

# TRENDS JOURNAL

HISTORY BEFORE IT HAPPENS



## The grand manipulation

Backroom deals go global

➤ Bankism, not capitalism ➤ The antidote to fear



# CHINA FALL



Thames Town (above), a virtually deserted English-themed town in China, is a popular photo spot among newlyweds.

Blaineo via photopin

New South China Mall (left and right) is the largest mall in the world, based on gross leasable area, but has been 99 percent vacant since its 2005 opening. Its location makes it accessible only by car or bus, but there are no adjacent highways.

Wikipedia



# Paper tiger, greedy dragon

## What's behind the Chinese real estate bubble?

By **Stefan Verstappen**  
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**To understand the insanity** of China's real estate bubble, imagine every state governor borrowing \$10 billion from the federal government to build a city to suit his own vision.

The result is China's Ghost Cities — sprawling new cities with almost no one living or working in them.

Many of these cities resemble a Las Vegas casino, such as the Paris-themed Tianducheng, built in 2007. There, newlyweds pose for pictures in front of empty storefronts along the faux Champs-Élysées and dirt-poor farmers squat under a rusting one-third-scale replica of the Eiffel Tower.

Ten new cities a year are being built. But in a nation where the average worker's annual income is between US \$2,000 and \$5,000, and where new-home prices start at about \$160,000, most Chinese cannot afford to live, shop or even eat in any of these cities. China's nouveau riche, who could afford to, are opting for the real deal — and moving their money overseas as fast as they can.

This is only the tip of the real-estate iceberg many are calling "Dubai on steroids," which also includes many massive office, industrial and shopping-mall developments, such as the largest mall in the world,







**The new city of Kangbashi, built to house at least 300,000 residents, is actually home to no more than 20,000 to 30,000 people.**

Bert van Dijk via photopin

the infamous South China Mall in Guangdong Province. Built with the anticipation that a newly emerging Chinese middle class would become the same mindless consumers of trinkets that Americans are, it has stood empty since its 2005 completion.

Where does the money come from to fuel this madness?

### **SHADOW BANKING RISES TO AN ART FORM**

Banks in China always have been tyrannical and humorless. This is why many Chinese traditionally formed lending circles (lun-hui) to fund small-business ventures. China's Big Four Banks, storefronts for the central bank, will lend only to big corporations with ties to the Communist Party, leaving small and medium-sized business in the cold. Even with proper credentials, getting a loan at a bank takes months, requires taking out managers for dinner and karaoke, waiting for approvals — and then, there's still no guarantee.

Enter the shadow-banking sector — a collection of investment firms, private lenders and loan sharks. Estimates on the size of this industry range from US \$7 trillion to \$9 trillion, with loan sharking alone

accounting for US \$630 billion a year. What is not exactly clear is how much of this shadow banking takes the form of off-the-record bank loans.

Under China's financial regulations, banks must maintain a 20 percent deposits-against-loans ratio. But banks have a loophole: the Wealth Management Product, a high-risk/high-return loan marketed as an investment. Since WMPs operate outside bank balance sheets, the 20 percent ratio doesn't apply — and banks are free to lend as much as they'd like.

Most of the money is used to speculate in real estate, where 9 percent to 12 percent returns stay ahead of the current 3 percent inflation rate.

While Beijing makes noises about cooling the market, it really can't afford to. Construction and development account for 20 percent of China's gross domestic product, and 33 percent of Chinese have their life savings invested in residential properties. If real estate prices drop, most Chinese investors and banks will be underwater; if they continue to rise, then even fewer Chinese will afford to enter a market that already has 64 million vacant residential homes.



## MONEY-PRINTING MACHINE

How much money is China printing? More than the US and Europe combined. The money supply of China's central bank exceeded US \$15.66 trillion by the end of 2012 — almost double its GDP and the highest disparity between money supply and GDP in the world.

To rein in shadow banking, and in turn the real estate market, the Chinese central bank cut the benchmark interest rate for one-year deposits by 25 basis points and the one-year lending rate by 40 basis points, in addition to easing some loan requirements. This will do nothing to cool the market because the Chinese government also is removing a restriction on owning more than one home. That's guaranteed to spur further speculation.

The other component fueling shadow banks and the real estate market is pure greed. The Chinese proverb "To get rich quick, become an official!" perfectly describes the current communist system. The wealthiest families are mostly old-time party members; the most successful entrepreneurs are their sons and daughters.

There is scarcely a business deal made in China

without a member of the Communist Party, either on a village, city or provincial level, taking a cut of the action. Somewhere, some party boss is going to be in on the deal. Anyone declining to hand over a piece of his business to the local official would risk having his business license revoked, bank account seized, and even his home and possessions confiscated by the state.

Old China Hands have seen this before. In the 1980s and 1990s, Asia's Four Tigers (Hong Kong, Singapore, South Korea and Taiwan) went through a similar cycle. Flush with cash from export surpluses, the Tigers went through a frenzy of stock market and real estate speculation. It all came to an end during the 1997 Asian financial crisis, when stocks and currencies lost 30 percent to 60 percent of their value. Long-abandoned construction projects can still be seen rotting away in the countryside.

For 2015, China has all the indications it will continue along the same pattern. Real estate values will rise; banks will print more money. Those who can will get rich — and get out before it all comes down.

In the end, China's economic miracle may just be a paper tiger, something that looks fearsome but is made only of paper. **TJ**

**A replica of the Eiffel Tower in the ghost city of Tianducheng.**

*bricoleurbanism via photopin*