

The Bursting of China's Housing Bubble

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“**Rows of Residential Towers**, some 26 stories high, stand unfinished in the Chinese city of Lu’an about 350 miles west of Shanghai, their plastic tarps flapping in the wind.” (WSJ Oct 5, 2021). Who could possibly so wildly over-estimate the need for apartments in a city where 1.6 million already live in dense urban housing? Who could miss an \$83 million interest payment on money borrowed to build those towers and hundreds of other projects? Evergrande.

Evergrande is a name you will soon associate with serious financial danger. This Chinese property development company, founded in 1996 as the Hengda Group, has been publicly traded since 2009 and is at \$0.38 (though trading has stopped in Hong Kong) this morning because they missed a massive interest payment (\$83.5 billion) to bondholders on September 23. Evergrande, not the largest land developer in China, is using the Chinese model of government-directed investment to build apartment buildings (and more) at a furious pace.

How Furious? The Numbers Are Staggering. The company had presold about 1.4 million such apartments worth about \$200 billion. Construction has stopped. “Evergrande has 700 projects under construction, covering 132 million square meters of total floor area.” That is about the floor space of 513 Empire State buildings. Evergrande is also building a \$9 billion theme park (bigger than Disney) and a \$4 billion electrical vehicle plant that ties local leaders’ dreams of prosperity in with China’s green priorities. The building is an empty steel shell. (WSJ Oct 6, 2021).

A woman who feared to give her full name said she and her husband spent all their savings (\$138,000) on a unit at the immense Jade Place in Lu’an where construction has halted in 47 *buildings* full of such apartments.

Why build in Lu’an? The city has lost 5% of its population since 2010. Many residents are over 60 years old and annual disposable income is \$3,500, below China’s average income of \$5000. Bubbles are not about facts.

The cycle of disaster began when that prepaid money from prospective owners was not spent by Evergrande to build those apartments, but to fund other Evergrande debt. Ponzi?

The is of international concern because about \$20 billion of the \$304 billion of Evergrande’s debt is dollar denominated and owned by foreign investors. These foreigners are the people who did not get paid in September. A huge default related to China’s housing bubble will have international repercussions. That’s a problem.

Cities will be Hurt: “For local leaders, development represented a revenue stream. With limited power to tax, Chinese cities get roughly a third of their revenue from selling land to property developers like Evergrande. Cities annex farmland to sell to developers. Farmers often get to buy apartments at a discount. Real estate became some cities’ biggest economic driver and the most important source of revenues. Lu’an’s take totaled \$1.2 billion from land sales in the first half of this year compared with total tax revenue of \$900 million.” (WSJ) That’s a real problem.

But Is This the China Communist Party’s Problem? “China’s vast and opaque financial system has long posed a threat to its economy and to the world. Banking assets have ballooned, and they sit alongside a large, Byzantine system of shadow finance.” (Economist Sept 25, 2021).

China opened the door to housing and its banks funded building with no limits. The government seemed content with having such a marvelously growing economy and a thriving housing market that improved living conditions for so many. When a housing bubble formed, it was ignored.

Now President Xi, who recently reigned in over-extended banks, will likely let Evergrande unwind, but the default will hurt China’s banks even more than foreign investors. ‘Unwind’ may sound harmless, but when a massive company in a key part of the economy (housing accounts for half of China’s economic growth) fails it can bring disaster to the banking industry, disrupt the economy, and even cause a severe recession just as with the banking- and housing-related Great Recession in the U.S. in 2008.

The Idea that Bubbles and Busts happen Only in the West is about to be tested. Governments are supposed to wisely contain capitalist excesses as we are attempting in the U.S. Maybe Congress should note Evergrande’s troubles.