

Economic Watch

China | Will the country abandon its “zero tolerance” strategy against Covid-19 soon?

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March 15, 2022

Recent Omicron flare-ups in China posing serious challenges to the country’s “zero tolerance” strategy

In contrast to most countries in the world, China has been strictly implementing a “zero tolerance” strategy in dealing with the Covid-19 pandemic since its inception. This strategy, albeit bearing high economic and social costs, was still successful in that it protected numerous lives from the fatal contagion in such a populous country. Thanks to its successful implementation, Chinese people managed to live a tranquil life over the past couple of years despite the initial outbreak in Wuhan at the beginning of 2020. In the meantime, China’s economy averted a recession in 2020 and engineered a V-shape growth rebound in 2021, outperforming most of major economies in the world. More importantly, the “zero tolerance” strategy has bought time for China to successfully carry out the domestic vaccine investigation and the ensuing national vaccination. Now with 87% of total population jabbed, all existing variants of the Covid-19 virus appear not as deadly to Chinese as two years ago.

Notwithstanding China’s achieved success in battling the Covid-19 pandemic, the newly mutated Covid-19 virus, namely Omicron, seems to pose a challenge greater than ever to the country. At the beginning of 2022, the wave of Omicron variant stormed Hong Kong ruthlessly, a special administrative region (SAR) of China with a population of around 7.5 million. The Hong Kong SAR government implemented the similar “zero tolerance” strategy before the coming of the current Omicron wave. However, within one month, the number of the daily confirmed Omicron cases rocketed exponentially from only 129 on February 1st to 34,466 on February 28th. Even with enormous aid from the mainland China, Hong Kong SAR government was forced to actually abandon its version of “zero tolerance” strategy and find a way to co-exist with the virus. In a worst-scenario forecast by The University of Hong Kong, more than half of population will be infected throughout the current wave of Omicron pandemic.

The de-facto fall of Hong Kong doesn’t bode well for the mainland China. Over the past couple of years, China’s authorities have strained every nerve to clear off domestic infected cases after they put out the very first flare-up of the pandemic in Wuhan and other cities in Hubei province throughout the first half of 2020. A number of Chinese cities also experienced a complete lockdown, including Shijiazhuang, Xingtai, Langfang, Zhangjiajie, Xi’an etc. However, the new Omicron wave has already spread to almost all the 31 provinces in mainland China in a short time. Even the metropolis such as Shenzhen (which is very near HK) and Shanghai are on the brink of a full-fledged lockdown, echoing the dire situation in Wuhan two years ago. Although the numbers are comparatively small given China’s 1.4 billion total population, the social and economic costs to maintain such a low infection rate have been staggeringly large. (Figure 1-4)

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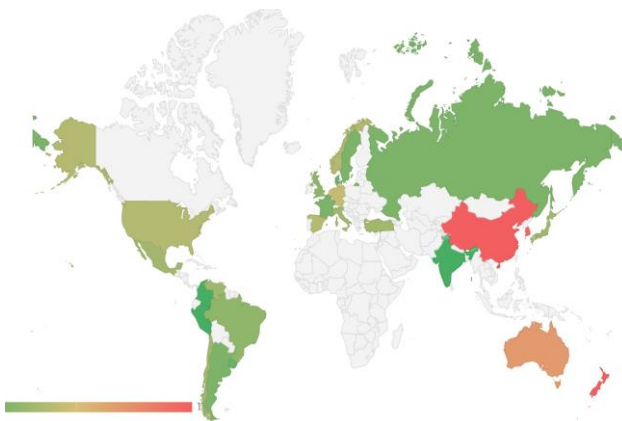
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The current situation begs a number of relevant questions: can China's authorities continue to rely on this "zero tolerance" strategy to defeat the more infectious Omicron variant? Is this strategy feasible in the long run or even forever? Under what condition will China exit this strategy? What kinds of arrangements should be in place if China's authorities decide to exit the "zero tolerance" strategy?

This note attempts to provide some preliminary answers to the above questions.

