The Strange China Feud of Soros and BlackRock

A bizarre war of words has erupted in recent days in the pages of financial media between billionaire hedge fund and color revolution specialist, George Soros, and the gigantic BlackRock investment group. The issue is a decision by BlackRock CEO Larry Fink to open the first foreign-owned mutual fund in China presumably to attract the savings of China’s new (and fast disappearing) middle income population. In a recent newspaper interview Soros called the BlackRock decision a threat to BlackRock investors and to US national security.

This seemingly absurd clash of views between two financial predator giants of Wall Street hides a far larger story—the looming systemic collapse inside China of a financial debt pyramid that is possibly the largest in the world. It could have a domino effect on the entire world economy far greater than the September 2008 Lehman Crisis.

“Global economic terrorist...”
On September 6, Soros wrote a guest Editorial in the Wall Street Journal sharply criticizing BlackRock for investing in China: “It is a sad mistake to pour billions of dollars into China now. This is likely to lose money for BlackRock customers and, more importantly, harm the national security interests of the US and other democracies.” Not like Soros to cite US national security... He went on to say, “The BlackRock Initiative threatens the national security interests of the US and other democracies because money invested in China will help advance President Xi’s regime, which is repressive at home and aggressive abroad.” BlackRock issued a response stating, “The US and China have a large and complex economic relationship...Through our investment activity, US-based asset managers and other financial institutions contribute to the economic interconnection of the world’s two largest economies.”

At a time when the bloated debt edifice of China banks and real estate conglomerates is collapsing almost daily, the defense of BlackRock and CEO Fink hardly ring true. It suggests there is far more behind the BlackRock-China relation as well as behind the Soros attack. Two days before Soros’ OpEd in the journal, the official China Global Times wrote a scathing article calling Soros a “global economic terrorist.” One of their charges was that Soros money financed a “color revolution” in Hong Kong in 2019 against Beijing new laws de facto ending the island’s independent status.

However the sharp attack on Soros was far more likely caused by an OpEd Soros wrote in the London Financial Times five days earlier in which he sharply attacked Xi Jinping and the current crackdown on private Chinese companies such as Jack Ma’s Alibaba and Ant Financial. In an August 30 OpEd Soros called President Xi Jinping’s crackdown on private enterprise, “a significant drag on the Chinese economy” that “could lead to a crash.” He further pointed out that major western stock indices such as MorganStanley’s MSCI and BlackRock’s ESG Aware, have “effectively forced hundreds of billions of dollars belonging to US investors into Chinese companies whose corporate governance does not meet the required standard — power and accountability is now exercised by one man (Xi) who is not accountable to any international authority.” He urged Congress to pass laws that would limit asset managers’ investments to “companies where actual governance structures are both transparent and aligned with stakeholders.”

The curious aspect about the Soros charges against Beijing financial transparency is that they are factually correct, based on public statements by Chinese regulators as well as Wall Street managers and regulators. China’s financial markets are opaque, and rules change unpredictably as to who gets rescued and who not. The ongoing meltdown of China’s huge Evergrande real estate and financial group is only one recent instance of the high risk of investing today in China.

Not so Evergrande

The world’s “most valuable” real estate group is also the world’s most indebted real estate group. Evergrande, based in Shenzhen, has been teetering on the edge of bankruptcy for months as it defaults on loan after loan and the major credit rating agencies lower its rating to junk status. The group owes a total of $305 billion and that debt is both offshore in dollar loans as well as domestic unregulated loans from what are termed WMPs or wealth management products. As its finances implode and unit apartment sales plunge, tens of thousands of prospective apartment owners are threatened with having paid for unfinished apartments. To date the central bank of China has not intervened but speculation grows that a state bailout of the group is days away in order to prevent a systemic financial contagion. The reason is apparently that Evergrande is only the tip of a very debt-bloated China corporate sector iceberg.

In August China Huarong Asset Management Co., a so-called “bad bank” created by the Finance Ministry to take on assets of troubled Chinese companies, itself had to be bailed out by the state to prevent what many feared would be China’s “Lehman crisis.” Huarong is one of four such state-owned companies created in the wake of the 1998 Asia financial crisis to manage assets of bankrupt state companies. While majority owned by the Chinese Finance Ministry, since 2014 it has sold shares to others including Goldman Sachs and Warburg Pincus.

After 2014 Huarong grew into a non-bank financial giant and financed spectacular growth via debt. That began to unwind in 2020 during the covid crisis. In January 2021 a Chinese court tried the chairman, Lai Xiaomin, who was sentenced to death without reprieve for bribery, embezzlement, and bigamy, in a strange collection of charges. The court declared, “He endangered [China’s] financial stability.”

