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Not going viral: How Auckland bounces back from covid-19

- Levels 4 and 3 limits on business activity, designed to prevent the spread of covid-19, have led to a dramatic slowdown in economic activity.
- There are learnings from recent global events such as the GFC and the SARS outbreak, but the similarities are few because of the cause of this downturn in the case of the former, and the scale in the case of the latter.
- We expect the recovery to be relatively sharp although not as sharp as the decline, with obvious ongoing weakness in international tourism despite a likely travel agreement with "trusted nations".
- One of the biggest challenges will be confidence to start spending and investing again, particularly in industries with an overseas orientation.

In mid-March, the national and Auckland economies enjoyed GDP growth in the 2% range, an unemployment rate of 4%, and business confidence that was catching up with reality rather than holding the dystopian outlook it had held for about 18 months. There was a bubbling US-China trade war and rising risk of recession in Europe. New Zealand's domestic outlook was solid. Reflecting this, house prices in Auckland were up 11% in a year and retail trade growth was strong.

Two months later, the world economy and our daily lives were brought to their knees by the global covid-19 pandemic.

Have we been here before?

Recent global downturns, pandemics and natural disasters provide some learnings on how recovery may look that we ignore at our peril.

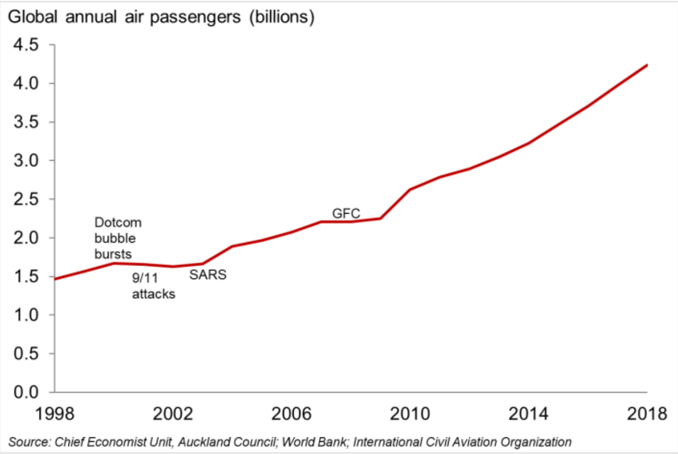
GFC – feet of clay, long recovery

The most recent global economic downturn was the Global Financial Crisis (GFC). Like this downturn, the first casualties in New Zealand were mainly lower-paid discretionary retail and tourism/hospitality workers.

But the similarities end there. The GFC was precipitated by speculative behaviour and shady credit ratings mostly in the US and Europe. Despite the populist rhetoric that nothing has changed in the regulatory environment, it has, certainly in the Australian and New Zealand context.

As we've highlighted before, the economic fundamentals in Auckland were solid going into the pandemic, and the actual economic downturn is largely the result of decisions to trade off economic activity against saving lives and not overwhelming health systems. This means that as New Zealand gets the virus under control domestically, which it has done, we can expect a resurgence in economic activity that wasn't possible after the GFC, where we languished at low growth for more than three years. It will help that our two biggest trading partners – China and Australia – are also recovering rapidly from the pandemic.

SARS – small impact with resilient tourism



SARS was also first spread by international travel, and hurt the tourism industry badly. Yet in calendar year 2003, total global passenger numbers still rose by 2.3%. The following year, they surged 13%. Even the earlier 9/11 attacks and the burst of the dotcom bubble combined for just a 2.8% decline in two years.

Ironically, the tripling in travel since 2010 is a big factor in the rapid spread of today's pandemic.

It is hard to get good data on what the SARS outbreak did to the world economy. One estimate was a cost of US$40 billion. Covid-19 will easily be 100 times that impact. Indeed, New Zealand's own fiscal and monetary response already exceeds this. Further, China was a much smaller player in the world economy in 2003, as both supplier and consumer. China shutting for two months this time round will hit many other countries. SARS spread to only about two dozen countries. Today's pandemic has hit practically everywhere. Third, containment has been poor as a direct result of the first two points, which means covid-19's impact will linger longer. Finally, borders weren't shut for SARS meaning the impact on international travel was far shorter.

