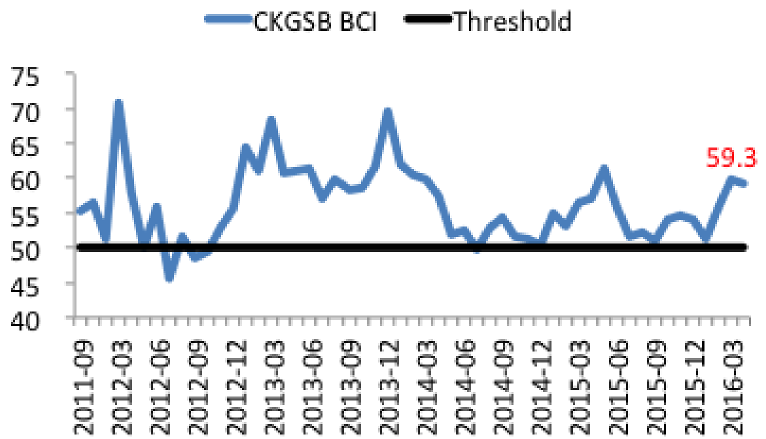
CKGSB BCI

April 2016

4 May 2016 CKGSB Case Center and Center for Economic Research

The CKGSB Business Conditions Index (BCI) registered 59.3 in April, falling slightly on March's overall index of 59.7 (Figure 1). This shows that for CKGSB's sample firms, of which the majority are relatively successful in China, the next six months are viewed with some optimism.

Figure 1



Source: CKGSB Case Center and Center for Economic Research

The CKGSB BCI comprises four sub-indices for corporate sales, corporate profits, corporate financing environment and inventory levels. Of these four sub-indices, three are forward-looking indicators, with only one, corporate financing, measuring current business sentiment. The April readings for these four sub-indices are discussed below.

Figure 2

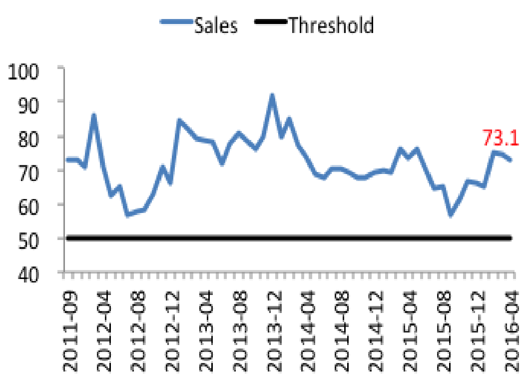
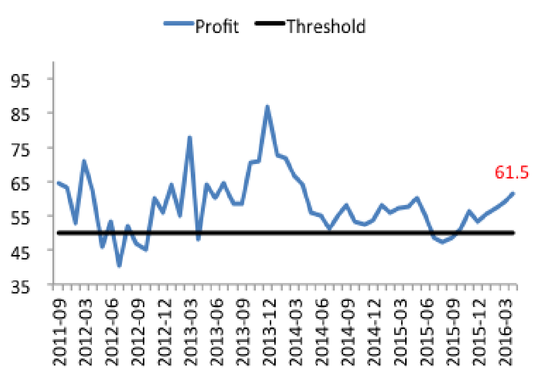


