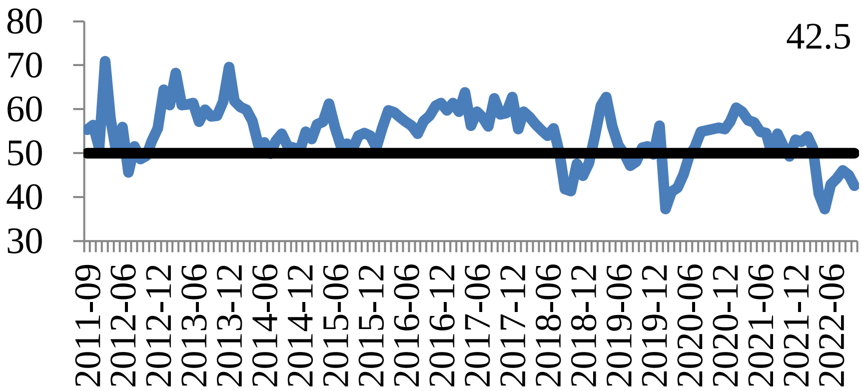
Commentary on the October 2022 CKGSB Business Conditions Index

Professor Li Wei

China's economy is in a particularly fragile state this month.

In October, the "CKGSB Business Conditions Index" (BCI) fell from 45.0 to 42.5, the second slide in two months, taking the index even further below the confidence threshold of 50.0.

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



Source: CKGSB Case Center and Center for Economic Research

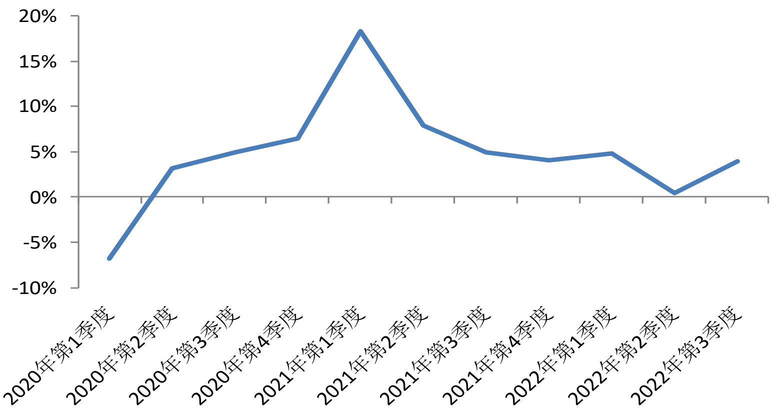
CKGSB's main BCI consists of four sub-indices for sales, profits, corporate financing and inventory that consider the upcoming six-month period in business among survey respondents. Of these sub-indices, only financing measures current conditions, while the others ask entrepreneurs for their expectations on how aspects of their business are expected to go in the half year to come.

For eleven years, we have calculated a total confidence index score on a monthly basis, and the lowest score we ever reached was 37.31, in February 2020. Understandably, this was when the first wave of Covid-19 hit Wuhan, paralyzing businesses and society nationwide. Since then, the BCI rose for nine consecutive months, before falling slightly in December 2020. The dip was followed by a positive trend reaching 60.3 in February 2022. China appeared, through the BCI, to have experienced a beautiful V-shaped Covid rebound.

However, the BCI then entered a period of fluctuation and doubt, mostly still above the confidence threshold of 50, and this ended in March 2022 with the last positive score: 51.3. In April 2022, the BCI sank to just 40.8, and in May 2022, we recorded the second-lowest overall index score since the survey began — minus 37.34. Subsequently, the BCI rose for 3 consecutive months, while remaining below 50. However, in September and October, the BCI has seen consecutive declines. Different from the strong rebound experienced in year one of the pandemic, this year's rebound has been extremely weak.

