

Chinese economy

A Ponzi scheme by any other name: the bursting of China's property bubble

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Only state intervention can save the day, but the pain is likely to fall on ordinary citizens, say observers.

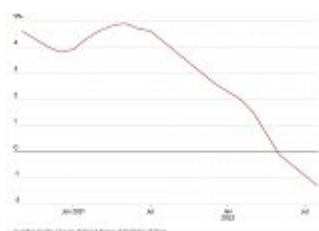
A little more than a year ago, a Chinese property developer largely unknown to the outside world said its cashflow was under “tremendous pressure” and it might not be able to pay back some of its eye-watering debts of \$300bn (£275bn).

Today, that company, China Evergrande Group, is all too well known as the poster child of the country's economic woes. House prices in China have fallen in [each of the 12 months](#) since Evergrande's now [prophetic warning](#), with Xi Jinping's government now preparing to throw billions of dollars at a property market that experts say increasingly resembles a giant Ponzi scheme.

Prices for new homes in 70 Chinese cities fell by a worse-than-expected 1.3% year on year in August, [according to official figures](#), reflecting a turbulent 12 months in which China's housing sector has gone from an unstoppable driver of growth and prosperity to being the chief threat to the world's powerhouse economy.

Nearly a third of all property loans are now classed as bad debts - 29.1%, up from 24.3% at the end of last year, [according to research by Citigroup this week](#) - with once safe state-owned property developers driving the increase.

China's house prices have fallen amid a mortgage boycott and the liquidity crisis hitting property developers



The crisis at [Evergrande](#), then China's second biggest property developer, has spread through the industry to the point where the government's pledge this week of 200bn yuan (£26bn) to kickstart investment was judged by analysts to be well short of what was needed.

The rating agency S&P said at least 800bn yuan would be needed - or even 10 times that much in the worst-case scenario - to rescue a property market in which prices have fallen, sales have slid, developers have gone bust and buyers have staged [an unprecedented and widening mortgage](#)

[boycott](#) in protest at having paid largely upfront for homes that have not been finished.

The market is experiencing a total collapse in confidence, analysts say, and only government intervention can save the day.

About 2m off-plan homes remain unfinished across [China](#), according to a rough estimate by S&P. That figure will grow if sales continue to fall and developers continue to run out of money to complete projects.

“China’s property downturn has turned into a crisis of confidence that only the government can fix,” S&P said. “If falling sales tip more developers into distressed territory, things will get worse. The distressed firms will halt construction on more pre-sold homes, hitting buyers’ confidence further. Our rough estimate is that about 2m unfinished homes presold by Chinese developers are now in limbo. This has shattered confidence in this market.”

For years, preselling homes – mainly apartments in large blocks and newly styled urban villages – kept the developers flush with cash and, along with borrowing on an epic scale, meant they could buy more land and keep building. In 2021, about 90% of homes were sold off plan in China.

But Xi’s decision two years ago to crack down on “reckless” lending starved developers of their funding and, when the music stopped, it emerged they could not finish homes they had already taken money for because they had spent it on buying the next parcel of land or project.

In short, it resembles a Ponzi scheme where money taken from new investors is used to pay off existing clients in an ever-decreasing spiral to collapse. It is even how the [sober pages of the Economist sees it](#).

George Magnus, an associate at the China Centre at the University of Oxford, said the Chinese market was not quite a classic Ponzi scheme in the style of [Bernie Madoff’s notorious scam](#) that was exposed after the global financial crisis, but it was very similar.

“Developers raise huge amounts money from customers to basically fund the purchase of the next construction projects. This continues on and on before it has got to the size it has,” Magnus said. “It’s not strictly a Ponzi in the asset management sense, the Madoff style, but they’re essentially using clients’ money to fund the next project, so yes, it’s the standard definition of what that means.”

The property market accounts for anywhere between 20% and 30% of China’s gross domestic product. This is a huge proportion compared with other large economies, and is thanks partly to the country’s investment-led economic model that has prioritised construction. As a result it has bred a hitherto blind faith in the property values, which have risen more or less uniformly for the past two decades or more.

But with repeated lockdowns also depressing the market, the longstanding belief that prices can only ever go up is starting to wane. This could lead to Chinese households moving 127tn yuan out of property in the next nine years and into other investments such as equities, bonds and wealth management products, according to the brokerage and investment group CLSA, [Bloomberg reported](#) last week.

“People are losing confidence in the presale model,” said Magnus. “It’s a reboot of the Chinese mortgage market ... the hallowed asset of property. The fabled rising middle class of China are not in great shape along with lockdowns as well.”

The situation presents a major challenge for the Xi government, especially with the all-important

party congress coming up in October when the president will seek to become ruler for as long as he wants.

But although his government is pushing for the restructuring of failing developers such as Evergrande and hoping to spread the debt burden across state-owned enterprises, banks and local governments, the pain is likely to fall on ordinary Chinese – just as it does on ordinary investors when a Ponzi scheme eventually collapses.

Anne Stevenson Yang, a co-founder of the US-based J Capital Research and a China expert, said the regime in Beijing was more interested in protecting the state-owned enterprises, institutions and billionaire owners of companies than homeowners – and that would inform its response to the crisis.

“There’s what they can do and there’s what they will do,” she said. “What they can do is to transfer money to households such as by gifting apartments, allowing people to live in places where mortgages are unpaid, and boosting pensions so people have confidence and spend again.

“But that’s not of course what is going to happen. The Chinese political system is not built around individuals, it’s built around companies, they are the constituents. The political system operates through them.

“The property market was not designed to be a Ponzi scheme – a Ponzi scheme needs to be designed. But it is an investment bubble. And the bubble has ended.”

Martin Farrer

P.S.

• The Guardian. Sun 25 Sep 2022 14.20 BST:

<https://www.theguardian.com/business/2022/sep/25/china-property-bubble-evergrande-group>

• Martin Farrer’s articles in The Guardian:

<https://www.theguardian.com/profile/martinfarrer>

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