Figure 1. **OUTBREAK ALERT: HONG KONG BECOMES THE MOST SERIOUS PLACE AMONG ALL THE COUNTRIES IN THE WORLD**



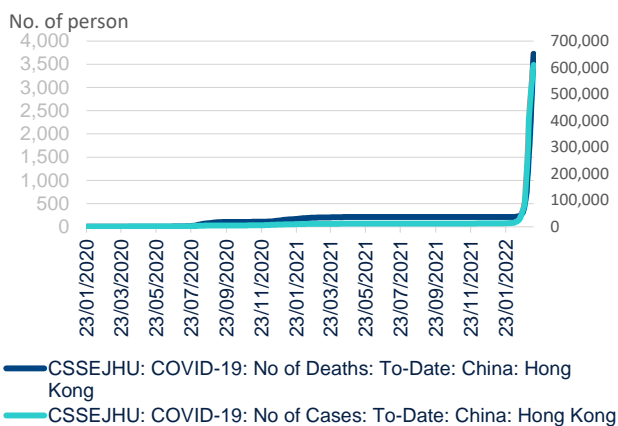
Source: CEIC and BBVA Research

Figure 2. **GLOBAL INFECTION ACCELERATION RATE**

	Infection acceleration rate* 01-mar	14-days Cumulative Incidence (per 100,000 pop) 01-mar
Global	0.98	
China	1.19	13
Japan	0.97	815
Singapore	1.01	4311
South Korea	1.07	3502
Australia	1.03	1133
New Zealand	1.29	1929
Belgium	0.95	960
Denmark	0.94	7111
Finland	0.87	1003
France	0.95	1483
Germany	0.99	2745
Italy	0.97	1074
Netherlands	1.00	3803
Norway	0.98	3598
Portugal	0.95	1639
Spain	0.98	733
Sweden	0.95	428
Turkey	0.97	1347
United Kingdom	0.96	817
United States	0.98	341
AL&TX	0.94	316
Argentina	0.95	337
Brazil	0.96	588
Chile	0.97	2137
Colombia	0.92	82
Mexico	0.97	169
Peru	0.88	211
Uruguay	0.94	1715
India	0.91	17
Russia	0.95	1403

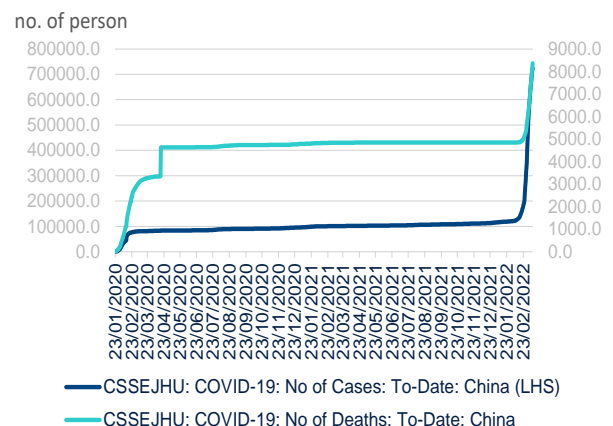
Source: BBVA Research and CEIC

Figure 3. **HONG KONG'S INFECTED CASES AND THE DEATH TOLLS**



Source: CEIC and BBVA Research

Figure 4. **CHINA'S INFECTED CASES AND THE DEATH TOLLS**



Source: BBVA Research and CEIC

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China's "zero tolerance" strategy can withstand the test of Omicron

We believe the strategy of "zero tolerance" is still technically feasible in China, even in the face of more contagious Omicron variant. The fall of Hong Kong rings the alarm for China. But it's not a good barometer to foretell the prospect of China's "zero tolerance" strategy, at least not for the current Omicron wave. Our conviction is based on our analysis of important elements included in the strategy.

