

China Debt Dynamics

China's COVID U-turn

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After almost three years of doing all it can to prevent the spread of COVID-19, China's government has begun dismantling its zero-COVID policy.

On Wednesday, the National Health Commission introduced 10 measures that represent a fundamental shift in the way the Beijing manages the pandemic. No longer will China's authorities pursue "dynamic clearing," the name given to its policy of strict contact tracing, quarantines, and lockdowns designed to stamp out COVID wherever it appeared. Instead, the focus will be on mitigating the impact on vulnerable groups while the virus is allowed to circulate freely among China's population, much as it does in most other parts of the world.

The change is sudden, and the transition is likely to be messy. Local authorities aren't prepared for the inevitable surge in infections. Moreover, local authorities will have to decide for themselves how broad guidelines from Beijing are implemented. Nonetheless, the measures are designed to return a degree of normalcy to the lives of ordinary Chinese people by removing most of the constraints on their freedom of movement. It represents a huge improvement in their quality of life.

It should also have a stimulatory effect on the economy. China's zero-COVID policy has suppressed consumption, particularly in the services sector. That's taken a huge toll on small firms that dominate services, many of which have struggled to stay alive. Weak demand for services has fueled unemployment, particularly among young people. It may have also suppressed housing demand, with households wary of making big new investments given uncertainty about job security, potential pay cuts, and overall financial stability.

Unwinding COVID restrictions should boost consumption, create new employment opportunities, and restore many small firms to health. The full extent of the economic recovery – and when it's likely to occur – remains to be seen. Still, government monetary and fiscal policy should return to a more normal footing sometime in the second half of next year as consumption starts contributing to economic activity in a more meaningful way.

Why is this happening now?

The shift in policy has been sudden and unexpected. While many pundits had predicted that Beijing would relax COVID controls following the 20th National Party Congress in October, that didn't occur. Instead, China's new leadership team repeatedly reasserted its commitment to dynamic clearing. However, they were open to tweaking the policy to make it less disruptive both to people's lives and the economy

On November 11, the National Health Commission (NHC) released 20 measures that tried to soften some of the most draconian aspects of China's containment policies. Implementation of the measures would have resulted in fewer people being put into lockdown, lockdowns would be lifted faster, fewer people would be sent to quarantine camps, and those that were could expect shorter quarantine stays.

However, the measures were implemented unevenly around the country, and authorities were forced to reassert that dynamic clearing was government policy, resulting in some local governments having to unwind some of the loosening measures they'd put in place. That became a source of widespread frustration for many people who had hopes that COVID controls were finally easing.

Then, in the last weekend of November, public protests broke out in dozens of cities around China. Protests took place at more than 50 universities, locked-down apartment blocks, and nightlife areas. There was also unrest in factory dormitories among migrant workers.

The nominal trigger for the protests was an apartment block fire in Urumqi, Xinjiang Autonomous Region, that killed 10 people a couple of days prior. Social media posts claimed that zero-COVID measures delayed firefighters' response. However, what fueled the protests was mounting frustration at zero-COVID and its uneven implementation on the ground.

Beijing's response to the protests has been to dismantle its zero-COVID policy. Of the measures rolled out by the NHC on Wednesday, the key ones include:

- Allowing asymptomatic COVID patients and those with mild symptoms – as well as their close contacts – to quarantine at home instead of being forced into quarantine camps
- Further narrowing down the designation of high-risk areas to specific floors or apartment units, instead of entire residential compounds or districts as was previously the case
- Lifting lockdowns on high-risk areas after only five days without new cases
- Banning the use of “temporary lockdowns” before contact tracing is completed
- Abolishing the need to show negative COVID tests to access most public spaces or travel between different regions

This is going to get messy

Testament to the suddenness of the policy change is China's relative lack of preparedness for what's about to happen. Vulnerable groups aren't adequately vaccinated. Specifically, only 60% of people over the age of 80 have been vaccinated.

Authorities are working to redress that. The State Council has released a plan to boost vaccinations for the elderly, and Caixin has reported that local governments have been given quotas for ensuring elderly vaccinations.

However, the real challenge is that China exclusively uses its own homegrown vaccine, and there are serious questions about its efficacy against new COVID variants. Even if vaccination rates for the elderly approach 100%, the protection they receive is questionable.

Regardless of the effectiveness of the vaccine, China's health system is about to find itself under unprecedented strain. In particular, China likely lacks enough intensive care units (ICU) to manage the coming surge of infections.

Beijing is undoubtedly hoping that the surge will be manageable. State media has started reporting that there's no reason for the public to be scared of the Omicron COVID variant. The media have recently run stories about COVID patients recovering from illness unharmed, and central government officials have said publicly that Omicron patients have significantly lower death rates and far less severe symptoms than earlier variants.

Not that long ago it seemed as though China's zero-COVID policy would remain in place for at least another year, and conceivably longer. However, China's leaders have pivoted. The extensive pandemic containment policies built up over the last three years are being dismantled with great speed. China still needs to learn how to live with COVID, and that will have its own costs. But the population at large is about to regain their freedom of movement, with significant positive consequence for the health of China's economy.

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