

**Global Economic Research**

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# China's Debts Are Coming Due

Evergrande is an example of the risk of debt defaults to China's financial stability.

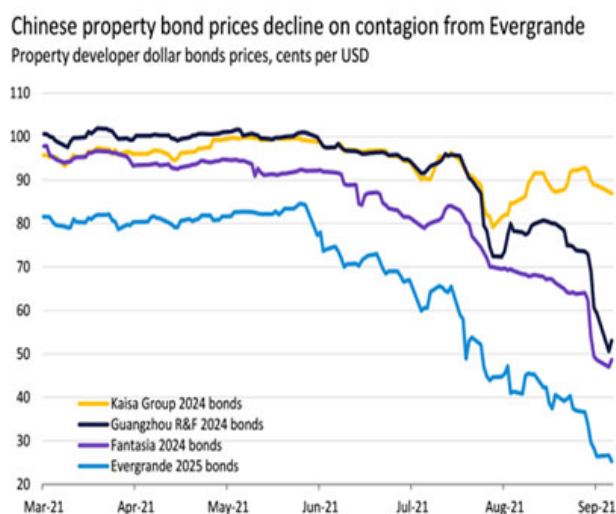
By Carl Tannenbaum



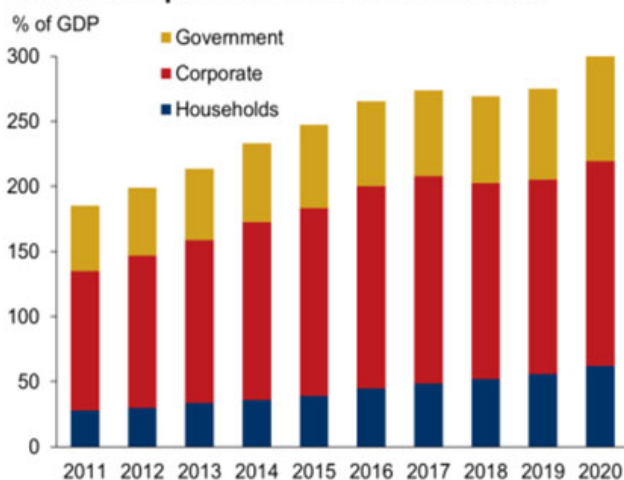
The name “Evergrande” was chosen by one of China’s foremost property developers to reflect its lofty aspirations. The company’s performance, however, has been anything but grand; its stock is nearly worthless, and its bonds are trading at twenty cents on the dollar. The situation

has become a challenge for China, emblematic of a difficult balancing act between promoting growth and controlling leverage.

China's construction boom is longstanding, founded on expectations of urban migration and lots of capital from investors. There have been periodic concerns about excess in this sector: reports of vacant properties, **price bubbles**, and mounting debt issues have been common. Evergrande has been at the center of the Chinese real estate sector, developing apartment blocks in multiple locations. Three years ago, it became the world's most valuable real estate company. Today, by contrast, the firm is struggling to generate cash flow sufficient to pay its obligations. Ratings on the company have been serially reduced, with Fitch stating that default "appears probable."



China: Composition of non-financial debt



Sources: Eurasia Group, Bloomberg, Oxford Economics, CEIC

China is a heavily leveraged country. Debt at the individual, corporate, and governmental level totals almost 300% of China's gross domestic product (GDP), almost double the level of a decade ago. Moreover, debt has been accumulating further over the past year, as China recovered from the COVID-19 pandemic.

The Chinese government has attempted to introduce some curbs on leverage, in an effort to reduce the risk of financial instability. Already, problems at Evergrande are being reflected in the bond prices of other property developers; the risk aversion could easily spread to other sectors. The fact that retail investors in China have significant exposure to the property sector makes the situation even more delicate.

*Debt excesses leave Chinese policy makers with no good options.*

Policy makers in Beijing have been trying to reduce the implicit government backstop enjoyed by companies like Evergrande. Their resolve will certainly be tested by the current situation; if they hold firm, they could be facing a financial crisis. If they relent, they perpetuate moral hazard. Whatever they decide, "Evergrande" may prove to be one of the most ironic corporate names in recent memory.

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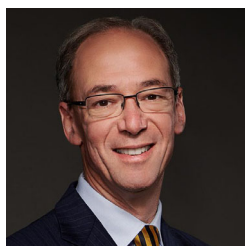
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Carl Tannenbaum is the Chief Economist for Northern Trust. In this role, he briefs clients and colleagues on the economy and business conditions, prepares the bank's official economic outlook and participates in forecast surveys. He is a member of Northern Trust's investment policy committee, its capital committee, and its asset/liability management committee.

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