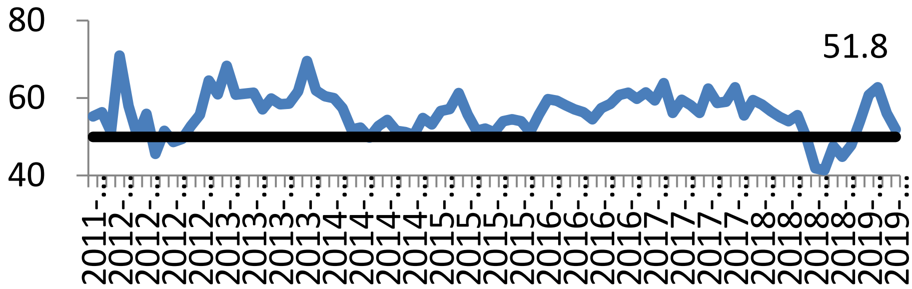
Commentary on the June 2019 CKGSB Business Conditions Index

Professor Li Wei

The CKGSB Business Conditions Index fell to 51.8 in June, a significant fall on last month's figure of 56.1 (Figure 1). As last month's BCI also fell significantly, we note that in recent months, the index resembles a steep mountain, climbing fast and dropping just as fast, with nothing to cushion the fall.

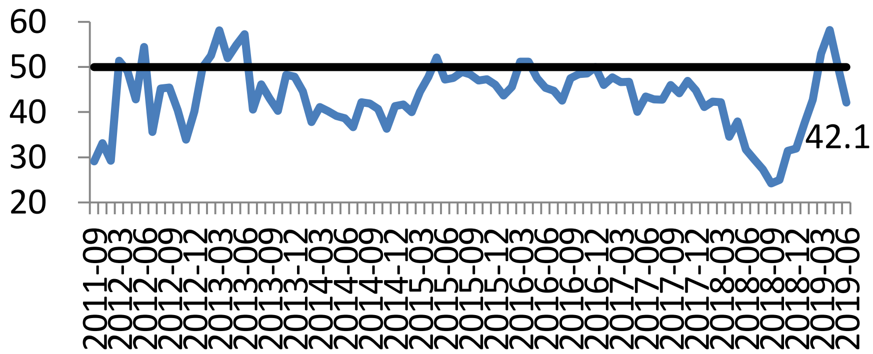
Figure 1 Business Conditions Index (BCI)



Source: CKGSB Case Center and Center for Economic Research

We should note that the financing sub-index fell to nearly 40.0 this month (Figure 2). In September last year, this sub-index had fallen to its lowest ever figure of 24.2. With a loosening of the national credit policy, financing options for our sample companies slowly improved. The indicator climbed to its highest historical value of 58.2 in April 2019. However, these good times were not meant to last. In just two months, financing conditions are back on the pessimistic side of the confidence threshold; a remarkable and rapid reverse in just a few months.

Figure 2 Financing conditions index



Source: CKGSB Case Center and Center for Economic Research

Apart from the main BCI and sub-indices, other forecasts have all seen changes this month. Cost indices have stayed stable, but financing, recruitment, consumer price and producer price forecasts have all dropped considerably. The overall impression is not positive. For specific data, please see the June BCI report.

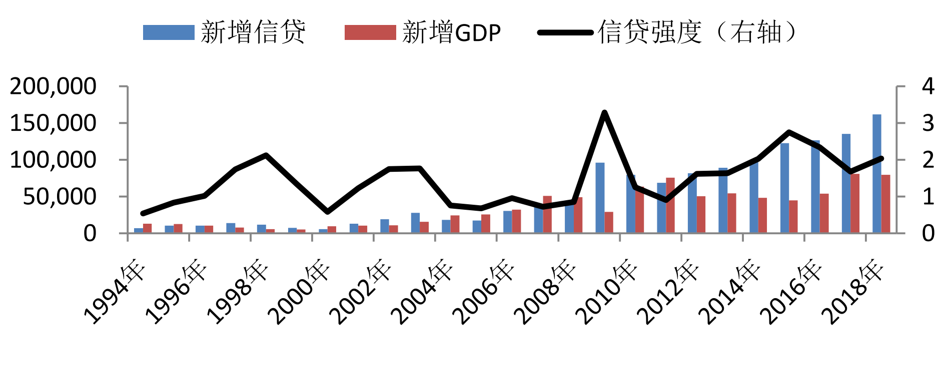
This month, the author will continue to explore how to deal with the weakening impact of national economic stimulus. Last month, this was discussed as a possibility, but this month it has become a real problem. The rapid deterioration of the BCI has left us no room for manoeuvre, which is something we did not think possible before.

