ASIA MONTHLY

March 2023

株式会社 日本総合研究所

https://www.jri.co.jp/en/reports/asia/

This report is the revised English version of the March 2023 issue of the original Japanese version (published 1st Mar.).

Topics *China's real-estate market is undergoing a protracted adjustment*

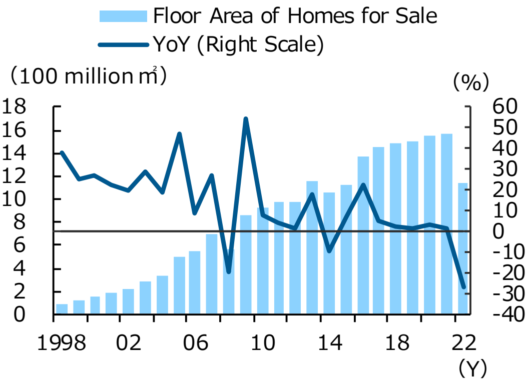
The real-estate market is vital to the Chinese economy. The current adjustment in the real-estate market is also being augmented by the structural factor of a declining population, and it would be premature to assume that the real-estate market will return to booming conditions through government support measures.

■ Real-estate sales are declining

In China, tourism and other services consumption have picked up with the end of the "zero-COVID policy," under which aggressive measures were taken to prevent the spread of even tiny COVID outbreaks. Meanwhile, the real-estate market continues to see declining home sales and falling prices.

From the beginning of 2023 to February 18, the floor area of homes sold in 30 major cities dropped 6.3% year on year (YoY). In 2022, the floor area of homes for sale nationwide decreased by 26.8% YoY, the largest fall since statistics began to be compiled, and these difficult conditions are continuing into this year. In January, prices of newly-constructed homes in 70 major cities slipped 1.5% YoY, staying in negative territory for the ninth straight month.

<Home Sales in China>



Source: Prepared by JRI based on data from the National Bureau of Statistics

The adjustment in the real-estate market has become a problem that could shake the very foundations of China's economy. Real-estate development investment, which accounts for 11% of GDP, declined 10.0% YoY last year due to lower home sales and government restrictions on loans for real estate. As a result of financial strain caused by the drop in income from land use rights transfers, local governments have been forced to suspend financial support for the infrastructure investment companies under their jurisdiction. As a result, there is growing financial uncertainty about the ability to collect receivables from real-estate developers and infrastructure investment companies under the control of local governments.

In the household sector, the reverse asset effect of falling real-estate prices will put downward pressure on personal consumption. Real estate accounts for 59.1% of household assets in China, according to an October 2019 People's Bank of China survey of 30,000 households in urban areas across the country. This is much higher than the 36.7% in Japan and 25.1% in the U.S.

In their 2020 paper "Peak China Housing," Harvard professor Kenneth Rogoff and his colleagues used China's latest input-output tables to estimate the added value of the real-estate industry, including construction and related sectors, as making up 29% of GDP. They also predict that a 20% contraction in economic activity in the real-estate sector would depress GDP by 5-10%, even if a financial crisis did not occur.

■ It is too early to assume that the government's support measures will bring the real-estate market back to life

Against this backdrop, the government has unleashed a series of measures to shore up the real-estate market. Toward the end of last year, the central government launched a financing support program for real-estate development companies, allowing them to expand their borrowing from banks and to issue bonds and shares. Regarding bank loans, with an eye to calming the turmoil caused by the suspension of housing construction work, the government called on financial institutions to postpone repayment by and expand lending to developers. And after the start of this year, it introduced a new preferential interest rate program for first-time homebuyers, and urged for more lending to quality development companies. Local governments are also rushing to ease restrictions on home purchases and provide assistance to buyers.

However, it is too early to assume that the real-estate market will return to booming activity as a result of the support measures, since the decline in home sales is not only due to policy factors such as the lending restrictions for developers that were announced in 2020, but also to structural factors such as the decline in the population.

