Protect employment and the productivity of private businesses

Commentary on the April 2020 CKGSB Business Conditions Index

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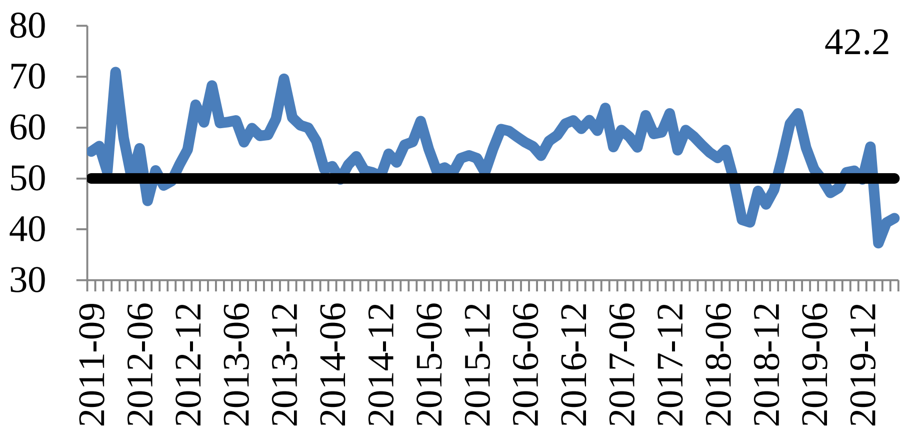
In April 2020, the CKGSB Business Conditions Index (BCI) rebounded slightly on March's result, rising from 41.3 to 42.2 (Figure 1). China's private economy is still very much in the doldrums: while the immediate threat of the novel coronavirus has been curbed, the shadow of the epidemic on the economy has yet to recede.

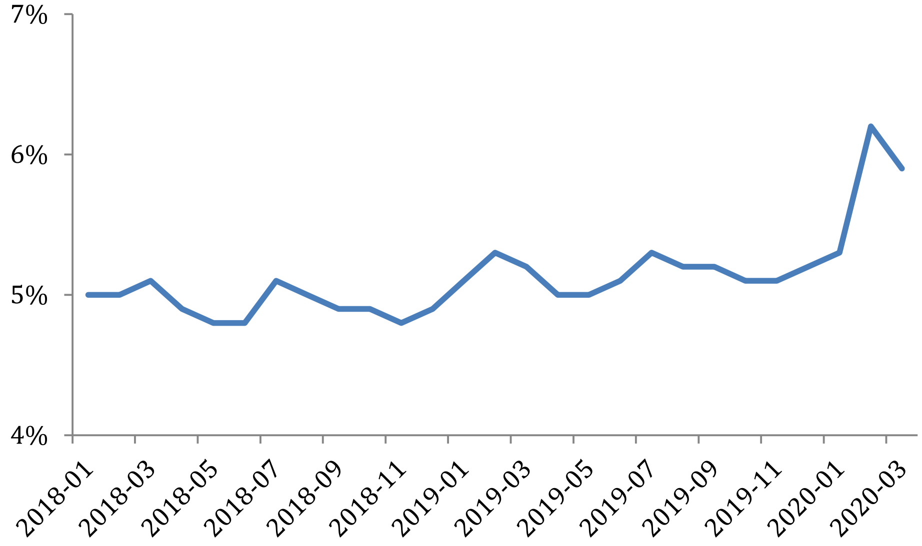
Figure 1 Business Conditions Index (BCI)



Source: CKGSB Case Center and Center for Economic Research

Our sample comprises primarily of private SME owners, for whom the pandemic has hit hard. This month, the BCI investment and recruitment indices register just 44.6 and 45.0 respectively, both below the confidence threshold of 50, showing how weak sentiment is in this regard. This is especially telling, as both indices have hardly dropped below 60 in the past ten years, despite periodic economic fluctuations in this period. Private SMEs are China's main job creation engine, and if this situation continues for long, employment rates will suffer. Official data substantiates this turn for the worse. Wind data reveals an urban unemployment rate of 6.2% and 5.9% in February and March 2020. The long-term average remains about 5% (Figure 2).