Government data is similar to ours. In 2020, the economic downturn due to Covid was brought under control due to strong government measures, bringing about an immediate rebound. The trend continued into the first quarter of 2021. Since then, the omicron variant of Covid has made the virus an ever-greater threat to a country determined to keep infections as near to zero as possible. Many cities had to implement harsh restrictions of free movement, "lockdowns," to stop its spread. China's GDP growth slid into the second quarter of 2022, rebounding in the third. Although the slide was controlled, the rebound remains vulnerable. Indeed, there is hardly any real economic rebound to speak of (Figure 2).

Figure 2 China's quarterly year-on-year growth rate from Q1 2020 to Q2 2022



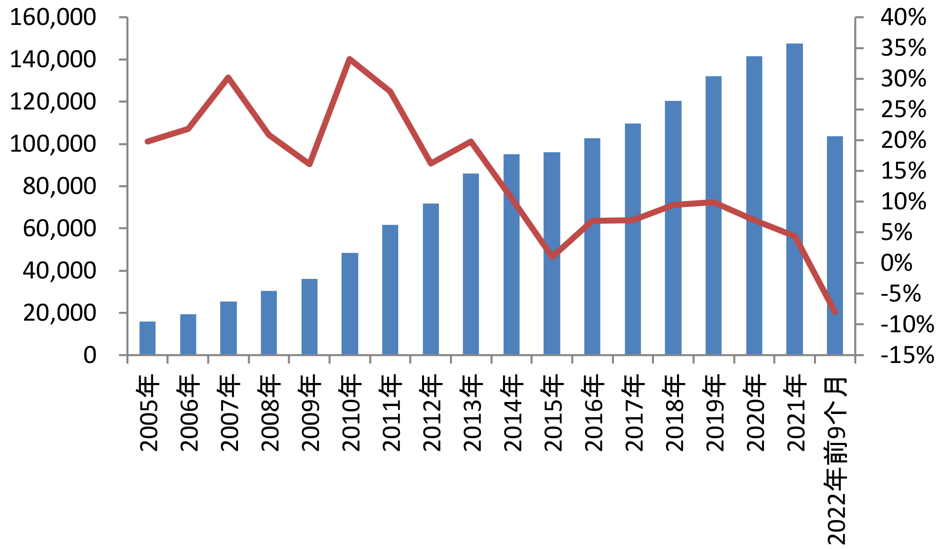
Note: Blue: GDP growth rate
Source: Public information

From Figure 2, when we take the past two and a half years into consideration, another factor at stake is the real estate industry. We use two data points from the main index to evaluate the influence of real estate on overall business confidence.

Since the highs of early 2021, GDP growth has done nothing but fall, and in the second quarter of 2022, indicators show a growth rate of just 0.4%. Observing the data over the past two and a half years, we find that the ups and downs of China's economy are explicitly connected to the course of the coronavirus, with sporadic outbreaks curbed with considerable intensity of effort and economic stifling. As with the negative growth rate in the first quarter of 2020, the downturn in the second quarter of 2022 is closely connected to deflated economic activity due to outbreaks of the omicron strain in China.

Aside from Covid-19, we cannot ignore the fact that economic growth has fallen in large part because the real estate industry is in deep trouble. About this, there is plenty of data to sift through. We pick two important aspects:

Figure 3 Investment in real estate

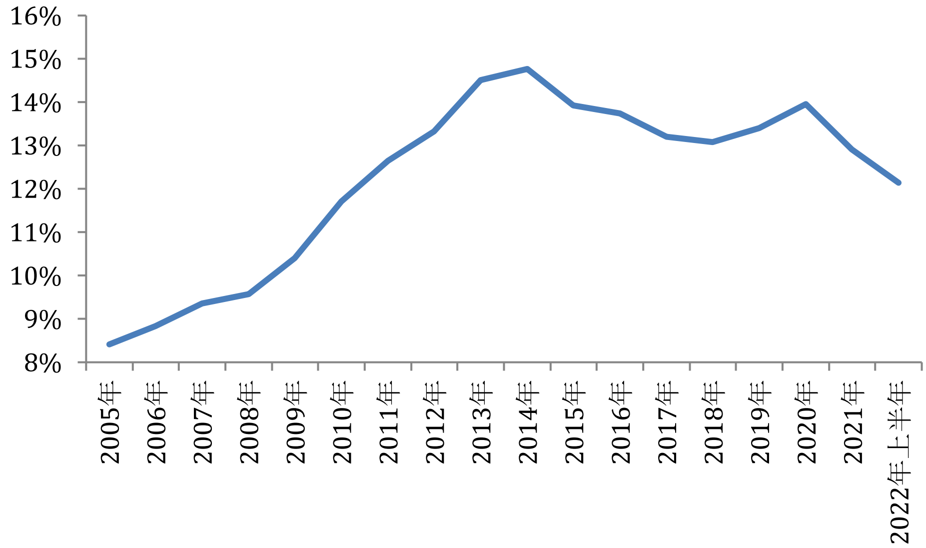


Blue: real estate investment (100 million yuan) on the left axis; Red: GDP growth rate (on the right axis)

Note: 2022 comparison is between the first nine months of 2022 and the first nine months of 2021

Source: CEIC

Figure 4 Investment in real estate/GDP growth rate



Source: CEIC

Figure 3 shows that the first eight months of 2022 bucks the trend of growing real estate investment every year since 2005. In the first eight months of 2022, year-on-year growth of real estate investment was negative 7.4%. Since 2015, the year-on-year growth rate of real estate investment can be characterized as an inverted U-shape.

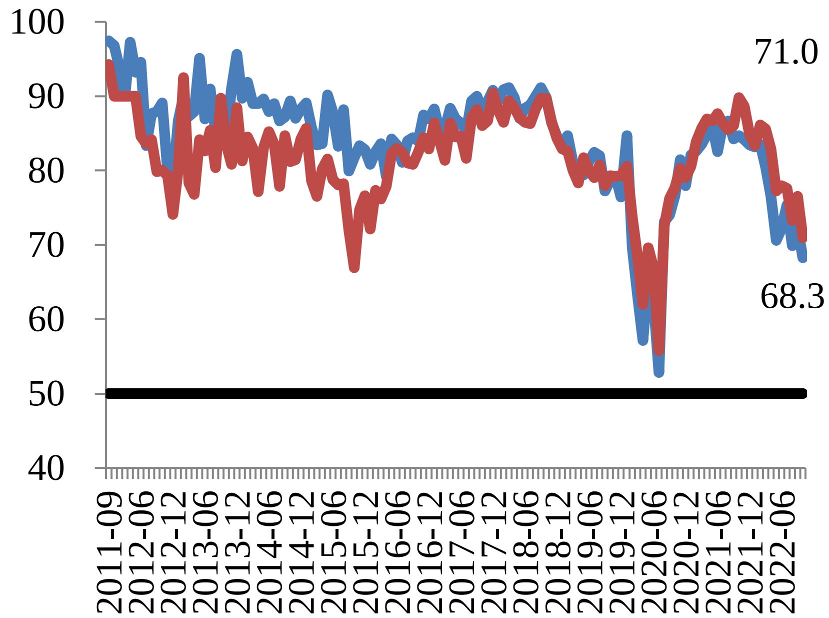
Figure 4 shows the contribution of real estate to the Chinese economy. According to the World Bank if upstream and downstream sectors like steel are added, the housing market's contribution to GDP would be as much as 30%, broadly speaking. This would make real estate a veritable pillar of the Chinese economy.

As we all know, China is an investment-driven economy. When investment loses momentum, the entire economy weakens, and this has a knock-on effect on employment.

