Economic Bulletin.

14 August 2020

The return of COVID-19: possible economic implications.

- Nobody knows how the re-emergence of Covid-19 will play out.
- This bulletin considers the economic impact of three possibilities.
- A short period at Alert Levels 2 and 3 would have little lasting economic impact.
- A new Level 4 lockdown would see us lift our unemployment forecast to 8%, from 7% now.
- The incremental damage would be less than the first lockdown, because there will be no new damage to international tourism.
- Another lockdown would require government support, so debt would rise to 55% of GDP.
- We have learned that the economy can bounce back surprisingly rapidly from a successful lockdown.
- International experience shows that losing control of the virus would be much more damaging to the economy.

Community transmission of COVID-19 has re-emerged in New Zealand. The Government has responded by raising the COVID Alert Level for Auckland to 3, while the rest of New Zealand is at Level 2.

Nobody knows how this is going to play out, so in this bulletin we discuss the economic implications of three possible outcomes. If this is just a scare, and the Alert Levels are raised only briefly, then the economic implications are small. If New Zealand goes into another strict Level 4 lockdown, the economic implication would be more severe. However, the incremental damage would be smaller than the original outbreak of COVID-19, mainly because there will be no new damage done to international tourism. If the virus gets out of control, that would be a real game changer for the New Zealand economy, based on what we are seeing overseas.

If it is just a scare.

If the Alert Levels are not raised further, and things return to normal within a couple of weeks, the economic impact will be relatively small. We have calculated that, for each week that Auckland is at Level 3 and the rest of New Zealand at Level 2, about $300m of economic activity is foregone. This equates to 0.5% of quarterly GDP. But, during a brief lockdown, a higher proportion of that lost activity would be recouped shortly afterwards, so the actual lasting economic damage would be significantly smaller than this $300m figure.

Our estimate of the cost is smaller than for the first lockdown because the economy is now taking a hit from an *already damaged* baseline. For example, this lockdown can't reduce international travel and associated services much further, because spending on these is already close to zero. Similarly, some events like sports fixtures were already cancelled before this lockdown, and some New Zealanders were already behaving more cautiously than normal.

Finally, we would not make any change to our GDP or unemployment forecasts in this scenario of a COVID 'scare'. We would continue to forecast an increase in the unemployment rate from today's 4% to a peak of 7%. That's because our central forecasts already allowed for occasional scares of this nature. Epidemiologists have been advising that bouts of community transmission were a matter of when, not if, and many other countries that had quashed the virus have had flare-ups recently.

Table of lockdown costs

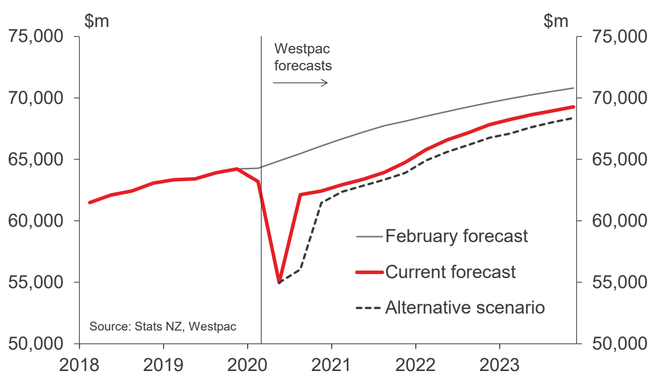
Scenario	$m per week	% of weekly GDP	% of quarterly GDP
Auckland at Level 3, rest of NZ at Level 2	304	-6%	-0.5%
Auckland at Level 4, rest of NZ at Level 2	717	-15%	-1.2%
All of NZ at Level 3	575	-12%	-0.9%
All of NZ at Level 4	1603	-34%	-2.6%

If there is a new lockdown.

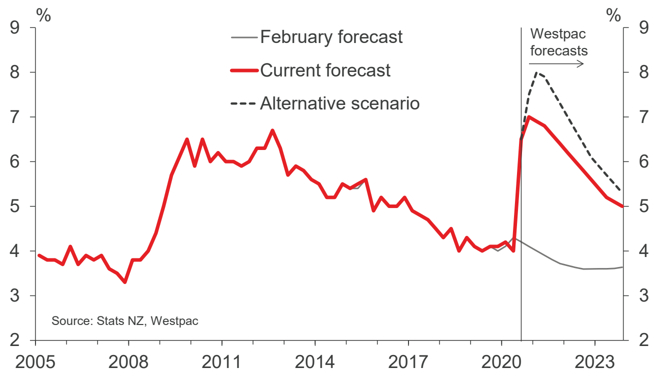
We have generated a forecast scenario that envisages New Zealand entering a new Level 4 lockdown for six weeks. The key points are shown in the charts. We stress that this is an illustrative scenario only, not our view on what is going to happen (nobody knows that!).

Following the first lockdown, there was a period of severely curtailed economic activity. The economy rebounded very quickly, but we estimate that it settled roughly 5% below our pre-COVID forecast. If there was another lockdown, there would obviously be another period of curtailed activity, so the September quarter would look similar to June. We estimate that this time, economic activity would rebound very quickly to around 5.5% below our pre-COVID forecast. This additional half percentage point of lasting economic damage would reflect additional business failures, additional layoffs, and a loss of confidence impacting investment activity.

