Despite interest payment, Evergrande is the "living dead"

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The giant Chinese property developer, Evergrande, has averted, at least for the present, possible lengthy legal proceedings. It came up with the money for an interest payment of $83.5 million on a dollar-denominated loan just a day before the expiration of a 30-day grace period on the payment of the debt last Saturday.

However, the payment does not mark the end of Evergrande's crisis. Another 30-day grace period for payment on a bond ends this Friday and the company has a further four interest payments on dollar loans due by the end of the year.

Next year it has a large amount of maturing debt falling due, both in dollars and renminbi, estimated to be $7.4 billion in dollar terms.

Last week's payment was greeted as positive news by bond holders, but no one is holding out much hope that Evergrande will be able to secure the cash necessary to meet upcoming payments.

"The payment looks like an attempt to kick the can down the road," one financial analyst told Bloomberg.

"We have seen this before," another told the news agency, adding that the Evergrande payment "does not solve the problem, and does not change the fact that it is the living dead."

The interest payments averted a situation where Evergrande would be formally in default, opening the way for bond holders to launch legal action to try to recover their debts. It bought some time for the company to seek cash through asset sales and a possible restructuring.

How successful that is remains to be seen. Chinese Estates Holdings, which had provided support for Evergrande, has been selling its shares and has said it could unload all its holdings.

The company made an effort to demonstrate it was still a going concern. It posted on social media that work has resumed at more than 10 projects in and around Shenzhen and in the Pearl River Delta area that were carried out in a "steady, safe and orderly manner." It had previously announced that hundreds of its building projects had been suspended.

Evergrande has been hit from two directions. On the one hand, the rise in the Chinese property and housing market—on which its finances have depended—is slowing markedly, and even entering a downturn. On the other, the company cannot obtain the volume of credit it previously did because of tightened restrictions, known as the "three red lines," introduced by the government last year.

"Evergrande is a candle burning on both ends, it needs to address declines in revenue and at the same time find cash for looming repayments," Justin Tang, the head of Asian research at United First Partners told Bloomberg. "Nothing short of a restructuring or white knight will do."

The problems are not confined to Evergrande. Chinese property developers Sinic and Fantasia have also missed payments and financial problems extend throughout the property sector with implications for the broader economy.

Data released last week showed a month-on-month decline in new home prices for 70 of China's biggest cities—the first such fall in more than six years.

Michael Pettis, a well-known finance professor at Peking University, pointed to the problems for the entire economy in comments to the *Financial Times* (FT) last week.

"In speculative markets, once prices stop going up, they tend to go down. If this were to happen to Chinese property prices, this would not only be terribly damaging to the banking system, but it would reverse the major source of wealth accumulation among Chinese households," he said.

"How do social, financial and economic institutions adapt after 40 years of inexorably rising prices, during which the belief developed that Beijing will never let real estate prices fall?"

The government's three red lines credit policy is an attempt to end the escalation of debt in the economy, which has more than doubled since the global financial crisis of 2008. It responded with a massive expansion of credit to finance the expansion of infrastructure and property development to ensure continued economic growth and the preservation of social stability.

Local governments were able to finance their infrastructure programs through revenues derived from land sales and by increased borrowings. However, Beijing is now attempting to bring about a vast shift under the banner of "common prosperity" promoted by President Xi Jinping.

Bloomberg reported that strategists at Bank of America have raised the prospect that "Xi may even be embracing a once-in-two decades restructuring of the economy akin to Deng Xiaoping's modernization of the late-1970s and Zhu Rongji's revamping of state-enterprises and finance in the late 1990s."

Deng was the instigator of the Chinese Communist Party's turn to the restoration of capitalism. Zhu deepened that process when, after opening the way to foreign investment in China, he cut back the state sector. This played a central role in ensuring US support for China's entry into the World Trade Organisation during the Clinton administration before final ratification in 2001.

In a report to clients last week, cited by Bloomberg, the Bank of America strategists said if the scale of Xi's restructuring matched that of his predecessors "the data flow from China could confound even the pessimists, and we are on guard for that scenario unfolding."

One of the main policies Xi is seeking to introduce is a property tax. It has two objectives: to lessen the reliance of local government authorities on rising land prices as a source of revenue and to dampen speculation in property.

Last Saturday China's state council announced it would expand pilot schemes to tax residential and commercial properties in cities. It did not disclose locations but said rural households would be excluded.

Despite having the support of Xi, who told planners in August to press ahead with it, the proposed tax is experiencing heavy going. As the FT noted, the proposed tax has pitched Xi "against deeply entrenched vested interests across an economy fuelled for decades by real estate development."

Some opposition is based on the claim that it is too risky and could lead to a sharp fall in the housing market with the fallout hitting the rest of the economy. Other opposition arises from the direct interests of sections of the Chinese Communist Party.

Mark Williams, chief Asia economist at Capital Economics, told the FT: "Opposition from insiders is not new. The correlation between party members and ownership of multiple properties is probably fairly high."