China risks Japan-style fate

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China's economy looks like Japan's did in the early 1970s, because interest rates have not risen despite soaring real estate prices.

China's situation is not necessarily an economic bubble, due to healthy actual demand. But it remains unclear whether the country can handle the property boom with only slight adjustments.

Hainan Island is dubbed "China's Hawaii" for its tropical climate. In January, the government announced its intention to turn Hainan into one of the world's top holiday resorts by 2020. Huge amounts of money are flowing in, pushing Haikou City real estate prices up 50 per cent, year-on-year.

China's property market appears to be overheating, due partly to the government's huge fiscal spending and easy monetary policy. Real estate prices in 70 big cities rose 11.7 per cent in March year-on-year, prompting Premier Wen Jiabao to express concern.

KEY POINTS

- China's per capita nominal GDP is $US3500 now and Japan's was $US3800 in 1973.
- Car ownership and the urban/rural population ratio in China are at almost the same levels as they were in Japan during the 1960s.

Financial authorities are trying to absorb excess money by urging banks to reduce loans and increase cash reserves. But they are reluctant to raise interest rates because that would slow down the economy.

For the same reason China has in effect pegged its currency, the yuan, to the dollar since the summer of 2008.

Japan experienced a similar situation when former prime minister Kakuei Tanaka launched his initiative to "remodel the Japanese archipelago" in 1972. The Japan Real Estate Institute's Urban Land Price Index stood at 31 in March 1970 and rose to 62 in September 1974.

The Bank of Japan took the same measures as Chinese authorities are taking now. It finally raised interest rates in April 1973.

The central bank's official history recounts that the Finance Ministry fiercely opposed a rate rise while the draft budget for fiscal 1973 was being deliberated in parliament.

A BOJ report released last month mentions the similarity between China today and Japan in the 1970s.

The report says only minor adjustments may be needed in the Chinese property market.

China's economic level is close to that of Japan's four decades ago.

The country's per capita nominal gross domestic product is $US3500 ($3760) now and Japan's was $US3800 in 1973. Car ownership and the urban/rural population ratio in China are at almost the same levels as they were in Japan during the 1960s.

Strong demand for housing and social infrastructure is expected to support property prices. That makes the similarity even stronger, as Japan made only slight adjustments when prices fell in 1975.

But Ryutaro Kono of BNP Paribas Securities (Japan) warned of the risk of an economic bubble if China failed to tighten its monetary policy in time. Japan's high inflation during the 1973 oil crisis is a reminder of the danger.

Huge amounts of speculative money are flowing into China from overseas, and local governments are experiencing a real estate boom.

The boom could develop into a bubble that requires large-scale adjustments like the one in Japan during the late 1980s and after.

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