

# Analyzing the Decline of China's Real Estate Market: Policy, Market and Future Strategies

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**Abstract.** In recent years, China's real estate market has been unstable and under pressure due to various kinds of factors in the current stage of China's economic development. The central government has actively responded to adjust its economic problems and implemented different policies, but due to obstructions from all aspects, the policies have not been successful. This paper examines the recent decline in China's real estate market, attributed largely to excessive housing speculation and ineffective government policies. Despite initial successes in stimulating housing demand, these policies have failed to address the underlying issues exacerbated by broader economic factors. The paper analyzes the recession from two perspectives: government policies and national economic development and offers recommendations for future actions. It reviews the historical role of real estate in China's economic growth, explores the causes of the market bubble, and proposes long-term strategies to mitigate the ongoing downturn and safeguard economic stability. According to the conclusions drawn in this article, a more favorable development policy for China's future economy should be to gradually move the real estate market away from finance and towards residential development. However, such a change requires a certain amount of easing time and appropriate judgments should be made based on the development of China's economy.

**Keywords:** Real estate bubble; Economic impact; Government policies.

## 1. Introduction

It's been a tough time for China's property market recently. Excessive speculation in the housing sector has led to a decline, which is really unfortunate. The government has come up with lots of great policies to help the economy grow through the property sector. These measures have been pretty successful in encouraging people to buy homes in the short term. Nevertheless, there is a possibility that they may be unable to effectively address the more significant economic challenges over an extended period of time. Given the multitude of external factors that exert influence over China's economy, it is plausible that the prevailing policies may no longer represent the optimal fit for the property market. Such an outcome could potentially exacerbate the situation.

The government has been exerting considerable effort to regulate the market and improve conditions, yet thus far, these endeavors have not yielded the desired results. This paper will examine the causes of the decline in the property market from two main perspectives: government policy and macroeconomic developments. In addition, recommendations will be presented based on these findings, with consideration of potential future scenarios.

The property sector has been a significant contributor to China's economic growth over the years, with notable developments occurring during this period. However, the recent challenges have had a notable impact on the country's economic progress. As the property market has become a bit of a worry, this paper looks at how it's been doing and what the problems are.

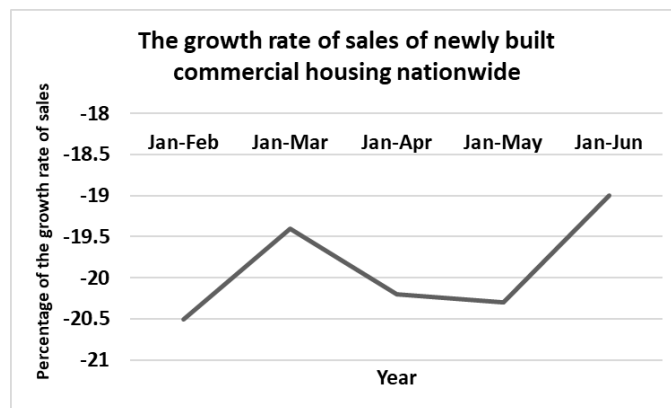
The paper is set out like this: the second section looks at how the property market has developed and how the bubble economy came about. The third section looks at what caused the property bubble and why the market has been in decline. Finally, the fourth section suggests long-term policy responses based on what we've learned about the real estate sector.

## 2. Development Process of China's Real Estate

Private property existed in China until the 1980s, when the government began selling land use rights. During the rapid urbanization of the 1990s and 2000s, large numbers of people migrated from rural areas to cities in search of better employment opportunities, which fueled demand for housing. This led to an enormous construction boom in the 2000s.

However, the price of real estate was growing rapidly not only due to increasing demand but also because land ownership in China was monopolized by the government. The government controls land supply and raises land prices to maximize profit [1]. Because of the continuously growing prices of housing, houses transitioned from being mere living spaces to investment assets, real estate has been a popular investment vehicle in China, often seen as a safer and more lucrative option compared to the stock market. In addition to investing in ready-made houses, private property offered a large number of pre-sold units, encouraging further investment. The funds received by private property were used to complete houses that had already been sold, ensuring delivery to buyers.