When the Huarong group failed to release its annual financial report by the deadline end of March, fears grew of a bankruptcy chain-reaction as billions of its offshore dollar bonds were at risk. Total debts were estimated at some $209 billion. Reportedly, instead of conservatively managing distressed assets, Lai used the state Finance Ministry status of the non-bank to deal in everything from private equity to real estate speculation to junk bond trading.
borrowing billions wildly. The state forced its own CITIC group to bail out Huarong in August. Yet it’s clear this is only the beginning of a snowballing financial crisis in China.

Crash landing?

For months the Xi Politburo has tried, with increasing desperation, to halt the growth of a colossal financial bubble in its real estate sector. Earlier this year Xi issued the slogan “housing is for living, not for speculation.” His moves to freeze and slowly deflate the huge real estate bubble are likely far too late. Real estate construction and sales are the largest single part of Chinese GDP, over 28% by official estimates. To demand that investment go now into “productive” projects and not speculation in real estate ever-rising prices is not so easy.

Xi has increasingly taken steps to control China’s out-of-control real estate bubble, and its threat of a systemic crisis like that in the US in 2008, by instituting steps to restrain real estate lending. According to Chinese data the amount of real estate total financing is down 13% for the first half of 2021 compared with 2020. At the same time debt due by Chinese real estate companies on bonds and other debts are more than RMB 1.3 trillion or $200 billion in 2021, and almost RMB 1 trillion in 2022. The contracting real estate sector will make such a huge repayment increasingly impossible and lead no doubt to new defaults across China. Recently Ping An, China’s largest insurance group, also heavily invested in real estate, was forced to set aside $5.5 billion in loan loss provisions related to its investment in defaulter, China Fortune Land Development Co.

If it were only Evergrande that is insolvent due to unpayable debts in a contracting economy, Chinese authorities could no doubt manage it in one or another way by demanding its state banks or large groups like CITIC simply swallow the bad debts to contain spread of the crisis. The problem is that Evergrande, Huarong, PingAn and other large Chinese property investors are clearly only symptoms of an economy which has taken on debt far beyond what was prudent. In April Beijing’s CCP State Council told local governments that their so-called Local Government Financing Vehicles with estimated (no one knows) trillions of dollars they had in unregulated shadow bank loans used to finance local projects, had to get rid of excess bad loans or go under.

On July 1 Beijing announced that local government revenues from land sales to developers, some half of all local revenues, must be sent to the central Beijing Finance Ministry and no longer used locally. That insures a catastrophic collapse in the multi-trillion dollar local shadow banks and construction projects. No more Beijing bailouts. At the same time solvency of China’s fragile multi-trillion “small” banking sector is in doubt, as bank closings increase. Now with national state-owned giants nearing bankruptcy, the verbal war between BlackRock and George Soros takes on a significant new light. China is in a serious debt collapse crisis.

China already has the world’s largest extent of high-speed rail track and those are losing money. The Belt Road Initiative is bogged down in debts that countries are unable to repay and China banks have sharply cut loans to BRI Silk Road projects from $75 billion in 2016 to $4 billion in 2020. Its demographic crisis means the endless flow of cheap rural labor to build that infrastructure is sharply declining. The middle class is deeply indebted from buying new cars and homes when times were good. 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.

Beijing’s Wall St Bailout?

It appears that Beijing is seeking a major de facto bailout from foreign investors into its troubled stocks and bonds led by Wall Street. Major Wall Street banks and investors have had close involvement in China for several years. With the US stock markets at dangerous historic highs and the EU in deep trouble, they perhaps hope China can save them, despite the clear evidence that Chinese corporate accounting rules are opaque, as Evergrande shows. Since 2019 Morgan Stanley’s widely used MSCI All Country World Index, has been allowed to list major Chinese companies, which, as Soros accurately noted, forces western stock funds to buy billions of dollars of China stocks. BlackRock is permitted now to invest Chinese personal savings in its funds. It is not clear if there are other parts to the deal.

This is the pot of potential gold which has Wall Street and BlackRock lining up outside Beijing. The Soros condemnation of BlackRock, the largest private investment fund in the world, clearly is strategic. Could it be that Soros intends to replay his 1998 toppling of the Russian bond market bubble after taking his profits? If so, no wonder the official China media calls Soros an “economic terrorist.” Whatever the trigger, such a collapse of the China debt bubble would make the 2008 Lehman crisis pale.
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