

WHAT'S CHINA'S ZERO-COVID-19 POLICY ON AGGREGATE ECONOMIC ACTIVITY?

Liqian Ren — Director of Modern Alpha
11/15/2021

As countries like New Zealand abandon their Zero-COVID-19 policies, China again becomes the last remaining holdout, with people both in and out of the country calling for its abandonment. China also announced a vaccination drive for children three years and older.

China has been in the spotlight for its regulatory headlines, but those are settling down. I believe the most important issue for Chinese markets going forward will be economic growth and the profit outlook impacted by the real estate slowdown and energy crunch.

There are concerns regarding how China's Zero-COVID-19 policy is impacting growth. Here's my take:

1. The aggregate service sectors, which are most impacted by lockdowns, are still expanding, after a brief contraction in September. At this point, the energy crunch and real estate sector slowdown likely have a greater impact on the Chinese economy than other factors like its Zero-COVID-19 policy.

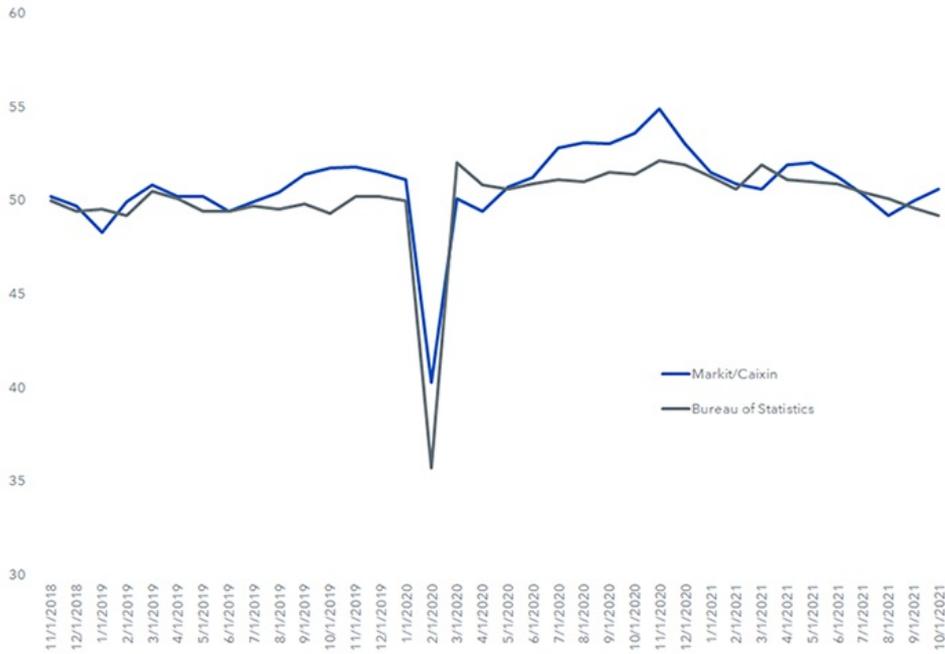
There are two [Purchasing Managers' Index \(PMI\)](#) providers, the [Bureau of Statistics](#) and private provider [Caixin/Markit](#), with higher than 50 indicating expansion. For each PMI, there are two main sub-components: the manufacturing and service sectors. As the below two charts show, the service PMIs are both back to their pre-pandemic trends. The manufacturing PMI is trending slower, with the larger sample and representative official PMI in <50 contraction territory.

China Services Purchasing Mangers' Index (PMI)



Source: One PMI is released by the government, based on a broad 3,000-company survey. The other is released by Caixin/Markit, based on about 430 companies. They are generally similar, but in recent months they've diverged. The Caixin/Markit sample is not as representative and likely missed some of the negative impact of the energy crunch, whose effect is not even across regions and company sizes.

