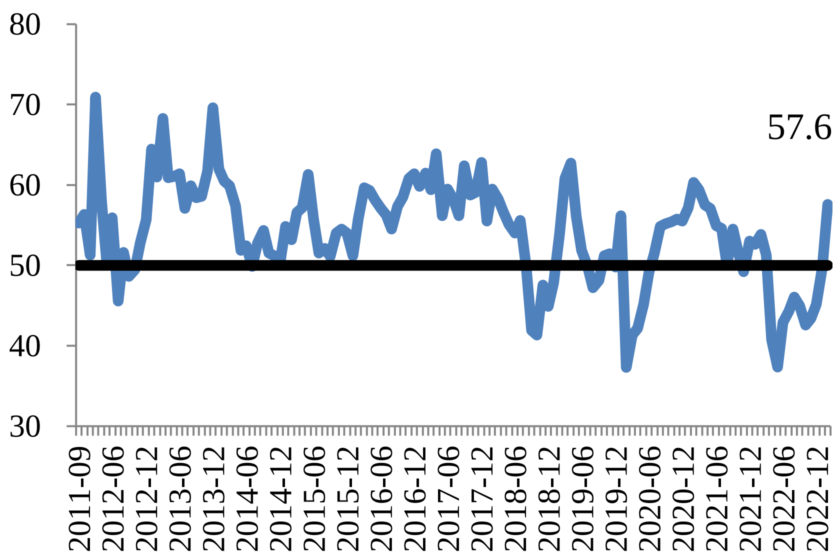
Strong rebound! CKGSB's monthly business confidence index shows all-round economic recovery in China

Commentary for the CKGSB Business Conditions Index

By Li Wei

In February, all four sub-indices of the CKGSB BCI rose, something that has rarely happened in the 12 years in which we have conducted our monthly study. Many of the indicators, including the main index, have risen sharply. If the recovery goes on like this, China's economic results this year will be worth the wait.

Figure 1 Overall Business Conditions Index



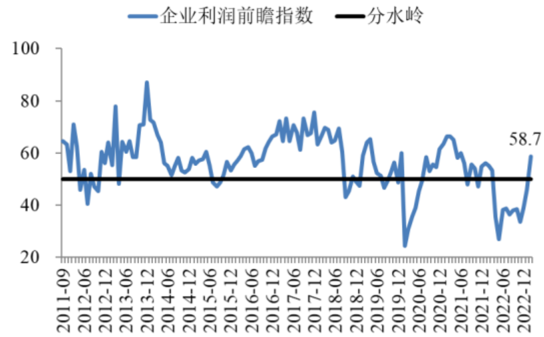
The BCI's four sub-indices are corporate sales, profit, financing environment and inventory. Three of the four are forward-looking indexes, while the financing environment index measures the current situation.

These sub-indices have all risen this month. The sales outlook rose sharply this month, from 59.9 last month to 73.1 this month (Figure 2). Profit prospects also registered a steep incline, landing at 58.7 this month compared with 45.9 last month (Figure 3).

The financing environment index lifted from 49.5 to 54.3 in February (Figure 4). Optimism regarding financing crossed the confidence threshold of 50.0. As for inventory, our survey respondents reported an improvement in warehousing that saw the index rise from 44.0 to 45.1, albeit remaining below the confidence mark, the only subindex to do so this month (Figure 5).

Figure 1 **Figure 2**

Source: CKGSB Case Center and Center for Economic Research

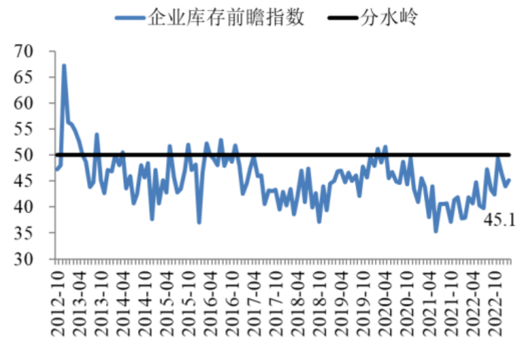


Source: CKGSB Case Center and Center for Economic Research

Figure 3

Source: CKGSB Case Center and Center for Economic Research

Figure 4



Source: CKGSB Case Center and Center for Economic Research

A positive figure for the four subindices means different things: if sales, profit, and financing scores rise, this means the situation is improving, and when they fall, the situation is worsening. As for inventory, a rise means goods in stock are reducing in quantity, while a fall means stock is building up.