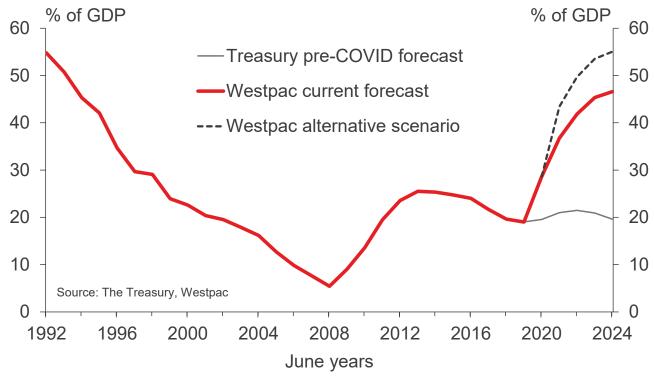
Level of GDP



Unemployment rate



Net core Crown debt as a % of GDP



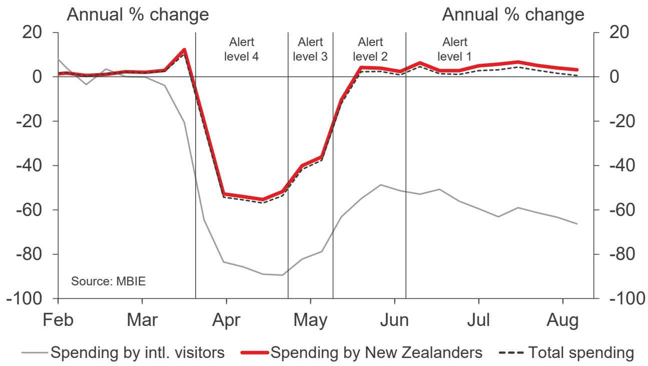
Our unemployment forecast would peak at about 8% in this alternative scenario, compared to a peak of 7% in our current forecasts. We expect that the Government would restart the clock on the wage subsidy scheme, preventing a sharp wave of layoffs, but the additional damage to the economy would still mean more accumulated job losses and a slower pickup in hiring.

While this additional economic damage is serious, it is a relatively small increment compared to the damage wrought by the original outbreak of COVID-19. That's because there will be no new damage to international tourism or the foreign education sector, because foreign residents have already been barred from entering New Zealand.

Our analysis shows that the majority of the lasting economic impact from the first lockdown has been in international tourism and education. For example, providers of accommodation, recreational and travel services are reporting that sales are still down more than 20% on this time last year, with the bulk of that fall due to the loss of spending by international tourists. Total spending by people using overseas electronic cards is down 66% compared to last year.

The remainder of the economy has stunned everybody by bouncing back from lockdown much more readily than anticipated. Retail spending by New Zealanders is back around the levels that we saw prior to the outbreak of COVID-19. Looking across categories of spending, anything not related to international travel has rebounded to roughly where it was a year ago. Electricity consumption is above year ago levels, heavy traffic is back to normal, house sales have been extremely strong, and building activity remains robust.

Weekly retail spending



If international travel can't be damaged much more, and the rest of the economy behaves like it did after the last lockdown, then the additional economic damage from a second lockdown will be incremental rather than transformative.

The surprising resilience of the non-travel economy was aided by substantial government support, particularly the wage subsidy. We are assuming that this would be repeated in another lockdown, and that would have big implications for Government debt.

The Government has $14bn left in its $62bn COVID response and recovery plan, but in a second lockdown they wouldn't be constrained to spending only that amount. We've assumed around $17bn of additional spending, focused on short-term income support to deal with the stresses of a second lockdown. A repeat of the wage subsidy scheme would account for much of this.

On top of the extra spending required, we estimate that the economic consequence of a second lockdown would reduce government revenue by $13bn over four years. Put together, this would leave the government's books in much worse shape, with an additional borrowing requirement of $30bn. On our forecasts, this would see net debt peak at around 55% of GDP, compared to 47% in our baseline forecast.

Even with a significant increase in Government spending, another lockdown would leave the economy with additional scars. For instance, continued pressure on balance sheets would prompt businesses to further scale back plans for investment spending or reduce staff numbers. As a result, New Zealand's recovery from COVID could be even more gradual, with GDP around 0.5 percentage points lower at the end of 2025 than in our base case forecast.

If the virus gets out of control.

If New Zealand loses control of the virus, that would be a game changer for the economy. Around the world, we are seeing a sharp divergence in the economic performance of countries that have control of the virus, compared to countries that do not. Countries that have implemented successful lockdowns are generally doing much better economically than countries that have not – illustrating that the 'choice' between health and economy was always a false dichotomy.

China largely has the virus under control, even if there have been occasional outbreaks. China's strict lockdown supressed the spread of the virus, but also saw GDP falling by 10% in the March quarter. The benefit of this aggressive action is now evident. GDP rebounded by 11.5% in the June quarter, with a recovery in production levels and the reopening of the services sector.

At the other end of the spectrum is the United States. After US economic output fell 9.5% in the June quarter, we were beginning to see signs of a nascent recovery, including a firming in the jobs market. However, the US reopened its economy early, allowing a second wave of the virus to take hold. Unemployment is now rising again, and our forecasts of US economic activity have been revised lower.

All of this suggests that if New Zealand goes into another *successful* lockdown, it will suffer only incremental additional economic damage, whereas if the virus gets out of control the economy would take a much bigger hit.

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