Although authorities have long been emphasizing some political implications of the "zero-tolerance" strategy such as "valuing human life", the strategy seems more like an expedient solution with certain "path-dependence" feature. The authorities introduced this strategy at the outbreak of the Covid-19 in Wuhan in January 2020. After witnessing the unprecedented infectiousness of the Covid-19 virus, China's authorities quickly reach a conclusion that they need to put out the flare-ups within the country as soon as possible. Otherwise limited medical resources are not able to deal with the massive contagion and associated medical demands. The successful experience of tackling the SARS crisis in 2003 enabled the authorities to come up with the original version of "zero tolerance" strategy in early 2020. From then on, this strategy has become the cornerstone of China's campaign against the Covid-19 and has constantly been refined according to the mutation of the virus as well as domestic flare-ups.

Nowadays, this "zero tolerance" strategy contains a number of key elements which ensured its successful implementation, including:

- large-scale universal tests wherever the positive case appears;
- strict border control and forbidden foreigners to come to China;
- 14 to 21 days of quarantine requirement of close contacts and passengers;
- accurate trace the close contacts through QR code and other technology;
- lockdown the infected areas;
- forced vaccination to 3rd dose and the 4th dose in the future;
- strict restrictions to "high-risk" businesses, such as restaurants, gyms, bars, etc.
- strict sterilization of imported goods, etc.

Complementary to the above elements, China's propaganda machine has been incessantly emphasizing the threat of the Covid-19 virus, at least partially for the purpose of justifying the rightness of this "zero tolerance" strategy, and encouraging people to cooperate with the authorities in implementing relevant measures. Indeed, universal tests, lockdowns, close-contact tracking etc. have already become part of many Chinese people's daily life. For the majority of them, they are quite willing to follow those strict measures to minimize the infection risk.

In our opinion, the cooperation of the general public constitutes one of important factors making the strategy feasible. Additionally, the super-strong capability of China's governments is also indispensable. Frequent universal tests combined with the accurate trace of individual movements, albeit at the cost of personal privacy, make it possible to identify the infected cases and their close contacts in the society in a very short term. With strong capability of resource mobilization and deployment, the government can effectively separate these high-risk people from the others, substantially reducing the risk of contagion. If a considerable fraction of people in a city is infected,

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the local government can impose very restrictive lockdown policy locally while receiving necessary supports from their neighbor regions or the central government.

On top of above cultural and institutional factors, China has a huge domestic market and a complete supply chain in almost all the economic fields. Unlike some small open economies, Chinese “zero tolerance” didn’t not have devastating impacts on the economy per se given its large domestic market; by contrast, the “zero tolerance” strategy helped China “first-in, first-out” of the pandemic and achieved 2.2% GDP growth in 2020, the only positive growth country among the main economies in the world.

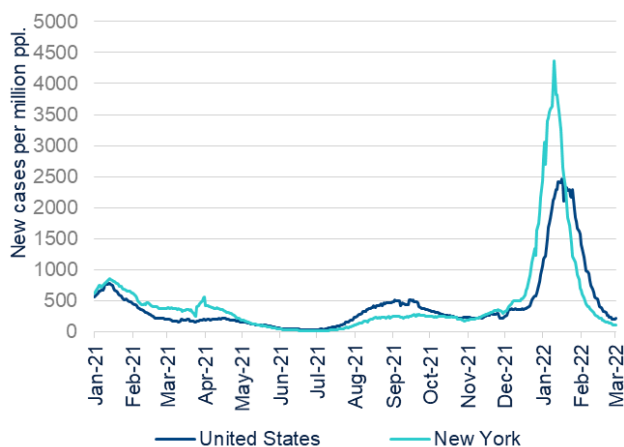
However, “zero tolerance” strategy has become unpopular internationally

Among all the countries in the world, China is the first one to initiate strict “zero tolerance” policy and will be the last one to abandon this policy. Chinese authorities have adopted this strict dynamic zero clearing strategy, which is by sharp contrast with the US and the EU starting from the very beginning to the end.

