

ANALYSIS OF CHINA'S ECONOMY SYSTEM FAILURE

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ABSTRACT

Volume of real estate market in some China's large cities decreased sharply in 2010. Based on rational reconstruction of some basic economic thought and analytical narrative of the real estate price bubble. I conclude that it should be contributed to a big gap between demand and supply, and financial crisis would break out in the coming few month in China. I make proposal that government should be reducing state-owned share.

Keywords: rational reconstruction, analytical narrative, financial crisis, reducing state-owned share

The report of Shenzhen estate research center shows volume of real estate market in some China's large cities decreased sharply. For instance, Trading volume in ShenZhen was 362.66 (10,000 s-m), Compared to 2009, it decreased 49.1%. It should be contributed to disappearing invest and speculated demand and accelerating supply. China's real estate market is at risk of crash, it would lead to financial crisis in the coming few month.

According to the standard asset pricing theory, the theory of real estate prices is the discounted value of the rent. Phenomenon that the theoretical value substantially deviated from actual value shows real estate investment and speculative demand beyond consumer demand. The invest and speculate demands dominate the market. That is the real estate price bubble. Take Guangzhou for example, according to the Guangzhou Municipal Bureau statistics in 2003, city's high-rise residential average price was 4,619 Yuan / s-m, and in December in 2007 it reached an average bid price of 10586 Yuan /s. m, increased as high as 229%. But real estate rent increased only 10% in the view of experience. What is the law that the evolution of the real estate price bubble followed? First, the purpose of investor is to expect some higher prices. Second is the role of herding. Herding role is a herd behavior, decision-makers often find asymmetry because of lack of information or expertise to identify the consequences arising from the uncertainty of knowledge they need someone provide information or judge the people around to conduct similar acts. Herding role make real estate bubble gradually bigger. And real estate bubble will break for some imbalanced factor such as economy cycle and some accident. Herding role speeds up break of real estate bubble. Chinese economy is a typical export-oriented economy, according to Hoffman's experience, is divided into three phases, the processing trade, light industry and heavy industry. Heavy industrialization has investment cycle of five years, heavy industrialization began in

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2002, It shows Chinese economy is at the end of an economic cycle. After the turning point was formed in December in 2007, China's real estate bubble had been breaking.

China's massive stimulus package in 2009 prevented real estate bubble from beaking. But this stimulus package mainly depended on government-led investment. In fact China's invest rate almost reached 50%, Diminishing marginal utility principle should be working.

China' Market Value of Trade in Jan in 2009 was 51845.8 (100million Yuan), however, In Dec it increased by 300% and reached 151,258.7(100million Yuan). China's selling Price Indices of House in Jan rose from 99.1 to 107.8, but Renting Price Index of House only rose from 99.5 to 100, Growth in China's Economy in 2009 partly benefited from asset bubble. It does not have strong basis. With decline of volume in estate market, a vicious circle is opening and demand is contracting. Property prices have dropped, collateral price fell, "Grudging lending" was prominent, people lost their confidence, the loan market has shrunk, and the collateral value plummeted. In the three quarter we also found that price of real estate had showed accelerated upward trend, Price in Shenzhen in July rose from 14656 yuan/s.m to 21660.5 yuan/s.m, increased by 40%. In the view of behavioral economics, it is a purpose of the act, because October is the intensive transactions in the property market, Because investment demand in estate market has profit-taking motive, I believe huge invest demand has disappeared. From the perspective of supply we know there is a two-year invest cycle in estate industry. In 2009 invest completed in real estate development was 36232 billion, increased by 16.1%. That will lead to growth in supply in 2011. Average Cash flow in the biggest list real estate Company WanKe was -0.55yuan/share. A big gap between demand and supply is looming in 2010.

Kenneth S. Rogoff (2008) pointed out once turning point was formed in real estate market, financial crisis would be triggered in one or more years. China's real estate market is close to this time window. The nature of estate market is economy system failure in China. I make proposal that government should be reducing state-owned share. State-owned shares of listed companies, which need not to be controlled by state should be issued to the public (low-income) through new shares placement method, and the price is determined by the price-earnings ratio in accordance with international standards. Government must retain some shares to award people who maintain the enterprise's core competitiveness. Reducing state-owned share not only benefits social security system to stimulate demand but also absorbs invest demand in real estate market.

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ANALYSIS OF CHINA'S ECONOMY SYSTEM FAILURE

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