In addition to the main BCI, we also asked companies for their expectations regarding costs, prices, investment and recruitment, to build a more comprehensive picture of the economy in addition to the main BCI statistics.

In terms of costs—

Figure 5

Figure 6

Source: CKGSB Case Center and Center for Economic Research

Source: CKGSB Case Center and Center for Economic Research

This month's rise in labor cost expectations means that more companies believe they will be paying more to employ people in the next six months, a prediction that impacts on business operations and is felt in overall cost calculations too. However, this could be a sign that as the economy picks up, companies have more demand for labor and expect costs to rise because of increased business activity. From this perspective, an index rise on the cost side might suggest better economic results are coming. For specific data, see Figures 6 and 7.

In terms of prices—

The index registering consumer prices rose significantly this month, from 44.0 last month to 51.7 (Figure 8). The index showing producer goods price expectations also rose sharply this month, from 34.4 last month to 44.2 (Figure 9).

Figure 7

Source: CKGSB Case Center and Center for Economic Research

Figure 8

Source: CKGSB Case Center and Center for Economic Research

In terms of investment and recruitment—

Investment and recruitment indices were high for a long time, but more recently sank into the doldrums. From this weak base, they both rose significantly in February, and since the Chinese economy is largely investment-driven, and investment is strongly tied to recruitment, this suggests that the Chinese economy is on the mend.

In addition, investment prognoses are higher compared with the same period last year, and a rise in the company recruitment score means more hiring will likely go on than in the same period last year. As these two indicators show whether the enterprise expects to expand or not, they are promising figures. The forward-looking index for investment rose sharply this month, to 63.0 this month from 53.6 last month (Figure 10). The forward-looking index for employment rose significantly too, to 61.6 this month, from 56.0 last month. (Figure 11)

图表 9

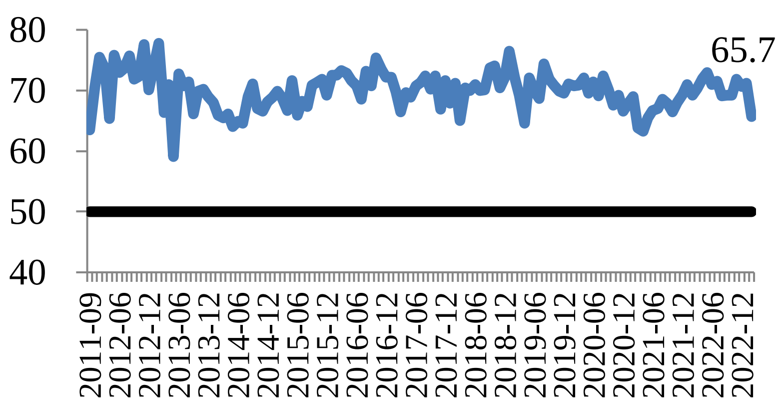
Source: CKGSB Case Center and Center for Economic Research

图表 10

Source: CKGSB Case Center and Center for Economic Research

The BCI team collected and collated completed surveys from representatives of more than 200 Chinese private enterprises in February. The results of the company competitiveness question show that respondents answer for some of the best companies in their industry. (Figure 12). In short, our sample comprises outstanding private Chinese SMEs.

Figure 11 Company Competitiveness



Source: CKGSB Case Center and Center for Economic Research

Behind the strong rebound shown in this month's BCI lurk unresolved structural issues

Why have the BCI and similar indices shown such a big improvement in such a short period of time? The author agrees with most commentators that at the bottom of this seemingly remarkable economic recovery lie two factors: the dropping of "Zero Covid" rules, and changes in real estate-related policies.

The rapid recovery of China's economy reflects its resilience, but we still have to confront structural problems that are in need of urgent resolution.

According to the expenditure method classification, Gross Domestic Product (GDP) is made up of household consumption, government consumption, capital formation (the sum of fixed asset investment and inventory adjustment, of which investment accounts for the vast majority) and net exports (exports minus imports).

These concepts help us talk about GDP growth. When aggregate demand is flagging, we focus on stimulating consumption, investment and exports. Since consumption in China, especially household consumption, has never been strong, and net exports are easily affected by global macroeconomics, investment is China's main lever to regulate economic growth.

There are two areas with the largest proportion of Chinese investment: real estate and infrastructure. Once the current real estate policies are reversed, investment in related sectors will naturally recover. In terms of infrastructure investment, as long as project approvals are relaxed and financial support is increased, investment growth will return.

