5 Lessons Evergrande Taught Us About The Chinese Economy,

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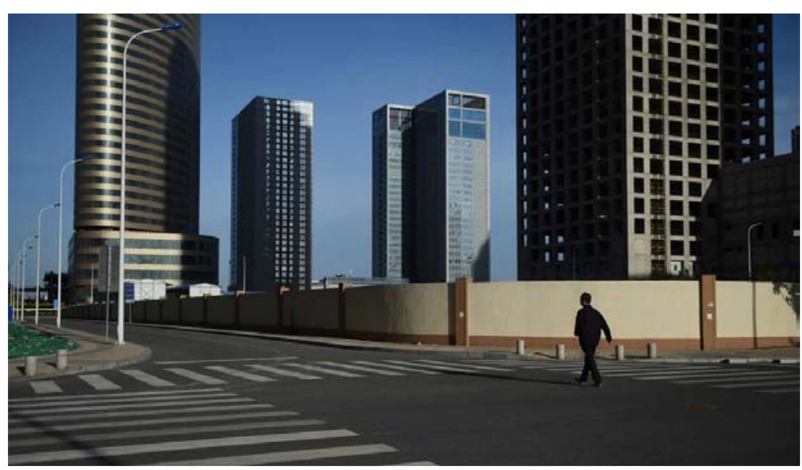
Interjection by Don Chapin: Back in '92-'93 when the Chinese Gov't attempted to impress us gualos (fat white foreigners) with their "progress and industrialization" in government-supported trips from Macau to the interior, the lack of occupancy was extremely evident... empty offices, over grown sidewalks, empty parking lots, etc. I wondered then how long this continuous building façade would last as the Chinese GDP growth was phenomenal, but obviously artificial on closer inspection.)

A man walks in an empty street in Conch Bay opposite the new Yujiapu Financial District in Tianjin, China, in 2015.

Greg Baker/AFP via Getty Images

Last week, global markets shook after a Chinese company named Evergrande fell into what looks like a downward spiral into oblivion. Evergrande is — or was — the second-largest real estate company in China. A couple years ago, it was the world's most valuable real estate stock. It's also been involved in an eclectic mix of other businesses, from mineral water to electric cars to pig farming. It even owns a professional soccer team. But recently it's been having a really hard time repaying a mammoth amount of



debt, a whopping [$300 billion] worth.

The Evergrande story is bigger than just one company. It's about China's unsustainable model of economic growth, which has relied on endless investment and a mad, debt-fueled development frenzy in recent years. That model helped China soar, but the country is now experiencing some turbulence. Last week, some alarmist observers were calling this China's "Lehman moment" — a reference to the collapse of Lehman Brothers that preceded the 2008 financial crisis — but China-focused economists argue that's overblown.

Nonetheless, given how interconnected the global economy is, investors remain worried about the future of the Chinese economy. It's been a nuclear reactor powering the globe's economic growth. Troubles there could have ripple effects around the world.

We decided to put together a little listicle about what we've learned from the Evergrande story so far.

1) Real estate has been a huge part of China's economic growth

The halted under-construction Evergrande Cultural Tourism City, a mixed-used residential, retail and entertainment development in Taicang in China's eastern Jiangsu province.
Vivian Lin/AFP via Getty Images

China's economic growth in recent years has been powered in large part by its roaring real estate market. The real estate industry, directly and indirectly, accounts for as much as 29% of China's entire gross domestic product. This growth has been fueled by a ginormous property bubble and mounting amounts of debt. For a while, China's national and local governments used their massive powers of command and control over the economy to keep the bubble inflating. As is commonly the case in bubbles, investors and companies have taken on massive amounts of debt to capitalize on surging real estate prices. Evergrande amassed more than $300 billion in debt to its banks, its bondholders, its suppliers and its customers, many of whom pre-bought homes months, even years, before they were built.

2) China's property bubble has created spooky "ghost cities" throughout the nation

Greg Baker/AFP via Getty Images

The Chinese property bubble, which observers have been talking about for years, has encouraged more and more speculation, with investors buying up properties with no intention of living in them. Unfinished and vacant buildings and apartments litter the provinces of China. Estimates vary, but around 20% of China's total housing stock now sits unoccupied. The *Financial Times* says there is now enough vacant property in the nation to house more than 90 million people. That's enough empty homes to fit the entire population of Canada. Or France. Or Germany.

In some cases, entire urban areas lie empty. These "ghost cities" include replicas of Paris, Venice and even Jackson Hole, Wyo.

3) The Communist Party of China is working to reduce financial risks and change its model for economic growth

Chinese President Xi Jinping appears on a large screen as performers dance during a June gala marking the 100th anniversary of the Chinese Communist Party at the Bird's Nest stadium in Beijing.

Kevin Frayer/Getty Images

One of the main differences between Evergrande's debt crunch and the collapse of Lehman Brothers is that this crunch was brought about on purpose. The Communist Party of China has been aware of the dangers posed by its wild real estate market for some time. In 2017, President Xi Jinping began signaling he wanted to do something about it with a speech to the 19th Party Congress. He said, "Houses are built to be inhabited, not for speculation."

Last year, the government followed up with a policy known as "three red lines," which aims to reduce debt in the property market, crack down on reckless borrowing and prevent a market correction from turning into a cataclysm. Historian Adam Tooze calls it "controlled demolition" of the real estate bubble.

More broadly, Xi has been pursuing radical new policies in the name of "common prosperity," an effort to fight growing inequality in China and intervene more forcefully in private industries.

In July, Xi released an essay outlining his ambitions for China. He said he wants the country to focus on "pursuing genuine rather than inflated GDP growth and achieving high-quality, efficient and sustainable development." Evergrande, a poster child for excesses of the real estate market, apparently does not represent genuine economic growth. And government policies, which once boosted the company, are now strangling it.

4) Cronyism may have lulled investors and creditors into overconfidence in Evergrande

Xu Jiayin, Evergrande's politically well-connected founder, addresses a March 2016 news conference on the sidelines of the fourth session of the 12th National People's Congress in Beijing.

Etienne Oliveau/Getty Images

Evergrande was founded by Xu Jiayin, who not that long ago was the richest man in China. Xu is well-connected. He is a member of the Chinese People's Political Consultative Conference, an elite group of advisers to the government. He's also politically shrewd. For example, he reportedly got Evergrande to buy Guangzhou Football Club after Xi said he wanted China to have a great soccer team. The company then sank millions buying some of the best soccer players in the world.

The New York Times suggests that Xu's connections gave investors and creditors confidence that the company could keep borrowing and get bailed out by the government if things went bad. They thought Evergrande was too big and too connected to fail. In August, however, as the company began to wobble, Xu resigned as chairman of Evergrande's real estate arm, sending it tumbling further.

5) Evergrande may be just the tip of the iceberg

(Interjection by Don Chapin: Which is what I observed in '92-'93)

Boats travel on the Huangpu River in August 2020 against the backdrop of Shanghai's skyline in the Pudong district.

Kevin Frayer/Getty Images

China's growth in recent years has depended heavily on a gargantuan expansion of real estate and all its accouterments — trains, bridges and sewers. China has been building and building and building, creating lots of economic activity. With Evergrande, that type of growth is finally showing itself to be unsustainable — and the Chinese economy is in for a period of turbulence. The weird part is this seems to be, in part, by design.

We still have questions. How forcefully will China act to contain the damage done by Evergrande? Will China be able to shift its economic model successfully away from real estate and endless development? How will this shift affect the broader global economy? We'll be paying attention in future weeks.