CEP council on economic policies

FINANCIAL REGULATION AND SUPERVISION IN CHINA

GRAPPLING WITH THE UPS AND DOWNS OF THE PROPERTY MARKET

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CEP POLICY BRIEF
March 2024

ABSTRACT

China's financial supervisors have employed a unique set of tools to address financial risk emanating from a key sector of the economy: real estate. This policy brief provides an in-depth description of the prudential supervisory instruments they have used to lean against the boom-and-bust phases of a credit cycle centered around the real estate market in recent years. After outlining the economic and policy context that shapes China's real estate development, the brief analyzes the supervisory toolkit and identifies features that are unique, such as measures targeting non-financial companies, joint rule-making with other government organs, and the use of informal instructions to financial institutions (so-called window guidance). It lays out the sequence of measures taken from 2017 to 2023, a period that can be divided into a restrictive phase and a phase of targeted easing. This analysis is intended to inform, with detail and clarity, the prudential supervisory community, financial experts in China and around the world, and anyone keen to understand the scope of the toolbox supervisors can wield in pursuit of a complex set of economic policy objectives.

EXECUTIVE SUMMARY

China's economic landscape bears the distinct imprint of its real estate sector, serving as both an engine of growth and a focal point for financial risk. This policy brief offers an exploration of the intricate relationship between financial regulation and the dynamic realm of real estate against the economic and policy backdrop that shapes this interplay.

The real estate sector occupies a unique position in China's economic policy environment. President Xi Jinping's call for a "New Normal" in 2014 marked a pivotal juncture, signaling a shift in China's economic policy priorities toward supply-side structural reform, common prosperity, and high-quality development. The real estate sector, a stalwart contributor responsible for a quarter of China's economic growth over the last decade, mirrors both vibrancy and complexity. Its expansive growth model resulted in overcapacity in lower-tier cities while fueling soaring property prices in premier urban hubs, accentuating disparities across regions.

The policy space for financial supervisors in the country's real estate sector is constrained by enduring market distortions. The symbiotic relationship between developers, banks, and local governments has been at the heart of frequent and significant challenges in the real estate market over the past two decades. Developers, operating on slim margins, leveraged aggressively for growth, while banks facilitated this cycle through substantial lending amid rising property prices. Local governments, reliant on land sales[1] for fiscal revenue, drove real estate development but inadvertently exacerbated market imbalances. Chinese households fueled demand for apartments. The homeownership rate rose from less than 30% of the population before the 1990s to over 80% by 2017.[2] Moreover, wealthier families bought more than one apartment because few other reliable retail investment options were available.

This brief unveils China's intricate toolbox of regulatory instruments wielded by financial supervisors. The supervisory interventions covered here have some unique and innovative characteristics: they (1) target a wider perimeter, (2) combine formal and informal instruments, (3) are issued across governmental silos, and (4) are more granular than what is common in other jurisdictions. China's financial authorities use tools that target not only financial institutions, and capital markets, but also non-financial institutions such as property developers directly. The instruments at their disposal range from formal balance sheet ratios and concentration limits to informal and nuanced window guidance. Often, they are issued jointly by several authorities such as the central bank, the banking supervisor, and the housing ministry. They are tailored, inter alia, to the size of financial institutions, the financial health of targeted firms, city size, and house buyer characteristics.

Documenting the sequence of financial regulatory actions between 2017 and 2023, the brief identifies two regulatory phases that go in opposite directions – a restrictive phase until end-2021, followed by a phase of targeted easing. In the first phase,

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[1] In China, land is not sold but leased for a period of up to 70 years. The term "land sales" throughout this brief refers to the sale of land use rights.

[2] Huang, Y., He, S. & Gan, L. (2021) Introduction to special issue: unpacking the Chinese dream of homeownership. *Journal of Housing and the Built Environment* 36, 1–7. See also China Population Census Yearbook 2020 (中国人口普查年检) See here. (Accessed on 26.02.2024)

regulators intervened with measures like the "Three Red Lines" for developers and concentration limits for financial institutions to temper excesses in the property market. Their actions aimed to curtail exuberance while steering the sector through deleveraging and restructuring, despite resistance from local governments reliant on land sales. When the credit cycle turned in 2021 and the real estate sector suffered from defaults, falling prices, and lagging demand, financial supervisors intervened in support of the sector as a whole and some developers in particular.

This policy brief provides insight into the complexity surrounding financial regulation for China's real estate sector. It offers insights into the mechanisms, challenges, and policy imperatives that define this critical domain of the nation's economy. And it outlines how policymakers confront the challenge of balancing financial stability, deleveraging the real estate sector, and facilitating sectoral and regional restructuring. This intricate task underscores the gravity of the challenge faced by China's financial supervisory authorities, encapsulating the complex interplay between policy, finance, and economic development. It is difficult to take straightforward lessons from the Chinese experience for real estate distortions or financial crises elsewhere because the political and economic context is unique. It is also too early to make judgments regarding the effectiveness of any given policy tool because the jury on China's real estate crisis is still out. Therefore, this brief refrains from adopting the perspective of a policy evaluation. Nevertheless, a thorough look at the unusually wide and innovative toolbox at the disposal of China's financial authorities provides insight into how very targeted supervisory tools can be wielded in response to a set of serious and complex challenges.

SETTING THE SCENE

Real estate plays a significant role as the source of both economic opportunities and risks in China. This section outlines the economic and policy context in which financial regulation of the real estate sector plays out. It identifies the key players and the main factors that made real estate a major engine of China's economic growth as well as a major concern for policymakers seeking to contain financial risk.

The measures China has taken over the last decade in the regulation of its real estate sector reflect a broader set of shifting policy priorities. In a speech in 2013, China's then newly appointed President Xi Jinping (习近平) laid out his vision of an economy entering three overlapping phases. He asserted that the country is facing "a slowing growth phase, a painful structural adjustment phase, and a phase of absorbing the adverse effects of previous stimulus policies".[3] A year later, Xi heralded a policy shift with the announcement of a "New Normal" at the Central Economic Work Conference, setting new expectations for China's growth rates, economic structure, and the drivers of growth.[4]

The call for an economic transition is reflected in three policy objectives that together form China's development strategy. Supply-side structural reform, common prosperity, and high-quality development emerged as key objectives in China's economic policy agenda over the past decade.[5] Since 2016, a growing spotlight on supply-side structural reform reflected the view that the country's supply of goods and services did not sufficiently adapt to changes in demand.[6] Elevated by Xi as the "most important task" for the economy, the policy calls for "cutting overcapacity, reducing excess inventory, deleveraging, reducing costs, and strengthening areas of weakness."[7] Common prosperity, the second policy theme, calls for a more even distribution between wealthy and poor citizens as well as between those in urban and rural areas.[8] The goal of high-quality development – the current guiding theme for Beijing – puts emphasis on the role of strategic sectors to become the growth drivers of China's next development phase.[9] It also lays out principles for rural development, a strengthened linkage between rural and urban areas, a balanced urban development across cities and provinces, and environmental sustainability.

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[3] People's Daily (2013). The Three Overlapping Phases Are the Interim Characteristics of China's Economy. ("三期" 叠加是当前中国经济的阶段性特征). People's Daily. See here. (Accessed on 26.02.2024)

[4] Xinhua (2014). Xi Jinping systematically expounded the "New Normal" for the first time. (习近平首次系统阐述 "新常态"). XINHUA. See here. (Accessed on 26.02.2024). Specifically, China was to move from "a period of high growth to a period of medium-to-high growth." The economic structure is said to "continuously improve and upgrade to a higher quality." Moreover, the driver of the economy was aimed to shift "from production and investment towards innovation."

[5] Xi Jinping (2021a). Understanding the New Development Stage, Applying the New Development Philosophy, and Creating a New Development Dynamic. QIUSHI. See here. (Accessed on 26.02.2024)

[6] Wang Yiming, Chen Changsheng & Li Chenjian (2016), Correct Understanding of Supply-side Structural Reform (正确理解供给侧结构性改革). PRC Government. See here. (Accessed on 26.02.2024)

[7] Xi Jinping (2021a).

