Commentary on the April 2021 CKGSB Business Conditions Index

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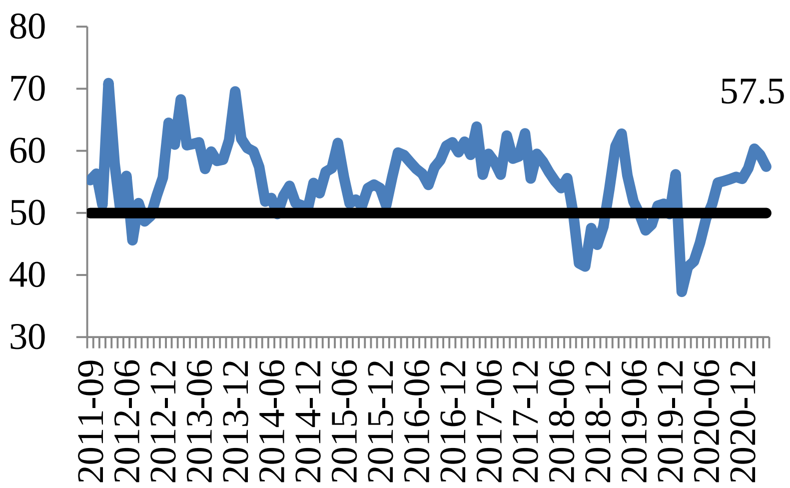
In April, the CKGSB Business Conditions Index (BCI) reported a slight fall from 59.4 in March to 57.5 (Figure 1).

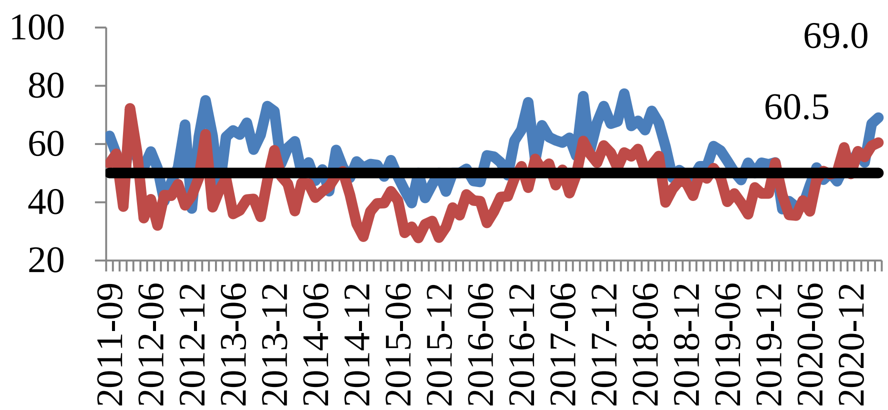
Figure 1 **Business Conditions Index (BCI)**



Source: CKGSB Case Center and Center for Economic Research

This month's commentary will start by looking at consumer and producer price prospects, as these are at confident end of the scale. Consumer price prospects are near 70 and producer price prospects have passed 60.

Figure 2 **Price Indices (BCI)**

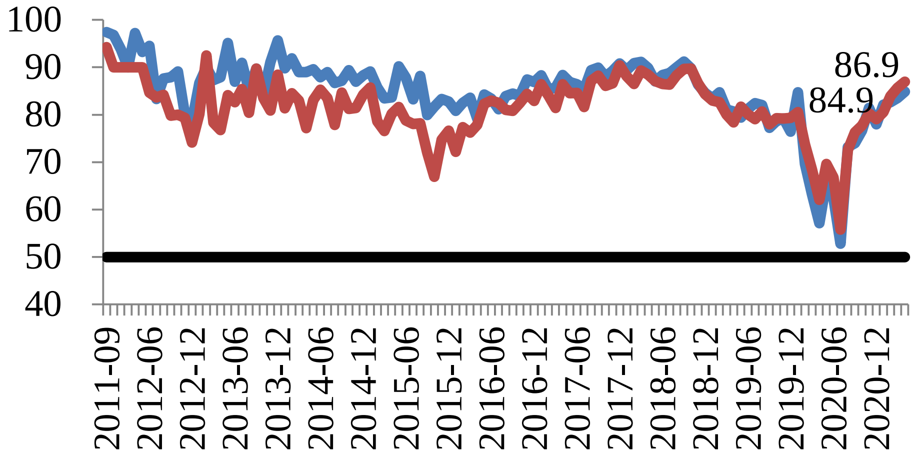


Source: CKGSB Case Center and Center for Economic Research

Blue: Consumer prices; Red: Producer prices; Black: Confidence threshold

Echoing this, costs are also at a high level (Figure 3). The outbreak of Covid-19 caused labor costs to plummet, but with the government's control of the pandemic and strong economic stimulus package, costs began to climb again. With growing costs, prices also began rising. To a certain degree, the resulting inflation stems from costs.

Figure 3 Costs Indices (BCI)

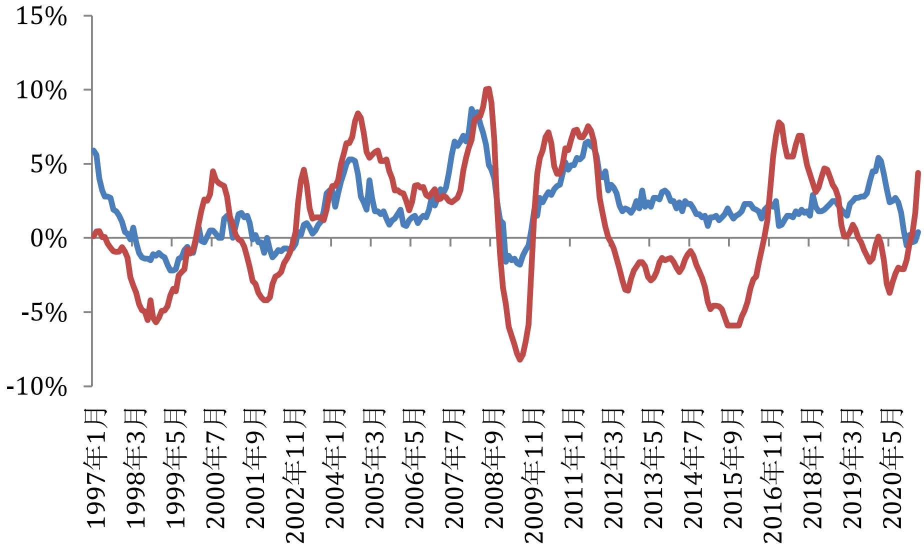


Source: CKGSB Case Center and Center for Economic Research

Blue: Labor costs; Red: Overall costs; Black: Confidence threshold

This result is aligned with the National Bureau of Statistics Consumer Price Indices (CPI) and Producer Price Indices (PPI) figures this Spring.

Figure 4 CPI and PPI (Industrial products)



Source: CEIC; Data until March

Blue: CPI; Red: PPI; Black: Confidence threshold

Figure 4 gives data from the National Bureau of Statistics. It is clear that the coronavirus has had an enormously negative impact on the economy, leading to falling price prospects. However, with the control of the pandemic in China and the injection of economic stimulus, PPI has made a rapid rebound in the country, a trend which is continuing. Since the economic stimulus policy is mainly focused on infrastructure construction and other industrial areas, there is still a long way to go before it passes the CPI, but the CPI has maintained a downward trend throughout 2020. After March 2021, the CPI turned positive and reached a value of 0.4% in one fell swoop.

