

Risk Logic and Policy Enlightenment of Real Estate Bubble and Financial Crisis

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Abstract. With the rapid growth of economy, residents' demand for real estate is not only limited to residential function, but also as an important investment product to buy. Therefore, under the joint action of these two demands, the real estate prices in China have increased rapidly. At present, the predicament of the real estate industry, especially the fluctuation of house prices, can easily cause the illusion that the real estate bubble is squeezed out or reduced, thus neglecting to guard against it and causing great disaster. Both the expansion and bursting of bubbles will lead to wealth transfer and social stratification, and the resulting political risks are more likely to lead to market panic or even financial crisis than financial risks. This paper analyzes the relationship between China's real estate industry and financial industry, and then puts forward some policy suggestions to prevent the financial crisis caused by the real estate bubble in China.

Key words: Real estate, Financial crisis, Risk logic

1. Introduction

The real estate industry has a strong correlation with other industries, and it is an important part of national fixed assets investment, which has a decisive influence on the whole national economy. The price of real estate will directly affect the rise and fall of prices, and the prosperity of real estate plays an important role in the stable operation of China's economy [1]. In a sense, the financial industry and the real estate industry are twin brothers. The financial crisis is characterized by throwing out a large quantity of real estate or long-term financial assets to exchange them for money based on the expected decline in asset prices [2]. However, financial prosperity or prosperity is characterized by a large quantity of money being thrown out and real estate or long-term financial assets being purchased based on the expected increase in asset prices. With the rapid growth of economy, residents' demand for real estate is not only limited to residential function, but also as an important investment product to buy. Therefore, under the joint action of these two demands, the real estate prices in China have increased rapidly. With the influx of capital and financial innovation, the virtuality and bubble of real estate are also increasing. Moreover, under the trend of economic globalization, a country's real estate crisis will not only deal a heavy blow to the country's economic situation, but also cause different degrees of negative impacts on the world economy through the international transmission mechanism [3].

At present, the plight of the real estate industry, especially the ups and downs of house prices, can easily cause the

illusion that the real estate bubble is squeezed out or reduced, thus neglecting to guard against it and causing great disaster [4]. Under the condition that China's capital market is not perfect, it is difficult for real estate financing to be directly financed in the securities market, and a large quantity of funds come from the financial support of commercial banks, forming a relatively single financing channel. Therefore, the close connection between China's real estate industry and commercial banks has brought great pressure to the stable growth of China's finance [5]. Real estate is not only a consumer product, but also an investment product, which has the function of maintaining and increasing the value. At the same time, it is a capital-intensive industry, which has the characteristics of large investment and long cycle. It occupies a large quantity of funds for a long time, which makes the idle funds in society have room for speculation and arbitrage [6]. This paper analyzes the relationship between China's real estate industry and financial industry, and then puts forward some policy suggestions to prevent the financial crisis caused by the real estate bubble in China.

2. Causes of real estate price bubble

2.1 Capital pricing of real estate investment attributes

Real estate is not only a real asset, but also a certain element of virtual economy when it is hyped, so it is easy to generate bubbles and become the accelerant of financial crisis. If the real estate is positioned as a consumer product,

the demand for real estate is the demand determined by the purchasing power of workers and the supply determined by the cost of real estate, which constitutes the market supply and demand, so the real estate price is limited by the purchasing power level of workers [7]. In other words, the irrational expansion of banks is likely to lead to a real estate bubble. If the real estate is positioned as an investment product that allows risk valuation and leveraged financing, the purchasing power of the real estate market will be decided by the self-occupied workers instead of the investors. The real estate evolution model is shown in Figure 1.