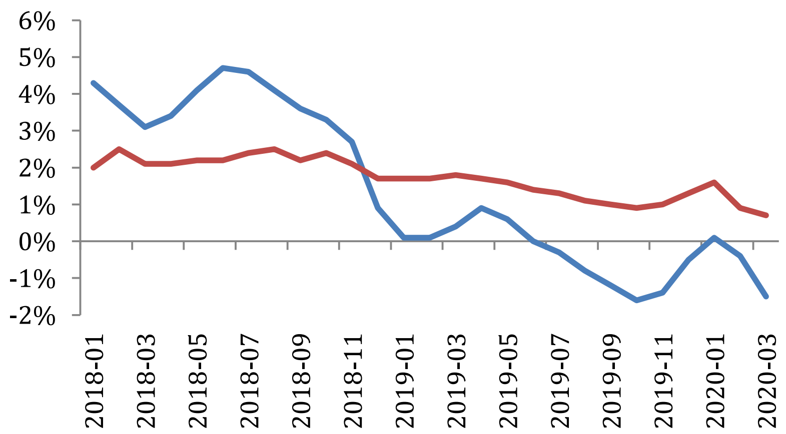
Figure 2 China's urban unemployment rate over time



Source: Wind

Tied closely to such an economic downturn is deflation. Despite some fluctuation in the prices of various products including farm produce, most of the economy is spiraling downwards. This is reflected in the consumer goods index and producer goods index, registering 38.4 and 35.4 in April, significantly below the confidence threshold of 50. This reflects the official data, whether non-food CPI or PPI, both at a low ebb. (Figure 3). Falling prices provide more evidence of the shrinking of Chinese macroeconomy, alongside rising bankruptcy and unemployment. Inflation is taboo world over, but deflation is just as worrying. We need only look to the US during the Great Depression a little under a century ago to remind ourselves of the need for vigilance.

Figure 3



Note: Blue line: PPI (all producer prices) Red line: CPI (non-food consumer prices)
Source: Wind

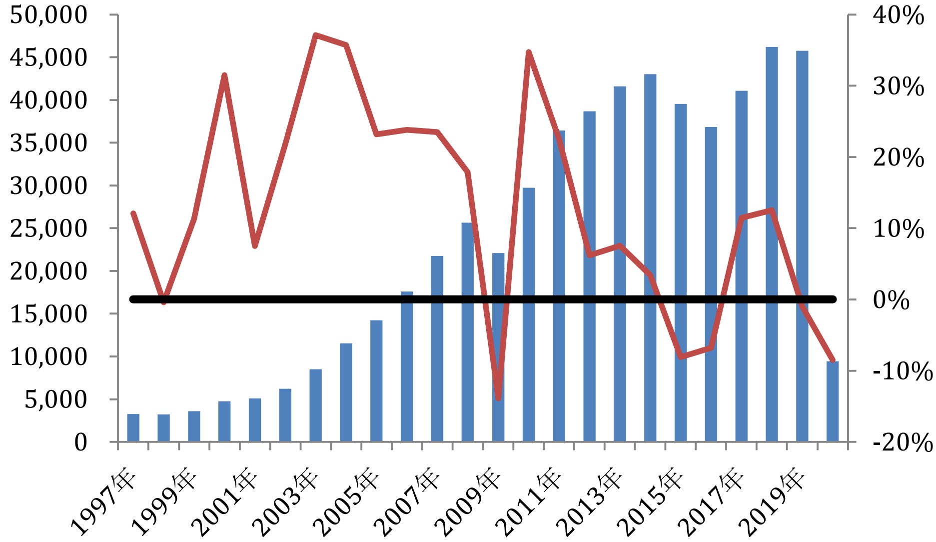
What has the government done about the situation? Since the beginning of this public health crisis, the government has issued rescue policies from all angles: industrial, taxation, fiscal, and finance, and many of these will benefit private enterprises. However, deleveraging in the past has undoubtedly had a greater impact on their financing environment. Many private companies have died, and survival has depended on operating cautiously and at low levels of leverage. While the government's relaxation of financial constraints will assist private companies, they are less constrained by leverage than in the past. Operating now under the severe impact of the coronavirus, private companies in fact have relatively stable financing conditions.

