

# Analysis of the loan suspension fiasco from an economic perspective

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**Abstract.** The importance of the real estate sector to China cannot be overstated, but the recent loan suspensions have had a definite impact on the Chinese property market, with several banks and brokerages showing weakness and an increase in non-performing loans in the face of the liquidity crisis in the real estate market. Investigating the causes of the loan suspension is of great importance to the study of the stability of the real estate market. This paper will use the loan suspension as an entry point to give an analysis of the importance of the real estate sector and point out the important role of real estate in China's economic growth. It will then analyze the relationship between supply and demand in China's commodity housing market from a micro perspective and finally speculate on the causes of the loan suspension by combining micro and macroeconomics.

**Keywords:** Loan Suspension; Mortgage; Real Estate Industry; Economics; Term Housing System.

## 1. Introduction

Real estate is a pillar industry in China, with the real estate sector's share of GDP rising by approximately 76% over the twenty years from 2002 to 2022 point. According to the final verified GDP figures for 2020 released by the National Bureau of Statistics in December 2021, the value added to the real estate sector in 2020 was RMB 734.25 billion, representing a GDP share of approximately 7.2%. In contrast, in 2000, China's real estate added value was only RMB 414.1 billion, accounting for about 4.1% of GDP in the same year, with the newly created value of real estate playing a huge role in China's economic growth.

At the same time, in terms of real estate industry structure, the real estate industry has a huge driving effect on several industries such as construction, building materials, social services, commerce, finance, and insurance, affecting dozens of industries along the industrial chain [1]. In the article "The Importance of the Real Estate Industry to the National Economy", by calculating the complete consumption coefficient of the real estate industry on the rest of the industries, it was concluded that real estate would have a multiplier effect of 1.4 times on other industries.

While the development of the real estate industry drives the country's GDP growth, how maintaining a steady growth of investment in the real estate economy is also important for the stability of China's national economy. 30 June 2022, more than 900 owners of property development in Jingdezhen, Jiangxi Province, after repeatedly defending their rights on-site and requesting for resumption of work to no avail, posted a "Notice of Compulsory Loan Suspension" on the internet, which was subsequently published in more than 20 provinces and cities. It has caused a strong chain reaction from owners of rotten properties suffering from the same problem. According to brokerage firms, as of July 2022, over 200 properties with 100,000 owners have collectively proposed to stop mortgage loan repayments because of the rotten buildings, and several listed banks have also been affected, with their share prices sinking as a result.

The crisis currently facing China's real estate sector lies mainly in the fact that the possibilities for property developers to raise funds from banks have been excessively restricted in the face of the over-indebtedness prevalent in the Chinese real estate sector. This industry consolidation has exposed the flaws in the system and the instability of the real estate financial market. The "loan suspension" incident, like a fuse, has exposed the potential problems of the real estate finance market to the public, and how to deal with it is of great importance to stabilize the Chinese real estate market.

This paper focuses on the adjustment of China's real estate policies in recent years, the financing problems of the real estate industry and the analysis of the balance of supply and demand in China's commodity housing market through the construction of microeconomic models, the psychology of home buyers and consumers in the post-epidemic era, and the analysis of the reasons behind the "loan suspension" incident to reveal some of the problems faced by the real estate industry and make corresponding recommendations. The analysis of the reasons behind the "loan suspension" reveals some of the problems faced by the real estate industry and suggests corresponding recommendations.

