GlobalResearch
Center for Research on Globalization

Will a China Real Estate Collapse Trigger the Global Financial Meltdown?

By F. William Engdahl
Global Research, March 28, 2021

Region: Asia
Theme: Global Economy

All Global Research articles **can be read in 51 languages by activating the "Translate Website"** drop down menu on the top banner of our home page (Desktop version).

***

Prevailing financial sector "wisdom" holds that while the bond and stock markets of the US and EU are dangerously inflated following huge COVID borrowings and unprecedented central bank measures, that China is the one example of a market suitable for investment as it has managed to get beyond COVID and restart its economy.

A closer look at recent official measures by Chinese financial regulators and the Bank of China suggest it is anything but safe, and that its domestic real estate sector could be a bubble whose collapse can trigger a global financial catastrophe beyond any seen in modern history.

In 1931 the world financial architecture of Versailles was bankrupt, but not yet in financial collapse. The key trigger to pull the world into the Great Depression was not the 1929 Wall Street stock crash, but rather the collapse of a relatively small Austrian bank.

In ways remarkably analogous to the unfolding global financial crisis of today, world credit had been built after 1919 on a pyramid of increasingly dubious debts, with the House of Morgan and Wall Street financial firms sitting at the peak of the pyramid.

Most of Europe and a large number of developing countries from Bolivia to Poland were linked into the Wall Street credit pyramid. In 1929-1931, the domino-style failure of those Morgan-initiated credit links to Europe and beyond turned a manageable American stock market crash into the worst deflation crisis in American history, precipitating a global depression.

The amount of foreign bonds issued by Wall Street in the decade until the 1929 market crash was about $7,000,000,000, a huge amount equal to nearly 10% of total US Gross Domestic Product. The war-damaged European economies used more than 90% of these American loans to buy American goods, a boon to major US corporations listed on the New York Stock Exchange.

When the buying collapsed after 1929, however, Wall Street's foreign lending boom became a vehicle that severely worsened the US industrial depression. The whole edifice of dollar credits that supported Europe's debt pyramid during the 1920's rested on the loans of New York banks, above all from J.P. Morgan & Co., to Europe to refinance short-term credits. The US Government had insisted at Versailles in 1919 that Britain, France and Italy repay its US

war loans in dollars.

Much of the credit from New York banks had flowed into Germany after the 1924 Dawes Plan currency stabilization. Within six years, various German municipalities, private companies, port authorities and other entities, had issued bonds underwritten by New York banks and sold to American investors. Germany borrowed nearly $4 billion from abroad during this period.

In the period from 1924 to 1931, almost $6 billion in American credit poured into Europe, equivalent in 2021 to some $92 billion. If US war loans by the Treasury, and the costs of the War itself were added, a total of $40 billion in US funds had gone into Europe in less than 15 years, fully one-fifth of total American GDP in 1914.

America's conspicuous consumption during the 'Roaring Twenties' was based on an illusion of rising household wealth for the majority of its citizens. This debt-driven consumption created the nation's illusory wealth — the Achilles Heel of the economy. In America, by 1929 fully 60% of all cars and 80% of home radios were bought on installment credit. Behind the façade of American prosperity of the 1920s was an edifice built on debt and illusions of permanent prosperity and rising stock prices, in many ways similar to China since 2000. Once the consumer credit carousel stopped in 1929-1931, the consumption boom collapsed, as the majority of Americans simply could not afford to buy on credit any longer.

In March 1931, Austria, a tiny shard of the prewar Austro-Hungarian Empire with 6 million people, announced it had entered talks with Germany to create a common customs union to boost trade, as depression threatened. Such a union would not even be a technical violation of the Versailles Treaty. It was certainly no threat to world security.

The Government of France reacted swiftly and demanded immediate repayment of some $300 million in short-term credits owed by Germany and Austria to French banks, to pressure both countries to halt their customs union. The demands triggered a panic flight from the shaky Austrian currency. The weakest link in the Austrian financial system was the Vienna Credit Anstalt Bank. It was also the largest bank in Austria. The collapse of the Credit Anstalt led to a depositor panic run on the Darmstaedter-und Nationalbank or Danat-Bank in Germany, and created a currency crisis for the Brüning government, as well. At that point, the Bank of England, the US Federal Reserve, the German Reichsbank, and the Bank of France met to discuss an emergency credit infusion to try to stop the spread of currency panic. It was too late.

