The Evergrande crisis explained: Should Australian investors worry?

Fears are mounting the collapse of one of China's real estate juggernauts could infect global markets and Australia's largest export.

21 September 2021

By Lewis Jackson

Lewis Jackson is a reporter and data journalist with Morningstar. Tweet him @lewjackk or get in touch via email. Any Morningstar ratings/ recommendations contained in this report are based on the full research report available from Morningstar.

Mentioned: VanEck FTSE China A50 ETF (CETF), BHP Group Ltd (BHP), Fortescue Metals Group Ltd (FMG), Rio Tinto Ltd (RIO)

One of China's biggest property developers is in trouble. Once the great hope of a booming property market, Evergrande is saddled with over AU$400 billion in debt—roughly two thirds as much as all Australian government debt—and is struggling to make payments. Creditors are circling.

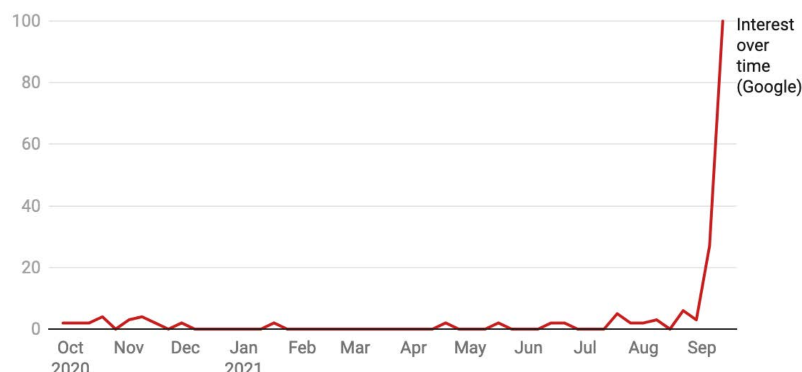
Like Lehman Brothers, which filed for bankruptcy with US$619 billion in debt and whose collapse was the tipping point of the 2008 global financial crisis, markets are worried that Evergrande's demise could send shockwaves through the Chinese economy and global markets.

The indebted developer says it owns thousands of projects across hundreds of cities in China. It also has interests in football teams, theme parks, bottled water and electric cars.

Will this issue be contained within China, or are we about to witness a global downturn? For those first hearing about Evergrande, Morningstar has put together a primer. We've spoken to several analysts about the likelihood of a government bailout, the long-term ramifications, and what it means for Australia.

Searches for "Evergrande" spike on Google Australia

Interest measured for week starting on each date



Numbers represent search interest relative to the highest point on the chart for the given region and time. A value of 100 is the peak popularity for the term.

Source: Google • Created with Datawrapper

© 2021 Morningstar, Inc. All rights reserved. Neither Morningstar, its affiliates, nor the content providers guarantee the data or content contained herein to be accurate, complete or timely nor will they have any liability for its use or distribution. Any general advice or 'regulated financial advice' under New Zealand law has been prepared by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) and/or Morningstar Research Ltd, subsidiaries of Morningstar, Inc, without reference to your objectives, financial situation or needs. For more information refer to our Financial Services Guide (AU) and Financial Advice Provider Disclosure Statement (NZ) at www.morningstar.com.au/s/fsg.pdf and www.morningstar.com.au/s/fapds.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Our publications, ratings and products should be viewed as an additional investment resource, not as your sole source of information. Morningstar's full research reports are the source of any Morningstar Ratings and are available from Morningstar or your adviser. Past performance does not necessarily indicate a financial product's future performance. To obtain advice tailored to your situation, contact a professional financial adviser. Some material is copyright and published under licence from ASX Operations Pty Ltd ACN 004 523 782.

Who is Evergrande?

Evergrande is one of the three largest property developers in China. According to its website, it owns over 1,300 projects in more than 280 cities.

For years, it pursued a high growth strategy of piling on massive debts to build property for China's urbanising middle classes.