Private companies' biggest three issues at the moment are resuming work, sales issues and foreign trade. For many companies, resuming work remains a problem. The risk of a second outbreak of the coronavirus remains, as does the contradiction between managing the outbreak and rebooting the economy. How to get past this contradiction is the current preoccupation of the government and business leaders alike. Getting back to work has its own problems. You need enough workers for one. Many cannot leave wherever they were at Chinese New Year to return to the factories. Travelling across regions is hard, and a green health-code is needed if travel is even possible. Primary and secondary schools are not yet back in full, so parents will be tied to home if no caretakers are available for their children. Full resumption of work is therefore far off, and may need to wait until the virus is vanquished or, at the very least, completely under control.

The second question relates to the lockdowns imposed across China to fight the virus. Unless a cure or vaccination is found, it is an effective way to reduce the rate of transmission, but cutting human interactions and disrupting transactions damages supply chains. This has called to a halt not just transmission, but also the economy as a whole. The economy is not a car engine to be switched on and off at will. Restarting a supply chain is a chaotic process. As some companies are yet to reopen, replacements are needed, and new buyers have to be found. Can raw materials still be sourced, and if so are restaurants and store sales solid enough for producers to pick up speed? And while the coronavirus is under control in China, our main trading partners are still in the thick of it. Social isolation prevails, as do work stoppages, and 'shelter in place' orders. The world economy is in shutdown. Chinese companies that depend on global supply chains are especially misfortunate. Private enterprises are beset by more than the usual financial problems, now dealing with extreme uncertainty about when normal operations here and abroad will resume.

The third problem is that foreign trade demand has fallen sharply. According to Wind's data, total import and export growth was -8.5% year-on-year from January to March 2020. This is the second lowest growth rate since 1997, after -13.9% in 2009 (Figure 4). No matter the state of domestic demand for which measures can be implemented, external demand is out of reach of our policies. The shutdown of production lines will inevitably affect Chinese exports, because China is an important part of the international industry chain, and any upturn remains out of sight.

Figure 4 Total Chinese import and exports (Left axis: 100 mil USD) (Right axis: Year-on-year growth)



Data accessed March 20, 2020

Source: Wind

The fall in foreign trade in 2009 was caused by the financial crisis, which responded immediately to the economic stimulus packages. Today's fall is caused by a pandemic. It has hit not just the demand side but also the supply side. Stimulus alone will not be able to kick start the economy. We cannot simply apply the same mitigation recipe as in 2009. Without a resolution of the virus situation, the drop in foreign trade will far surpass that of ten years ago.

One policy particularly worth noting is infrastructure spending. In a system where resource allocation is dominated by the government, we expect beneficiaries of this to be mainly state-owned and large-scale private companies. Even if private small and medium-sized enterprises were able to benefit, they would have had to first survive the storm. A better way is targeted rescue methods to enable most private small and medium-sized enterprises to survive. This will protect the most vibrant part of the Chinese economy, which is the closest to consumers and offers the most job opportunities. Employment is a cornerstone of social stability, and it is no exaggeration to emphasize its importance. SMEs offer a "bridge" to a brighter future, but if the difficulties they face are left unresolved, we will have more than short-term unemployment to deal with. We will also be left facing a large-scale fall in the long-term potential growth rate of the Chinese economy.

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

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