<Main Financial Support Measures for the Real-Estate Market>

・The due dates of bank loans and trust loans for real-estate developers due within six months from the date of the release of the notice can be extended by one year.
・Financial institutions are encouraged to provide financing support to quality state-owned and private real-estate developers with sound corporate governance.☐
・Minimum downpayment ratios and interest rates for home loans to individuals that are based on a differentiated trust lending policy and reflect local conditions will be established.
・Support will be provided for credit enhancement for debt issuance by quality real-estate developers and real-estate development enterprises that are experiencing short-term funding
・Policy banks, such as the National Development Bank, will be encouraged to provide special loans to guarantee housing delivery, and financial institutions will be encouraged to deliver support through related lending.
・Support will be focused on projects that involve quality real estate developers merging with and acquiring distressed real estate developers. Asset management companies will be encouraged to utilize their experience and capabilities in areas such as nonperforming-loan disposal and risk management.☐
・Financial institutions will be encouraged to negotiate with homebuyers on extending repayment dates if they have become unemployed due to COVID-19 or if or their real-estate purchase contracts are modified or canceled.

Sources: Prepared by JRI based on data from the People's Bank of China and the China Banking and Insurance Regulatory Commission

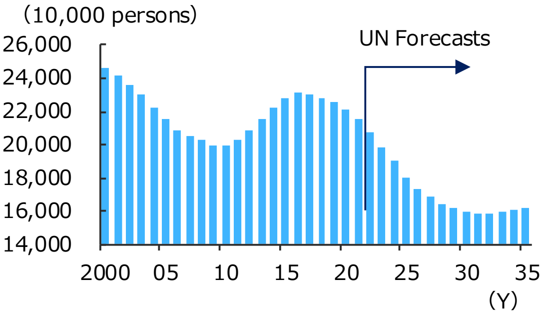
The population aged 25-34, the volume zone for demand for first homes, has already begun to decline and is expected to plunge by 47 million between the end of last year and 2030.

According to the China Real Estate Industry Association and other sources, the average age of homebuyers is 27, and buyers aged 25-34 account for the largest share of all first-time homebuyers at 38.4%. In China, since owning a home is advantageous in finding a marriage partner, parents often finance the purchase of a home for their child to put them in good stead for marriage. As a result, the average age of first-time homebuyers is low at 27 years old.

The government used to control the number of births through fertility policies centered on the famous one-child policy, but recently it has been unable to halt the decline in the birthrate. According to the National Bureau of Statistics, the fertility rate, births as a percentage of the total population was 0.677% in 2022, the lowest since the founding of the People's Republic of China. In the background to this is the one-child policy, which had been in place since around 1980 and has led many families to believe that one child is enough, as well as the heavy economic burden of raising a child and the zero-COVID policy, which accelerated the decline in the number of births.

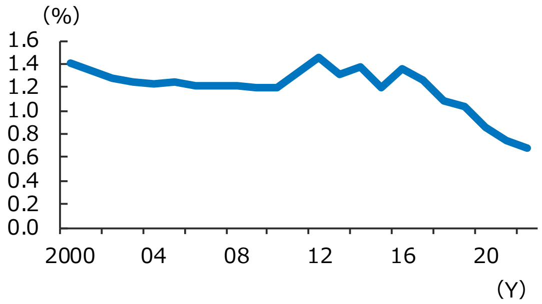
The real-estate market is expected to experience a prolonged period of severe adjustment as the

<Chinese Population Aged 25-34>
(Volume Zone for First-home Demand)



Source: Prepared by JRI based on data from the UN

<China's Birthrate>



Source: Prepared by JRI based on data from the National Bureau of Statistics
Note: Birthrate = No. of births / total population

population continues to decline. Therefore, the recent financing support measures may end up only helping to extend the lives of real-estate development companies that should be exiting the market. The effects of demand stimulus measures, such as the introduction of the new preferential interest rate program, will also need to be carefully monitored.

The Chinese real-estate market has traditionally been easy to heat up but hard to cool down, but is likely to become easier to cool down and harder to heat up in the future.

(Shinichi Seki)

Topics *Japanese companies eye India for investment*

As uncertainty over China's politics and economics continues, Japanese companies are more interested than ever in doing business in India. However, unless India's business environment improves, investment in the country may not increase.

