Commentary on the BCI of December 2017

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In December 2017, the CKGSB Business Conditions Index (BCI) registered 62.8, slightly higher than November's index of 59.1.

Of the four sub-indices that comprise the BCI, sales, profits and inventory increased in December, while the corporate financing index decreased. Both producer and consumer price indices witnessed a significant rise. This indicates that there will be inflationary pressures in the economy in the near future, but whether this will lead to a trend is still unknown. Meanwhile, the investment and recruitment indices began to rise, and the costs index remained at a high level. This may also indicate a risk of overheating in the economy. For specific contents, please check this month's data report.

In view of this month's data, I have the following three comments:

Firstly, the World Bank raised its forecast for China's economic growth from 6.7% in October to 6.8% in its *China Economic Update* on December 19th. This was the second time the World Bank raised the value this year. In October, the figure was raised from 6.5% to 6.7%. However, the World Bank did not raise its forecast for the growth of the Chinese economy in 2018 and 2019, which still remains at 6.4% and 6.3%, respectively. For this year, the debate over China's economic growth has ended, but there are still differences over the next few years. For the rapid growth of the Chinese economy this year, our conclusions from the BCI data are consistent with the mainstream view. Meanwhile, the BCI and its relevant indices are mostly prospective indices, which generally forecast business operations over the next six months. Presently, the BCI is doing well, and the indices of investment and recruitment have risen sharply. Thus, we expect that the Chinese economy will be able to maintain this relatively strong growth for at least the next six months.

Secondly, we need to pay attention to the problem of price risk. Since the onset of the US financial crisis in 2008, the monetary authorities in the world's major economies have slashed interest rates and have taken other measures to pump money into the market, such as Quantitative Easing in the US. Due to this loose monetary policy, some people in the market thought that this would lead to inflation, so they invested in gold, so as to avoid risk. However, the result has been contrary to it. Inflation has not happened, but the price level has still been under the target of inflation for a long period of time. However, the situation seems to have begun to change, and an increase in the Fed's continuous interest rate is a positive sign.

There are many similar cases in China. In order to save the economy, the government implemented the "four trillion" economic stimulus plan at the end of 2008, where a lot of money was injected into the economy. This led to a rapid rebound in the Chinese economy, but it has also caused a series of problems, including the rapid rise in the debt rate. Presently, our interest rate is still very low, with a one-year deposit rate of just 1.5%, which is at an all-time low. According to data from the BCI survey, the Chinese economic expansion appears to be increasing, while the trend of rapid economic development has started to increase prices. If the inflation trend takes shape, China may have to make a choice between maintaining growth and combating inflation. Since the policy is often lagging, the final effect will be a big challenge to the Chinese government.

Thirdly, the global economy is generally good at the moment, the job market is in good condition and the price level has risen, which opens up space for increasing interest rates in all countries. Earlier this month, *The Wall Street Journal* reported that the global stock market has experienced a bumper year of profit growth. Some listed companies are in the most profitable state in history (though data can only be traced back to 2001).

The average earnings per share of a FactSet index covering more than 20,000 listed companies worldwide is presently at $9.69, which is an increase of nearly 19% from the past year. On February 14th, the Fed increased rates again, raising the target range for the federal funds rate by 25 basis points to 1.25-1.5%. Moreover, the expected median of policymakers is to increase interest rates by 25 basis points three times in 2018, as well as increase interest rates another two times in 2019, although they can admit that inflation is still below the target.

The rise in US rates poses a dilemma for China. With the continuous rise in US interest rates, RMB assets will become less attractive and the impetus for the outflow of funds to China will be strengthened. Although capital controls can partially address this problem, history suggests that the longer capital controls are implemented, the less effective it will be, because people will find more ways to bypass capital controls. If the tendency of capital outflow is to be suppressed, there are various ways to choose, such as letting the RMB exchange rate become subject to market forces as soon as possible. However, experience over the past years shows that it's unlikely that this policy will be chosen. Another way is that China should also raise interest rates to increase the yield of RMB assets. However, increasing interest rates is a tight policy, which is not conducive for economic growth. Moreover, there are still a lot of zombie companies in China which are over-indebted and less profitable. If they do not have a government or a bank bailout, it is difficult for them to sustain. The central economic work conference, which was held this month emphasized that China is to pursue high-quality growth rather than high-speed growth in the future. Furthermore, the country needs to improve the efficiency in order to obtain quality and get more output with less input, so that the structural reform will be in a prominent position. Most structural reform policies are tight, such as governing zombie companies, which is sure to affect economic growth in the short term. On the one hand, external pressures may force us to raise interest rates, while structural reforms will require us to tolerate a slowdown in economic growth on the other. With the overlay of these two factors, how do we deal with the relationship between growth and structural adjustment?

In short, the Chinese economy currently has no issues of immediate concern, but we should still maintain a long-term outlook. Adjusting structure is easier said than done. Moreover, the Chinese economy has been deeply integrated into the global economic system. The economic policies of other countries, especially those of great powers like the US, will have a considerable impact on the Chinese economy. It is quite difficult to maintain a delicate balance between increasing and adjusting the structure, and, presently, the major external factors are changing. To address this problem, China should take precautions and comprehensive consideration of these issues, so that it will not be forced into a passive position in the future.

Finally, 2017 will soon be over and BCI will start its eighth year. Thanks to all the teachers and friends who have constantly supported the BCI both in and out of CKGSB, especially our alumni who participate in the survey. Without their support, the BCI would not be able to move forward. Thus, on behalf of the entire CKGSB BCI team, I'd like to take this opportunity to wish you all the best in the New Year!

This is my commentary on the BCI statistics for December 2017. For more inquiries, do not hesitate to contact the BCI team using the e-mail addresses provided in the accompanying report.

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December 2017