

CKGSB BCI

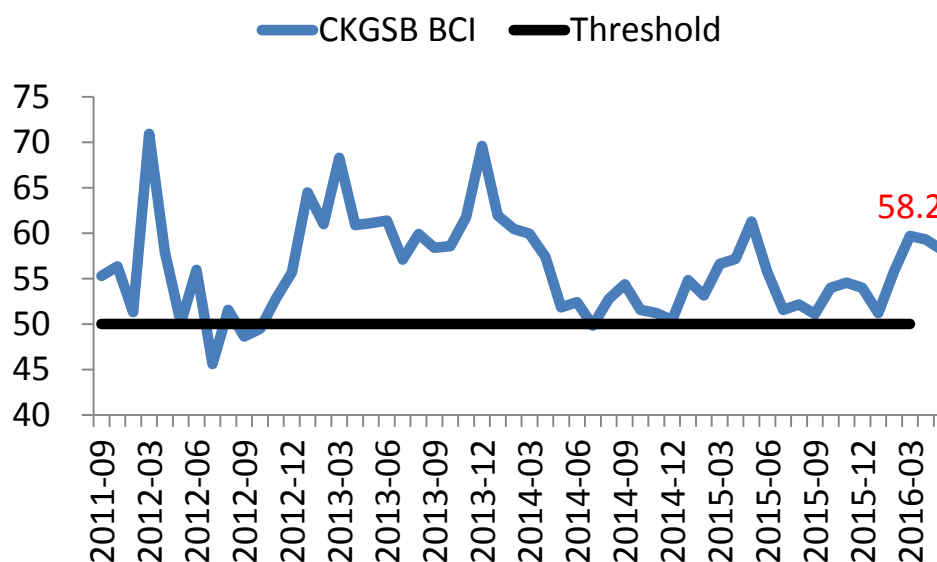
May 2016

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CKGSB Case Center and Center for Economic Research

The CKGSB Business Conditions Index (BCI) registered 58.2 in May, less than April's overall index of 59.3. Despite this small dip, this shows that for CKGSB's sample, of which the majority represent relatively successful businesses 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, only the corporate profits index rose this month. The other three fell slightly.

	Corporate sales	Corporate profits	Financing environment	Inventory levels
April 2016	73.1	61.5	51.2	50.0
May 2016	71.8	62.3	47.5	49.4

Source: CKGSB Case Center and Center for Economic Research

Apart from compiling the main BCI, we also forecast costs, prices, investment and recruitment demand for the next six months. Labor costs and overall costs expectations rose somewhat in May, both recording indices of over 80. Prices of consumer and producer goods slipped, however, falling to 47.3 and 40.6, respectively, below the confidence threshold. The data shows that Chinese

firms are experiencing financing trouble: high costs grow apace but prices keep contracting.

	Labor costs	Overall costs	Consumer prices	Producer prices
April 2016	79.2	77.8	51.5	42.6
May 2016	84.3	82.3	47.3	40.6

Source: CKGSB Case Center and Center for Economic Research

However, in the face of adversity, our sample firms continue to recruit and invest. No matter the macroeconomic conditions over the past five years of the BCI, the Chinese firms sampled have prioritized corporate investment and recruitment, proving a conundrum for observers. It is important to note that most sample companies are leading Chinese private SMEs and so their competitiveness is consistently higher than the average (50 points) for their respective industries.

	Corporate investment	Recruitment demand	Industry competitiveness*
April 2016	68.0	67.1	72.8
May 2016	67.6	69.9	71.7

*We ask respondents to indicate whether their firm is more, the same, or less competitive than the industry average. The higher the figure, the more competitive our sample firms are in their respective industries.

Source: CKGSB Case Center and Center for Economic Research

Analysis

That the BCI tracks credit expansion in China should not be surprising. The growth of the Chinese economy has been driven in the last three decades by massive investments, which have been largely financed by bank loans.

In addition to tracking the cyclical fluctuations of the Chinese economy, the monthly CKGSB BCI releases also contain additional indices that allow analysts to infer structural issues facing the Chinese economy. Our data have shown consistently the following stylized facts since 2011:

- Chinese firms have not been able to pass cost increases onto either downstream firms or consumers.
- Producer prices have often been falling since 2012, and the pace appears to have accelerated since the end of 2014.
- Chinese firms have consistently been bullish in planning additional capital expenditure and in hiring.

The first two stylized facts are consistent with the view that there is overcapacity in many of China's industrial and service sectors.

The third stylized fact suggests that either Chinese business owners and operators are highly enterprising – as they should have been given the extraordinarily high economic growth that they have

brought about – or that there is something rather more worrisome. An alternative interpretation, which I find more convincing, is that Chinese managers are betting that the government will act aggressively using expansionary monetary, fiscal and industrial policies to boost economic growth whenever the economy faces strong head winds. Chinese managers, of course, rationally expect government actions in this regard because the Chinese government has rarely disappointed those expectations.

Such individually rational expectations, however, may not be collectively rational. In a time when overcapacity problems are widespread and expected investment returns have trended down to dismal levels, it is hard to argue that additional mass investments can be socially optimal.

Overcapacity is a worldwide problem. In countries where infrastructure investment has lagged behind, there is indeed a case to be made that investments there may be a positive on a global level. Here we are looking at the US and much of Europe.

China can also benefit from additional investments in some areas. But China's corporate sector needs to reduce leverage, while Chinese banks need time to repair their balance sheets. All of this means that China's 'new normal' will result in slower growth and some painful restructuring.

We all need to adjust to this new reality.

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 to May 2016, the research team has undertaken 54 surveys and published 49 monthly BCI 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.

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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.

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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.

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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

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