The impact of China’s zero-covid strategy on global supply chains

Blog post by Ross Nugent, Associate, Trade and Manufacturing, 30 March 2022

As most of the world’s major economies learn to live with covid-19, China remains committed to a strategy of suppressing even single-digit caseloads of the virus. Until recently, the policy could be credited as a relative success in both epidemiological and economic terms. As mounting caseloads and more infectious variants prompt officials into renewed lockdowns in China’s busiest port cities, the zero-tolerance policy has become an increasing headache for policymakers in Beijing. Will the zero-covid strategy compound supply chain disruption in the months ahead, and is it a sustainable policy?

The arrival of the Omicron variant in the New Year saw China record its highest cases since the country’s punishing first wave in 2020. Having recently hosted the Winter Olympics with no major outbreaks, clusters in Shanghai’s financial district have now prompted Chinese policymakers to impose a two-stage lockdown. The Shanghai lockdown could be extended if more cases are uncovered.

A lockdown in Shanghai is especially important from the perspective of global supply chain disruption. Shanghai is the world’s single busiest port, handling more than 43mn TEUs in its last pre-covid year of 2019 and 47mn TEUs in 2021, including 32mn for international trading. What’s more, Shanghai ports consistently rank among the world’s best-connected, and started the year strong after setting a monthly record of 4.35mn TEUs in January alone.

Port authorities insist that 24-hour service will continue at all terminals. However, this needs to be taken with a degree of caution. Ports terminals at Shenzhen might have remained operational through its recent lockdown, but yard congestions and queues of ships were widely reported as truckers struggled to access the port and warehouses were abruptly closed. Most expressways into Shanghai have been brought to a halt and logistics firms warn that Shanghai Pudong Airport is increasingly difficult to access.

Factories themselves have been forced to close, choking off supply before it even reaches ports. While most leading manufacturers have managed to keep their plants open in the early days of the Shanghai lockdown, Tesla has not, and the temporary closure of Foxconn factories in Shenzhen in mid-March suggests that critical manufacturers remain exposed no matter how rigorous their “closed loop” facilities may be.

This alone is likely to have material implications for the broader challenge of unknotting supply chain blockages that have developed over the last two years. If lockdowns extend across other Chinese centres this will be compounded. Not least because China’s east coast ports are critical nodes in the China-Europe rail corridor, already under pressure from the war in Ukraine. Firms that are re-routing to Ningbo or further afield to Qingdao may find that lockdowns overtake them.

The IMF's latest research suggests that the inflationary pressure of these shipping disruptions and costs is poised to rise through the end of this year, impacting businesses in the immediate future before the cost is passed on to consumers within the next 12-18 months. Much of this research does not even fully account for this new wave of disruptions.

The key point here is that China's policy of snap lockdowns proved effective at containing the pandemic in its early phases, but lockdowns come at a high price in potential supply chain disruption. With a relatively weak home-grown vaccine safety net - roughly 86% of its population is vaccinated, but some evidence suggests that the protection provided by these vaccines is lower than Western-developed mRNA alternatives – Chinese policymakers have another reason to fear the health costs of abandoning a zero-covid policy. The absence of a short-term exit strategy from the cycle of snap lockdowns remains a considerable risk to already fragile supply chains.