

Evergrande Crisis and China's Economic Growth Model

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The American Chamber of Commerce in Shanghai

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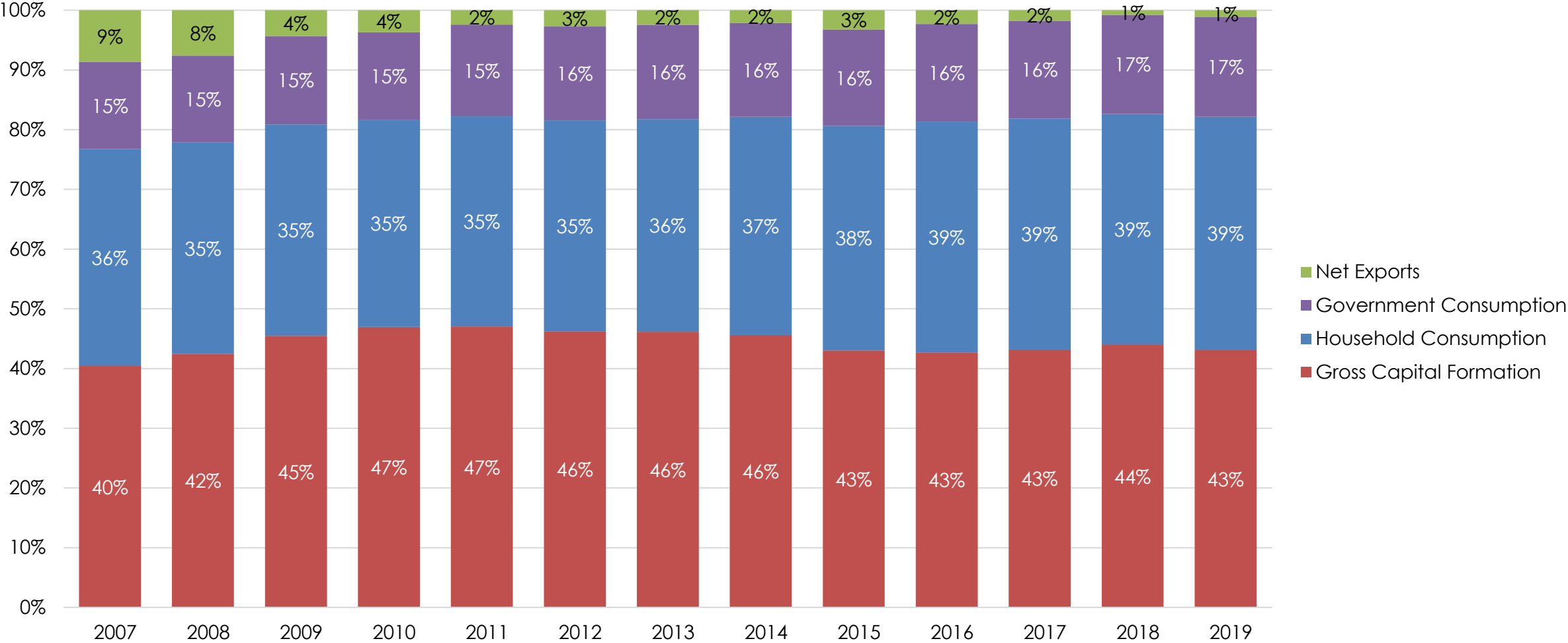
Explaining Evergrande

Big themes

- China's model is an investment-driven model, at the expense of consumption.
- In recent years, China has been able to sustain high levels of growth primarily through significant growth in debt.
- Local governments depend on land to meet fiscal obligations. Land sales now represent 60% of total local government revenues (2020). Land can also be collateralized to allow for LGFV borrowing.
- Beijing wants to force a correction and steer more debt away from residual non-productive investment to “high quality” investment.
- But...80% of Chinese household wealth stored in real estate.
- Evergrande crisis a symptom and at the crux of this dilemma.