## 2. Literature Review

Hao and Yu (2020), by calculating the contribution of the real estate and related industries to GDP and the complete consumption coefficient of the real estate industry to the rest of the industry as well as other relevant data, point out that the real estate and related industries contribute significantly to the national economy and that the real estate industry also plays an important role in promoting the economic growth of other industries[1]. Fang and Zhou (2022) provide an in-depth analysis of the concept of "housing without speculation" and point out that the current development of the real estate industry is characterized by an imbalance between supply and demand in the market, the risks of real estate finance and the lack of a sound market economic system[2]. The policy of "no speculation in housing" and its effectiveness in stabilizing property prices are further discussed, and the future development trend of the real estate industry is predicted. Ji (2018) found that the impact of fiscal policy on the real estate industry is mainly through fiscal revenue (taxation) and fiscal expenditure (financial subsidies) to regulate the structure of the real estate industry, which has the effect of adjusting the real estate structure and regulating real estate prices[3]. Li (2021) finds that even though the government has implemented monetary easing policies, the liquidity of real estate funds has been strictly limited to maintain the stability of property prices due to China's strict adherence to the policy of "no speculation in housing"[4].

## 3. Macro real estate policy

### 3.1. The cyclical development pattern of real estate

The history of the development of China's real estate industry reveals that China's real estate development is distinctly cyclical [3]. From 2006 to the present, China's real estate market has broadly undergone four cycles. The first cycle was from mid-2006 to mid-2009. Among them, the US subprime mortgage crisis in 2008 affected the world and established an easing policy led by 4 trillion yuan, with several interest rate cuts, discounted first home interest rates, lower down payments, preferential stamp duty VAT, and support for housing enterprise financing ..... Due to the lagging nature of the policy, house prices rose all the way up after the launch of the Golden Three and Silver Four markets in 2009. In the cycle of rising house prices, the growth rate of house prices in first-tier cities was significantly higher than that of second-and third-tier cities; the second cycle was from mid-2009 to mid-2012, when real estate policies were dominated by tightening policies, repeatedly raising quotas, and interest rates, and setting strict purchase restrictions in second-and third-tier cities. However, due to the lag in policy transmission, house prices still maintained their inertial upward trend in the initial period of policy implementation, especially in second and third-tier cities, which also ushered in a bull market; the third cycle was from mid-2012 to mid-2015, with real estate policies mainly showing an easing trend. The fourth cycle, however, showed very different characteristics, with the stock market beginning to falter in 2015 from a bull market, and the famous "pay off loans count as the first set" policy coming into effect, after the first-tier property market, which relied on the replacement market, detonated. The policy of "housing is not speculative" was first introduced in mid-December 2016, resulting in the spring of 2017, after the first-tier property market experienced a return to the general madness, layers of policies to increase the code. 17 March 2017 Beijing released the strictest regulation policy ever "317 regulation" [4]. Since then, the volume of

transactions in the first-tier property market has plummeted, but the fragmentation of the property market continues, with second-tier cities rising and third- and fourth-tier cities also soaring due to the stimulation of "shanty reform", with the rotation up until 2019.

Taken together, the real estate development in China before the epidemic was subject to several parallel regulatory policies, with the degree of real estate regulation gradually rising and macro policy adjustments having a greater impact on the property economy. It also shows that government intervention in the property economy can only be led from the general direction, and the policy has a certain lag due to the inertia that exists in the property market [5].

### **3.2. The Phased Housing System.**

In the Chinese system of term housing, the owner pays first and the developer delivers the house later. If the owner does not have enough money, he can use the house as collateral to borrow money from the bank, and the bank will then transfer the money to the developer. The system was introduced from Hong Kong in the early years of China's history. The system has been in place for many years and has also led to problems such as abnormally high property prices and real estate monopolies, reflecting the fact that the system is more of a "short-term profit-seeking" system [6].

The advantage of the pre-sale system is that in the context of rising urbanization, property owners can lock in prices in advance, developers can raise funds in advance, and banks can earn interest charges. To achieve what appears to be a "win-win-win" situation for all three parties, it must be based on rising (or sustainable) property prices. If house prices fall, property developers can easily be put under pressure to complete their projects. In 2021, for example, Evergrande Group sent out a letter of distress in late September 2021 when it faced a crisis of a broken capital chain. The rapid collapse of the Evergrande Group, the magnitude of its debts, and the widespread impact it had, marked the bankruptcy of the real estate "big but not down". Although the crisis was eventually lifted, Evergrande's credit was difficult to fully restore, and investor confidence in the property market was subtly changing at this time.

