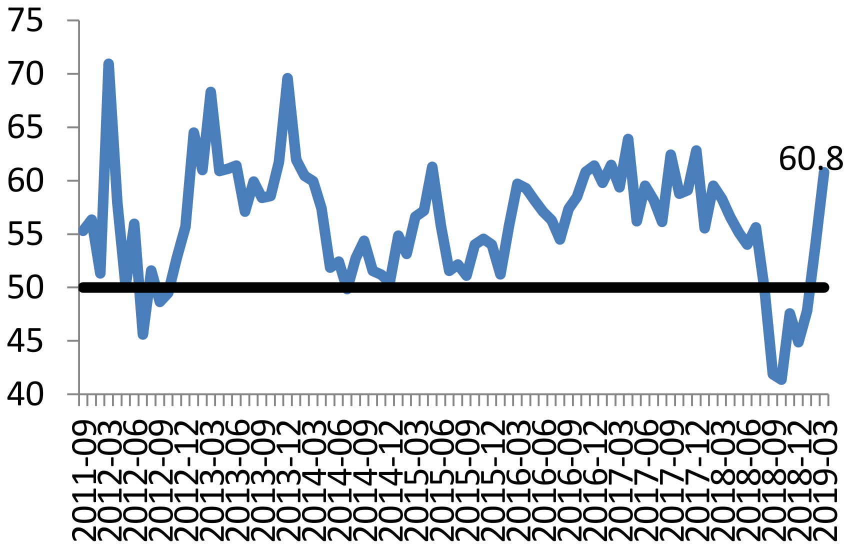
Commentary

CKGSB Business Conditions Index - March 2019

Professor Li Wei

February's Business Conditions Index surprised us by rising dramatically, after a run of poor results. This month, the positive trend continues, with the overall index reading 60.8. We now see that since October 2018's record lows, BCI forecasts have rapidly corrected themselves, manifesting as a V shape rebound (Figure 1), bringing us to this month's BCI at almost the same level as the highest records in the past two years.

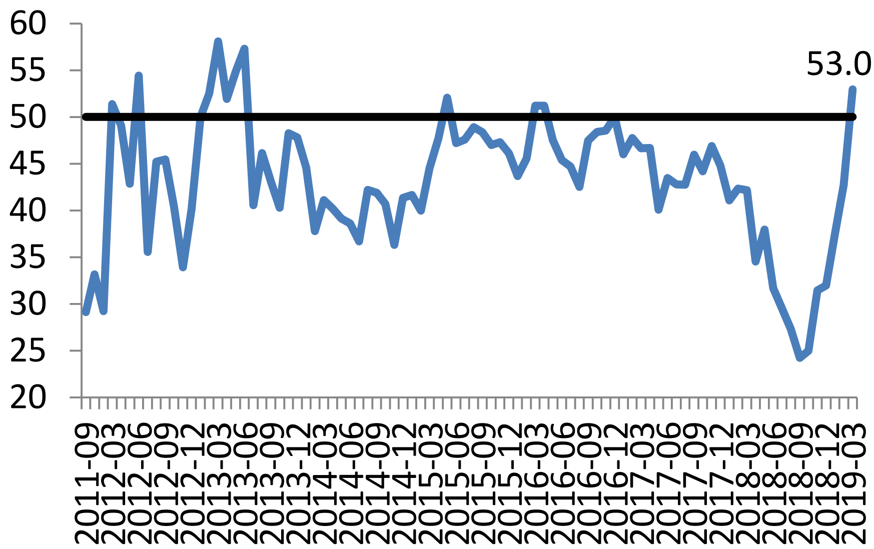
Figure 1 Business Conditions Index (BCI)



Source: CKGSB Case Center and Center for Economic Research

We should note that, as one of the four sub-indices, the financing conditions index has now crossed over to the positive side of the confidence threshold of 50.0, something that has not happened since December 2016 (Figure 2). This means that in just a few short months, financing options for China's private firms have increased considerably. This improvement suggests we are witnessing a major government policy transition in progress. The government's emphasis on the financial health of private firms vastly contributed to this fast turnaround.