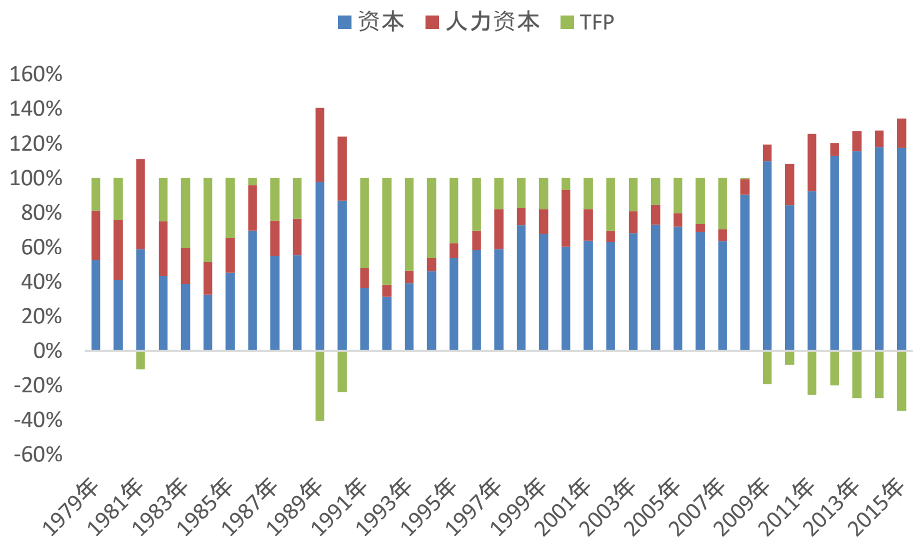
However, there is a problem with analyzing GDP from the perspective of expenditure: it measures short-term more than long-term economic growth. In the long run, GDP growth mainly comes from three aspects: the first is an increase in capital investment, the second, human resources. The third is Total Factor Productivity (TFP). The impact of an increase in capital and human resources on GDP is well understood, but the difficulty lies in TFP.

TFP refers to improved efficiency brought about by technological progress. This means not only specific developments, but also institutional improvements. TFP is, by definition, a concept of residual value. In other words, economic growth that cannot be attributed to capital investment and human resources investment is growth brought about by TFP. In fact, it is not difficult to understand, that when an economy continues to grow when its capital investment and human capital investment remain the same, then this can only be due to efficiency, and this improvement is known in academia as TFP-driven growth.

Generally speaking, there are three sources of TFP growth. One is the efficiency improvement brought about by the adoption of new technology or equipment. Another is the transfer of labor from low-value-added industries to high-value-added industries, such as when farmers move to the cities as migrant workers, shifting from primary industry employment to secondary and tertiary industry employment. The third is the transfer of resources from low-efficiency enterprises in an industry to high-efficiency enterprises. Economists have researched their way to an important conclusion: that an economy can achieve economic growth by increasing investment in capital and human capital in the short term, but to achieve long-term economic growth, it relies on the growth of TFP.

So, how has China's TFP measured up to economic development since the beginning of reform and opening up. According to research by Professor Wei Shangjin of Columbia University, the sources of China's economic growth from 1979 to 2015[1] are as follows (Figure 13):

Figure 12



Notes: Blue: Capital; Red: Human Resources; Green: TFP
Source: Shangjin Wei et al., 2017

According to Figure 13, before 2009, China had three negative TFP years. TFP was highest in 1992, as Deng Xiaoping's "Southern Tour" sparked an upsurge in economic activity. Indisputably, China achieved leapfrog development in the past few decades, thanks to reform and opening up, as the policy environment went through enormous changes. Resources shifted from relatively inefficient enterprises to more efficient enterprises, which greatly improved China's TFP score.

It is worth noting that from 2009 to 2015 (the last year for which data is available), China's TFP was negative, and economic growth came predominantly from capital investment. Although the Chinese economy achieved relatively high growth rates after 2008, the decline in TFP is noteworthy.

