

INFOCUS

MACRO COMMENT

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Momentum builds towards zero-Covid pivot in China

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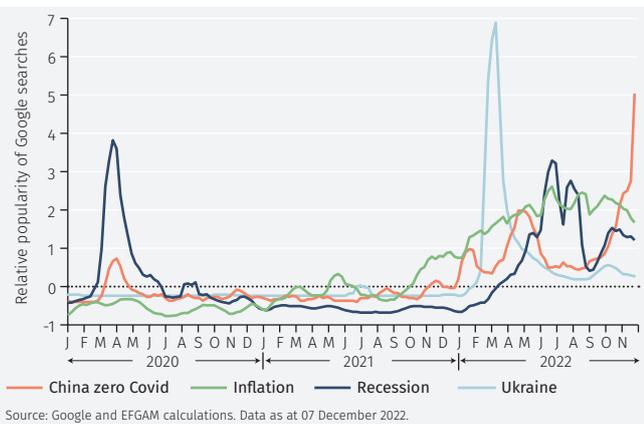
REGIONAL PORTFOLIO
CONSTRUCTION

MOMENTUM BUILDS TOWARDS ZERO-COVID PIVOT IN CHINA

Momentum is building in China towards a shift away from the controversial zero-Covid policy. In this edition of Infocus, Sam Jochim discusses why this is, what headwinds remain, what the pivot might look like and what the impact on China's economy could be.

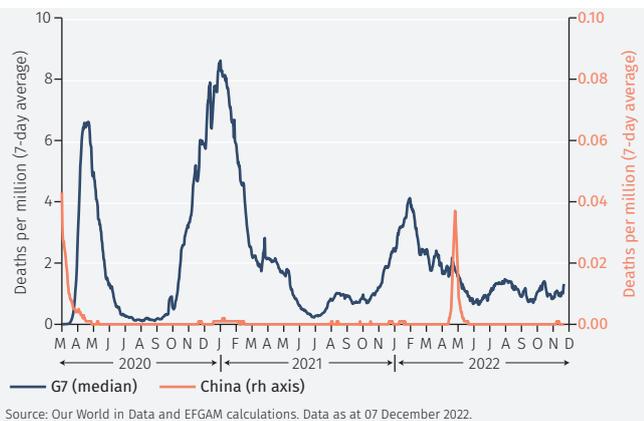
Much attention has been paid to China's zero-Covid policy recently, with a noticeable pickup in the news flow since the Chinese Communist Party National Congress in October, despite President Xi signalling that a pivot away from the policy would not be a near-term priority.¹ However, in relative terms, 'China zero Covid' has recently gained more interest than other key topics such as inflation, recession and Ukraine (see Figure 1).

1. Google trends (data normalised over 5 years, 4-week average)



A significant factor in the recent increase in news flow was the protests held in relation to the zero-Covid policies. Such outbursts in China are not a rarity but multiple protests across multiple cities simultaneously, all with the same message, are unusual. Nothing of this nature has been seen in China since Tiananmen Square in 1989.

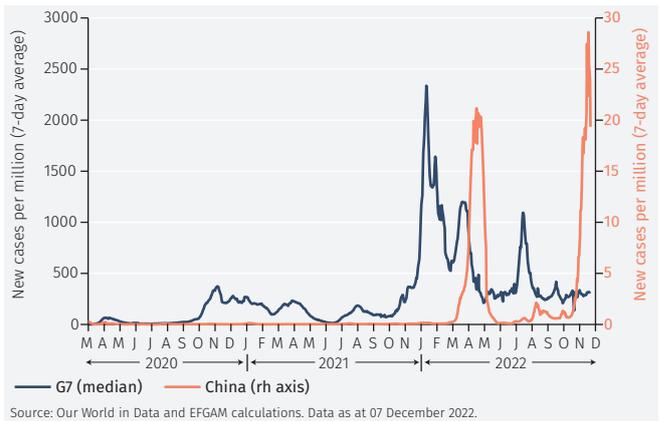
2. Covid-19 deaths per million (7-day average)



Under China's zero-Covid policy local lockdowns, which have a significant impact on economic activity, are enforced even after a relatively small rise in Covid cases. The aim is to prevent a spike in the number of serious illnesses or deaths. In this aspect, the policy has worked. China's death rate in comparison to many western countries is very low (see Figure 2), a point that has been celebrated by the central government as a key success separating them from the West.