Investment Continues to Be Major Source of GDP

2007-2019



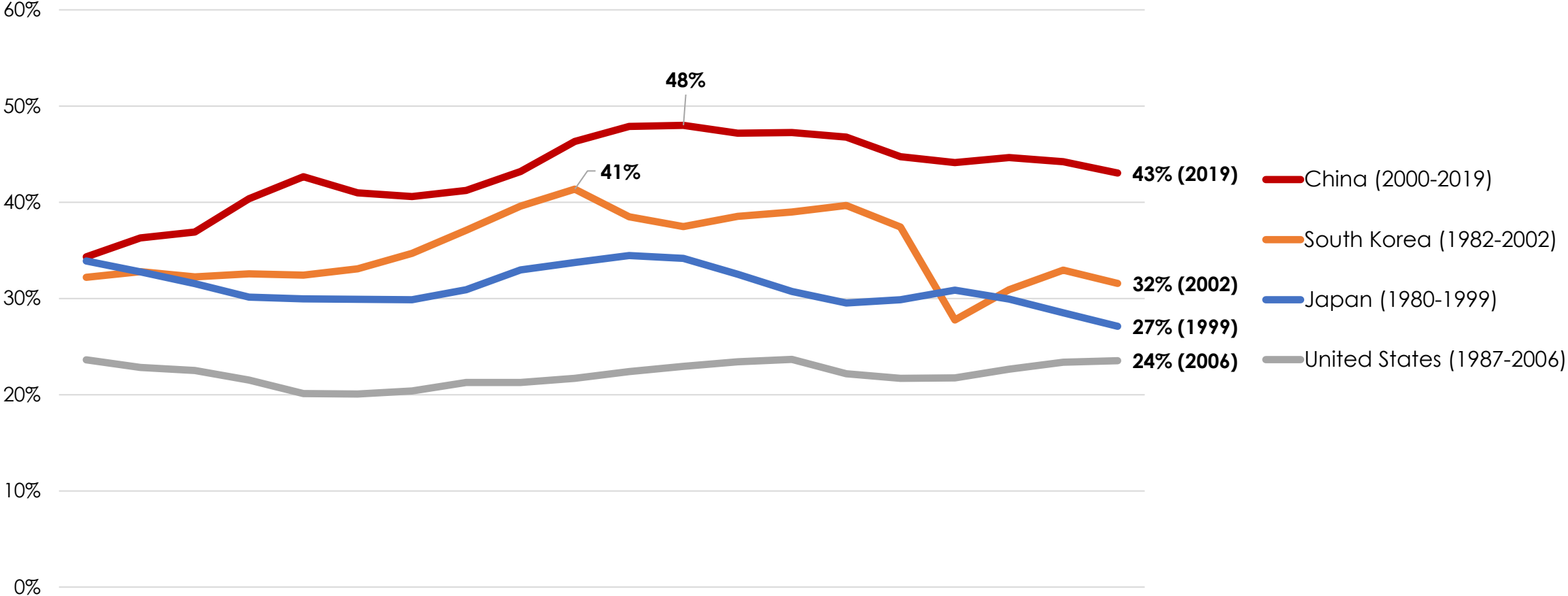
Source: National Bureau of Statistics of China, 2021.



