

Economic Update – First Impressions.

17 March 2020



NZ Government's Covid-19 support package.

- The NZ Government has announced a Covid-19 economic support package worth 4% of GDP, although only about two-thirds of that will hit the economy soon. This will cushion the blow, but the next step is to plan for the post-virus phase.

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The New Zealand Government's Covid-19 support package is suitably aggressive and will cushion the blow to parts of the economy, but it is only the start of what is required. While the package was costed at \$12.1bn, that figure actually bundles in the four-year cost of some measures that are permanent, and that the Government was probably planning to do anyway. We estimate that the actual stimulus hitting the economy over the next few months will be up to \$7.5bn (depending on uptake of the wage subsidy). That is still a huge figure, equivalent to 10% of quarterly GDP.

The package will not prevent a large decline in GDP due to the virus. We are still finalising our forecasts, but indicatively GDP could decline by 2% to 3% in the June quarter. To put that in perspective, during the 2008/09 recession GDP declined by 2.7% over 18 months. There is nothing the Government or the Reserve Bank can do to prevent a sudden decline in economic activity. Trying to support demand at this juncture would be futile, and possibly counterproductive, because containing the virus actually requires suppressing some forms of economic activity.

The best contribution Government can make is to tide businesses and households over through this period of economic disruption, minimising economic damage and allowing for a smoother post-virus recovery. The Government's measures should be timely enough to prevent economic damage, while being targeted and temporary enough to avoid unnecessary damage to the Crown's own balance sheet. Some elements of the package announced today meet those criteria, and will cushion the blow to the economy, while other elements are not particularly relevant to Covid-19 – we provide case-by-case assessments below.

While the package announced today will cushion the blow to the economy, the Government has yet to work out how it will assist with the recovery phase. The Minister of Finance was clear that today's package is a start, and further economic aid will be announced later. That makes sense – we don't



yet know when any recovery might begin and what might be required to facilitate it.

Today's package will cause Government debt to begin rising sharply. The debt to GDP ratio is currently about 20%, but could rise by two to three percentage points for each quarter that these measures are in place. Fortunately, the Crown balance sheet is starting from a strong enough position to withstand that for some time.

\$5.1bn wage subsidy.

Firms that can show revenue is down by at least 30% compared to a year ago will be paid \$581 per week per full-time employee. The subsidy is available for 12 weeks. The maximum per firm is \$150,000, which would cover 21 workers. This will be a significant aid to small and medium sized businesses, and prevent unemployment from rising quickly, although it won't help all businesses. It is targeted in the sense that only struggling businesses will receive a subsidy, although it will have the unintended consequence of bailing out businesses that were failing even before Covid-19 struck. The actual cost of this policy is wildly uncertain. The \$5.1bn budgeted is enough to subsidise around 750,000 full-time workers, or a third of the workforce, but it is not clear that that many businesses will qualify. That said, if the virus causes deep disruption for a long time this policy could become extravagantly expensive, and the Government wouldn't be able to keep it up for more than a year or so.

\$2.8bn increase in benefits.

The permanent increase in benefits of \$25 per week smacks of something the Government wanted to do anyway, but is bringing forward. It is not targeted or temporary. It won't do much specifically to cushion the Covid-19 blow, except insofar as laid-off workers receive a bit more each week. Doubling the winter fuel payment is also poorly targeted. The main effect will be to increase the income of people already not in work, while doing very little to tide over people who have lost their job. The Government suggested this would be a demand stimulus. But as noted above, demand stimulus is not what is required right now (although it may help with the subsequent recovery). That said, this aspect of the package is actually quite small, since it is costed over four years.

\$100m to pay sick leave for people in self-quarantine or suffering Covid-19.

This makes a lot of sense, and will ease the burden on households and businesses.

\$500m for the health system.

Absolutely necessary – we are surprised it wasn't a lot bigger.

\$2.8bn in business tax measures.

Tiny businesses won't have to pay provisional tax, and the IRD will be able to waive penalty interest on late tax payments for firms disrupted by Covid-19. This makes a lot of sense – it amounts to the Government extending short-term credit to the business sector.

One uncosted initiative is that "officials are working with banks to explore working capital support, including in the form of loan guarantees for businesses that face temporary credit constraints" Something along these lines would make a lot of sense and would tick all of the boxes in terms of being timely, targeted and temporary.

The plan to reinstate depreciation on buildings is something that will affect businesses over a timeframe of years, rather than particularly helping with the Covid-19 crisis. It shouldn't really be counted as a stimulus measure.

The package announced today is squarely aimed at small business, which makes sense because they probably have the most fragile balance sheets and the least ability to access working capital. However, if large businesses get into trouble, it could be more dangerous for the economy. The Government does have more time to help large businesses, and it seems it is "working on it". A \$600m "aviation support package" will presumably be to recapitalise Air New Zealand. The Government has instructed officials to work on support options for other large businesses, which will presumably be dealt with on a case-by-case basis.

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