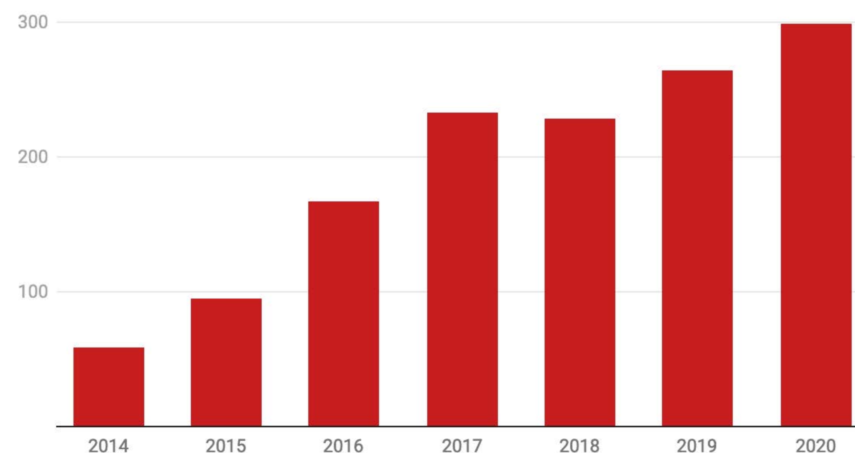
It was a strategy possible in a country with tens of millions migrating to cities. China's urban population rose more than 10% between 2010 and 2020, according to the World Bank.

"Chinese developers have been engaged in the indiscriminate pursuit of growth and scale", says Cheng Wee Tan, a Morningstar senior equity analyst.

Evergrande was once successful. Its share price soared 410% between 2017 and 2020. The developer built a soccer stadium and bought a national team to fill it. It launched a line of bottled water—spruiked by none other than Jackie Chan. It started an electric car subsidiary.

Evergrande's liabilities have grown steadily

Total liabilities (USD)



Periods are financial years ending 31 December

Source: Pitchbook • Created with Datawrapper

Regulators have been watching the situation with concern. In August 2020, the government announced the "three red lines" policy, which banned overly indebted developers like Evergrande from borrowing.

At the same time, the government has been trying to reduce soaring house prices. Measured by price to income, Chinese capital city real estate is among the most expensive in the world.

© 2021 Morningstar, Inc. All rights reserved. Neither Morningstar, its affiliates, nor the content providers guarantee the data or content contained herein to be accurate, complete or timely nor will they have any liability for its use or distribution. Any general advice or 'regulated financial advice' under New Zealand law has been prepared by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) and/or Morningstar Research Ltd, subsidiaries of Morningstar, Inc, without reference to your objectives, financial situation or needs. For more information refer to our Financial Services Guide (AU) and Financial Advice Provider Disclosure Statement (NZ) at www.morningstar.com.au/s/fsg.pdf and www.morningstar.com.au/s/fapds.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Our publications, ratings and products should be viewed as an additional investment resource, not as your sole source of information. Morningstar's full research reports are the source of any Morningstar Ratings and are available from Morningstar or your adviser. Past performance does not necessarily indicate a financial product's future performance. To obtain advice tailored to your situation, contact a professional financial adviser. Some material is copyright and published under licence from ASX Operations Pty Ltd ACN 004 523 782.

The effect has been to make it harder for Evergrande to get the cash it needs to service its mountain of debt. It only has enough cash on hand to meet 54% of its short-term debt, according to Pitchbook.

Why is it blowing up now?

If lots of debt slowly strangles a company, then a liquidity crisis is more like a heart attack.

Evergrande has staved off the coronary thanks to customers and capital markets. Its customers make sizable pre-payments on unfinished homes, often funded by mortgages. Evergrande has also tapped banks and bond markets, at home and overseas.

But banks and bond investors are now running for the exit, says Tan.