The key to the fact that the term loan system has always existed, but has not caused such a big collective move as the "loan suspension" incident in the past, is that the public's confidence in rising property prices has made it more likely that developers will be able to unwind their projects and resume work, and owners' expectations are completely different. In this case, the problems with the term loan system have been fully exposed: in an upturn in the real estate market, homeowners can own their own homes and ride on the rising prices; in a downturn in the real estate industry, if the developer has problems, homeowners face the risk of not receiving their homes, and whether they receive their homes or not, they will have to repay their loans to the bank or face debt collection by the bank. Otherwise, they will face debt collection and even prosecution [7].

The shortcomings revealed by the term housing system are thus focused on the issue of funding. Banks are required to provide funds to real estate agents, and the funds received by real estate agents are difficult to properly supervise, making the misappropriation of funds a prominent problem; home buyers are required to make regular long-term repayments to the bank, while the money paid is at risk of disappearing.

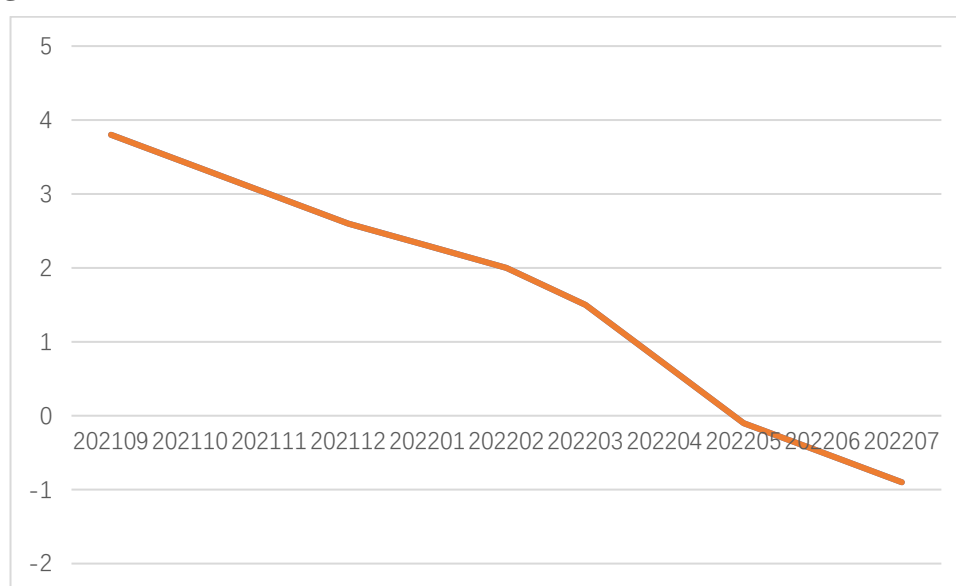
### **3.3. Funding problems for real estate companies**

According to a relevant report by brokerage firms, just the first 12 bailed-out real estate enterprises have short-term rigid expenditures of 2 trillion yuan and a shortfall of 1 trillion yuan, while they account for only 15% of the volume of real estate enterprises nationwide. In the first half of the commodity housing sales than the background of last year's cut, the bailout situation may also rapidly deteriorate after the wave of loan suspension. 2022 previous year, the cumulative new construction and completion area year-on-year decline continued to expand, and the cumulative real estate investment volume continued to decline year-on-year. 2022 January-May, real estate development enterprises in place funds fell 25.8% year-on-year.

