Commentary on the February 2022 CKGSB Business Conditions Index

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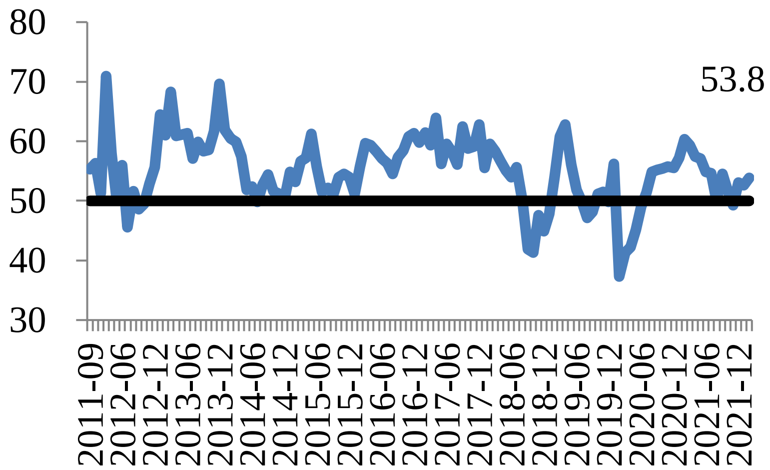
In the first month of the Year of the Tiger, the CKGSB Business Conditions Index (BCI) rose by a little, from 52.6 to 53.8, remaining above the confidence line of 50.0 (Figure 1). According to our sample comprising of successful business owners in China, company prospects remain positive for the next six months.

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



Source: CKGSB Case Center and Center for Economic Research

As the BCI and its related indices have not changed much this month, this commentary will focus on macroeconomics. First, we live in a debt-ridden world. It used to be that when we thought of debt, we thought of Japan. And while Japan, especially the Japanese government, has an unrivaled debt ratio, after the financial crisis of 2008, many countries including the United States, the European Union and China took on vast amounts of debt to stimulate economic growth in the face of crisis. Although the debt ratios of these countries are still lower than Japan's, rapid growth in debt has made them increasingly Japanese.

According to the Bank for International Settlements, as of the second quarter of 2021, the overall debt ratio of the United States, Japan and China was 286.2%, 416.5% and 284.7% respectively, while in the first quarter of 2007, these three indicators were only 222.9%, 304.3% and 143.4% respectively. Although China kept out of the financial crisis, its debt ratio has almost doubled, with the rate of increase much higher than that of the United States and Japan.

The Chinese people are not actually blind to China's debt problem. Regardless of the fact that the issue of local financing platforms is hotly discussed every once in a while, the market has recently focused on the issue of local implicit debt, showing that the debt issue has long been an important theme in people's minds. For some activists, the debt problem, especially at local government level, has become a “Sword of Damocles” over the Chinese economy.

There are largely two ways for China to curb its rising debt ratio: making the numerator smaller, that is, reducing the total debt, or to make the denominator larger, that is, increasing GDP. Real increases in GDP will only work through structural reform and improving economic efficiency. But structural reform is a very difficult thing, and it is not easy to achieve results in a short period of time. Therefore, it is particularly important to reduce total debt. There are many ways to reduce total debt, one of which is to reduce financing costs. China’s current year-on-year CPI growth rate is not high, which gives us some room for interest rate cuts.

However, from the perspective of the international economy, China's interest rate cut faces external constraints, the most important of which is the US monetary policy. In January 2022, the year-on-year CPI growth rate in the United States was as high as 7.5%, the highest in 40 years. Once the Fed begins to tighten monetary policy, U.S. interest rates will rise, which will put pressure on global interest rates.

Therein lies the problem with the RMB exchange rate. According to Mundell's impossible triangle, among the three policy objectives of autonomous monetary policy, fixed exchange rate and free capital flow, an economy can have two, but not all three at the same time. If the RMB is deeply bound to the U.S. dollar, then this is equivalent to China’s introduction of the Federal Reserve’s monetary policy, and when the United States implements a tightening monetary policy, China must follow it. Therefore, independent monetary policy is a crucial thing for China today, and cannot be ignored. Considering that the free flow of capital is an unstoppable trend, we can only abandon our fixed exchange rate and let the RMB float against the US dollar.

After the marketization of the RMB exchange rate, the impact of the Fed’s monetary policy on China will be greatly reduced. We can formulate our own monetary policy according to China’s own economic conditions, benefiting all corners of the economy.

This is a commentary on the CKGSB BCI report for February 2022 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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