Canterbury earthquake – the need for catalysts

Among recent natural disasters in New Zealand, only the Canterbury earthquakes come close in terms of direct costs to New Zealand – estimated at around $40 billion. One of the criticisms of the rebuild was the slow pace at which anchor projects were delivered, one stand-out being the convention centre, which has still not been completed nine years after the most devastating February 2011 quake.

One of the main arguments for accelerating the convention centre and other anchor projects was that they could catalyse confidence and investment in the city centre through the hospitality and retail sector. We wasted this opportunity. The learning for government is that going hard and early applies to both the lockdown to save lives, and to getting going again afterwards.

Where does it end?

We have had a more optimistic view than some commentators since the beginning of April. Partly, this view is driven by the political and economic imperatives to getting the country moving again. There is only so much dampening of economic activity that can happen before politics requires an opening up. There is only so much debt you pass to your children to protect those most vulnerable to the health effects of the virus.

Alert level

We are technically in Alert Level 2 but with case numbers this low, we really are in Alert Level 1 by the government's own health definition ("Isolated household transmission could be occurring"). There is no evidence of ongoing community transmission. For conservative financial modelling purposes, we have assumed we are at Level 1 by 1 October, having navigated flu season, but in reality, we should be there in June. By May 2021, if a vaccine is in place, we could be down to Level 0.

Assumed alert levels by month, conservative scenario

2020							2021					
JUN	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
2	2	2	2	1	1	1	1	1	1	1	1 ?	1 ?

No confidence trick

Confidence in two forms will be the bedrock of economic recovery. First, confidence that the health risks have abated so people don't fear hopping on the bus or train, sitting down in a restaurant, or sending their kids to school. Second, confidence that the economy is on the up and that we can start opening our wallets again, investing in a home or new vehicle, plant or machinery, or just a discretionary restaurant meal.

Health confidence should be high. Health officials have by and large done excellently at containing covid-19 here. There should be limited nervousness at Level 1.

In our most likely scenario, we believe people will overcome nervousness to use public transport. With many businesses operating under relatively normal conditions (acknowledging the hit to internationally-oriented tourism businesses), public transport will return to being the most sensible way for many people to get to work. Nevertheless, one positive from the pandemic is that we have seen the practicalities of more working from home and we expect to see more people choosing to work from home more often.

Weak ***economic*** confidence will linger. Central and local government stimulus will help. Reserve Bank liquidity and relaxed loan-to-value restrictions will help. But it is important that we lead the way by catalysing other economic activity by investing in projects that provide good long-term social and environmental benefits while meeting shorter-term financial needs.

Governments can't do all the lifting. Even with low interest rates for the foreseeable future, credit ratings agencies will struggle to "look through" all the new debt. Much lower interest rates will make more debt manageable, but agencies' views on manageability of debt will still drive credit ratings.

Headline economic performance

A risk produced in nature has led to an almost entirely manmade economic slowdown. This isn't to say a lockdown wasn't needed – it was. But there will be very different levels of economic impact by country for similar or worse health outcomes. Commentators agree that New Zealand's lockdown has been among the strictest in the developed world. We estimate an 11.6% reduction in GDP for the year to March 2021.

A descent to level 1 will mean the economy (international tourism excepted) will bounce sharply. Our two biggest trading partners (China and Australia) seem to have the outbreak under control, which is good news. We expect GDP to bounce 8.6% in the year to December 2021.

Unemployment has surged and could peak as high as 12% although the government is aiming to keep it below 10%. Labour force participation patterns will change. In the boom years, we saw many people eke out a couple more years of work because jobs were plentiful and salaries were growing. We could now see the opposite. Disheartened jobseekers may drop out of the workforce altogether, those close to retirement might go, students may prolong time in education, and some may remain caregivers at home rather than seeking work.

Churn in employment will be significant as many businesses will disappear altogether. This means that employment will not recover nearly as fast as it has declined. But the government's additional stimulus will help and the unemployment rate will likely be around 7% by the end of 2021.

International borders

We expect to resume travel with Australia soon – likely by 1 October. Australia accounts for 40% of our international tourists, so this will be very welcome. In a best case scenario, we may have a few other trusted nations with mutual travel permitted by then.

