How Big is Chinese’s Real Estate Bubble and Why Hasn’t It Yet Burst: A Comparative Study between China and World Major Financial Crises 1980-2014

Abstract

This paper represents an international, comparative, empirical study of the relationship between financial crises and real estate development – with a focus on Japan, Hong Kong, the U.S. and China. We look at the way nine variables related to real estate and financial sector development change during a crisis. We then discuss the ways real estate crises develop into financial crises (considering that most recent financial crises actually trace their origins to real estate bubbles). We summarise the similarities and differences in major crises around the world from 1980 to 2013, demonstrating the linkages between real estate bubbles and financial crises. We also look at China’s current economic situation, and identify potential threats to country’s economic development by comparing its current situation with other countries’ historical experiences. We further explore the deep-seated underlying Chinese systemic causes and characteristics that explain why China’s economic bubble has yet to burst. Historical heights in nine variables in particular, used to predict economic bubbles, foretell an upcoming burst in China’s bubble economy. In our quantitative analysis, we developed a stock-flow model for predicting the onset of a macroeconomic crisis. We found the impact of exogenous changes in property prices to changes in Chinese GDP from our quantitative modelling-- and showed that roughly a 30% drop in property prices would cause recession in China. Our findings suggest that a financial crisis often emerges from a weak financial system which is too closely linked to the country’s real estate sector. These linkages allow real estate crises to mushroom into financial crises. In turn, these financial crises balloon into macroeconomic crises. China’s current situation is extremely alarming, though the country shows remarkable resilience to crisis. The government seems to possess the tools and capacity to avoid a hard landing. We particularly draw parallels between modern-day China and the pre-asset bubble period in Japan. These two experiences resemble each other in many ways – and such resemblance should sound a clear warning to China’s policymakers.