Investment as a Share of GDP

Select countries, over 20-year periods

Share of GDP



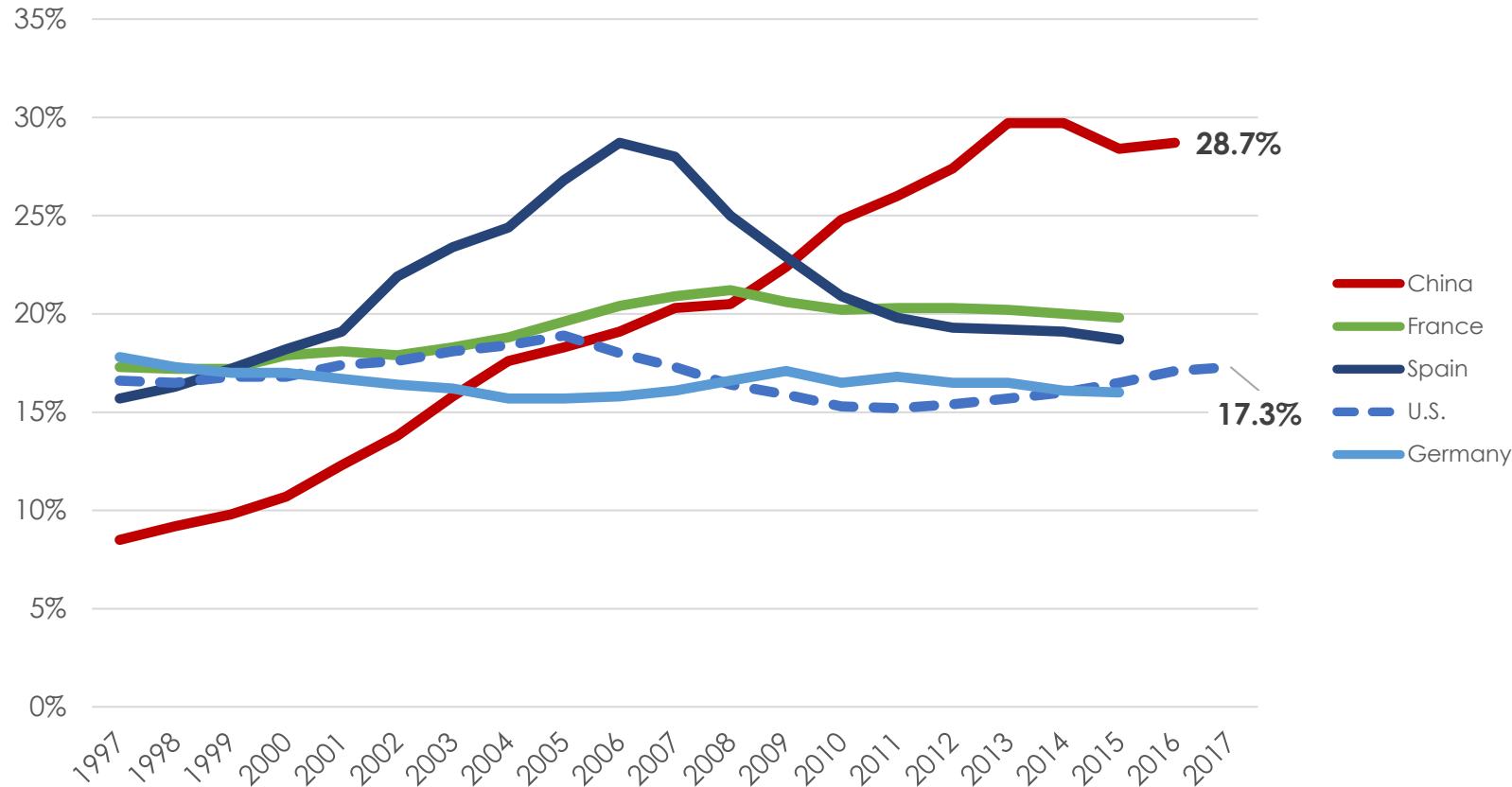
Source: IMF, World Economic Outlook, 2021.



Real Estate Sector in China

Share of economy

Share of GDP,
including multiplier
effects



- Accounts, directly and indirectly, for an estimated 29% of China's GDP.

- Rogoff and Yang, 2020.

- 6.5% of direct value-added.
- 78% of Chinese household wealth tied up in residential property, versus 35% in the U.S.

