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Domestic and Global Impacts of China's Real Estate Crisis

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Abstract: A real estate crisis has occurred in China since around 2020. China's economy has been seriously impacted since the real estate sector is a significant part of China's GDP. This crisis would lead to impacts on both the domestic economy and the global economy. The domestic impacts include a fall in consumer confidence, rising unemployment, increased financial instability, and decreased government revenue; the global impacts include negatively influenced trading markets, a rise in risk for foreign investors, and stress on the international monetary system. To address the problem of the real estate crisis, the Chinese government has implemented some policies, including re-lending to commercial banks, lowering down payment thresholds, reducing mortgage interest rates, and loosening criteria for qualification of first-time buyers. To resolve the crisis, the government should aim to reduce the significance of real estate to the overall economy. This process should be gradual while progressive policies should be implemented. Policies that aim to directly contract or expand the market could be dangerous for the economy due to the significance of the real estate sector.

Keywords: China, Global impact, real estate.

1. Introduction

The property market has long been a significant sector of China's economy, accounting for approximately 25% of the nation's GDP [1]. However, since around 2020, there has been a great fall in China's real estate sector. From 2021 to 2023, property sales by value in China fell from over 15 trillion yuan to less than 12 trillion yuan. In addition, new residential developments have decreased by 58% from 2019 to 2023 with a fall of 6% in new property sales in 2023 [2].

This paper will mainly discuss the causes of the real estate crisis, the domestic and international impacts of the crisis, and government policies with evaluation. The domestic impacts of this crisis include a fall in consumer confidence, a rise in unemployment, stress on the financial system, and decreased government revenues; the global impacts of this crisis include negatively influenced supply chains, higher risks for foreign investors, and stress on the international finance system.

There are a few factors that led to this real estate crisis, and one of them is the shrinking population of China. This is mainly caused by the aging population and low birth rates. As the population shrank, the demand for houses fell, which would therefore lead to a fall in housing prices.

Unemployment, or pessimism of consumers about jobs, is one of the causing factors of this real estate crisis as well. The instability of real estate developers also contributed to the crisis. The beginning of this crisis is marked by the fall of two of the largest developers in the industry:

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Evergrande and Country Garden. Country Garden faced a liquidity crunch with a debt of $205 billion while Evergrande defaulted on over $300 billion [3].

2. Domestic Impacts of the Real Estate Crisis

2.1. Consumers/Society

The real estate crisis would lead to a higher rate. The fall in property prices and rise in the unemployment rate form a negative feedback loop. First, according to the wealth effect theory, when the house prices dropped, people who owned houses felt less wealthy. Then, consumers were less confident about their assets and tended to be more financially insecure. As a result, consumer expenditure, which is one of the factors in GDP, falls, contributing to a decrease in GDP. In China, the real estate sector accounts for 77.7 % of household assets on average [4]. This large proportion of the real estate sector makes the wealth effect even more significant in China, leading to a larger drag in aggregate demand. This fall would affect China's overall economy, so the unemployment rate would rise in all industries other than just real estate. Additionally, a crisis in the property sector would contribute to a shrink in the number of job opportunities in the industry, which would raise the unemployment rate as well [5].

2.2. Consumer Confidence and the Wealth Effect

The financial impact of fluctuations in the real estate sector is directly reflected in the indirect financing sector, which is dominated by banks, both in terms of real estate development loans and individual housing mortgage loans, which are affected at different times.

In a residential development cycle, according to China's bank loan policy, real estate developers in the payment of the government's land premium and the initial construction capital investment of 30%, then began to need bank loan support, 70% of the housing construction funds from bank loans, repayment from the sale of housing back to the bank, and the bank will also be the corresponding land and buildings as collateral, which is the second source of repayment. This is the first stage of real estate development and is a corporate loan with a term of three to five years. When housing is built to the point where it is ready for sale, the development company sells it and the individual consumer buys it, converting it into a mortgage loan with the individual as the borrower, which is the second stage of housing development and can last up to 30 years [6].

Both phases of lending are based on the assumptions that housing prices are stable and predictable, that there is liquidity in the market, that there is demand for housing, and that lending policies are stable. However, when housing prices are repeatedly restricted and homebuyers are unable to borrow, there is bound to be a lot of pressure on the sale of homes, and pressure on the sales chain will further affect sales returns and development loan repayments.

What are the possible consequences? the development loan cannot be repaid, and the bank faces non-performing loans due to the broken capital chain caused by delinquent supplier payments, construction payments, and other behavior, cannot deliver the building according to the progress. Personal loan customers, may therefore cut off the mortgage, and stop paying monthly each month to pay back the bank's loan. The above situation will be in both corporate credit and personal credit in into non-performing loans [7].

