The National Bureau of Statistics (NBS), is a deputy-cabinet level agency directly under the State Council of the People's Republic of China.

The National People's Congress (NPC) is China's highest legislative body which holds annual sessions in spring to discuss on policy matters.

People's Bank of China (PBoC) is the central bank of the people's republic of China.

Purchasing manager indices (PMI) provide an indicator of the economic health of the manufacturing sector and are based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. The composite PMI includes both manufacturing and services sectors. They can be published by public sector or private agencies (For example, Caixin, Nikkei etc.)

Producer price inflation (PPI) measures the change in prices received by producers (e.g. firms) for their output.

USD is the currency code for the U.S. Dollar.

Performance	20.5.2019 - 20.5.2020	20.5.2020 - 20.5.2021	20.5.2021 - 20.5.2022	20.5.2022 - 20.5.2023	20.5.2023 - 20.5.2024
Hang Seng	-12.2%	16.6%	-27.2%	-6.1%	1.0%
Hang Seng Tech	50.7%	42.1%	-45.9%	-10.8%	8.2%
Hang Seng China Enterprises	-6.9%	7.5%	-33.1%	-7.4%	5.6%
MSCI HK Real Estate	-27.9%	14.7%	-11.5%	-12.2%	-18.0%
China A Shares	11.6%	46.8%	-21.5%	-8.9%	-12.4%
China H Shares	-6.9%	7.5%	-33.1%	-7.4%	5.6%
MSCI China	10.2%	26.8%	-36.8%	-6.8%	3.9%
Shanghai Composite	0.5%	21.6%	-10.3%	4.4%	-3.4%
CSI 300	8.8%	31.8%	-21.4%	-3.3%	-6.4%
USD/CNY	2.8%	-9.4%	3.7%	5.2%	3.0%

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