

ANDBANK RESEARCH

Global Economics &
Markets

Alex Fusté
Chief Economist

alex.fuste@andbank.com

+376 881 248



Working paper - 41

***You might get such a face if you keep betting on the
collapse of the real state in China***

March, 2013

ANDBANK /
Private Bankers

Someone I respect once told me: “Keep it simple and do not give opinion about many topics. Follow this rule and you will go little wrong.”

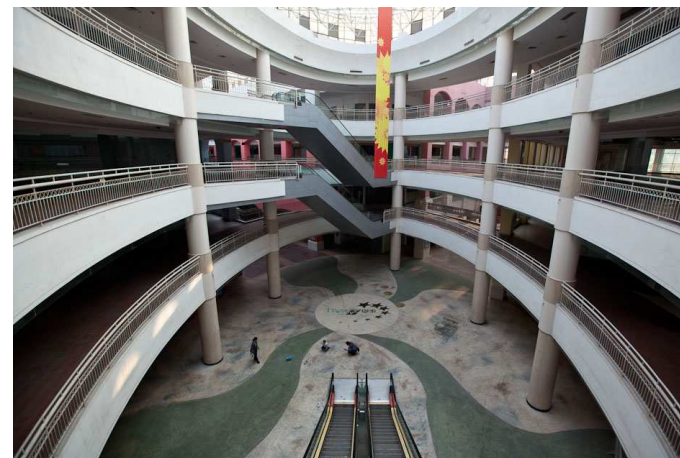
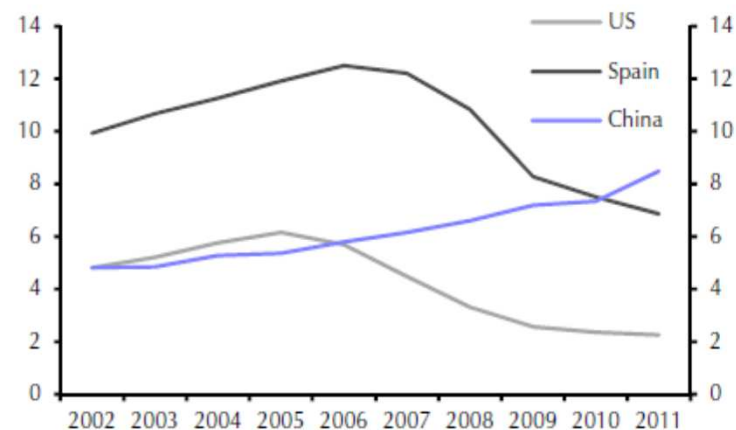
The problem is that I and the rules do not cohabit in the same sentence, so I tend to complicate myself.

The reason behind my insolence is that I have detected a common denominator among those who enact such a rule. A blind support to the prevailing view.

Is Chinese property sector teetering on the brink of collapse?

- So often we get warnings that the Chinese property bubble is about to burst.
- Proponents of the property-collapse theory love to do two things:
 1. compare volumes of residential activity in China and other Western bubbles (eg, the USA).
 2. They also love to visit vacant shopping mall of oceanic scale, acres of desolate cities, and towns sprouting from the desert sands and used only as a backdrop for wedding photos.
- Defendants of this, also projects the so-called "hard-landing" in China, whose effects will spread across the entire East-Asia region (who accounts for $\frac{3}{4}$ of global growth) and thus will impact severely the rest of the world.

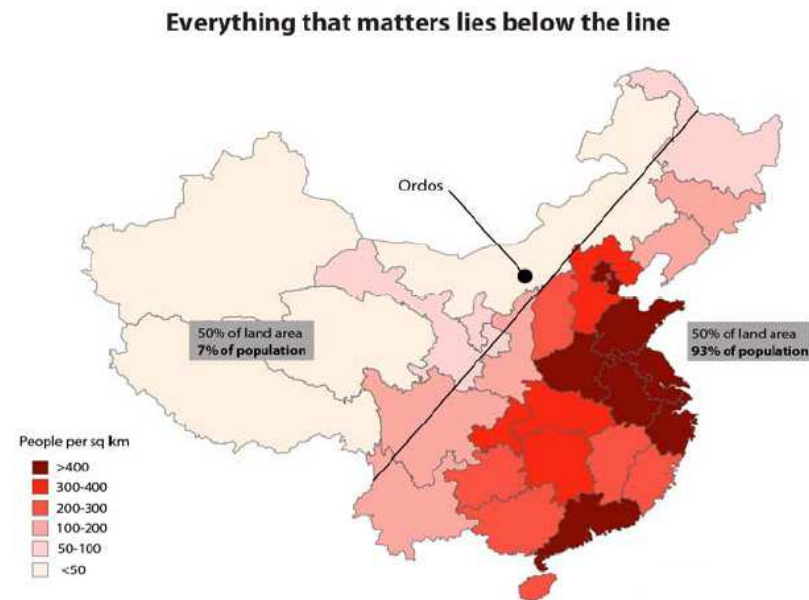
INVESTMENT IN RESIDENTIAL PROPERTY (%GDP)



Three reasons to believe that the “housing bubble” could not burst.

