

How much longer will the bust in Chinese housing last?

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Schroders says China likely to miss its GDP targets this year – and much more decisive policy action required for it to start beating growth expectations again.

The August data round from China brought little cheer and suggested that sequential GDP growth in the third quarter may not show any improvement from the 0.7% quarter-on-quarter increase in Q2. That is some way off levels of growth required to achieve the country's 5% target.

While exports continued to beat expectations last month, the domestic economy remained weak as consumer and investment spending fell short of consensus forecasts.

On Tuesday, China's financial regulators announced a host of fiscal stimulus measures at an ad-hoc press briefing. Notwithstanding these initial fiscal stimulus measures, we still think China will miss its 5% GDP growth target this year, and that economic activity will cool even further in 2025 unless further action is taken by Government.

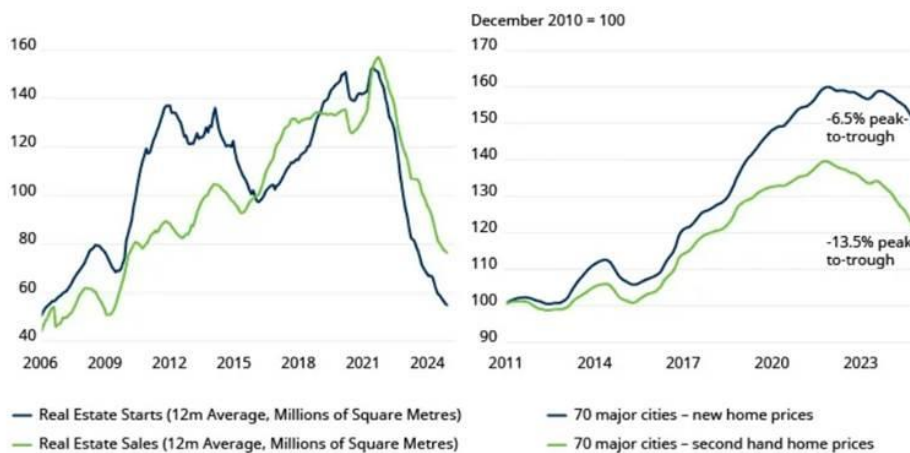
In the absence of additional fiscal measures equivalent to 4-5% of GDP geared to the demand side of the economy, including additional support for the housing market, the risks to our forecast are to the downside.

Housing crisis continues to weigh heavily

There are some bright spots in the domestic economy, such as investment in manufacturing and infrastructure. But the bigger picture is that the housing crisis continues to weigh heavily on the economy both directly through real estate activity and indirectly via shattered confidence and wealth effects.

Housing sales continued to tumble in August and have now fallen by more than 50% since mid-2021 to levels last seen in 2010. The collapse in housing starts has been even deeper, while official data show that house prices also continued to fall last month. This has left prices of new and second-hand homes down about 6% and 13% respectively since mid-2021.

China's housing market has still not found a bottom



Source: LSEG Datastream, Schroders. 613587

All of this begs the question of how much longer will the housing bust go on? According to our analysis of data from 20 major economies published by the Bank for International Settlements (BIS), on average house price corrections last almost six years with peak-to-trough falls in nominal prices of almost 30% (see table, below).

Moreover, house prices typically take another six years or so to recover to their prior peaks, and in some cases such as Japan and Spain it takes much longer to recoup the losses if they ever are recouped.

That would imply that the current housing correction in China has roughly three years to go, implying significant further falls in house prices. If anything, it could be argued that the slump in China will last longer than average given the degree of overvaluation in the housing market and demographic trends, which imply structurally weaker long-term demand for real estate. Meanwhile, the authorities have been resisting market forces through regulations such as price controls.

How much pain is there to come?