[8] Xi Jinping (2021b). Firmly Promote Common Prosperity. (扎实推动共同富裕) PRC Government. See here. (Accessed on 26.02.2024)

[9] Qiushi (2023). Striving for High-Quality Development. QIUSHI. See here. (Accessed on 26.02.2024)

The real estate sector and its regulation play a central role in targeting these objectives. As a foundational driver of China's growth for the last two decades and more, it is estimated to have contributed up to 25% of China's annual output via direct and indirect channels.[10] Much of its vibrancy is said to stem from an undifferentiated high growth model, which led to overcapacity in the sector, especially in lower-tier cities, where education and employment opportunities are limited.[11] In contrast, property in first-tier cities became the most unaffordable in the world relative to people's purchasing power and income.[12]

Within China's development context, two structural issues stand out in determining China's policy space in financial regulation. The first is the coexistence of state-owned and private enterprises in a dual-track economy, at times at conflicting terms.[13] This setting constrains the transmission mechanism of monetary policy, as banks tend to prefer lending to state-owned enterprises with lower risk profiles due to implicit state guarantees.[14] It also creates imbalances in the sector for financial supervision, as easier access to funding provides a cushion to state-owned enterprises against liquidity crises vis-a-vis private enterprises. Second, local governments face funding pressures as fiscal spending becomes more localized while fiscal revenue becomes more centralized. From 1980 to 2020, local fiscal expenditure as a share of total fiscal expenditure rose from 46% to 86%. At the same time, local fiscal revenue as a share of total fiscal revenue over the same period declined from 75% to 55%. The fiscal pressure drove local governments to raise funds through alternative means, notably via local government financing vehicles (LGFVs) and land sales.[15]

Sales of land usage rights to generate local fiscal revenue have been a key driver of real estate development in the past decades. Land rights sales accounted for 5.9% of China's fiscal revenue in 2000, it rose to 42% in 2020. Adding taxes that property developers must pay, real estate accounted for 52% of China's fiscal revenue in 2020. To attract businesses, local governments offered low taxes and kept prices low for industrial land. As property development and growing economic activity attracted migrants, residential land became increasingly scarce and higher demand for homes led to ever stronger price pressures. From 2008 to 2021, the price of residential land grew on average 14% per year from 884 to 4835 yuan/m2 while the price of industrial land declined by 0.6% per year on average. As local governments sold rights to residential land for higher prices, it allowed

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[10] Wang, Tao (2021). How Sharp Will China's Property Downturn Be in 2022. Caixin Global. See here. (Accessed on 10.08.2023)

[11] Pettis, Michael (2022). China's Overextended Real Estate Sector Is a Systemic Problem. Carnegie Endowment for International Peace. See here. (Accessed on 10.08.2023)

[12] Reuters (2021). China Walks a Tightrope on Property Clampdown. Reuters. See here. (Accessed on 10.08.2023)

[13] Huang, Yiping and Wang, Xun (2021a). Understanding China's Financial System: An Economic Analysis of the Reform Policies (读懂中国金融：金融改革的经济学分析). The People's Daily Press. See here.

[14] Huang, Yiping (2021b). The Value of Finance (金融的价值). Citic Press.

[15] Liu, Jin (2022). China has Two Great Bubbles, But There is Only One Underlying Reason (中国地产有两大泡沫，但背后原因只有一个). The Economic Observer. See here. (Accessed on 26.02.2024)

them to balance their previous costs from tax discounts and other subsidies while creating ever larger migration to their cities.[16]

On the developers' side, business is determined by the context created through the dependency of local governments on land related income. About 54% of property developers' revenue – 40% for land use rights and 14% for taxes – is generally paid to the local government.[17] A popular operational strategy among developers was to take on leverage and start new projects aggressively. Companies such as Evergrande benefitted from scaling up their business this way, applying for more credit and paying back debt in faster cycles.[18] Developers that slowed down the cycle earlier had healthier balance sheets but often also smaller market shares.[19]

Banks fueled this cycle by lending significant amounts for real estate projects. Developers used existing properties as collateral for additional credit from banks. Banks deemed such collateral safe during a period when property prices were continuously rising in China. In addition to the official bank lending channel, the 2010s saw the rapid growth of a "shadow banking" network that connects banks, non-bank financial institutions such as trust companies, LGFVs, and real estate developers in ways that circumvented prudential supervision.

In sum, the real estate sector is both a key driver for China's growth and an enduring challenge for economic policymakers. As a strong source of demand for materials, goods, and labor, as well as a key element in China's urban planning, the real estate sector has played an outsized role in the country's economic development. At the same time, many of the distortions that policymakers have aimed to address in the 2010s, such as excessive investment-led growth, overcapacity, a widening gap between rich and poor, and between top-tier cities and the hinterlands, are still manifest in the sector.[20]

In this context, financial supervisors face a daunting task. China's authorities are asked to walk a fine line between two undesirable policy outcomes. If they crack down hard on excess capacity in the real estate market and excess leverage among property developers, they risk jeopardizing local government finances, affecting business confidence, and triggering a serious economic downturn. Yet if they do not intervene forcefully enough, the distortions surrounding the real estate sector are likely to pose an ever-growing threat to financial stability that could escalate into a full-blown financial crisis, something that has happened in many other jurisdictions in the past. In this delicate situation, China's financial supervisory authorities have employed a combination of established and innovative tools, which we will describe in the next section.

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[16] Liu, Jin (2022).

[17] Liu, Jin (2022).

[18] Liu, Zongyuan Zoe (2024). Does Evergrande's Collapse Threaten China's Economy? Council on Foreign Relations Brief. See here (Accessed on 15 Feb 2024).

[19] Li, Wei (2023). Evergrande's Dilemma and the Healthy Development of China's Real Estate Industry. (恒大的困境与中国房地产业的良性发展) Cheung Kong Graduate School of Business. See here. (Accessed on 26.02.2024)

[20] Glaeser, Edward, Wei Huang, Yueran Ma, and Andrei Shleifer (2017)."A Real Estate Boom with Chinese Characteristics." Journal of Economic Perspectives, 31 (1): 93-116.

CHINA'S SUPERVISORY TOOLBOX

In China, several organizations are tasked with supervising the financial sector and ensuring financial stability. The People's Bank of China (PBC) has a macroprudential mandate and supervisory authority over financial holding companies, the payment system, and other parts of the financial sector. The banking and insurance regulator, formerly the China Banking and Insurance Regulatory Commission (CBIRC), which was renamed National Financial Regulatory Administration (NFRA) in March 2023, carries out micro-prudential supervision. The authorities responsible for China's bond market are the National Development and Reform Commission (NDRC), the PBC, and the China Securities Regulatory Commission (CSRC), which also oversees the stock market. Often, rules issued by the supervisory authorities in Beijing are complemented by policies from other parts of the state, such as the Ministry of Housing and Urban-Rural Development (MHURD), as well as provincial and municipal governments. Underlying it all is policy guidance by the Communist Party, which formulates the general direction of economic policy and priorities of financial regulation at regular intervals.

Local governments issue complementary rules that regulate the real estate market from the customer side. The "four-restriction policy" (四限令) that major cities started introducing in 2010 to address scarce housing supply, is a case in point. The policy comprises sales restrictions (限购), non-resident restrictions (限外), credit restrictions (限贷), and price restrictions (限价). From the onset of the sales restriction policy, families could only buy one additional property irrespective of one's previous history of property purchase or place of residency. The non-resident restriction implies that those who could not demonstrate proof for a certain number of years of tax or social security contributions in the same city may not be eligible for property purchase. Credit restriction dictates that no mortgage was to be issued for the purchase of a third property while a predetermined downpayment must be placed for the first property in order to apply for a loan. Finally, a price ceiling has also been set up for certain cities. These four restrictions were introduced nationwide from 2010 onwards, but local governments implemented them flexibly depending on the market environment.

Financial supervisory authorities focus on three targets in their oversight of the property market. Their policies are aimed at property developers, financial institutions, and capital markets, respectively. Table 1 presents an overview of regulatory instruments used in the context of the property sector.