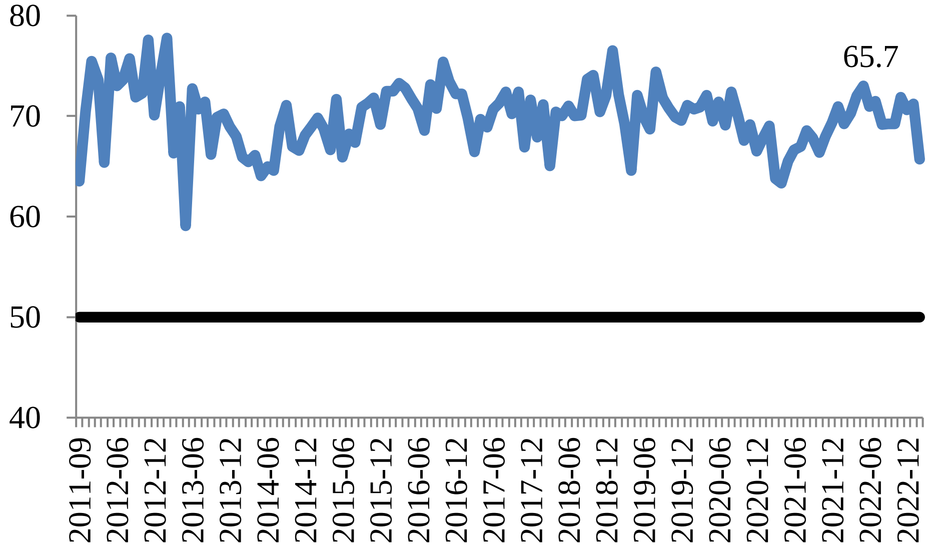
Why did China's TFP growth generally perform well before 2009?

The author believes that it mainly comes from the following four points: first, the relaxation of

[1] [1] Shangjin Wei et al., From "Made in China" to "Innovated in China": Necessity, Prospect, and Challenges, Journal of Economic Perspectives—Volume 31, Number 1—Winter 2017—49–70pp

control on rural residents, allowing them to work in cities; second, the reform of state-owned enterprises; third, opening up to the outside world; and fourthly allowing the development of the private sector. With the development of private enterprises, the efficiency of the entire economy improved, absorbing more people into the labor force.

Figure 14 Company Competitivity

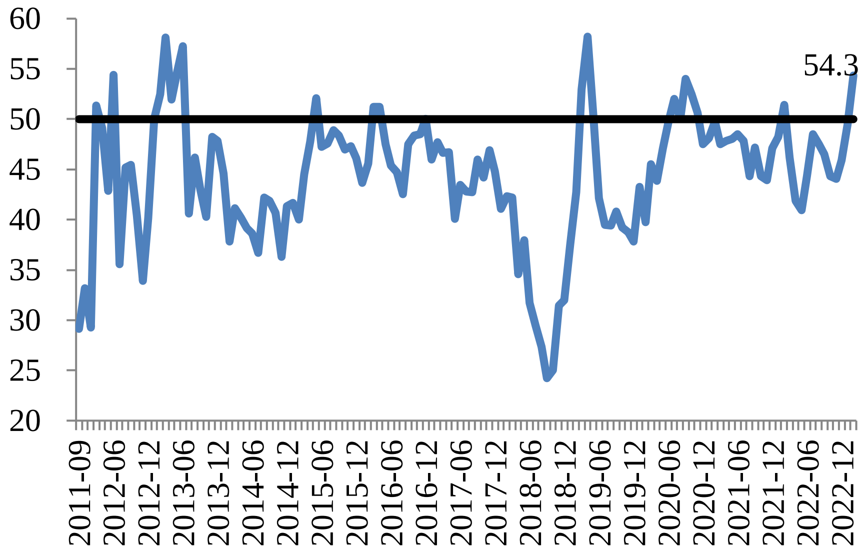


Note: statistics up until February 2023
Source: Case Center and Center for Economic Research

Take the BCI data for example. CKGSB's corporate competitiveness index has been tracking China's private economy for 12 years (Figure 14). The enterprise competitiveness index measures the difference between the average quality of the enterprise in the industry and the overall enterprise. The higher the index, the better the quality of the enterprise. It can be clearly seen from Figure 14 that no matter how the economic environment changes, the competitiveness index of these private enterprises interviewed has been at a high level for a long time, which means that they are generally a group of high-quality enterprises. These should get more resources.

However, the financing index (Figure 15) shows that the surveyed companies still have trouble getting the funding they need to grow. Better quality companies are faced with financing difficulties and high costs, meaning that resources have not completely flowed from inefficient enterprises to high-efficiency enterprises.

Figure 15 Financing conditions



Note: statistics up until February 2023

Source: Case Center and Center for Economic Research

Although the rapid recovery of the economy is gratifying, there is still a long way to go to solve many of these structural problems. The purpose of regulating short-term economic growth is to create a favorable environment for further reform and opening up. The best way to reform is to plan ahead.

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