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News & Information

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China Evergrande Stalling Payments, but the Jury's Still Out on Global Effects

In the latest development in the Evergrande saga, Reuters reports that the Chinese property giant is seeking a six-month delay in repayment of a $157 million bond. This comes hot on the heels of Evergrande being placed under a "restricted default" classification by Fitch Ratings, after missing a debt payment in early December 2021.

Overall, Evergrande's financial outlook is still a cause for concern in China, and internationally, as the developer struggles to meet over $300 billion in liabilities.

From Build-Up to Bust

Over the past 30 years, the Chinese real estate market has been bolstered by a combination of easy credit and demand, but changing national policies have halted the property development boom.

Professor of finance at Peking University, Michael Pettis, outlined the situation in a Carnegie article in September, saying:

"[Chinese] regulators implemented what became known as the three red lines for property developers last year. These consist of hard limits on a company's debt-to-asset ratio, its debt-to-equity ratio, and its cash-to-short-term-debt ratio. The three red lines almost immediately began to affect the operations of highly indebted developers."

He adds that the problem has been compounded by pre-selling of apartments and buildings, sometimes years in advance of construction.

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Outlook Uncertain

The fallout of Evergrande's difficulties is still playing out in real time, and the full ramifications for commercial real estate (CRE) and beyond are likely a few years in the making. We do know that China's housing market is currently facing an all-time slump, with the Wall Street Journal (quoting Morgan Stanley data) reporting:

"In December, contracted sales for 24 major property developers fell 31% from a year earlier."

As a counterpoint, Reuters notes that Chinese regulators have started to ease restrictions in a bid to: "… foster long-term development of the real estate industry, while maintaining stability in market expectations, as well as land and property prices."

Global Repercussions

How these developments will play out in international markets is a matter of debate. Although an overall slowdown in Chinese GDP is something to keep an eye on, Morgan Stanley chief global strategist, Ruchir Sharma, notes that China seems to be decoupling from global markets:

"China is still the leading trade partner for more nations than any other and the main global buyer of commodities. Should, for example, its campaign to reduce massive corporate debts, particularly in the property sector, end in a meltdown, the effects will be global and inescapable. But lesser tremors may no longer be so consequential. It may be that when China stumbles, the world no longer falls with it."

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