In recent years, as a result of the bubble economy, developers have taken huge number of debts, which are often financed through shadow banking and other non-traditional means, posing significant risk. From the year-on-year growth of house sales from January to June 2024, although there are some fluctuations, the overall growth rate has been negative (Figure 1); and the growth data related to the real estate market, such as real estate development investment and housing construction area, all show a negative growth percentage (Figure 2). It can be seen that the bursting of the real estate market bubble has led to a series of negative impacts that are difficult to save in the short term.



**Figure 1.** The growth rate of sales of newly built commercial housing nationwide.



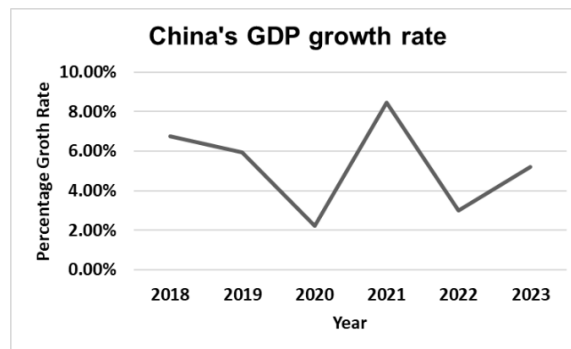
**Figure 2.** National real estate development and sales from Jan to Jun 2024.

### 3. Factors Contributing to Real Estate Risks

#### 3.1. Bubble Economy

The real estate bubble was largely caused by China's economic system. China's economic growth depends on the real estate market. To stimulate the domestic economy, the Chinese government strongly supports the development of the real estate market and encourages future financial products, which has led to houses gradually becoming investment products [2]. People buy houses in large quantities, driving up housing prices [3]. The rapid increase in demand has caused prices to be inflated, forming a real estate bubble [4]. This bubble lasted for many years, and the reason it was able to maintain was that despite the high housing prices, people could still afford it and were very optimistic about the prospects of real estate. In recent years, the central government has proposed "housing is not for speculation", which has severely hit the real estate market speculation, resulting in a large number of vacant houses that cannot be sold, and there is not enough money to complete the construction of houses. Many small real estate companies have therefore withdrawn from the market; at the same time, the domestic economic situation is not as good as before, people are worried about future economic development and are unwilling to spend money to buy houses.

#### 3.2. Overall Economic Challenges



**Figure 3.** China's GDP growth rate.

The primary reason for the decline in China's real estate market is the high social leverage and reduced social consumption capacity. The recent economic development in China has been less than ideal. China's GDP shows a long-term positive growth trend, but the growth rate has generally declined from 2018 to 2023. Although GDP grew significantly in 2021, with a growth rate of more than 8%, it quickly fell back to about 3% in 2022; compared with 2022, the growth rate in 2023 has increased slightly, but it is still lower than that in 2018 (Figure 3). As a major exporter to many developed countries, China has faced a decline in export volumes in recent years, with European and American countries relocating their manufacturing to Vietnam and other developing countries. Moreover, China's ambition to achieve currency internationalization like the United States requires the circulation of its currency in the international market. China's policy to transfer low-end industries overseas and maintain medium and high-end industries is flawed. The high-end manufacturing sector is thriving, and low-end industries are naturally disappearing or relocating. However, the administrative forceful withdrawal of low-end industries has led to numerous closures or relocations to Southeast Asia, further exacerbating economic difficulties.

#### 3.3. Government Policy

##### 3.3.1. Factors that cause bubbles to burst

To rectify the real estate market, China issued new regulations in 2020, known as the "Three Red Lines", which aim to reduce leverage among property developers; first, the liability to asset ratio should be less than 70% to avoid too many liabilities; second, the net gearing ratio, which is a way of measuring debt compared to equity, should be less than 100%; third, the cash to short-term debt ratio

should be no more than one. Many private properties fail to meet these criteria, preventing them from contracting more debt to fund their ongoing projects, ultimately leading to bankruptcy.

