Commentary on the January 2019 CKGSB BCI

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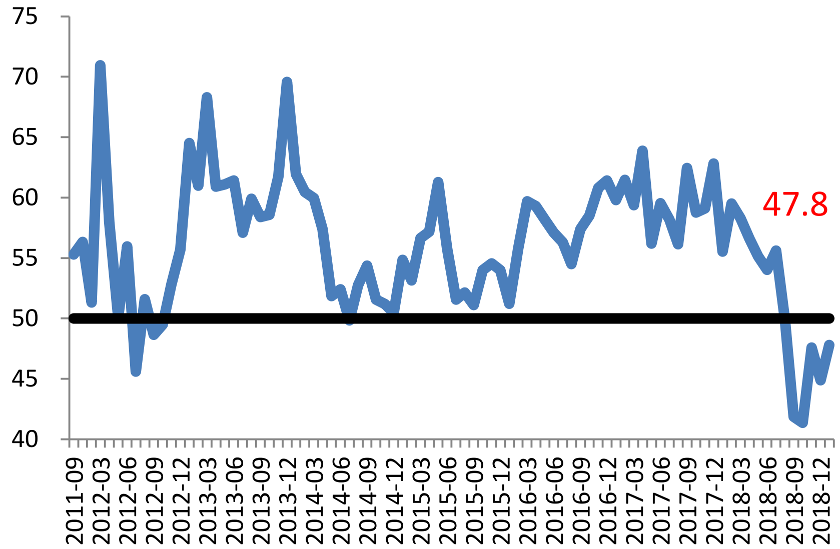
In January, the CKGSB Business Conditions Index (BCI) read 47.8, a noticeable improvement on December's reading of 44.9 (Figure 1).

Figure 1 Business Conditions Index (BCI)

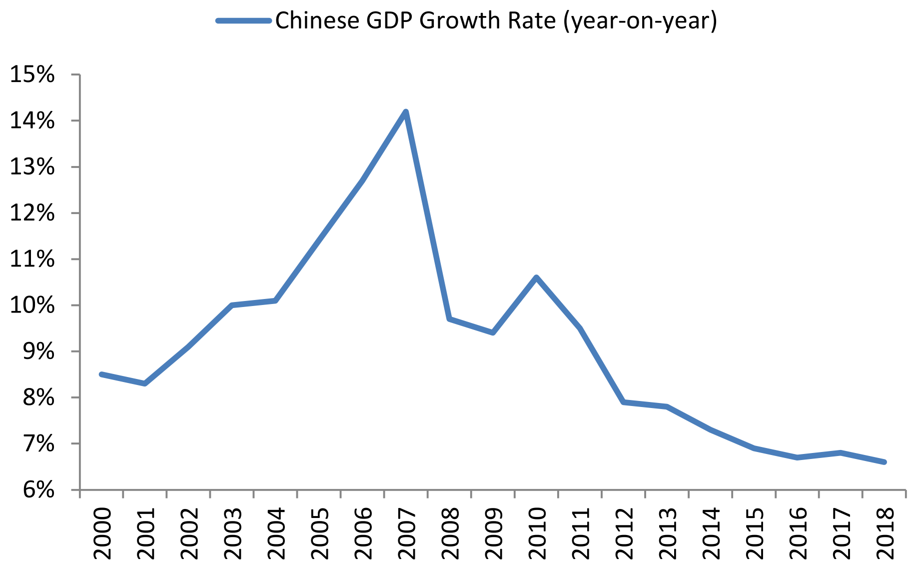


Source: CKGSB Case Center and Center for Economic Research

While last month's BCI will have left readers frustrated, this month's index is cause for moderate optimism. Aside from the BCI index, costs and prices forecasts are still falling, but more importantly, the investment index has reversed its negative trend this month. The BCI recruitment index has also stopped falling after several months of consecutive bad news, and is now headed in a positive direction. We may not be sure if this rebound will continue, or if the private economy has bottomed out, but for now, we will settle for the renewed sense of stability that these results indicate. For detailed statistics, please refer to this month's BCI Report.

The most recent major economic news to come out of China was 2018's macroeconomic data. According to the National Bureau of Statistics, China's GDP grew by 6.6% in 2018, underperforming 2017's figure of 6.8%. GDP growth in the fourth quarter of 2018 dropped to 6.4%, the lowest rate since Q2 of 2009.

Figure 2 Chinese GDP Growth Rate



Source: CKGSB Case Center and Center for Economic Research

Taking a longer term perspective on China's GDP growth rate, we can see that this decline has been ongoing for several years. In 2007, China's GDP grew at a rate of 14.2% year-on-year. Eleven years have passed, and the current growth rate is only 46% of the peak rate (Figure 2). Some reasons for this are well known. For example, China's low starting point. The Chinese economy was so much smaller and lower level that it was fairly easy to achieve such high growth rates. With a much larger economy in terms of volume and value, achieving a similarly high-level of growth is naturally harder these days. Any emerging economy will face the same problem. Giving it a positive spin, one of the reasons for low growth today is the high growth rate of yesterday.