Ratings agency Fitch downgraded their debt earlier this month, saying a default was 'probable'. Markets are pricing in armageddon. Evergrande's bonds are trading at less than 30 cents to the dollar. The share price has fallen 48% in September alone.

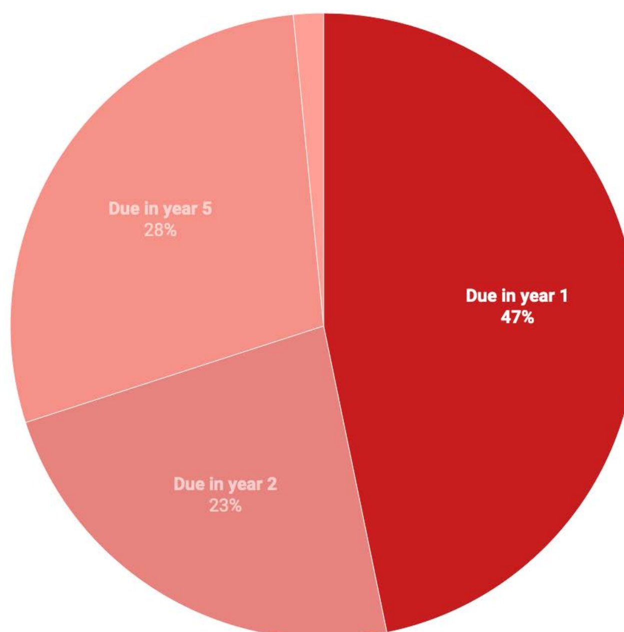
"What is certain is that Evergrande will be shut out of the capital markets," Tan says.

Then, in a 13 September statement to the Hong Kong stock exchange, Evergrande said that property sales vital for keeping it afloat had halved. It also announced it was calling in restructuring advisers. The next day angry investors swarmed its headquarters.

Almost half of Evergrande's debt obligations are due soon

Debt maturity schedule, FY 2020 (USD)

Due in year 1 Due in year 2 Due in year 5 Due beyond



Financial obligations for financial year ending 31 December 2020

Source: Pitchbook • Created with Datawrapper

© 2021 Morningstar, Inc. All rights reserved. Neither Morningstar, its affiliates, nor the content providers guarantee the data or content contained herein to be accurate, complete or timely nor will they have any liability for its use or distribution. Any general advice or 'regulated financial advice' under New Zealand law has been prepared by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) and/or Morningstar Research Ltd, subsidiaries of Morningstar, Inc, without reference to your objectives, financial situation or needs. For more information refer to our Financial Services Guide (AU) and Financial Advice Provider Disclosure Statement (NZ) at www.morningstar.com.au/s/fsg.pdf and www.morningstar.com.au/s/fapds.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Our publications, ratings and products should be viewed as an additional investment resource, not as your sole source of information. Morningstar's full research reports are the source of any Morningstar Ratings and are available from Morningstar or your adviser. Past performance does not necessarily indicate a financial product's future performance. To obtain advice tailored to your situation, contact a professional financial adviser. Some material is copyright and published under licence from ASX Operations Pty Ltd ACN 004 523 782.

Last week Bloomberg reported Chinese regulators had notified major banks Evergrande would not be making upcoming loan payments.

All eyes are on 23 September, when interest payments on two different bonds are due.

It's not just those that sold Evergrande cement or foreign bondholders that are in trouble. There are the buyers of Evergrande's potentially 1.6 million unfinished apartments. There are the investors who bought the firm's wealth management products promising double digit returns. Then there are Evergrande's 200,000 employees, tens of thousands of whom were asked to make short-term loans to the company.

It doesn't have to be Lehman Brothers to be bad

Markets are gripped by fears about how Evergrande's debt problems will ripple through the Chinese financial system, into its economy and out into the world.

The "doomsday" scenario is a Lehman Brothers-style implosion, where fleeing lenders cause credit markets to freeze for the entire sector. Defaults could then spread to other developers and the banks that have lent to them.