Monetary policy has a big impact on the property market [5]. Back in 2012, the central bank made things easier by cutting both reserve and benchmark lending rates twice. They kept this up with more rate cuts in 2014 and even more in 2015, which really heated up the property market. But starting in 2017, things began to change. The central bank started to tighten its approach. By 2020, they introduced a new strategy aimed at better managing the economy over different cycles. Then in 2022, they proposed changes to improve how policy interest rates are set. This shift from a more relaxed to a stricter monetary policy helped slow down speculation and cool off the overheated market, which in turn contributed to the decline in the real estate sector.

### **3.3.2. Inefficient New Policy**

Recently, the government has implemented three major policies to help the real estate market recover. First, it has reduced the down payment ratio: for the first home, the down payment requirement has been lowered from no less than 20% to no less than 15%, and for the second home, from no less than 30% to no less than 25%. Second, mortgage interest rates have been lowered to encourage home purchases through loans. Third, the government has allocated 300 billion yuan to local governments to buy back existing housing and reduce housing inventory. However, in my opinion, these policies lack sufficient strength to address the root causes of the issue.

Specifically, the effectiveness of the third policy is questionable. To alleviate the pressure from excess inventory, about 770 million square meters of housing sales would be needed, which would require roughly 7 trillion yuan. In contrast, the 300 billion yuan provided is just a small fraction of what's needed.

Moreover, the first two policies might not be adequate either. The government seems to overlook the fundamental reasons behind the lack of housing demand. The assumption that high loan interest rates are the main barrier to home purchases doesn't fully address the underlying issues.

## **3.4. Epidemic and Aging Problems**

### **3.4.1. Factors that impact the real estate market negatively**

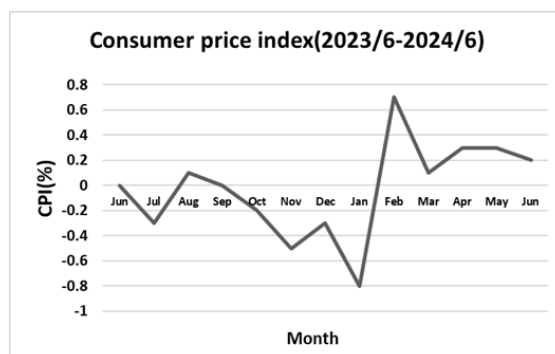
A significant proportion of people decided to return to rural after covid-19 epidemic due to a job crisis, further reducing housing demand [6]. Additionally, the Chinese government's crackdown on private enterprises caused private entrepreneurs to reduce confidence, leading them to withdraw business capital and invest abroad. During covid-19 epidemic, China implemented a "dynamic zero-clearing policy", which also hit China's economy, which adversely impacted the economy [7]. As a result, people lost confidence in the economy and preferred to save money rather than invest it, leading to stagnation of liquid assets and eventual deflation. From the CPI index chart from the second half of 2023 to the first half of 2024, we can see that the CPI index in the second half of 2023 is a negative percentage, and shows a downward trend; although there was a relatively obvious growth rate in January 2024, it fell rapidly to a relatively stable level in the following months. The biggest difference between the CPI in the first half of 2024 and the second half of 2023 is that the CPI index in the first half of 2024 is positive, reflecting a certain inflation trend (Figure 4).

As China's economy develops, the country's population is aging [8]. National aging is a common problem faced by every developed country, and for a country with a rapidly developing economy like China, this problem has gradually emerged. For this situation, a series of problems have arisen, and the most critical one is that the demand reduction has affected the development of the real estate market. People's demand for material things may not be as good as before, and house sales have become one of the problems.

Moreover, this recent years' epidemic has significantly boosted the development of the Internet, particularly in the live streaming and e-commerce sectors. Many people now prefer online shopping over physical stores due to lower prices and time efficiency. However, this economic model also

presents a problem: the decline in offline store jobs leads to unemployment. When people buy the same products at lower prices, GDP declines, and government tax revenue is affected.