Country	Dates of house price correction	Years to trough in house prices	Peak-to-trough fall in house prices (%)	Change in real consumption growth during house price falls (%-pt) ¹	Change in core inflation during house price falls (%-pts) ²
Brazil	2015-2017	2.75	-5.5	-6.5	0.0
Denmark	2007-2011	4.25	-19.6	-2.1	+0.3
Finland	1989-1993	3.75	-40.4	-7.6	-2.7
Greece	2008-2017	9.0	-42.4	-10.0	-2.6
Hong Kong	1997-2003	6.0	-65.0	-6.5	-8.2
Hungary	2008-2012	4.25	-17.2	-5.9	-2.6
Ireland	2007-2013	5.0	-54.0	-6.7	-2.3
Japan	1991-2012	21.8	-45.9	-2.9	-2.2
Netherlands	2008-2013	5.25	-20.6	-2.6	0.0
Norway	1988-1993	5.0	-31.9	-6.8	-4.3
Portugal	2008-2013	5.0	-15.8	-4.2	-1.6
Romania	2009-2014	5.5	-27.8	-9.4	-2.1
Russia	2015-2017	2.5	-10.9	-10.5	+1.3
South Korea	1991-1999	7.5	-21.5	-3.2	-1.2
Spain	2007-2014	6.5	-36.9	-5.4	-1.2
Sweden	1991-1993	2.0	-20.2	-1.5	-1.6
Thailand	1998-2001	1.25	-26.9	-11.5	-2.0
UK	1989-1992	3.25	-12.3	-3.0	-1.4
UK	2007-2009	1.5	-17.8	-3.3	+0.4
US	2006-2011	5.0	-31.2	-2.5	-0.3
Average		5.5	-28.5	-5.6	-1.6

¹Difference between the annual rate of private consumption growth in the decade prior (or nearest where data not available) to the peak in house prices versus the rate of consumption growth during the period that house prices were falling.

²Difference between the annual rate of core inflation in the decade prior (or nearest where data not available) to the peak in house prices versus the rate of core inflation during the period that house prices were falling. Headline inflation used where core inflation not available.

Source: BIS, LSEG Datastream, Schroders. 613587

Our analysis also shows that housing corrections tend to have significant implications for the broader economy. Of the major economies that we analysed, private consumption growth was on average 5-6 percent points (%-pts) slower during housing corrections than in the prior decade to the peak in house prices.

Weaker demand conditions also typically shaved almost 2 %-pts off the annual rate of core inflation. And while many of the housing crises we analysed occurred during regional or global events such as the Asian and Global Financial Crises of the late 1990s and mid-2000s, the economic impact of other, idiosyncratic house price crashes were broadly similar.

Conditions clearly call for more aggressive policy action

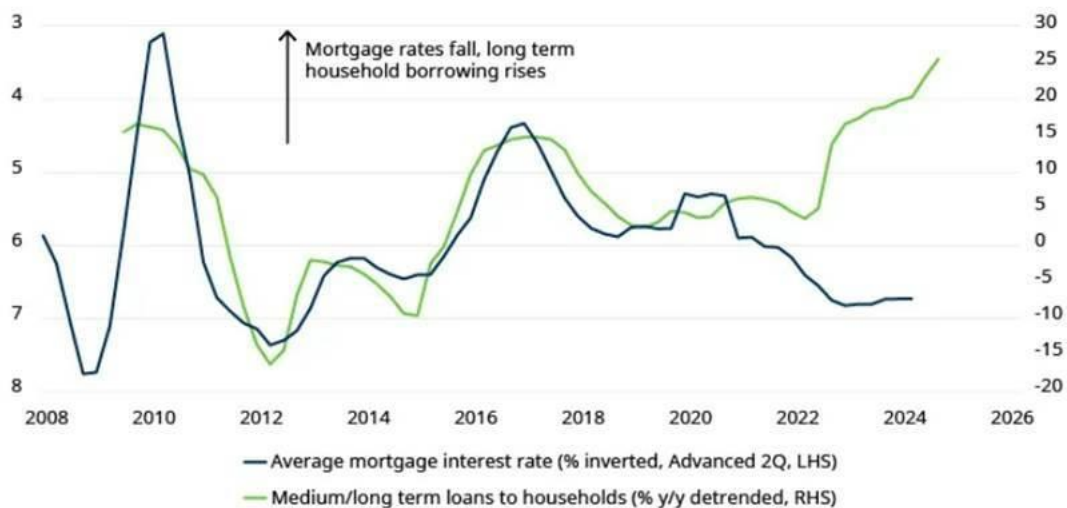
This chimes with our view that economic growth in China will remain subdued and that expectations for inflation to pick up next year are optimistic.

