The Impact of the Covid Pandemic on China's Real Estate Market

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Abstract. With the outburst of pandemic, the global economy is under influence, especially China's economy with its strict pandemic policies. An important section, real estate section, is impacted significantly. China's real estate market holds a paramount role in China's economy with its multiple utilities and contributes to the economy significantly. Analyzing to the data from National Bureau of Statistics of China, the correlation of pandemic and the real estate market slowdown is established. With the investigation of different reports, data, and policies, how the strict quarantines policies in different periods affects the real estate market by building up leverage issues among companies, compromising real estate construction and national productivity, and decreasing demands is shown. This research demonstrates the clear relationship between recession in both China's real market and whole economy with its Covid-zero policy and Covid-19 pandemic. It suggests the need for new monetary and fiscal policies and strategies to invigorate the real estate market and whole economy growth.

Keywords: Real Estate · Monetary Policy · COVID-19 · Chinese Housing Market

1 Introduction: History of the Opening of the Chinese Housing Market

In history, China's real estate market has undergone five stages of development, similar to Hung-Gay Fung (2009). The first stage was when China executed the "planned economy", from 1949, when China was founded, to 1978. At that time, there was no private property, which means everything was collectively owned. All real estate was owned by people and administered by governments or collectively by governments and enterprises and rented to employees at a negligible price. This strategy is called "welfare housing" which originated from the Soviets.

The second stage was between 1978 and 1987, in which a new mode called the "One Third Housing Sale Model" was designed and tried out in some designated cities. In these cities, people began to pay for one-third of new housing and could live in them without continuously paying rent. The other two third of costs were evenly afforded by governments and companies.

The third stage began in 1987 and lasted until 1991. In this period, governments sought to partly pass the responsibility of distributing housing to the market. Though

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the land was still legitimately administered by the governments, the right to exploit land was traded to enterprises when the constitution was revised to allow such a transaction. The land was reclaimed by real estate companies to build apartments which were then traded as goods to people in need. The previously existing real estate was also sold by the governments at low prices to either individuals or enterprises to circulate in the market. PAF, Public Accumulation Fund was also founded in Shanghai and gradually spread to China during this time, which aims to relieve the burden for enterprises.

As the "Reform and Opening-up" was appealed by Deng Xiao Ping, the real estate markets soared, especially in areas that were appointed to be special economic zones. In those areas, regulations on the transfer of land use rights were loosened up more, allowing the real estate market to expand with more firms developing new real estate units. Moreover, as this new market thrives, new legislation, the Urban Real Estate Law, was enforced in 1994 to protect both individuals and firms. This phase lasted from late 1987 through early 1997.

After 1998, in the fifth stage, the market experienced tremendous growth and abolished the remaining policies from the "planned economy". Firms stopped offering employees "welfare housing", and instead provided housing financial aid. To purchase real estate, individuals resort to personal income, mortgages, financial subsidies, and the PAF. The policy became more assisting than controlling [1].

2 The Stake of the Real Estate Industry in China

Chinese real estate market holds significance for two major reasons, one with regard to consumers, and the other one with regard to China's Economy as a whole.

2.1 The Dual Purpose of Housing

The Utility of Owning a Property

One of the purposes is the utility housing offers. Consumers purchase real estate to own the use right of one house when they believe a mortgage is more manageable than paying rent. Other than considering the economic aspect, Chinese traditional value also plays an important role in encouraging people to buy real estate instead of renting one. For thousands of years, having one owned housing has been a symbol of wealth and settling down. Practically speaking, when one proposes to marry, the bride and her family will consent after considering wealth aspects, in which whether owning a house or not is one determining factor. This tradition is still so ingrained in a majority of families that if private housing is missing, marriage is off the table. Moreover, owning a house to conform to social norms also secures individuals emotionally. Chinese citizens are more assured by the fact they own real estate than any other one.

The Investment Potential of Real Estate

In addition to the utility perspective, the investment function of real estate is another dispositive factor in buying it. A lot of consumers are focusing on the stable revenue of renting housing to others. In most places, especially megacities, it is unaffordable to own an apartment for workers, which leaves renting to be the only choice. Therefore, purchasing and renting apartments has become a safe and lucrative investment given that demand for rented housing is high enough for almost every housing to be leased. Moreover, from the start of the marketization of housing, the price of real estate has been burgeoning continuously. Seeing the growth of this market, a generation of people assumes that the price will always increase and never fall. Hence, it seems profitable to simply purchase a house earlier with a lower price and trade them in the future for a higher price, which is considered speculation in economics.