1st The greatest migratory movement in history

- Comparisons of China with the US housing bubble (common among Western investors) fall apart immediately.
- **The US completed the depopulation of its countryside in the mid-1950s**, so urban and suburban housing demand of recent decades is essentially a function of relatively modest natural population growth, immigration from abroad and speculation.
- **China by contrast has moved 500mn people from country to town since 1980.**
- Proponents of the property collapse theory love to visit places like Ordos, a mining boom town in Inner Mongolia that epitomizes the ghost city, with a housing vacancy rate of perhaps 80%.
- Indeed a picturesque example of insane excess but it is also **completely irrelevant** to a discussion of the Chinese property market, since it is the result of these migratory movements.



Three reasons to believe that the “housing bubble” could not burst.

2nd Future demand is assured

- About one-third of China’s current 700mn urban residents live in shelters with no kitchen or bathroom and so represent future housing demand.
- And another 300mn people—a population the size of the entire US—are likely to move into the cities over the next two decades.



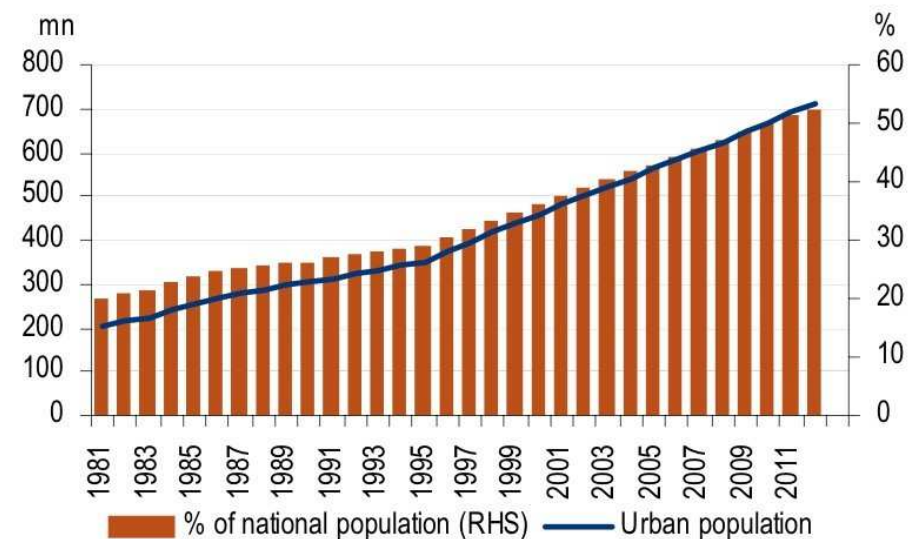
Many of the so-called “ghost cities” are simply efforts to build ahead of this tsunami of demand.

Three reasons to believe that the “housing bubble” could not burst.

3rd In aggregate, supply is being slow to catch up

- In aggregate China’s housing market fails to meet the most elementary definition of a bubble: *supply exceeding underlying demand*.
- Despite years of frenzied building, the year 2011 was the first ever in which total new urban housing completions exceeded total new demand (Dragonomics Research – “Crazy, but not that crazy”).
- Experts in the region estimate that to meet future new demand, eliminate the current shortage, and replace dilapidated stock, China still needs to build at least 10mn housing units every year for the next 15 years – 40% more than it built on average in 2000-2010.

Chart 3: China’s urbanization pace



Source: CEIC, BofA Merrill Lynch Global Research

Conclusions.

