Chinese provinces in talks with state banks on debt

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11 March 2024

An important meeting took place last week during China's National People's Congress (NPC) to try to deal with one of the major problems facing the country's economy and financial system.

The *Financial Times* (FT) reported that officials from some of the country's most indebted provinces met with leading state banks to negotiate debt repayments on billions of dollars of liabilities.

Over the past decade and a half, in the wake of the global financial crisis of 2008, borrowing by local governments, both directly and indirectly through local government funding vehicles (LGFVs), has been a key source of funding for infrastructure projects that have played a major role in advancing economic growth.

Local governments have raised the revenue to back the loans from the sale of land to real estate and property developers for housing projects. But the crisis in real estate, which has seen the collapse of major companies, of which the failed giant Evergrande is the most prominent, has now left local governments with huge debts without the means to pay them off.

Goldman Sachs has estimated that total local government debt, including that of the LGFVs, is the equivalent of $13 trillion.

According to the FT report, citing two people familiar with the discussions, officials from the Liaoning and Hebei provinces as well as officials from the city of Tianjin, attending the NPC "engaged in extensive high-level debt discussions with leading state bankers."

One banker cited in the report said that while the visits to banking authorities were "in passing," the "fact that they sat down for such discussions speaks to the great importance they attach to the issue of local debt reduction and what kind of financial resources they can still access at this stage."

The proposed solutions include restructuring the debt and refinancing the loans using local state assets as security.

Officials from Liaoning, described as a "rust belt province," also met bankers from 18 state financial institutions last Saturday, according to an official statement.

The debt problems go beyond the provinces involved in the latest talks. Last August, China's State Council sent a team of officials to examine the books of more than 10 of the provinces with the biggest problems.

The budget report presented to the NPC said the central government would "firmly prevent any increase in hidden government debt and steadily address existing hidden debt." The government has said it will gradually reduce the risks of local government debt by cutting the number of LGFVs and pushing local authorities to sell assets while offering some financial support.

However, the central government will not provide the level of stimulus made available in the past because it fears this will only create more financial problems.

The property and real estate crisis has taken another turn with the decision by a Hong Kong-based creditor, Ever Credit, to file a liquidation petition against the property developer Country Garden, which until recently was the country's largest.

In its petition, Ever Credit cited a non-payment equivalent to $204 million on a loan facility plus accrued interest.

When the property giant Evergrande started to run into problems in 2021, as a result of the government's tightening of credit in 2020, Country Garden was touted as a safe company. But it ran into the same problems as Evergrande—reduced access to credit in conditions of a falling market.

The extent of the crisis in local government financing

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was highlighted by an official document cited by the FT.

According to its report: “In south-western Yunnan, 1153 government-funded infrastructure projects such as highways and theme parks have been suspended and new construction halted to limit expenditures and focus on debt resolution.”

Government policy at this stage appears to be to push the problem down the road for as long as possible.

“You probably won’t see the stress on [banks’] balance sheets straight away, but debt resolution is putting real pressure in banks this year,” a banker present at one of the recent meetings said.

“The prevailing strategy is aimed at deferring risks by trading time for breathing space.”

One of the problems with this strategy, however, is that the situation in real estate and property development, on which local governments have been dependent for revenue, is getting worse and the overall economy is weakening. The official growth target for this year is “around 5 percent”—the lowest in three decades amid warnings that it will be hard to achieve.

Back in August when the government moved to examine the books of the weakest provinces a person described as “close to the finance ministry” noted that financial shuffling would not be sufficient.

“Debt swap programs won’t resolve the root problem as highly leveraged local governments may still have trouble paying off their debt going forward. Much slower economic growth will undermine fiscal revenue, which is a major source of debt repayment,” the person said.

Ivan Chung, managing director of Moody’s Investor Services, put the issue bluntly at the time: “Without growth, how can you generate more resources to repay the debt?”

Since then, the problems facing the Chinese economy have not improved and may in fact have worsened. Deflation appears to have set in, the stock market has experienced a major fall, only halted in the recent period by state intervention, and the economic warfare being conducted by the US against Chinese high-tech development has intensified.

In the most recent developments, the Biden administration has called on the commerce department to investigate whether Chinese high-tech products, such as electric vehicles, are being dumped on US markets and whether their “smart phone” type capacities pose a “national security risk.” The move is almost certain to lead to new restrictions.

The US is also pressing Japan and the Netherlands to tighten restrictions on the export of computer chipmaking equipment to China. It has been spurred into action by the fact that despite earlier sanctions the tech company Huawei and the Shanghai-based Semiconductor Manufacturing Internal Corporation last year revealed they had been able to develop a more advanced chip for mobile phones.

The US actions are aimed at cutting across the key economic strategy of the Xi Jinping government, which is to shift the economy away from its dependence on real estate and infrastructure development towards high-tech industries.

But the development of what Xi calls the “new productive forces” is regarded by the US as the chief danger to its economic hegemony which it is determined to crush by all means considered, including war.

US economic warfare, adding to the problems China already confronts, threatens to have major international consequences in conditions where global growth is largely stagnant.

In the wake of the global financial crisis of 2008, set off by the rampant speculation and outright criminality in the US financial system, Chinese expansion was a major factor in preventing the global recession from deepening further. That scenario is not going to be repeated.

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