As investment in the property market falls, transaction speed turns glacial, and housing prices drop, there has been a knock-on effect on the land market. Data from the Ministry of Finance shows that in the first nine months of 2022, revenue from selling state-owned land use rights was RMB 3,850.7 billion, down 28.3% compared with last year. The depressed land market is coupled by falling land prices. To stop this trend in its tracks, certain local authorities have started requesting that their state-owned enterprises bid for land. The Ministry of Finance recently issued a document ("Notice on Strengthening the Management of 'Three Public' Funds and Strictly Controlling General Expenditure"), stating that inflating land transfer income by this method is not allowed. This is an apparent acknowledgement that, as it stands, land market statistics are awash with overvalued sales by state-owned enterprises.

Let's consider the other indices that make up the BCI, starting with cost-end indices (Figure 5). At the beginning of the Covid pandemic, China's economy was hit hard. Not surprisingly, this reduced pressure on costs. For a long time, the cost-side index was hovering at a high level, showing how high the pressure of rising costs was for companies, and that overheating is a problem in the Chinese economy. However, in the past three years, this situation began to change. Outbreaks of Covid, and depression in the real estate market, pushed the entire Chinese economy into a quagmire. After bottoming out in mid-2020, the cost-side indexes came out in a near-perfect V-shaped rebound, but in the last year, these indexes fell into a marked decline again. There are many reasons for the reduction of cost pressures on companies, but the poor economic environment is prime among them. If the overall environment for doing business is poor, the pressure on enterprise operations increases, the number of new recruits drops, and the prices of various materials falls, reducing cost pressures. China's economy has long suffered from "getting expensive before becoming rich", meaning costs rose before China has been able to reach developed economy status. This has had a negative impact on China's economic competitiveness. Now the pressure on costs has fallen, not through structural reforms, but because of falling aggregate demand, a bad sign for the economy.