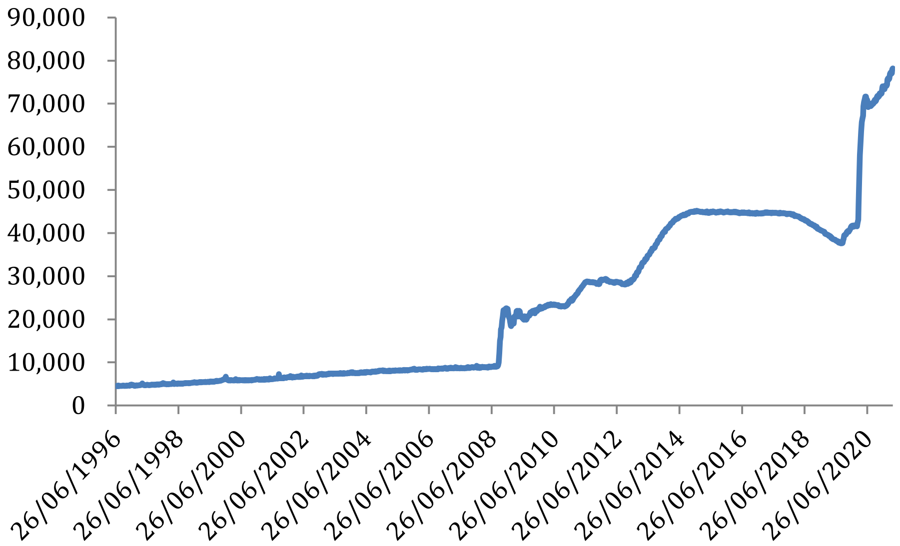
It is worth noting that the official data compares the present period with the same time last year, focusing on the present, but our data is forward-looking: we ask our sample how things will evolve in the next six months compared with the same period last year. From this we can see that if the current situation continues, inflationary pressure will be significant over the next six months.

The following topic is rather complex, that is, how to deal with loose monetary policy in the future. This issue is not only very important to China at present, but also a difficult problem for the United States. If withdrawn too early, the economy may lack support and sink again, rendering all previous efforts redundant. But if the loose monetary policy is maintained for too long, rising debt ratios will increase their grip, a situation that holds hidden dangers for future development. This is not an easy question to answer, and there is no standard answer. Sometimes we can only apply the lesser of two evils, but sometimes history provides inspiration. In this case we can refer to the 2008 U.S. financial crisis.

In the early 21st century, Greenspan was still in charge of the U.S. Federal Reserve. The impact of the internet stock bubble bursting on the U.S. economy made the Fed reduce interest rates to a historic low of 1% for over a year. This fueled a thriving U.S. real estate market. At the same time, a large number of real estate assets improved their liquidity after financial innovation and entered the financial market. After Bernanke became chairman of the Fed, inflation and other factors led it to begin raising interest rates. All too soon, the interest rate hike pierced the American real estate bubble, and housing prices began falling. The fall in housing prices hit the value of all financial products based on these assets, and the investors who held them suffered huge losses. At first, Bear Stearns was acquired by JPMorgan Chase, then Lehman Brothers was bankrupted and Merrill Lynch was acquired, and finally Goldman Sachs and Morgan Stanley were caught up in the mess. This crisis was later rated as the worst financial crisis the U.S. had experienced since the Great Depression.

Obviously, before 2008, the Fed kept interest rates low for too long. Although this saved the U.S. economy at that time, it caused bigger problems in the future. Thirteen years have since passed. In these years, the Fed has maintained interest rates at near zero for much of the time and employed a large-scale quantitative easing policy (Figure 5). The U.S. CPI reached 2.6% in March, exceeding its 2% target. However, the Fed believes that the current inflation in the U.S. is cost-driven inflation - temporary and unsustainable. For this reason, raising interest rates in the current situation has been deemed unnecessary.

Figure 5 **Total Federal Reserve Assets (100m USD)**



Source: CEIC; Data until April 21

Judging from the current situation, the Fed is in a dilemma, but if it continues to drag on, it may face a larger bubble in the future, and a more difficult situation may arise.

Finally, let's talk about China's issues. China is currently facing a similar quandary to the U.S. Federal Reserve. If its stimulus policy is withdrawn too early, the economy may well suffer, but if it does so too late, an economic bubble will form, holding major hidden dangers. However, there is one difference between China and the United States, that is, China is still developing, and there are still many low-hanging fruit to be picked. As long as you spend more on structural reform, growth can be achieved without too many extra economic stimulus policies. China can consider withdrawing from expansionary macroeconomic policies at an earlier stage and strengthening structural reforms to achieve high-quality growth.

This is a commentary on the CKGSB BCI report for April 2021 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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