CAPITAL ECONOMICS

GLOBAL ECONOMICS UPDATE

How many global risks lie in China's Country Garden?

- **The immediate global economic and market fallout from troubles at Chinese property developer Country Garden seems likely to be limited. Foreign exposure to China's property sector has fallen sharply over recent years and policymakers should step in to prevent a meltdown in China. However, the developer's problems are indicative of a structural downturn which will shape the global economy for years to come.**
- China's largest private property developer Country Garden's debt problems deepened after a decision to suspend its onshore bonds drove a further 16% drop in its share price to a record low today, adding to speculation that the company is heading for a debt restructuring. The debacle is the latest in string of troubles surrounding the Chinese property sector, all of which we have covered in our China service.
- **As far as the global implications are concerned, there are several reasons not to be too concerned. Direct financial exposure is small.** Country Garden, which until recently was considered one of China's more financially sound developers, reportedly has around $10 billion of dollar bonds outstanding. Its problems are having spillover effects on the rest of the sector. But foreign investors have already pulled back from the Chinese property sector over the past few years and a run of defaults has further limited exposures.
- **As was the case for Evergande, state backstops can probably be relied upon to prevent a full-blown Chinese credit crunch** – for all its flaws, this is one advantage of having a tightly controlled financial system versus a more free-market system. All of that is probably why the reaction in global financial markets has been fairly muted – see our forthcoming *Capital Daily*.
- **Country Garden's woes will further undermine homebuyer and creditor confidence, potentially exacerbating the downturn in the property sector and weakness of the economy more generally. But they could also encourage further policy support.** Remarks by China's housing minister a few weeks ago had already pointed to further declines in mortgage rates and downpayment requirements and continued efforts to ensure that developers have enough funds to complete unfinished projects. (See here.)
- With consumer confidence weak and policymakers still keen to encourage deleveraging in the property sector, any support is unlikely to generate a rapid recovery. But weakness in the property sector has already been factored into our forecasts for the Chinese economy and, to a seemingly lesser extent, those of the consensus. (See Chart 1.)
- **If the situation did snowball into a construction-led slump in China, the demand spillovers would be bigger for EMs than DMs, but smaller than often thought.** Parts of Africa, Latin America and Australia are exposed through their exports of metals (see Chart 2), but there is otherwise little trade exposure to China's construction sector. A more general fall in commodity prices would hurt export revenues, but also benefit net-consumers in a time of high global inflation. Meanwhile, cross-border investments with China are small, and foreign bank claims on its private sector are less than 1% of GDP.
- **The far bigger issue which the Country Garden turmoil highlights is that China's construction sector is in structural decline which policymakers will be unable to prevent. This will contribute to a slowdown in its GDP growth to 2% by 2030, which is a key theme that has long shaped our long-run global forecasts.**

Chart 1: China Official GDP (% y/y)

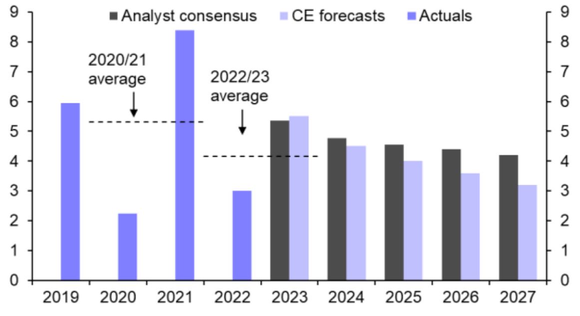
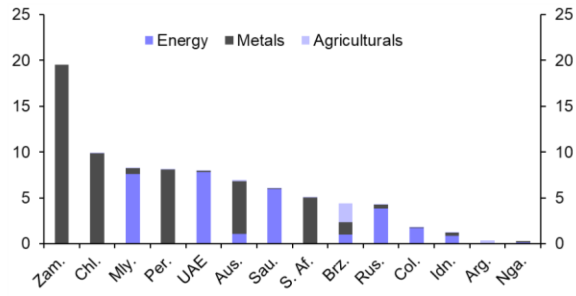


Chart 2: Commodity Exports to China (% of GDP, 2022)



Sources: OECD, Intracen, Refinitiv, Capital Economics

Jennifer McKeown, Chief Global Economist, +44 (0)20 7811 3910, jennifer.mckeown@capitaleconomics.com