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Will Putin's War Slow China's Growth?

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CHICAGO – On March 5, China announced a GDP growth target for this year of about 5.5%, the lowest target since 1991. But that should not come as a surprise. In 2013, World Bank economists and the Chinese State Council projected that China's annual growth rate would decline to 5% by 2030. This may still be an overestimate, given that growth rates during 2010-16 have been found to be inflated by 1.8 percentage points and that average growth in OECD economies is around 3%.

Back then, economists and policymakers also accurately predicted the main challenges to long-run growth in China, including increasing inequality, corruption, an aging population, inefficiency in large and often state-owned firms, and pollution. But no one could have foreseen the additional significant economic uncertainty stemming from the COVID-19 pandemic and now Russia's invasion of Ukraine.

The pandemic has severely disrupted supply chains and pushed up prices everywhere. China is particularly worried about rising food prices, because the country is a net importer of food, with the bill totaling \$133 billion in 2019. Supply problems and bad weather caused the price of vegetables in Chinese cities to increase by 30.6% year on year in November 2021. The price of eggs, a major source of protein for the middle class, rose by 20.1% over the same period.

China's other main concern is the cost of energy, because it is also a net importer of coal, natural gas, and crude oil. Increased demand from Chinese factories resuming production during the post-pandemic economic recovery contributed to further increases in the prices of energy commodities. Chinese regulators responded by increasing the cap on subsidized electricity prices. But this was insufficient to offset the losses to electricity generators as coal prices and domestic demand continued to rise. As a consequence, power plants in several northeastern provinces shut down in September 2021, leading to sudden mass power outages and a cascade of economic and social disruptions.

The Chinese government has since increased the price cap even more and boosted domestic

production of coal, using its large reserves. But China's reserves of other energy sources are limited, and demand for energy is likely to continue to rise.

These economic concerns, along with a desire to present a common front against the United States, help to explain China's commitment to the "no limits" relationship with Russia that President Xi Jinping and Russian President Vladimir Putin proclaimed in early February. Energy is the economic centerpiece of Sino-Russian relations. In 2019, fuel accounted for about 17%, or \$344 billion, of China's total imports of \$2.1 trillion. Russia has been the biggest crude oil exporter to China since 2016, and is its fastest-growing supplier of natural gas. Twelve percent of all Chinese oil and gas imports now come from Russia. To meet domestic energy demand and moderate its greenhouse-gas emissions, China plans to increase the share of natural gas in its primary energy consumption to 15% by 2030. Russia holds nearly a quarter of the world's gas reserves and is the largest exporter. The two countries therefore agreed last month to a long-term contract under which Russian gas exports to China will increase to 48 billion cubic meters, or nearly 10% of China's predicted gas consumption of 526 billion cubic meters, by 2025.

Russia's invasion of Ukraine, and the subsequent Western-led economic and financial sanctions imposed on Russia, has suddenly cast a shadow of uncertainty over these plans. Besides exacerbating existing supply-chain disruptions, the wide-ranging sanctions have made it difficult for Chinese firms to operate in Russia. Most importantly, the war involves two of the largest global exporters of food and energy.

Ukraine and Russia together account for 28% of world grain exports, and wheat futures on the Chicago Mercantile Exchange have soared by more than 50% since the invasion. Similarly, oil, gas, and coal prices have surged due to supply disruptions and the sanctions against Russia. These inflationary pressures could have potentially devastating effects on the Chinese population, as well as on the country's manufacturers.

But the Chinese government's neutral political stance toward the Russia-Ukraine war may also yield economic payoffs if China becomes more important to Russia without overly offending major Western trading partners such as the US and Australia. Russian food exports in 2021 totaled \$38 billion, of which \$4.7 billion went to the European Union. So, Chinese food-price inflation could be moderated if EU sanctions cause Russia to divert some of its food exports to China on favorable terms.

Similarly, China is likely to gain more favorable terms for its energy imports as the war continues and other countries reduce their purchases of Russian oil and gas. The US has banned imports of Russian oil, and other countries are likely to follow suit. Likewise, the EU plans to reduce its reliance on Russian natural gas by two-thirds this year and seek alternative suppliers and energy sources to compensate.

While the switch away from gas will take time, it seems inevitable that Russia will need to look for other buyers soon. Given that oil and gas accounted for 60% of Russia's exports and generated 39% of its federal budget revenue in 2019, China will be in a strong bargaining position.

Ultimately, the Russia-Ukraine war's impact on the Chinese economy will depend on the duration of the conflict and the extent of the devastation that it causes in Ukraine and Russia, and other parts of the global economy. It will also depend on how much goodwill remains between China and Ukraine's Western allies when the fighting stops.

Clearly, 2022 will be a year of uncertainty in which China has limited control over its rate of economic growth. New risks arising from the war in Eastern Europe have compounded the challenges that policymakers anticipated owing to the slow and uneven post-pandemic recovery. At this point, how China and the rest of the global economy will fare in the coming months is anyone's guess.

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