Commentary on the September 2018 CKGSB BCI

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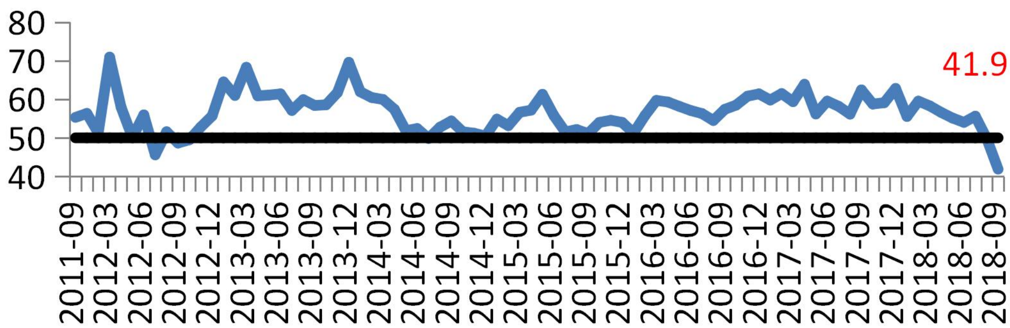
Last month we wrote, "It may be that looking back, this month's CKGSB Business Conditions Index (BCI) will have added significance." Now it seems this statement come early. This month's BCI has made something very clear: it can always get worse.

In September, the CKGSB Business Conditions Index (BCI) fell considerably, from 49.8 to 41.9 (Figure 1). This is the lowest index reading to date.

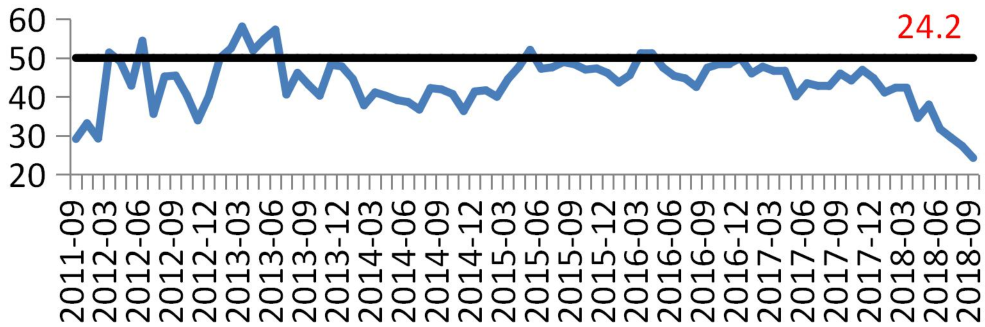
Figure 1 Business Conditions Index (BCI)



Source: CKGSB Case Center and Center for Economic Research

The BCI comprises four sub-indices. In September, the corporate sales and profit indices fell massively, with the profit index registering just 43.0, far below the confidence threshold of 50. These two indices had, up to now, remained fairly stable. From an already low level of confidence, the corporate financing index fell yet again, this time to 24.2. Among our sample of successful Chinese companies, few are left with positive stories to tell about their financing options (Figure 2).

Figure 2 Corporate Financing Index

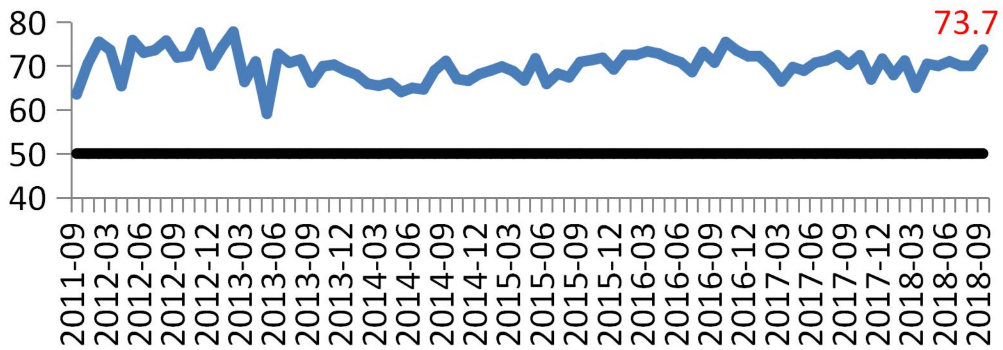


Source: CKGSB Case Center and Center for Economic Research

The deterioration of other indicators has caught us by surprise this month. The producer price index dropped sharply, and while the relatively stable investment and recruitment indices may still register above 50, they also fell significantly. If the trend were to continue, they would probably be heading below 50 in the near future. What is incredible is that the producer costs index has set a record high this month.

These indices paint a picture: sales have fallen, profits are sluggish, financing is hard to secure, costs are rising fast, yet these pressures cannot be relieved by rising prices to downstream firms and consumers. Sampled companies are in seriously hot water and have had to curb plans, reduce investment and put a freeze on hiring. Let us not forget that these businesses are among the most efficient in their respective industries (Figure 3).

Figure 3 Industry Competitiveness



Source: CKGSB Case Center and Center for Economic Research

Downward pressures on the economy have become impossible to ignore, and since Summer 2018, the government has dropped its deleveraging campaign and picked up renewed stimulus (although it has not relaxed controls on real estate). There are even policies designed to ensure financing bodies improve small business access to financing.

From our data it appears that the authorities are very clear as to where the problem lies, and have taken many targeted measures. However, we can see that up until now, small business access to financing remains extremely restricted. While it is possible that policies still need time to kick in, it may be the case that they will not work.

In China today, the majority of people are employed by small companies, and most new jobs created annually come from small companies. In any country, employment is what people care about most. People need to earn to consume; they want to support their families and develop a livelihood. A job is naturally everyone's first priority.

Officially, economic statistics are good. In 2018, Q2 GDP growth was 6.7%, just 0.1 percentage point slower than Q1. But the news has been full of stories of redundancies and pay cuts, and the new idea of a "consumption downgrade." In literal terms, this is the opposite of the "consumption upgrade" by which the standard of goods and services went up as incomes increased. In much the same way, they can also go down. Has there ever been such a thing since reform and opening up?

There have also been calls recently to rein in and restrict growth in the private sector, where the investment and recruitment indices have dropped significantly. This may not be a coincidence. Repression of private companies is bound to reduce entrepreneurs' confidence in the future, especially in such sensitive times. As this appears to be the case, investment and recruitment naturally suffer. This must been known to the authorities, which is why the official media has repeatedly criticized such arguments.

Although these companies have faced similar financing difficulties before, then the economy was booming and could handle poor access to money. Now, things are more serious and the "low-hanging fruit", policies that easily stimulate growth, are harder to find. To ensure that development continues, structural reforms, channeling funding towards highly efficient small companies rather than large scale "zombie" SEOs, are essential.

Structural reform has been talked about for many years, but despite the noise, little has been delivered. Serious structural reform is hard for any country; most have to be dragged into it. But hasn't that day already come for the Chinese economy? From the BCI data, it seems fast approaching even if it has not yet arrived. The government has so many resources at hand, and is capable of taking the initiative. If problems are left until they absolutely have to be corrected, the cost will be high, and it will become so much harder. So in the end, the government will be left with a choice: to be passive and powerless, or too heavy-handed to help.

This is the author's commentary on the CKGSB BCI report for September 2018. 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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