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FOREIGN AFFAIRS & TRADE
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China Market Update – Economic stabilisation and adjustment of Covid-19 control settings

Market Report

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Summary

- Most economic forecasters do not expect China's 2022 GDP growth target of 5.5% to be achievable. GDP growth in Q2 was just 0.4%, reflecting the impact of restrictions imposed in Shanghai, Beijing and other locations to curb Omicron outbreaks.
- There is evidence that the risk of a resurgence of Covid-19 and the impacts of any restrictions to contain an outbreak, will continue to constrain consumer and investor confidence.
- While the Chinese government continues to maintain its 'dynamic zero' Covid policy, it has also placed significant emphasis on 'stabilising' the economy through stimulus and other support measures. On 23 May Premier Li Keqiang announced 33 measures designed to stabilise economic growth amid Covid-19 shocks and other downside pressures.
- Premier Li has also signalled that while China was focused on economic recovery, the intention was to avoid overstimulating the economy. He suggested that "macroeconomic policies will be targeted, forceful, and reasonable" and that "we will not introduce super large-scale stimulus measures, over-issue the currency, and overdraft the future, in order to achieve an overly-high growth target".
- The Chinese government has also sought to take various steps aimed at reducing economic disruption caused by 'dynamic zero' Covid public health measures. For example, it has reduced the quarantine period for inbound international travellers to a 7+3 model (seven days in hotel quarantine followed by three days of home isolation), and reduced pre-departure testing and other requirements. Since the start of June, major Chinese cities that faced significant Covid-related restriction on movement, such as Shanghai, have had restrictions further eased.
- According to available data, air connectivity into and within China has improved over June-July. The reduction in some pre-departure and quarantine measures, the expansion of available air routes into China, and financial support provided to China's aviation sector have all supported an increase in the number of flights to and from China.
- Since May, China's economic indicators have shown some improvement in the manufacturing sector, fuelled by the suppression of Covid-19 outbreaks and the relaxation of related control measures. However, low levels of confidence and domestic consumption continue to act as a drag on growth, as does the uncertain external environment.

Report

Suite of Economic Measures to "stabilise" the Chinese economy

In Q2 of this year, China's economy was significantly affected by the restrictions imposed to contain Covid-19 outbreaks in major cities such as Shanghai and Beijing. Growth was just 0.4% for the quarter, compared with 4.8% in Q1, giving a growth figure of 2.5% year-on-year in H1.

Premier Li Keqiang's 33 economic support measures

On 23, May at a meeting of China's State Council, Premier Li Keqiang announced a package **of 33 support measures designed to stabilise China's economy**, many targeting SMEs (see annex for list of measures). The package includes additional tax relief for businesses (bringing the full year total of tax relief to around NZ$600 billion), social security contribution exemptions for SMEs, emergency loans to airlines, as well as a directive to local authorities to increase "other support" to SMEs. A number of credit and investment measures were also announced, including bringing forward the timeframe for deploying funds raised from bond issuance, and issuing additional bonds to support infrastructure investment, as well as promises to defer SME loan repayments for the remainder of the year.

Then, on 25 May, Premier Li held a teleconference of local and national officials to discuss the challenges facing economic growth. In the official account of the Premier's address, he stated that **the current economic disruption was in some respects larger than that which China experienced in early 2020**, when China's economy contracted 6.8% year-on-year in the first quarter. Premier Li is reported as comment that, were China to fall further off the pace of growth, it would be extremely difficult for it to regain economic momentum. Premier Li also used his speech to urge local officials to roll out "as many practical measures as possible" to help stabilise the economy.

A focus on infrastructure spending

In support of the 33 economic measures announced, on 28 June the National Development and Reform Commission (NDRC) indicated that it would **accelerate infrastructure projects, and roll out further policy tools to boost domestic demand and drive economic recovery**. NDRC also stated that China would speed up efforts to implement a package of stimulus measures, such as the sale of big-ticket items including cars or home appliances to further increase consumption potential.

At a provincial level, local government, including Beijing, Shanghai, Guangzhou, Inner Mongolia, Heilongjiang, Nanjing and Ningxia have also unveiled region-specific policies to boost foreign investment and shore up local economy in response to the 33 measures.

New infrastructure stimulus announced since May is estimated at approximately RMB 3.1 trillion (2.7% of GDP), delivered through a state infrastructure investment fund, special purpose bonds, and policy bank lending. Major infrastructure projects are also seen as a way to boost employment and spur consumption. The NDRC urged the implementation of key job-boosting projects at both the central and local levels (in June unemployment was sitting at 5.5%). These infrastructure projects will fall into several major categories including: transportation, water conservation, energy, agriculture, rural affairs, urban construction, ecology, environment and rebuilding from disasters.