In addition, as China's economy continues to develop, some problems that exist in economically developed countries have gradually emerged in China's economy. One of the most obvious ones is the aging of the population. It is very different from China's policy more than ten years ago. In the past, having a second child required paying extra fees to the country. But now, on the contrary, the country has opened up the second-child policy to encourage having children. This also reflects that China's development process has spanned a new stage. But at the same time, problems also arise. The aging of the population indirectly affects housing demand and slows down economic activity. This is an unfriendly signal for the real estate market.



**Figure 4.** Consumer price index.

### 3.4.2. Consequences

The demand for housing dropped due to rapid aging, the main reason is the share of Chinese household income in GDP is declining year by year, making it difficult for people to afford additional houses. At the same time, as disposable income is insufficient, mortgage pressure has increased.

High mortgage pressures and low disposable incomes create a vicious cycle: declining consumption leads to falling corporate profits, layoffs, job losses, loan defaults, and bank failures. The aging population exacerbates the issue, as housing unaffordability discourages childbearing. Even with relaxed birth policies, the willingness to have children has not significantly increased.

## 4. Solutions

China's real estate crisis is inevitable, serving as a direct signal that the country must reduce its economic dependence on real estate. National development is not without mistakes and setbacks. China should recognize the underlying national issues highlighted by this real estate crisis and firmly resolve to implement necessary changes [9].

The first step to solving the housing crisis is to lower the price of land. Most developers purchase land at high prices and subsequently sell houses to the public at elevated prices, resulting in substantial financial transfers from the public to the developers. While it appears that developers reap significant profits, their profit margins are not as high as presumed; often, not even half of the sale price of houses. A substantial portion of the money goes to the central government. Therefore, reducing land prices can enhance developers' purchasing power and indirectly lower housing costs for the public.

Considering the macro factors driving the economy and the interaction between the real estate market and the economy, improving the quality of life of Chinese residents can also improve the real estate economy. According to statistics, the average annual income of Chinese citizens is 23,000 yuan, of which a significant portion is used to pay taxes to the state. This implies that from a monthly salary of 2,000 yuan, various taxes are deducted, while the actual average monthly income is slightly more than 10,000 yuan. This heavy tax burden is a considerable economic strain. Reducing taxes to increase people's disposable income would encourage consumption. For essential needs such as housing, enhanced economic capacity will naturally lead to increased purchases.

Additionally, increasing investment in education and healthcare is crucial. One reason for the decline in confidence in the domestic economy is the inadequate education system and healthcare benefits in China. Although China implements nine-year compulsory education, this policy does not ensure equal educational resources or quality. Parents aspire for their children to attend prestigious schools, but opportunities are limited, and policy constraints require significant effort from children to gain admission to good schools. This has led to reluctance among many families to have children due to poor state welfare, the high cost of child-rearing, and insufficient state support for education, exacerbating the problem of declining fertility.

Moreover, while China's medical advancements have been remarkable, medical expenses remain a significant concern for the general public. Although there is now state medical insurance, it is not substantially effective, and medical treatment, particularly for serious illnesses, is still costly. This financial strain discourages people from spending, leading them to save extra income rather than spend it, in case of future medical expenses. Increasing investment in education and healthcare can indirectly address the current domestic deflation problem, encourage consumption, and alleviate the real estate issue.

## 5. Conclusion

The ongoing crisis, marked by elevated levels of debt among developers, speculative overbuilding, and a shifting demographic landscape, underscores profound structural deficiencies within the economy. Government interventions in land price regulation, alongside policies such as the "Three Red Lines," have imposed both immediate and enduring pressures on the real estate sector. Despite recent efforts to stimulate the market, such as reducing down payments and mortgage interest rates, these measures may prove inadequate in addressing the fundamental economic vulnerabilities.

To effectively resolve the current challenges facing China's real estate sector, it is imperative for the government to enhance financial support for the market to facilitate its recovery [10]. Considering the pandemic's extensive impact on economic development and prevailing economic trends, the central government must undertake a thorough analysis and implement strategies to restore pre-pandemic economic conditions. This approach should aim to bolster public confidence in future economic prospects, thereby stimulating economic activity and promoting consumption.

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