

CKGSB BCI

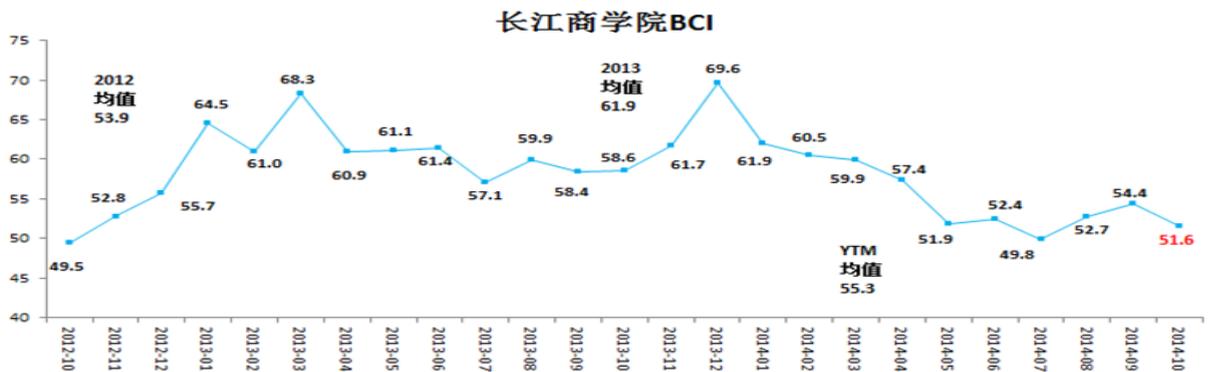
October 2014

23 October 2014

CKGSB Case Center and Center for Economic Research

The CKGSB Business Conditions Index reads 51.6 in October, lower than last month's index of 54.4 but still above the confidence threshold of 50 (Graph 1). This shows that our sample of comparatively successful business leaders in China is fairly positive about the macroeconomic environment. While a downward trend set in during the first quarter of the year, Q2 and Q3 have seen data rising. China's macroeconomic conditions now appear to have stabilized. However, compared with last year, and considering financing, inventory and other data, risks of a downturn remain. Significant operational challenges remain to be addressed.

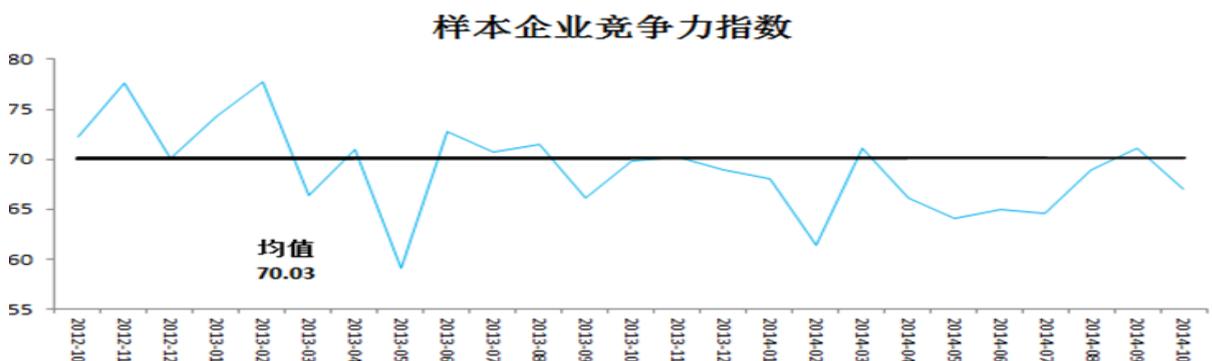
Graph 1. The CKGSB Business Conditions Index



Source: CKGSB Case Center and Center for Economic Research

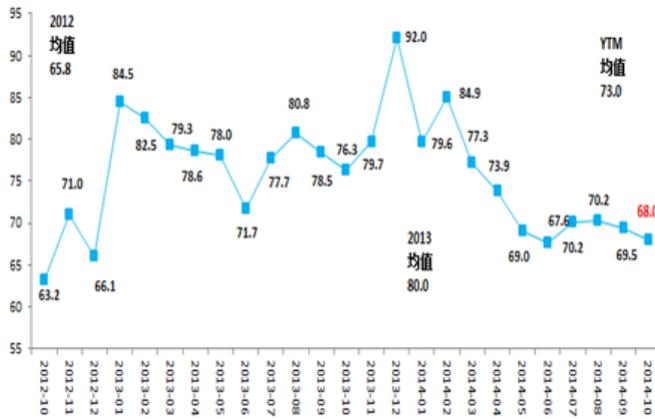
The CKGSB Business Conditions Index is generated wholly on the basis of statistics gathered from leading enterprises whose executives have studied or are studying at Cheung Kong Graduate School of Business. In the questionnaire we ask respondents to indicate whether their firm is more, the same, or less, competitive than the industry average (50), and from this we derive a sample competitiveness index (Graph 2). Consequently, as our sample firms are in a relatively strong competitive position in their respective industries, the CKGSB BCI indices are higher than government and industry PMI indices. Users of the CKGSB BCI index may therefore focus on data changes over time to forecast trends in the Chinese economy.

Graph 2. Industry Competitiveness

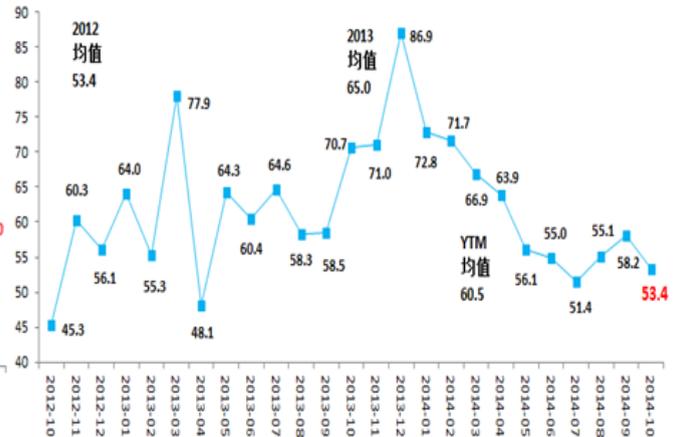


Source: CKGSB Case Center and Center for Economic Research

The CKGSB BCI comprises four sub-indices that are forwarding-looking indicators for corporate sales, corporate profits, corporate financing environment, and inventory levels.

Graph 3. Sales


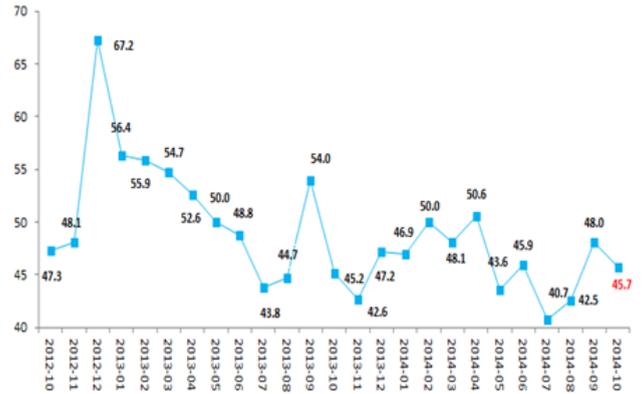
Source: CKGSB Case Center and Center for Economic Research

Graph 4. Profit


Source: CKGSB Case Center and Center for Economic Research

Graph 5. Financing


Source: CKGSB Case Center and Center for Economic Research

Graph 6. Inventory


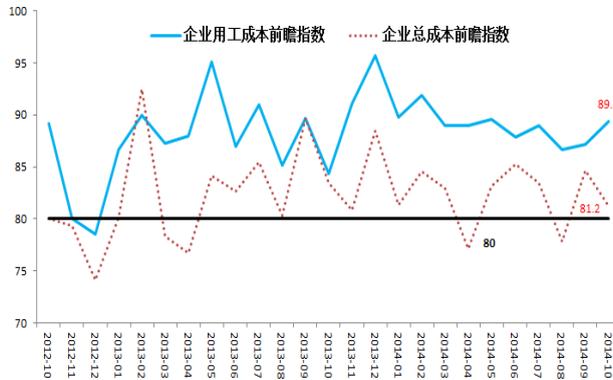
Source: CKGSB Case Center and Center for Economic Research

The corporate sales index registered 68 in October, lower than last month's index of 69.5 (Graph 3), and the profit index registers 53.4, a significant decrease on last month's index of 58.2 (Graph 4). Both currently register higher than 50, showing a degree of optimism about prospects over the next six months. The statistical trend is towards stabilization, with sales and profits forecasts rising over the past two quarters.

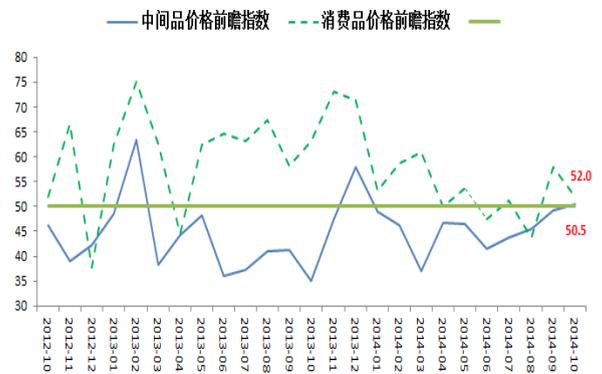
The corporate financing environment index reads 40.7 in October, slightly lower than in September (Graph 5), and below the confidence threshold. This indicates that compared with the same period last year, the financing outlook for the next six months is not optimal. Since the majority of our sample are private firms (especially SMEs), our data show that firms in the private sector face particularly challenging financing and operational pressures.

The index measuring inventory levels registered 45.7, lower than last month's index of 48 and under the confidence line (Graph 6). It is evident from the past two years' of statistics that the inventory backlog is the result of over-investment, and it has still not improved to any significant degree. High inventory levels will continue to be of concern.

Besides the main indices, we also surveyed respondents on forecasted costs, prices, investment plans and employment conditions, to form a supplementary set of indices.

Graph 7. Costs


Source: CKGSB Case Center and Center for Economic Research

Graph 8. Prices


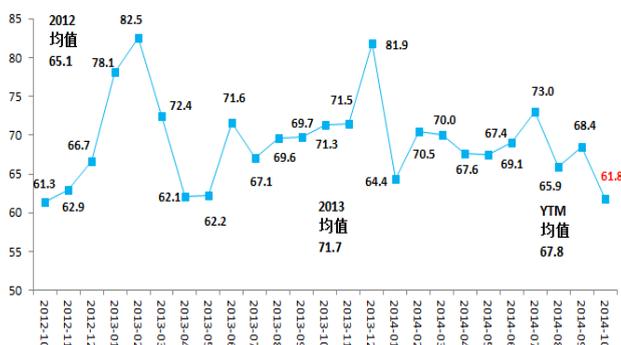
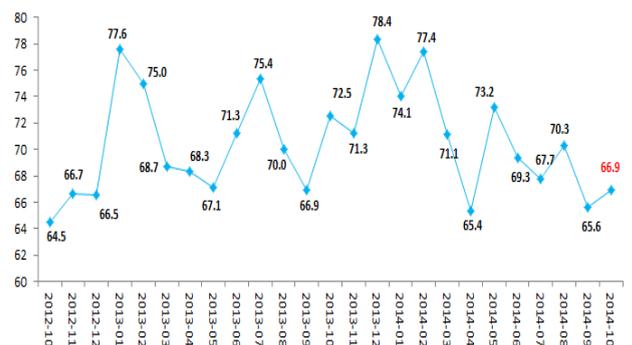
Source: CKGSB Case Center and Center for Economic Research

In October, labor costs and overall costs registered 89.4 and 81.2 respectively (Graph 7), both at a high level. These two costs indices are predictions of change in the upcoming six months, and show that most sampled firms expect costs to increase compared with this time last year.

The consumer prices index registered 52 in October, from 58 in September (Graph 8) and producer prices registered 50.5, up from September's figure of 49.2. From the reduction in volatility since the beginning of 2014, it appears that domestic price levels are stabilizing, and the fall in producer prices will become more moderate.

The corporate investment demand index fell from 68.4 in September to 61.8 in October (Graph 9), above the confidence threshold of 50. This index shows that the majority of sampled firms still plan to invest in fixed assets in the next six months.

In terms of labor demand, the October index is at 66.9 (Graph 10), above the confidence threshold. This shows that a majority of companies sampled aims to expand their workforce in the next six months, showing belief in future growth. Corporate investment and labor demand indices are important factors in production output and optimism here shows that while increasing output levels has an important role in growing the economy, a smooth transition will rely on efficiency.

Graph 9. Investment

Graph 6. Labor Demand


Source: CKGSB Case Center and Center for Economic Research

Source: CKGSB Case Center and Center for Economic Research

Overall, the 2014 business forecast of China's macroeconomic conditions has begun to stabilize, but risks of a downturn remain. With growth at 7.4% in Q3, the annual target of 7.5% appears hard to reach. For private Chinese firms, financing difficulties, high inventory levels and stubbornly high costs continue to present a huge challenge to operational efficiency. The government should continue to introduce economic reform policies, which companies should be actively ready to embrace.

BCI October: An Analysis – Professor Li Wei

Breaking with the recent upward trajectory, October's BCI reported an overall index of 51.6, a lowering of business confidence since September's 54.4. From December 2013 to July this year, the index had fallen each month, even registering below the confidence threshold of 50 in July. In August and September however, the index rebounded a little, but has now returned to close to the confidence threshold of 50.

Looking to the four composite indices, consumer sales have fallen slightly from 69.5 to 68, indicating that companies are still optimistic about sales in the next six months. The profits index has fallen from 58.2 to 53.4 and the financing environment is still on a low ebb at 41.9, up from last month's 40.7. The inventory index is still well below the confidence threshold at 45.7, down from last month's figure of 48.

These four indices provide a basic overview of business conditions for China's private firms. Together they show that firms are relatively optimistic about business in the next six months and have some confidence in near future profit margins. In terms of financing, confidence has been dampened, but this is nothing new, as shown in the BCI's past indices. Inventory levels remain a problem, with the inventory index staying below the confidence threshold.

This year's economic situation has shown itself to be more complex than previous years. The government's GDP growth forecast of 7.5% is looking hard to reach. Third quarter growth was 7.3% and the first three quarters of 2014 averaged 7.4%. Comparing this year with growth from 2009 to 2013 at 8.3%, 10.2%, 8.7%, 8.1% and 7.4% respectively, it is clear that China's economic growth rate has slowed, and that the rate by which it has slowed has only been increasing.

Some feel that the answer to this is economic stimulus to control the rate of the slowdown. Others see no need for stimulus, given that employment rates have been less affected than overall growth. In the past, China's high growth rates relied on investment rather than by quality economic activity. Slower growth may address the issue of the quality of economic growth which would be good for the national economy as a whole.

In 2008 and 2009, in order to cope with the impact of the global financial crisis, the Chinese government implemented a huge stimulus package, which triggered an economic rebound in a very short period of time, but it also brought with it increased leverage and debt. According to Standard Chartered Bank, it is estimated that as of the end of June 2014, China's total debt relative to GDP expanded to as much as 251%.

The current government cannot afford to resort to such a huge stimulus, and instead is stressing the need for comprehensive structural economic adjustments. However, on observing recent government strategy, there is still a

strong concern to maintain the growth rate. The government has balanced its twin concerns by focusing on mini-stimuli – in areas such as railroads, and rural, small, medium and micro-enterprises, and for suburban redevelopments. To this end, the government has granted large loans to the Central Development Bank for financing suburban redevelopment and reducing the statutory deposit reserve ratio of financial institutions providing loans to rural, small, medium and micro-enterprises. For example, the latter must now account for a certain percentage of financial services companies' clientele.

These measures have now been in place for some time, and the investment they have promoted will stimulate growth. However, only time will tell if government investment will have a knock-on effect on private investment.

Our survey respondents expect labor costs to increase, based on the index rising from 87.2 last month to 89.4 this month. Total costs are expected to fall, with the index dropping from 84.7 to 81.2. These costs indices have fluctuated, but as they have remained consistently high, the fluctuation is not particularly significant.

The consumer price index has fallen, with the index registering 52 this month, a drop on last month's figure of 58. Entrepreneurs expect consumer prices to rise in the next six months, but only marginally. The producer price index has risen from 49.2 to 50.5, finally crossing the confidence threshold for the first time since December 2013. The index has rebounded, and this implies that overcapacity has eased. However, whether or not this is sustainable needs to be followed closely.

October's recruitment index rose from 65.6 to 66.9 in October. This shows that while companies are experiencing recruitment trouble and payroll costs are on the rise, companies are still willing to hire and expand production. The investment index dropped significantly from 68.4 to 61.8, but taken with the recruitment index, indicates that companies still have clear investment intentions and are willing to recruit and are relatively optimistic about the next six months.

The CKGSB BCI samples companies for their industry competitiveness, and the higher the figure, the better off the firm considers itself when ranked alongside others in its industry. This month's index of 67 is lower than September's figure of 71.1, but still high on the scale. Overall, our sample considers it is performing better than average, so it should be noted that business conditions for most Chinese firms are likely tougher than the CKGSB BCI indicates.

Introduction to the BCI

In June 2011, CKGSB Case Center and Center for Economic Research initiated a project to gauge the business sentiment of executives about the macro-economic environment in China – called an index of business conditions.

Under the direction of Professor Li Wei, in July 2011, the two research centers designed and tested the BCI survey. In September 2011, the first surveys were distributed and results computed. Since May 2012, the research team has published monthly BCI survey reports.

The CKGSB Business Conditions Index (CKBCI) is a set of forward-looking, diffusion indices. The index takes 50 as its threshold, so an index value above 50 means that the variable that the index measures is expected to increase, while an index value below 50 means that the variable is expected to fall. The CKGSB BCI thus uses the same methodology as the PMI index.

Methodology

The survey asks senior executives of companies whether their main products are for consumers or non-consumers, and then asks how they think product prices will change in the next six months. Based on survey responses, we have been able to report expectant changes in consumer and producer prices.

We ask companies for information pertaining to their relative competitive positions in their respective industries. Based on survey responses, we compute a competitiveness index for our sample. The higher the competitiveness index, the more competitive our sample firms are in their respective industries.

Calculation

During each survey, respondents are asked to indicate whether certain aspects of their business (e.g., sales) are expected to increase, remain unchanged, or decrease over the forthcoming six months as compared to the same time period last year. The diffusion index is calculated by summing the percentage of "increase" responses and half of the "remain unchanged" responses.

Of all the indices measured for the CKGSB BCI, the overall business conditions index is an aggregate index, which has been calculated, since December 2012, by averaging its four constituent indices of sales, profit, financing environment and inventory. The aggregate BCI index before December 2012 uses a different composition of constituent indices, and is therefore not directly comparable to the current BCI index.



About Cheung Kong Graduate School of Business

Education for a New Era of Global Business

Established in Beijing in November, 2002 with generous support from the Li Ka Shing Foundation, CKGSB is a private, non-profit, independent educational institution and the only business school in China with faculty governance. The school offers innovative MBA, Finance MBA, Executive MBA and Executive Education programs. In addition to its main campus in the center of Beijing, it has campuses in Shanghai and Shenzhen and offices in Hong Kong, London and New York.

Thought Leaders on Business in China

CKGSB faculty, through their on-the-ground research and close relationships with leading domestic executives, provide global thought leadership on both the theory and the practical reality of real-life business in China. They consistently generate important insights into areas that are poorly understood outside of China, such as the globalization strategies of Chinese companies and competition and collaboration among state-owned enterprises, private businesses and multinationals.

World-Class Faculty with a Global Perspective

CKGSB is the only business school in China with the reputation and resources to attract faculty from top business schools such as Wharton, Stanford, NYU, and INSEAD. The majority of CKGSB faculty members were born and raised in China before leaving to study and teach abroad. Their bicultural backgrounds have endowed them with a valuable capacity to interpret global business in the context of both China and the West.

Disclaimer

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