Commentary on the August 2020 CKGSB Business Conditions Index

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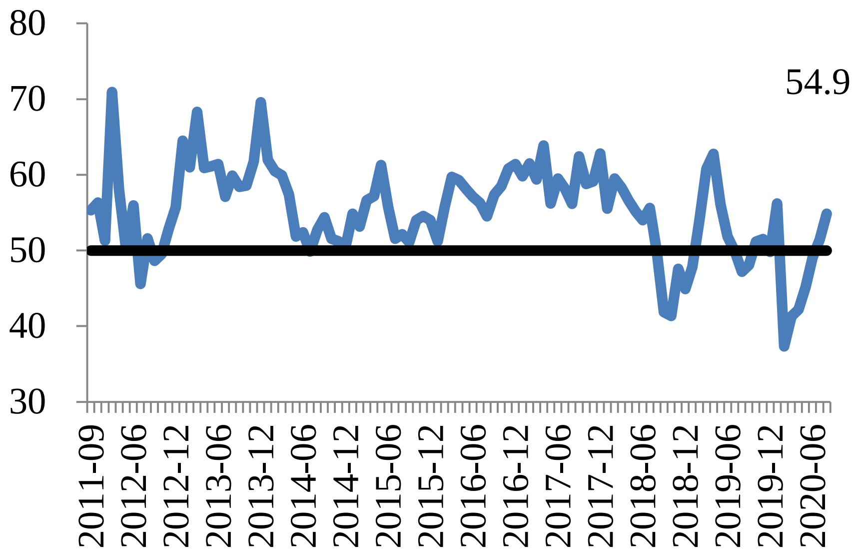
The August 2020 CKGSB Business Conditions Index (BCI) welcomed a small rebound, increasing from 51.4 to 54.9 (Figure 1). It's important to note that the government's economic rescue policies are starting to make an impact. If the situation continues along this path, there is now a high chance that China's economic performance this year will end positively.

Figure 1 Business Conditions Index (BCI)



Source: CKGSB Case Center and Center for Economic Research

This month's BCI data looks considerably healthier than in recent months, and there are several bright spots to examine. First of all, labor costs and total costs have bounced back to a certain degree, which means companies are beginning to have higher expectations for the next half of the year. It also indicates that the economy may be in better operating conditions. When costs rise, the economy should be booming.

Second, the consumer and producer goods are performing relatively well. Product prices looks optimist, although the consumer prices gauge remains below 50, which means that surveyed companies still have reservations about future developmental trends. Somewhat unexpectedly, the index for producer goods not only passed the confidence watershed, but also exceeded that of consumer prices.

Past data shows that the consumer price index has been above 50 for a long time, while that of producer prices has languished below 50 for an equally long period. Now the two are inverted, and we believe this is due to economic stimulus. Amid the Covid-19 pandemic, China's economy has been hard hit, and the government has resorted to heavy "new infrastructure" spending as a form of stimulus. This is the likely the origin of the producer price index hike.

There is a problem here. In years past, real estate and infrastructure were seen as the solution to China's economic development. The government then discouraged those who speculated in real estate and has held back from supporting the sector ever since. This leaves infrastructure. However, with the continuous increase in infrastructure construction, rates of return are falling. Take high-speed rail as an example - the already dense network has led to railways being built in underdeveloped areas, and in these cases, there are considerably doubts about whether these projects can be profitable.

Finally, we turn to the investment and recruitment indices. Both of these indexes are currently above 60, at a level of confidence they occupied before Covid-19. The recovery of these two indexes represents confidence of our sample in development, but increased investment and recruitment risks overheating the economy, and bringing about inflation.

From this point of view, we support the Chinese central bank's position of "staying its ground" and not "flooding the economy." As private firms remain the main driver of the country's economy, from the second half of this year to next year, there is a high chance China's economy will return to growth levels seen in recent years.

This is a commentary on the CKGSB BCI report for August 2020. Do not hesitate to contact the BCI team by email as shown in the accompanying BCI data report.

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