China property market crisis deepens

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Every day seems to bring a new turn in the deepening property, real estate and associated financial crisis in China amid rising concerns in the business world that the government is not doing enough to alleviate, much less, overcome it.

On Wednesday, the real estate developer Country Gardens, until recently held up as a model of financial stability, announced it had made a record loss of 48.9 billion renminbi, the equivalent of around $US7 billion, for the first half of the year.

The losses are the highest ever for the Quandong-based group, and, as the Financial Times noted, “highlight the dire outlook for an industry typically responsible for more than a quarter of economic activity in China.”

They indicate an accelerating decline. The company made a loss of 6.7 billion renminbi for the second half of 2022 following a profit of 612 million renminbi in the first half.

In a statement on the loss, Country Gardens said it might not be able to meet its debt obligations “which may result in a default” and pointed to “material uncertainties” that could cast “significant doubt on the group’s ability to continue as a going concern.”

If it does go under then it will have a bigger impact than the failure of the property developer Evergrande because Country Gardens has four times as many property projects.

The company said it had increased sales by 39 percent but had “struck a balance” between sales volume and selling price at some of its property projects to ensure punctual delivery of finished properties. This is an indication that it has been forced to cut prices in order to maintain cash flow—a sure sign of major problems.

Country Garden’s issues first came into public view last month when it missed coupon payments on two international bonds. It has until September 6 to make the payments before it can be declared to be in default.

The company may well make the payments, but its financial problems are clearly worsening because earlier this week it asked creditors to give it a 40-day grace period for payments on renminbi bonds that are maturing next week.

The problems of Country Garden are reflected across the board with data published by Dealogic revealing that Chinese developers must make $38 billion worth of payments in renminbi and international bonds due over the next four months.

Bruce Pang, the chief economist for Greater China at the global real estate firm JLL, told the Financial Times: “Developer defaults will certainly continue as almost all private developers face cash flow pressure that isn’t going away any time soon.”

Pang said that any support from the government that did come would need time to feed through to cash flow and new construction starts.

Financial authorities have promised greater support, but the relaxation of some interest rates and the promise of cuts by major banks on existing mortgages are regarded as insufficient. There are calls for a major stimulus package but so far there is little sign of that coming from the government which has been trying to reduce debt levels in the economy.

This lack of confidence and the concerns over a liquidity crisis for the real estate sector were reflected in the Hong Kong stock market when shares in the property developer Evergrande, which defaulted on its debts in 2021, made a reappearance after an absence of 17 months. They fell by almost 90 percent.

The liquidity problems extend far beyond the property sector and are reaching into the shadow banking system.

Major concerns have been raised over the trust fund Zhongrong and its parent entity Zhongzhi after they halted payments to wealthy investors attracted by the
higher interest rates available elsewhere, some of which has been invested in the property market.

Bloomberg has reported major financial firms, one linked to the Citi group and CCB Trust, an entity backed by the China Construction Bank, have been asked by authorities to examine the books of Zhongrong “potentially paving the way for a state-led rescue of the troubled shadow bank lender, according to people familiar with the matter” who asked not to be identified.

According to the report: “While losses have been building in the trust industry for years, Zhongzhi may pose the biggest challenge yet. The private firm manages more than 1 trillion yuan (renminbi) and its interconnectedness with wealthy investors, struggling developers and other financial institutions has spurred concerns that troubles are beginning to cascade across the financial industry.”

The $2.9 trillion trust industry has been an important source of finance for weaker borrowers unable to get regular bank loans for property development, but now the decline in the housing and real estate market threatens to bring about collapses in this risk-laden area of the financial system.

Zhongrong and Zhongzhi won’t be the last. Goldman Sachs has estimated that the total losses could be the equivalent of $38 billion.

The growing China financial crisis has drawn the attention of the London-based Economist magazine. This week it ran a major article entitled “China’s shadow banking industry threatened its financial system.”

It noted that when Xinhua Trust went bankrupt last May it was the first trust company to go under in more than two decades.

Pointing to the reasons, the article said the country’s growth was weaker than expected and property developers were “caught in an unprecedented wave of defaults and restructurings.” Trust funds, which channel money from investors into infrastructure, property and other developments, were exposed to both.

The Economist said given that the initial losses in trust funds will be borne by wealthy investors this may not set off a fully-fledged financial crisis giving “the government time to clean up the mess.”

After noting the Bloomberg report that the banking regulator had set up a task force to investigate the problems at Zhongzhi, the article said, “given the vast, shadowy connections such firms have across the economy, government inspectors might not like whey they find.”