- Proponents of the property collapse theory love to visit mining boom towns in frontier regions that epitomizes the ghost city, with a housing vacancy rate of perhaps 80%...
- ... Indeed a picturesque example of insane excess but It is also **completely irrelevant** to a discussion of the Chinese property market.
- More than 90% of China's population lives crammed in the half of the country that lies south and east of the Great Wall. **In most of the cities in this area, property markets are vibrant, prices are high but within reach for the burgeoning middle class,** and building ahead of future demand stays within modest limits.
- Examples plucked from frontier towns in the under populated west may be colorful, but **tell us nothing useful about the bigger picture.**
- This is not to say that everything is fine and dandy in China's property sector. The housing market remains deeply distorted, with too much high-end housing and **not enough mass housing to cater to the lower-income working class,** which is where most new demand will come from.
- And the government's urbanization strategy so far has focused too much on construction and far too little on the software of cities (social services, cultural amenities, and ensuring full residence rights for migrant workers).
- Ghost cities or no, the building probably will go on and, ... if true, certain risks should be got off the table, what will fed our positive stance for the economy and markets in the region.

Recommended instruments

▪ **Equity Instruments**

- ✓ Andbank Equity Fund Emerging Markets –A (USD)
- ✓ Andbank Equity Fund Top Exporters EUR - A
- ✓ Andbank Equity Fund Emerging Europe –A (EUR)*

▪ **Fixed Income & Fx Instruments**

- ✓ Schroder ISF RMB Fixed Income Fund A – CNY (LU0845698876)
- ✓ Schroder ISF RMB Fixed Income EUR – A (LU0845699254)
- ✓ Schroder ISF RMB Fixed Income USD – A (LU0845699502)
- ✓ Goldman Sachs Growth & Emerging Markets Debt Local Portfolio E Acc - EUR (LU0302284640)
- ✓ Goldman Sachs Growth & Emerging Markets Debt Local Portfolio A Acc - USD (LU0302283246)
- ✓ Invesco Emerging Local Currencies Debt Fund Class A USD Accumulation - USD (LU0275062247)
- ✓ Invesco Emerging Local Currencies Debt Fund Class E EUR Accumulation – EUR (LU0275060464)
- ✓ BlackRock Global Funds - Asian Tiger Bond E2 – USD (LU0147399801)
- ✓ ING (L) Renta Fund Asian Debt Hard Currency X USD Acc – USD (LU0546914242)
- ✓ Legg Mason Western Asset Asian Opp. Fd - CI A Euro Acc – EUR (IE00B2Q1FK59)
- ✓ Allianz Renminbi Fixed Income A USD – USD (LU0631904975)
- ✓ Schroder ISF Hong Kong Dollar Bond A Acc – HKD (LU0149525270)
- ✓ db x-trackers II Markit iBoxx ABF Singapore Govt 1C – SGD (LU0378818560)

* This region is also included within our most preferred areas of investment.

Legal Disclaimer

All the sections in this publication have been prepared by the team of analysts from the financial institution.

The views expressed in this document are based on the assessment of public and private information. These reports contain evaluations of a technical and subjective nature on economic data and relevant social and political factors, from which the financial institution's analysts have extracted, evaluated and summarized the information they believe to be the most objective, subsequently agreeing upon and drawing up reasonable opinions on the issues analysed herein.

The opinions and estimates in this document are based on the market events and conditions that took place before the publication of this document, and therefore cannot be determining factors in the evaluation of future events that take place after its publication.

The financial institution may hold views on financial instruments that differ completely or partially from the general market consensus. The market indices chosen have been selected following the exclusive criteria that the financial institution regards as most appropriate.

The financial institution cannot in any way guarantee that the predictions or events given in this document will take place, and expressly reminds readers that any past performances mentioned do not in any circumstances imply future returns; that the investments analysed may not be suitable for all investors; that investments can fluctuate over time in terms of their share price and value; and that any changes that might occur to interest rates or currency exchange rates are other factors that may also make it unadvisable to follow the opinions expressed herein.

This document cannot be regarded, under any circumstances, as an offer or proposal to buy the financial products or instruments that may have been mentioned, and all the information herein is for guidance purposes and should not be regarded as the only relevant factor when it comes to making a decision to proceed with a specific investment.

This document does not, therefore, analyse any other determining factors for properly appraising the decision to make a specific investment, such as the risk profile of the investor, his/her knowledge, experience and financial situation, the duration or the higher or lower liquidity of the investment in question. Consequently, investors are responsible for seeking and obtaining the appropriate financial advice in order to assess the risks, costs and other characteristics of any investments they wish to make.

The financial institution cannot accept any responsibility for the accuracy or suitability of the evaluations or estimates of the models used in the valuations in this document, or any possible errors or omissions that may have been made when preparing this document.

The financial institution reserves the right to change the information in this document at any time, whether partially or in full.