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China Catches COVID

Changes in local pandemic policy will have global repercussions.

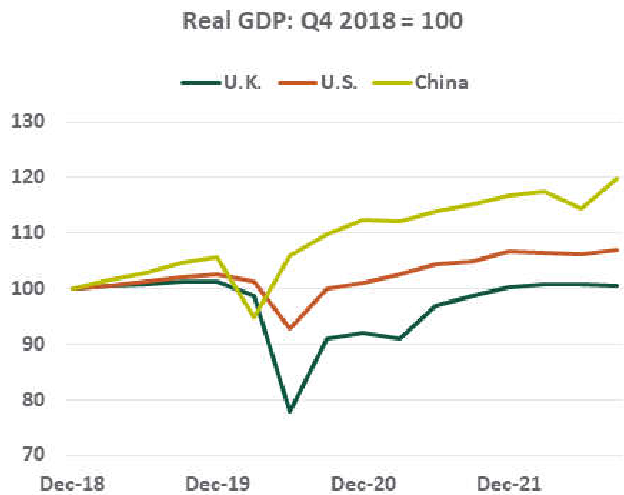
By Carl Tannenbaum

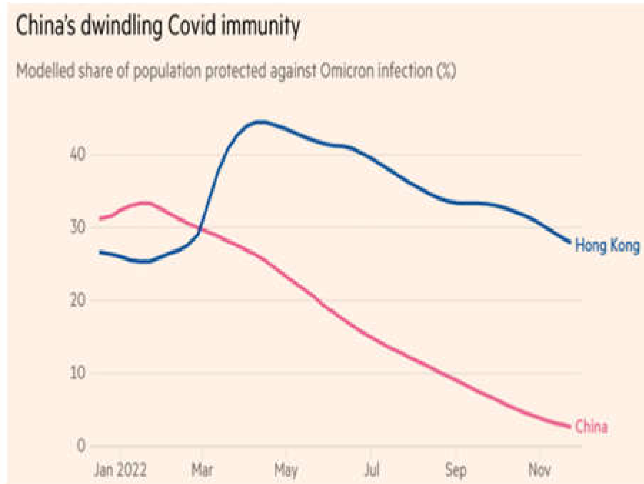
For the first time in three years, we were able to gather the whole family for Christmas. It was chaos: twenty-five people crammed into my sister-in-law's family room, tearing open gifts and stuffing themselves with holiday treats. The decibel level was high...but it was music to my ears. How special it was to be together again.

In two weeks, freedom from COVID will allow us to attend our first in-person Lunar New Year celebration since 2019. Those assembled will toast the reunion...but our thoughts will be on friends and relatives in the Far East. Having lowered its guard against the virus, China is fighting an outbreak which is challenging its population and its economy. The consequences of this development will complicate the global fight against inflation.

China was first into the pandemic, and will likely be the last to exit. The COVID-19 virus initially came to prominence in Wuhan, a city of 11 million that is 500 miles west of

Shanghai. Chinese authorities were anxious to isolate cases, and so they moved to lock down the city and enforced strict contact tracing. That strategy, considered harsh by some, was nonetheless effective; China's caseload was smaller than seen elsewhere, and its economy recovered faster.





Sources: Haver Analytics, Airfinity, Financial Times

By the end of 2020, miraculously, the first vaccines against COVID-19 had been administered. Slowly, Western countries stemmed the tide of infections and moved away from social distancing. China began vaccinating shortly thereafter, but the products it used for the purpose have proven less effective. Only 55% of Chinese have received at least one booster, which is considered the minimum level of protection. Coverage is even lower among the elderly, who are the most vulnerable to severe infections. And so the "**zero COVID**" policy persisted.