These fears have crushed the share prices for similarly indebted Chinese property companies like Guangzhou R&F Properties and Kaisa Group. The former is down 32% this month, the latter 13%. The cost of borrowing for many developers has skyrocketed in recent weeks.

But Morningstar's Tan says a chaotic default is unlikely. He says regulators learnt hard lessons from the collapse of Lehman Brothers and will step in to keep credit flowing, especially in China where many banks are state-owned.

"We don't think the government will let it happen. Previous examples show the government has done organised restructuring"," says Tan.

"Evergrande is very important so would expect the government to step in, perhaps bringing private investors for its assets."

China Evergrande Group

1-Yr Market Price, USD, -86.18%

Source: Morningstar • Created with Datawrapper

© 2021 Morningstar, Inc. All rights reserved. Neither Morningstar, its affiliates, nor the content providers guarantee the data or content contained herein to be accurate, complete or timely nor will they have any liability for its use or distribution. Any general advice or 'regulated financial advice' under New Zealand law has been prepared by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) and/or Morningstar Research Ltd, subsidiaries of Morningstar, Inc, without reference to your objectives, financial situation or needs. For more information refer to our Financial Services Guide (AU) and Financial Advice Provider Disclosure Statement (NZ) at www.morningstar.com.au/s/fsg.pdf and www.morningstar.com.au/s/fapds.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Our publications, ratings and products should be viewed as an additional investment resource, not as your sole source of information. Morningstar's full research reports are the source of any Morningstar Ratings and are available from Morningstar or your adviser. Past performance does not necessarily indicate a financial product's future performance. To obtain advice tailored to your situation, contact a professional financial adviser. Some material is copyright and published under licence from ASX Operations Pty Ltd ACN 004 523 782.

In a note published last Tuesday, ratings agency Fitch said it expects authorities to work to avoid a disorderly default.

On Friday, China's central bank injected 100 billion Yuan or US$15.5 billion into the banking system to keep cash flowing.

A test by the Chinese central bank earlier this month showed the 27 of the country's 30 banks large had enough cash to handle a "severe economic slowdown".

But there will be pain. An organised default could see bondholders, especially foreign ones, take big losses.

Bond funds owned by UBS, HSBC and BlackRock have been buying Evergrande bonds in the last six months.

Equity investors are also in for a world of pain. After staging recoveries in early September, Hong Kong's Hang Seng Index and the Shanghai Composite Index have fallen 5% and 2.3%, respectively, in the last five days.

The VanEck FTSE China A50 ETF (ASX: CETF), which tracks the 50 largest mainland Chinese companies, is down 6% since Monday.

The turmoil is coming at a time when many markets are falling from all-time highs and central banks are considering withdrawing stimulus, says Stephen Miller, an adviser at GSFM funds management.

"These things never happen at a good time. But Evergrande is happening when central banks are withdrawing liquidity and US fiscal policy may temporarily have run out of room to manoeuvre," he says.

If China sneezes, Australia catches cold

The more enduring risk for Australia is that Evergrande triggers a slowdown in the Chinese construction and real estate sectors. That could send house prices lower and squeeze household spending in the world's second largest economy, says Yixiao Zhou, an economist at the Australian National University.

According to Reserve Bank research, residential investment accounted for around 20% of Chinese GDP at its peak in 2016, roughly four times Australian levels.

Its importance has declined slightly since then but the associated construction sector still employs around twenty million workers, says Zhou.

