

# Evergrande crisis of China

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**In news**— Evergrande Group, a Chinese real estate conglomerate, has been in the news due to its inability to pay interest on its massive debt obligations.

## About Evergrande crisis

- The company recently defaulted on interest payment and is set to miss more deadlines.
- Many fear that the company is insolvent, and its share price has dropped over 80% in the last one year and hit a 10-year low.
- This group is China's second-largest real estate company in terms of total sales and employs over 200,000 employees.
- Its core business deals with buying large amounts of land, developing them into houses, restaurants and so on and selling them to interested buyers.
- The company uses large amounts of debt from banks and investors as well as short-term loans extended by suppliers and property buyers to fund its business.

## Reasons of the crisis

### Chinese government's new rules for property developers

- In August 2020, the Chinese government came up with rules (also called the 'three red lines') stating how much a property developer can borrow given its financial position as measured by three debt metrics.
- The new rules practically cut off Evergrande from taking on any more debt on its balance sheet.
- This was a big hit to Evergrande's business as it engaged in heavy borrowing to run its business.
- The company was thus forced to sell its land and other properties at steep discounts to meet its debt

obligations.

- This fire sale of assets eventually led to Evergrande's insolvency.

### **Government's bid to puncture property bubble**

- The Chinese government's new rules as a bid to puncture the country's property bubble and bring about a 'soft landing' of the economy might have led to this crisis.
- Chinese authorities have traditionally encouraged businesses to take on huge amounts of debt through the heavily state-controlled financial sector to develop new properties. This led to the indiscriminate development of properties, so much so that almost a third of the Chinese GDP is made up of the property sector. Millions of properties with very little demand from buyers have been seen in Chinese 'ghost cities'.
- Over the years, Chinese authorities have also tacitly supported the property bubble by bailing out troubled developers.
- It is said that the Chinese authorities now want the country's resources to be allocated towards other sectors such as technology and have thus decided to withdraw their support for property developers.
- The Chinese government has in recent years let various business entities with exposure to the property sector go bust instead of bailing them out of trouble.

### **Long time crisis of the group**

- Other analysts, however, believe that the current crisis was a long time coming.
- They argue that the company's business model has been unsustainable for a long time.
- It was said that the company held properties that it could not sell on its balance sheet as inventory, thus avoiding the booking of losses.
- The company was also accused of running a ponzi scheme

as it relied on the constant inflow of funds to prop up a business model that is fundamentally unsustainable.

### **Impact of the crisis**

- Many have called the Evergrande crisis China's own 'Lehman moment', alluding to the failure of U.S. bank Lehman Brothers, which precipitated the 2008 financial crisis.
- foreign investors with direct exposure to Evergrande or to companies that are financially linked to Evergrande may experience losses.
- Any slowdown in the Chinese economy as the country tries to rebalance its economy away from the property sector will have effects on the global supply chain.
- Metal stocks in India, for instance, have witnessed a sharp correction, and the move was attributed to fears of a slump in Chinese demand.
- Some analysts, in fact, believe that Chinese growth could drop to as low 1-2% as the country massively rebalances its economy.