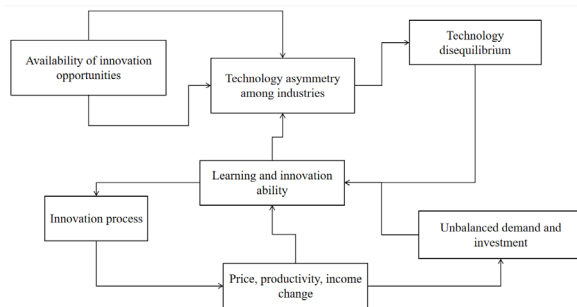


Figure 1 Evolution model of real estate industry

The durability and storability of a house are most suitable for hoarding goods. When the real estate market is in short supply, it will generate rising expectations. Investors with capital, with their keen sense of smell, will inevitably hoard real estate investment through leveraged financing. Even if there is a serious shortage in the real estate market, a sharp rise in real estate prices will not produce a price bubble, because the rise in real estate prices will not only reduce residents' purchasing power and curb real estate demand, but also stimulate the expansion of real estate construction and supply, and real estate supply and demand will reach a new balance under the action of the law of value [8]. Financial leverage investment in capital real estate to greatly increase purchasing power will lead to real estate price bubble, and the capital pricing formed by the property of real estate investment is the root of real estate price bubble.

2.2 The financial push of financial leverage

The inflow of funds into the real estate market will promote the rise of real estate prices, and the rise of real estate prices will objectively attract the inflow of funds for real estate investment. Logically, there is a causal relationship between the expansion of real estate price bubbles and money and credit. Due to the fixed location, value-added and high rate of return of real estate, many banks violate the government's restrictive policies and relevant regulations in the actual operation of loans, and issue a large quantity of loans to developers without even verifying their credit rating. In the modern capital market, real estate and stock have become the two carriers of virtual capital, especially the real estate industry [9]. Because the real estate industry is a capital-intensive industry, its development can not be separated from the support of financial institutions. With the continuous expansion of the scale of real estate development, it is far

from enough for developers to rely solely on their own funds. The main source of their development funds is actually bank loans. When the financial system is not perfect, a large quantity of funds flock to the real estate market, and banks blindly pursue the scale of credit while ignoring the potential risks of investment projects, resulting in all kinds of speculative behaviors getting worse and worse, accumulating financial risks and laying a hidden danger for the bubble.

2.3 Interest-driven game of speculation

Urban development will continue to promote land investment and infrastructure construction, and urban real estate prices will increase with the value of urban land investment. However, capital will not meet the income from the increase of real estate value, and additional income from the risk premium of real estate price bubble will be obtained through capital pricing, and speculative games on the real estate market will lead to the inflation of real estate price bubble. In the rising stage of the real estate bubble, the speculation of real estate has greatly increased people's demand for funds, resulting in the pressure of rising interest rates. For the optimistic expectation of the future, the increase of interest rate will not restrain investors' demand for funds, and the demand is still increasing, so banks have the impulse to raise interest rates again. The optimization model of real estate structure is shown in Figure 2.

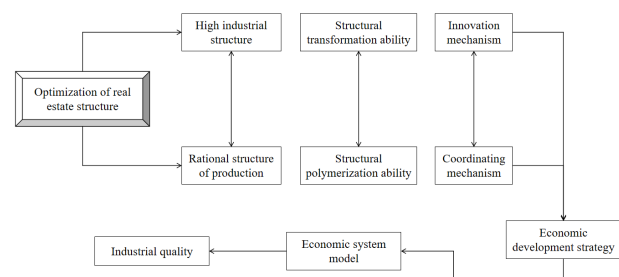


Figure 2 Real estate industrial structure optimization model

When the bursting of the bubble means the confirmation of the transfer of labor value, wealth is transferred from the real estate consumers who pay high prices to speculative capital, especially in the monetary environment of loose monetary policy and low interest rate, capital will further expand the low-cost financing to enhance the purchasing power of real estate, and form a bubble expansion by pushing the real estate price up, thus pursuing the return of risk premium [10]. High interest rate and high transaction volume double the profits of banks, which will inevitably expand credit and loosen monetary policy. At the same time, affected by the false prosperity caused by the expansion of the bubble and the substantial increase in credit demand, banks will not only absorb deposits from home at high interest rates, but also conduct short-term financing from foreign financial institutions. China's real estate market still lacks negative feedback mechanism such as levying progressive tax in the maintenance and appreciation links, while banks' leveraged financing, real estate development and

investors all tend to gain the inflated benefits of the real estate price bubble, forming a positive feedback cycle and then continuously expanding risks.

