



Evergrande crisis

Description

Theme:

- Evergrande, the second-largest property developer company in China is not in a position to repay its debt of \$300 billion.

What is the Evergrande crisis:

- Evergrande group has been borrowing money to build its real estate projects such as houses, residential apartments etc. Recently, it missed interest payments and halted many projects due to its inability to pay the suppliers. That means, companies that had to be paid by Evergrande may also miss interest payments to banks. This created bad loans.
- Many middle-class people paid money beforehand to buy the houses built by Evergrande's group. Some of them took loans from banks. At present, there are 16 lakh houses under construction by the Evergrande group.
- So, it will be difficult for banks of China to issue fresh loans and has already held back loans to other property development companies to prevent the formation of more bad loans. It will be difficult for many of those companies to operate without loans from banks.
- Everyone is wondering whether China government will step in to bail out the Evergrande group or will it let the company collapse.

Cause of the Evergrande crisis:

- China's housing boom was started in the late 1990s. Real estate companies took this opportunity and started building houses on a large scale for middle-class people. Local governments started making revenues by selling land to real estate companies. With time, people have started buying houses as an investment. This led to the rapid growth of property prices. So, to leverage this opportunity real estate companies including Evergrande has been continuously taking debts to construct houses. This debt-fueled growth model of China is burdening the country. At present, China's debt is almost 3 times its gross

domestic product (GDP).

- To control house prices and to improve the financial health of the real estate sector, China implemented the “three red lines” policy, under which it restricts further borrowings by property developers. To cut down debt, Evergrande started offering discounts on all real estate properties. But it could not meet the target and missed interest payments and is struggling to repay its debt of \$300 billion.

Steps taken by China government:

- China injected \$14 billion cash into the banking system to stabilize the economy.

Possible consequences:

- To prevent the Evergrande financial crisis and its negative impact on the overall economy, the government of China may step in to bail out the company. But if it did so, other companies will expect the same treatment. This will defeat the actual purpose of forcing companies to reduce their debts.
- China government may protect the investors and may let the Evergrande company collapse.
- As several construction projects halted, demand for building materials such as steel may decrease. This effect may impact countries that export these materials to China.
- A possible economic slowdown in China can reduce its imports from other countries.

Lessons from the Evergrande crisis:

- The concentration of development in some regions resulted in rapid urbanization, which caused housing bubbles. This led to high price rises of houses. To prevent this, development should be distributed.
- Governments should encourage people to invest money in alternative investments instead of investing in houses.
- Bad loans result in an economic crisis. So, they should be dealt with from the very start.
- Countries should not fall into the trap of debt-fueled economic growth. Its benefits may not last forever.

Conclusion:

The property-driven growth model of China led to the Evergrande crisis. This may cause an economic slowdown in China. Disperse development, providing reliable savings options and restructuring the country’s growth model can prevent the repetition of such incidents.

Your Turn!

What’s your take on the Evergrande crisis? Express your thoughts through the comment section below. And subscribe to our blog to read answers to the trending GD topics.

References:

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 - [The global economy could feel the effects of China's Evergrande crisis. Here's what investors should know](#)
 - [Evergrande crisis could spell the end of China's "miracle" growth](#)
 - [Lessons from China's Evergrande](#)
 - [Evergrande | The "grey rhino" of China's property boom](#)
 - [How fall of property giant Evergrande sent a shockwave through China](#)
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