In addition to the bank-based indirect financing market, the real estate industry has two other financing base camps: the stock market and the bond market, almost all of China's large real estate companies are listed companies (Vanke), and there are also more real estate companies active in the bond market, and even issue perpetual bonds (Evergrande), overseas bonds and so on. Once the real estate market had the emergence of large-scale default problems, the bond market was also facing

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large-scale defaults, such as Evergrande Real Estate and other outbreaks of bonds to stop the payment of the storm. Overseas bond defaults will even indirectly affect China's credit rating [8].

The formation of a large number of non-performing loans will cause instability in the financial market, which is reflected in the following aspects: In the era of high real estate, some banks attach importance to the development of the industry while ignoring the management of the concentration of the industry, the banks in the real estate industry to form a higher level of non-performing assets in the period, it will be because of the concentration of too high, and suffer a greater impact, the provisioning of a high level of provisions, erosion of the level of profits. The securities market and the bond market will suffer the corresponding impact, thus leading to a sharp decline in profits, the lack of investor information, and then withdrawal from the market. 3, the real estate market fluctuations on the residents of the consumer confidence to deal a great blow to the purchase of housing as the residents of the largest consumer spending, the decline in this consumption, has a direct impact on the residents of the overall consumer confidence and spending.

The real estate crisis would lead to decreased government revenues. Normally, the developers purchase land from the government. When the residential property price rises, the developers tend to buy more land, contributing to the government revenue. However, when the house prices dropped, few developers would buy land from the government, therefore hurting the government's revenue. In addition, the government has implemented policies to promote the real estate market, the cost of which would come from the government revenue. For example, the lending policy of 300 billion RMB was implemented, costing the government revenue. This revenue mainly comes from tax, so the tax rate would also rise to cover the loss of revenue. The lowered government revenue would also lead to less revenue spent on other sectors, like public service and social benefits, which would hurt citizens' well-being.

3. Global Impacts

The global trading market would be negatively impacted by the real estate crisis. The most severely impacted would be the supply chain. Since the real estate sector has been significant in China's economy, there have been materials imported from abroad. With the real estate crisis, the construction of residential properties was greatly reduced. This would lead to a decrease in the import of goods related to residential property construction. In addition, the situation of foreign investors would be worse off. With the house price dropping, the risk of foreign direct investment increases. The international financial system in general would be impacted as well. As mentioned above, the real estate crisis would have a significant negative impact on China's economy due to its large proportion of GDP. On a global scale, China is one of the biggest economies in the world. As a result, damage to China's economy would impact the global economy.

To minimize the negative impacts of the real estate crisis, the Chinese government has already implemented some policies. One of these policies is the re-lending of 300 billion RMB to over 21 commercial banks. In addition, the government has lowered down payment thresholds from 25% to 15%. Mortgage interest rates have been reduced by 0.25 percentage points, and now there are more relaxed criteria to qualify as a first-time buyer. To minimize the impact of the real estate crisis, the government should be making efforts to lower the significance of the real estate sector in China's economy. However, this process should be gradual, and policies should be progressive. The significance of the housing market makes it dangerous to implement any policy that aims to expand or contract it.

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4. Conclusion

Various types of new policies summary: Among the new real estate policies issued by all levels of government, there are several types of policies to stimulate the market: tax policy, such as reducing the transaction of the deed tax, etc., to reduce the cost of purchasing a home. Financial policy: By reducing interest rates, stabilizing the supply of real estate development funds, and guaranteeing the delivery of the building. There are also approaches to ensure the supply side of the market to stabilize the activity of the supply side of the market. For example, in China, about 297 cities government established a financing coordination mechanism, in order to ensure that Real estate development enterprises that meet the requirements can obtain loan support from commercial banks, so as to ensure the delivery of the project on schedule; on the other hand, is the stimulation on the demand side of the market, starting from the reduction of the down payment ratio, lowering the interest rate of the home loan, in order to enhance the willingness to purchase housing consumption and reduce the difficulty of people purchasing a home. Other policies: reduce or cancel the restriction of apartment purchase policy, encourage housing replacement, or purchase of the second apartment or more.

Real estate plays an important balancing role in the smooth development of the national economy, and there have been many financial crises caused by real estate bubbles in history. Although the Chinese government has introduced a series of policies to reverse the real estate economic downturn brought about by the decadence, in any case, real estate this round cannot embark on the old way of blind investment, and extensive development. The future of the real estate economy will continue to explore the practice several times, to safeguard the well-being of people's livelihoods, drive upstream and downstream industry chains, and promote the consumption of growth in the economy, steadily rebounding this several aspects of balanced development.

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