Figure 5 BCI Investment and recruitment indices

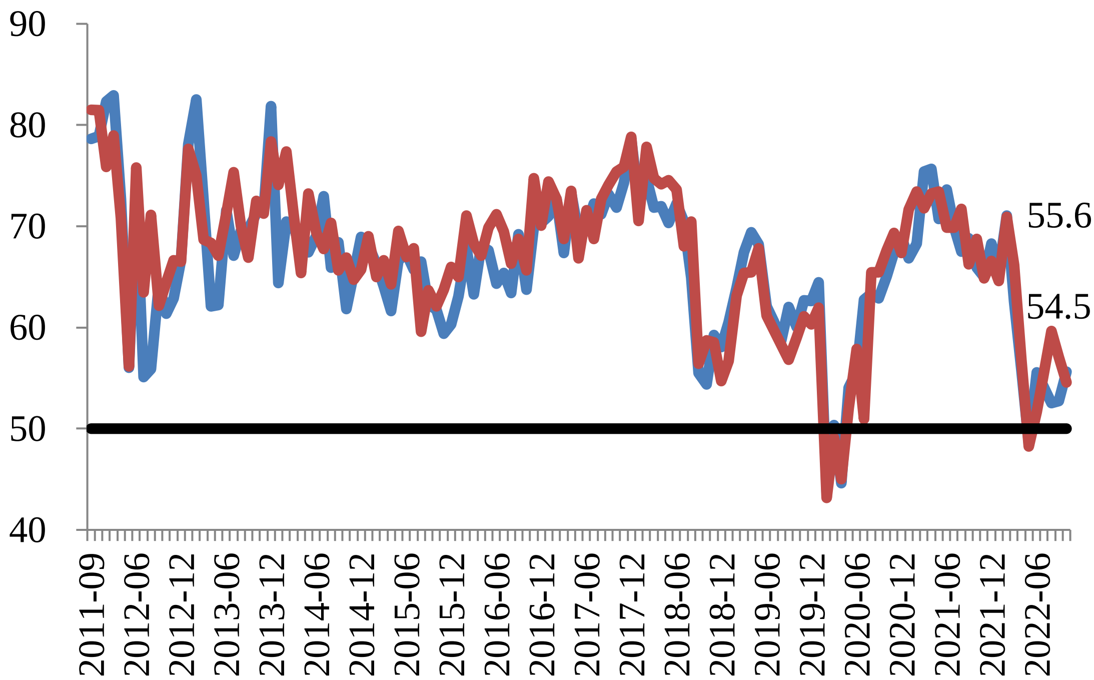


Note: Blue: corporate investment index; Red: recruitment index

Source: CKGSB Case Center and Center for Economic Research

Let's take a look at two other related indices, the Corporate Investment Prospective Index and the Corporate Recruitment Prospective Index (Figure 6).

Figure 6 BCI indices for sales and profit



Note: Blue: corporate sales index; Red: corporate profit index

Source: CKGSB Case Center and Center for Economic Research

Although the corporate investment index and corporate recruitment index were never as high as the costs index, they remained at a high level for a long time. This pattern also changed over the past three years. First, the impact of Covid brought them to a historic low, and back out in a V-shaped rebound. Then, in the past year and a half, the indices began a slow decline, even falling below 50 at one point. There are two factors behind this decline: the recurrence of Covid, and depression in the real estate market.

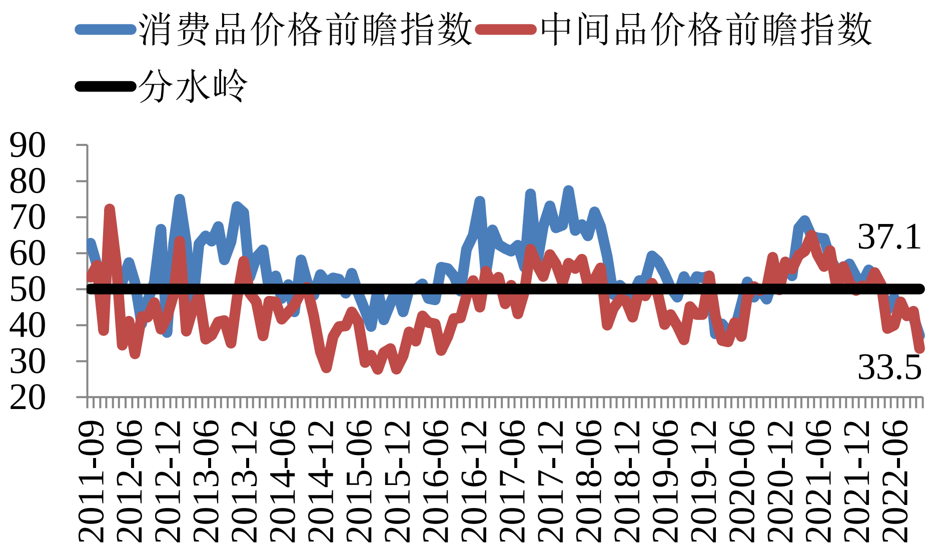
Both indexes are now hovering at low levels, suggesting that both companies' willingness to invest and their willingness to recruit new workers is sluggish. Our survey respondents are mainly small and medium-sized private enterprises, traditionally the most active enterprises in China's economy, as well as the biggest job creators. If they are unwilling to invest and recruit this reflects badly on the economy as a whole. Comparing these two indices with the costs end, we find that they are actually two sides of the same coin.

Most notable here is employment. The central government insists on maintaining strong employment figures because it the biggest factor affecting social stability. Employment is the highest priority for any country. Judging from official data, the current employment problem is not serious. For example, according to the National Bureau of Statistics, in the first three quarters of 2022, the average urban unemployment rate in the country was 5.6%, not a high rate. But it's worth noting that among 16- to 24-year-olds, surveyed unemployment has reached 17.9%, which is not a statistic to ignore.