China As the new Credit Anstalt?

The analogy today with the unsound Austro-German credit bubble of the 1920s lies ironically, not with the United States, but rather with the Peoples' Republic of China, and the staggering growth of personal household debt there since the 2008 global financial crisis. The Beijing central authorities in a panic reaction, released an unprecedented volume of $504 billion in credit to local authorities with a mandate to invest to spur the economy. Nowhere was the investment more than in housing, where a new middle-income population was willing to borrow to get their own home.

By 2016-17 Beijing authorities realized that a dangerous speculative bubble in rising house prices threatened the economy. Restrictive measures only drove local authorities and banks into covert "off-balance sheet" lending via so-called local government financing vehicles

(LGFV), where the local governments create an investment company that sells bonds to finance real estate or other local projects. With real estate prices inflating at double digits annually to the present, the size of real estate debts has grown to the point today the Peoples' Bank of China and other regulators openly warn of a bubble as many families rush to borrow for a second home for speculative gain.

Total household debt including mortgage and consumer loans for cars and household appliances in 2020 was a whopping 62% of GDP. The Institute of International Finance (IIF) estimated that China's total domestic debt rose to 335 per cent of gross domestic product (GDP) in 2020. Some have drawn comparisons to the insane real estate inflation in Japan in 1990-91 before the collapse.

In 1998 the Beijing Government allowed citizens to own their own home. The emerging middle class eagerly bought new apartments that were rising everywhere in the major cities. Real estate was viewed as the only safe investment as stocks and bonds were volatile, and capital export was controlled. For the past two decades home price valuations have risen significantly, leading many Chinese to believe it could never stop. This February, despite official measures, China home prices rose year-year by 16.8 %. According to data from China's National Bureau of Statistics the total market value of China's real estate is currently around 65 trillion US Dollars– that's trillion. In 2019, China's GDP was $14 trillion US, making China real estate far more inflated than USA or EU values by a big margin. A 2018 study found Chinese home prices averaged 9.3 times annual incomes, outstripping inflated San Francisco's 8.4 times.

Beijing is clearly alarmed and since January has issued strict measures to force local governments away from continuing to feed the real estate bubble. In 2020 to counter the corona lockdowns and economic recession, Beijing issued major stimulus measures. Now with the economy slowly restarting, Beijing is determined to deleverage the bubbles in stocks as well as real estate in hopes of creating what Xi Jinping calls "dual circulation" which in effect, means while trying to maintain growth of exports, that China increasingly gets its 1.4 billion citizens to consume more domestically to lessen dependence on risky exports. This will be no easy job, even for the formidable Chinese.

What Beijing authorities are attempting to do is to cap the real estate bubble, to block speculative borrowing for second homes, in hopes the funds will go to other consumption.

China Debt Pyramid

Xi Jinping and the central government face a high risk dilemma. With the world economy descending by the day deeper into decline, Xi recently issued orders for local governments to insure spending on infrastructure to maintain "dual circulation" economic growth. Yet at the same time, to deflate what it sees as a potentially systemic real estate bubble, Beijing demands local authorities stop new lending off-balance sheet to finance home buying via LGFVs. Something has to give, and it could be default of millions of Chinese on their mortgage loans as unemployment, largely hidden in government data, reportedly grows significantly.

Last September, China's Evergrande Group, as of 2018 the world's most valuable real estate company with some $121 billion in real estate and related debt, underwent a cash crisis owing to its excessive debt burden and the slowing economy. In a desperate effort to develop new revenue sources, the real estate group has diversified into solar panels, pig

farming, agribusiness, and baby formula. Not a reassuring sign.

The Evergrande crisis is for the time being under control, as it sells billions of assets to reduce debt. However the scare led Beijing authorities to double down on local hidden real estate debts.

According to the state's National Institution for Finance and Development estimate, total local hidden debt reached an impressive 14.8 trillion yuan or $ 2.3 trillion in 2020. That's likely very conservative. Standard & Poors estimates the total at between 30 trillion yuan (US$4.2 trillion) to 40 trillion yuan (US $6.1 trillion). Even that may be conservative, as it is deliberately hidden. Since January strict new rules from the central authorities seek to kill or cap such hidden real estate loans in a drive to shift investment into local infrastructure and industry—dual circulation.

On March 16 Liu Guiping, a deputy governor of the People's Bank of China wrote about financial risk, "We need to… actively and effectively curb the spread of financial risk contagion, and resolutely maintain the bottom line of avoiding systemic financial risks." That however is easier said than done.