But New Zealanders will not be travelling to a wide number of countries. This means the return of the Kiwi holiday. We will see a boost in domestic tourism, which will partly offset the loss in international revenues.

Even when borders re-open, many airlines will have disappeared. While mothballed aircraft will litter aprons and deserts across the world, it will take time before we see big money poured into air travel again. This means international travel will be more expensive and options more limited, again discouraging overseas travel.

Migration/population growth

We may see a stronger outflow of Kiwis to Australia than we have for some years if the relative openness of their economy during Levels 4 and 3 means they escape with a smaller lasting economic impact. There will be an ongoing trickle of NZers coming back from overseas where the health or lockdown impacts have made life there unattractive. This will offset some of the possible losses to Australia.

But the biggest change will be the limits on immigration from our biggest source countries –China, India, South Africa and the Philippines, which will be reduced.

Export education

Pressure to allow international students will be strong. We may see an exemption for students to study here, subject to self-funded quarantine at an approved facility.

House prices and development

The lockdown brought the real estate market and construction to a standstill. The market will take time to re-establish. How will a bank know what a house is worth post-lockdown? There may be several months of limited credit access while banks prioritise borrowers with more equity. By the end of August we expect we'll have a clearer picture of the economic damage and the new "right" price level for housing although the usual winter blues will dampen that.

House prices will fall, but not as much as some suggest. Probably in the 5-7% range (seasonally adjusted from the April 2020 peak) when the mortgage holidays end in October or November. Many of those who have been most susceptible to job losses sadly could not afford a home before the pandemic, but higher unemployment may push rental income growth down.

This uncertainty in prices will affect development activity. Developers will wait and see what will happen to the market. New resource consents and building consents will be down significantly over the next six months and growth in new rateable units will be muted.

In non-residential development, we were already tapering off pre-covid-19. This pattern will continue as developers assess demand for space with higher unemployment and perhaps greater willingness to allow more flexible working among office-dwellers. The jury is out on flexible working as some employers may have found productivity suffered or technology failure stopped efficient work from home. There will undoubtedly be more working from home at the margins, with positive impacts on congestion and emissions, but also potentially an impact on the viability of the public transport network.

Will infrastructure be the knight in shining armour?

Only in part.

Building more infrastructure will play a vital role in the recovery. First, good infrastructure decisions enable other economic activity. New pipes allow more housing development and town centre regeneration encourages more people into their local retail community. Second, not all infrastructure projects require highly skilled workers. There will be some opportunities for workers in hard-hit sectors like tourism to retrain.

But there will be limits to how many can switch. Infrastructure projects also take a long time to plan, get approved and start building. This means other than projects that were already underway or about to begin when the lockdown began, we're unlikely to see an immediate surge.

Digging holes and filling them up again won't have any lasting impact. Not everything that can be built should be built. We must be picky about what we prioritise.

Other industries that benefit and lose

For some industries or businesses, the writing was on the wall before the pandemic, and it simply accelerated their decline. This includes many traditional retailers who can't compete with online trade, or print media competing with an endless array of online content.

For others, the pandemic will spark or expand a revolution. One of these is transport and logistics. There will be people wondering why they ever spent their Saturday morning at the supermarket when for a few dollars, the driving, car-park-finding, and aisle-traipsing while child-minding can be avoided. While some will return to this, we'll likely see a permanent spike in online grocery and other product purchases.

Last word: Learning the lesson of trade-offs

There is much to learn from the pandemic and various responses. One lesson must be the naivete of talking in absolutes when it comes to priorities and needs. Those who, before the pandemic, thought social equity, or climate change, or homelessness, or clean waterways, or macro-prudential stability, or jobs, or any other single issue was our most important challenge (they are all big issues), have been confronted with a frightening example of how needs and priorities can change quickly.

Countries have been forced to trade off the risk of large-scale loss of life and an overwhelmed health system against economic implosion that destroys livelihoods, affects mental health and imposes trillions of dollars in extra debt on future generations. No one wants to have to make this trade-off, but suddenly, the hazards of making it through to next month and perhaps next year were thrown in stark relief.