A very important segment of this employment group is college graduates. In 2022, there will be 10.76 million college graduates, a yearly increase of about 1.67 million, and a record high. Combined with multiple internal and external shocks such as economic structural transformations, rising international political risks, and restrictions resulting from repeated outbreaks of Covid-19, employment pressure on fresh graduates has increased significantly. Originally, an increase in college grads means rising human capital, generally counted as a good thing. But when the economic structure does not match up and cannot provide work opportunities, it can become a burden. In this sense, any policy that may have a negative impact on employment, especially the employment of future college students, should be introduced with extreme caution.

Let's also take a look at price side figures (Figure 7).

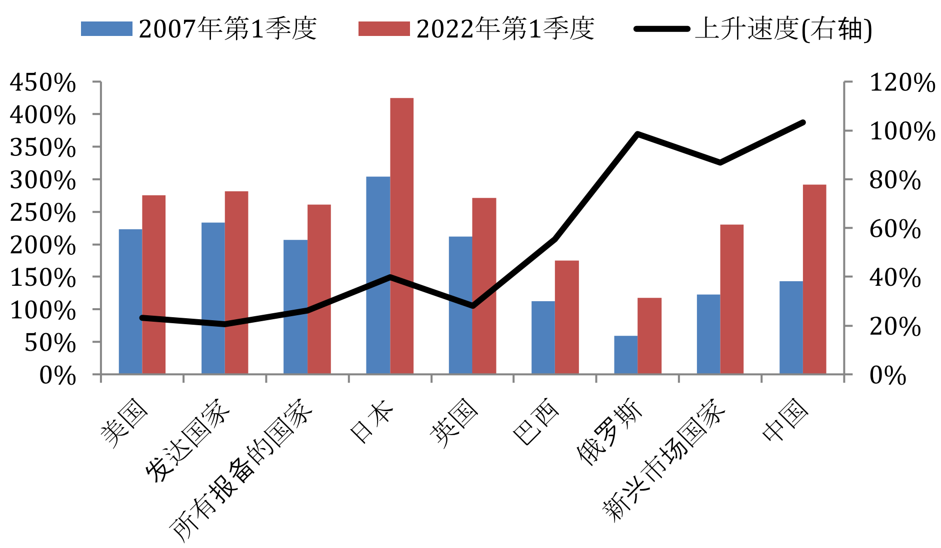
Figure 7



It is clear that the price-side index is very depressed recently, albeit not at an all-time low. The advantage of having a low-price index is that China has enough room to implement expansionary macro policies without having to take inflation into account. This is very different from the case of the United Kingdom and the United States, both of which are experiencing high inflation, giving them no room to implement expansionary monetary policies.

However, we note that China has a big problem: excessive debt (Figure 8). In the past when the economy was growing at a high rate, debt could be diluted by growth, but now the growth rate has fallen sharply, with year-on-year GDP growth in the first three quarters of this year only 3%, debt could become problematic if it continues to grow as before.

Figure 8



Note: 左轴数据为非金融部门债务总额占 GDP 的比例。从图中可以看出，中国的绝对比例不是最高的，但其上升速度是最快的。

Source: 资料来源：国际清算银行。

To summarize, the Chinese economy is in a relatively weak state. As total demand falls, there has also been considerable pressure on business operations. A series of indicators including the overall BCI, costs, prices, investment and recruitment are all operating at a low level, and the Chinese economy has entered a tough patch. The downturn in the BCI, investment and recruitment indicate that China needs to stimulate economic growth. The relatively low level of cost and price expectations offers a way to resolve this through spending, but the hidden danger of debt requires us to invest efficiently, or debt will become a big problem in the future. The government is likely to introduce more economic stimulus policies. We will wait and see their impact.

Finally, I would like to thank all the CKGSB alumni who have participated in this survey over the years. You have opened up a new window for us to understand the Chinese economy, or at least one part at a time, aiding us in finding a suitable angle from which to understand the complexities of the Chinese economy.

This is a commentary on the CKGSB BCI report for October 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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