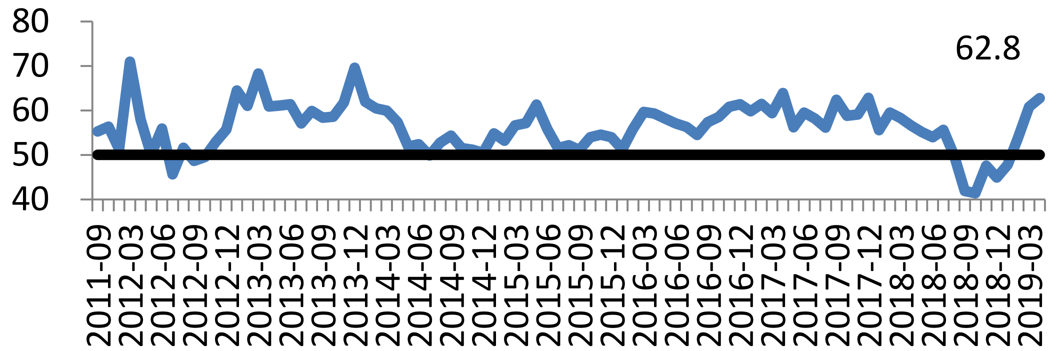
Commentary
CKGSB Business Conditions Index - April 2019
Professor Li Wei

The CKGSB Business Conditions Index continued to rise in April, albeit somewhat slower, reaching 62.8 (Figure 1).

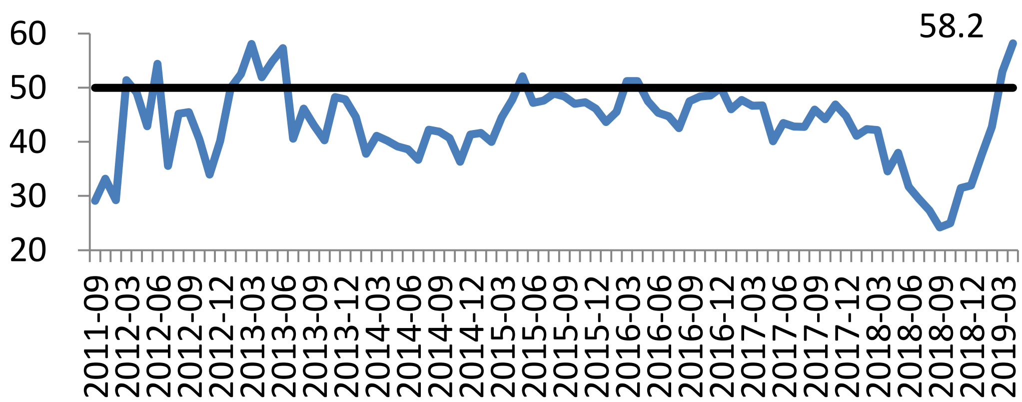
Figure 1 Business Conditions Index (BCI)



Source: CKGSB Case Center and Center for Economic Research

We should note that the important financing conditions sub-index continued to make rapid progress, now registering close to 60.0. This is higher than it has ever been since the survey began in 2012 (Figure 2). The huge impact of recent quantitative easing contrasts dramatically with figures from the first half of last year showing the painful effect of deleveraging on private enterprises in China.

Figure 2 Financing conditions index



Source: Wind

Apart from the main BCI, the forecast for labor cost and overall cost have fallen marginally. This is possibly the result of the government's recent introduction of tax breaks. Prices indices have risen as a result of brighter overall economic conditions, and related to that, investment and employment prospects are also looking up. For specific data, please see the main BCI report.

On 19 April, the CPPCC held a meeting at which top level party leaders expressed their renewed optimism in the economy. They insisted that “structural deleveraging would continue.” Indeed, while economic recovery continues, deleveraging remains absolutely essential. The Chinese economy was hit hard by the global financial crisis in 2008. The government responded by rapidly implementing economic stimulus of epic proportions aimed at redressing downward pressures on the economy. These measures enabled the Chinese economy to achieve a V-shaped rebound, which kickstarted growth elsewhere – something for which China can be proud. It has taken years for the full cost of these actions to be revealed. One of the most obvious impacts has been increased leverage. Although there is no consensus on exactly how high the level of leverage actually is, the Bank for International Settlements and the International Monetary Fund, and the research bodies of major multinational commercial banks agree that after 2008, Chinese debt rose too fast, to the extent that the overall ratio of leverage could no longer be ignored. Eventually, decision-makers in China became aware of what was happening and resolved to solve the ensuing problems. The government insisted it would never again implement this kind of “flooding” stimulus, and since 2017, has set about deleveraging as an important national economic goal. This shows how seriously deleveraging has been taken.

In light of current economic conditions however, deleveraging easily turned into a campaign against private enterprise, targeted at the leverage held by SMEs. In the process of deleveraging, banks and other financial institutions have severely curtailed loans to private enterprises. A large number of private enterprises have suffered liquidity crises and have been essentially starved of funds.

Whether looking at official or privately collated data, the evidence shows that private enterprises in China are far more efficient that state-owned enterprises. Despite this, it is private firms that have borne the brunt of deleveraging actions, impacting on resource allocation in China and reducing overall economic efficiency. It goes without saying that declining efficiency leads to declining output. As the academic community tends to use total debt to GDP to measure a country’s macro-economic leverage, the deleveraging policy has undoubtedly reduced total debt, but it has also put the brakes on GDP growth. In this way, deleveraging has been counterproductive. As debate heats up, some have called for a shift in focus beyond debt itself to efficiency. Inefficient companies need to deleverage and reduce debt. Efficient enterprises need funds and access to more. Money should be used to expand production in the most productive facets of the economy.

Officially, the message is now that private SMEs are being offered priority financing, which is as it should be. However, there are doubts about the realities behind this policy. From the perspective of efficiency, deleveraging should remove financing from inefficient enterprises. Many of these enterprises are state-owned and supported by the government, especially local government. These companies are often in a strong position in capital markets, with access to easy low-cost loans. Under such circumstances, how can structural deleveraging be implemented? If the current relationship between the government and state-owned enterprises is not reformed, there are only two ways to go about it. The first is, as before, to let private enterprises take the blame while reducing total debt, leaving resources allocation depleted, and the economy under downward pressure. The other is to open up to the private enterprise network, which risks making the deleveraging campaign meaningless. In the final analysis, more important than deleveraging is reform of state-owned enterprises. This is related to the future of the Chinese economy. Resistance is strong, but in order to achieve high-quality growth, this hurdle cannot be circumvented.

This is the author’s commentary on the CKGSB BCI report for April 2019. Do not hesitate to contact the BCI team by email as shown in the accompanying BCI data report.

CKGSB Professor Li Wei

April 24, 2019