Housing, Inflation and the Chinese Middle Class | Alrroya

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The past decade has seen substantial growth in the Chinese middle class. Growing from 65.5 to 80 million between 2005 and 2007, the Chinese middle class is expected to expand to a massive 700 million by 2020. While the percentage of the population that fits into this category is still far below the 60 per cent in many developed countries, there seems to be tremendous desire among Chinese families to join the ranks of the middle class.

A December 2009 survey of Chinese workers showed that the average period within which they expected to become middle class was 5.85 years. Almost 70 per cent said they wanted to become middle class within 5 years.

Several reasons have been cited for this growth. Steady improvements in the quality and availability of education have led to an increase in the percentage of the population with college degrees. At the same time, foreign companies that have come in to take advantage of China's booming economy have created jobs for educated, middle-class workers. The overall effect is that disposable income and home sales have jumped among the middle class. But while these results have created new opportunities for foreign investment and local entrepreneurship, they have also created challenges for foreign investors as well as the Chinese government.

Businesses have not hesitated to take advantage of this growing market. Many consumer goods and retail companies such as Procter & Gamble, Inditex, and Tesco are making major investments in China. But China's landmass is enormous, and one challenge for foreign investments has been identifying the best areas to cater to the growing middle class.

According to a recent article in Forbes, In 2005, a consumer company doing business in 70 locations (cities and counties) in China could reach 70 per cent of consumers in the middle and affluent classes. To achieve the same coverage today, a company must be in nearly 240 locations. By 2020, that number will exceed 400. A dramatic shift in the geographic distribution of consumer spending power is under way in China. The middle classes are expanding out beyond the largest cities more rapidly and in greater numbers than any market has ever witnessed.

Just as the location of the burgeoning middle class is creating challenges for foreign investments, their impact on the housing market as a whole is also raising concerns. Skyrocketing home prices may actually stifle the growth of the middle class, as more and more workers find themselves priced out of home ownership. According to Gu Yunchang, Deputy Director of China Real Estate Research Association, Chinese people will pay half of their income to buy an apartment this year. Experts predict the government will react by strengthening regulation and control on the real estate industry in 2010. The effectiveness of the government's regulation will be an important issue in the years to come.

Projections about the growth of the middle class are susceptible to a multitude of variables, and poor governance could undermine this growing market. Furthermore, with the impact of the U.S. housing meltdown still fresh in mind, some foreign businesses may be hesitant to invest too heavily in a middle class that could be undercut by a similarly disastrous housing bubble.

Increases in property prices followed record levels of lending by domestic banks and a 4 trillion yuan (about $585 billion) stimulus package. These facts also call attention to another issue of concern to foreign investors and the Chinese government: inflation.

With the growth in the middle class, increased disposable income, and the economy as a whole indicative of China's formidable presence on the world stage, many in China's government recognise that uncontrolled economic growth can lead to runaway inflation rates later on.

As workers pour a large portion of their income into their homes, inflation could severely undermine the buying power of the middle class’s disposable income. Goldman Sachs' chief economist, John O'Neill, has recently hinted that China may move to strengthen its currency as much as 5 per cent in a bid to slow the pace of its economic growth. O’Neill’s prediction followed an announcement by China's central bank of a 50 basis-point rise in commercial bank reserve requirements in a bid to soak up excess liquidity.

Chinese authorities are also moving to curb credit growth in response to 2009’s fourth quarter numbers, in which the economy registered its fastest growth since 2007. So far the 2010 numbers suggest that the situation is not yet under control. Data indicates that banks in China had already extended about $1.1 trillion, or 19 per cent of the 2010 lending target of 7.5 trillion yuan, in January alone.