Financial regulation for China's property sector aims at ways to intervene in the supply and demand of funds directly or via financial intermediaries. With measures targeted at property developers, regulators influence the demand for real estate financing. With instruments targeted at financial institutions and capital markets, the authorities regulate the supply of funds to the real estate sector via three funding channels: loans, bonds, and equity – also referred to as the Three Arrows.[21]

[21] Yi Gang (2019). China's Monetary Policy Framework – Supporting the Real Economy and Striking a Balance Between Internal and External Equilibrium. Bank for International Settlements. See here. (Accessed on 04.10.2023)

Table 1. Instruments Overview

Tool	Illustration
Property Developers	
Balance Sheet Ratio (Three Red Lines)	Liability to Asset Ratio (excluding pre-sales) must not exceed 70%
	Net Debt to Equity Ratio must be lower than 100%
	Cash to Short-term Borrowing Ratio must be at least 1
Window Guidance	Repay retail investors
	Avoid default on dollar bond holders
	Complete pending projects
Financial Institutions	
Sectoral Credit Risk Assessment Requirement	Make banks stress test their exposure to the real estate sector
Concentration Limits	Loans to developers must not exceed certain % of loan portfolio
	Mortgage loans must not exceed certain % of loan portfolio
Loan to Value Ratio	Minimum downpayment requirement for mortgages (differs by city tiers and borrower characteristics)
Interest Rate Target	Floor or ceiling of interest rates on mortgage loans
Window Guidance	Lend (or refrain from lending) to specific purpose (e.g. project completion) or segments (e.g. developers with sound corporate governance)
	Refrain from or increase issuance of trust products to specific segments (e.g. builders of retirement homes)
	Extend loan maturity
	Guided sales of assets
Letters of Guarantee	Allow banks to extend quasi-loans to developers by issuing a letter of guarantee that covers a share of the funds in the pre-sale escrow account
Capital Markets	
Requirements for Bond Market Issuance	Bond support programs incl. bond guarantee (Lifting of) Ban on new bond issuance (for specific purposes)
Listing Requirements and Guidance for Stock Market	(Lifting of) Ban on new share sales
	Grant share sales for specific purposes (e.g. mergers and acquisitions)

The supervisory authorities use several formal tools, some of which are tailored to the characteristics of market participants. Traditional instruments such as concentration limits and loan-to-value ratios are employed in many jurisdictions to safeguard financial stability. In China, their application is often tailored in granular fashion, distinguishing between first, second, and third-tier cities, between first and second home buyers, and between highly and medium-leveraged developers, for example.

The authorities also apply window guidance to make supervised firms act in directions not captured in formal regulatory measures. This instrument is understood as an "informal mechanism by which government authorities [...] communicate policy to market players."[22] Window guidance (窗口指导) comes in the form of private, written or oral messages from the supervisory authority to a set of firms, never as a public document. There is no legal obligation to comply with window guidance. But firms have a strong incentive to maintain good relations with the authorities. A financial journalist describes window guidance as "an informal but high-pressure policy tool that lenders ignore at their peril."[23] Window guidance is commonly used by China's monetary policy authority, but financial supervisors also employ this tool.

Property Developers

A key regulatory instrument targeted at Chinese property developers in the past years are three balance sheet ratios referred to as the "Three Red Lines". Developed jointly by the PBC and the MHURD, balance sheet ratios are quantitative regulatory requirements a firm must meet to continue its commercial activity. The Three Red Lines consist of three ratios aimed at restricting developers' ability to increase their debt. First, the liability-to-asset ratio (excluding pre-sales) must not exceed 70%. This ratio dictates that up to 70% of the firm's assets can be financed with debt while the remaining 30% must be financed by shareholders' equity. Secondly, the net debt to equity ratio must be lower than 100%. This implies that total debt minus the amount of cash at hand must be lower than the book value of equity. Finally, the cash to short-term borrowing ratio must be no lower than 1, which implies that firms' cash holdings must be enough to cover their short-term debt.

Compliance with the Three Red Lines determines how much further debt, if any, developers can take on. Developers must present their balance sheets to the PBC on a regular basis. Those that are non-compliant with all ratios are banned from increasing their debt further. Those who cross either two, one, or none of the Three Red Lines can increase their annual interest-bearing liabilities by up to 5%, 10%, or 15%, respectively. Those who have overshot one or more ratios must submit a plan on how they intend to meet one of the missed requirements within a year. The measure was introduced in January 2021 for all developers while 12 developers in the initial pilot project already submitted reports as of September 2020. By the end of 2023, all developers were expected to meet the requirements

[22] Caixin (2022a). Five Things to Know About China's Overarching Financial Stability Law. Caixin Global. See here. (Accessed on 04.10.2023)

[23] Wu et al. (2022). Caixin Explains: China Takes Another Step to Unshackle Interest Rates. Caixin Global, 6 Jul 2022.See here. (Accessed 26.02.2024).

of all three ratios. Those from the pilot project were required to meet all three ratios by the end of June 2023.[24]

Financial supervisors can also provide window guidance to property developers. At the height of the real estate crisis in September 2021, for example, financial supervisors reportedly issued a set of instructions to the embattled property developer China Evergrande Group. The authorities asked Evergrande to communicate proactively with bondholders to avoid a near-term default on dollar-denominated bonds, complete unfinished projects, and repay retail investors.[25]

FINANCIAL INSTITUTIONS

Bank loans are a key source of funding for the real estate sector. China's financial system is a bank-driven system, as bank assets account for around 90% of China's overall financial assets.[26] Additionally, loans consistently account for around two thirds of the country's aggregate financing to the real economy.[27] Loans are the most important source of funds for property developers. Easing and tightening restrictions on banks for their loans to property developers and homebuyers is a forceful instrument to affect funding to the real estate sector.

Financial supervisors ordered credit risk assessments to evaluate financial institutions' exposure to the property sector. In 2017, supervisors asked banks to make assessments on off-balance-sheet activities and nonperforming loans in industries with overcapacity such as the property sector. They also conducted stress tests on collateral values. Additional instructions required lenders to classify their collateral under the categories of financials, real estate, and accounts receivable. This credit risk assessment laid the foundation for subsequent supervisory measures, and it also communicated to banks that real estate exposures were an acute concern for the authorities.

The authorities then set concentration limits for loans to property developers and homebuyers. The CBIRC capped the maximum share of loans to property developers and mortgage loans in the loan portfolio of China's banks at the beginning of 2021. The ratios are defined with financial institutions being categorized into five tiers. Larger banks are granted higher concentration ratios while loans from smaller financial institutions are more restricted. For the big six state-owned banks and the China Development Bank, the ratios of outstanding property development loans to total loans and outstanding mortgage loans to total loans are 40% and 32.5%, respectively. For the Agricultural Development Bank, the Exim Bank of China and the 12 joint-stock commercial banks, the two ratios are 27.5% and 20%. Further down are city banks, rural commercial banks, rural cooperative banks, and rural

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[24] Reuters (2020). China's New "Three Red Lines" Financing Regulations for Real Estate Companies Will be Fully Rolled Out Next Year. Some Companies May Resort to Shadow Banking (中国房企"三道红线"融资新规明年全面推开 部分公司或借道影子银行). Reuters China. See here. (Accessed on 26.02.2024)

[25] Bloomberg (2021). China Urges Evergrande to Avoid Default, Repay Retail Investors. Bloomberg News. See here. (Accessed on 06.10.2023)

[26] PBC (2023d). Assets and Liabilities Statistics of Financial Institutions (the end of 2023Q2). PBC Statistics and Analysis Department. See here. (Accessed on 26.02.2024)

[27] PBC (2023e). Aggregate Financing to the Real Economy (Stock). PBC Statistics and Analysis Department. See here. (Accessed on 26.02.2024)

cooperatives at 22.5% and 17.5%. The last two tiers comprise local rural cooperatives and village banks with more restrictive ratios.[28]

The concentration limits are adjustable according to regional economic performance and the extent to which financial institutions are overexposed. The two ratios can be revised up- or downward based on assessments of the level of development in regions where financial institutions reside as well as the systemic financial risks they pose. Furthermore, lenders that overshoot the requirements by less than two percentage points must commit to meeting them within a transition period of two years. Those that miss by more than two percentage points are given four years. Financial institutions can apply for exceptions to prolong their transition period in case of exceptional circumstances. In case of continued non-compliance, the regulator can raise capital requirements for the lender.[29]

Loan-to-value ratios for mortgages are determined by the financial supervisory authorities together with municipal governments. In order to foster responsible borrowing and manage demand for residential properties, the authorities regulate how much of a property's value must be paid upfront as downpayment, and how much can be financed with a mortgage. First-tier cities are subject to higher downpayment requirements because demand is higher than in lower-tier cities. In addition, retail borrowers irrespective of location must pay a higher downpayment if they buy a second (third, etc.) property.