China won't overstimulate the economy

On July 19, in a virtual address to the World Economic Forum, Premier Li signalled **that while China was focused on economic recovery, it would not overstimulate the economy**, stating "macroeconomic policies will be targeted, forceful, and reasonable". In even clearer terms, Premier Li said "we will not introduce super large-scale stimulus measures, over-issue the currency, and overdraft the future, in order to achieve an overly-high growth target" and "we must insist on seeking truth from facts, do our best, and strive to achieve a relatively good level of economic growth throughout the year."

Economic commentators have interpreted Premier Li's statements as a recalibration of expectations around meeting the 5.5% annual growth target. However the Chinese system will still be aiming for significant recovery in H2. Given Chinese officials will have to contend with low levels of confidence and domestic consumption that continue to act as a drag on growth, economic stimulus will be needed to sustain an economic recovery and create jobs. So the focus on delivering economic stimulus will likely continue, albeit targeted and measured.

Relaxing of China's quarantine measures

China continues to make adjustments to its 'dynamic' zero-Covid policy response, as it balances public health and economic objectives. On 28 June, the State Council announced it would **reduce the length of the quarantine period for inbound international travellers**. Pre and post-arrival testing requirements have also been adjusted. In practice, foreign arrivals will now need to complete seven days of centralised quarantine, followed by three days of home isolation. This change has been widely adopted across Chinese cities, including the key ports of entry for New Zealand-originating flights, Shanghai and Guangzhou.

Chinese officials have stated that the **shortened quarantine period reflects a "fine-tuning" of zero-Covid** based on its experience with Omicron. Travellers will still be required to complete five PCR tests (throat swabs) during those seven days. As another safety measure, all individuals who work in roles where they come into contact with inbound travellers and cargo would now be required to be tested every 24 hours (this includes workers at the airport, border and quarantine facilities). Beijing, municipality which has often imposed additional measures on international arrivals, now also applies the 7+3 approach.

Improving Air Connectivity

Following the relaxing of quarantine measures, the **volume of international flights booked online in China have reportedly surged, with seats on incoming flights in strong demand**. China's Civil Aviation Administration (CAAC) officials reported that in July domestic flights have rebounded to 10,000 a day, 64.5% of pre-pandemic levels. This represents a rebound, and is being attributed to a combination of: the recovery from Covid-19 outbreaks in Beijing and Shanghai; the relaxation of quarantine requirements; increases in the number of flights and flight routes into China; loosening of Covid-related control measures in the aviation sector; and monetary support provided to the sector.

In June, the Civil Aviation Administration of China (CAAC) announced that there would be **a gradual increase in the number of international flights authorized to fly to China**. The announcement reportedly attracted applications to CAAC from several Chinese airlines for flights on over 41 international routes. To date, the **experience of foreign airlines in securing flight routes has been mixed**. We understand that while some have been offered commercially attractive routes (e.g. slots at major Chinese airports), others have been offered options with less commercial appeal.

Since 1 June, CAAC has also tweaked the policy that allows it to impose flight bans on airlines that bring more than a certain number of Covid-19 cases into China. The 'window' for counting caseload has been reduced from seven to five days, which in theory should lower the likelihood of flight cancellations. However, in practice, the increased virulence of new strains of Covid-19 has meant the use of the circuit breaker policy has increased (in the period of June 1-15 2022, 82 inbound international flights were cancelled under the circuit breaker policy compared to 26 in the same period last year). For context, since coming into effect in June 2020, the policy has been applied over 700 times leading to the cancellation of over 1600 international flights (NB: this does not include those instances where air crew tested positive on arrival into China, necessitating the cancellation of the aircraft's return service.)

For passenger services involving New Zealand, the Air New Zealand Auckland-Shanghai service, the China Eastern Auckland-Shanghai service, and the China Southern Auckland-Guangzhou service remain the key passenger routes between New Zealand and China. This provides a basis of continuity for ongoing New Zealand-China air connectivity. It remains unclear when/whether other pre-pandemic passenger routes between New Zealand and China will resume.

Economic situation improving, but consumption weaknesses remain

Data released from China's National Bureau of Statistics on 30 June pointed to an **improving manufacturing sector**. In June the manufacturing purchasing managers index (PMI), the production index, and the new order index all returned to positive growth. **Supply chains have also become more stable** according to the supplier delivery time index. These improving economic indicators point to the impact of easing Covid restrictions.

However, Premier Li warned senior local government officials on 7 July that “the foundation for recovery is not stable, and arduous efforts will be required to stabilize the economy”. The **manufacturing industry remains challenged by weak market demand**. In June, 49.3% of firms reported insufficient orders, compounded by narrowing of profit margins. Smaller firms are reported to have felt the impact of weak demand and reduced profit margins the most.

It is therefore unsurprising that SMEs featured prominently in the 33 economic support measures announced by Premier Li. The focus on SMEs reflects the oversized impact of Covid-19 related disruptions on SMEs and their importance to the Chinese economy and employment (with 80% of China’s non-governmental workforce comprised of firms with 300 employees or less). Several of the announced measures would ease some of the fiscal pressure on SMEs and encourage capital investment into expansion, procurement or R&D. However, SMEs remain particularly vulnerable to the impact of further Covid-19 restrictions due to their underlying need to sell to generate immediate cash flow (even more so for SMEs in the services sector, which rely on regular operating capital, with tourism and hospitality most impacted).