As individuals, cities and countries, we face hundreds of competing needs at any one time with limited resources, and always we should be trying to do two things. First, we need to value things as accurately as we can. Good environmental outcomes are one area where in the past we've been guilty of not estimating value well, and we're now paying the price. But second, we must get away from a single-agenda mindset. We have always made, and must continue to make, trade-offs with our limited natural, human, financial and social capital that aims for the maximum wellbeing for all our people here today and those who will be born tomorrow.

Auckland Economic Commentary

Shyamal Maharaj
Economist, Chief Economist Unit

- The Covid-19 global pandemic has been identified as a once in a hundred-year event. Such an event requires unconventional support from governments and central banks.
- Where free markets do not suffice, governments and central banks need to step in.
- We have seen the Government inject $12bn as an initial response to COVID-19, and now set aside an additional $50bn in Budget 2020. This stimulus is necessary to keep the economy on its feet, but where this money is spent will also matter.
- The Reserve Bank of New Zealand has also stepped up, dropping rates to all-time lows, and boosting its Long-Term Asset Purchase Programme from $33bn to $60bn.
- But providing this kind of support to an ailing economy has long-term consequences and will impact generations to come.

The Government and Reserve Bank of New Zealand (RBNZ) are able to influence the economy through fiscal and monetary policy, respectively. This means that in good economic times, they should work together to strengthen institutions and the broader economic system for the rainy day that will inevitably come. In contrast, during economic crises/downturns, governments and central banks are tasked with protecting and stabilising the wider economy. This can range from enabling people to continue to access money from banks (to prevent bank runs) to providing employment support like the wage subsidy scheme, greater investment in infrastructure, or support to businesses so as to limit the rise in unemployment and economic upheaval.

The halt to economic activity under level 4 resulted in an estimated 40% of the economy ceasing to operate, a trade-off against the long-term health impacts on the people that make up the economy.

The wellbeing of people is fundamental to economic policy, whether fiscal – how government spending, taxes and borrowing meet the needs of people – or monetary – the RBNZ setting the Official Cash Rate (OCR) and injecting liquidity into the financial system. At all times, but particularly during crises, we need these policies to work together to support economic activity.

The Government's fiscal policy response

The Government's fiscal strategy in the 2020 Budget aims to inject a whopping $190bn of stimulus over five years, in comparison to the $42bn originally planned in the Half Year Economic and Fiscal Update in December 2019. Net Core Crown Debt will rise from under 20% to a peak of 53.6%, close to record highs from the 1990s.

Notably, over the next 5 years there is an additional $50bn of spending expected, with $39.3bn yet to be allocated, bringing the COVID-19 spending package to $61bn over five years. The strategy so far is about front-loading the spending to support households and businesses. For now, we have seen an eight week extension to the wage subsidy scheme (albeit with stricter conditions than the current 12 week scheme), an initial $3bn allocated to "shovel-ready" infrastructure projects, funding for state housing and job creation schemes to help pivot workers from sectors highly exposed to COVID-19.

Nevertheless, questions remain on the unallocated $39.3bn. Not all spending is created equal. This is an ideal time for the Government to invest into projects that could lead to a step change in productivity and other long-term goals that have been previously challenging to secure funding for. Thorough review of investment opportunities that generate long-term economic benefits will also make it easier to pay down debt.

The Government should pull hard on the fiscal lever, which this budget suggests is the plan. But this amount of planned spending is also not without its risks. How will we pay back these debts? How do we balance the action taken to protect more vulnerable people today against the future generations who will now foot the bill for the recovery? The Government will still have to face its obligations over the long-term such as an aging population that requires increasing contributions toward healthcare and superannuation.

The Treasury's forecast in Budget 2020 relies on the economy picking up quickly. COVID-19 has caused major disruption to global institutions and has revealed how under-prepared many economies are to health crises of scale. Domestically, the Treasury is forecasting unemployment to peak at under 10% by September 2020 and to bring it back down to pre-COVID-19 levels of 4.2% in two years. This is more optimistic than our central view, but our view was based off an expected $20 billion of extra stimulus, so if the extra stimulus ends up in the right projects, this may help keep a lid on unemployment. If the economy takes longer to recovery, this will make it even harder to repay debt.

