CKGSB 长江商学院

Commentary on the November 2017 BCI

Professor Li Wei

In November 2017, the CKGSB Business Conditions Index (BCI) registered 59.1, slightly higher than October's index of 58.8. Of the sub-indices that comprise the BCI, those for sales, profits and financing environment increased in November. The inventory index continued to fall. This month's score of 39.5 is the third lowest since the BCI started. Apart from consumer prices, none of the other indices changed by much this month. For the comprehensive figures, please refer to this month's accompanying data report.

On November 21, CKGSB's well-attended "*4th China Economic Symposium: Is China Marching into a New Economic Era?*" was held in Beijing. The symposium was broadcast live and can be viewed here on Sina Finance (in Chinese). I spoke on various aspects of China's economic development and presented two historical case studies – the impact of silver on imperial China's economy, and Japan's economic recovery bubble in the 1990s. A discussion followed with Tom Orlik from Bloomberg. I examined the BCI's statistics throughout and the video provides a full account. However, the following provides a summary.

Firstly, as the year ends, the BCI is near 60. From this point of view, China's GDP growth this year is likely to be around 7% (compared with 6.9% in the first three quarters). As the BCI is a forward-looking index, the first six months of 2018 are likely to continue the current trend in GDP growth rates. Seen from a larger perspective, the BCI is relatively stable, and if this trend continues there is unlikely to be any major problem with GDP growth next year. In other words, short-term economic growth is likely to remain at a high level as long as nothing untoward happens.

Secondly, the stability of short-term economic growth has created an opportunity for China to undertake serious structural reform. There are different views on all aspects of long-term economic development of China, but it is generally agreed that China will not experience an economic crisis in the short term. This should not give us peace of mind, however. On the contrary, China's structural economic issues are reducing the efficiency of the entire economy. A paper[1] published recently looks at China's Total Factor Productivity (TFP) and refers to external inputs, not including capital and labor, that affect output, such as new technologies, new management methods and institutional changes, all of which can be generally interpreted as changes in productivity. The economic history of many countries shows that, over the long term, stable and benign economic development depends on positive TFP. The paper divides China's sources of economic growth into three: capital, labor and TFP. It finds that, from

[1] *From "Made in China" to "Innovated in China": Necessity, Prospect, and Challenges* by Shang-Jin Wei, Zhuan Xie and Xiaobo Zhang, *The Journal of Economic Perspectives* Vol. 31, No. 1 (Winter 2017), pp. 49-70.

1979 to 2015, TFP had a significant positive effect on economic growth in most years, but there were eight years in which the impact of TFP was negative. In 1981, 1989 and 1990, TFP had a negative impact on economic growth. Critically, from 2009 to 2015, TFP had a continuously negative impact on economic growth. This is unprecedented in the reform and opening up period. Almost two years later, we do not know whether this situation has changed or not. Given the fact that China's economy has not seen any major structural reform breakthroughs in the past two years, I suspect this trend has continued.

The continuous worsening of the TFP situation is a wake-up call for the Chinese economy. Seen through the prism of the BCI, we can see that the phenomenon is not new. As we have said before, our sample is made up of the most efficient players in the market, namely, private SMEs. The financing environment for these enterprises has been plagued by funding barriers and high costs that have limited their growth and effectiveness. This is tantamount to reducing the overall efficiency of the economy, so it is unsurprising that TFP is deteriorating.

In summary, we are confident in the stability of the Chinese economy, but also concerned. Short-term economic stability has provided an opportunity for structural reform which is not to be missed. If missed, China will be faced with an increasingly difficult situation, with structural problems that will only deepen without reform. In time, even without a major crisis, the Chinese economy may have to substantially slow down. Local governments and state-owned enterprises are burdened with huge debts and many projects do not make their interest payments. If the GDP growth rate plummets again, there will be less room for reform and change will be more painful. But if it is nipped in the bud, this pain can be kept to a minimum. The sooner these problems are handled, the greater the hope for China's economic future.

CKGSB Professor Li Wei
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This is the author's commentary on the BCI statistics for November 2017. To schedule a media interview with Prof Li Wei, please email markdreyer@ckgsb.edu.cn