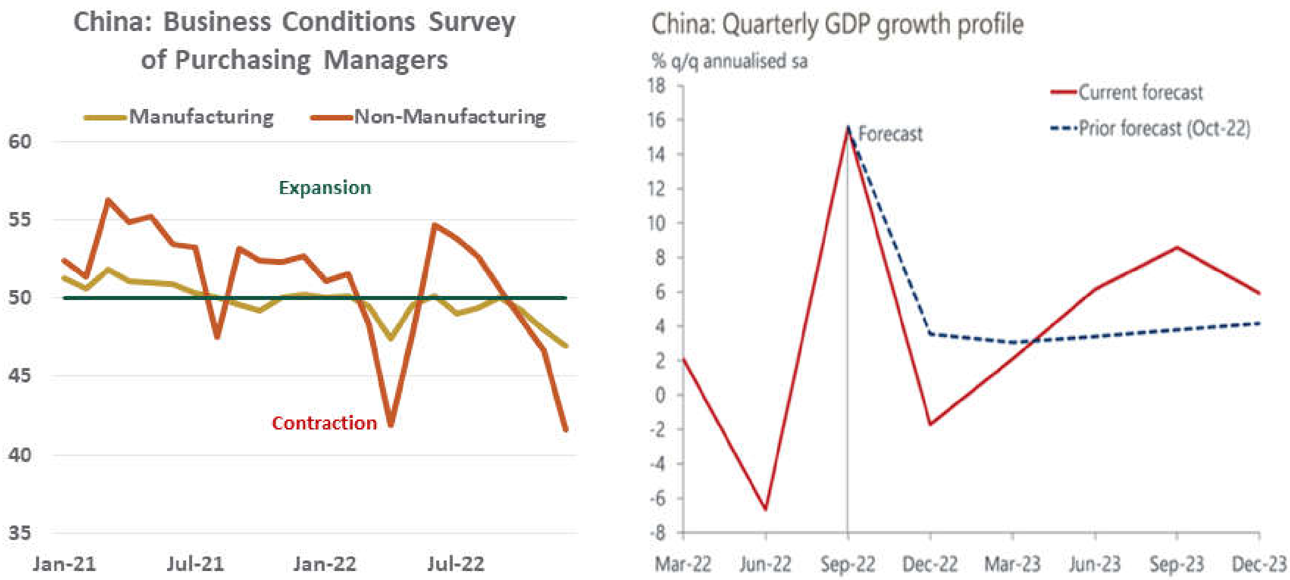
While the Chinese approach undoubtedly saved lives, it has come at great cost. Fear of quarantine has weighed on Chinese consumer confidence and consumer spending. Disruptions to manufacturing processes snarled supply chains and increased costs the world over. Real economic growth in China fell to only about 3% last year, the lowest non-pandemic result in decades. Frustration over the zero COVID policy became the root of growing discontent, some of which spilled out into the streets.

The calculus of managing COVID-19 has been challenging for all countries (and states within countries). Finding balance between public health and commerce has been the subject of active debate; the equation has been revisited many times during the past three years. At some point last fall, Chinese authorities reached the point where persisting with their full court press against COVID was no longer deemed to be their best option. Restrictions have gradually been relaxed over the past several months.

The massive COVID outbreak in China will have global consequences.

Predictably, the short-term result has been a surge in infections. Chinese public health statistics are not considered reliable by many in the West; their caseload per capita is still well below what might reasonably be expected given their vaccination levels and population density. Nonetheless, incoming information depicts a very serious situation.

population density. Nonetheless, incoming information depicts a very serious situation. Our thoughts must always begin with the human toll that the pandemic is taking. But the economic toll is becoming increasingly evident. Leading indicators of activity have dropped sharply; illness is preventing millions from working; and many Chinese are self-isolating in an effort to avoid infection. We know from the experience of other countries that the labor force can suffer permanent damage at the hands of COVID-19, a fate which will befall China.



Sources: Bloomberg, Haver Analytics, Oxford Economics

If there is a silver lining behind all of this, China will develop a much higher level of acquired immunity as a result of what it is going through now. As winter gives way to spring, the spread of the disease should slow, allowing a safer and more extensive reopening. Western countries recovered a large fraction of the economic ground lost within a couple of quarters of the worst phase of the pandemic; forecasters are consequently anticipating that China will have a strong second half of 2023 that will help to offset some of the difficult months that lie ahead.

The cycle of infection and recovery in China will have a series of impacts on the global economy. Most prominently, it will likely spell bad news for inflation. Employee absenteeism is having an impact on operations at factories and ports, leading to renewed supply chain stress. And the prospect of a durable reopening in China later on this year will create incremental demand that could stress the prices of commodities like oil and products which are sourced from the Far East. As a result, monetary policy in Western countries may have to stay tighter for longer.

It is often said that when a major economy sniffles, the world economy catches cold. As China catches more COVID, it is sending a chill through world markets.

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