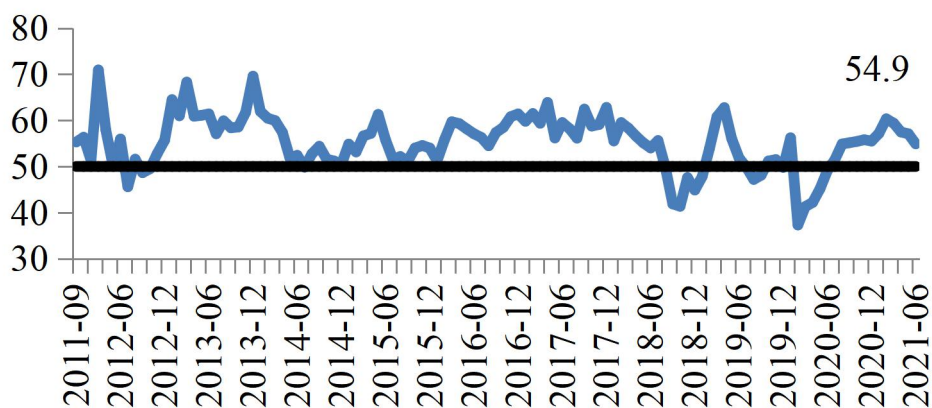


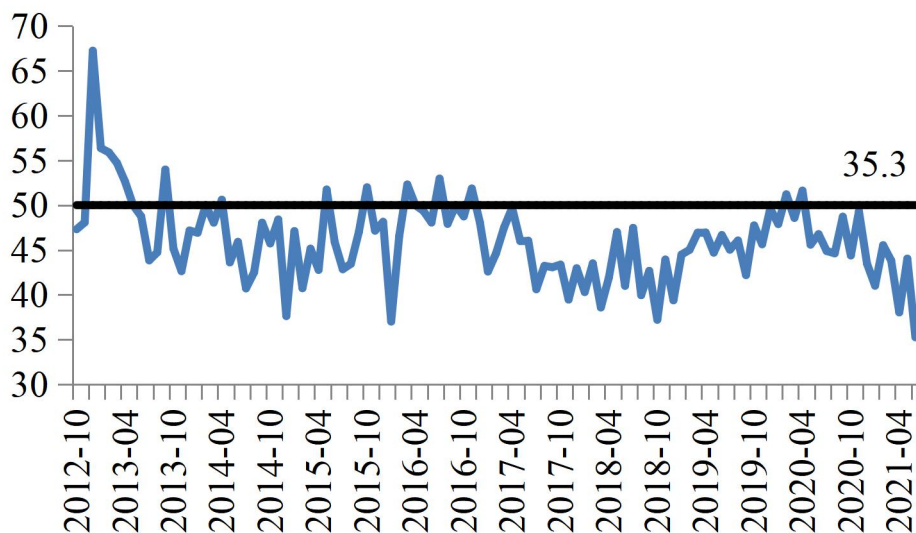
**Commentary on the June 2021 CKGSB Business Conditions Index**
*Professor Li Wei*

In June, the CKGSB Business Conditions Index (BCI) fell again, from 57.1 to 54.1 (Figure 1).

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


Source: CKGSB Case Center and Center for Economic Research

As with last month's BCI, there was a slight decline in performance this month. However, one of the four sub-indexes of BCI caught my attention, and that was the inventory index (Figure 2).

**Figure 2 Inventory Index (BCI)**


Source: CKGSB Case Center and Center for Economic Research

The index fell heavily to 35.3, the lowest value since the BCI began. How can we explain this? At

best, we can only make educated guesses. It could be that the companies we survey are stocking up for their next round of production, leading to a bulking up of inventory. Or it could be that Covid-19 is still causing significant trouble in manufacturing. The biggest impact of the pandemic on China's economy is actually foreign trade. Recent outbreaks in Guangdong have intensified border controls in the region. At Yantian Port, the speed of logistics has slowed almost to a standstill, as goods pile up waiting for processing. While not many of our surveyed companies export directly, they may be upstream and downstream companies of export companies. Therefore, if export companies are affected, our respondents will also suffer. This month's inventory index can be described as a sharp drop, but we still don't know whether it will continue as a trend. For this, we need to continue to observe the data over the next few months.

In fact, the pandemic has reminded us many times of the risks of over-reliance on external demand. This is why “dual circulation” and its emphasis on domestic demand is so important. China is a big country, and this means it operates in a fundamentally different way from a small economy. For example, Singapore has relied heavily on external demand to develop its economy, because it is small and its impact on the world economy as a whole is therefore small. China is different. As a massive economy, if China were to continue to depend on external demand, the United States probably couldn't handle the pressure. Political friction will continue to mount.

China still has a current account surplus. In economics, this equates to net capital outflow. As a major developing country, China's net capital outflow is abnormally large, while economic development is fast. In theory, we should have a current account deficit and a surplus in capital and financial accounts. Because China's economy is growing fast and its rate of return on capital is high, international capital hopes to flow into China and share the fruits of its economic growth. China may then use this inflow of capital to import goods and services, accelerating development even further. Currently, China's private sector capital inflow is transferred to the Chinese government which uses it to invest in U.S. treasury bonds. Foreign investment in China is high-yield investment, while U.S. treasury bonds purchased by China have a far lower yield. Therefore, the net international investment position of the United States is negative (making the United States a debtor country), but the net investment income to the United States is positive. I can only sigh to the savvy Americans and suffering Chinese.

If we gradually reduce our dependence on external demand and turn our current account into a deficit based on domestic demand, China may grow faster, or if it achieves the same growth rate, it can invest less. In either case, ordinary people will end up with strong spending power and a higher standard of living. The main aim of our country's economic development is to improve the living standards of the people, enabling them to consume more, and this can be achieved by moving towards domestic demand.

Continuing to build domestic demand will also reduce trade frictions with other countries. As imports grow, other countries will become more dependent on China as a large market, and China will be more likely to take the initiative in international exchanges. In short, in the future, China

needs to reduce its dependence on foreign markets, abandon the idea of earning foreign exchange through exports, develop exports based on comparative advantages, and make exports and international trade a tool to enhance the welfare of the Chinese people instead of accumulating foreign exchange reserves. Only by putting the welfare of ordinary people first and allowing ordinary people to obtain tangible benefits from economic development can this country grow in the right way, which means expanding the benefits to all.

This is a commentary on the CKGSB BCI report for June 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.

CKGSB Professor Li Wei

30 June 2020