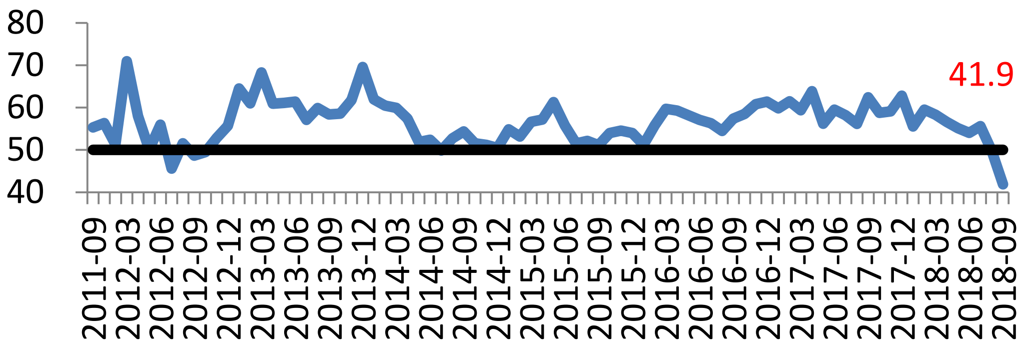
Commentary on the September 2018 CKGSB BCI

Written by Professor Li Wei

In September, the CKGSB Business Conditions Index (BCI) fell considerably, from 49.8 to 41.9 (Figure 1) making the situation go from bad to worse. This is the lowest index reading to date.

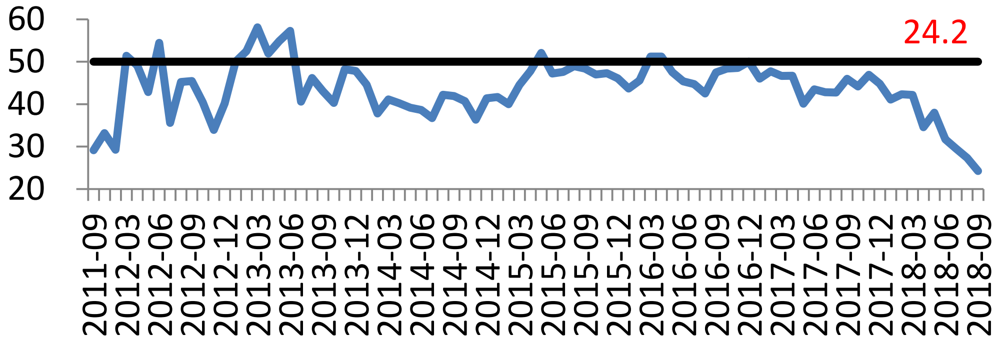
Figure 1 Business Conditions Index (BCI)



Source: CKGSB Case Center and Center for Economic Research

The BCI comprises of four sub-indices. In September, the corporate sales and profit indices fell massively, with the profit index registering just 43.0, far below the confidence threshold of 50. These two indices had, up to now, remained fairly stable. From an already low level of confidence, the corporate financing index fell yet again, this time to 24.2. Among our sample of successful Chinese companies, few are left with positive stories to tell about their financing options (Figure 2).

Figure 2 Corporate Financing Index

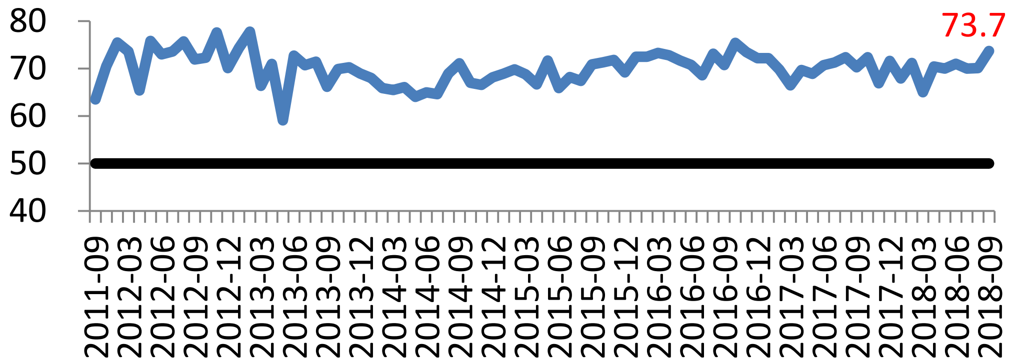


Source: CKGSB Case Center and Center for Economic Research

The deterioration of other indicators has caught us by surprise this month. The producer price index dropped sharply, and while the relatively stable investment and recruitment indices may still register above 50, it also fell significantly. If the trend continues, it will be heading below 50 in the near future. What is incredible is that the producer costs index has set a record high this month.

These indices paint a dire picture: sales have fallen, profits are sluggish, financing is hard to secure, costs are rising fast, yet these pressures cannot be relieved by rising prices to downstream firms and consumers. Sampled companies are in serious hot water and have had to curb plans, reduce investment and put a freeze on hiring. Let us not forget that these businesses are among the most efficient in their respective industries (Figure 3).

Figure 3 Industry Competitiveness



Source: CKGSB Case Center and Center for Economic Research

Downward pressures on the economy have become impossible to ignore, and since summer 2018, the government has dropped its deleveraging campaign and picked up renewed stimulus (although it has not relaxed controls on real estate). There are even policies designed to ensure financing bodies improve small business access to financing.

From our data, it appears that the authorities are very clear as to where the problem lies, and have taken many targeted measures. However, we can see that up until now, SME's access to financing remains extremely restricted. While policies will need time to kick in, it may be too little, too late.

In China today, the majority of people are employed by SMEs, and most jobs are created by SMEs. Employment is crucial in a robust consumer-driven economy.

Officially, the economic statistics look good. In 2018, Q2 GDP growth was 6.7%, just 0.1 percentage points lower than Q1. But there are many stories of redundancies and pay cuts, and the new idea of a "consumption downgrade." In literal terms, this is the opposite of the "consumption upgrade" by which the standard of goods and services go up as incomes increase.

Recently, we have seen calls to rein in and restrict growth in the private sector, which is reflected in the significant drop in our investment and recruitment indices. This is not a coincidence. Repression of private companies is bound to reduce entrepreneurs' confidence in the future, especially in such sensitive times.

Although these companies have faced similar financing difficulties before, it was a different situation when the economy was booming and could handle poor access to money. Now, things are more serious and the "low-hanging fruit", policies that can easily stimulate growth are harder to find. To ensure that development continues, structural reforms, like channeling funding towards highly efficient small companies rather than large scale "zombie" SEOs, are essential.

Structural reform has been debated for many years, but despite the noise, little has been delivered.

Serious structural reform is hard for any country; most have to be forced into it. But from this month’s BCI data, the need for structural reform is fast approaching. The government has many resources at hand, and is capable of taking the initiative. If problems are left until the last minute, the cost will be high, and it will become much harder to correct. The government is left with a choice: be passive and powerless, or too heavy-handed to help.

This is the author’s commentary on the CKGSB BCI report for September 2018. Do not hesitate to contact the BCI team by email as shown in the accompanying BCI data report.

CKGSB Professor Li Wei

September 27, 2018