However, does the current situation mean that China's economic growth will continue on its downward trajectory? We believe that the answer is no, and for these three reasons: First, according to World Bank data, with the current value of the US dollar, China's per capita GDP is only about 10,000 US dollars, roughly one-sixth of that of the United States. Even considering the price differential between the two countries, there is still a considerable gap between the two countries' GDP levels. China still has huge room to grow, economically speaking.

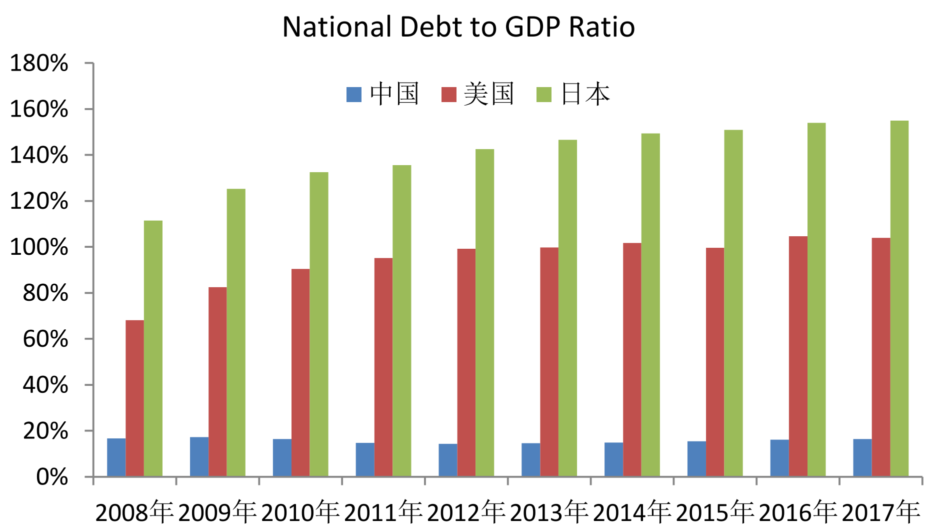
Second, why has economic growth slowed so much in recent years? And why, especially in 2018, has it been coupled with obvious employment setbacks? Has this occurred naturally because of economic growth? Or is China experiencing the impact of the Sino-US trade war, where it hurts? We believe, although they are related to a large extent, current troubles are largely just adjustments to economic reform. Since 2017, the regulatory authorities have been busy standardizing the finance sector, putting its goal of financial deleveraging first. Although the government is right to tackle this, a large number of private enterprises have gotten caught in the wake, and their financing options put in jeopardy. This is clearly reflected in the BCI corporate financing index. Among China's private companies, our survey reflects the best performing ones, but with the government's efforts to tighten up financing channels, private firms have suffered the most, some to the point of closing down. Comments have circulated around the negative value of private business and these points of view have gained influence. As this intensified in the second half of 2018, central government officials and leaders were forced to come forward in support of the private sector.

Another example is investment. In 2018, national fixed asset investment (excluding agriculture) grew at only 5.9% year-on-year, the lowest since 1995, and lower than GDP growth. The rate of investment in basic tertiary infrastructure has fallen by 15.2 percentage points since last year. In China, investment decisions largely come down to the government. In 2018, because of concerns about local debt, many local investment projects were suspended, including the famous Baotou subway project.

Therefore, we believe downward pressures on the economy in 2018 were driven by government policy. If these policies change, certain related outcomes will also change. For example, after recognizing the negative impact of deleveraging, the government rapidly put in place a series of corrective measures, with fairly immediate effect. Having fallen to its historical low of 24.2 in September, the BCI's corporate finance index has since rebounded to 37.5. A similar turnaround happened to investment prospects too. The corporate investment index was 72.5 in January 2018, and fell to 54.3 (historical low) in October 2018. By January 2019, the index has rebounded to 60.5.

Third, there are many resources available to the Chinese government to stimulate economic growth. Fiscal policy is one such example, China's central government's debt-to-earnings ratio is very low (Figure 3), so the government is able to raise large amounts of capital at low interest rates, and use this as a growth stimulus. The governments of many countries look on in envy; for them this would be unimaginable.

Figure 3 National Debt-to-GDP Ratios



Source: Wind (Bars - Blue: China, Red: US, Green: Japan)

The author has two conclusions to make. First, despite serious structural issues, the Chinese economy is highly resilient, and is performing nowhere near as badly as people may think. Second, the government has recently implemented a large number of measures that are favorable to private enterprises, which hopefully means they are past the worst. Although we are unlikely to see another stimulus like the "four trillion" again, we should be glad to see the slow improvement of conditions for private enterprises, and sincerely hope that they will be sustainable.

This is the author's commentary on the CKGSB BCI report for January 2019. Do not hesitate to contact the BCI team by email as shown in the accompanying BCI data report.

CKGSB Professor Li Wei

January 28, 2019