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Chinese Covid Zero Tolerance and the Supply Chain

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Despite their repeated denials, China was responsible for not containing Covid-19 at its source in a wet market in Wuhan in 2019. When it became apparent that the Coronavirus strain was deadly and spreading rapidly, the Chinese pivoted to a zero tolerance policy. They locked down Wuhan and successive cities in their attempts to control viral spread. China continues this approach even though the virus has spread across the world and the omicron strain that emerged in South Africa has come back around to infect China. Our concern has to do with Chinese Covid zero tolerance and the supply chain. China currently has 20 million people under lockdown. Companies across the world that outsource to China are worried about another nail in the coffin of the ailing world supply chain.

How to Best Contain Covid

Because Covid-19 is transmitted by coughs, sneezes, and even loud talking through the air simple measures like wearing a face mask, keeping “socially distanced” at six feet or more, and washing hands and face all help. A valid question at this phase of the pandemic is whether or not totally shutting down a city like the Chinese are doing is the best idea or not. When the Covid-19 pandemic began, death rates were substantially higher than they are now. Doctors know better how to treat the disease and which medicines will help. And, where vaccines are available and are being taken they have substantially reduced the incidence and severity of the disease in vulnerable populations like the elderly. And, the new omicron variant is less lethal than the original strain or the delta variant. The Chinese approach seems like “overkill” at this point and is likely to result in consequences such as slowing the economic recovery (China’s GNP is down) by reducing production of goods and transport from China.

Supply Chain Problems and Inflation

Prices are going up in response to the law of supply and demand. Because US companies have come to rely on offshore manufacturing, especially China, any disruption on that end results in closed down assembly lines in North America. Something that many folks would not have expected is that the prices of used cars have gone up because a shortage of computer chips has reduced the number of new cars being built. The problem for investors is that inflation has reached levels not seen in forty years and that is prompting the Fed to reduce their stimulus bond purchases more rapidly than expected. They will be raising interest rates and reducing their balance sheet. All of this will likely reduce inflation but it may also send the country into a recession or at least increase unemployment as the [price of taming inflation](#) like it did in the 1980s.

Which Stocks Will Get Hurt the Most by China’s Zero Tolerance Covid Policy?

The mix of stocks that will be hurt this time around by a Covid-related situation are not necessarily the ones that got hurt in early 2020. Hospitality and travel are still hurting from Covid but do not offshore anything to

China. The big tech companies like Microsoft and Google should not be greatly affected. Manufacturing companies have come to rely too greatly on parts manufactured in China, including things like lithium [batteries for electric vehicles](#). To the extent that the Fed misses when trying to tame inflation the damage could be a lot more widely spread.

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