China’s latest Covid symptom: a loss of GDP growth

The cost of China's latest clampdown against Covid, notably in Shanghai, isn't just limited to its people; the cost to growth is huge. We're going to try to put a number on it, but we can't give the full picture as the government will provide stimulus to repair at least some of the economic damage. That said, we are revising our forecasts

Lockdowns in Shanghai due to Covid-19 are hurting China's overall growth rate

Covid cases in Shanghai reach another peak

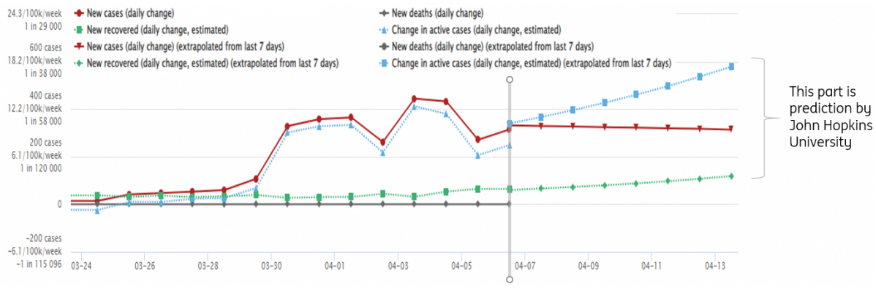
Shanghai is one of China's major finance, commerce, and trade centres. But right now, its population is locked down because of surging Covid-19 infections.

Confirmed and asymptomatic cases were 76,000 as of 5th April 2022 in the city, which is 0.3% of the city's population. This number is big for the country, but more than 85% of cases found in mass testing are asymptomatic. Right now, the policy is to only release people from lockdown once no more positive cases are found.

John Hopkins University estimates the number of Covid cases will continue to climb, mainly among people showing no symptoms. The number could surpass the previous peak on 4th April. In that case, we can assume most locations in Shanghai city will have positive cases, and tests will continue for most of the month.

That means GDP activities will mostly be wiped out this month as factories can't operate with any sense of normality. Office work, especially for those in the financial industry, should be fine as most employees can work from home. But it is uncertain whether they can work from isolation facilities as network connections can be poor.

Covid cases are predicted to surpass the previous peak



Source: John Hopkins University, ING

Our estimate of GDP loss from this round of Covid outbreak in Shanghai

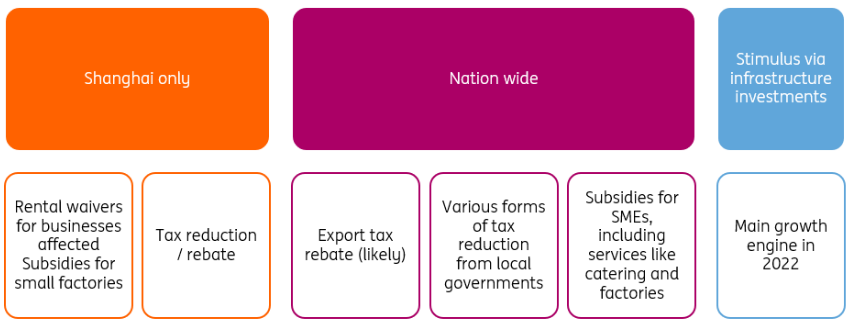
We estimate that Shanghai will suffer a 6% GDP loss if the current lockdowns persist in this month alone; that's a 2% GDP loss for the whole of China. Remember, the authorities are being incredibly strict. One infected person could affect the whole of a factory's workforce. Ports suspend operations for disinfection if one person is found to have the virus.

But that's not the whole picture. The government, both locally and nationally, will deliver relief and stimulus. These measures will be around 1% to 1.5% of GDP. But timing is crucial. The full extent of those measures isn't yet known and we need to see implementation before we can adequately calculate the impact. Measures from central government, such as export tax rebates, can't come too soon.

We also expect the People's Bank of China to cut the Reserve Requirement Ratio for small and medium enterprises and to lower interest rates, maybe as early as this month.

China's possible relief measures and stimulus

Fiscal support:



Source: ING

Monetary policy projections in 2022

RRR cut	Rate cut
Most likely to be a targeted RRR cut for SMEs	The central bank, PBoC, is likely to cut 1Y Medium Lending Facility rate and Loan Prime Rate by 10 bps to 2.7% and 3.6% in April
So banks could lend to SMEs at a lower interest rate	Further cuts are possible
The benefit of a targeted RRR cut compared to a broad based RRR cut is that it won't flood the market with cheap liquidity. The government is still concerned about real estate property developers would ride on any opportunities to get cheap credits.	Bottom line: rate cut would not be more than 1 percentage points from the current level because the central bank has to avoid a too low interest rate environment, and 7D interest rate at 1% is the bottom line (currently at 2.1%)
Timeline: April, July	Timeline: April, July, October

Source: ING

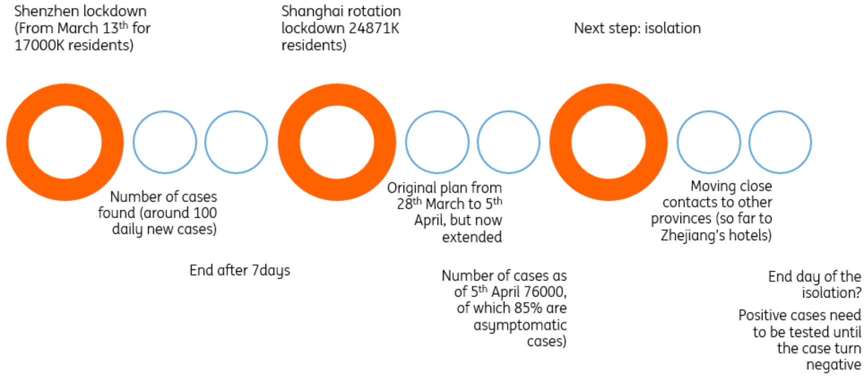
Other cities are at a risk of similar measures

We need to compare the model of Shenzhen and Shanghai in how they're handling Covid to see what the local government will do next if Covid cases are found in their cities. From the chart, we can see that Shenzhen had a very short lockdown, and the damage to economic activities was not large at all. The difference between Shenzhen and Shanghai is that Shenzhen decided to lockdown even though the number of cases was small. One reason for this is Shenzhen is located next to Hong Kong, and Hong Kong had many cases; the lockdown after mass testing broke the infection link and the city recovered quickly.

Shanghai hesitated to go into a full lockdown because it worried about the harm to the economy. But the delay led to an out-of-control situation meaning the harsh restrictions were needed for longer. Comparing the two models indicates that other cities are likely to do mass testing early to avoid Shanghai's harsh predicament.

There is, of course, also another possibility and that is to live with Covid. But as we see in Shanghai, that's unlikely not least because hospital capacity is small compared to the size of the population. So far, there are no signs that China is prepared to change tack and deal with Covid as an inconvenience rather than a widespread medical emergency that needs to be totally eliminated.

Two different stories from the Shenzhen and Shanghai lockdowns



Source: ING

Forecast downgrades

We are revising down China's GDP growth rate to 4%YoY from 5%YoY for the second quarter of this year after considering the timing of relief measures. GDP growth for 2022 is downgraded to 4.6% from 4.8%.

On any PBoC interest rate cut, we expect a 20bps cut and a targeted RRR cut of 50 bps for SMEs in 2Q22.

We are keeping the USD/CNY exchange rate forecast at 6.5 for now, but we're monitoring it closely as the lockdown factor seems to be playing a more important role now compared to the safe-haven status we saw even just one month ago.