

# Evergrande fails to make interest payment

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26 September 2021

Chinese property developer Evergrande failed to meet an interest payment of \$US83.5 million on a dollar-denominated bond on Thursday. This puts the fate of the company in doubt, if it fails to come up with the money within a 30-day period of grace, before a formal default is declared.

Failure to meet the payment will be the largest-ever default by an Asian company on a dollar-denominated debt. Overall Evergrande has a total of 1.97 trillion renminbi (\$305 billion) in debts, of which \$20 billion is in dollar-denominated bonds.

The company faces a new deadline on Wednesday, when a \$45 million payment on another bond becomes due.

Before last Thursday's deadline, Evergrande said it had arranged to meet an interest payment on a renminbi-dominated bond, equivalent to \$35.9 million, without providing any details as to whether the payment was being made in cash or other assets. The statement got the thumbs down. In trading on the Hong Kong market on Friday, the company's shares fell a further 11.6 percent, bringing the decline for the year so far to 84 percent.

After significant falls last Monday, as a result of the Evergrande crisis, global share markets seem to have shrugged off immediate fears that its demise could spark a "Lehman moment" for the world's financial system, with Wall Street recording a rise for the week.

But there could be flow-on effects in the future. Thu Ha Chow, a senior financial analyst for Loomis Sayles in Singapore, told the *Wall Street Journal* that Evergrande was a "controlled, managed default" that did not catch authorities or investors by surprise. "It is not a 'Lehman moment,' but the market will be watching for any unintended consequences that result."

However, long-time financial trader Jim Chanos told the *Financial Times* (FT) it could be worse than a Lehman situation, because all property developers

looked like Evergrande.

The chief concern in financial circles is what the Evergrande crisis signals for the development of the Chinese economy. Based on the ever-greater accumulation of debt, to finance massive property development, its business model has been described as a smaller version of the Chinese economy as a whole.

As an FT article last week put it: "Evergrande, for all the high drama of the meltdown, is merely the symptom of a much bigger problem. China's vast real estate sector, which contributes 29 percent of the country's gross domestic product, is so overbuilt that it threatens to relinquish its role as a prime driver of Chinese economic growth and, instead, become a drag on it."

Such has been the expansion of property development that, according to one estimate cited in the article, there is enough empty property in China to provide accommodation for over 90 million people.

The immediate cause of the Evergrande crisis was the decision by the Chinese government to significantly tighten credit regulations, instituting so-called "three red lines." Evergrande failed on all three, and the flow of credit, the basis of its operations, dried up.

Chinese authorities instigated the new regime out of fear that the highly-leveraged property market was becoming a threat to financial stability, with far-reaching economic and social consequences, the like of which have been on display in the Evergrande crisis.

Last week the *Wall Street Journal* reported that Beijing had called on local governments to prepare for the downfall of Evergrande. Officials had been tasked with "getting ready for the possible" storm but had been told to only intervene at the last minute, should Evergrande's efforts to stave off the crisis fail.

Local governments were told to set up groups of accountants, and that lawyers should be set up to examine ways of having local state-owned property

developers take over Evergrande's projects.

Moves have already begun in that direction. The FT has reported that last Wednesday, in the southern city of Guangzhou, an Evergrande subsidiary was asked to put revenue into a state-controlled custodial account, so that "homebuyers' interest can be protected and project construction continues."

The Beijing directive called for the setting up of law enforcement teams, to monitor public anger and so-called "mass incidents." This followed demonstrations by buyers, who have paid out large sums of money for apartments they may never receive, as well as small investors who have put money into Evergrande.

An editorial in the FT pointed to two aspects of the crisis—economic and political. The property crisis, it noted, had the potential to set off a chain reaction. "As developer sales slump, they have less money to buy land, thus squeezing the finances of local governments, which, in turn, are less able to invest in infrastructure. A property rout, therefore, would disable an engine that has propelled Chinese growth for at least two decades."

It said there was a possibility for a transformation in China's growth model, based on high-tech manufacturing and the development of green technologies. But any transition would be in conditions very different from the past. Between 2010 and 2019 growth averaged 7.68 percent, but was now forecast to decline significantly.

This meant that China's president Xi Jinping was working in a changed environment from his predecessors, and "if mishandled attempts to fix the property bubble lead to slower growth, Beijing risks not just investor flight, but losing support of its population."

According to a comment in the *Wall Street Journal* last Wednesday, the conditions that produced the Evergrande crisis are by no means confined to China.

It said the question was not so much whether the shrapnel from the Evergrande explosion could be contained, because of China's closed financial system. "The better question is whether similar explosives lie ticking in other developed economies. The answer is that there's probably some version of Evergrande in most of them. China's dysfunctions are not as unique as outsiders want to believe."

The warning is not misplaced. The massive injections of money into the global financial system, after the

2008 crisis, accelerating after the March 2020 financial meltdown at the start of the pandemic, have helped generate an international property bubble.

Last week the International Monetary Fund issued a warning to Australia, one of the countries where this bubble is most pronounced, that unless it is brought under control, a "property price correction" would pose a significant risk for economic stability.

In previous times, the prescription from the IMF and economic authorities would have been to increase interest rates. But such is the dependence of all major economies on the ultra-low interest rate regime, initiated by the world's major central banks, that this is regarded as too dangerous. As Harald Finger, the IMF mission chief, said in delivering the report: "Increasing interest rates now would not be the right instrument that would endanger the broader recovery."

In other words, the same issues that have arisen in China are present everywhere, albeit not in exactly the same form. The escalation of property values, in a speculative bubble, threatens to bring about a financial crisis, but measures aimed at trying to prevent that can have major economic consequences.



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