Problems have arisen because newer strains of Covid are more contagious and have become more difficult to contain, leading cases to spike to record daily highs despite stringency remaining at elevated levels (see Figures 3a and 3b).

3a. Covid-19 new cases per million (7-day average)



3b. Covid-19 stringency index²



¹ See EFGAM Macro Flash Note, 'Chinese Communist Party 20th National Congress' (October 2022).

² The stringency index is a composite measure based on nine response indicators including school closures, workplace closures, and travel bans, rescaled to a value from 0 to 100 (100=strictest).

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The protests make clear that the zero-Covid policy has become unsustainable in its current form and there have been recent signals that the central government may be moving closer to this view. China's Vice-Premier, Sun Chunlan, recently spoke of China's pandemic containment entering a new stage and temporary lockdowns were lifted in some districts despite rising cases.

This is not an admission of a policy failure by Xi. State media released a newspaper article in which people who had tested positive for Covid gave accounts of how mild the latest variant is. Pointing to the past success of zero-Covid and the milder symptoms of newer variants is a narrative Beijing can pursue to exit its zero-Covid strategy without any implied policy missteps.

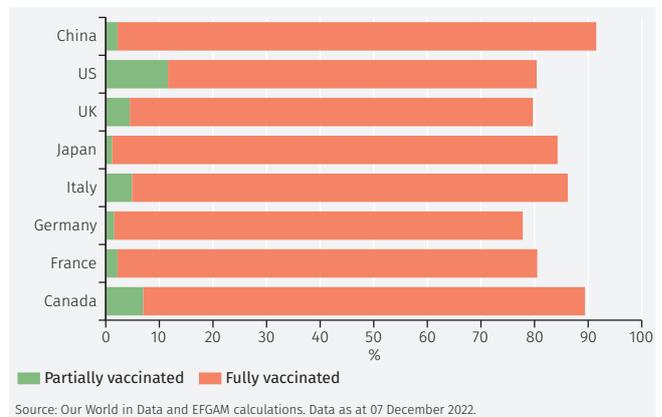
Regardless of the strategy Beijing pursues to control the narrative, China is clearly moving towards reopening. The question is now what this will look like and how long it will take. This will largely be determined by the speed with which remaining headwinds are addressed and how severe the strain of Omicron in circulation proves to be.

One of these headwinds is the lack of natural immunity to Covid in China's population. While the low level of case numbers has ensured a low death rate, it has also resulted in a lack of natural immunity in the Chinese population. This increases the importance of vaccinations.

Vaccination rates in China are higher than in the G7 (see Figure 4). But while 89.3% of China's population has had at least two doses of a vaccine, only 65.8% of its population over 80 are fully vaccinated.⁴ The push to vaccinate the elderly, announced in a recent press conference by the National Health Commission, is a positive signal.⁵ The effective implementation of this policy will play an important role in determining the speed of China's pivot given it is one of the main requirements for a successful reopening.

There are also questions regarding the efficacy of Chinese vaccines.⁷ In this respect, the visit of German Chancellor Scholz in November, which resulted in an agreement for foreign nationals living in China to be allowed access to the BioNTech vaccine, could be seen as an initial step in a lengthy process

4. Covid-19: % of population vaccinated⁶



that allows use by the domestic population at some point in 2023. President Xi will not be keen on the use of Western vaccines but compromising on this would speed up the reopening of the economy.

Healthcare infrastructure also requires improvement to ensure a smooth reopening.⁸ The government is planning to increase hospital capacity and is building quarantine zones, implying readiness to deal with larger case numbers. The speed at which this infrastructure is built will also impact the speed at which China can reopen.

Given the headwinds still to overcome, the most likely path to reopening will be cautious and is unlikely to be smooth. To make the containment strategy more sustainable, it is likely that there will be gradual reductions in PCR testing requirements, more targeted and shorter lockdowns, and more quarantines allowed from home. Measures are unlikely to be fully lifted until vaccination levels in the elderly population and healthcare infrastructure have improved significantly. This slow and measured pivot is likely to gain more momentum in the first half of 2023 and could have significant economic implications.

Economic growth in China has been weak in 2022 and is set to miss the central government's 5.5% target by a significant margin. A slow shift away from the zero-Covid policy would support a gradual recovery in 2023, as consumer confidence rebounds. This will also support emerging Asian economies

³ *The Beijing News*, 29 November 2022.

⁴ National Health Commission of the People's Republic of China, 30 November 2022.

