朱雀基金
Rosefinch Fund
[021]2030 5888 [021]2030 5999
58 Floor, New Bund Center, NO.555 West Haiyang Road/588 Dongyu Road, Pudong New Area, Shanghai
上海市浦东新区海阳西路 555 号/东育路 588 号前滩中心第 58 层，邮编：200126

Rosefinch Weekly

Real Estate Sector Is A Drag On Economy

Real Estate has been a focal area of the Chinese market, which also is a key factor impacting major asset classes lately. The latest issue is the mortgage-strike protests by the owners waiting for the project delivery. It's worth noting that mortgage-strike is different from mortgage-default. The main reason for the home-buyer to boycott the mortgage is because the developer failed to deliver the homes on time. For the home-buyers, they expected the mortgage payments to replace the rental cash flow. But when the homes are not delivered in time, they're forced to pay both the current rental cost and the mortgage cost. The home-buyers are therefore using mortgage-strike as a method to compel the government and the banks to find resolutions in delivering the homes. Their main goal is therefore to ensure smooth delivery of the homes, not to skip the obligation of paying off the mortgage.

Indeed if the mortgage-strike can accelerate the completion of the projects, then it will have limited impact to the financial system. While this risk for the financial system is manageable, it may lead to stricter control on the project funding usage which will exasperate an already challenging liquidity situation for the real estate developers and the entire value chain. The slow progresses of the affected projects are mostly due to lack of developer funding to pay the construction firms or other subcontractors. With greater regulatory and financial scrutiny, the weaker developers will have an even tougher time to secure funding to continue construction.

Even though most banks have reassured the investors that their exposure to such mortgage-strikes are limited, it may have more serious shocks to the financial system. In terms of size, the new mortgages in 2020-21 were about 6-7 trillion RMB. Those developers who are currently caught up in such mortgage-strikes account for about 20% of these mortgages, so the hidden risk is sizeable. Policy makers need to quickly bring this under control in order to prevent further spreads. The bigger and longer shocks will come from the negative impacts on home-buyers. Certainly, home-buyers' confidence in smaller private developers will reduce significantly, with home-buying confidence dropping. To most private developers, it's already been very challenging to get enough working capital liquidity. With the drop in real estate sales and likely reduction in future purchasing intentions, it'll be even more difficult to secure bank funding. Like a self-fulfilling prophecy, the worsening outlook will squeeze liquidity conditions which in turn will worsen the outlook. There will likely be continued pressure to real estate credit cost and reputation.

Recent real estate data generally reflect a weakening trend with June YoY rates at around -10%. While Shanghai did see some pent-up demand pushing up the June rate, the overall major cities' July transaction volume are going down again. New opening and land pool remain at low levels, reflecting little improvements in the capital investment side. Overall, the real estate market is recovering only marginally, with no clear upswing despite the recent policy loosening. We'd expect 3Q22 real estate data to continue the weak trend, which coupled with the low capital investments will be a clear drag on the economy.

Financial market has reacted to the weak real estate sales data and the potential new risk from the mortgage-strike. Most of the real estate sector companies and associated value chains have come off recently, dragging A-share risk sentiments down along the way and bringing down the bond yields as well. In June, those sectors that had sharp corrections before had sizeable recovery: automobile, advanced equipment, electrical machinery, and electronics. We see the domestic manufacturing sectors continue upgrading. **Looking ahead, when the real estate sentiment stabilizes, and with a stable macro-economic policy support framework, we'd expect the advanced manufacturing sectors with strong outlooks to outperform.**