

Chinese property giant Evergrande another step closer to collapse

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The fate of the highly indebted Chinese property developer Evergrande is hanging in the balance as attempts are made to get its restructuring back on track before liquidation proceedings start in a Hong Kong court on October 30.

The restructuring process for the company, which is reported to have the equivalent of more than \$300 billion in debts, has been in train for more than a year following its default on bond repayments towards the end of 2021.

Authorities are anxious to avoid a liquidation because it can set in motion a scramble by creditors to grab what they can from the carcass of the failed company. That can lead to unpredictable consequences which can reverberate through the financial system.

It is why considerable effort has been made to try and effect a restructuring.

This effort was derailed last week by two developments: the inability of a subsidiary company to make payment on a bond and the announcement that Evergrande founder and chairman Hui Ka Yun was under investigation by authorities. He potentially faces criminal charges, as yet unspecified, but believed to involve attempts to move money offshore.

Born into rural poverty and raised by his grandmother, Hui, now aged 64, started the company in 1996 and became a multibillionaire on the back of China's property and real estate boom, rising to a high level within the ruling Communist Party.

In a speech in 2018, he highlighted the intimate connections between the CCP and the financial oligarchy.

With a fortune at that time estimated to be almost \$44 billion, he said: "All I have and all that Evergrande Group has achieved were endowed by the party, the state and the whole society."

In July 2021, he was among the guests onstage at Tiananmen Square during the celebration of the 100th anniversary of the founding of the Communist Party.

Within months of reaching that pinnacle, Evergrande had defaulted on debts and its rapid downward slide was underway.

It was set in motion by a decision of the government in 2020 to clamp down on the easy money policies that had led to the elevation of Evergrande and other property developers.

Evergrande's business model was not exactly a Ponzi scheme but close to it because it depended on the continual inflow of credit. The scheme worked while the going was good and then failed when it was not. It borrowed money to finance projects with home buyers often paying in advance before the projects were completed. This money, together with borrowed funds, was used to finance other developments.

The model continued to function so long as apartment prices kept rising and credit was freely available.

However, Chinese authorities became fearful that the growth of debt was becoming so great that it might threaten the stability of the financial system. Instituting the new regime, Chinese president Xi Jinping insisted houses were for living in, not for speculation.

There was also a political dimension to the government's moves as was seen in the simultaneous clamp down on major tech company giants. It reflected the fear that with increased financial power, the oligarchs acquired greater political clout that could undermine the stability of the regime.

As the World Socialist Web Site analysed in 2018, when Xi moved to acquire power beyond the normal two terms as president and rule indefinitely, it was becoming a Bonapartist regime with "Chinese characteristics" seeking to balance between conflicting

forces.

Under conditions of slowing growth, it defended the interests of the oligarchy as a whole against the working class, while strengthening the state apparatus against the growing bellicosity of US imperialism. At the same time, it sought to regulate and control the different interests within the oligarchy itself.

Now the growing property market crisis has compounded economic and financial tensions. It would be significant enough if Evergrande were an isolated case. But it is the expression of a crisis throughout the property and real estate sector which, when all its interconnections are considered, accounts for about 25 percent of the Chinese economy.

The impact of Evergrande alone is indicated by the fact that it has acknowledged it still owes the suppliers of construction materials the equivalent of \$82 billion.

Since its demise, another major developer, Country Garden, has come under the spotlight after experiencing problems in debt repayments despite being touted as secure. Many smaller developers have gone under.

One of the key questions confronting the government and financial regulators is how far the property crisis will reach into the financial system.

As the *New York Times* reported recently: “China’s giant banking system, the world’s largest, is heavily exposed to the real estate crisis: nearly 40 percent of all bank loans are related to property. Pressure is building on those banks as dozens of real estate developers have defaulted or missed payments on overseas bonds ...”

Parallels have been drawn with the crisis in the US in 2007-2008 which originated in the property market. However, there are significant differences. The US crisis was sparked by speculation in the securities market whereas the problem in China is loans that cannot be repaid.

There is also the added factor of state involvement in the Chinese banking system providing a degree of support.

This is not to say that there not major problems.

As the NYT noted back in January, shortly before stepping down, the then Chinese vice-premier Liu He told the World Economic Forum in Davos there were major problems that could arise from the real estate crisis.

“If not handled properly, risks in the housing sector are likely to trigger systemic risks—that is why prompt

steps must be taken to address them,” he said.

One channel through which those risks could emerge is the so-called shadow banking system where problems have already taken place. One of the oldest shadow banks, Xinhua Trust, went bankrupt in May after expectations of government backing failed to materialise.

Another shadow bank, Zhongrong, a trust fund, is on the edge of going under after missing payments to 150,000 investors. It holds \$136 billion worth of client investments. In total, the shadow banking system manages around \$4.5 trillion.

A recent analysis in the *Economist* summed up the situation as follows: “The risk of contagion is high because lending by trusts is ubiquitous and investment in them produces tangled ties. They have also lent to local government projects—and now cities and provinces across China are struggling to repay debts, which are estimated to have hit \$12 trillion at the end of 2022.”

The policy of the government and financial authorities at this stage appears to be to restructure debts and secure their repayment over a longer term. That, at least, was the strategy with regard to Evergrande which was to have issued new bonds as part of a restructure plan, but that scheme fell apart when a subsidiary defaulted.

The hope in the real estate sector and among its financial backers is that the government will step in directly, but so far there is little sign of this.

As Lestor Ross, the managing director of the Beijing office of the US legal firm Wilmer Hale told the NYT: “The system is carrying this forward, waiting and waiting and waiting for some kind of bailout, and it has not come.”



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