The RBNZ's monetary policy response

In terms of policy levers, the Government's fiscal decisions come with a certain lack of flexibility. The RBNZ is well positioned to fill gaps the Government can't (and vice versa) by being able to change tack quickly through interest rate adjustments and its Long-Term Asset Purchase programme (LSAP).

The RBNZ in its May Monetary Policy Statement (MPS) came out swinging. It had earlier signalled the OCR was likely to remain at 0.25% until early 2021, but in the MPS expressed a willingness to take the OCR negative if necessary.

The MPS also set out an extension of the LSAP programme from $33bn to $60bn, consisting of New Zealand Government Bonds, local government bonds and inflation-indexed bonds.

The RBNZ, in discussions with banks, recognises that a negative OCR poses operational challenges. Yet even though quantitative easing is an unconventional tool, it does fill in the gaps that changing the OCR has. Of note, the RBNZ is also relatively optimistic in its forecasts of inflation and unemployment, which are key to setting monetary policy. But if fiscal policy and monetary policy work together as they should, there is a real possibility of results being better than forecast.

Where does this leave us?

What does this all mean for taxpayers and ratepayers?

In times of economic weakness, governments and central banks need to pull appropriate levers. But there are real long-term consequences from such bold moves such as higher taxes or lower spending in the future. Even though governments are the best placed to borrow to enable recovery, the private economy has to bounce back stronger in order for debts to be repaid without sapping growth. It is crucial that government stimulus and monetary policy align over the next several years. As taxpayers and ratepayers, well-thought out policies and spending will be crucial to outcomes that are net beneficial to all New Zealanders.

Data summary provided by **Ross Wilson** - Analyst, RIMU

Note this data reflects only the first few days of the economic impact of the lockdown as data is to the end of March 2020.

Indicator	Mar-20 quarter	Dec-19 quarter	Mar-19 quarter	5-year average	Rest of New Zealand Mar-20 quarter
Employment indicators					
Annual employment growth (%pa)	0.5%	1.6%	2.1%	2.5%	2.2%
Unemployment rate (%)	4.8%	4.1%	4.4%	4.7%	4.3%
Unemployment rate among 20 to 24 year olds (%)	11.1%	9.4%	8.6%	9.1%	7.5%
Unemployment rate among 15 to 19 year olds (%)	16.6%	17.5%	21.4%	20.2%	20.0%
Earning and affordability indicators					
Annual nominal wage growth (%pa)	3.1%	3.1%	2.8%	2.8%	3.5%
Annual geometric mean rent growth (%pa)*	2.9%	-0.4%	1.2%	3.3%	5.3%
Geometric mean rent to median household income ratio (%)*	26.6%	26.6%	26.6%	27.7%	24.8%
Annual median house price growth (%pa)*	10.5%	3.0%	-2.8%	5.3%	14.5%
Mortgage serviceability ratio (relative to Dec-06)*	10.6%	4.1%	4.7%	-3.9%	24.0%
Construction					
Annual new residential building consents growth (%pa)	7.6%	17.8%	24.0%	13.5%	9.8%
Annual m2 non-residential building consent growth (%pa)	-22.5%	-11.3%	39.9%	4.8%	-0.8%
International connections					
Annual Auckland Airport passenger movements (%pa)	-4.1%	0.7%	2.8%	4.6%	NA
Confidence					
Annual retail sales growth (%pa)	4.6%	4.4%	4.1%	6.0%	3.2%
Quarterly Survey of Business Opinion (net optimists)	-66.3%	-12.4%	-23.8%	-6.7%	-71.5%
Westpac Consumer Confidence*	105.9	112.9	101.0	110.1	104.2

*Sources: Chief Economist Unit, Auckland Council; Statistics New Zealand; Ministry of Business Innovation and Employment; Real Estate Institute of New Zealand; New Zealand Institute of Economic Research; Westpac; Reserve Bank of New Zealand. * Rest of New Zealand figures are for all of New Zealand including Auckland. Data is not seasonally-adjusted.*

Find out more: visit the Auckland Council Chief Economist Page
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