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Economic Newsletter

Could Chinese Policy Derail Global Growth?

Chinese citizens have once again been plunged into full or partial lockdown in order to curb the spread of Covid-19 cases within the country. Since the beginning of the pandemic China has adopted a hard-line zero-Covid policy, using measures such as lockdowns, border closures, quarantining and mass testing to quell the virus. The recent uptick in Covid cases has resulted in both Shanghai and Beijing, together the largest cities in China, being placed under severe lockdown restrictions.

The Social and Economic Impact

Locals residing in these cities have been forced to stay within their homes for several weeks, with many not having proper access to food and medical supplies. These residents have not been allowed to leave their homes under any circumstances and many schools and hospitals have been forced to close their doors and suspend operations. Authorities have adopted a draconian approach to upholding the lockdown measures, and in some areas fencing has been erected in order to prevent residents leaving their homes. As a result, citizens have been forced to rely on food distribution to obtain their provisions, which has been dysfunctional and erratic, causing many to go hungry and receive inadequate supplies.

The rise in Covid cases has been partly as a result of the stance China has taken regarding vaccine production and implementation. To date the country has refrained from using foreign mRNA vaccines for its population, opting instead to use less effective vaccines produced and tested by local companies. As a result, the population, and particularly the elderly, are still thought to be at risk to the virus, despite a vaccination rate of nearly 90%. Many have urged the Chinese authorities to make use of foreign vaccinations or face the exacerbated economic and social costs of the ongoing lockdowns.

The lockdown measures have put immense strain on many economic sectors which rely on workers being present in the workplace in order to properly function. In order to maintain activity, several firms have gone so far as to mandate that their staff live full-time at the office in an effort to maintain their levels of productivity. Employees have been made to sleep on their office floors, and food supplies have been brought into the offices to feed the workers. As a result, many surrounding Chinese provinces have been gripped by panic-buying as residents prepare themselves for the possibility of lockdown measures similar to those witnessed in Shanghai.

Growth Implications

The economic impact of the lockdown restrictions on the Chinese economy are projected to be as bad, if not worse, than those of the spring of 2020, when Covid-19 caused a global lockdown. Shanghai, which is one of China's largest and most popular manufacturing and export cities, is facing severe supply-chain issues, which are projected to filter into the broader Chinese economy. Many manufacturers are struggling to get crucial components on time, causing a drag on output. The waiting time for ships in Shanghai to unload their cargo has increased by over 150% since early March of this year, just before the city went into lockdown. This is having a knock-on effect of exacerbating global inflation, with businesses struggling to obtain components from Chinese manufacturers, thereby driving up prices.

Already the IMF has revised China's GDP growth forecast down to 4.4% from 4.8% for the full year. Chinese unemployment reached a 21-month high in March of 2022 as many high-profile businesses operating in China, including the likes of Volkswagen, Tesla, and iPhone assembler Pegatron, have been forced to suspend their operations.

Perhaps the hardest-hit industry is that of the Chinese property market, which has seen new home sales fall by over 30% in the last eight weeks. It is estimated that there is currently enough empty real estate in China to house 90 million people, about one-and-a-half times the entire population of South Africa. The Chinese property sector, which has already been under severe pressure due to the Covid pandemic, was showing signs of a potential revival earlier this year as policymakers put forward a wide variety of incentives to encourage buyers. These included lower mortgage rates, cash subsidies for first-time buyers, lower tax rates, and smaller down payment requirements, amongst others. Despite these efforts, consumers are reluctant to take out mortgages due to the prevailing lockdowns and uncertain employment conditions.

The Global Earnings Cycle

The impact of the Chinese lockdown comes at a precarious time for the global economy, which is currently entering its first-quarter earnings season. Already Apple executives have warned that the company could face losses of up to $8bn in the wake of the Chinese lockdowns. The company, which has close to 100 of its top suppliers' facilities within the Shanghai region, has stated that supply constraints and silicon shortages are impeding their ability to carry out operations and meet customer demand.

Global markets, which have had a jittery start to the year, will be looking to the earnings results of underlying companies for a sense of direction. Currently, earnings remain buoyant on an index level, however underwhelming company results have the potential to derail growth. Netflix, whose earnings and subscriber numbers were released in mid-April, serves as a prime example of the underlying levels of nervousness in markets. The streaming giant, which has grown its subscriber base consistently for over a decade, announced that it had lost around 200 000 users in the first three months of 2022. While this number is relatively small in comparison to the estimated 220 million total global subscribers, the negative announcement sent the share price into a 40% free-fall, shedding nearly $60bn in market value. The firm, which up until the announcement had been confident that its subscriber base would grow in the first quarter of 2022, now expects further subscriber losses in the upcoming quarter, leading the company to explore the option of an ad-supported streaming service.

Elon Musk, who often appears to thrive on market volatility and is not afraid to buck the trend of global markets, caused headlines in late April when he bought the social media behemoth Twitter for $44bn in one of the largest leveraged buyouts in Wall Street history. The move by Elon Musk promises to promote freedom of speech on the platform, by making the algorithms open source in order to increase trust. The company initially resisted Musk's buyout plans, implementing a poison pill to impede Musk's takeover bid, however the firm was forced to enter into negotiations after Musk put forward his $46.5bn financing deal.

Currently the earnings picture remains strong throughout most of the US, with around 80% of S&P 500 companies beating analyst forecasts. Investors should, however, remain vigilant of the ongoing restrictions playing out in China and the effect these could have on global markets.