

China's Evergrande crisis at a turning point

Nick Beams
21 October 2021

The financial crisis of the highly indebted Chinese property developer Evergrande enters a new stage tomorrow when a 30-day grace period to settle a missed payment on a dollar-denominated bond on September 23 ends.

If Evergrande, which has a total of \$300 billion worth of liabilities, fails to pay the debt or come to some arrangement with bond holders, it could be formally declared to be in default.

Evergrande's attempt to raise cash to meet its debts suffered a blow on Wednesday when it was announced that a deal to sell a majority portion of a property services unit to another developer for 20 billion Hong Kong dollars (\$US2.6 billion) had been terminated the previous week.

Since Evergrande missed its bond payment last month, two other property companies have followed suit. On Monday the Hong Kong-listed company Sinic announced it had failed to make payments on \$246 million of dollar-denominated bonds, following a default by the developer Fantasia Holdings on \$205 million of bonds earlier this month.

In line with the policy of the government to rein in leverage in the real estate sector, the People's Bank of China has pointedly refused to offer a bailout for Evergrande, saying fallout effects from its crisis are "controllable."

But the bigger issue is whether the government and financial authorities will be able to stave off the effects of the developing slump in real estate and property development on the broader economy. It has been estimated that property development and the industries that supply it account for upwards of 25 percent of the Chinese economy. There are a number of indications of a significant downturn in housing and property development.

It has been reported that home prices in China fell in September for the first time in six years. The latest GDP numbers showed a slowdown in the third quarter—growth was only up by 0.2 percent from the previous quarter—with property and construction industries contracting for the first time since the start of the COVID-19 pandemic.

Bloomberg reported that falling home prices could start a vicious cycle, worsening the cash shortage of builders and forcing them to offer bigger discounts. It cited one financial

analyst who said the sector had entered a downward cycle and the priority "is to prevent a state of panic."

Residential sales fell by 17 percent in September, normally a peak month for purchases, and the rate of failed land auctions climbed to the highest level since 2018.

According to data compiled by China Real Estate Information, which tracks auctions across 128 Chinese cities, about 27 percent of land offered by local governments went unsold in September because there were no bidders. Proceeds from land sales dropped by 18 percent in August from a year earlier.

Last month, in a sign of tightening credit conditions and fears about the direction of the market, loans taken out by property developers from banks fell by 8.4 percent last month, the biggest fall since 2016.

Larry Hu, the head of China Economics at Macquarie Securities, told Bloomberg: "Developers are hoarding cash to avoid becoming the next Evergrande. The contagion risk is real."

If this trend continues it will have far reaching effects. Local governments derive around \$1 trillion of revenue, some 40 percent of their total, from land sales, which is used to finance infrastructure projects.

The roots of the present crisis lie not in the Chinese economy per se but in the global financial system. The 2008 financial meltdown, triggered by the collapse of the Lehman Brothers investment bank, hit the Chinese economy very hard with the loss of 23 million jobs virtually overnight.

The Chinese regime concluded that the economic growth model, based on the supply of cheap consumer goods to Western markets, had run its course and a new economic strategy had to be developed.

In order to maintain economic growth and social stability, the regime embarked on a massive stimulus package based on housing and infrastructure financed by the provision of very cheap credit. Land prices soared and developers used the land as collateral to finance construction. Local governments raked in increased revenue from land sales, which they used to finance infrastructure development, together with increased borrowings.

Rising property prices enabled the process to continue. In

1998, when the Chinese government loosened tight restrictions on the sale of land, only one third of the population lived in towns and cities. That proportion has now risen to two-thirds, with the addition of 480 million to the urban population.

The extent of the property and infrastructure boom is indicated by the estimate that in the three years 2011–2013 more concrete was used in China than in the US for the whole of the 20th century.

The rise of Evergrande was bound up with this development. Its founder Hui Ka Yan started his economic activity in Shenzhen as an exporter-importer but then moved into property development when he founded Evergrande in 1997. By 2016 Evergrande was the largest property developer by sales and Shenzhen, like many other small towns across China, had been transformed into a major city.

In a speech in 2018, Hui, now a prominent member of the Chinese Communist Party, (CCP) delivered a speech in which he declared: “Everything for me and Evergrande is given by the Party, the state, and society.”

As a recent Bloomberg article noted: “Even making allowances for flattery, Hui wasn’t wrong: The forces that allowed Evergrande to grow so rapidly emanated, in large part, from Beijing.”

But now the winds from Beijing have started to blow in another direction. The CCP regime has concluded that the debt-fuelled growth model, initiated in response to the 2008 global financial crisis, is unsustainable.

For the past several years it has tried to cut back on the debt growth, which now stands as 290 percent of GDP and has doubled since 2008.

After previous efforts had failed, it instituted tightened restrictions on credit, known as the three red lines, in August 2020, which restricted debt accumulation by property developers. Evergrande, for example, failed to meet all three of the criteria.

The regime concluded that the rise of debt could lead to a financial crisis, with massive social consequences, and the rise of debt-fuelled wealth to the heights of society was producing a dangerous social polarisation.

In a speech delivered in August, the full text of which was published in a CCP theoretical journal *Qishui* earlier this month, President Xi Jinping pointed to the rise of income inequality as a prominent issue around the world, declaring that “our country must resolutely guard against polarisation, drive common prosperity, and maintain social harmony and stability.”

And in indication of what is at stake, he said the drive for “common prosperity” was needed to “continuously consolidate the Party’s foundation for holding power over the long term.”

The speech had little specific to say on property development as such but Xi repeated earlier remarks that it was necessary to improve housing supply and “insist on the position that housing is for living in and not for [financial] speculation” and that “we must actively and steadily push forward property tax legislation and reform.”

But it appears that the proposed tax changes, which it is claimed will make it more expensive to speculate on property and help bring down prices, have run into significant opposition from within the upper ranks of the CCP.

According to an article published in the *Wall Street Journal* on Tuesday, citing “people with knowledge of government deliberations,” Xi is facing resistance for the new measures.

It said that “in internal debates, the feedback from his property-tax plan both from the party elites and rank-and-file members, has been overwhelmingly negative.”

Arguments against the tax plan have “flooded in” since the ministries of finance, housing and taxation started to seek feedback to the proposal in the spring. “Many officials contend that such a levy could crush housing prices, cause consumer spending to plunge and severely harm the overall economy.”

Apart from the expressed concern about the impact on the economy, there are immediate material interests at stake.

The article reported that some senior retired party members have also petitioned against the new tax saying they could not afford it.

According to one of those people familiar with the deliberations, cited by the *Journal*: “So many people, including party members, own more than one property. The tax proposal is becoming a potential social-stability issue.”

The opposition from within the CCP appears to be having an effect as an initial proposal to trial the tax in 30 cities has been scaled back to 10.

There is an old political adage that there is no more dangerous situation for a bad regime than when it seeks to reform itself.

The economic re-orientation of the Xi regime is provoking divisions within the ruling apparatus and could well also lead to the eruption of a movement by the Chinese working class from below.



To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact