

CKGSB BCI

September 2014

29 September 2014

CKGSB Case Center and Center for Economic Research

The CKGSB Business Conditions Index reads 54.4 in September, higher than last month's index of 52.7 and above the confidence threshold of 50 (Graph 1). This shows that our sample of comparatively successful business leaders is feeling relatively positive about the macroeconomic environment. However, this year's overall downward trend shows that firms are feeling pressure and operational challenges and difficulties remain. With the data rising for the past two consecutive months, China's macroeconomic conditions appear to be stabilizing. However, compared with last year and considering financing, inventory and other data, risks of a downturn remain and operational challenges still need to be addressed.

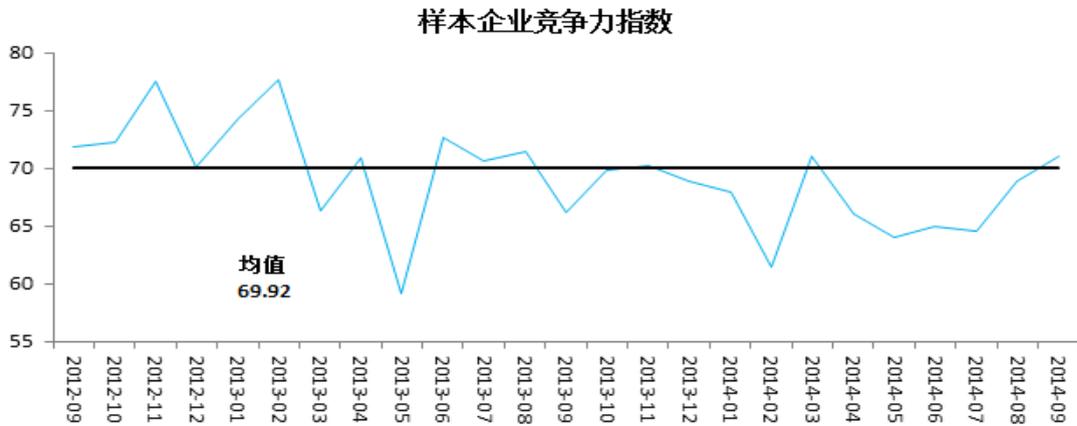
Graph 1



Source: CKGSB Case Center and Center for Economic Research

The CKGSB Business Conditions Index is generated wholly on the basis of statistics gathered from leading enterprises whose executives have studied or are studying at Cheung Kong Graduate School of Business. In the questionnaire we ask respondents to indicate whether their firm is more, the same, or less, competitive than the industry average (50), and from this we derive a sample competitiveness index (Graph 2). Consequently, as our sample firms are in a relatively strong competitive position in their respective industries, the CKGSB BCI indices are higher than government and industry PMI indices. Users of the CKGSB BCI index may therefore focus on data changes over time to forecast trends in the Chinese economy.

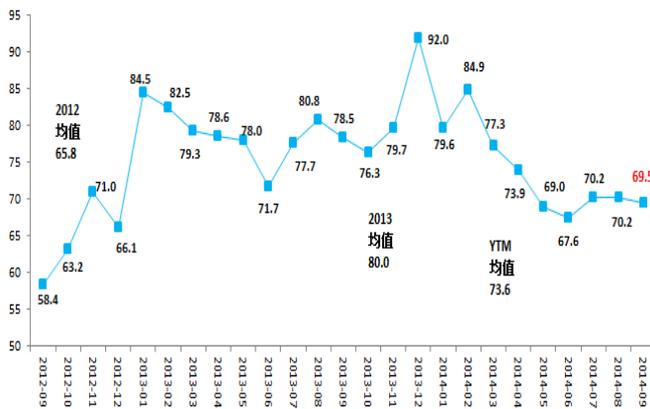
Graph 2. Industry Competitiveness



Source: CKGSB Case Center and Center for Economic Research

The CKGSB BCI comprises four sub-indices that are forwarding-looking indicators for corporate sales, corporate profits, corporate financing environment, and inventory levels.

Graph 3. Sales

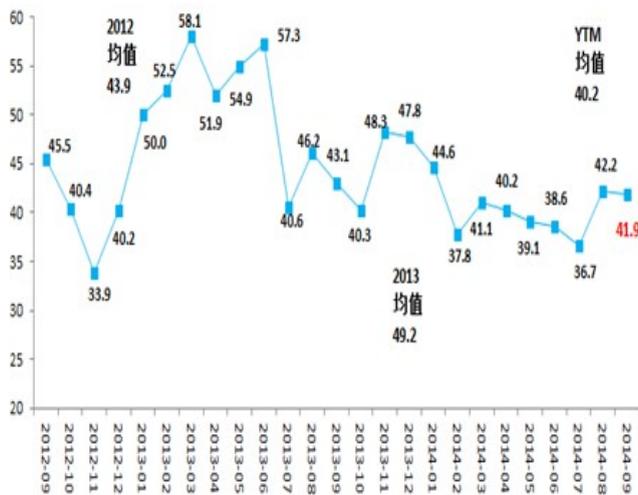


Source: CKGSB Case Center and Center for Economic Research

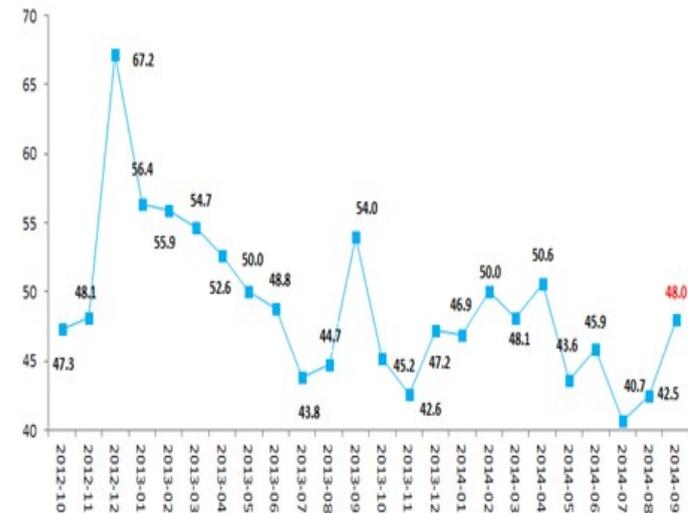
Graph 4. Profits



Source: CKGSB Case Center and Center for Economic Research

Graph 5. Financing


Source: CKGSB Case Center and Center for Economic Research

Graph 6. Inventory


Source: CKGSB Case Center and Center for Economic Research

The corporate sales index registered 69.5 in September, approximately level with last month (Graph 3), and the profit index registers 58.2, a significant increase on last month (Graph 4). Both currently register higher than 50, showing a degree of optimism about prospects over the next six months. The statistical trend is towards stabilization in both sales and profits indices, with profits forecasts rising for the past two consecutive months.

The corporate financing environment index reads 41.9 in September, slightly lower than in August (Graph 5), and below the confidence threshold. This indicates that compared with the same period last year, the financing outlook for the next six months is not optimal. Since the majority of our sample are private firms (especially SMEs), our data show that firms in the private sector face particularly challenging financing and operational pressures.

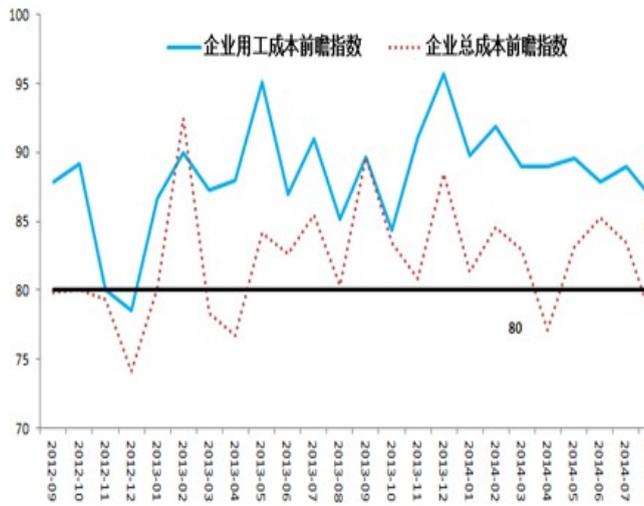
The index measuring inventory levels registered 48.0 which is a higher than last month's index of 42.5 but still under the confidence threshold (Graph 6). In fact, the inventory backlog over the last two years has been caused by over-investment, and has still not improved to any significant degree. High inventory levels will continue to be of concern.

Besides the main indices, we also surveyed respondents on forecasted costs, prices, investment plans and employment conditions, to form a supplementary set of indices.

In September, labor costs and overall costs registered indices of 87.2 and 84.7 respectively (Graph 7), both at a high level. These two costs indices are predictions of change in the upcoming six months, and show that the majority of sample firms expect costs to increase compared with this time last year.

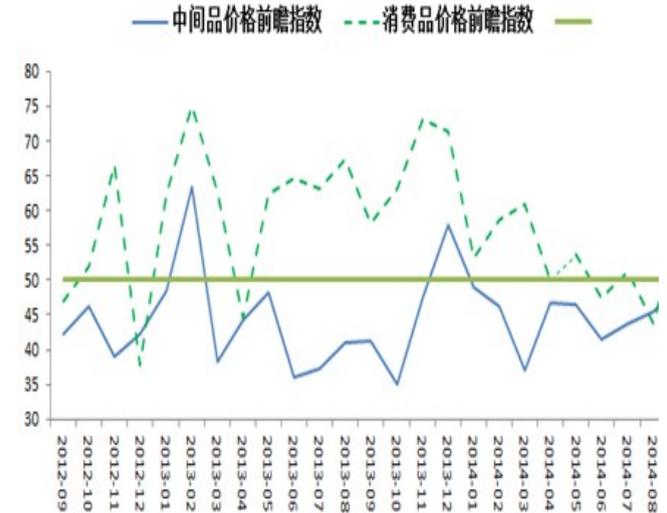
The consumer prices index registered 58 in September, from 43.8 in August (Graph 8) and producer prices registered 49.2, up from August's figure of 45.5. From the reduction in volatility since the beginning of 2014, it appears that domestic price levels are stabilizing, and the fall in producer prices will become more moderate.

Graph 7. Labor and overall costs



Source: CKGSB Case Center and Center for Economic Research

Graph 8. Producer and consumer prices

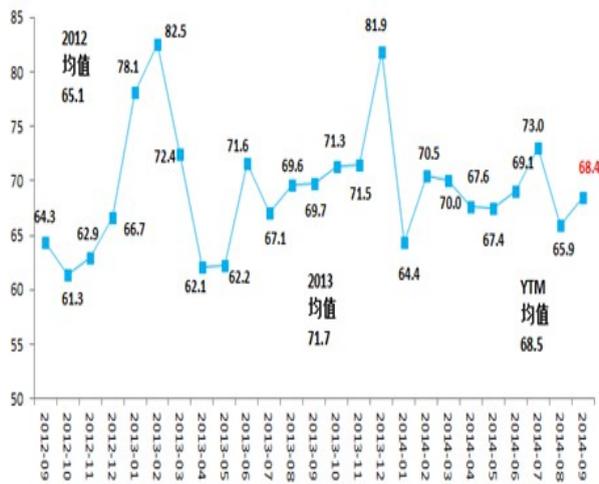


Source: CKGSB Case Center and Center for Economic Research

The corporate investment demand index rose from 65.9 in August to 68.4 in September (Graph 9), registering above the confidence threshold of 50. This index shows that the majority of sampled firms still plan to invest in fixed assets in the next six months.

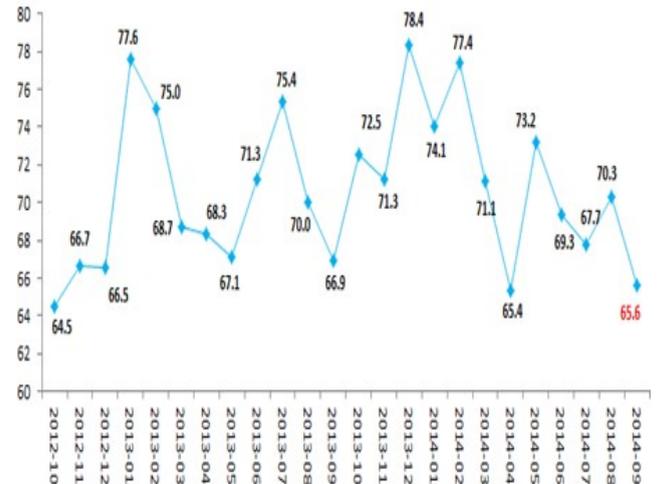
In terms of labor demand, the September index is at 65.6 (Graph 10). This shows that a majority of companies sampled aims to expand their workforce in the next six months. Corporate investment and labor demand indices are important factors in production output and optimism here shows that while increasing output levels has an important role in growing the economy, a smooth transition will rely more on economic efficiency.

Graph 9. Investment



Source: CKGSB Case Center and Center for Economic Research

Graph 10. Labor demand



Source: CKGSB Case Center and Center for Economic Research

Overall, the 2014 business forecast of China's macroeconomic conditions has begun to stabilize, but the risk of a downturn remains. Financing troubles, an inability to reduce inventory levels and stubbornly high costs continue to present a huge challenge to operational efficiency for China's private businesses. Companies should actively prepare for tough times ahead, increase production efficiency and consumer services transformations, respond to trends when making investments, make contingency plans for operational risks, and be ready to react to the government's new

economic policies as they are implemented.

Analysis of September 2014's BCI

Professor Li Wei

This month's BCI continued an upward trend set in motion in August. The overall business conditions index now stands at 54.4. For seven consecutive months from December 2013 to July 2014, the BCI had fallen, with July even dropping below the confidence threshold of 50. The rebound that began in August has now taken the index above 50, marking a significant shift in perceptions of macro-economic conditions among successful entrepreneurs in China.

Of the indices that comprise the BCI, the sales index has dropped slightly from 70.2 to 69.5, showing that companies forecast slightly slower sales in the next six months. The profits index has risen from 55.1 to 58.2 and the financing environment index has fallen from 42.5 to 41.9. The inventory index has risen significantly from 42.5 to 48.0.

These four indices provide a basic overview of attitudes towards business operations in the next six months. They show that relatively successful business leaders in China are optimistic about sales and confident in their future profit margins, yet concerned by the poor financing environment. While they have some expectation of a reduced inventory backlog, the inventory index still registers below the confidence threshold.

This year's economic situation in China has been tough – with the government's GDP growth rate target of 7.5% hard to attain. In the first two quarters of 2014, GDP grew by 7.4%, but between 2009 and 2013, 1H GDP growth had been 8.3%, 10.2%, 8.7% 8.1% and 7.4% respectively. Data from recent years clearly depicts a slowing growth trajectory, but the magnitude of that decline is more marked than expected.

In 2008 and 2009, in order to cope with the knock-on effect of the global financial crisis, the Chinese government spent a huge amount on economic stimuli, generating a short-term rebound but also increased leverage and government debt levels.

In consequence, the current government is unwilling to implement large-scale economic stimuli again. So to maintain growth in the face of pressure, a series of explicit pro-growth policies, such as increased investment in the railways and agriculture, micro-loans to SMEs, and upgrades to substandard suburban housing, are being put in place. To this end, the government has given large loans to the China Development Bank for financing housing, reduced the statutory deposit reserve ratio of financial institutions, and offering micro-loans to the agricultural sector, and this now accounts for a proportion of the budding financial services sector.

As these provisions have only just started to be implemented, the prospects are that such investments will accelerate economic growth, but will such centrally-driven stimuli lead to widespread private sector investment?

Beyond the main index, the labor costs index has risen from 86.7 last month to 87.2 this month and the overall costs index has risen from 77.8 to 84.7. Both indices register at a high level and have done since our survey began in 2011, not matter whether growth has been strong or not. Costs, especially labor costs, are high, which means there is difficulty in recruitment. From a general point of view, when economic growth slows, unemployment will rise.

However, our index shows that this is not the case. This may be due to changes taking place in China's macro-economic structure, dominated by a shift from secondary to tertiary industry. The demand for labor in the tertiary sector is greater than for the secondary sector.

The index measuring consumer prices surged forward from 43.8 to 58.0, crossing the confidence threshold and suggesting that entrepreneurs expect consumer prices to increase significantly in the next six months. The producer price index rose from 45.5 to 49.2, close to 50, and if that confidence line can be crossed in the coming months, it is likely that China's economic rebound will absorb excess capacity in the producer goods sector.

The recruitment index declined this month from 70.3 to 65.6. This index indicates that despite the existence of recruitment problems, payroll costs are on the rise and companies are still willing to hire and to expand production. The index showing business investment rose from 65.9 to 68.4, representing positive intentions to invest. Companies are willing to hire and are still taking a relatively optimistic view of the next six months.

Lastly, the business competitiveness index, which measures the status of survey respondents' firms status relative to their industry, is at 71.1 this month, an increase on August's figure of 69.0. Companies sampled are in a good position compared to their industry averages. This means that the current operational status of the vast majority of Chinese businesses is likely to be worse than the data presented in the CKGSB BCI.

Notes:

CKGSB BCI Introduction

In June 2011, CKGSB Case Center and Center for Economic Research initiated a project to gauge the business sentiment of executives about the macro-economic environment in China – called an index of business conditions.

Under the direction of Professor Li Wei, in July 2011, the two research centers designed and tested the BCI survey. In September 2011, the first surveys were distributed and results computed. Since May 2012, the research team has published monthly BCI survey reports.

Explanation of the Index

The CKGSB Business Conditions Index (CKBCI) is a set of forward-looking, diffusion indices. The index takes 50 as its threshold, so an index value above 50 means that the variable that the index measures is expected to increase, while an index value below 50 means that the variable is expected to fall. The CKGSB BCI thus uses the same methodology as the PMI index.

The survey asks senior executives of companies whether their main products are for consumers or non-consumers, and then asks how they think product prices will change in the next six months. Based on survey responses, we have been able to report expectant changes in consumer and producer prices.

We ask companies for information pertaining to their relative competitive positions in their respective industries. Based on survey responses, we compute a competitiveness index for our sample. The higher the competitiveness index, the more competitive our sample firms are in their respective industries.

Method of Calculation

During each survey, respondents are asked to indicate whether certain aspects of their business (e.g., sales) are expected to increase, remain unchanged, or decrease over the forthcoming six months as compared to the same time period last year. The diffusion index is calculated by summing the percentage of "increase" responses and half of the "remain unchanged" responses.

Of all the indices measured for the CKGSB BCI, the overall business conditions index is an aggregate index, which has been calculated, since December 2012, by averaging its four constituent indices of sales, profit, financing environment and inventory. The aggregate BCI index before December 2012 uses a different composition of constituent indices, and is therefore not directly comparable to the current BCI index.



About Cheung Kong Graduate School of Business

Education for a New Era of Global Business

Established in Beijing in November, 2002 with generous support from the Li Ka Shing Foundation, CKGSB is a private, non-profit, independent educational institution and the only business school in China with faculty governance. The school offers innovative MBA, Finance MBA, Executive MBA and Executive Education programs. In addition to its main campus in the center of Beijing, it has campuses in Shanghai and Shenzhen and offices in Hong Kong, London and New York.

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CKGSB faculty, through their on-the-ground research and close relationships with leading domestic executives, provide global thought leadership on both the theory and the practical reality of real-life business in China. They consistently generate important insights into areas that are poorly understood outside of China, such as the globalization strategies of Chinese companies and competition and collaboration among state-owned enterprises, private businesses and multinationals.

World-Class Faculty with a Global Perspective

CKGSB is the only business school in China with the reputation and resources to attract faculty from top business schools such as Wharton, Stanford, NYU, and INSEAD. The majority of CKGSB faculty members were born and raised in China before leaving to study and teach abroad. Their bicultural backgrounds have endowed them with a valuable capacity to interpret global business in the context of both China and the West.

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The Research Team

Wei Li

CKGSB Economics Professor

Director, CKGSB Case Center and Center for Economic Research

+86 10 8518 8858 ext.3235

wli@ckgsb.edu.cn

Yi Zhou

Assistant Director, CKGSB Case Center and Center for Economic Research

+86 10 8518 8858 ext. 3915

yzhou@ckgsb.edu.cn

Chongqing Gu

Senior Researcher, CKGSB Case Center and Center for Economic Research

+86 10 8518 8858 ext. 3336

cqgu@ckgsb.edu.cn

Yan Yang

Senior Researcher, CKGSB Case Center and Center for Economic Research

+86 10 8518 8858 ext. 8479

cqgu@ckgsb.edu.cn

Guchuan Yang

Assistant Researcher, CKGSB Case Center and Center for Economic Research

+86 10 8518 8858 ext. 3318

gcyang@ckgsb.edu.cn

Heather Mowbray

Researcher, CKGSB Case Center and Center for Economic Research

+86 10 8518 8858 ext. 3716

heathermowbray@ckgsb.edu.cn