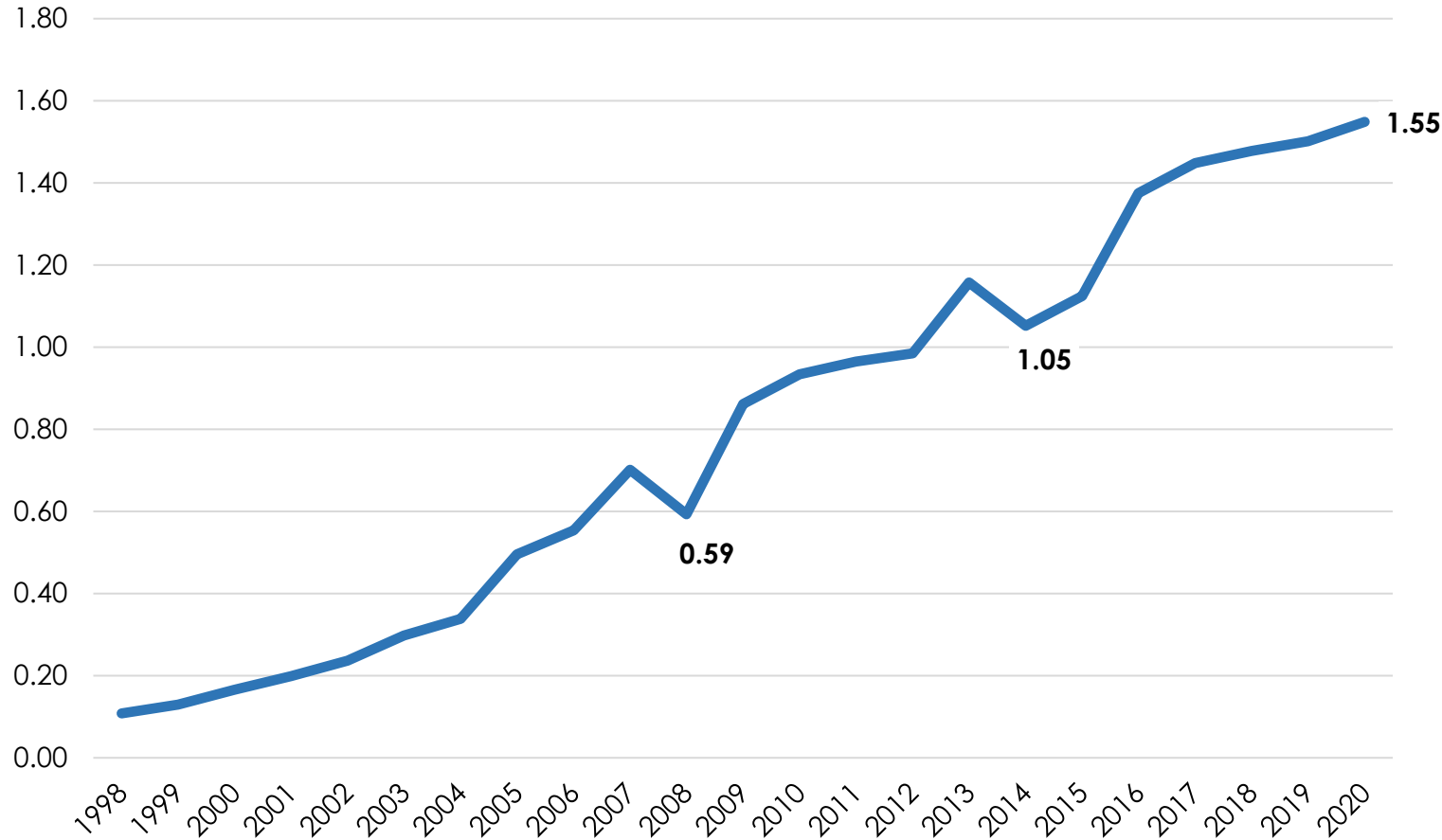
- China Guangfa Bank and Southwestern University of Finance and Economics.

Source: Rogoff, Kenneth, and Yuanchen Yang. 2021. "Has China's Housing Production Peaked?" *China and the World Economy 21 (1): 1-31.*

Real Estate Sector in China

Residential building space sold, 1998-2020

Billions of Square Meters



Source: National Bureau of Statistics of China, multiple years.

- Housing market reform in 1998.
- Residential floor space increased 6.7% per year (CAGR) between 2014 and 2020.
- The total value of Chinese homes and developers' inventory hit **\$52 trillion** in 2019, twice the size of the U.S. residential market and outstripping even the entire U.S. bond market

• Goldman Sachs Group Inc.



