Te Waka
Anga Whakamua Waikato

Quarterly Economic Update Q3 : 2020

Blair Keenan

PRINCIPAL ECONOMIST, WAIKATO REGIONAL COUNCIL & ECONOMIC ADVISOR TO TE WAKA

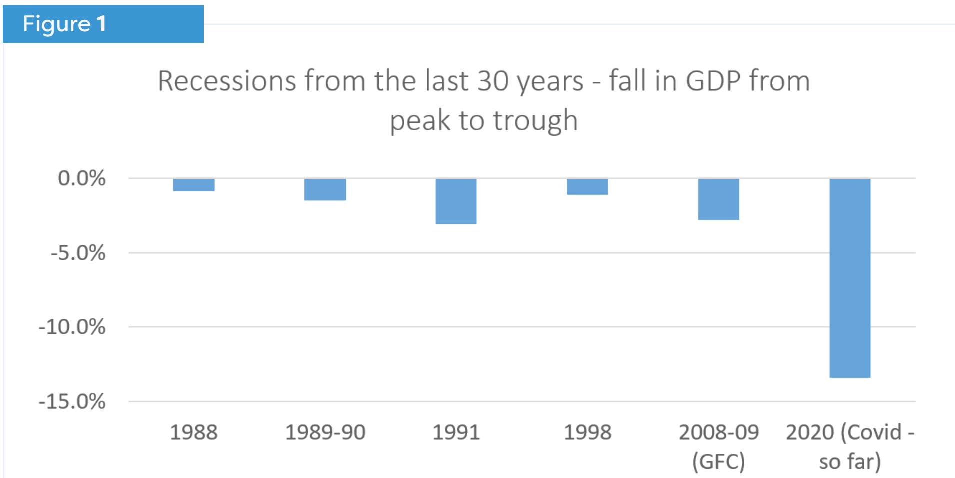
Blair Keenan has an undergraduate degree from the University of Otago. Keenan worked at ANZ as a macro-economist and industry analyst for five years before heading overseas as a researcher for Japan's External Trade Organisation in the UK. While in the UK, he also received his Master's degree in applied environmental economics from the University of London and was an economist at the National Farmers Union of England and Wales.

Back in New Zealand, he held several policy roles at Landcare Research, Department of Internal Affairs and Housing New Zealand before his current role as principal economist at Waikato Regional Council. He also continues to collaborate on projects with the University of Waikato, CRIs, central and local government, and a variety of industry groups.

The COVID-shock… so far

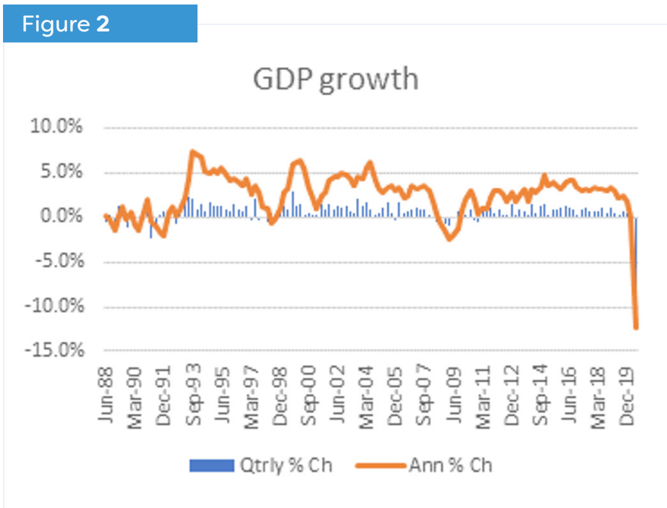
In the first quarter of 1991, New Zealand saw a fall in economic activity (at least, as measured by gross domestic product [GDP]), of 2.4 percent. From peak to trough of that recession, the economy shrank by 3.1 percent. That was the largest such fall we have seen since quarterly GDP statistics have been published. Until now.