For some Asia-Pacific countries, such as Australia, New Zealand, Singapore, they followed China’s “zero tolerance” initially but quickly abandoned it to join “co-existence” camp after the more infectious Omicron became the dominant variant. Till now, among all the economies in the world, only the mainland China, HK, Taiwan and North Korea are still sticking to the “zero tolerance” strategy while others are adopting “co-existence” with various degree. More importantly, after countries started the “co-existence” strategy, their infected rates have actually declined gradually together with an improving vaccine rate in the past two years. (Figure 5-8)

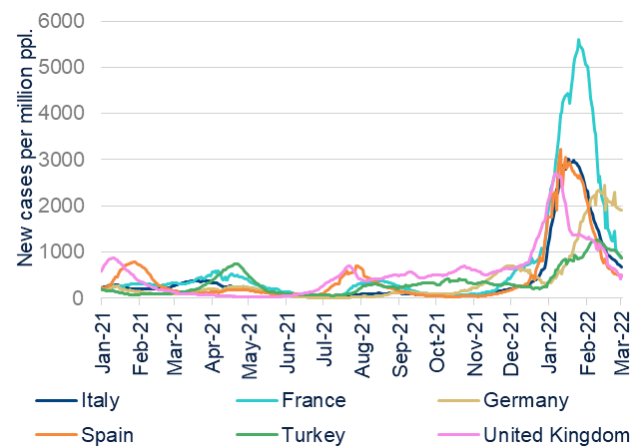
Australia, New Zealand and Singapore have good reasons to choose the “co-existence” with the Covid-19 virus. First, the new variance virus Omicron, with higher transmission rate and lower severe and death cases, is gradually becoming more likely an endemic or flu rather than pandemic. Second, the improving vaccination rate and the investigation of Covid-19 special medicine also largely reduced severe cases and death toll. Third, countries with economic pressure have to normalize the economy as soon as possible to avoid social instability and to support growth. Fourth, countries, for example Singapore, having tight relationship with the global economy and international people movement, have to re-open their borders to maintain their economic growth vitality.

Figure 5. THE US NEW INFECTED CASES (7-DAY MOVING AVERAGE PER MILLION PEOPLE)



Source: CEIC and BBVA Research

Figure 6. THE EUROPE NEW INFECTED CASES (7-DAY MOVING AVERAGE PER MILLION PEOPLE)



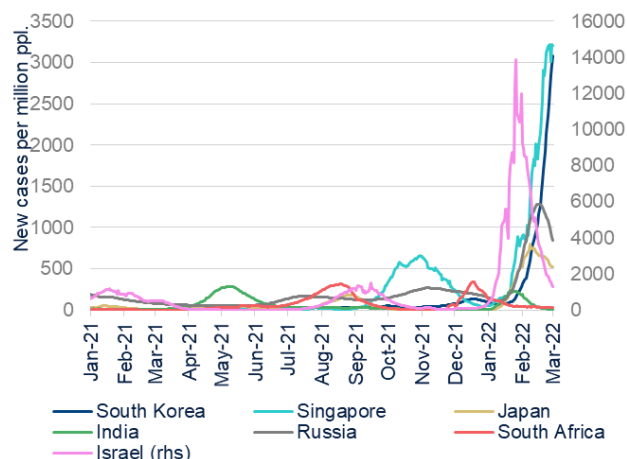
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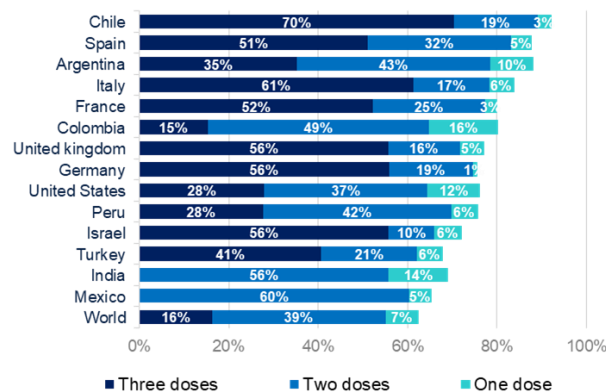


Figure 7. **NEW INFECTED PEOPLE: OTHERS**
(7-DAY MOVING AVERAGE PER MILLION PEOPLE)



Source: CEIC and BBVA Research

Figure 8. **POPULATION VACCINATED WITH AT LEAST ONE DOSE (*)** (% OF TOTAL POPULATION)



Source: BBVA Research and CEIC

China still needs time to transit its Covid-19 strategy

Will China abandon its “zero tolerance” strategy? The short answer is “no” in the short-term, and “yes” in the medium-to-long term with a series of pre-requisites and in an orderly, gradual and restricted manner. According to the talks of the high-level experts of China’s National Health Commission, China is indeed trying to figure out a Chinese-style “co-existence” roadmap which will be implemented in an appropriate time in the future. In addition, they also emphasized that “zero tolerance” is the specific strategy for China in the specific time which cannot be unchanged forever.