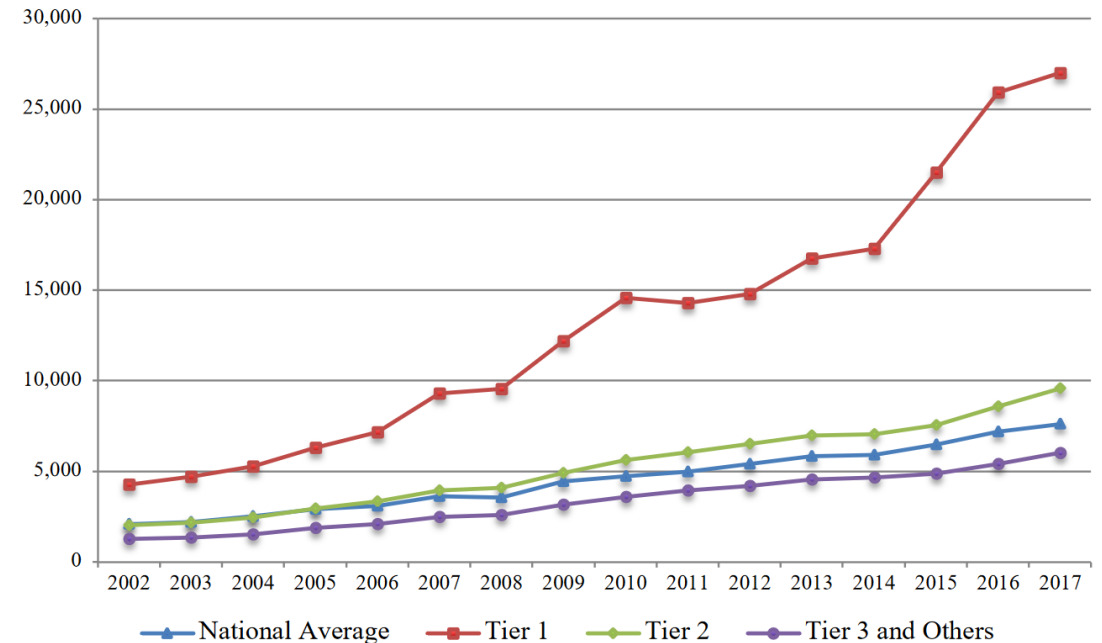
Real Estate Sector in China

Background and recent trends

- Globally, China accounted for around 57% of the \$11.6 trillion increase in household borrowing over the decade through 2019. The U.S. accounted for about 19%.
- 90% of new homes sold via presale.
- Price-to-income ratio in tier I cities now 14x.
 - In the U.S., the ratio is currently 7.
 - The San Francisco Bay Area ~9.

Figure 2. Residential Housing Prices by City Tier (yuan/sq.m)

This figure depicts the annual housing prices in first-, second-, third-tier cities from 2002 to 2017. National Bureau of Statistics provides annual data for 35 large and medium-sized cities. Tier-1 cities include Beijing, Shanghai, Guangzhou, and Shenzhen. The other 31 cities belong to tier-2. The rest belong to tier-3.