3. Risk logic of real estate price bubble

3.1 Policy effect of real estate price bubble

In the rising stage of the real estate bubble, which is also the stage of the whole economic situation, the speculation of real estate has greatly increased people's demand for funds, which will contribute to the rise of interest rates. For the optimistic expectation of the future, the increase of interest rate will not restrain investors' demand for funds, and the demand is still increasing, so banks have the impulse to raise interest rates again. The most direct harm of the real estate bubble is that it increases the financial risk. When the financial risk accumulates to a certain extent, it may lead to a financial crisis. The financial crisis caused by the real estate bubble is mainly caused by the imbalance of the lending market.

High interest rate and high transaction volume have doubled the profits of banks. Driven by high profits, banks have the impulse to further expand credit, which in turn stimulates banks to continue to expand the scale of real estate credit. At the same time, affected by the false prosperity caused by the bubble expansion and the substantial increase in credit demand, banks will not only absorb deposits from home at high interest rates, but also make short-term financing from foreign financial institutions. This credit expansion will further raise the real estate price. Real estate pricing is mainly determined by three dimensions: market, value and system. The market dimension mainly reflects the supply and demand of real estate and the competition between the two sides, which shows the market behavior of real estate commodities following the law of value. The value dimension mainly reflects factors such as civil engineering, supporting facilities, infrastructure and land replacement costs, etc., which is represented by the labor and resource costs condensed by the attributes of real estate consumer goods. The dimension of the system mainly reflects the laws and regulations related to real estate, which is the norm of the real estate market behavior. In order to cope with the unfavorable situation, regulators may implement stricter supervision measures, increase the review of real estate credit, and implement stricter bank credit review regulations, as well as credit control for the real estate industry, and so on, so as to reduce the credit of the real estate industry.

3.2 Instability of real estate price bubble

Expanding real estate financing channels and cultivating financing mechanism are the important contents of developing real estate financing, solving the situation that real estate enterprises rely too much on bank loans and dispersing risks. Through loan securitization, bank risks can be dispersed to investors through the capital market, asset liquidity can be increased, the dilemma between developing housing loans and the decline of bank liquidity can be solved, and meanwhile, the bank can further

expand the credit scale and improve the structure of assets and liabilities. Due to the large scale of investment in real estate development, real estate development needs to invest a lot of money, and the operation and related business of real estate are very professional, which requires investors to have professional knowledge, which forms an insurmountable obstacle for small and medium investors.

The price bubble of real estate comes from the game of capital in the market. Logically, the bubble is unstable in the market environment. Once the bubble is generated, the result is that it will burst without expansion, instead of being stable or gradually shrinking. The price bubble of real estate is inevitably unstable when it is freely regulated by the market. To stabilize the real estate price, we can only adopt non-market means to regulate the real estate price. Real estate investment funds will concentrate the funds scattered in the public and hand them over to professional fund managers for real estate investment. In this way, on the one hand, by obtaining investment funds, development enterprises broaden their financing channels, reduce their dependence on loans and reduce their business risks. On the other hand, the investment mechanism of real estate investment fund is an effective dispersion of real estate investment risks, which can reasonably guide the investment direction of real estate development enterprises and promote the healthy method of real estate industry.

4. Conclusions

The continuous rise of housing prices has increased the demand of real estate developers for bank credit, and at the same time stimulated people to engage in a large quantity of real estate speculation. As the real estate industry is a pillar industry in the growth of China's national economy, its development has a great influence on the growth of China's economy. In the rising stage of the real estate bubble, which is also the stage of the whole economic situation, the speculation of real estate has greatly increased people's demand for funds, which will contribute to the rise of interest rates. For the optimistic expectation of the future, the increase of interest rate will not restrain investors' demand for funds, and the demand is still increasing, so banks have the impulse to raise interest rates again. The price bubble of real estate comes from the game of capital in the market. Logically, the bubble is unstable in the market environment. Once the bubble is generated, the result is that it will burst without expansion, instead of being stable or gradually shrinking. Ignoring the causes of huge fluctuations in the real estate market and the hidden areas of potential risks in real estate finance will probably lead to a big real estate financial crisis.

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