In the short term, relevant government departments, banks, and real estate companies must act quickly and join forces to offer reasonable solutions to prevent the collapse in confidence from spreading to a wider area and to ensure that the vast majority of term home buyers continue to choose to repay their mortgages [8]. In the medium term, real estate companies are facing a classic liquidity crisis, with their credit being called into question and their normal financing cycle being disrupted, for which the classic liquidity crisis solution should also be adhered to, on the one hand, by rapidly promoting industry consolidation and organizing measures such as bankruptcy trusts for real estate companies that are essentially unable to operate, to try to avoid the spread of rotten properties, and on the other hand, providing those real estate companies that are essentially able to operate normally with strong syndicated loan support to rearrange debt terms and get operations up and running again.

## 4. Microeconomic models of the commodity housing market

### 4.1. Housing Index

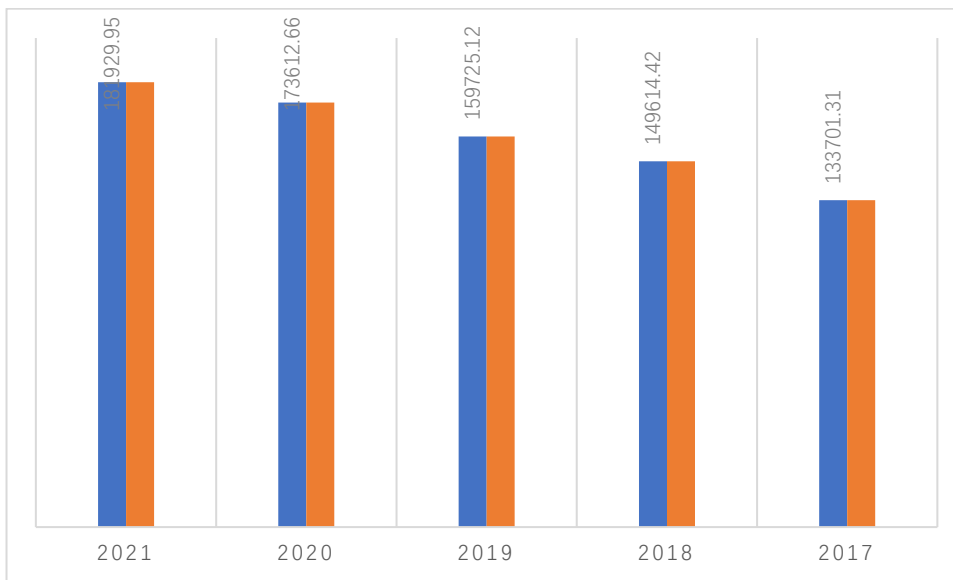


**Figure 1.** Change in China's housing index for selected months 2021-2022

The housing index is measured by the year-on-year change in the index of new residential buildings in 70 large and medium-sized cities. The index is calculated using a weighted average method, with the weighting for each city based on population [9].

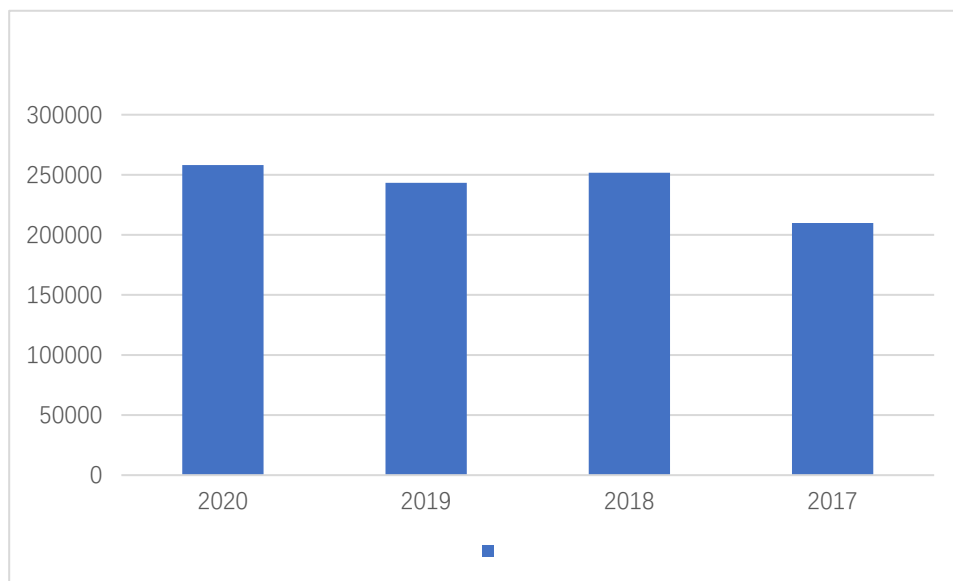
Looking at the change in the housing index from 2021-2022, it is clear that house prices are trending down significantly over the 2021-2022 epidemic period. The three elements that determine market size and capacity are buyers, purchasing power, and desire to buy. There are many factors that influence house prices, including population, homebuyer expectations, land prices, and more. During the epidemic, nothing will have a greater impact than national income. 2022 will be a tough year for employment in China, with economic growth slowing and structural adjustment intensifying while labour supply remains at a high level. Without a stable source of income, the purchasing power and willingness of homebuyers to buy homes will plummet. The property market, which has lost its "takers", is going down against the backdrop of the epidemic.