Supervisors can also establish interest rate ceilings or floors for mortgage loans. Customarily, the PBC and the banking supervisor jointly issue interest rate policies, while allowing cities to determine their own interest rate levels for the property sector. In August 2023 for example, the PBC and the NFRA changed mortgage rate floors for existing individual mortgages. The floor for first-time buyers would be 20 basis points below the loan prime rate (LPR), the central bank's key interest rate, while the floor for second-time buyers would be 20 basis points above the LPR.[30]

In addition, financial authorities regulate access to escrow accounts for developers, directly, and via guarantee letters by banks. Escrow accounts play an important role in China's real estate market. Homebuyers typically transfer their funds to an escrow account, which can only be accessed by the developer after reaching certain stages of construction. Local governments have tightened and eased restrictions on what share of funds property developers can access at a given stage of construction. If developers need to obtain funds earlier, banks can provide funding equivalent to a certain share of the funds in escrow based on a letter of guarantee, which would cover the shortfall in case the developer fails to meet

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[28] CBIRC (2020b). Announcement by the PBC CBIRC Administrative Committee on Establishing the Management Mechanism of Property Asset Concentration for Banking Sector Financial Institutions (中国人民银行 中国银行保险监督管理委员会关于建立银行业金融机构房地产贷款集中度管理制度的通知). The China Banking and Insurance Regulatory Commission. See here. (Accessed on 26.02.2024).

[29] Ibid.

[30] PBC (2023b). Notice by MHURD, PBC, NFRA on Optimizing Standards for Numbers of Housing for Individual Mortgages (住房城乡建设部 中国人民银行 金融监管总局关于优化个人住房贷款中住房套数认定标准的通知). The People's Bank of China. See here. (Accessed on 26.02.2024)

its obligations.[31] The CBIRC, PBC, and MHURD jointly issued guidelines in 2022[32] to stipulate which banks can issue such guarantee letters for which developers and to what extent, seeking to unify the wide array of local rules.[33]

Additional measures target lending that evades formal bank regulations via 'shadow banking'. The financial authorities are engaged in ongoing efforts to improve prudential supervision of the country's shadow banking sector, which includes trust companies and other non-bank financial institutions, to crack down on regulatory arbitrage.[34] Studies suggest that 70% of trust products in China were originated by banks, and thus refer to the sector as "bank's shadow".[35] Banks could evade regulatory restrictions by extending loans at lower regulatory risk weights via various channels to intermediaries, such as smaller banks or trusts, which then would on-lend to real estate firms. In addition, banks purchased financial products issued by non-banking financial institutions such as security firms, insurance companies, and mutual funds, which again have lower risk weights than loans to enterprises. This 'channeling business' associated with the financial sector channeled bank funds to the real estate sector, other sectors with overcapacity, or local government financing vehicles. In 2022, CBIRC Chairman Guo Shuqing (郭树清) mentioned that the financial regulator compelled the shadow banking system to reduce its balance sheet by 25trillion yuan from 2017 to 2022. There were, however, still around 29 trillion yuan of shadow banking assets remaining.[36]

In addition to these traditional regulatory tools, financial supervisors also use window guidance to instruct market actors to adopt certain market behaviors. In cases of relevance for the real estate sector, supervisors instructed financial institutions to adjust their loan portfolio, change interest rates, and treat certain clients with greater flexibility than others. The authorities called on banks to support property developers with sound corporate governance. They encouraged policy banks to extend special loans for property project completion, and trusts to provide funding support for mergers and acquisitions, rental properties, and retirement homes. The authorities also allowed banks and trusts to extend

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[31] Clare Jim and Ziyi Tang (2023). Exclusive: Chinese cities tighten property firms' access to escrow funds. Reuters. See here (Accessed 26.02.2024)

[32] CBIRC (2022b). Notice of the General Office of CBIRC, MHURD, PBC On the Issuance of Letters of Guarantee by Commercial Banks to Replace Pre-sale Regulatory Funds (中国银保监会办公厅 住房和城乡建设部办公厅 中国人民银行办公厅关于商业银行出具保函置换预售监管资金有关工作的通知). See here. (Accessed on 26.02.2024)

[33] Far East Credit Research 远东研究 (2022). What do you think about allowing banks and real estate enterprises to carry out the business of replacing pre-sale funds with letters of guarantee? (银保监允许保函换预售资金规定的点评) See here (Accessed on 26.02.2024).

[34] CBIRC (2020c). China Shadow Banking Report (中国影子银行报告). CBIRC Working Paper. See here. (Accessed on 26.02.2024)

[35] Sun, Guofeng (2019). China's Shadow Banking: Bank's Shadow and Traditional Shadow Banking. BIS Working Papers No 822. See here. (Accessed on 06.10.2023)

[36] CBIRC (2022a). Transcripts of Q&A of the CBIRC Press Conference. The China Banking and Insurance Regulatory Commission. See here. (Accessed on 26.02.2024)

their existing loans or trust products, which were due to mature within six months, for a year while easing transition period requirements for concentration limits.[37]

CAPITAL MARKETS

The regulation of bond issuance is another important way to manage capital flows to real estate companies. In China's context, bonds are traded on the interbank market or the country's exchanges, which are overseen by the PBC and the CSRC, respectively. The issuance of bonds is approved by designated regulators. In the case of enterprise bonds – a sub-category of corporate bonds – the NDRC used to approve those traded in the interbank market while the CSRC had responsibility for those traded on an exchange.[38] This divide was eliminated when the CSRC assumed the role to supervise all enterprise bonds as a result of national legislative changes in March 2023.[39]

The supervisors that oversee China's bond markets can target the real estate sector through the regulatory approval process. Concretely, they can grant, ban, or suspend the issuance of bonds for property developers. The 16-point plan in November 2022, for example, allowed bond issuance by quality developers after they were shut out from the market in 2016. The approval or ban of bond issuance is often subject to a limited timeframe contingent on economic environments. For targeted policies, the authorities can also grant bond sales for specific activities, such as mergers and acquisitions or repaying old debt. Finally, supervisors can authorize and fund support programs for bond sales, including bond guarantees, credit risk mitigation warrants, and credit enhancements.[40]

Financial authorities can also target the property sector by regulating access to the stock markets. The CSRC is the supervisor of the country's stock exchanges, including the Shanghai Stock Exchange, the Shenzhen Stock Exchange, and also the new Beijing Stock Exchange. It can approve, ban, or suspend the sales of shares of companies in a certain sector. It can also mandate the delisting of a company in case of regulatory non-compliance or insolvency issues. For targeted policies, the CSRC can grant share sales to companies for specific purposes. In November 2022, for example, it allowed property developers to resume their listed share sales only for mergers and acquisitions, construction of existing projects, replenishing working capital, and repaying debt. Additionally, the CSRC also granted share sales through private placement for replenishing working capital, repaying debt, completing unfinished housing projects, shantytown redevelopment, urban housing renovation, and for-sale affordable housing projects.[41]

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[37] Chen and Zhang (2023). China Regulators Roll Out Property Rescue for Embattled Developers. Caixin Global. See here (Accessed on 26.02.2024).

[38] Caixin (2016). Regulators Beef Up Curbs on Property Developers' Effort to Generate Funds. Caixin Global. See here. (Accessed on 10.10.2023)

[39] Xinhua (2023). The Central Committee of the Communist Party of China and the State Council issued the "Plan for the Reform of Party and State Institutions" (中共中央 国务院印发《党和国家机构改革方案》). XINHUA. See here. (Accessed on 26.02.2024)