This boils down to a question of government-market relations. After a long history of exploration, humankind has come to recognize the primacy of the market economy as a means of creating wealth. The national implementation of a market economy means that the market plays a decisive role in resource allocation. This is not to say that the market has no limitations, or there will not be market failures. For example, externalities may mean the market is unable to achieve optimal resource allocation. However, in most cases the market is effective. Failure is an exception, not the other way around. We can see from before and after China's 'Reform and Opening Up Policy' that planned economic model is a dead end. Under the planned economy, everyone works hard and no one gets rich. Reform and Opening Up and the market economy have boosted everyone's enthusiasm and creativity, and made it possible for miraculous high-speed growth to take place over the last 40 years - Long-term economic growth that has turned China from global outcast into the world's second largest economy (at current exchange rates). At purchasing power parity, China is already the world's largest economy.

This period is undoubtedly the longest period of continual economic growth a country has seen since the Industrial Revolution. According to data from Wind, excluding the price factor, China's 2018 GDP was 36.77 times higher than in 1978. Per capita GDP in 2018 was 25.25 times than in 1978. Compared with other countries, we will see similar results. World Bank data, adjusted to the current US dollar rate, records 2017 per capita GDP of China, the world and the United States of 8,827, 10,749 and 59,928 respectively. In 1978, the three figures were 156, 1999 and 10,587 respectively. The gap has clearly been greatly reduced.

Since the global economic crisis of 2008, the Chinese government has carried out several rounds of economic stimulus. Many of these have played a helpful role, such as making more credit available in 2009, enabling the Chinese economy to perform a V-shaped rebound in the context of the international financial crisis. They also helped other countries fight the impact of the financial crisis. However, the costs are heavy, with the biggest one being loss of efficiency (Figure 3). Moreover, the stimulus policy meant abandoning earlier real estate control policies, meaning housing prices have risen sharply, laying down many hidden dangers for future economic development.

Figure 3 Financing conditions



Note: New credit = blue bars; Increased GDP = red bars; Credit strength = black line

Source: Wind

We have again reached a crossroad. Insightful commentators have long called for structural reforms. However, in the past decade or so, the pace of reforms has faltered or ceased altogether. This phenomenon is by no means unique to China. Structural reforms are hard for any country, chiefly because as they involve redistribution of resources and may damage vested interests. Such reforms often face enormous resistance. Internationally and historically speaking, structural reforms are often the least popular, and most likely to peter out. In this, we should be clear.

They may be hard, so we cannot simply ignore the situation and relax. If the Chinese economy is to continue developing, we must find a way to improve efficiency, and structural reform is the best choice. In the past, economic stimulus was proposed every time there was a slowdown, giving just enough space for growth to return over time. This is not entirely unfeasible, but it is effectively just an expedient. The main meal cannot comprise of appetizers alone. These days there is decreasing space for such a practice. Our BCI forecasts have been propped up by macroeconomic policy and immediately squashed again. This all goes to show that paths taken before have become narrower, almost to the point of being implausible.

What can be done? The answer is hard yet simple. China should implement structural reforms, such as financial system reform, interest rate liberalization, and property tax as soon as possible. Finally, the author wants to remind readers that although structural reforms are tough, the situation will never be as bad as that facing people in 1978. At that time, China lacked money, talent, knowledge reserves and institutions. But with daringness, the Chinese people killed off the planned economy and achieved today’s economic miracle via market reforms. Thinking back to this, what reason do we have to be pessimistic or timid today? We just need a little courage and wisdom.

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

CKGSB Professor Li Wei

June 26, 2019