■ The Indian economy is steadily becoming a greater presence

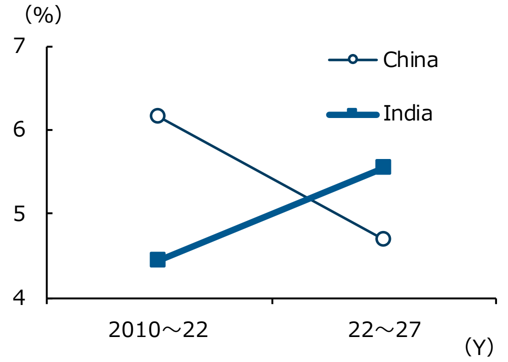
As its economy and society continue to normalize in the wake of the COVID pandemic, India continues to experience solid economic growth and is steadily increasing its presence in the global economy. In 2022, its nominal GDP in dollars is projected to have surpassed that of the U.K., making it the world's fifth largest economy after the U.S., China, Japan, and Germany. Also in 2022, the country overtook Japan in automobile sales, ranking third in the world behind China and the U.S. Furthermore, according to UN estimates, India is expected to usurp China as the world's most populous country by the end of 2023.

Given its large catch-up potential compared to other emerging economies and its demographics, it is highly probable that India's presence in the global economy will continue to grow. Current nominal GDP per capita is only in the $2,000 range, and auto sales per capita remain far below those of other countries. The expansion of the middle class is expected to accelerate the diffusion of durable consumer goods such as cars and home appliances. Urbanization is also progressing, and economic growth driven by domestic demand looks set to continue.

The rising sense of stagnation in the Chinese economy is also a factor in India's growing presence. China's real GDP slowed to +3% YoY in 2022, mainly due to its zero-COVID policy. Although its economy is expected to pick up in 2023 following the lifting of this policy, there is a strong sense of political and economic uncertainty, including with respect to the U.S.-China tensions. China's nominal GDP per capita is already above $12,000, and in light of the experience of other countries, its growth rate is likely to slow as its economy matures. The IMF expects China's average real growth rate for the 2022-27 period to slow to the +4% range, while India's is expected to be in the +5% range.

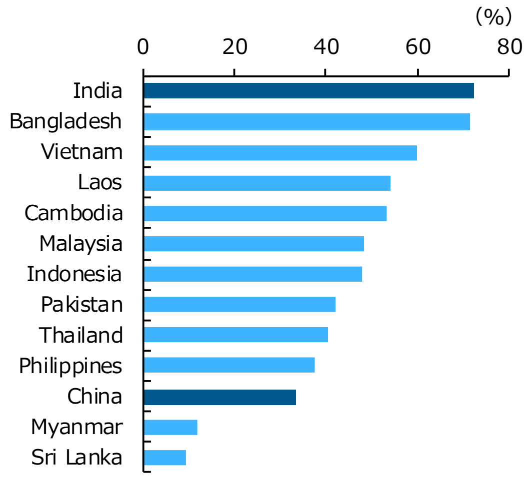
Because of these differences in economic conditions between China and India, Japanese companies are more interested than ever in India as an alternative to China as a destination for expanding their businesses. According to a survey conducted by JETRO (Japan External Trade Organization) in 2022 of Japanese companies with operations in Asia ex-Japan, only about 30% of them are considering expanding their China business during the next one to two years, while over 70% are considering expanding their India business. And in a JBIC (Japan Bank for International Cooperation) survey of manufacturers, India ranked first as both a short-term (the next three years) and long-term (the next 10 years) promising business destination, and the gap in vote share with China widened from the previous year's survey.

<Real GDP Growth Rate(Period Average)>



Source: Prepared by JRI based on data from the IMF

<Approach to Future Business Plans in the Next 1-2 years (the Share of Enterprises that Responded "Expansion")>



Source: Prepared by JRI based on data from JETRO

■ Japanese investment in India did not increase during the past India boom phase

In light of past experience, it should be noted that the growing interest of Japanese firms in Indian business will not immediately translate into increased investment in India or increased trade between Japan and India.

