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A Weekly Comprehensive Macroeconomic Overview

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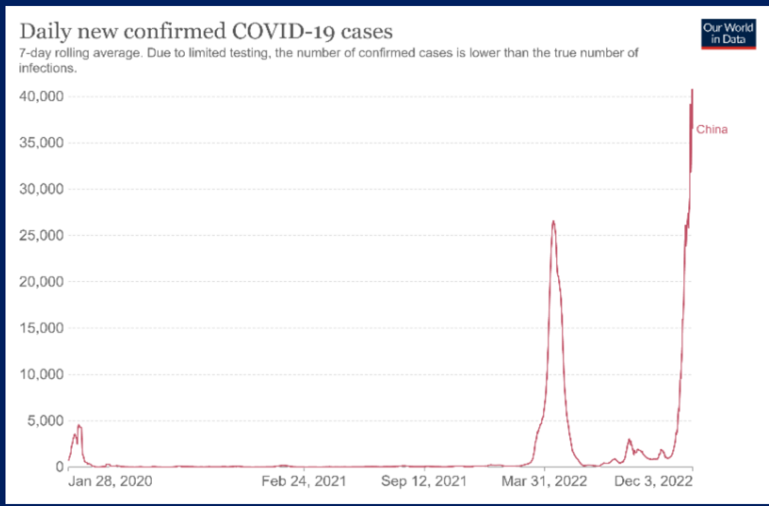
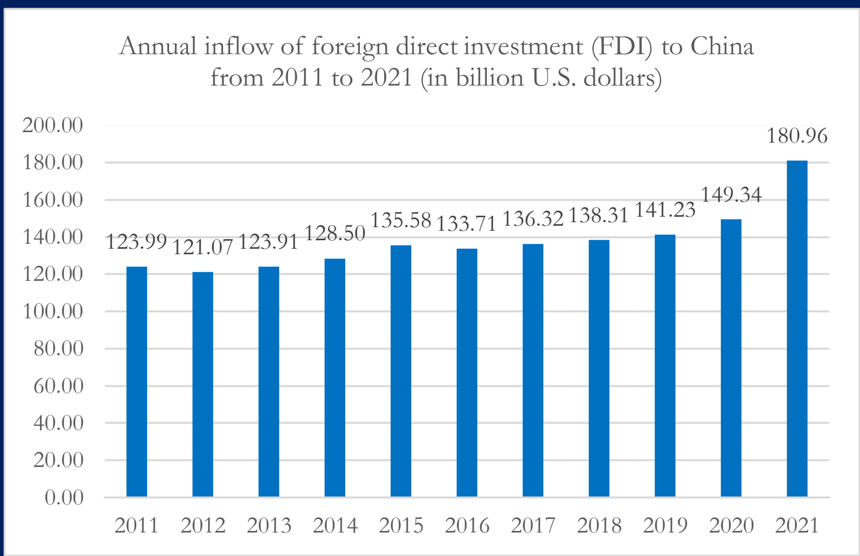
China – Current Domestic State and Outlook



Source: Our World in Data

China is notorious for its tough approach to restrain Covid-19 domestically. During the past two years Chinese citizens have been very compliant with the imposed regulations, halting the spread of Covid relatively successfully considering the circumstances. Citywide lockdowns, like that of the 25 million metropole Shanghai in 2022, have been perceived globally as causing media outrage as well as major economic disruptions in supply chains and investments. Most recently however, Chinese citizens have started to speak up, no longer willing to submit to the government's strict rules. The global ramifications of this development will heavily depend on the government’s response to these protests.

Investors and businesses are closely following the recent developments in China, as FDI (foreign direct investments) are at an all-time high, in 2021 with $181Bn, bringing the total to $2.1Tn , primarily in the manufacturing and service sector. The now nation-wide protests started as a reaction to a fire in a locked down high rise building in Urumqi, Xinyang, leaving at least 10 dead. These sparks ignited hundreds of Foxconn workers at the world’s largest iPhone factory in Zhengzhou to revolt and break out of the production site, where they lived for months in the context of a closed loop operation.



Source: Statista

This is a direct disruption of international supply chains with Simon Geale, executive vice president of procurement at Proxima, pointing out, “what supply chains thrive on is predictability”. Evidently, these political unrests are extremely unpredictable, and this, paired with the instable working conditions faced by many in China, does not bode well for supply chains. Further “deglobalization” or in general, heightened local production, could follow. Biden’s pledge of $250Bn to aid in US production of computer chips, closely linked to Samsung’s new $17Bn chip factory set to be built in Texas, are first symptoms. Traditionally, these industries have taken advantage of the cheap labour and land available in China, which profoundly contributed to the country’s FDI.

If the Chinese government decides to further extend its zero-Covid policy, its domestic economy could suffer negative effects. It is not unlikely that China’s GDP growth rate will continue to decelerate. This week, the IMF chief warned that downgrades to China’s 2022 GDP forecast are a possibility, as economic activities remain hampered due to an increase in lockdowns in November. A driver behind this is the decline in private consumption with stores and facilities being forced to close. Retail sales in China decreased by 0.5% YOY in October and ended a four month recovery span of positive YOY growth. Equities that have exposure to domestic demand in China need to be considered carefully. Moreover, China’s PMI

(Purchasing Managers' Index) numbers are expected to further deteriorate, after already facing a four-month continuous decline in factory activity. Companies with production facilities in China risk their product delivery schedules being impacted and will require careful monitoring of inventory levels to meet domestic and global demand.

Comparable mass protests have been non-existent over the past 30 years in China, which causes great uncertainty for investors world-wide. The China CSI 300 has had a major fall since Xi Jinping's third presidential run and is now at risk of falling once again. Given the general risk aversion of investors over this year, the protests might scare off foreign investments further and weaken the Renminbi. Bridging this bearish period for international investors largely depends on the decisions to be made by the Chinese government.

If the Chinese government were to lift the zero-Covid policy, global markets are expected to respond positively. Global markets would increase steadiness if supply chains gained stability; jobs would be created, and shipping costs would decrease. As many companies are outsourcing manufacturing to China, a lift in restrictions would allow manufacturers to improve profitability, reliability, and efficiency. China is the largest exporter, and the second largest importer of goods in the world, so returning operations similar to pre-Covid levels would result in large benefits for trade. The importance of this is due to the fact that China makes up approximately 19.16 % of the global GDP, adjusted for purchasing power parity. While with eased restrictions China would inevitably experience an initial spike in Covid cases, other major supply chain hubs, such as India, Bangladesh and Vietnam, could serve as an example for a new approach to dealing with Covid.

How the Chinese government will respond to the protests plays a key role in the future of global trade. Currently, the government appears to be responding to some of the protestors demands, however the final outcome and full impact of Chinese citizens rising up is yet to be observed.