2.2 The Paramount Position in the Chinese Domestic Economy

The other reason why real estate is important is its paramount position in China's economy and its contribution to economic growth. The real estate market section roughly takes up 30% of China's annual GDP and provides 5% of China's working position. All these data show clearly why China's real estate market is infallible. However, there is a serious underlying problem in China's current real estate market—the leverage ratio. As the real estate market advances, more and more people see the profitability of entering this market. New firms borrow money from banks, holding the belief that this market will continue to grow. Larger companies also raise their liability to maintain their growth. The result is that a plethora of companies have a very high liability-to-equity ratio which means they are at a higher risk. Once a small part of this market changes, the chain effect is devastating. If consumers, seeing the growth of the economy and real estate market slow down, turn pessimistic about this market, the demand will shrink, leading to a recession of this market. Companies with high liabilities will crash for cash flow shortage and inability to pay loans. Thereafter, the troubles of default of these companies will further the recession of the whole market, eventually causing the collapse of the economy.

Given this fact, China has implemented a policy called "Three Red Line" recently to regulate the leverage ratio in most companies. If a company shows signs of dangerous liability to equity ratios or shortage of cash flow, it will be constricted from borrowing money. The more lines they violated the less money they can borrow. Nevertheless, companies in crises will suffer more from limitations to borrow money because with less available cash flow, it is harder to solve their existing liabilities problems [2].

3 The Impact of COVID-19

The development of the real estate market of China after the covid-19 swept China can be divided into three phases. The first stage is the outbreak of the pandemic in 2019 which crashed the real estate market in China. As China realized the significance of covid-19 pandemic, the government decided to enforce strict quarantine rules, which required all workers to work from home. The national quarantine lasted from January till April. According to Fig. 2, the YoY Growth Rate of Investment in Real Estate Development decreased by 16.3%, the Growth Rate of floor space and sales decreased by 35.9% for sales of commercial buildings sold and 39.9% for floor space of commercial buildings, shown in Fig. 3, and the growth rate of source of funds for real estate decreased by 17.5%, suggested in Fig. 1, when the work from home rule was enforced in January. The whole real estate market was severely affected since all economic production activities were stopped, the national real estate climate index being 97.4 until the pandemic subsided, and normal work restarted.

The second stage is roughly from February to the end of 2020 when the recovery of the real estate market continuously takes place. As the real estate market and governments adapted to pandemic induced real estate market growth slowdown, several new policies and strategies were developed and adopted. Governments allowed the delay of housing fee payment and completion for suppliers and more liquidity and credit for both suppliers and consumers. The consumers also reacted quickly to adopt online sales which increased the sales of real estate during the pandemic time when they could not see the houses like they always preferred to. The adjustment of both governments and the market has relieved the pressure on the real estate market, therefore contributing to the recovery process having a V-shape [3]. However, the recovery still took place very slowly with an overall growth rate being 7.0% for the whole year lower than usual since the work was restricted to prevent the pandemic from striking again. The growth rate of investment in fixed assets of the whole society, 2.7%, halved compared to 2019, and the average statistics, 6.3%, for the past three years [4].

The third stage is the entire 2021 when the real estate market continues to recover from the pandemic slowdown stage with some regulations designed for the pandemic still in effect and new policies like "three red lines" to tackle overly high liability to equity ratio issues. In this stage, the real estate market did not go back to the normal growth rate we might expect. The Growth Rate of Investment in Real Estate Development is 4.4% illustrated in Fig. 5, the growth rate of space and sales of commercial buildings sold is 4.8% for sales of commercial buildings sold and 1.9% for floor space of commercial buildings sold as they appear in Fig. 6, and the growth of sources of funds for real estate development enterprises is 4.2% in Fig. 4 [6]. Combined with the national real estate market index continuously decreasing from February to December, the real estate market was still in a recession stage. As the "three red lines" policy was executed from the beginning of 2021 to maintain a healthy credit market, a lot of developers were cut from financial backup to expand or continue the real estate development, which further