China Manufacturing Purchasing Managers' Index (PMI)

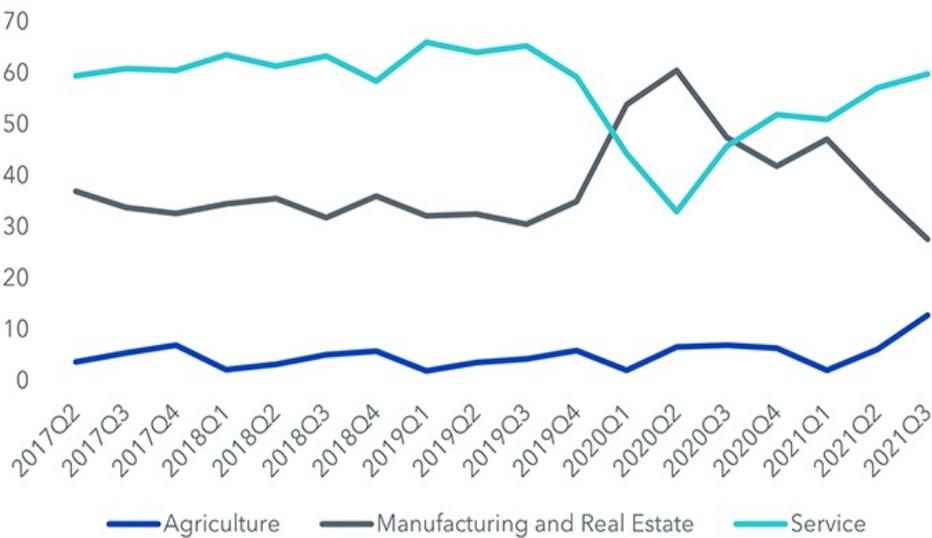


Source: One PMI is released by the government, based on a broad 3,000-company survey. The other is released by Caixin/Markit, based on about 430 companies. They are generally similar, but in recent months they've diverged. The Caixin/Markit sample is not as representative and likely missed some of the negative impact of the energy crunch, whose effect is not even across regions and company sizes.

2. Many other statistics point to the service sector now getting back to pre-pandemic trend growth, which [People's Bank of China \(PBOC\)](#) has stated as a range of 5%–6% GDP growth. China relied on exports and fixed asset investment for 2020 growth, but 2021 looks more like a normal trend, as the following chart shows.

However, there are new headwinds for energy and real estate, both of which are in a downtrend. The uncertainty for 2022 growth mostly comes from these two, not COVID-19, unless a significantly worse variant emerges.

Contribution to China GDP (%)



Source: China National Bureau of Statistics.

3. Many people question Chinese data. As there is significant money to be made with accurate economic data, private data providers and high-frequency data like the Baidu Congestion Index generally show that government economic data quality has improved in recent years.

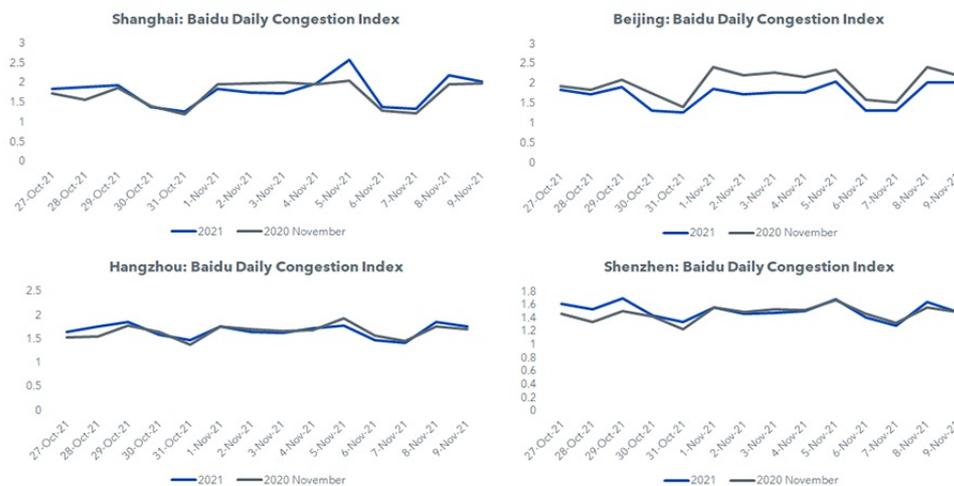
The Baidu Congestion Index has shown that when a city reports COVID-19 cases, congestion is lower than the same month a year ago, suggesting a negative impact on the service industry. But the number of cases is low

enough that, at any given time, the actual total number of people impacted is not widespread.

