



Evergrande Collapse Sparks Global Economic Fear

Description

The world is in the midst of an economic panic, and it's all because of a company few had heard of until just days ago.

China Evergrande ([SEHK:3333](#)) is a Chinese property development firm that is carrying about \$300 billion in debt on its balance sheet. It is the second-largest developer in China and the most indebted developer in the world.

Evergrande does not have enough cash flow to pay its upcoming bills. It has a [\\$83 million interest payment due this week](#) that it has told creditors it won't be able to make. Looking further ahead, Evergrande has multi-billion-dollar maturities to pay for. For example, it has \$7.4 billion worth of principal repayments coming up in 2022. While Evergrande had ¥196 billion in cash (approximately US\$25 billion) as of June 30, the amount had been shrinking over the course of several years. Today, the company says it doesn't have enough money to pay back its creditors.

Why people are worried

It would be one thing if [Evergrande simply defaulted](#), and that was the end of it. Big companies have defaulted in the past — life went on. But the complicating factor with Evergrande is the sheer amount of debt on its balance sheet. With \$300 billion in total liabilities, the company owes money to many creditors. The biggest ones are Chinese banks. After that, there are several major U.S. and European financial institutions. Canada's very own **Royal Bank of Canada** is among the institutions holding Evergrande bonds.

If Evergrande defaults on the full \$300 billion worth of liabilities it has, the ripple effects in the financial system could be felt worldwide. Certainly, Chinese banks will lose out on enormous sums of money — Western banks, too, to an extent. It has been well publicized that banks all around the world own Evergrande debt. What's sometimes missed is the fact that the foreign banks owning Evergrande bonds don't have that much exposure. Most of their holdings are in the hundreds of millions, not billions, and these are institutions with trillions in assets. Still, the default of a company as large as

Evergrande could push China into a recession, and that could have effects felt around the world.

What's the worst-case scenario?

Having assessed the amount of money on the line in the Evergrande implosion, we can move on to another question: what's the worst that could happen?

Evergrande has been compared to Lehman Brothers and Bear Stearns in the 2008 and 2009 financial crisis. Those were banks whose enormous losses on mortgage backed securities contributed to the global recession of the late 2000s. These banks' problems started when borrowers began defaulting on high-interest, sub-prime loans. Lenders began losing money on those loans immediately. The problem was compounded when \$3.7 trillion worth of mortgage-backed securities held by Fannie Mae and Freddie Mac couldn't be serviced. Ultimately, the two received about \$200 billion in bailout money to meet their obligations.

According to the Chicago fed, there were 3.8 million foreclosures between 2007 and 2010. The average price of a U.S. house at that time was about \$205,000. So, that was approximately \$780 billion worth of mortgage debt that couldn't be serviced.

The total for Evergrande comes in at around \$300 billion. Estimates range from \$305 billion to \$313 billion (it depends on the exchange rate). That amount puts the Evergrande debt in the same league as the mortgage debt that kicked off the financial crisis. It's certainly not as high, but it's up there — a little less than half. This suggests that the Evergrande debt has the magnitude needed to start a financial crisis.

However, the mortgages involved in the Great Financial Crisis impacted a full \$3.7 trillion worth of mortgage-backed securities. That's more than 10 times Evergrande's total debt. So, it's not quite clear the scale of the crisis Evergrande could trigger. Its debts aren't as large as the debts that triggered the 2008/2009 crisis, but the indirect effects of default could be significant.

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