The Great Chinese Housing Boom

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Housing and land prices in China have increased continuously and dramatically for the past two decades. In fact, housing price growth has significantly outstripped income growth. Current housing prices are roughly 11 times annual income in large cities such as Beijing and Shanghai; the price-to-income ratio is as high as 23 to 1. By comparison, Tokyo house prices were 15 times income and U.S. house prices 5 to 6 times income when the Japanese and U.S. housing bubbles, respectively, burst in 1990 and 2006. Rapid price growth, large price-to-income ratios, and high vacancy rates (between 25 and 30 percent) suggest the possibility of a bubble.

The top chart compares key facts for the Chinese and U.S. housing booms and the bottom chart compares the recent mortgage debt as a share of gross domestic product for both. While in both cases nominal house prices increased by close to 50 percent over a 5-year period, the differences are striking. The U.S. housing boom reflects overconsumption and overborrowing, whereas the Chinese housing boom reveals large investment in construction and apartment holdings. Most of the “vacant” Chinese homes have been sold to private owners but are being held as investments alongside multiple other homes.

Asset bubbles are typically defined by the relative role of fundamental and speculative demand. Those who argue against a Chinese housing bubble point out that China is currently undergoing “the greatest urbanization story the world has ever seen” (Roach, 2012). Over the past decade, the Chinese urban population increased by over 20 million people (while the rural population decreased by 14 million people). The United Nations forecasts that another 20 million people are likely to migrate to China’s urban centers in the coming decade, which could create demand for roughly 10 million new housing units. If these fundamentals hold, China’s housing boom is purely demand driven.

Williams (2013), however, points out that construction growth is well on pace to exceed demand from migration. High vacancy rates may also suggest “speculative” demand. China’s extraordinarily high household savings rate (about 25 to 30 percent) is well documented, and financial repression and highly underdeveloped financial markets severely limit the supply of quality assets for investment. In combination, these forces encourage demand for housing as a store of wealth (Chen and Wen, 2013). Individuals hold housing as they would gold because they wish to save and housing offers the most attractive return of all available financial assets. This explains why most of China’s empty apartments are sold properties. Store-of-value demand is speculative in nature because it hinges on the expectation that housing prices have increased continuously and dramatically for the past two decades.