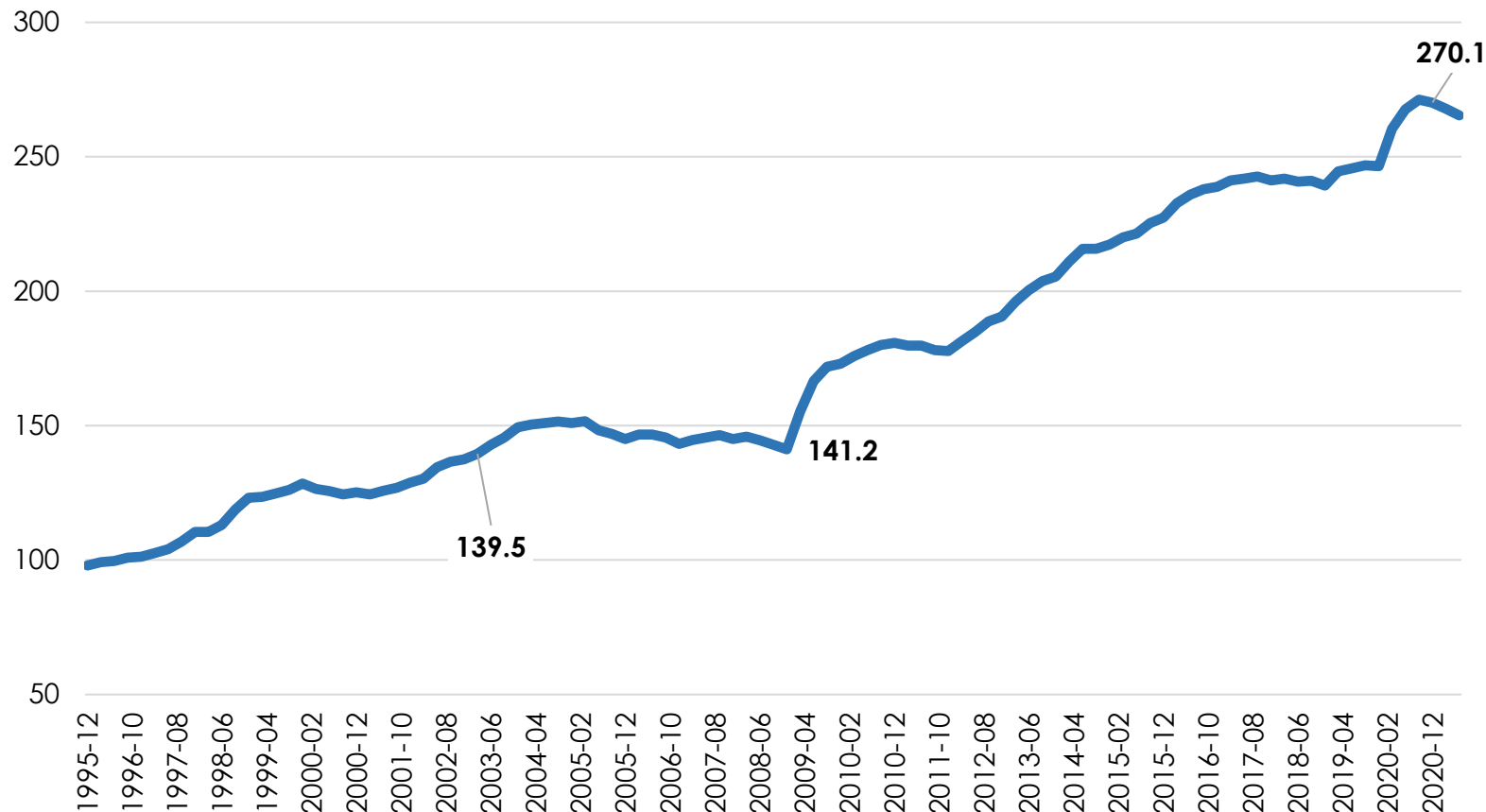
Source: National Bureau of Statistics

Sources: Rogoff, Kenneth, and Yuanchen Yang. 2021. "Has China's Housing Production Peaked?" *China and the World Economy* 21 (1): 1-31; Bank of International Settlements, 2021; Li Sun. April 2020. *Housing Affordability in Chinese Cities (Working Paper WP20LS1)*. Lincoln Institute of Land Policy; China Guangfa Bank and Southwestern University of Finance and Economics. January 2019. "2018 Urban Household Wealth Report."

How We Got Here

Non-financial sector debt-to-GDP ratio, 1995 Q1 – 2020 Q2

Debt-to-Nominal
GDP



- Chinese banking system's assets are strongly tied to the property sector.
- Ratio nearly doubled during Global Financial Crisis to 2021 Q1.