#### 4.2. Supply and demand in the commercial housing market



**Figure 2.** Sales of commercial properties in China in recent years (in billions of yuan)

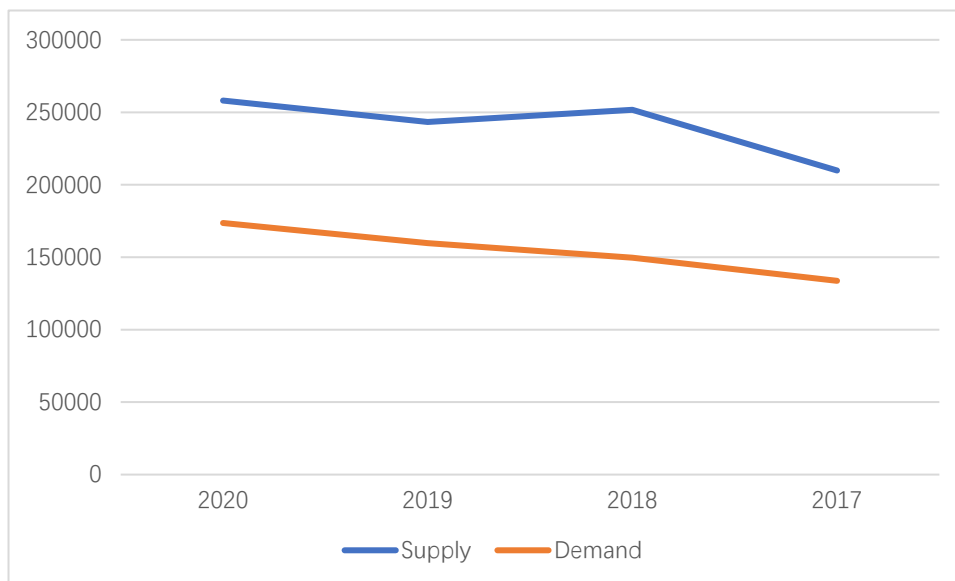
Commercial property sales represent the total contracted price of new commercial property sales during the reporting period (i.e. the total contracted price confirmed in the formal sales contract signed by both parties)



**Figure 3.** Number of new commercial housing projects launched in China in recent years (in billion yuan)

According to data from the Bureau of Statistics, using 2020 as the base year, sales area will fall by approximately 30% year-on-year in January-April 2022 and 9% year-on-year for the whole of 2021. On the demand side of real estate, customer demand and the ability to pay are generally on a downward trend due to sluggish economic growth, with fewer jobs in cities, declining incomes, increased job instability, slower population inflow to cities, and even a backward population flow in some cities. The youth group, which is the main force of home purchase, has seen a continuously high unemployment rate so far this year [10]. And since 2022, due to the epidemic, the growth of most contact and aggregation-based service industries has slowed down, and real estate sales have thus been greatly affected. In the first half of 2022, China's total cumulative social consumption retail sales fell by 0.2% year-on-year, indicating that social consumption is still depressed, and the consumer market in the second half of the year is still full of greater instability. Sales of commercial

housing are bound to face a decline in sales due to the impact of focused separation and also the valve factor of social consumption confidence.