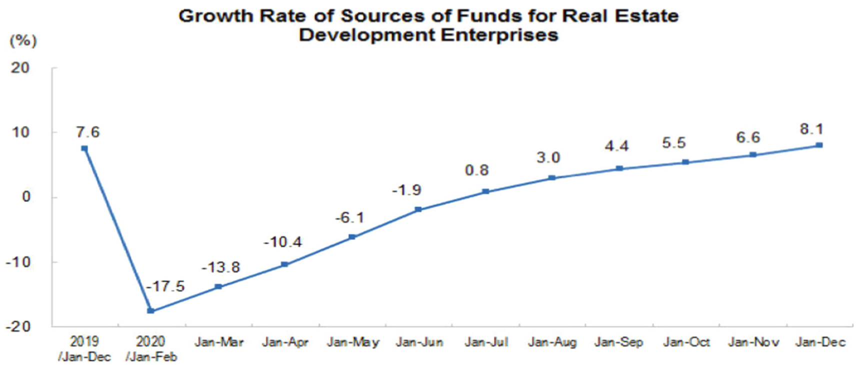

Fig. 1. Growth Rate of Source of Funds for Real Estate Development Enterprises in 2020 [5]

Fig. 2. Growth Rate of Investment in Real Estate Development in 2020 [5]

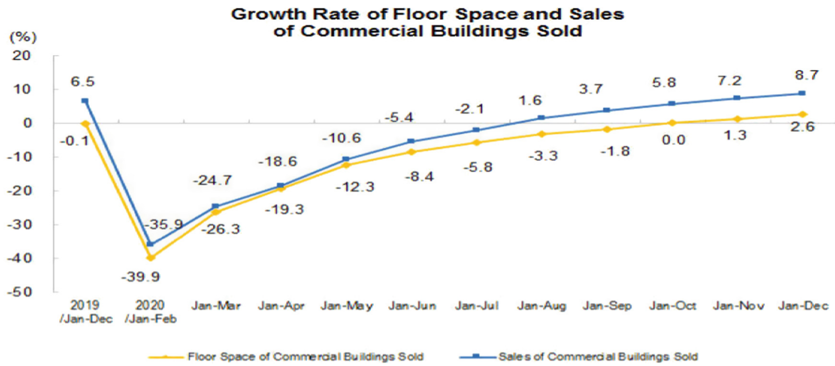

Fig. 3. Growth Rate of Floor Space and Sales of Commercial Buildings Sold in 2020 [3]

slowed down the economic growth in the real estate market. In addition, the outburst of occasional pandemic and other pandemic prevention policies all restricted the workload and productivity of the whole market.

The fourth stage is from the beginning of 2022 till recently when the highly infectious variant omicron swept the whole country again incessantly. The YTD Growth Rate of Investment in Real Estate Development continues to drop following the trend of 2021, demonstrated in Fig. 7, hitting −2.7% from March compared to the previous year. YTD Growth Rate compared to the previous year of Floor Space of Commercial buildings decreased continuously from −9.6% in January to −23.1% in July, and for Sales of Commercial buildings, the growth rate fluctuates around −30% since April, clearly seen as a sign of recession in Fig. 8. It is also shown in Fig. 9 that the YTD growth rate of sources of Funds for Real Estate Development Enterprises also averaged around −25% since April compared to the previous year. Along with the continuous decrease of the National Real Estate Climate index which fell to 95.26, the recession of the real estate industry seems to intensify even compared to the first outbreak of the pandemic in the first stage [7]. Since China insisted on its Covid-zero policy even when omicron appeared, economic progress was severely constrained to maintain zero infection. A good

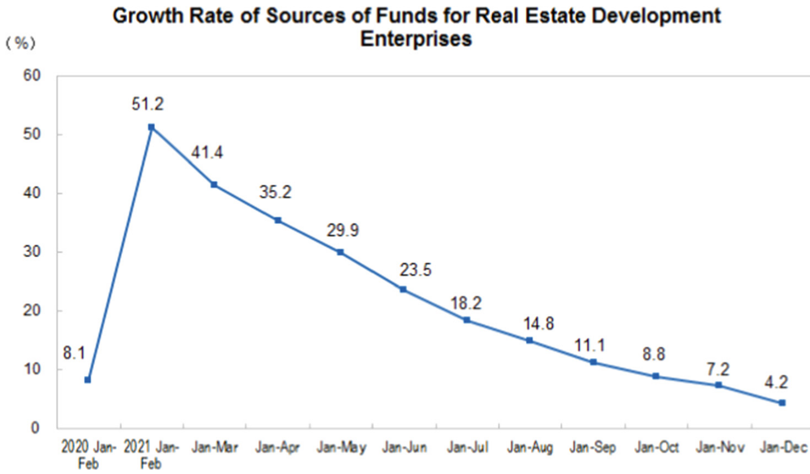

Fig. 4. Growth Rate of Sources of Funds for Real Estate Development Enterprises in 2021 [6]