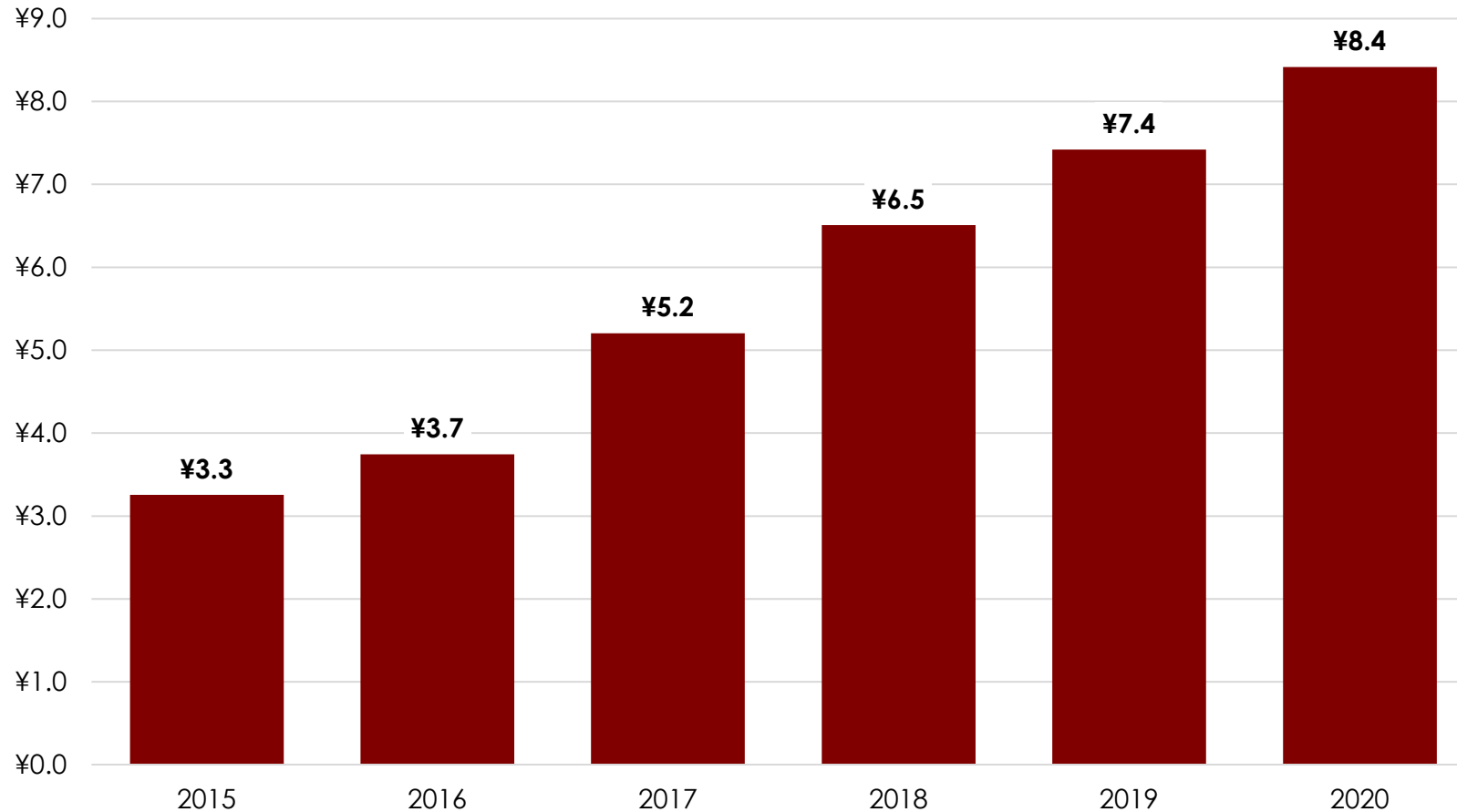
Source: National Institution of Finance & Development (国家金融与发展实验室). 2021. China's Macro Leverage Ratio Database.



Land Finance (土地财政)

Local government land conveyance fees (土地出让金), trillions nominal RMB, 2015-2020

Trillions RMB



Sources: China Ministry of Finance. March 5, 2021. Report on the Execution of the Central and Local Budgets for 2020 and on the Draft Central and Local Budgets for 2021; National Bureau of Statistics, National Statistical Yearbook, various years.

