Economic Monthly [Asia]

Downward pressures on the Chinese economy from new developments in the pandemic are growing

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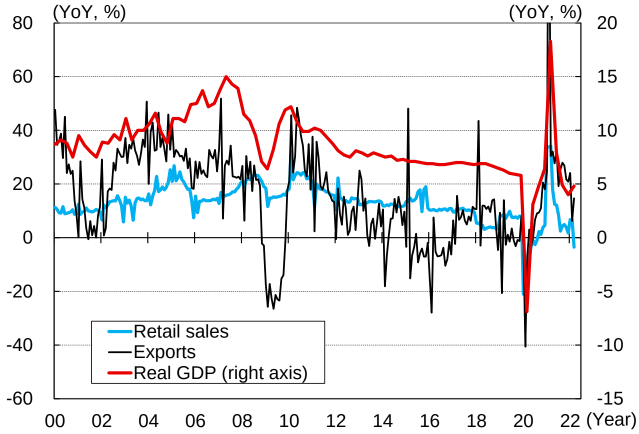
China's real GDP growth rate for the January-March quarter was firm at 4.8% YoY – an acceleration from 4.0% YoY in the October-December quarter last year. However, with monthly statistics showing a 3.5% YoY decrease in retail sales in March, there has been an abrupt rise in concerns about a deceleration of the economy (Chart 1).

A decrease in China's retail sales from the previous year is extremely unusual and there is a feeling that the burden of China's "zero COVID-19" policy has been growing recently. Since the end of last year, the world has adopted a "trial and error" approach to dealing with the Omicron variant, which presents with relatively mild symptoms but is highly contagious. Countries will probably maintain economic activities with the help of vaccination – mainly in developed countries – and their own policies to prevent the spread of infection. In China's case, the number of cases is still very low compared with other major countries, yet completely eradicating the infection is not easy due to the highly contagious nature of the Omicron variant. This means China has been forced to continue its stringent measures to contain the infection owing to its "zero COVID-19" policy. Since March, there have been continuous lockdowns in economically-significant regions, such as Guangdong Province (12% of nominal GDP) and Shanghai (4% of nominal GDP). In particular, there is rationing in Shanghai and economic activities are reported to be very limited. It is possible that the impact of city lockdowns will be greater than the downward pressure on the economy from the "zero COVID-19" policy, which the Economic Research Office calculated in January to be a 1.4% point drag on in this year's economic growth rate (see China Economic Monthly published 18th February: Although it carries the risk of an economic downturn, China maintains its "zero COVID-19" policy).

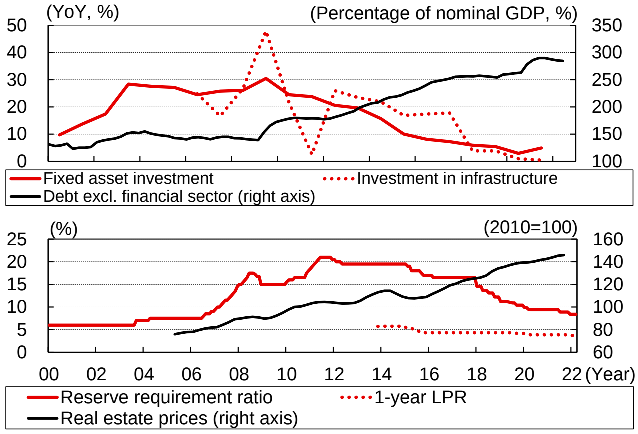
In the past, China would overcome a worsening of its economy due to exogenous factors with large-scale fiscal and monetary policy. In recent years, the global financial crisis of 2008 and the outbreak of the COVID-19 pandemic in 2020 come to mind. However, issues of excess debt and soaring real estate prices have emerged and it is unclear how much scope remains for monetary easing and increasing investment this time (Chart 2). In addition, measures to control the spread of infection have led to serious supply constraints (people, logistics and production), and there are concerns about how effective demand-stimulating policies could be in tackling this issue. Strict measures to control infection were effective in suppressing the first wave of the pandemic, but it appears to be more difficult to respond with such policies now. In addition, production activities in China are an important part of the global supply chain, which means developments in China's situation will be important in terms of the global economy.

Chart 1: China's Major Economic Indicators



Source: National Bureau of Statistics of China,
MUFG Bank Economist Research Office

Chart 2: China's Investment, Debt and Monetary Policy



Source: National Bureau of Statistics of China,
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