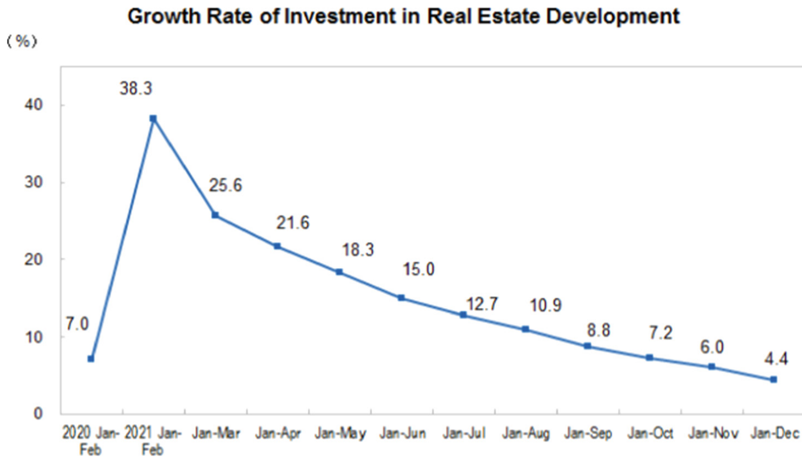

Fig. 5. Growth Rate of Investment in Real Estate Development in 2021[6]

example of this is Shanghai's lockdown for over a month when everybody was locked completely in their home. Megacities like Beijing suffering from constant outbursts of infection had to lock down working areas and quarantine workers nonstop. The slowdown of the entire economy puts pressure on both developers and consumers. Building on the pressure imposed by policies like "three red lines", companies like EverGrande experienced serious liquidity problems which led them to halt the construction process for pre-sold houses. Consumers who suffered in the economic slowdown, including people who lost their jobs, even threatened to stop paying mortgages in reaction [8]. Although companies and consumers were aided to get through this crisis with financial

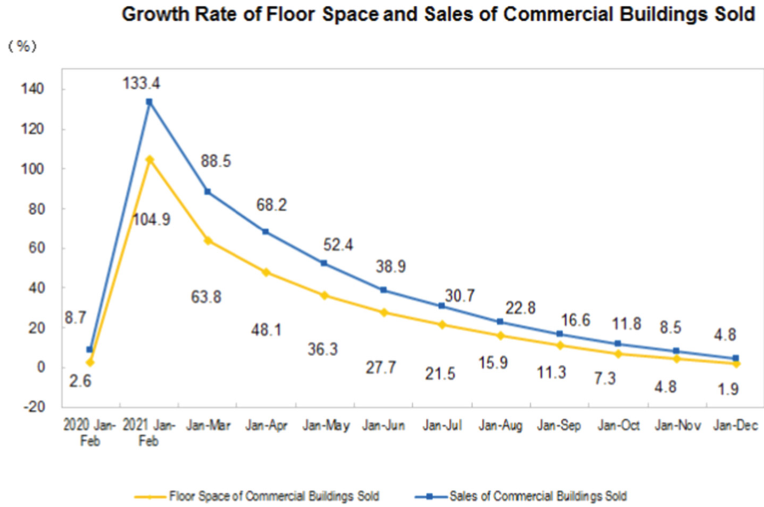

Fig. 6. Growth Rate of Floor Space and Sales of Commercial Buildings Sold in 2021 [6]