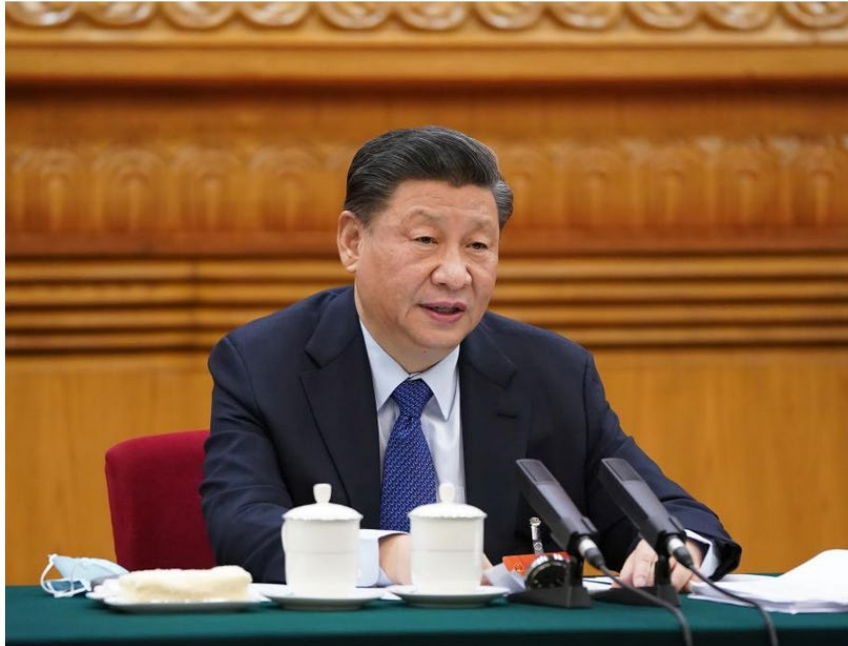
- Total local government revenues in 2020 summed to 14.1 trillion, including special purpose bonds and central government transfers.
- Income from land sales accounted for 60% of local governments' revenue in 2020.
- Land reserves also transferred to LGFVs to be used as collateral for borrowing.

Policy Context

New economic theory leaves little room for real estate

Xi Focus: Xi stresses high-quality development, improving people's well-being

Source: Xinhua | 2021-03-07 21:36:48 | Editor: yhy



GT Global Times

SOURCE / ECONOMY

Evergrande 'not too big to fail': Chinese analyst responds to foreign hype

China-bashers lack professionalism in hyping single case

By GT staff reporters

Published: Sep 23, 2021 09:33 PM



把握新发展阶段，贯彻新发展理念，构建新发展格局

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把握新发展阶段，贯彻新发展理念，构建新发展格局*

习近平



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对今年以来国民经济和社会发展计划 执行情况报告的意见和建议

总体上看，下半年经济形势主要存在三方面问题，一是经济恢复边际放缓；二是经济恢复存在消费恢复滞后于生产和投资、内需恢复滞后于外需、**基础设施和制造业投资恢复滞后于房地产投资**等三个不平衡。

- One key concern is "the resumption of infrastructure and manufacturing investment lags behind real estate investment." (August 19, 2021)



How We Got Here

Policy and political economy context

Policy Shifts and New Policy Frameworks

- New efforts to deleverage the economy and rein in shadow banking.
- China 2025 and focus on more productive sectors than real estate.
- “Common Prosperity” (2021).
- “Dual Circulation” (2020).
- Efforts to encourage higher fertility rate.
- Deprioritizing rate of economic growth.

Preceding Factors

- Fiscalization of land, or “land finance” (土地财政).
- Rapid expansion of debt and diminishing ROI.
- Demographics.
- Increasing housing “unaffordability.”
- Local government incentive structure.

Tactical Measures

- Restructuring of defaulting institutions, e.g., Huarong, Baoshan Bank.
- Three Red Lines.
- Government-stewarded deleveraging of major conglomerates HNA, Anbang, Fosun, and Wanda.
- State Council says that LGFVs should restructure or go bankrupt if unable to pay back debt.



Additional Questions and Feedback:

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