

What Drives Urban Consumption in Mainland China? The Role of Property Price Dynamics

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Summary

With property prices soaring in China due to rapid economic growth, rising family incomes, accommodative monetary policy during the financial crisis, and continued migration to the cities, many economists worry that China risks being host to the next great property bubble set to burst. Housing affordability in some of the larger cities such as Beijing, Hangzhou, Nanjing, Ningbo, Qingdao, and Shanghai has also become an increasingly prominent political issue.

Against this background, the paper adds to the literature on house price effects on consumption by disentangling property price effects for mainland China. In a stochastic modelling framework, the riskiness, speed and persistence of house price movements have different implications for the consumption/housing ratio. We apply panel data techniques to a quarterly city-level dataset for mainland China for the period 1998Q1 - 2009Q4. The heterogeneity present in the city-level data allows us to test whether the predictions from the theoretical model hold in the data, in addition to examining whether there is a significant overall impact of house prices on consumption in China.

The benchmark results, obtained by the pooled mean group estimator, show that there is a significant impact of overall housing price movements on consumption. Splitting the sample in terms of riskiness of housing prices and speed of asset price growth, we find that the cities with faster growth in housing prices and higher volatility show the strongest links between housing prices and consumption, in line with the theoretical model. Similarly, permanent shocks to housing prices have a positive and statistically significant impact on consumption, in stark contrast to temporary house price shocks. Thus, we conclude that the strong rise in property prices over the past decade has had a significant effect on consumption spending in China.