China’s Evergrande crisis

What is the issue?

Chinese real estate conglomerate Evergrande Group has been in the news recently over its inability to pay interest on its huge debt obligations.

What is the trouble at Evergrande?

- The Evergrande 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 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 to fund its business.
- It has total liabilities worth over $300 billion and has to pay around $37 billion in interest and maturing debt over the next year.
- Its share price has dropped over 80% in the last one year and hit a 10-year low.
- The company has also taken money in advance from buyers and from its own employees but has defaulted on these products

Why is the company in trouble?

- Almost a third of the Chinese GDP is made up of the property sector with Chinese authorities traditionally encouraging businesses to take on huge amounts of debts
- But the recent Chinese government’s rules for property developers called ‘**three red lines**” that states how much a property developer can borrow given its financial position as measured by three debt metrics
- This policy practically cut off Evergrande from taking on any more debt on its balance sheet
- Some analysts 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 to avoid booking of losses.
- The company was also accused of running a ponzi scheme as it needed constant inflow of funds to prop up a business model that is fundamentally

unsustainable

- Many have called the Evergrande crisis **China's own 'Lehman moment'** where the failure of U.S. bank Lehman Brothers precipitated the 2008 financial crisis

What lies ahead?

- **Any bailout by Chinese government will require the creation of a fresh supply of money which in turn will debase the value of the Chinese currency.**
- **Foreign investors with exposure to Evergrande may experience losses.**
- **Any slowdown in the Chinese economy in the course of rebalancement away from the property sector will have effects on the global supply chain.**
- **For instance, metal stocks in India have witnessed a sharp correction in attribution to fears of a slump in Chinese demand.**
- **Some critics have warned investors to refrain from investing in China pointing to the absence of the rule of law.**
- **Some analysts believe that Chinese growth could drop to as low 1-2% as the country massively rebalances its economy.**

Source: The Hindu, the Indian Express

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