**Figure 4.** Supply and demand in China's commercial housing market in recent years (unit: billion yuan)

Using China's commercial property sales as the demand and the number of new commercial properties launched in China as the supply, we can draw a relatively rough picture of the supply and demand relationship in China's commercial property market.

At present, China's real estate industry as a whole is showing a downward trend, and the continued decline in real estate investment may result in a relatively tight supply and may lead to an increase in house prices in the future. China's real estate market has been experiencing an oversupply in recent years. However, due to hoarding by developers and speculators in previous years, the appearance of oversupply in the real estate market has led to false expectations of house prices among homebuyers, thus exacerbating the distorted phenomenon of oversupply in the real estate market.

House is a necessity of life, and house prices do not meet the law of supply and demand and will not plummet because of oversupply. As an important part of China's economy, real estate involves many upstream and downstream industries and contributes significantly to GDP, a fall in house prices would lead to economic instability. Once house prices fall too far from their original base, the value of the house itself will not be able to repay the mortgage, and the phenomenon of "abandoning the house and breaking the mortgage" will occur. At this point, the purchaser may not only lose their home but may also be left with a large loan. The bank is also at risk of not being able to recover the loan due to the significant depreciation in the value of the collateral.

## 5. Conclusion

After summarising the macroeconomic and microeconomic findings, this paper has put forward the following two conjectures as to the causes of the 'loan suspension' incident: firstly, the real estate market was on a downward trend under the tight monetary policy, banks' lending standards for real estate were raised, real estate developers had a large shortfall in their capital chain and were unable to deliver their houses on time, and The problem of "rotten buildings" has intensified; secondly, against the background of the epidemic, investors' willingness to buy houses has decreased, and confidence in the commodity housing market has decreased, leading to the mandatory suspension of loans and an oversupply of flats

At this point, we can once again review the whole economic development and the current economic situation in China after the epidemic: the term housing system was introduced from Hong Kong in the early years of China, and the term housing system in Hong Kong has been implemented

for many years, with many problems such as abnormally high property prices and real estate monopoly, which also reflects the nature of the term housing system, which is more "short-term profit-seeking". The advantage of the pre-sale system is that in the context of rising urbanization, property owners can lock in prices in advance, developers can raise funds in advance, and banks can earn interest charges. To achieve what appears to be a "win-win-win" situation for all three parties, it is necessary to build on the basis that property prices are rising (or can be maintained). If house prices fall, real estate developers can easily be put under pressure to complete their projects. The key to the fact that the term housing system has always existed but has not in the past given rise to such a major collective initiative as the "loan suspension", is that the public's confidence in rising house prices has made it more likely that developers will be able to unwind and resume work on their projects, and that homeowners have entirely different expectations.

In the case of the real estate bubble, Japan can be said to be a mirror of China. In Japan, during the bubble economy, many houses were sold for every inch of land. After three decades of loss, a new trend has emerged in many parts of Japan, namely the era of "negative chattel", where houses have become "thick junk" that many Japanese families do not want, and even have to pay to get rid of them [11-12]. The bursting of the real estate bubble in Japan was not related to a specific system of buying and selling, such as term houses, but essentially to the fundamentals of a failing economy and negative population growth, which made the cost of the real estate bubble infinitely more expensive. Returning to the issue in China, again, it is not the specific system of buying and selling houses, but the various risks in the real estate market that are behind it that matter. It could be argued that the wave of loan suspensions has sounded a piercing and valuable alarm, reminding all parties concerned that the issue of real estate risk has become a matter of urgency.

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