

How Strong are the Linkages between Real Estate and Other Sectors in China?

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Summary

International experience points to the critical role of stable property markets in maintaining financial stability. In China, the real estate sector has become increasingly important for the economy, but existing evidence has likely understated its importance as its linkages with other sectors have not been taken into account. This paper attempts to shed some light on these linkages through both real and financial channels. Our analysis based on input-output tables shows that the linkages between real estate and other sectors have strengthened through real economy channels, and the real estate sector has been much more important to the economy's output than suggested by the share of its value added in total value added.

The real estate industry is also closely linked to other sectors through financial channels. First of all, shocks to the property market can affect the profitability of any sector that is vertically integrated with the real estate sector and weaken its debt servicing capacity. Secondly, it is common for firms to use property as collateral to borrow so any adjustment in the property market could affect collateral values and hence debt quality. Thirdly, local government debt in China has been in part supported by land sales revenue, suggesting any property market adjustment could affect the quality of local government debt as well.

We quantify these possible financial linkages by studying the spill-over of credit risks across sectors using data of listed firms. We find that corporate credit risks have generally risen in recent years, especially for industries that have substantial over-capacity problems. Of particular note, the real estate and machinery sector are the two industries that could potentially spread credit risks to the largest number of industries, and they remain the most influential in terms of the magnitude of spill-over effects. As a result, any adjustment in the property market could have larger impact on the Chinese economy than suggested by headline figures.