China Evergrande Group Liquidity Crisis

中國恒大集團 CHINA EVERGRANDE GROUP

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About China Evergrande Group (CEG)

- Founded in 1996 by Xu Jiyain, headquartered in Shenzhen, Guangdong Province.
- A conglomerate with core business in residential real estate, is the Second largest property developer in China by sales.
- The group has over **1,300 projects spread across 280 Chinese cities**.
- Ranked 122nd on the Fortune Global 500. **Became the most valuable real estate company in the world in 2018.**

What is the China Evergrande Liquidity issue?

- The biggest real estate developer in China has **total liabilities worth $305 billion** and has to pay around $37 billion in interest and maturing debt over the next one year.
- Evergrande currently has approx. **$1 trillion worth unfinished Projects**
- The company's bonds have been downgraded by rating agencies such as Fitch and S&P and have traded well below 50 cents on the Dollar.

What led China Evergrande Group close to default?

The most immediate trigger of the current crisis is the **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 cut off Evergrande from taking on any more debt**. This was a big blow to Evergrande's debt ridden business.

The company to meet its debt obligations had to sell its land and other properties at steep discounts. This eventually led to Evergrande's insolvency.

The interest payment worth $83 million was due on 23rd September for a $2 billion dollar-denominated bond that's due to mature in March 2022. As of today, the company has not made any announcement, or any filing to the Hong Kong exchange.

Implications if Evergrande Defaults

China

- Default **can put selling pressure on housing sector pushing prices of houses down further**. Real estate accounts for a large sum of wealth for Chinese citizens, therefore this **can severely impact consumption in China**.
- China's Debt to GDP ratio at the end of June quarter stood at 353%. **Around 29% of China's gross domestic product is related to real estate**. This default **could put China in a tough spot as the government has less space for fiscal manoeuvring**.
- Evergrande has liabilities that involve 128 banks and 121 non-banking institutions. If the company is not bailed out, possible **liquidation can cause domino effect** as banks and other institutions could have to restructure themselves.

Global

- As an immediate effect this news made investors nervous across markets, however the markets recovered on the hope of debt restructuring and government intervention to prevent a disorderly collapse.
- China is the **world's largest exporter and the second largest importer**. Its also the biggest trading partner for most Asian countries .Slowdown in China will have serious **ripple effect on global economy**.
- At a time when China is the biggest driver of the global economy post the COVID-19 disruption, any negative impact on the country's **economy will slow down the global economic recovery.**

India

- **Commodity exporting companies** will continue to take hit and would be major loser if this crisis is sorted out in time since China is the largest importer of commodities
- If Chinese currency Yuan depreciates, then Indian companies in sectors like textile, tyres, chemicals, where India and China both compete for the international market will face intense competition from Chinese companies.

How policymakers in China might respond

The Chinese government has started taking action response to Evergrande's problems. Government might divide up Evergrande's projects and ask state-owned enterprises (SOEs) or quasi-SOEs to take over. We believe that the government will seek to limit the economic fallout and rescue certain creditors instead of simply bailing out or letting it collapse in a disorderly manner.

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