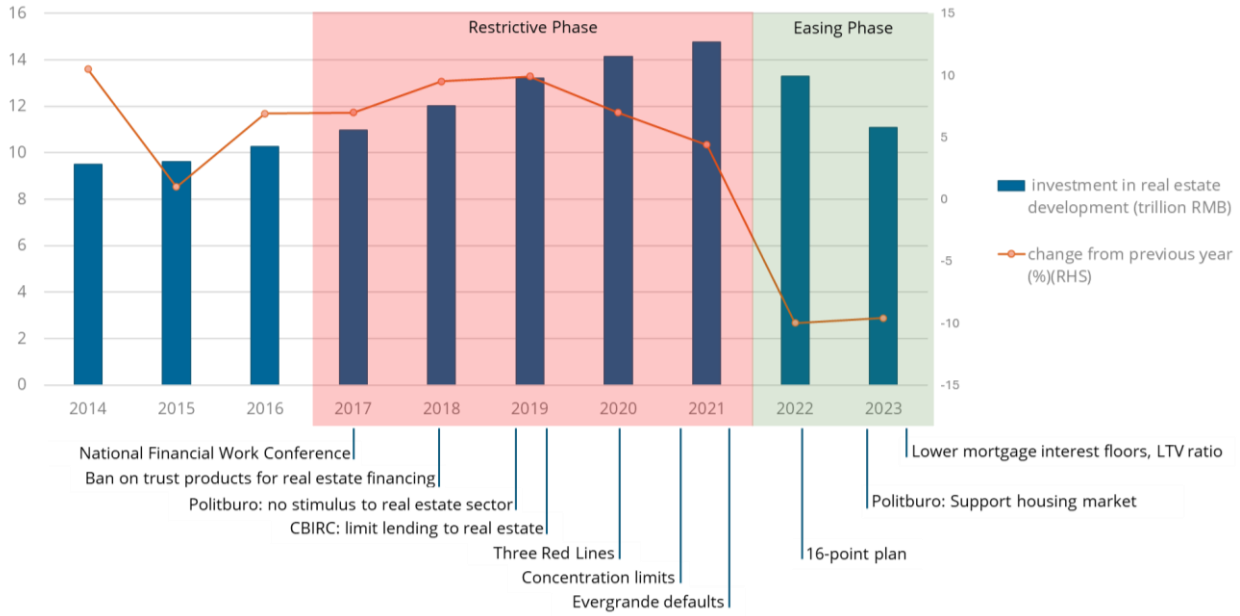
[40] NAFMII (2022). Extend and Expand Capacity of "the Second Arrow" to Support Private Enterprise Bond Financing ("第二支箭"延期并扩容 支持民营企业债券融资再加力). See here. (Accessed on 26.02.2024)

[41] Caixin (2022b). Five Things to Know About Lifting the Ban on Chinese Developers' Share Sales. Caixin Global. See here. (Accessed on 13.10.2023)

FINANCIAL REGULATION OF THE PROPERTY SECTOR 2017–2023

This section documents the sequence of China's financial supervisory actions for the real estate sector from 2017 to 2023. We identify two phases with different supervisory tendencies, namely a restrictive phase and a targeted easing phase (see Figure 1).

Figure 1: Investment in real estate development and selected policy interventions



THE RESTRICTIVE PHASE

The real estate sector came under increased supervisory scrutiny in 2017. The 5th National Financial Work Conference in 2017 laid out the task of financial policymakers to a) steer finance to serve the real economy; b) improve the financial system's structure; c) strengthen supervision; and d) provide conditions for market guidance.[42] In the same year, the banking supervisor ordered banks to monitor credit risks in their businesses with a focus on excess capacity sectors such as real estate. It instructed banks to conduct regular stress tests on collateral values and to diversify pledged assets.

When the economy experienced a slowdown, regulators refrained from supporting the real estate sector. In August 2018, the CBIRC switched its previous position from tightening lending to calling on banks to lend more. It aimed to "guide banking and insurance institutions to have an accurate grasp of the relationship between promoting economic growth and controlling and preventing risk, and to correctly understand the intentions of

[42] Xinhua (2017). Xi Jinping: Deepen Financial Reform, Promote Healthy Economic and Financial Flows and Development. (习近平：深化金融改革 促进经济和金融良性循环健康发展). XINHUA. See here. (Accessed on 26.02.2024)

regulatory policies."[43] Notably, while the issued document highlighted several support areas such as infrastructure projects and SMEs, it did not mention the real estate sector. The omission was interpreted as a signal that no change was to be expected in the tightening of the sector.[44]

Additionally, the CBIRC ordered several trust companies to stop launching new trust products for real estate financing. The window guidance came under a larger regulatory crackdown on the asset management industry in China. The industry boomed from 2012-2017 via "channeling lending". Banks were restricted from lending to companies that didn't meet regulatory requirements, but they could continue to do so via trust companies. Banks would sell wealth management products to their customers and invest the proceeds in trust products. Trust companies would then funnel the funds to companies that struggled to receive a bank loan due to regulatory restrictions. As the investor in the trust product, the risk for these loans would continue to be borne by the bank while trust companies attained revenue by charging commissions.[45]

In 2019, financial supervisors maintained their restrictive stance on the property sector even though the Chinese economy continued to struggle. In June, CBIRC chairman Guo Shuqing gave a first official warning on speculation in the sector. A month later, the CBIRC ordered selected trust companies to halt the growth of their real estate financing business through the third quarter and wait for approval in the fourth quarter.[46] Shortly thereafter, the National Development and Regulatory Commission (NDRC) issued a policy document that announced the restriction of offshore bond offerings for all property developers. Any new offshore bond could be issued only for the purpose of replacing medium- and long-term offshore debt maturing in the following year.[47] Additionally, the NDRC restricted several property developers from issuing domestic bonds while allowing others to issue bonds to repay their old debts. In July 2019, the CBIRC launched a special inspection on 75 banks in 30 cities for violations of regulatory metrics on property-related loans.[48]

An important meeting of the Party in July 2019 signaled shifting expectations for the property sector. The Politburo gave a key signal at a quarterly meeting that policymakers should refrain from using the real estate sector as a means for short-term stimulus.[49] In

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[43] CBIRC (2018). Strengthen Supervision and Lead the Opening Up of the Monetary Policy Transmission Mechanism (加强监管引领 打通货币政策传导机制). See here. (Accessed on 26.02.2024)

[44] Caixin (2018a). Chinese Regulator to Banks: Lend More, Please. Caixin Global. See here. (Accessed on 28.08.2023)

[45] Caixin (2018b). Regulator Tightens Scrutiny of Real Estate Trust Business. Caixin Global. See here. (Accessed on 22.01.2024)

[46] Caixin (2019a). Regulator Confronts Trusts About Real Estate Financing. Caixin Global. See here. (Accessed on 29.08.2023)

[47] Caixin (2019b). Exclusive: China Bars Some Developers From Selling Bonds to Curb Risks. Caixin Global. See here. (Accessed on 29.08.2023)

[48] Caixin (2019c). Regulators to Inspect Banks' Property Loans to Curb Risks. Caixin Global. See here. (Accessed on 29.08.2023)

[49] Caixin (2019d). The Communist Party Politburo Convenes, Refrain from Using the Real Estate Sector as a Means for Short-term Stimulus (中共中央政治局召开会议 不将房地产作为短期刺激手段). Caixin China. See here. (Accessed on 29.08.2023)

response, sentiment among market participants turned negative as they started to expect further financial tightening for the real estate sector.[50] In September, for the first time, the CBIRC told banks explicitly to limit their lending to property developers and homebuyers even though the central bank took measures to support the slowing economy.[51]

In 2020, financial supervisors began to introduce further hard measures in the real estate sector. In August, the CBIRC chairman Guo issued a warning in a Party magazine that the greatest financial stability threat to China was its real estate bubble.[52] Four days later, the PBC and the Ministry of Housing and Urban-Rural Development (MHURD) launched a pilot project that set hard limits on debt expansion based on the developers' existing leverage and cash ratios. This pilot was widened to the entire real estate sector by the start of 2021 and became known as the Three Red Lines. The Three Red Lines have been the strictest regulation thus far. Immediately after its rollout, it was expected that the measure would slow down developers' pace of land acquisition, which was a major driver of their profitability.[53]

Supervisors imposed additional limits on the supply of bank credit at the beginning of 2021. In December 2020, in preparation for the 14th 5-year plan, Guo published a landmark article in which he highlighted the risks of a real estate bubble. He noted that about 100 of the past 130 financial crises in the world were related to the real estate sector. In China, Guo stated, real estate loans accounted for 39% of all banking sector loans.[54] In January 2021, the PBC and the CBIRC imposed concentration limits on all bank loans to property developers and on all mortgage loans. The limits were adjusted according to banks' size and risk profiles while a grace period was given to banks that did not meet the requirements.[55]

Supervisors also stepped up efforts to curb regulatory arbitrage and evasion. In March 2021, the CBIRC, the MHURD, and the PBC issued a joint statement to announce a nationwide inspection.[56] The inspection targeted the misuse of individual and corporate loans for the purpose of housing market speculation. By the end of the inspection, the banking regulator announced its intention to step up their supervision of real estate loans, as many

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[50] Caixin (2019e). Developers Prepare for Winter as Tightening Control is Expected to Continue. Caixin Global. See here. (Accessed on 29.08.2023)

