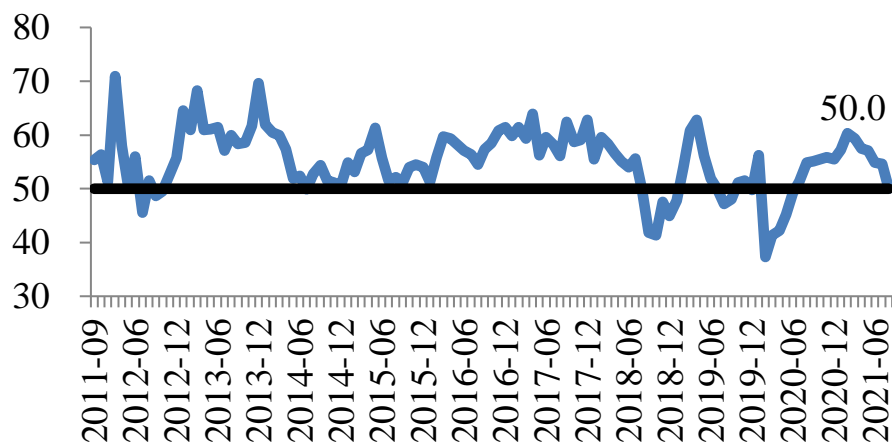


## Commentary on the August 2021 CKGSB Business Conditions Index

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The August reading of the CKGSB Business Conditions Index (BCI) dropped from 54.6 to 50.0, the point on the scale between confidence and concern (Figure 1).

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

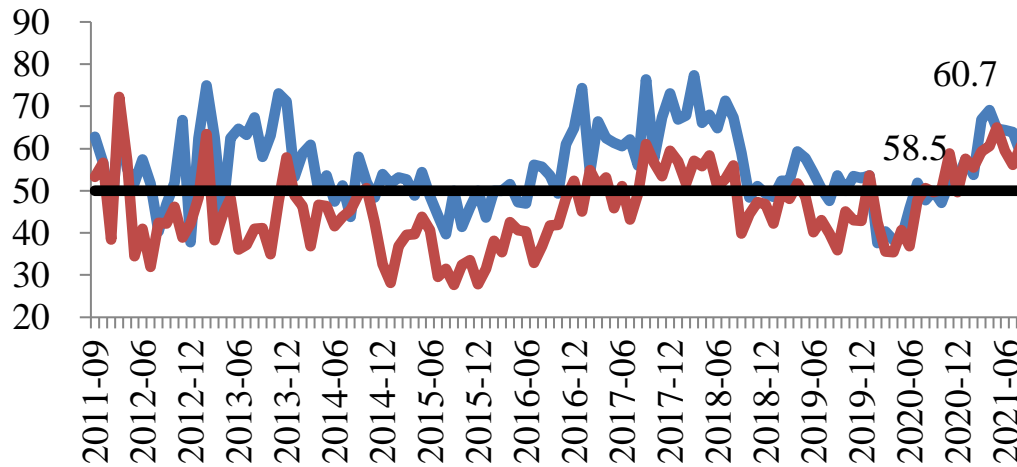


Source: CKGSB Case Center and Center for Economic Research

The first figure to note this month is the overall BCI itself. Since February 2021, the index has been on a six-month downward trajectory. Unlike the preceding upward period, the BCI now hovers on the confidence threshold of 50.0, indicating that future developments one way or another should be watched closely.

Looking at the BCI sub-indices, sales, profit, and financing prospects are all diminishing, with only the inventory index on the up. The profit index has fallen as much as 8.1 percentage points, slipping to 48.0, below the confidence threshold. Profit is the main indicator of the operational health of an enterprise. The core value of a modern company is to create profit for its shareholders. Given the current macroeconomic situation, an index showing poor corporate profit prospects should grab interest.

Another aspect of this month's BCI that is worthy of our attention is the price indices (Figure 2).

**Figure 2 Price Indices (BCI)**


Source: CKGSB Case Center and Center for Economic Research

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

From Figure 2, we can see that high inflation has begun easing off, allaying our concerns in this regard. This opens up the possibility of more monetary and fiscal policies to stimulate economic growth. When Covid-19 took hold at the end of 2019, the Chinese government took drastic measures to deal with the disease. The measures worked well, but at high cost, and with a correspondingly drastic impact on the economy. The year-on-year GDP growth rate in the first quarter of 2020 was negative 6.8%. After China's epidemic situation eased, the government took action to stimulate economic growth, giving the country a final GDP in 2020 of 2.3%, a very hard-to-beat achievement under the circumstances.

However, the price of excessive stimulus applied too fast was the possibility of inflation. The data shows that this risk was real. BCI price indices were on the rise from mid-2020 onwards, only recently dropping down. We can not say that China is completely free of the risk of inflation, but overall, this risk is now at a controllable level.

Aside from the main topic: Although our price indices have recently fallen, producer price prospects are up this month, above consumer price prospects. To a certain extent, a high producer price index comes from strong base commodity prices. China is the largest consumer of a wide range of international commodities. When China's economy is growing rapidly, these commodities have risen sharply in price, driving up the price of related domestic products. When the price of international commodities rises sharply, more people participate in this game, chasing higher prices, which will inflate commodity prices even more.

With commodities, China actually has a negative feedback effect tool at its disposal, namely the flexible RMB exchange rate. If the exchange rate were fully market-oriented, an increase in economic growth would bring about a higher exchange rate. With this, commodity prices would rise too, and the exchange rate will hedge against the pressure of such rising prices, thereby reducing

domestic inflationary pressures. When an economic growth rate falls, the exchange rate weakens and commodity prices fall. In the end, changes in the exchange rate reduce the impact of the prices of commodities on businesses, which is helpful in operational terms.

This is a commentary on the CKGSB BCI report for August 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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