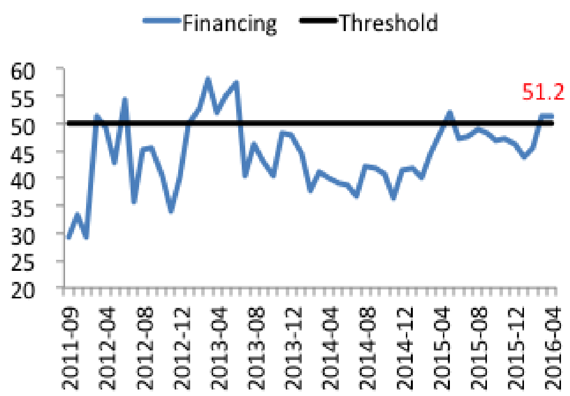
Figure 3



Source: CKGSB Case Center and Center for Economic Research

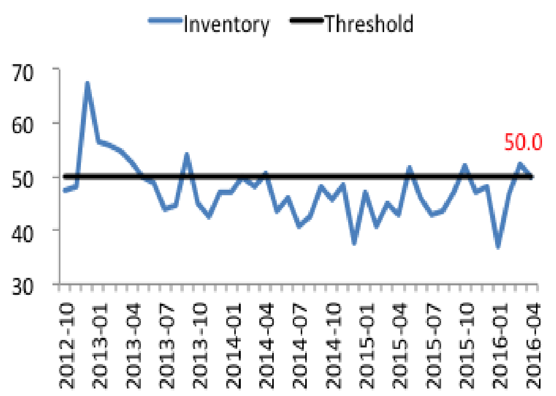
Of the four sub-indices, two fell, one stayed the same and one rose in April. We will proceed to address the data in detail. Starting with corporate sales, the sub-index fell slightly from 74.5 to 73.1. The profit index rose from 58.9 in March to 61.5 in April. With the sales forecast falling and profit forecast rising, this shows that cost expectations are improving.

Figure 4



Source: CKGSB Case Center and Center for Economic Research

Figure 5



Source: CKGSB Case Center and Center for Economic Research

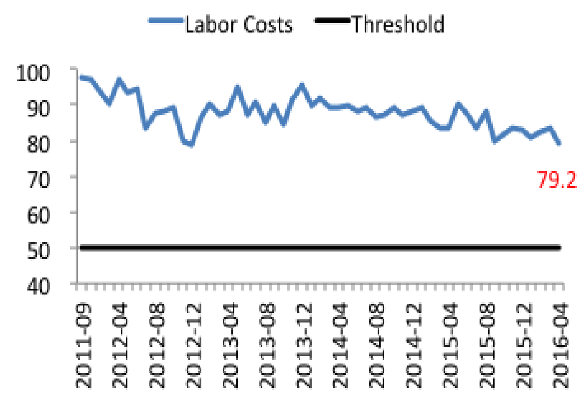
The financing index stayed the same in April at 51.2, above the confidence threshold for the second month. From Figure 4, we can see that the financing index has been below 50 over the long term, even falling below 30 in some months. This shows that the financing situation for Chinese companies is far from ideal. Companies face both financing difficulties and high costs. The BCI – and this reading in particular – predominantly reflects the situation for Chinese SMEs.

The financing index has continued to improve, and is now above 50, showing clear improvements in financing conditions for private SMEs in China. This sector is the most dynamic, but also the most vulnerable in the capital market. If more capital were to be made available to this group, their financing costs would fall, which would without a doubt benefit the Chinese economy as a whole. Whether or not the current upward trend in the index is sustainable remains to be seen.

The inventory index fell from 52.3 to 50.0 in April, back to the confidence threshold of 50. In May 2015, the index briefly rose to 51.7, crossing the confidence threshold, but it quickly fell again, and in October dropped under 50, remaining in the doldrums in November and December. Regarding inventory, we are most concerned with whether the current level is sustainable. How this will play out, we have to wait and see. But one thing is certain: from the data we have collected over the long term, the inventory situation is far from positive.

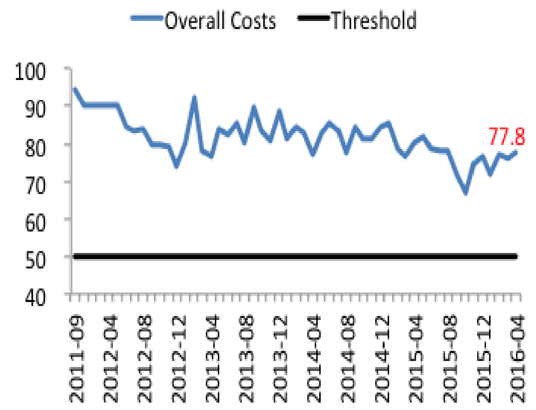
Apart from the main BCI, we have compiled statistics on costs, prices, investment and recruitment forecasts. Let us consider these sub-indices in turn, beginning with costs:

Figure 6



Source: CKGSB Case Center and Center for Economic Research

Figure 7

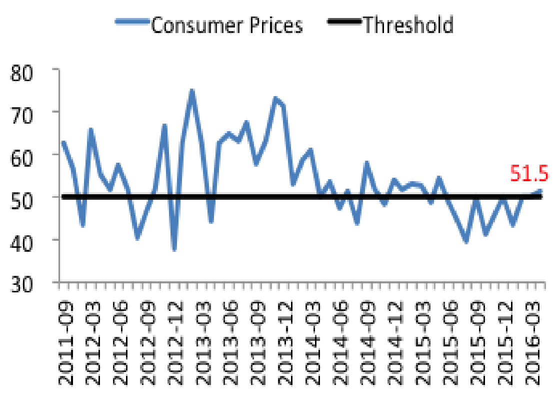


Source: CKGSB Case Center and Center for Economic Research

This month, the labor costs index fell from 83.6 to 79.2, while overall costs rose from 76.2 to 77.8. From Figure 6 we know that, from September 2011 when this survey began, labor costs have been high, only once previously falling below 80 (79.9 in September 2015). This month is therefore the lowest recorded labor costs figure. The fact that labor costs have remained at a high level over the long term indicates two things: firstly that high labor cost levels in China are structural rather than cyclical. Secondly, after 2015, company leaders' expectations regarding costs have fallen somewhat. This is only a tentative explanation, and how this will play out and what it means will need further investigation.

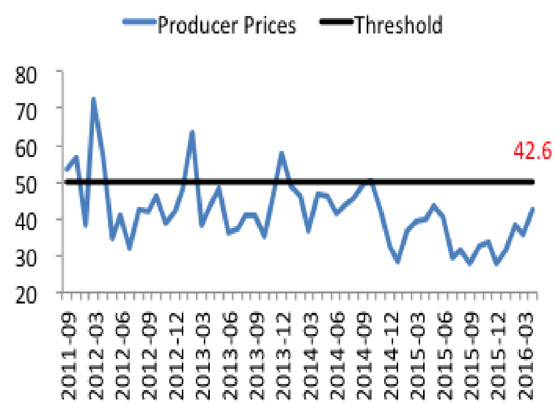
Overall costs have rebounded slightly, indicating that other factors of production other than labor costs are rising. Price hikes, especially for producer prices, are likely to be responsible. On the prices side, the consumer prices index rose slightly this month to 51.5. Producer prices also rose, from 35.5 to 42.6.

Figure 8



Source: CKGSB Case Center and Center for Economic Research

Figure 9



Source: CKGSB Case Center and Center for Economic Research

From our data, the "high costs, low prices" combination means that companies cannot increase prices to consumers or downstream producers to steer their way out of cost pressures. We believe this reflects one of the biggest structural problems facing the Chinese economy – manufacturing overcapacity. This does not indicate that Chinese people are now so well off that they do not need as many goods or services. On the contrary, for a middle income country, China's domestic demand is astonishing, but there are countless sectors in dire need of investment, including healthcare, education and pensions. Overcapacity is a result of misallocation of resources, placing resources in low-return sectors such as the steel industry.

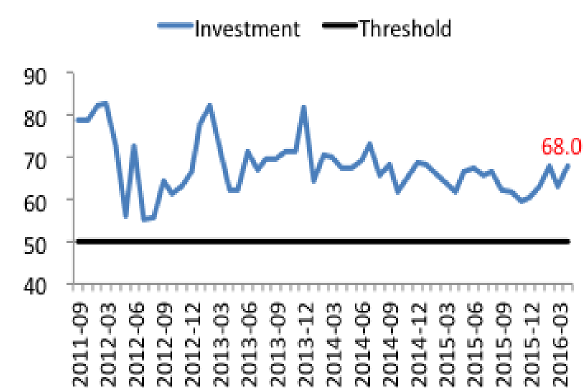
Overcapacity means we need to carry out economic structural reforms, allowing the market to guide an outflow of resources that has become stagnated, and configure a way to put valuable resources to better use. In the short term, such reform may trigger a greater slowdown with rising unemployment likely to damage vested interests, and this causes resistance to such a plan. However, for the long-term health of the Chinese economy, this is an unavoidable step.