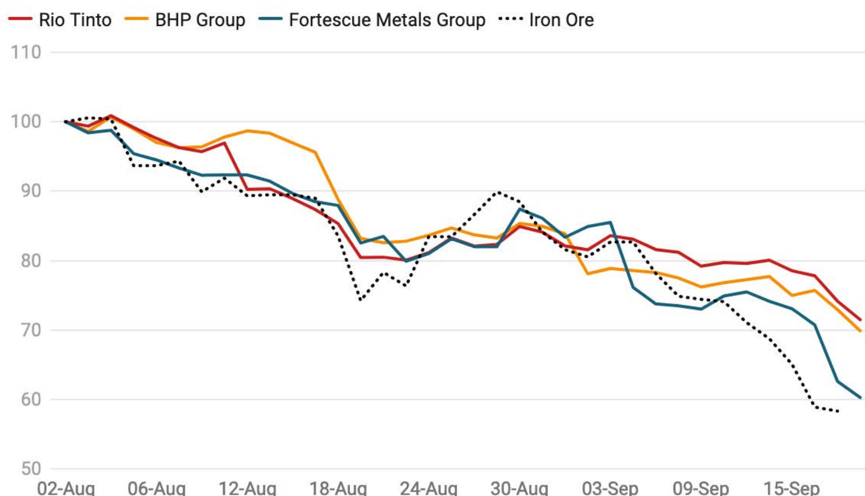
"You'd be worried that if construction slows down what happens to these workers," she says.

"The real estate sector is a large engine of the Chinese economy. If it slows too dramatically growth does too."

© 2021 Morningstar, Inc. All rights reserved. Neither Morningstar, its affiliates, nor the content providers guarantee the data or content contained herein to be accurate, complete or timely nor will they have any liability for its use or distribution. Any general advice or 'regulated financial advice' under New Zealand law has been prepared by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) and/or Morningstar Research Ltd, subsidiaries of Morningstar, Inc, without reference to your objectives, financial situation or needs. For more information refer to our Financial Services Guide (AU) and Financial Advice Provider Disclosure Statement (NZ) at www.morningstar.com.au/s/fsg.pdf and www.morningstar.com.au/s/fapds.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Our publications, ratings and products should be viewed as an additional investment resource, not as your sole source of information. Morningstar's full research reports are the source of any Morningstar Ratings and are available from Morningstar or your adviser. Past performance does not necessarily indicate a financial product's future performance. To obtain advice tailored to your situation, contact a professional financial adviser. Some material is copyright and published under licence from ASX Operations Pty Ltd ACN 004 523 782.

Australia would first feel the impact through iron ore. About half of Chinese steel—which relies on Australian iron ore—is used in residential construction.

This would add pressure to an already tumbling iron ore price. Prices have halved since August, as China separately tries to cut output in the steel sector. On Tuesday they fell past US$100.



Australian miners have been cut by the falling knife. Fortescue Metals (ASX: FMG) is down 38% since August. BHP (ASX: BHP) has slumped 29% and Rio Tinto is down (ASX: RIO) 27%.

Iron ore is the primary channel from China to Australia but if Chinese households cut spending we could feel the impact on tourism and education once borders open, says Miller.

“Australia is the developed economy most leveraged to China,” he says.

“If they sneeze, we catch cold,” he says.

© 2021 Morningstar, Inc. All rights reserved. Neither Morningstar, its affiliates, nor the content providers guarantee the data or content contained herein to be accurate, complete or timely nor will they have any liability for its use or distribution. Any general advice or ‘regulated financial advice’ under New Zealand law has been prepared by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) and/or Morningstar Research Ltd, subsidiaries of Morningstar, Inc, without reference to your objectives, financial situation or needs. For more information refer to our Financial Services Guide (AU) and Financial Advice Provider Disclosure Statement (NZ) at www.morningstar.com.au/s/fsg.pdf and www.morningstar.com.au/s/fapds.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Our publications, ratings and products should be viewed as an additional investment resource, not as your sole source of information. Morningstar’s full research reports are the source of any Morningstar Ratings and are available from Morningstar or your adviser. Past performance does not necessarily indicate a financial product’s future performance. To obtain advice tailored to your situation, contact a professional financial adviser. Some material is copyright and published under licence from ASX Operations Pty Ltd ACN 004 523 782.