Spotlight: China

Less than a month after President Xi Jinping proudly announced that "friendship between China and Russia has no limits", some limits, in fact, have been reached. The Asia Infrastructure Investment Bank (AIIB) suspended all business with Russia and Belarus on March 3rd. China state refiners such as Sinopec, CNOOC, PetroChina, and Sinochem are avoiding new Russian oil contracts, despite the steep discounts. Chinese companies such as DiDi, Lenovo, and Semiconductor Manufacturing International Corporation have all announced they will cease doing business in Russia for fear of sanctions.

China's economic growth, even before the war in Ukraine, was faltering – in large part reflecting policy decisions in two key areas. First, the regulatory crackdown in 2021 damaged many traditionally high growth Chinese industries such as consumer internet, education, and – in particular – real estate. It marked the end of an era of a focus on high export-led growth. President Xi moved instead to prioritize issues such as income inequality and to urge a renewed role for state enterprises. This shift weakened China's economic growth and dampened consumer confidence going into 2022.

Second, China's "zero-Covid" policy has curtailed production and likely also impacted consumer demand – with spillover effects on the rest of the world. Immediate steps to stamp out infection have been the hallmark of China's approach to Covid. The policy of swift and drastic lockdowns in response to reported cases has succeeded in holding deaths to extremely low levels, in contrast to the nearly one million lives lost in America. However, as the highly contagious Omicron variant began to sweep across China in Q1, the limits – and costs – of the zero covid policy became more evident. A low vaccination rate – especially among the elderly – risks an uncontrollable wave of illness and death if infection outbreaks occur. However, adhering to the zero-Covid policy comes at a high cost to the economy.

Hong Kong was the first place in China hit by Omicron. After eventually abandoning the zero-Covid policy, the city now has the world's highest Covid fatality rate. But life for most inhabitants is getting back to normal. Elsewhere, President Xi has made clear that the policy must continue, despite its economic and social costs. Omicron outbreaks late in Q1 triggered lengthy lockdowns in Shanghai and Shenzhen, the first and third largest cities by GDP. The impact on consumer confidence and industrial production will spill into slower growth in Q2 and likely lead to GDP below this year's official target of 5.5%. The IMF is now projecting growth of just 4.4% for the year.

China's top electric-car maker, Nio, has been forced into temporary shutdown; and the Chairman of Xpeng Motors has warned that if companies in the auto supply chain in Shanghai and neighboring cities cannot find a way to resume production, then by May all of the China's automakers will have to shut down production.

President Xi's approach has global implications. At the ports of Shanghai and Shenzhen – two of the world's busiest – images show large container ships idling offshore, unable to load or unload the goods that comprise an essential part of the global supply chain.