It is also true that inter-province travel has been impacted, with people reluctant to travel as stories of being quarantined for weeks emerge. But if people still spend money for services locally, then Zero-COVID-19 policy's impact on the **aggregate economy** is not significant.

Here, I have Baidu Congestion Index charts for Beijing, Shanghai, Hangzhou and Shenzhen, all among the top six Chinese cities for the morning and afternoon peak hour congestion data of the last 14 days (blue) as compared to the average in November 2020 (gray). For impacted cities like Beijing, plus its political center, the congestion is indeed lower than last year, but for other cities like Shenzhen, which is not as impacted, the congestion is generally more or less the same as compared to last year.

Shanghai was considered a model city in China for deploying rapid testing, but it never used the strict lockdowns that other cities did after the initial 2020 lockdown. The recent news that 33,000 tourists in Disneyland got tested in one night showed that people are out being entertained again, and it was viewed positively in China as an example of living with COVID-19 in the Shanghai way—a light dig at other cities.



Source: Baidu

4. There is uncertainty as to what living with the virus looks like for China. As of October 31, Singapore had 1,710 people in the hospital with COVID-19 out of a population of 5.9 million, while Japan had 2,589 in the hospital out of a population of 124.8 million. At its peak in late August, Japan had about 220,000 patients in the hospital. China watches other Asian countries closely, particularly Singapore, Japan and South Korea. Although China has six million hospital beds, scaling Singapore to the Chinese population would mean close to half a million COVID-19 patients in hospitals and an additional five million in some form of quarantine or community treatment. The hypothetical economic impact on the service sector of living with COVID-19 in that kind of Singapore-like scenario is not necessarily lower than the current Zero-COVID-19 policy.

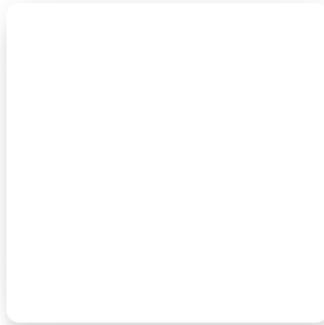
5. China also has a very significant political event, the 20th National Congress of the Chinese Communist Party, coming up in fall 2022, where the world will know whether the current president is able to consolidate power and get a recently unprecedented additional 10-year term.

The whole government is aiming for stability to prepare for that event. Staying with a Zero-COVID-19 policy would be the low-risk decision. Ordinary Chinese citizens don't seem ready to abandon the policy, as evidenced by heated debates online every time a new country decides to just "live with the virus." The people on the outside may not like it, but, ultimately, lasting social change only comes from the people within China making a collective political decision.

There are many sad stories about the effects of the Zero-COVID-19 policy. In Chinese media, the town neighboring Burma, Ruili, was in the headlines for constant lockdowns due to human smuggling and importing cases. Mental health and family separation stories are both prominent in Chinese and English media. However, the media needs to be cautious about going from the news to a narrative that the Zero-COVID-19 policy is the main factor causing the current economic slowdown.

In summary, the biggest uncertainty for 2022 is still growth—not COVID-19—and it depends on whether China could have a soft landing from the energy crunch and real estate slowdown.

For more insights on China from Liqian, make sure to check out her [China of Tomorrow](#) podcast. You can listen to the last podcast below.



nov. de 2021 - China of Tomorrow

Data References

<https://www.moh.gov.sg/covid-19/testing/situation-report-pdf>

https://www.mhlw.go.jp/stf/covid-19/kokunainohasseijoukyou_00006.html

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Kara Marciscano, Jianing Wu, Brian Manby and Scott Welch are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Purchasing Managers' Index (PMI) : An indicator of the economic health of the manufacturing sector. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. A reading above 50 indicates an expansion of the manufacturing sector compared to the previous month; below 50 represents a contraction while 50 indicates no change.

Bureau of Labor Statistics (BLS) : A federal agency that collects and disseminates various data about the U.S. economy and labor market.

Caixin Manufacturing PMI : Chinese manufacturing composite indicator designed to provide an assessment of manufacturing activity. A number below 50.0 indicates that the manufacturing economy is declining, and a value above 50.0 indicates an expansion of the manufacturing economy.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.