

China's Evergrande crisis has far-reaching implications

Nick Beams
1 October 2021

The crisis surrounding the debt-laden Chinese property developer Evergrande has disappeared from “headline news”—at least for the moment—but its implications for the Chinese economy are coming more clearly into view.

The Evergrande crisis was sparked by a decision of the Chinese government in August to tighten the regulations on access to credit—the so-called three red lines—out of fear that the build-up of debt, particularly in the property sector, was threatening to create the conditions for major financial turbulence.

Evergrande was hit hard as the inflow of money needed to finance its business model dried up because it fell far short of the new requirements. But the problems confronting Evergrande, which has failed to meet interest payments on dollar-denominated loans, extend throughout the property sector.

This week Bloomberg published a list of 10 property companies, excluding Evergrande and others that had defaulted, now facing major issues.

First on the list was Fantasia Holdings, based in Shenzhen, which operates across China, including in the Guangdong province and Shanghai. On Monday Moody's cut its rating for the company further, citing its “increased refinancing risks because of weakened funding access and sizable amount of maturing debt.”

A dollar bond maturing in 2024 issued by the company has fallen to 31 cents on the dollar compared to 98 cents when it was issued in March. Its share price on the Hong Kong stock market has plunged by 58 percent this year and it holds cash and cash equivalents of \$4.2 billion compared to liabilities of \$12.9 billion.

Other companies showed similar tendencies, though not quite as extreme.

A typical example was China South City Holdings, which is based in Hong Kong and has projects in

Shenzhen and Nanchang. S&P Global revised its outlook for the company to negative this month saying it may need to “run down its cash buffers to meet large offshore maturities” and that it “may not be able to refinance at reasonable costs.” A 2023 bond which stood at 93 cents on the dollar when issued in March has fallen to 61 cents and the company's share price has dropped 43 percent this year. And the list goes on.

The crisis in the property market has far-reaching implications for the Chinese economy as a whole because of the role property development and land sales have played in fuelling economic growth.

An article this week in the *Economist* provided some facts and figures on how significant it has been, noting that the turbulence could imperil everything “from local-government and household finances to the country's growth model.”

Residential investment makes up 15 percent of Chinese gross domestic product (GDP). But according to calculations by economists Kenneth Rogoff of Harvard University and Yuanchen Yang of Tsinghua University, once construction and related industries are added property development accounts for 29 percent of GDP.

Their article traced the origins of the crisis to changes made by the Chinese government in 1994 when the central government overhauled the tax system and local government authorities lost a large portion of their revenue. They were also prevented from directly raising debt, yet at the same time were charged with reaching high-growth targets, sometimes exceeding 10 percent a year.

Rogoff and Yang explained that “Selling land became one of the few things municipal officials could do to generate revenues, which would in turn finance roads and other public works. They could also set up

companies that could borrow from banks and raise debt from other sources.”

“This arrangement,” the article continued, “meant economic growth was tightly bound to booming property” with Chinese leaders cheering on the process “for the best part of 30 years.”

According to the article, between 1999 and 2007 the quantity of rural land transferred to urban use increased at an annual average rate of almost 23 percent and public land sales rose by an average of 31 percent a year.

In 2008, the Chinese economy was dealt a major blow as some 23 million jobs were lost with the onset of the global financial crisis. Fearing the eruption of social struggles by the working class, the Chinese government undertook major stimulus measures, amounting to \$586 billion, much of which came in the form of loans and shadow-banking funds for property developers. As a result, by 2010, land sales accounted for more than 70 percent of municipal revenues.

Over the past several years, Chinese authorities have been trying to rein in the growth of debt, fearing its consequences for the stability of the financial system. With previous sources of finance becoming more constricted, property development firms became increasingly reliant on pre-sales income where buyers paid for their apartments, sometimes in full, months or even years before completion.

According to calculations by the French bank Natixis, cited in the article, “between 2015 and July 2021 the share of pre-sale funds as a source of funding for developers rose from 39 percent to 54 percent.” In the case of Evergrande, thousands of buyers have paid out large amounts of money only to find that the apartment they bought may not be completed—a situation that has led to protests outside Evergrande offices.

Other commentary on the Evergrande crisis has pointed to its implications for the economy as a whole. A recent article in the *Financial Times* described it as the end of China’s “build, build, build model” and reported there is enough empty property in China to house more than 90 million people.

Because of their intimate connection with the property market, there is a financial crisis building up for local government authorities.

This week Bloomberg reported that, according to economists at Goldman Sachs, hidden local

government debt had risen to an amount equivalent to more than half of China’s GDP.

The report said the total debt of local government financing vehicles rose to around 53 trillion yuan (\$US8.2 trillion) at the end of last year, up from 16 trillion yuan in 2013. This is equal to 52 percent of GDP and more than outstanding government debt.

The feverish property development and build-up of debt have created the conditions for a major financial crisis. Their unravelling will also spur explosive social struggles by the working class against the Chinese Communist Party regime.



To contact the WSWS and the
Socialist Equality Party visit:

wsws.org/contact