⁵ National Health Commission of the People's Republic of China, 29 November 2022.

⁶ Fully vaccinated refers to individuals who have received a complete initial protocol. For example, in a two-dose protocol, a fully vaccinated individual would have received two doses of the vaccination.

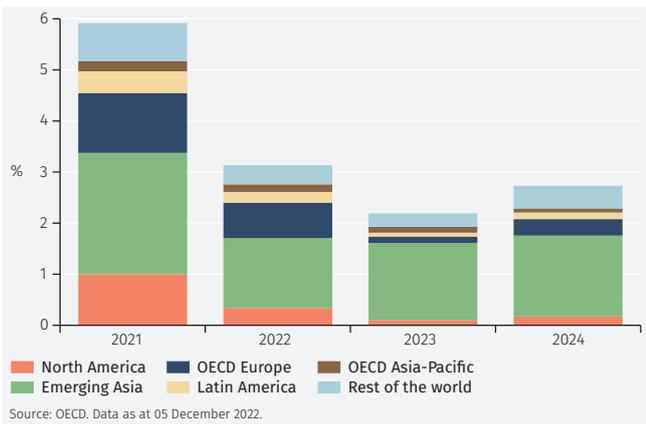
⁷ A study in Singapore showed that compared to individuals vaccinated with the Pfizer vaccine, individuals with the Sinovac-CoronaVac and Sinopharm vaccinations were 2.37 and 1.62 times more likely to catch Covid-19 respectively. Furthermore, they were 4.59 and 1.58 times more likely to develop severe disease respectively.

⁸ Estimates point to less than 4 ICU beds per 100,000 people in China, compared to 33.9 in Germany and 25.8 in the US.

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surrounding China, which could play an important role for the global growth picture (see Figure 5). Europe could be an additional beneficiary of China's recovery, with 12.9% of China's imports sourced from euro area countries in 2020, compared to 7.9% from the US.⁹

5. Contributions to global GDP growth (percentage points)



Given inflation has been consistently below the People's Bank of China's (PBoC) 3% target this year, there is also greater room for looser monetary policy going into 2023. The PBoC has cut the one- and five-year loan prime rates by 15 and 35 basis points respectively in 2022. The reserve requirement ratio has also been cut by 60 basis points. The PBoC is focusing on growth and rates could be lowered further to help stimulate the economy in 2023 if it is seen to be underperforming and covid is deemed to be under control.¹⁰

6. Chinese CPI inflation (% year-on-year)



The composition of growth in 2023 may be influenced by what fiscal stimulus is provided by the government. It is likely that a large portion of the stimulus will go to infrastructure and

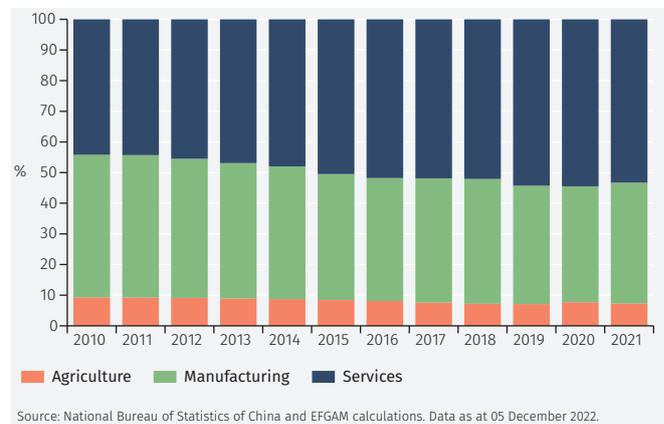
boosting the struggling property sector. There could also be some additional support provided to small businesses and households to boost the services sector, which has been suffocated by zero-Covid policies (see Figure 7).

7. Caixin PMI indices



The services sector had been growing its contribution to Chinese GDP but this trend lost momentum in 2021 (see Figure 8). A recovery of growth as zero-Covid restrictions are eased could see renewed momentum in the services sector.

8. Contributions to Chinese GDP by sector



In summary, a pivot away from zero-Covid appears to be underway in China but is likely to be a slow and cautious process given the headwinds still to overcome. In turn, this should support a gradual recovery of economic growth in China in 2023, with surrounding emerging Asian economies and European economies also reaping some of the rewards.

⁹ Based on EFGAM calculations using Observatory of Economic Complexity data as at 06 December 2022

¹⁰ <https://tinyurl.com/5d6hff82>

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