Figure 2 Financing conditions index



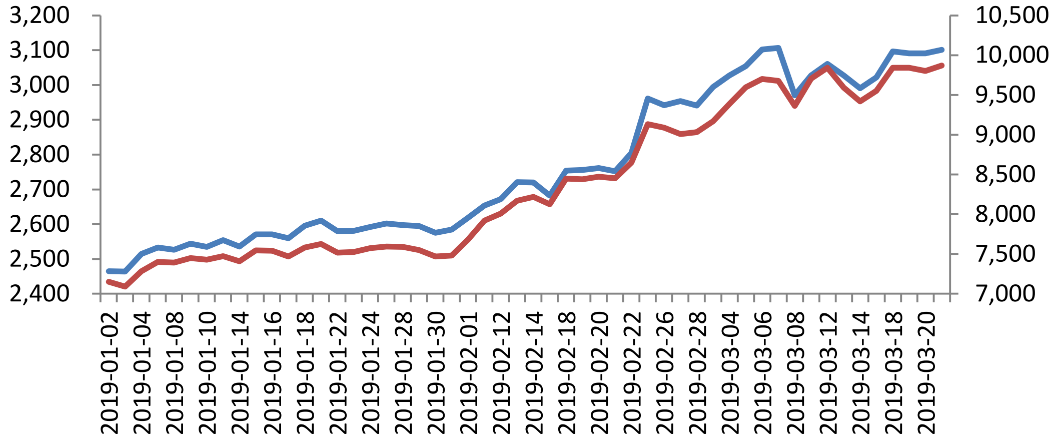
Source: Wind

Apart from the main BCI, labor cost and overall cost forecasts have fallen. This is very interesting, as it is contrary to common economic understanding that rebounds drive job market recovery and bring up wages. Raw material costs and rent costs also tend to rise in a recovery. Falling costs indices are contrary to such an understanding.

Despite being unusual, the author believes falling costs should be celebrated, as they mean government tax and fee reductions are already bearing fruit. Prices indices have remained basically stable this month, and investment and recruitment prospects are now more positive. For specific data, please refer to the BCI report this month.

The A-share markets are on the rise, compared with last year's gloomy trend (Figure 3). As a barometer of the economy, positive A-share performances seem appropriate to the overall improvement in economic conditions this spring.

Figure 3 Chinese stock market indices



Blue: Shanghai SSE Composite Index; Red: Shenzhen Composite Index
Source: Wind

This data tells us that an economic rebound is clearly taking place. Of course, as the BCI is a forward-looking forecast index, it is likely to take some time for all the economic consequences to show. Looking back however, last year's economic downturn really did seem to get out of control, taking China by surprise. Once the government was fully aware of the situation however, it took strong measures to control matters. Now that things are calmer, putting a finger on whether or not the government's anti-crisis measures were correct or sufficient takes work. So how should we view this roller-coaster economic ride?

From the author's perspective, marking the turnaround as a win or a loss, does not discount the fact that the Chinese economy has suffered over the past two years. Why was there such a sharp downturn in 2018? This was mainly due to deleveraging. That is not to say that deleveraging itself was wrong. Many domestic and foreign institutions have shown how, since the "four trillion RMB" stimulus plan was enacted in 2008, China's macroeconomic leverage rose rapidly, undermining economic sustainability. With the country awash with money, it was high time for a national deleveraging campaign. The problem is that private enterprises, especially small and medium-sized enterprises, were in a weak position in capital markets. With relatively plentiful state-sanctioned funding options, state-owned enterprises, local governments and other powerful parties could gorge themselves, while private SMEs were left with little or no sustenance. That is not to say that a diet of "soup" is bad. It is of course better than nothing! But when funds are scarce, private SMEs are easily "starved" and their financing conditions naturally deteriorate. And in recent times, deleveraging costs have mainly been borne by private SMEs.

The issue is that in China today, the private sector has created more than half the country's GDP and brought in more than half its taxes. Most people work for private companies. The vast majority of new jobs each year are absorbed by private firms. At a national level, employment is not only about the wallet or about the economic development of the people. It is also a country's most important social stabilizer. Any government will tell you this.

As the saying goes, "the one who started the problem should find a way out." Since private enterprises took on the burden of deleveraging, it is their woes that should be alleviated. With this in mind, every level of government, from the president to the premier, down to ministers and local leaders, implemented policies specifically designed to ease financing trouble for private enterprises as quickly as possible.

One advantage of China's political system is that when put to a single-objective task, a solution can be easily and speedily executed. When the government focuses on financing for the private sector, an effective method will come naturally. In the final analysis, the goal can be summarized in a sentence:

let us not allow private firms to become the victims. Judging from changes over the past two years, the Chinese government has retained a relatively strong ability to govern the economy, but can this be adapted for more complex multi-objective dilemmas? For this, we will have to wait and see.

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

CKGSB Professor Li Wei

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