[51] Caixin (2019f). Chinese Banks Told to Curb Loans to Developers, Homebuyers. Caixin Global. See here. (Accessed on 22.01.2024)

[52] Guo Shuqing (2020). Firmly Maintain Fight to Defuse Financial Risks (郭树清：坚定不移大号防范化解金融风险攻坚战). PRC Government. See here. (Accessed 28.08.2023)

[53] Caixin (2020). Developers Face New Debt Limits as Property Crackdown Continues. Caixin Global. See here. (Accessed 28.08.2023)

[54] Guo Shuqing (2020). To Improve the Modern Financial Supervision System. (完善现代金融监管体系). Local Administration of Financial Regulation Guangxi. See here. (Accessed 26.02.2024)

[55] CBIRC (2020a). Notice of the CBIRC and the PBC on the Establishment of a Centralized Management System for a Real Estate Loans of Banking Financial Institutions. (中国人民银行 中国银行保险监督管理委员会发布《关于建立银行业金融机构房地产贷款集中度管理制度的通知》) The China Banking and Insurance Regulatory Commission. See here. (Accessed on 26.02.2024)

[56] CBIRC (2021). CBIRC, MHURD, PBC Issue <<About Announcement to Prevent Operational Use of Illicit Loans to Flow into the Real Estate Sector>> (关于防止经营用途贷款违规流入房地产领域的通知). CBIRC. See here and here. (Accessed on 26.02.2024)

irregularities were found.[57] Despite signs of downside pressure in the real estate sector, the authorities remained steady in their tone and policies in 2021. In its annual financial stability report of 2021, the PBC stated that lending restrictions for banks in the real estate sector would stay in place as a normalized policy.[58]

By autumn 2021, the first signs of trouble in the real estate sector set in. Evergrande Group, China's then second largest property developer, was facing a liquidity crunch. To evade loan restrictions, the Group issued high-yielding wealth management products in which many of its employees, their families, as well as the company's construction partners invested. As Evergrande's funding sources and pre-sale revenue started to dry up, it could not repay its debt to a wide range of investors and lenders ranging from construction companies to financial institutions. Given the size of the conglomerate and the entanglement with other sectors, Evergrande's crisis prompted financial analysts to ask whether it was "China's Lehman Moment" – a term referring to a rapid unraveling of a systemic crisis.[59] The negative sentiment spread to the entire real estate sector throughout the rest of the year. By September, sales by China's top 100 developers plunged by 36% year-on-year.[60] From September to mid-October, the credit outlook of nine developers had been cut about 20 times.

After several developers defaulted on their obligations, authorities sought to restore confidence. The CBIRC stressed that financial institutions must work with local governments to resolve the housing sector pressures. Local governments deployed measures to ease liquidity pressures of property developers but warned at the same time that developers should not cut prices too much. The PBC stressed that credit to the sector must remain stable and orderly while pointing out that the credit crunch of property developers was a normal market phenomenon.[61] In the immediate reaction, banks started to accept new mortgage applications in October, and mortgage extensions increased by 41% in value from September to October.[62] By the time Evergrande defaulted on its offshore financial obligations, however, the CBIRC noted that the event would not affect the country's banking and insurance sectors, and that support for developers' financing would follow prudential principles.[63]

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[57] Caixin (2021a). China Steps Up Pressure on Financial Institutions to Limit Property Lending. Caixin Global. See here. (Accessed on 30.08.2023)

[58] Caixin (2021b). Real Estate Lending Caps Will Stay in Place, Central Bank Says. Caixin Global. See here. (Accessed on 30.08.2023)

[59] Authers, John (2021). China's Evergrande Moment is Looking More LTCM than Minsky. Bloomberg Opinion. See here. (Accessed on 30.08.2023)

[60] Caixin (2021c). China's Property Sector Shrinks for First Time Since Pandemic Hit. Caixin Global. See here. (Accessed on 30.08.2023)

[61] Caixin (2021d). Cover Story: How China's Housing Market Landed in the Deep Freeze. Caixin Global. See here. (Accessed 30.08.2023)

[62] Caixin (2021e). Chinese Property Stocks Surge on Signs of Policy Easing. Caixin Global. See here. (Accessed on 30.08.2023)

[63] CBIRC (2021). CBIRC spokesperson responded to reporters' questions: Evergrande Group's failure to fulfill its guarantee obligations will not have any negative impact on the normal operation of the banking and insurance industries. (中国银保监会新闻发言人答记者问 恒大集团此次未能履行担保义务不

THE TARGETED EASING PHASE

The first signs of regulatory easing set in at the end of 2021 as financial supervisors began to support mergers and acquisitions (M&A) of real estate projects and companies. In December 2021, a PBC-backed magazine reported that the CBIRC and the PBC issued a joint message to financial institutions requiring them to lend support to M&A operations for distressed real estate companies.[64] It also called for support for bond issuance of healthy real estate companies for M&A purposes. In addition, it was reported that property firms were no longer restricted in their borrowing for M&A purposes under the Three Red Lines.[65]

Bank loan policies and city-wide policies began to ease, as the crisis worsened. In March 2022, CBIRC Chairman Guo Shuqing indicated that he preferred an orderly transition over a radical restructuring of the real estate sector as the latter would affect the economy negatively.[66] In that month, property sales by the 100 largest real estate companies dropped 52.7% by value year-on-year.[67] At the same time, banks cut mortgage interest rates in more than 100 cities, and many cities started to ease their policy on mortgage conditions and purchase restrictions.[68] Debt distress among property developers worsened by summer as at least ten of China's large or midsize banks had reportedly seen a rise in their non-performing loan ratios (NPLs) for the property sector in the first half of 2022.[69]

The worsening conditions triggered a boycott on mortgage payments and prompted the Politburo to call for stabilizing the real estate market. By July 2022, a wave of mortgage boycott events started to spread from Zhengzhou, the capital of Henan Province, to the rest of the country. Homeowners became frustrated by construction delays and halted their mortgage payments. At the heart of the crisis was the real estate project cycle in China. Funding for home ownership is divided into a downpayment and a bank-funded mortgage. In theory, the downpayment is made in full to an escrow account under the authority of the local government before construction has started with the funds being earmarked for that project – also referred to as pre-sales funds. In practice, however, local governments have allowed developers to use the escrow funds to start new projects. Over time, developers began to announce pre-sale projects more frequently than they could complete them, as the practice became a means for developers to obtain quick financing. Nomura estimated that

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会对银行业保险业的正常运行造成任何负面影响). China Banking and Insurance Regulatory Commission. See here. (Accessed on 26.02.2024)

[64] Xinhua (2021). The PBC and the CBIRC Jointly Issued a Document to Encourage Mergers and Acquisitions of High-quality Projects of Risky Housing Companies (央行银保监会联合发文 鼓励并购出险房企优质项目). XINHUA. See here. (Accessed on 26.02.2024)

[65] Bloomberg. (2022). China Urges Banks to Boost Property Lending on Default Fears. Bloomberg. See here. (Accessed on 19.09.2023)

[66] Xinhua (2022). Guo Shuqing: Financial Bubble of the Real Estate Sector has turned around. XINHUA. See here. (Accessed on 19.09.2023)

[67] Caixin (2022c). In Depth: Why Easing Policies Might not Revive China's Property Market Any Time Soon. Caixin Global. See here. (Accessed on 19.09.2023)

[68] Ibid.