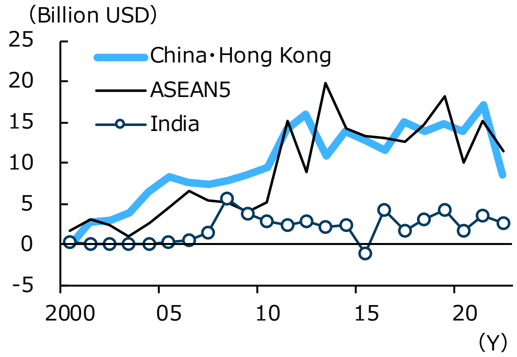
Japanese interest in Indian business surged when a government headed by Narendra Modi, who had implemented aggressive economic reforms to attract foreign investment during his tenure as Chief Minister of Gujarat, came to power in 2014. At that time, too, a slowdown in economic growth and rising labor costs in China created momentum for a shift of production facilities from China to Southeast Asia and South Asia. Ultimately, however, Japan's direct investment in India remained below that in China and the ASEAN zone. In fact, the pace of growth in the number of Japanese companies in India has slowed since the Modi government took office, and the number of facilities they operate in the country has been declining since 2019.

The following two points can be cited as reasons Japanese companies have not made inroads into the Indian market despite a high level of interest in doing business in India:

First, the Modi government's bold institutional reforms and the economic and social turmoil wrought by the COVID pandemic have discouraged Japanese companies from expanding into India. Companies have put off investing there due to repeated economic and social disruptions caused by measures such as 1) the demonetization in 2016, 2) the introduction of the GST (Goods and Services Tax) in 2017, 3) the introduction of the strict BS6 emission standards in 2020, and 4) the strict lockdown imposed during the COVID pandemic.

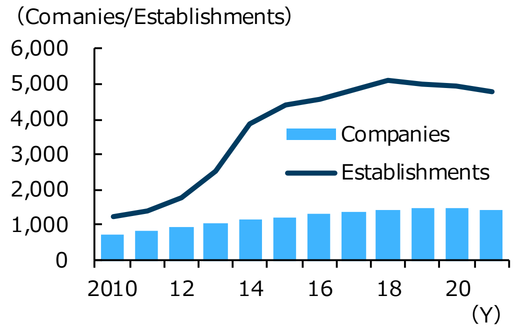
Second, a number of business challenges remain, which are also hindering expansion into India. Although the business environment in India has greatly improved since the Modi government took the helm, such factors as 1) a complex and opaque legal system that differs from state to state, 2) stiff competition from other companies, and 3) underdeveloped infrastructure have been pointed to as impediments to Japanese companies entering the Indian market. Therefore, Japanese companies are focusing on business development in the

<Japan's Outward FDI>



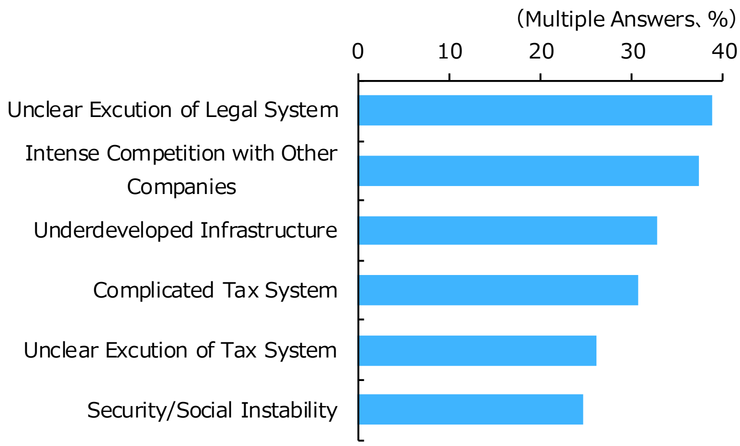
Source: Prepared by JRI based on data from JETRO and Ministry of Finance
Note: ASEAN5 are Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam

<The Number of Japanese Comapnies/Establishments in India>



Source: Prepared by JRI based on data from the Embassy of Japan in India

<Japanese Company's Business Challenges in India >



Source: Prepared by JRI based on data from JBIC

ASEAN zone, where the business environment is favorable and governments are forward-looking on free trade.

While the former reason is transitory, the latter is structural and will continue to stand in the way of expansion by Japanese companies into India. Although the Indian government indicated its intention to quicken the pace of economic reforms when it announced its budget proposal for FY2023, it is unlikely that reforms in controversial areas, including the land system and labor issues, will be accelerated as the country readies for a general election for the lower house of parliament in mid-2024. In particular, if resolution of the land expropriation issue, which is viewed as a bottleneck, is postponed and infrastructure development and factory construction continue to be delayed, Japanese companies, despite showing a high level of interest in India, will, just as before, continue to be hesitant about entering the country in earnest.

(Shotaro Kumagai)