Meanwhile, the authorities’ political agenda will largely determine the timing of ushering in the transition from “zero tolerance” to “co-existence”. The Chinese Communist Party (CCP) is going to hold its 20th National Congress this autumn at which the new leadership of the Party is to be elected. In March 2023, the leadership will officially assume their roles in the administration at the 14th People’s National Congress. Therefore, the market consensus expect that the authorities won’t allow any failure of the “zero tolerance” or its transition to “co-existence” before the completion of national leadership change.

In addition, there are a number of pre-requisites for China to secure a smooth transition from “zero tolerance” to “co-existence” with the virus:

First, the “co-existence” in China will be based on the investigation of the evolution of the Covid-19 virus including its variance and the experience gained from the countries that opened the economy. Chinese authorities believe that it is not time yet for the human society to completely master the evolution and characteristics of the Covid-19 variance virus, for instance, what is the frequency of the appearance of new variance virus and what will be their characteristics such as the death toll and severe cases in the future. China’s gradual opening highly depends on the authorities’ progress to master these knowledges based on investigations for international data.

Second, the implementation of “co-existence” strategy also depends on three important medical factors, namely the specific Covid-19 medicine development in China, the clinic results of China-produced vaccines and the vaccination rate for the 4th dose in China (particularly for the elder people). China has 1.4 billion population and an

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aging society, so that Chinese authorities will be very cautious on the death toll and severe case rate when “co-existence” strategy applies.

Third, China’s “co-existence” will be conducted in an orderly, restricted and gradual manner and we do not expect a sudden overall re-opening of the economy. For instance, China may start the re-opening by easing the restrictions of border control, allowing foreigners to apply business visa to travel to China and reducing the quarantine length for passengers or close-contacts from 21 days to 7 days, etc.

Fourth, based on Chinese authorities’ experience of “crossing the river by feeling for the stones”, there will be some pivot program of re-opening in some specific cities after March 2023. Although the details have not been released yet, starting with trial programs is always the authorities’ practice in history.

Last but not least, the government’s rhetoric needs to swerve to dissipate the public’s fear of the Covid-19 virus so as to prevent a massive panic during the transition from “zero tolerance” to “co-existence”. It is envisaged that the perceived contagion at the beginning stage of transition could prompt many people to scramble to obtain medical helps regardless of the seriousness of their symptoms. It could lead to a grave medical run and, as a consequence, raise the death toll by failing to allocate limited resources to the patients in real need. Good psychological preparations for the general public will alleviate this problem and ensure a smoother transition.

Altogether, we do not see the possibility that China will re-open the economy and abandon the “zero tolerance” policy before the 20th National Congress of Communist Party of China in Autumn and the winter flu season of this year. The possible timing of Chinese authorities to ease the “zero tolerance” policy will be March 2023 after the political factors settle down. Chinese-style “co-existence” will be conducted in an orderly, gradual and restricted manner amid the progress of medical investigation of the new variance virus, the special medicine development for Covid-19 and the 4th dose vaccination rate among Chinese people etc.

However, as the infectiousness of Omicron is much higher than all its precedents, the economic and social costs of implementing the “zero tolerance” policy will rise substantially. The flare-ups spreading around the country and ensuing restrictive measures will not only dampen domestic economic activities but also lead to the production disruptions as well as serious logistics backlog. It might put this year’s official 5.5% growth target at risk. The global inflation outlook could deteriorate as well. We will analyze the economic impact of this zero tolerance strategy in a separate note in future.

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