

## 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**