Mr. Samsonite

Mega property developer China Evergrande Group (3333 on the Hang Seng) will repay a $1.47 billion offshore bond this week, Reuters reports, a few days ahead of a June 28 deadline. In reaction to that bulletin, along with an announced $400 million in asset sales, shares jumped by nearly 10% to log their biggest gain since February.

Of course, the outsize response to those routine corporate events suggests that not all is well at single-B-plus-rated Evergrande, which stands as both Asia's largest issuer of junk bonds as well as the world's most-encumbered real estate firm with a marketable debt load of RMB 717 billion ($108 billion) as of Dec. 31. Indeed, Evergrande's dollar-pay, senior secured 8 3/4% notes due 2025 changed hands at 72.5 on Friday for a yield-to-worst of 18.8%. The company aims to trim its debt load to RMB 560 billion by year-end, as it attempts to reach compliance with Beijing's three red lines policy governing capping developer's debt loads on pain of restrictions against further liability growth.

"What worries us is the possibility that Evergrande has just reported the tip of the iceberg," Zhou Chunayi, credit analyst at Lucror Analytics, told the *South China Morning Post* over the weekend. The fact that the company, currently outside each of the three red lines, is effectively blocked from accessing the credit markets, further complicates matters.

Then, too, another, unusual source of financing may be on the fritz, as Caixin's WeNews division reported last week that, as part of a planned bailout of stricken lender Shengjing Bank, authorities have notified Evergrande that they are likely to dilute the developer's controlling stake in Shengjing. The pair have a deeply intertwined relationship, as Evergrande coughed up RMB 13.2 billion (paying a 40% premium in the process) in the summer of 2019 to raise its stake in the bank to 36% from 17%, while Shengjing, for its part, holds "large amounts" of Evergrande debt on its books, per WeNews.

Anecdotal signs of liquidity trouble bring the situation into further relief. As the *SCMP* relayed, Chinese social media users report that local banks have begun rejecting commercial acceptance bills (CABs), or IOUs issued by Evergrande to its suppliers, in recent weeks.

"We cannot get paid with Evergrande's CABs and our company will die soon," one lamented on June 2. A screenshot included by the complainant showed CABs worth RMB 400,000 which had expired back in March. Others corroborated that experience, with another Evergrande contractor noting that a payment is now two months in arrears, compared to last year when all outstanding CABs were settled within 20 days.

The unfolding Evergrande saga is taking a toll on the Chinese offshore bond market, as yields on the ICE BofA Asian Dollar High Yield Corporate China Index rose to 9.93% on Friday, up from 8.5% as recently as May 26 and far above the 4.65% on offer for the equivalent U.S. gauge. That 536 basis point spread marks a near-decade high, apart from a brief spasm during the March 2020 liquidation. Yet, that rough price action hasn't derailed insatiable investor appetite for yield: Chinese developers sold $20.3 billion in dollar bonds through June 2 per Refinitiv, up 16% from last year's pace and running "completely contrary" to investor expectations for subsiding deal flow, Owen Gallimore, head of credit-trading strategy at ANZ, commented to *The Wall Street Journal*.

More broadly, as a debt-fueled fixed asset investment and a bloated financial system (featuring $50.3 trillion in banking assets as of March 31, more than half the $84.5 trillion in global GDP last year) stand as the centerpieces of the Chinese economic miracle, a brisk pace of economic growth is paramount for avoiding trouble.

Yet on that score, recent data are less than encouraging, as total social financing (i.e., aggregate credit and liquidity flows) came to RMB 1.92 trillion in May, light of the RMB 2 trillion consensus estimate to mark the third straight negative surprise. Similarly, M2 money supply growth registered at 8.3% year-over-year in May, down from 10.1% three months earlier and near the lowest level since at least 1996, while the credit impulse (or growth in borrowing as a percentage of GDP) slipped to 25.6% last month, down from 31% in February and the lowest reading since early 2020.