Market Insights

Update on China Property Market

09/2017

Towards the end of September, we saw further property policies on eight cities in China, as the authorities seek to maintain their control over the sharply rising property prices. The policies restrict property owners from re-selling within a 2-3 year period after purchase, in order to stamp out speculation. This has come just ahead of the National Day golden week holidays, a popular week for property sales in China, which emphasizes the government's on-going focus on this sector. China property sector equities sold-off due to the uncertainty related to the tighter property measures and some profit-taking. However, China USD property credits were resilient with bond prices remaining intact.

Looking ahead, we expect a cyclical moderation in the Chinese property market as tight credit and policy measures moderate sales volume. However, many Chinese property developers will head into the slowdown with a stronger footing given that H1 2017 results were good with a pick-up in margins buoyed by the strong physical market sales growth over the preceding 12-18 months. Financials have generally improved with better liquidity due to strong cash flows. Investment grade property developers showed a deleveraging trend while leverage for high yield developers stabilized but remained high.

We continue to expect that the current round of adjustment in the sector will be more moderate compared to the previous property downturns (most recently in 2014) given lower inventory levels, lower borrowing costs, more targeted policies and a supportive monetary policy backdrop. (Refer to table below which shows a comparison between the previous downturn in 2014 and the current situation.)

China Property Market Cycle: 2014 vs current

Market Condition	2014	2017 Forecast
PBOC benchmark lending rate	6.0%	4.4%
Mortgage benchmark rate	6.6%	5.1%
Average 1st home mortgage rate	~7.0%	~5.1%
Inventory (month)		
• Tier 1	12.8	7.8
• Tier 2	17.5	7.0
• Tier 3	19.5	11.1
Top 30 developers' market share (by sales value)	26.1%	40.8% (in H1 17)

Source: CREIS, CRIC, CEIC, Rong360, Deutsche Bank estimates, Bloomberg, as at September 2017.

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Industry consolidation will continue with the larger, financially stronger and more diversified developers benefiting from increased market share at the expense of smaller, more indebted developers.

Key Risks

Recent measures to reign in credit growth and shadow banking activities have resulted in higher interbank rates which may increase funding costs for property developers ahead. A larger maturity pipeline in 2018 and 2019 across both offshore and onshore bonds could give rise to refinancing risks especially if we see continued approval delays of offshore issuances from the National Development and Reform Commission (NDRC). Leverage of Chinese high yield property developers has stabilized but remains high. Finally, sharply higher interest rates, driven by the US Federal Reserve tightening or domestic inflation for example, are also risks; but not our base case scenario at this juncture. These are all factors that we monitor closely and consider when selecting investments.

Investment Strategy

We remain constructive but selective when investing in the Chinese property sector. While much of the good news has been largely priced in, Chinese property bonds still offer attractive yield enhancement, in an environment where we expect credit spreads and US Treasuries to remain range-bound. In addition, there have been no defaults in China USD property bonds over the year-to-date period (as at 27 September 2017). We prefer property developers that we believe have greater resilience to a market slowdown and those that we believe will benefit from industry consolidation. The key factors that we look for include large scale, diversification across different tier cities, strong sales execution capabilities, prudent financial management, access to funding, discipline in land-banking and good liquidity profiles.

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