The CPC Central Committee has a clear perspective on this, and has promoted its views publicly. In the Central Economic Work Conference held at the end of 2015, the Central Committee made clear the importance of tough structural reforms in economic and social development in 2016. Five key areas were highlighted, namely: production overcapacity, inventory levels, leverage, efforts to reduce costs and making up for systemic shortcomings. Mentioned first in this list of government tasks, it seems that the central authorities are well aware of the issue of production overcapacity.

However, the CPC Central Committee faces a real problem if it chooses to use the same old way to maintain growth. Although there are many opinions about how to balance growth with structural adjustments, the last few years' experience show that without institutional reform, government investment will only encourage growth in the real estate sector. This is contrary to the goals of structural reform. Driven by the current policy, the real estate sector has gained new life, and steel prices have climbed. Forecasts for producer prices have risen just as expected. However, our problem is, in such circumstances, should we produce to capacity or not? And if we decide to, how to go about it?

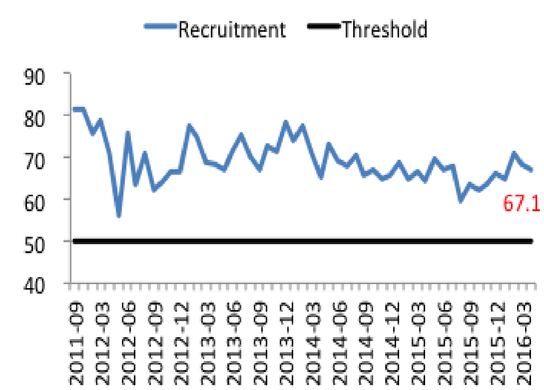
Following the discussion of costs and prices, investment and recruitment will be considered. The corporate investment index rose from 63.3 to 68.0, in line with the recent upward trend. The labor demand index fell marginally from 68.3 to 67.1. These two indices are interesting, as since September 2011, while other indices have fluctuated significantly including profit and inventory and the overall BCI, these two and the costs index have remained consistent.

Figure 10



Source: CKGSB Case Center and Center for Economic Research

Figure 11



Source: CKGSB Case Center and Center for Economic Research

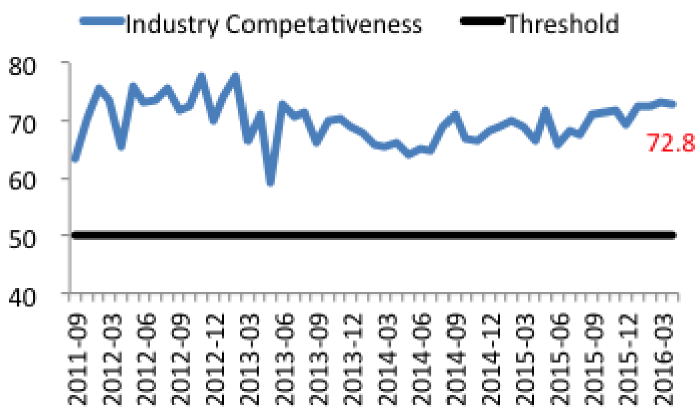
The investment index and labor index have both been above 50 over the long term, and comparatively high at that. Taking investment as an example, since September 2011, the index has been between 50 and 60 four times, and the rest of the time above 60, and above 80 on four occasions. The labor demand index has only been between 50 and 60 twice, and above 60 for the rest of the time, twice registering above 80.

While sales are still good, cost pressures are mounting, long-term poor financing conditions exist and prices and profit performance are weak. But what is most interesting is that firms are still in expansionary mode, ploughing more money into investment and recruitment. With such poor short-term business expectations, why are businesses making such counter-cyclical decisions?

Perhaps, for good quality companies, a time of adversity is indeed the right opportunity to expand. But there is another possibility, that for companies "expansion is the only way" sums up how industries such as real estate, and the related sectors of steel, glass and cement, feel under the government's favorable policies. Whenever there is an economic downturn, the government applies the logic it first used in 2009 and then again more recently, leading companies to expect an expansionary period following a contraction. From this perspective, reverse-cycle business operations make sense. But what about for the economy as a whole?