Figure 1



Source: Stats NZ

Figure 2



The release of the national accounts for the June 2020 quarter showed GDP fell by 12.2 percent (seasonally adjusted) from the March 2020 quarter, and was 12.4 percent lower than the June 2019 quarter. This followed a 1.4 percent contraction in the March quarter. By far, this is the largest quarterly fall recorded in this country – more than four times larger than the 1991 recession (so far!) – and reflects the lockdown under Alert level 4, which began at the end of March.

Official regional GDP figures are published with a very long lag, but based on the sectoral make-up of the Waikato economy, it's likely that activity shrank by a slightly smaller (but still very large) amount – perhaps in the order of 10-11 percent.

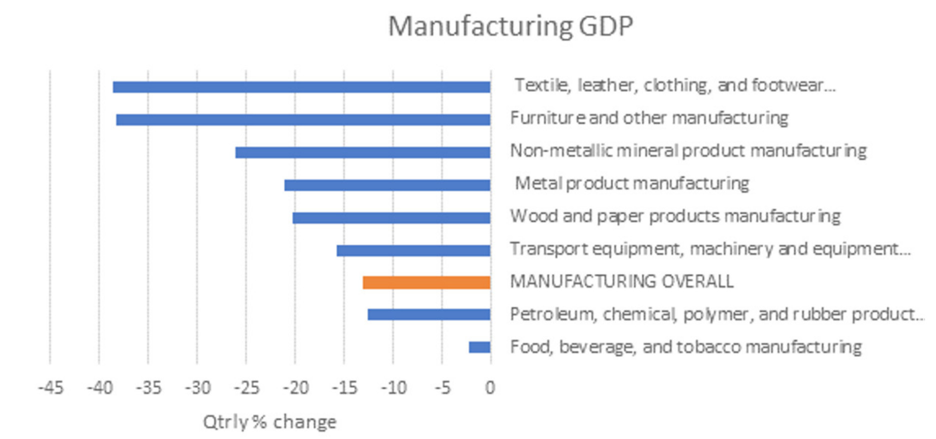
The agriculture sector, which contributes a relatively large share of the Waikato economy (around 10 percent, compared with around 4 percent for the national economy as a whole), was relatively stable, down just 0.4 percent for the quarter. This reflects the fact that farming was, to a large extent, able to carry on through lockdown, and export volumes and prices have held up well. This also showed in the manufacturing sector: while some subsectors were down by as much as 38 percent on the previous quarter, the food, beverage and tobacco subsector declined by only 2.2 percent, limiting the decline in the overall sector to 13 percent.

Parts of the service sector (which makes up the largest share of the economy) were relatively unaffected, either because they represented essential services (such as with the health sector) or because they were largely able to continue to work remotely.

However, some service sectors were severely hit; the single largest fall in any sector was for accommodation and food services – down 47.4 percent nationally. This reflects not just the Alert level 4 lockdown, but travel restrictions and the closure of borders that resulted in large parts of the tourism sector effectively shutting down. This also shows in the retail trade sector, where activity declined by 15.8 percent in the quarter.

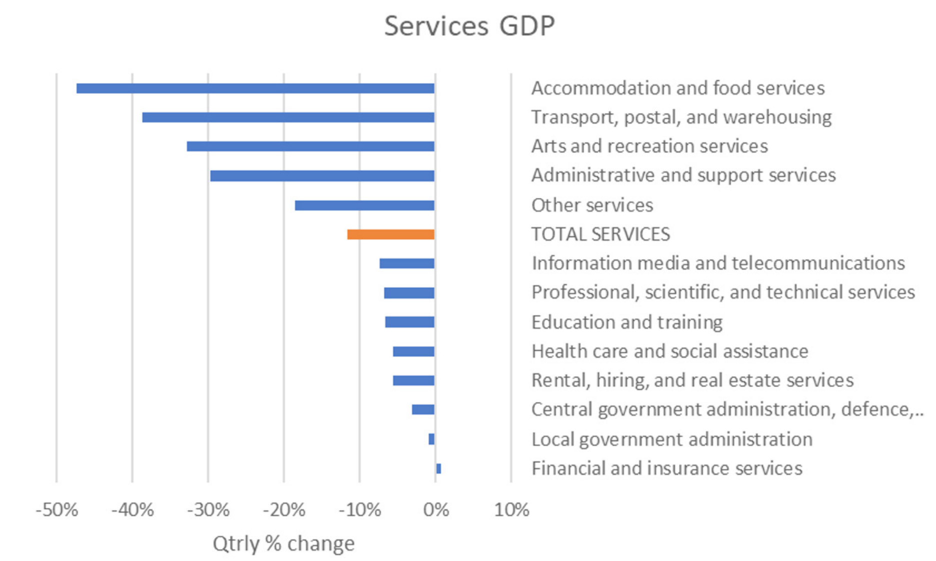
The single largest fall in any sector was for accommodation and food services – down 47.4 percent nationally

