Commentary on the June 2022 CKGSB Business Conditions Index

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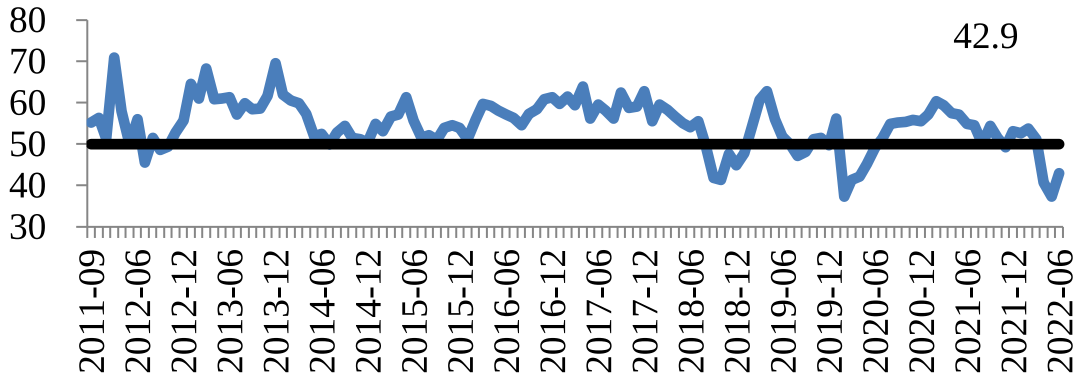
This month, the BCI rebounded somewhat, ending a three-month slide.

The data shows that June improved on May in terms of business prospects, with the "CKGSB Business Conditions Index" (BCI) up 5.6 percentage points from 37.3 to 42.9 this month, despite remaining below 50.0. This reflects a degree of recovery among businesspeople in China, but reminds us that this recovery is precarious.

Figure 1 Business Conditions Index (BCI)



Source: CKGSB Case Center and Center for Economic Research

It should be noted that the government's policies to stimulate economic growth have had an immediate effect, reflecting the advantages and responsiveness of the Chinese government in focusing its efforts on major tasks. So, what policies has the government introduced? An article in state media magazine, *China Comment* titled, "A policy package should go all the way" gives a partial answer:

First, maintaining a certain growth rate is seen as the bottom line of economic policymaking. The Chinese government's targeted GDP growth rate this year is 5.5%. For a long time, there has been a debate on GDP growth. One view is that it is inappropriate to set a GDP growth target, because once set, growing for the sake of meeting the target means an inevitable sacrifice of growth quality. Another view is that China is the most populous country in the world, and it needs to generate huge job opportunities every year to solve employment issues, and employment is closely related to economic growth. Both views contain some truth, and China's policy goal has to be a compromise between the two, in an effort to achieve a balance between short-term employment growth and long-term economic growth quality.

Second, this recovery period should be elevated in importance to boost market confidence. Expectations play a pivotal role in economic growth and macroeconomic operations.

The article says, “To restore and stabilize market expectations, we must maintain policy continuity and stability. Relevant departments must shoulder their responsibilities, introduce policies that are beneficial to the market, and prudently employ contractionary policies.” This is very important, as it indicates the direction of travel for economic regulations for some time to come. One example is property tax, a policy that is very beneficial to China’s economic and social reform in the long run, but with negative near-time impact on the economy, especially today. The overall state of real estate is not good, so bringing in a real estate tax right now might not be the best plan.

Third, insist on focusing on key points, targeting efforts, and making more practical and tougher new rules. In this regard, the central government has highlighted small, medium and micro enterprises with weak anti-risk capabilities, proposing that “through various measures such as tax reduction and exemption, rent reduction, and loan extensions, we should help increase liquidity so businesses can survive the crisis.” Small and micro enterprises are an employment mainstay in China. With stable employment rates, society will be more stable, people will live and work in peace, and the country will grow rich and strong.

The situation for prices in China and abroad are largely disparate. In developed countries such as the United States, inflation is very high (8.5% y-o-y in May), which led the Federal Reserve Bank to add 75 basis points to its latest rate hike. In China the situation is very different, whether it is the official CPI (2.1% y-on-y in May) or our consumer prices outlook (47.5 in June, below the 50.0 confidence threshold), both suggest that China’s biggest threat is deflation, not inflation. Excess supply and insufficient demand in China are ongoing issues, and policy-makers should take note.

The non-synchronization of prices between China and the United States will also lead to another problem – changes in international capital flows. When the Federal Reserve Bank raises interest rates, the attractiveness of US dollar assets increases, and funds will flow back to the United States. If we implement a fixed exchange rate at this time (assuming capital controls cannot close all loopholes), then there may be a lot of funds flowing out of China, causing depreciatory pressure on the Renminbi (RMB). Foreign exchange reserves will decrease, which is not ideal for China’s economy. The best way to deal with this situation is to let the exchange rate float, as a flexible exchange rate will move with changes in domestic and foreign economics. When the RMB is under pressure to depreciate, the exchange rate can quickly depreciate, so less capital will flow out, more foreign exchange reserves remain, and exports increase. This makes it especially important to orientate the RMB exchange rate towards the market.

Finally, U.S. inflation may be a boon for Made in China manufacturing. As we all know, during the Trump administration, the United States taxed many Chinese goods, and the Biden administration continued this practice. Sadly, these tariffs are being passed on to American consumers more than to Chinese manufacturing. As far as the current situation is concerned, this has raised prices in the United States, which is detrimental to the anti-inflation agenda of the United States. According to foreign media reports, the Biden administration has considered partially or fully lifting taxes on Chinese manufacturing in order to reduce inflation. It is hoped that the US government will soon get out of the misunderstanding that using tariffs in a trade confrontation will benefit the American people.

This is a commentary on the CKGSB BCI report for May 2022 to which you are welcome to refer for detailed statistics. Do not hesitate to contact the BCI team by email for the accompanying BCI data report.

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