[69] Caixin (2022d). China Banking Regulator Pushes Banks to Dispose of Bad Loans. Caixin Global. See here. (Accessed on 19.09.2023)

developers only delivered around 60% of their pre-sold homes between 2013 and 2020.[70] When demand for new housing slowed and pre-sales funding dried up, developers experienced a liquidity crunch with many homes unfinished and related protests arising.[71]

In reaction to the crisis, regulators called on all relevant actors to deliver housing projects and ease restrictions but found little market improvement. The CBIRC reportedly issued window guidance to banks to increase their lending to property developers in efforts to help them complete housing projects.[72] The Politburo told local governments to roll out city-specific policies. Zhengzhou, for example, issued measures and set deadlines for restarting stalled projects. If developers failed to cooperate, the local government threatened to probe the companies and their personnel for fund embezzlement and tax evasion.[73] Despite the interventions, new-home prices in the top 70 cities fell for the twelfth consecutive month in August 2022. In the following month, authorities at various localities in China rolled out at least 650 policy measures to ease restrictions in the property market. Yet, market sentiment turned grim, as the housing market slowdown coincided with the governments' prolongation of its zero-Covid policy.[74]

Regulators from different agencies accelerated policy easing for the property sector, which culminated in the so-called 16-point plan. In September 2022, the CBIRC and the PBC issued guidance to further lower or scrap the floor on mortgage rates for first-home buyers by the end of the year.[75] The interbank self-regulator National Association of Financial Market Institutional Investors (NAFMII) expanded a support program that helped developers to raise funds through new debt with state support. In November, the CBIRC and the PBC circulated the 16-point plan policy, and together with the MHURD jointly announced that qualified property developers were allowed to receive loans backed by a letter of guarantee equivalent to as much as 30% of pre-sale funds in escrow for project completion.[76] The CSRC lifted their restrictions for listed developers to raise funds from the mainland and Hong Kong stock exchanges for purposes of debt repayment and acquisitions. Of the measures, the 16-

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[70] Reuters (2022). China Banks, Property Stocks Slump as Homebuyers Stop Mortgage Payments. Reuters. See here. (Accessed on 19.09.2023)

[71] Caixin (2022e). In Depth: What's Behind China's Mortgage Strikes? Caixin Global. See here. (Accessed on 19.09.2023)

[72] Caixin (2022f). China Seeks to Stem Mortgage Boycott with Developer Loans. Caixin Global. See here. (Accessed on 19.09.2023)

[73] Caixin (2022g). China's Mortgage Boycott Epicenter Gives Developers an Ultimatum. Caixin Global. See here. (Accessed on 19.09.2023)

[74] Caixin (2022h). China Allows Cities to Further Cut Mortgage Rates Amid Housing Slump. Caixin Global. See here. (Accessed on 19.09.2023)

[75] PBC (2022). PBC, CBIRC Will Gradually Ease Restrictions of Mortgage Rates for First-Time Buyers in Certain Cities (人民银行、银保监会阶段性放宽部分城市首套住房贷款利率下限). People's Bank of China. See here. (Accessed on 26.02.2024)

[76] CBIRC (2022b). Notice of the General Office of CBIRC, MHURD, PBC On the Issuance of Letters of Guarantee by Commercial Banks to Replace Pre-sale Regulatory Funds (中国银保监会办公厅 住房和城乡建设部办公厅 中国人民银行办公厅关于商业银行出具保函置换预售监管资金有关工作的通知). See here. (Accessed on 26.02.2024)

point plan was the most consequential since it was the first policy to indicate that the government was willing to roll back the Three Red Lines and bank loan exposure limits.[77]

In the months following the 16-point plan, property developers made active use of policy support amid a fluctuating economic period. More than 30 developers received credit lines by early December 2022.[78] Numerous developers disclosed plans to sell new shares on the stock market.[79] Selected developers also raised funds by issuing new debt although this was limited to developers that had not defaulted on their debt thus far.[80] The housing market downturn slowed as distressed property developers – including Evergrande, Sunac, and China Fortune Land – issued restructuring plans. Nonetheless, the slowdown persisted and coincided with overall low confidence in the Chinese economy.[81]

In reaction to the continued downturn, authorities announced and rolled out stronger policy easing measures in 2023. In July, the newly formed NFRA and the PBC issued a joint notice to extend the credit line exception for property developers for another year.[82] Shortly thereafter, the Politburo outlined that the country should adapt to the new supply and demand environment of the housing market. It also dropped the party dictum "housing is for living in, not for speculation" for the first time since 2019.[83] In August 2023, the MHURD, NFRA, and PBC issued a joint notice that banks ought to treat private homeowners who did not own a property in the same municipality as first-time homebuyers.[84] Later that month, the NFRA and the PBC issued two joint notices to provide guidance for lowering interest rate floors on existing loans and loan-to-value ratios.[85] Although cities could determine on their own whether to adopt the guidance, China's four most sought-after first-tier cities – Beijing,

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[77] The Business Times (2022). China issues 16-point plan to rescue ailing property sector. See here (Accessed on 26.02.2024).

[78] Caixin (2022h). Commercial Banks Offer $310 Billion of Credit Lines to Developers. Caixin Global. See here. (Accessed on 26.02.2024)

[79] Caixin (2022i). Chinese Developers Rush to Sell Shares Under Policy Easing. Caixin Global. See here. (Accessed on 26.02.2024)

[80] Caixin (2022j). As China's Top Developers Plan Debt Sales Under Aid Plan, Weakest Miss Out. Caixin Global. See here. (Accessed on 26.02.2024)

[81] Caixin (2023a). In Depth: Country Garden's Troubles Mount as It Misses Offshore Bond Interest Payment. Caixin Global. See here. (Accessed on 26.02.2024)

[82] PBC (2023a). Announcement by PBC and NFRA on the Period Extension of Financial Support for Stabilizing Healthy Development of the Property Market (中国人民银行 国家金融监督管理总局关于延长金融支持房地产市场平稳健康发展有关政策期限的通知). The People's Bank of China. See here. (Accessed on 26.02.2024)

[83] Xinhua (2023). Communist Party Politburo Meeting, Analysing and Studying Current Economic Developments and Economic Work, Communist Party General Secretary Xi Jinping Presides over the Meeting (中共中央政治局召开会议 分析研究当前经济形势和经济工作 中共中央总书记习近平主持会议). XINHUA. See here. (Accessed on 26.02.2024)

[84] PBC (2023b). Notice by MHURD, PBC, NFRA on Optimizing Standards for Numbers of Housing for Individual Mortgages (住房城乡建设部 中国人民银行 金融监管总局关于优化个人住房贷款中住房套数认定标准的通知). The People's Bank of China. See here. (Accessed on 26.02.2024)

[85] PBC (2023c). Q&A on Optimizing Mortgage Policy Adjustment by PBC, NFRA Representatives (中国人民银行、国家金融监督管理总局有关负责人就调整优化住房信贷政策有关问题答记者问). The People's Bank of China. See here. (Accessed on 26.02.2024)

Shanghai, Guangzhou, and Shenzhen – have done so. Regulators also uniformly lowered the minimum downpayment requirements to 20% for first-time buyers and 30% for second-time buyers, respectively.[86]

In addition, the central authorities doubled down on window guidance. In November 2023, the PBC, NFRA, and CSRC met first with developers and then with the largest banks, asset management firms and brokerages to encourage the financial institutions to meet reasonable funding needs of developers via loans, bonds, and equity issuance.[87]

In summary, over the past half-decade China's financial authorities have aimed to avoid a large-scale crisis emanating from the real estate sector, first by tightening financial regulation and then by easing conditions selectively. The regulatory cycle began with credit risk assessments in 2017 and reached a height in 2021 with the Three Red Lines and concentration limits. The restrictive phase ended in late 2021 as regulators started to slowly roll out targeted supportive measures for the real estate sector. Targeted policy easing intensified around the 16-point plan in November 2022, shortly after the 20th Party Congress. By summer 2023, regulators made stronger use of window guidance. Despite policy easing and selective support, the real estate sector remains under significant financial stress by end-2023, and supervisors have plenty of work to do to ensure stability and foster growth in the financial sector and the economy at large.

[86] In addition, the PBC set up structural monetary policy tools that extended discounted credit to help developers finish housing projects and to support national asset managers in acquiring bad assets of distressed developers. See here. (Accessed on 26.02.2024). For more on structural monetary policy, see Guo (2022). China's Structural Monetary Policy Tools: Objectives, Limitations, Unintended Consequences. See here. (Accessed on 26.02.2024)

[87] Wang Shiyu and Denise Jia (2023). China Tells Top Financial Institutions to Bolster the Property Market. 18 Nov 2023. Caixin Global. See here. (Accessed on 26.02.2024).

CONCLUSIONS

China's financial supervisors have employed a large and changing set of tools to reduce financial risk emanating from a key sector of the economy. They have targeted both financial institutions and players outside of the traditional regulatory purview, that is real estate developers. The sequence of tightening and subsequent selective easing measures shows how difficult it is to engineer a soft landing for a sector that is more entangled in financial distortions and yet more vital for the Chinese economy than most others.

