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Marketing material

# The Chinese Property Market in Flux

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- Responses on the recent property market developments have been mixed. Overall, the market remains uncertain, and a conservative outlook prevails.
- Recent policy initiatives appear to be incremental enhancements rather than bold new measures.
- Destocking is a crucial element for stabilizing the market, but the current scale of destocking efforts seems to be far from sufficient.

The Chinese property market remains a complex and dynamic landscape, sparking both optimism and skepticism among observers. On the positive side, recent monthly data shows a year-over-year improvement in property sales in May. However, some analysts attribute this uptick to a lower base effect rather than a sustained recovery.

Through discussions with Chinese banks, developers, and property agencies, I've observed mildly positive signs in the secondary housing market within core areas of select tier-one cities. Yet, the majority of unsold inventory lies outside these prime locations, and primary sales continue to lag. The overall market recovery thus remains uncertain, and a conservative outlook prevails.

## Policy Responses and Limitations

The government has taken steps to address the property market downturn, though their efforts face limitations within the broader financial ecosystem. Recent policy initiatives, such as reductions in down payment requirements, appear as incremental enhancements rather than bold new measures.

Historical data suggests that previous down payment adjustments did not lead to lasting improvements in sales. Additionally, the elimination of minimum mortgage rates is not entirely novel, as banks must still ensure profitability and maintain a minimum charge of around 3% - a level that affects the positive carry for home investors relative to rental yields.

## Destocking: A Crucial but Daunting Task

The central government's focus on destocking, or reducing excess inventory, is a crucial element of their approach. While this policy is not new, the recent increase in the destocking quota (from RMB 100 billion in January 2023 to RMB 500 billion) has caught investors' attention.

However, JP Morgan analysis indicates a significant gap between the official data on completed but unsold properties (391 million square meters) and the actual sellable but unsold inventory (1,800 million square meters, or roughly 25 months' worth). Despite progress, the sheer size of unsold inventory remains a formidable challenge and RMB 500 billion seems to be far from enough.

While a full recovery of the Chinese property market remains elusive, investors have actively engaged in recent deals in other sectors. Notably, three internet giants have issued convertible bonds (CBs) totaling over $7 billion in the past two months.

For these tech companies, CBs offer a cost-effective way to fund share buybacks while retaining the option for share sales at higher prices through conversion. For investors, CBs offer a balanced risk-return profile to access the Chinese market now. In summary, China's property market faces ongoing challenges, but policymakers recognize the importance of destocking. Investors remain cautiously optimistic, and tech companies are leveraging strategic financial instruments. As the market navigates this pivotal moment, we can expect further shifts in dynamics and the emergence of a fresh landscape.

## Glossary

The carry (of an asset) is the cost or benefit from holding the asset.

A convertible bond is a fixed-income debt security that yields interest payments, but can be converted into a predetermined number of equity shares. The conversion from the bond to stock can be done at certain times during the bond's life and is usually at the discretion of the bondholder.

A share buyback involves a company buying back its own shares.

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