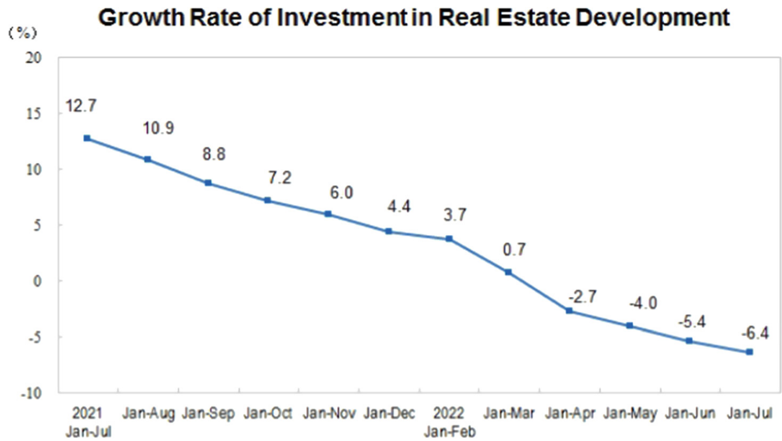

Fig. 7. Growth Rate of Sources of Funds for Real Estate Development Enterprises in 2022 January–July [7]

aid and policies published earlier loosened, the real estate market continued to suffer with the Covid-zero policy still in effect.

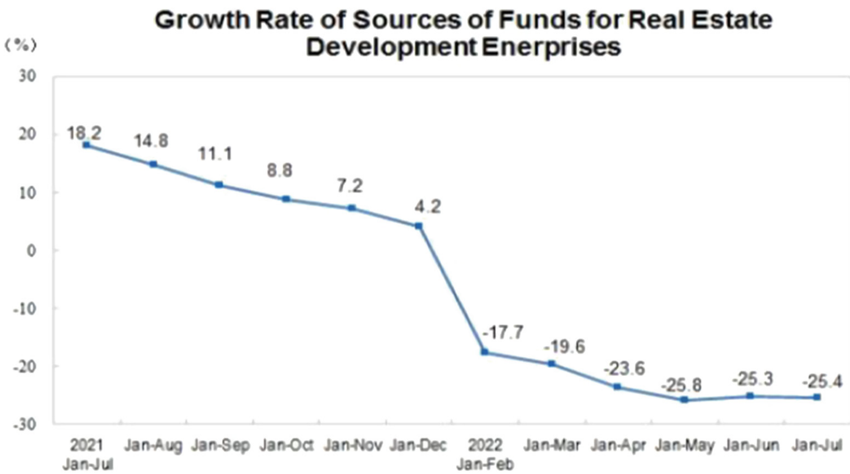

Fig. 8. Growth Rate of Investment in Real Estate Market in 2022 January–July [7]

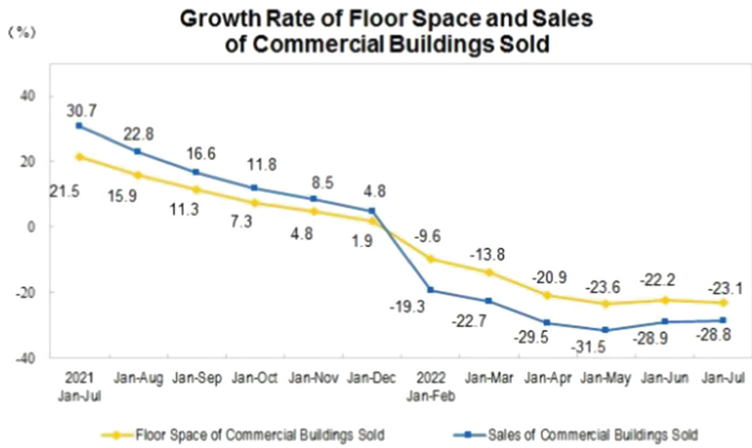

Fig. 9. Growth Rate of Floor Space and Sales of Commercial Buildings Sold in 2022 January–July [7]

4 Conclusion

All in all, the real estate market in China has come a long way to prosper before the pandemic. Given its significant role in Chinese people's hearts and its contribution to China's economic growth, it is too important and big to fall currently. The above data and analysis have shown how Covid-19 compromised this important market and caused several long-standing problems like a liability that reciprocally heightens the effect of Covid-19 to slow down the real estate market and the whole economy further. Due to the Covid-zero policy, China's economy never returned to its full capacity in terms of work and utilization of resources in the past three years. Now that this policy was recently lifted, we may want to focus on how China's real estate market continues to deal with an infection-induced slowdown, and how it may adapt and continue to evolve. To fully recharge economic growth, governments and central banks might also need to consider monetary stimulus. For example, lowering mortgage rates or proving other subsidies for home buying can effectively relieve some pressure on consumers and revive the real estate market as well as the whole economy. Finally, another great way is to pull the demand by increasing direct investment by state-owned companies.

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