Supervisors in China have aimed to lean against both the boom-and-bust phases of a credit cycle. Real estate leverage was buoyed by cheap credit, expectations of seemingly endless demand, and ever-rising prices that made collateral look safe. When deleveraging picked up pace in the restrictive phase, financial stability faced increasing pressure. Recent statistics show that more than 50 Chinese developers have defaulted since 2021.[88] As the credit cycle reversed, expectations shifted for participants in the upstream and downstream supply chain as well as for the end user. The shift created a sudden decline in demand for projects, a run for safe assets, and an accelerating sale of illiquid assets. As the crisis unfolded, supervisors took measures to avoid defaults by property developers and mitigate risks to the financial system. They prioritized debt restructuring and helping developers roll over their debt and extend maturities. Mergers and acquisitions were encouraged to help healthy developers assume projects that could be finalized.

China's financial supervisors work under structural constraints. The measures they have taken over the last half-decade work within limited policy space. For sustainable and long-term results for China's economic transition, coordination with other key economic policies is key, including fiscal rules, growth alternatives, and avenues for retail investment. Without changing underlying structural issues – in particular the need for local government revenue – both deleveraging and restructuring will prove to be difficult.

China's ongoing campaign to deleverage the real estate sector safely holds valuable lessons for financial supervisors and policymakers at large. At the time of writing, the jury is still out on whether China's financial authorities will succeed bringing the real estate market onto a sustainable path while maintaining financial stability. This study has focused on the toolbox at the disposal of financial supervisors and the sequence in which formal and informal regulatory measures were taken. The economic and political context in which China's financial supervisors are operating is unique, but the toolbox at their disposal may not be. Their innovative use of traditional and new regulatory instruments at different phases of the real estate crisis carries valuable lessons not only for anybody interested in the Chinese experience, but also for those keen to understand the scope of the toolbox supervisors can wield in pursuit of a complex set of economic policy objectives.

[88] Financial Times (2023). How China's Property Crisis has Unfolded, From Evergrande to Country Garden. Financial Times. See here. (Accessed on 26.02.2024)

Appendix 1. China's Supervisory Policy Mix for the Real Estate Sector

Institutions	Policy Announcements	Channel	Time Period
The Restrictive Phase			
CSRC	Property developers were largely banned from issuing additional shares. Those who considered applying for an IPO or refinancing were required to seek opinion from the Ministry of Land and Resources on their land-use records. The regulation was loosened on an on-and-off basis and restricted again in 2016. Only a handful of developers have conducted IPOs since 2010 while refinancing slumped after 2016.	Share sales, stock listing	04.2010 07.2016
CSRC, NDRC	Developers have been told to refrain from issuing bonds and from listing on the domestic and Hong Kong stock exchanges. NDRC formally halted approvals of offshore corporate bond issuance in 2017Q2.	Bond issuance, stock listing	25.10.2016 23.06.2017
CBRC	Banks were reportedly ordered to monitor credit risks in their businesses, in particular loans overdue more than 90 days. Banks were asked to focus on real estate companies and industries with overcapacity that have borrowed more than 50 mln yuan, including through wealth management products.	Credit Risk Assessment	08.03.2017
CBRC	Banks were ordered to conduct regular stress tests on collateral values and classify collateral under new categories in financial, real estate, and accounts receivable.	Credit Risk Assessment	08.05.2017
CBRC	The CBRC issued an announcement to crack down on 'channel lending' to the property sector through which banks evade regulations via trusts as intermediators.	Channel lending	22.12.2017
CBIRC	The CBIRC has given city and rural banks until the end of 2019 to classify all loans that were more than 90 days overdue as NPLs.	Credit Risk Assessment	08.06.2018
CBIRC	Banks were told to lend more money but were given no guidance on lending to the property sector.	Bank lending	13.08.2018
CBIRC	Several trust companies were reportedly ordered to stop issuing new trust products to finance real estate projects.	Trust financing	21.08.2018
CBIRC	Several trust companies were reportedly ordered to ensure no growth in the outstanding amount of their real estate financing businesses at least through the remaining year's third quarter.	Trust financing	08.07.2019
NDRC	Several property developers were restricted from selling domestic debt while some were allowed to borrow new debt only to repay old debt to avoid liquidity crises.	Bond issuance	13.07.2019

CBIRC	The regulator launched special inspections of 75 banks in 30 cities to crack down on institutions that violated lending restrictions on property developers.	Bank lending	23.07.2019
CBIRC	Banks are told to limit lending to property developers and homebuyers even as policymakers are taking measures to shore up slowing economic growth, according to reports.	Bank lending	11.09.2019
MHURD, PBC	Regulators introduce the Three Red Lines as a pilot project.	Balance sheet ratios	20.08.2020
CBIRC, PBC	Loan exposure ratios are introduced.	Bank lending	01.01.2021
CBIRC, MHURD, PBC	Authorities jointly announced a nationwide inspection of business loans, targeting borrowers illicitly using individual or corporate business loans to speculate in the housing market.	Bank lending	26.03.2021
Financial Regulators	Authorities reportedly issued a statement to ask Evergrande to avoid default.	Bond financing	23.09.2021
CBIRC, CSRC, MHURD	Authorities issue separate statements affirming that the Evergrande crisis won't affect financial stability.	Financial Stability	03.12.2021
The Easing Phase			
CBIRC, PBC	According to PBC-backed magazine Financial News, regulators issued a joint statement to require banks to support mergers and acquisitions operations of real estate companies with focus on sustainable projects.	Bank lending	20.12.2021
Regulators	Banks are reportedly told to boost real estate lending. At the same time, borrowing by major property firms used to fund mergers and acquisitions would no longer be counted toward the Three Red Lines metrics.	Bank lending	07.01.2022
CBIRC, PBC	CBIRC issued announcement that government-subsidized housing shall not be included in the loan exposure limits for banks.	Bank lending	07.02.2022
CBIRC	CBIRC has reportedly issued guidance in response to the mortgage boycotts, aiming to expedite the delivery of homes to buyers.	Bank lending	19.07.2022
Politburo	The Politburo Quarterly Meeting called for action to stabilize the real estate market and for the use of city-specific policies.	Policy guidance	11.08.2022
NAFMII	China Bond Insurance is reported to provide unconditional and irrevocable guarantees for bond sales in the interbank market by property developers	Bond Issuance	16.08.2022
CBIRC, PBC	Authorities issued guidance to allow qualified cities to lower or scrap the floor on mortgage rates for first-home buyers through year-end.	Interest rates	29.09.2022
CSRC	The regulator allowed firms involved in the property business to raise funds from the Chinese mainland	Bond issuance	20.10.2022

	stock market if their core business is not in real estate and funds raised are not invested in real estate		
NAFMII	The regulator widened a financing support program launched in 2018 to support about 250 billion yuan ($34.5 billion) in debt sales by private companies including developers. The support includes bond guarantees, credit enhancement and bond purchases.	Bond guarantee, bond issuance	08.11.2022 23.11.2022
CBIRC, PBC	The CBIRC and the PBC jointly issued the 16-point plan. Financial institutions were encouraged to set "reasonable" down payment ratios and interest rates to support demand for mortgages	Overall policy guidance	11.11.2022 (in English)
CBIRC, MHURD, PBC	Authorities jointly announced that qualified developers were allowed to access as much as 30% of pre-sale escrow accounts to complete projects	Letters of Guarantee	13.11.2022
Financial Regulators	Onshore creditor banks were reportedly told to sell assets and collateral they held in real estate companies, including Evergrande, before the year-end instead of waiting for a holistic restructuring.	Credit risk assessment	24.11.2022
CSRC	A 12-year ban was lifted to allow developers raise funds from the mainland and Hong Kong stock markets through share sales for completing projects, debt repayment, and acquisitions.	Share sales	28.11.2022
NFRA, PBC	Regulators issued a joint notice to allow property developers to extend their outstanding loans due before end-2024 by an additional year.	Bank lending	10.07.2023
Politburo	Politburo meeting drops "housing is for living in, not for speculation" for the first time.	Policy guidance	24.07.2023
MHURD, NFRA, PBC	Authorities issued joint announcement that banks shall treat homeowners who don't own a house in the same municipality as first-time homebuyers.	Bank lending	25.08.2023
NFRA, PBC	Regulators jointly issued a notice on uniformly lowering the minimum downpayment ratio required for first-time homebuyers and second-time homebuyers.	Downpayment quota	31.08.2023
NFRA, PBC	Regulators jointly issued a notice on lowering interest rates floors for existing mortgages across the country to 20 basis points above the LPR rate for second-time buyers and 20 basis points below the LPR rate for first-time buyers.	Interest rates	31.08.2023