

China: Significant Policy Change in Property Market

China's Ministry of Finance announced yesterday evening (Wed 22 Oct) a series of sweeping changes to the property market which include lowering of downpayment requirement and mortgage interest rates. Among the changes announced:

- Downpayment for first homes (regardless of size) is lowered to 20% from 30%;
- Mortgage interest rate is now pegged at 0.7x of benchmark interest rate, from 0.85x;
- Deeds tax (for home transactions) will be cut to 1% (from 1.5%) for first homes smaller than 90sqm;
- Stamp duty (at 0.05%) for purchases and sales will be scrapped temporarily;
- Value-added tax for land sales will be suspended;
- The govt will accelerate construction of low-rental housing and boost subsidies for lower-income households;
- Local govts are allowed to issue own policies to encourage home purchases.

Implications

The latest policy move effectively reversed tightening policy introduced in 2005 in the sector, in response to weaker-than-expected 3Q08 figures announced earlier (for details, please see our Flash report dated 20 Oct) and expected slower growth in 2009 as the global financial crisis deepens. While these measures are property-sector specific, they are consistent with the central government's plans to stimulate domestic demand which have included earlier cuts in interest rate and reserve requirement ratio, and reforms of agricultural land transfer, as well as recent property-boosting measures introduced in a number of cities, among others.

As residential-related investments account for about 18% of China's fixed asset investment (FAI), or about 8% of GDP (given fixed capital formation's 42% share in China's GDP), it is clear that the government's intent is to boost domestic demand as external demand is expected to be headed lower in the quarters ahead. The latest announcement is also expected to put a floor on the deterioration of property prices across the country. For instance, urban property prices rose just 3.5%/y in Sep vs. 5.3% in Aug.

How effective these latest measures would be remains a question as overall growth decelerates, making future wage increases and employment situation highly uncertain. While the relaxation of property measures would reduce costs and attract first time buyers, banks may be hesitant to lend at the now-lowered rates and higher asset quality risk given the change in downpayment requirement, at a time where the global financial system is under severe stress and capital preservation among lenders is a top priority. In addition, home ownership among urban Chinese is relatively high (the latest figure cited was nearly 80% homeownership among urban Chinese*), suggesting that beyond the marginal buyers, potential buyers may actually take their time before committing, thus diluting the effect of the new policy.

As such, it is highly likely further and more comprehensive fiscal measures would be announced to further boost domestic demand such as investment spending in the areas of infrastructure and related activities. We are also keeping to our view that further relaxation of monetary policy is expected in the months ahead, with at least another five rounds of interest rate reductions of 27bps each before mid-2009, bringing the 1Y lending rate to 5.58% from the current 6.93%. We expect loosening of policy to extend into areas such as credit growth quota, which is now capped at around 15%.

* http://english.peopledaily.com.cn/200208/09/eng20020809_101182.shtml