Opinion **Coronavirus pandemic**

The rest of the world should watch what is happening in Shanghai

Covid lockdown in China's biggest city will have global economic reverberations

ROBIN HARDING

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Robin Harding YESTERDAY

One of the hardest things to bear about the Shanghai lockdown, says a contact who has been shut in a small apartment with her father for the past two weeks, is the uncertainty. She spends her days on WeChat message groups, trying to co-ordinate bulk food orders, or looking out of the window to see where the authorities have placed the red lines of their cordon sanitaire, which residents must not cross. There is little other information.

Social media shows a city on the edge. Residents yell from their balconies and demand food. Drones broadcast messages demanding they return inside. Thousands of people who have tested positive are crammed into isolation centres.

On Tuesday, the US state department ordered non-essential workers to leave its consulate in the city because of "arbitrary enforcement of local laws and Covid-19 related restrictions".

It is one of the most severe lockdowns of the entire pandemic. It will affect the economies of Shanghai, China and the whole world. Yet it is happening at a time when, in Europe and the US, many people are on to their third or fourth round of infection and ready to ignore the whole thing. There is a risk, therefore, that they miss the significant consequences of what is taking place in China's largest city.

Three economic impacts stand out: on supply chains, on China's own growth and on the country's internal debate about reform.

One of the biggest inflationary shocks to hit the world economy in the early days of the pandemic was supply chain disruption caused by shipping delays at ports. Shanghai is the biggest port in the world. Although its terminals are working in a "closed loop" bubble — where staff have no contact with the outside world — there are problems with logistics across the region, so vessels have begun to queue up in the waters offshore as they wait to load or unload. Factories across Asia will have to wait for components. Europe and the US will feel the disruption with a time lag of some weeks or months.

That will manifest itself as an inflationary shock at a moment when western economies already have too many others to deal with, from the jump in commodity prices caused by the war in Ukraine to their own labour market disruptions after the pandemic.

The impact should be less severe than it was in 2020 or 2021, because the new delays will hit just as previous supply shortages unwind, but it will, at the minimum, add extra uncertainty to an already confusing price environment for beleaguered central banks.

Within China, the lockdown of its commercial capital will have an escalating effect on growth, and premier Li Keqiang has repeatedly sounded the alarm over the past week. The economist Jingjing Chen of Tsinghua University and colleagues have used tracking data from 1.8mn long-haul trucks to study the economic impact of China's city-by-city lockdowns. Truck traffic to a city drops by around 60 per cent when a city enters full lockdown; putting those impacts into a trade model allowed them to estimate the spillover costs elsewhere.

A one-month lockdown in Shanghai — close to the scenario now playing out — would cost 4 per cent of national income for the month in question, according to their model. That is already enough by itself to have a meaningful effect on annual growth, but in the extreme case where all Chinese cities are locked down, national income would fall by more than half for that month — an enormous and unsustainable cost.

The more Covid lockdowns drag on China's growth, the harder policymakers will find it to stick to their plans for deleveraging in the property sector, the struggles of which are exemplified by the giant developer Evergrande. The larger the economic losses to the pandemic become, the greater will be the pressure to boost activity with a fresh real estate binge.

Most fundamental is the question of how Chinese policymakers interpret Shanghai's suffering and what it prompts them to do next.

One interpretation would be that neither Shanghai nor any other city can be expected to go through such a lockdown twice, so China must prepare to end its zero-Covid strategy and live with the virus. The other interpretation — which is the one more likely to prevail among local officials without a clear signal from the top — is that Shanghai's mistake was to delay its lockdown until too late.

Guangzhou recorded just 27 cases on Monday, but it has moved schools to online learning and restricted movement in and out of the city. All but 13 of China's 100 most productive cities have already imposed some degree of quarantine, according to analysis by research firm Gavekal. Given how infectious the Omicron variant is known to be, it could mean frequent lockdowns across China for the rest of the year — a downside risk that markets are barely pricing in.

The best political option for President Xi Jinping, as he aims to secure a third term in office this autumn, may be a hard line on lockdowns. The best choice for China's economy is clearly to maximise vaccine coverage, preferably using more effective mRNA vaccines, and then exit zero-Covid. That choice — politics or growth — will drive the global economy for the rest of this year.

robin.harding@ft.com