ECONOMY | ASIA ECONOMY

China Seeks to Cushion Blow of Economic Pain as Momentum Slows

Beijing eases some earlier tightening policies amid uncertainty around Covid-19, property-market slump and looming drop-off in export demand

People were tested for Covid-19 in Beijing on Monday, as China faced rising uncertainty around the spread of the pandemic.

PHOTO: THOMAS PETER/REUTERS

By Stella Yifan Xie Follow

Updated Jan. 17, 2022 9:31 am ET

HONG KONG—Last year, Chinese policy makers shook up the world's second-largest economy just as its rebound from the pandemic was starting to wear off, unleashing a flurry of measures to address longer-term economic imbalances—and delivering a short-term hit to business activity.

Now, China's leaders are hoping that they can put a floor under the economy, which officials said Monday expanded by just 4% in the fourth quarter of last year, the slowest pace since the beginning of the Covid-19 recovery in the second quarter of 2020.

To do so, they are easing some of their earlier tightening policies, for example by increasing mortgage lending to home buyers. The country's central bank on Monday cut two key interest rates that could pave the way for further cuts to the benchmark lending rate.

But they face rising uncertainty around the spread of the Covid-19 pandemic, as well as a continued property-market slump and what economists say is a looming drop-off in export demand during a politically important year. Chinese leader Xi Jinping is expected to break with recent precedent and seek a third term as leader at a closely watched Communist Party meeting later this year, and the political imperative for growth and stability have raised the likelihood that Chinese policy makers respond to any weakness by easing some of its regulations.

While the country's gross domestic product expanded by 8.1% in 2021 from a year ago, the figure "masks a significant loss of growth momentum," said Eswar Prasad, a professor of trade policy and economics at Cornell University, who pointed to weak consumer demand caused by China's strict Covid-19 measures.

"More stimulus measures [are] likely to be unveiled if domestic and external circumstances remain unfavorable," said Mr. Prasad, a former head of the International Monetary Fund's China division.

There are risks too in easing too quickly or dramatically, underscoring the tightrope that authorities must walk this year.

Loosening restrictions threatens to leave unresolved long-festering issues such as a frothy housing market, a fast-declining birthrate and widening social inequality, which could further undermine Beijing's goal of ensuring stable growth.

The world is increasingly reliant on China as a market for commodities and as a vital hub in the global supply chain; a cargo ship in Qingdao.

PHOTO: YU FANGPING / COSTFOTO/ZUMA PRESS

Monday's data showed the number of newborns in China falling for a fifth straight year in 2021 to the lowest level in modern Chinese history, despite new measures unveiled last year by Beijing to encourage births.

"The more you emphasize stability, the more you emphasize avoidance of defaults, redistribution and paying the costs of indebtedness, the more it creates conditions for instability down the road," said George Magnus, a research associate at Oxford University's China Center.

After staging a spectacular rebound from the pandemic based largely on its manufacturing sector, China's economy quickly slowed in the second half of 2021 as a flurry of regulations roiled private businesses in the consumer internet, education and real-estate sectors.

The direction of China's recovery will be closely watched around the world, which has grown increasingly reliant on China as a market for its commodities and as a key hub in the global supply chain.

Manufacturers in Germany, Europe's biggest economy and industrial powerhouse, are feeling the squeeze by the slowdown in China, which was Germany's largest trading partner in 2020. German exports to China declined by 4.2% in November year-over-year, to €8.9 billion—worth $10.1 billion—while its exports to the U.S. surged by about 15% to €11 billion over the same period, according to the federal statistics agency.

At Volkswagen AG , global vehicle deliveries declined by almost one-third in the three months through December, to about 1.9 million. Sales in China, its biggest single market, were particularly weak, declining by about 37% year-over-year in the last quarter of 2021 to about 755,000.

Many economists expect Beijing to set a growth target of at least 5% this year, largely in line with the country's pre-pandemic trajectory. If economic conditions deteriorate more dramatically, China could respond by further easing some of the earlier tightening policies.

Wei Yao, chief China economist at Société Générale, said new easing measures, including attempts to stimulate infrastructure spending and consumption, could come as early as annual legislative meetings set for March.

One key sector to watch will be the property market, which by some estimates accounts for roughly one-fifth of overall economic activity in the country.

Though many economists predict the real estate slowdown to stabilize by midyear, the sector is unlikely to bolster the economy like it has in the past.

"The government is managing a downturn in the real-estate sector to avoid any kind of crisis, but I also don't expect too much growth from that," said Bert Hofman, director of the East Asian Institute at the National University of Singapore and a former World Bank economist.

Another risk is Covid-19 and China's zero-tolerance policies to contain the virus' spread. Beijing has shown little appetite to change course on its "zero-Covid" approach, which economists say could mean more economic pain this year as consumers spend more frugally.

Monday's data showed retail sales, a gauge of consumer spending, weakening further in December, rising just 1.7% from a year earlier. Over the past two years, monthly retail sales have increased by just 3.9% on average in year-over-year terms, far below the roughly 8% level before the pandemic.

China's headline measure of joblessness, the urban surveyed unemployment rate, also increased to 5.1% in December, the third straight monthly increase. The jobless rate for the 16-24 age group remained unchanged at 14.3%.

"The biggest downside risk for 2022 is still with consumption, due to lockdowns and public concerns over Omicron," said Yue Su, China economist at the Economist Intelligence Unit.

Ms. Su worries that stimulus efforts may not reach the private sector, which supplies 80% of jobs in urban areas. Further weakness among private companies could portend a decline in investment, rising joblessness and stalled income growth, she said.

—Grace Zhu, Bingyan Wang and Tom Fairless contributed to this article.

Write to Stella Yifan Xie at stella.xie@wsj.com