Funding the Future

Is Evergrande another tipping point?

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Evergrande is a name that most people do not know, but as the FT reports this morning:

Investors in an Evergrande offshore bond say they have yet to receive a closely watched interest payment that was due on Thursday, adding to uncertainty over an unfolding liquidity crisis at the world's most indebted property developer.

The $83.5m payment had a deadline of midnight in New York on Thursday, or noon on Friday in Hong Kong.

Reports suggest that the payment has not been made.

Why does this matter? First, this is a potential default by, as the FT note, the world's biggest property developer. What that obviously implies is that property might not be worth what people thought it was. The financial obligations has might be expressed in renminbi (although this debt seems to be secure, at least for now) or dollars (which is the part currently at risk) but the underlying asset is a real thing - a building - and that is no respecter of monetarily recorded value attributed to it, which is only the expression of an opinion at a point of time. If that opinion on value changes - as it seems it might well be doing, in China at least - the leverage in fixed currency amounts becomes unsustainable. If this is replicated the value of whole property sector is in doubt, and that is what caused the 2008 crisis.

And, second, that can, of course, lead to a debt crisis. Evergrande debt is already trading at a significant discount to face value for precisely this reason. But once again, if that become commonplace balance sheets that are based on the perception of the value of debt rather than tangible assets (like buildings) also become subject to doubt and the whole edifice of corporate value comes into question.

Third, the whole reason why this issue is, in that case, receiving so much attention is that there is speculation that this event could be akin to the suspension of trading in various subprime debts by BNP in August 2007, which was the first real sign of the coming global financial crisis.

What do I think? Candidly, I cannot say whether this is the second tipping point I have needed to write about this morning. Only history identifies them. But that there is massive asset overvaluation on corporate and bank balance sheets is to me obvious: low-interest rates, financialisation, over leveraging and exuberance in the face of reality has left markets and property over-valued as supposed stores of value for the excess of global savings that now exists, and which will surely be subject to a serious price adjustment and a haircut for the wealthy sometime soon. Evergrande may be the indicator of that. If it isn't, something else will be.