Finally, the BCI is generated wholly on the basis of statistics gathered from leading enterprises whose executives have studied, or are studying, at Cheung Kong Graduate School of Business (CKGSB). In the questionnaire, we ask respondents to indicate whether their firm is more, the same, or less, competitive that the industry average (50), and from this we derive a sample competitiveness index. Consequently, as our sample firms are in a relatively strong competitive position in their respective industries (Figure 12, a reading of 72.8 in April), the CKGSB BCI indices are higher than government and industry PMI indices and the conditions for most companies are even more difficult.

Figure 12



Source: CKGSB Case Center and Center for Economic Research

CKGSB BCI Introduction

In June 2011, the CKGSB Case Center and the Center for Economic Research initiated a project to gauge the business sentiment of executives about the macro-economic environment in China – called an index of business conditions.

Under the direction of Professor Li Wei, in July 2011, the two research centers designed and tested the BCI survey. In September 2011, the first surveys were distributed and results computed. From May 2012 until today, the research team has published monthly BCI survey reports.

Explanation of the Index

The CKGSB Business Conditions Index (CKBCI) is a set of forward-looking, diffusion indices. The index takes 50 as its threshold, so an index value above 50 means that the variable that the index measures is expected to increase, while an index value below 50 means that the variable is expected to fall. The CKGSB BCI thus uses the same methodology as the PMI index.

The survey asks senior executives of companies whether their main products are for consumers or non-consumers, and then asks how they think product prices will change in the next six months. Based on survey responses, we have been able to report expectant changes in consumer and producer prices.

We ask companies for information pertaining to their relative competitive positions in their respective industries. Based on survey responses, we compute a competitiveness index for our sample. The higher the competitiveness index, the more competitive our sample firms are in their respective industries.

Method of Calculation

During each survey, respondents are asked to indicate whether certain aspects of their business (e.g., sales) are expected to increase, remain unchanged, or decrease over the forthcoming six months as compared to the same time period last year. The diffusion index is calculated by summing the percentage of "increase" responses and half of the “remain unchanged” responses.

Of all the indices measured for the CKGSB BCI, the overall business conditions index is an aggregate index, which has been calculated, since December 2012, by averaging its four constituent indices of sales, profit, financing environment and inventory. The aggregate BCI index before December 2012 uses a different composition of constituent indices, and is therefore not directly comparable to the current BCI index.

About Cheung Kong Graduate School of Business

Education for a New Era of Global Business
Established in Beijing in November, 2002 with generous support from the Li Ka Shing Foundation, CKGSB is a private, non-profit, independent educational institution and the only business school in China with faculty governance. The school offers innovative MBA, Finance MBA, Executive MBA and Executive Education programs. In addition to its main campus in the center of Beijing, it has campuses in Shanghai and Shenzhen and offices in Hong Kong, London and New York.

Thought Leaders on Business in China

CKGSB faculty, through their on-the-ground research and close relationships with leading domestic executives, provide global thought leadership on both the theory and the practical reality of real-life business in China. They consistently generate important insights into areas that are poorly understood outside of China, such as the globalization strategies of Chinese companies and competition and collaboration among state-owned enterprises, private businesses and multinationals.

World-Class Faculty with a Global Perspective

CKGSB is the only business school in China with the reputation and resources to attract faculty from top business schools such as Wharton, Stanford, NYU, and INSEAD. The majority of CKGSB faculty members were born and raised in China before leaving to study and teach abroad. Their bicultural backgrounds have endowed them with a valuable capacity to interpret global business in the context of both China and the West.

The Research Team

LI Wei - CKGSB Economics Professor; Director, CKGSB Case Center and Center for Economic Research
+86 10 8518 8858 ext. 3235 wli@ckgsb.edu.cn
GU Chongqing - Senior Researcher, CKGSB Case Center and Center for Economic Research
+86 10 8518 8858 ext. 3336 cqgu@ckgsb.edu.cn
LIU Xiaoting - Researcher, CKGSB Case Center and Center for Economic Research
+86 10 8537 8461 xtliu@ckgsb.edu.cn

Disclaimer