During the outbreaks of the Omicron variant across China in Q1 and Q2 2022, surveys from foreign business chambers of commerce in China overwhelmingly named China’s dynamic zero Covid controls as the largest impediment to doing business. The logistical challenges of lockdowns and the unpredictable nature of restrictions made business planning extremely challenging, according to the foreign chambers of commerce. Premier Li met with representatives of the foreign business community in late May to understand the impacts of China’s policies on foreign business activity in China.

Emphasis on ‘economic stabilisation’ to continue; risk of Covid-19 resurgence lingers

China’s soft economic growth in Q2 has demonstrated the impact of restrictions imposed in Shanghai, Beijing and other locations to curb Omicron outbreaks. With only 0.4% in growth in Q2 (2.5% y-o-y in H1) most economic forecasters do not expect China’s 2022 GDP growth target of 5.5% for the full year to be achievable. Given the low growth figure in H1, economic commentators anticipate that the Chinese government will employ further economic stimulus – that is measured and targeted – to recover ground in Q3 and Q4.

Sitting in behind this, the risk of periodic resurgences of Covid-19 and the impact of any restrictions to contain outbreaks remains. This uncertainty will continue to constrain consumer and investor confidence. Looking ahead, while the Chinese government continues to maintain its ‘dynamic zero’ Covid policy, it is likely that the emphasis placed on ‘stabilising’ the economy will also be sustained in the longer term.

ANNEX

The 33 Economic Support Measures announced by Li Keqiang on May 23

Fiscal policies:

- RMB 14.20 billion in new tax returns. Potential expansion of tax returns to more sectors such as wholesale, retail, hospitality, education, health, sports and recreation etc. Sectors such as manufacturing, scientific research & technology, energy, ICT, and air services etc. have already been granted tax returns.
- Transfer payments to be sped up.
- Expansion of special local government loans
    - Complete the insurance of RMB 3.45 trillion loans by the end of June and usage by the end of August.
- Capitalise on government-guaranteed financing.
    - At least RMB 1 trillion in new government-guaranteed financing to support of eligible SMEs and self-employed businesses in transport, hospitality and tourism etc.
- Government purchases from SMEs will benefit from a greater discount (from 6%-10% to 10%-20%).
- Deferral of the payment of social securities.
- Reduction of the unemployment rate
    - Return 50% of unemployment insurance payments to large enterprises (previously 30%).

Monetary policies:

- Encourage deferral of interest and payment of loans for SMEs, self-employed businesses truck drivers, and individuals whose payment of property mortgages and consumption loans have been affected by the Covid-19 pandemic. The deferral can be extended to no later than the end of 2022.
- Strengthen support for small universal beneficial loans
- Gradually reduce loan interest
- Encourage IPOs, listings and financial bonds
    - Support Chinese mainland businesses to list in Hong Kong. Platform companies can list overseas in accordance with laws and regulations.
- Issuance of further loans for infrastructure construction

Supporting investments and stimulating consumption:

- Commissioning the construction of water conservation projects
- Speeding up investments into transport projects
- Renewal of urban underground facilities
- Encourage the private sector to prioritise investment into infrastructure
- Encourage the platform economy
    - emphasise healthy development and fair competition
- Encourage the consumption of major commodities like automobiles and home appliances
    - relax trade restrictions and reduce taxes and fees

Food security and energy security:

- Issue allowances for agricultural production, including a second round of agricultural subsidies worth RMB 10 billion (following the first batch of RMB 20 billion).
- Relax restrictions on coal-fired power, while ensuring environmental protection
- Commission the construction of new energy projects
- Enhance the capacity of coal storage
- Enhance the capacity of storing energy resources such as crude oil

Stabilising industrial and supply chains:

- Reduce SMEs' fees for water, internet and electricity
- Exemption of three to six months' worth of rent for SMEs and individual businesses if the workspace is

state-owned.

- Solve funding shortages and extend RMB 150 billion in new loans for the civil aviation industry. The aviation industry is permitted to issue RMB 200 billion bonds.
- Facilitate enterprises to resume production by developing a “white list” of businesses
- Ensure sound logistics and unblock transportation routes
- Issuance of further loans for logistics and transport pivots
- Encourage foreign investment in major projects
    - streamline investment procedures
    - speed up the updating of the Catalogue for Encouraged Industries for Foreign Investment
    - guide foreign investment in manufacturing and high-tech areas, as well as in central and western China

Supporting livelihoods:

- Deferral of payment by employers and employees to the housing provident fund (to reduce the financial burden on businesses and household budgets).
- Fiscal allowance for localities that absorb more rural employment
- Provision of social securities to disadvantaged groups

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