If anything, consumption growth in China has so far been relatively resilient. While it contributed about 4 %-pts to GDP growth in the decade prior to the mid-2021 peak in house prices, it is currently adding about 3%-pts. This suggests that there is more downside to consumer spending in the event of a protracted housing correction. And with core inflation already barely rising month-to-month, and the economy over-supplied and highly leveraged, we think outright deflation remains a clear risk.

The upshot of all of this is that macro-economic conditions in China clearly call for more aggressive policy action. It seems clear that past policy initiatives to stabilise the housing market, such as lower mortgage interest rates and lighter regulations on property purchases, have not worked.

Certainly, the wedge that has opened up between mortgage interest rates and mortgage borrowing (proxied by household medium- and long-term borrowing) implies that potential homebuyers in aggregate are not willing to buy real estate at any level of mortgage rate.

Lower mortgage rates have been completely ineffective

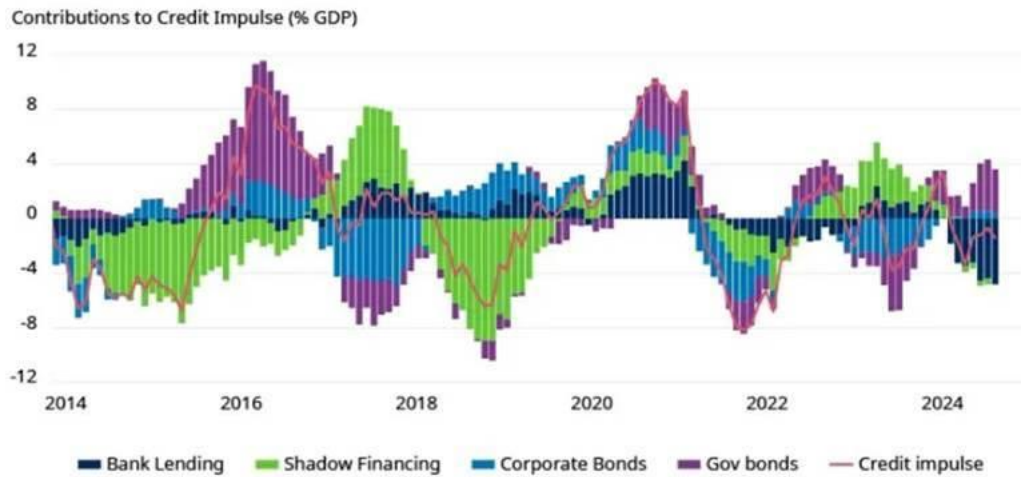


Source: LSEG Datastream, Schroders. 613587

Fiscal stimulus has been supportive of activity in some sectors such as infrastructure investment, but it has so far not been big enough to offset the housing crunch. Indeed, as the breakdown of the credit impulse shows, while government bond issuance has been a positive force, weak bank lending has dragged the credit impulse down.

Given that the credit impulse typically leads activity by about nine months, this is a negative signal for activity in 2025. And with the impulse from government bond issuance starting to lose steam, the outlook may deteriorate further in the coming months.

Weak private sector demand for credit is weighing on the growth outlook



Source: LSEG Datastream, Schroders, 613587

The government has so far remained reluctant to deliver additional support to the economy. One reason for the lack of action might be that the steady deterioration in public sector debt dynamics has simply left less room to stimulate that in the past. This could perhaps tilt future policies more towards reforms and monetisation of state assets.

However, it may simply be the case that policymakers are waiting for the result of the pivotal US election in November, given that the outcome could have major implications for China's economy and financial markets. Either way, much more decisive action is required if China is to start beating expectations again.