China's domestic debt has been growing at an average annual rate of around 20 per cent since 2008, far faster than its gross domestic product, a recipe for serious trouble. Official data showed that outstanding household debt, including mostly real estate debt, at the end of 2020 stood at 63.19 trillion yuan (US$9.7 trillion). That's equivalent of 62 per cent of Chinese gross domestic product.

In 2021 a record 7.1 trillion yuan ($1.1 trillion) of such special local bonds come due and must be rolled over to avoid collapse of local governments. That will mean that the big state banks must somehow finance the local debt, much of it of dubious or "junk bond" value. This, just as Beijing demands the banks finance new infrastructure and growth initiatives outside real estate while also reducing own debt. Despite official loans from Beijing to local authorities to finance small and mid-size business, South China Morning Post reports that in some cases the financing was being obtained by dummy shell corporations and then used illegally for real estate investments.

If troubles in this local bond market spill over into the national sovereign bond market, a huge market worth a staggering $18 trillion, that would drive bond rates far higher, triggering a wave of local defaults in less viable projects including real estate. It is certain that the PBOC, the state central bank, would then pump liquidity to save its giant state banks. But given the scale of the debt, that could well force liquidation of China dollar assets abroad, including its estimated $1.04 trillion of US Treasury debt, as well as Euro bonds.

Ironically, major Wall Street firms such as Ray Dalio's Bridgewater or BlackRock, and major Wall Street banks, have been investing in the promise of a China economic recovery. With the US bond markets on a razor's edge in recent weeks with a new $1.9 trillion Biden stimulus and national debt soaring skywards, it would take little from a China bond crisis to trigger a repeat of the 1931 Austria crisis. Only this time, the entire world economy is bound in a debt system that is out of control. As of January, global debt has climbed to a record $281 trillion, adding an unprecedented $24 trillion in 2020 for corona measures. It looks like this is all part of the Great Reset plan: Blame China for what the BIS central bankers, the real gods of money have engineered since 2008.

*

Note to readers: please click the share buttons above or below. Forward this article to your email lists. Crosspost on your blog site, internet forums. etc.

F. William Engdahl is strategic risk consultant and lecturer, he holds a degree in politics from Princeton University and is a best-selling author on oil and geopolitics, exclusively for the online magazine “New Eastern Outlook” where this article was originally published.

He is a Research Associate of the Centre for Research on Globalization.

Featured image is from New Eastern Outlook

Seeds of Destruction: Hidden Agenda of Genetic Manipulation

Author Name: F. William Engdahl
ISBN Number: 978-0-937147-2-2
Year: 2007
Pages: 341 pages with complete index

~~List Price: $25.95~~

Special Price: $18.00

This skilfully researched book focuses on how a small socio-political American elite seeks to establish control over the very basis of human survival: the provision of our daily bread. “Control the food and you control the people.”

This is no ordinary book about the perils of GMO. Engdahl takes the reader inside the corridors of power, into the backrooms of the science labs, behind closed doors in the corporate boardrooms.

The author cogently reveals a diabolical world of profit-driven political intrigue, government corruption and coercion, where genetic manipulation and the patenting of life forms are used to gain worldwide control over food production. If the book often reads as a crime story, that should come as no surprise. For that is what it is.

The original source of this article is Global Research
Copyright © F. William Engdahl, Global Research, 2021

Comment on Global Research Articles on our Facebook page

Become a Member of Global Research

Articles by: F. William Engdahl

Disclaimer: The contents of this article are of sole responsibility of the author(s). The Centre for Research on Globalization will not be responsible for any inaccurate or incorrect statement in this article. The Centre of Research on Globalization grants permission to cross-post Global Research articles on community internet sites as long the source and copyright are acknowledged together with a hyperlink to the original Global Research article. For publication of Global Research articles in print or other forms including commercial internet sites, contact: publications@globalresearch.ca

www.globalresearch.ca contains copyrighted material the use of which has not always been specifically authorized by the copyright owner. We are making such material available to our readers under the provisions of "fair use" in an effort to advance a better understanding of political, economic and social issues. The material on this site is distributed without profit to those who have expressed a prior interest in receiving it for research and educational purposes. If you wish to use copyrighted material for purposes other than "fair use" you must request permission from the copyright owner.

For media inquiries: publications@globalresearch.ca