Significant economic slowdown as China battles COVID

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The world economy took another step towards recession with the announcement yesterday that China, the world's second largest economy, had grown by only 0.4 percent year-on-year in the second quarter. This was below the 1.2 percent predicted by economists and well down from the 4.8 percent year-on-year growth recorded in the first quarter.

The main reason for the slowdown was the effect of the two-month lockdown of Shanghai as the government sought to implement its policy of Zero-COVID.

Shanghai has re-opened but China is now facing the effects of the BA.5 variant of the virus which is rapidly spreading around the world because of the abandonment by all governments of even limited mitigation measures, let alone pursuing the necessary policy of global elimination.

According to an analysis made by the Japanese financial firm Nomura, 31 Chinese cities are under full or partial lockdown, affecting almost 248 million people and accounting for 17.5 percent of the country's economic output.

The Chinese experience demonstrates two things: public health safety measures can bring the pandemic under control, but elimination is impossible solely on a national basis.

Besides the devastating health impact as millions are condemned to an unnecessary death, the refusal to adopt such an international strategy is not only fuelling inflation, it is pushing the world economy into a slump.

On a quarter-by-quarter basis, the economy contracted by 2.6 percent in the three months to the end of June, compared with 1.4 percent growth in the first quarter. The June quarter contraction was well above predictions of a 1.5 percent shrinkage.

Unemployment is starting to rise with the level of youth joblessness rising to a record 19.3 percent.

Releasing the figures, a spokesperson for the National Bureau of Statistics, Fu Linghui, tried to put the best face on the situation at a press briefing yesterday morning.

"Generally speaking, with a series of policies to solidly stabilise the economy achieving notable results, the national economy has overcome the adverse impact of unexpected factors, demonstrating the momentum of stable recovery," he said.

During a visit to Wuhan last month, Chinese President Xi Jinping indicated that Zero-COVID would continue. While he acknowledged there were economic problems, he said it was better to "temporarily affect a little economic development rather than risk people's health and safety."

Chinese authorities have estimated that hundreds of thousands, if not millions, could die if the "let it rip" policy in the rest of the world were adopted.

But there are signs of cracks in the regime. In its report on the COVID-induced economic downturn, the *Washington Post*, one of the many media outlets around the world calling for the abandonment of Zero-COVID, eagerly seized on such indications.

It reported that when Chinese Premier Li Keqiang visited the coastal city of Fuzhou to hold discussions with officials in the south-eastern industrial area about how to bring stability, he urged they steer the economy back on track.

Photographs in state media have shown Li in meetings where no one was wearing a mask, and these appearances "have been interpreted by some as a show of support… for a faster return to normalcy."

It described the Zero-COVID policy as "increasingly controversial and economically damaging." But apart from sections of the upper middle class, whose objections are eagerly seized on by the western media, the official policy enjoys wide public support, and the government fears it would face massive opposition were it abandoned.

The Chinese government is seeking to alleviate the

COVID economic damage by loosening financial conditions and allowing local government authorities to issue additional bonds to finance new projects. But financial stimulus measures are restricted by the shift by major central banks to a higher interest rate regime. Authorities fear there will be a fall in the value of the renminbi and a capital outflow if monetary policy is relaxed too much.

The economic slowdown in China means that the three major economic regions of the world—the US, Europe and China—are moving closer to recession.

The escalation of inflation in the US—it jumped to 9.1 percent in June, up from 8.6 percent the previous month—means that the Fed is certain to again lift interest rates by 0.75 percentage points at the end of the month, and possibly by a full 1 percent.

This has fuelled predictions of a recession under conditions where the US economy contracted by 1.6 percent on an annualised basis in the first quarter and a similar result appears likely for the second.

The present Fed rate is between 1.5 and 1.75 percent. But according to Jeffrey Lacker, a former president of the Richmond Fed, it would have to go to 6 percent to influence inflation. Such an escalation would virtually guarantee a recession under conditions where the financial system, as well as consumer and business spending, have become dependent on a low interest rate regime.

Former treasury secretary Lawrence Summers has said that an unemployment rate of 10 percent, lasting for a year, is necessary to bring inflation down.

The economic outlook in the euro zone is going from bad to worse. This week the value of the euro has fallen to parity with the US dollar—at one point it went below parity—amid fears that a cut-off of Russian gas supplies as a result of the US-NATO war in the Ukraine could induce a deep recession.

The European Central Bank (ECB) is committed to start lifting its interest rate when it meets later this month, but only by 0.25 percentage points, well below the rate rises in the US, and this is driving down the value of the euro.

The falling euro adds to the cost of imports driving up inflation from its present level of 8.6 percent and adding to pressure on the ECB to move faster with rate hikes. But such moves threaten to lead to "fragmentation" in financial markets as the interest rates on the bonds of the more indebted countries of the south rise above those on the bonds of countries of the north.

In 2012, this divergence threatened the continuation of the single currency. The ECB has said it will develop measures to counter this threat when it meets next week.

Under what were once regarded as "normal" conditions, a fall in the currency would be regarded as having some benefits by making exports cheaper in world markets. But not in the present situation where currency falls drive up inflation.

"The extreme price increases in import and producer prices overshadow any profit that exporters can book for themselves due to a weaker currency," Sonja Marten, head of foreign exchange and monetary policy at DZ Bank in Frankfurt told the *Wall Street Journal*.

Summing up the implications of the euro's plunge, James Athey, investment director at Abrn, a major UK investment company, told the *Journal*: "What it is indicative of is that this is a horrific situation for the eurozone."

In the past, during periods of major currency misalignments, international agreements were reached—one recalls the Plaza and Louvre accords of the 1980s—to stabilise the situation. No longer.

Speaking after a meeting this week with the Japanese finance minister Shunichi Suzuki, where the rapid fall of the yen against the dollar was discussed, US treasury secretary Janet Yellen made it clear there would be no intervention to bring down the dollar and G7 countries should have market-determined exchange rates.

The position of the Biden administration is that a strong dollar is of assistance in bringing down inflation. Yellen did not use the words of Nixon's treasury secretary John Connally in 1971, after the president closed the gold window, "the dollar is our currency but it's your problem," but she could well have.

In a world of growing recessionary trends, escalating inflation, financial turbulence, and currency storms, it is very much every man for himself and the devil take the hindmost.