Figure 3



Source: Stats NZ

Figure 4



Source: Stats NZ

Largest positive effect was an improvement in net exports

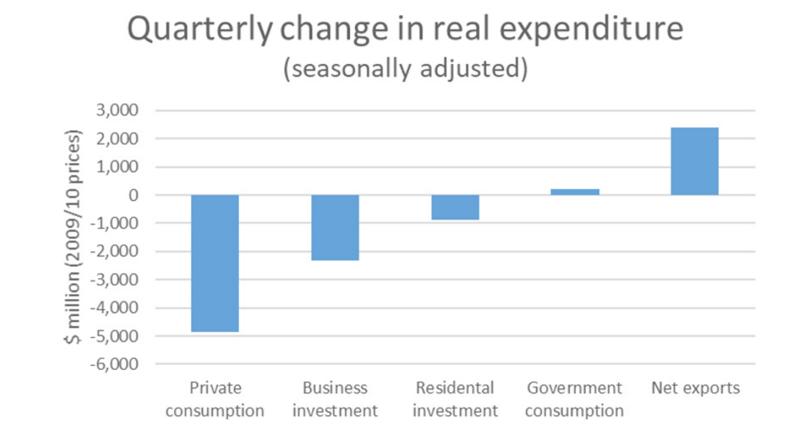
Measured by expenditure type, private consumption and investment fell markedly – largely as a result of the lockdown. Government consumption was steady (central government was up 1.9 percent, while the much smaller local government was down 0.2 percent). The largest positive effect was an improvement in net exports. However, this reflected a particularly sharp drop in our spending on imports – down by 25 percent (seasonally adjusted) on the previous quarter, outweighing a 16 percent fall in exports – hardly a reflection of economic strength. The fall in services exports reflects the disappearance of international tourists (and to a lesser extent, students) from our shores.

WHAT NEXT...?

Treasury projections

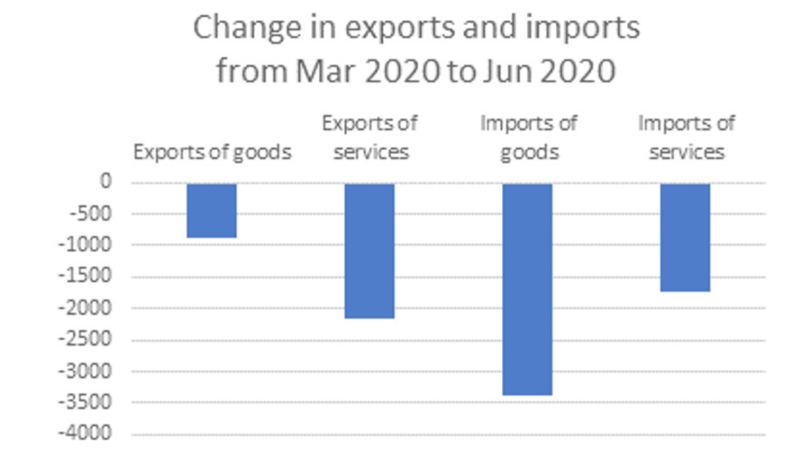
As part of its pre-election fiscal update, the Treasury has also outlined its projections for recovery. It expects to see a bounce-back in the September 2020 quarter and 1 percent real GDP growth per quarter thereafter. At that rate, GDP does not return to pre-COVID levels until the second half of 2022. Unemployment is expected to increase further, peaking at just under 8 percent in later 2021, albeit much less than the 10 percent that the Treasury had forecast at the time of the budget.

Figure 5



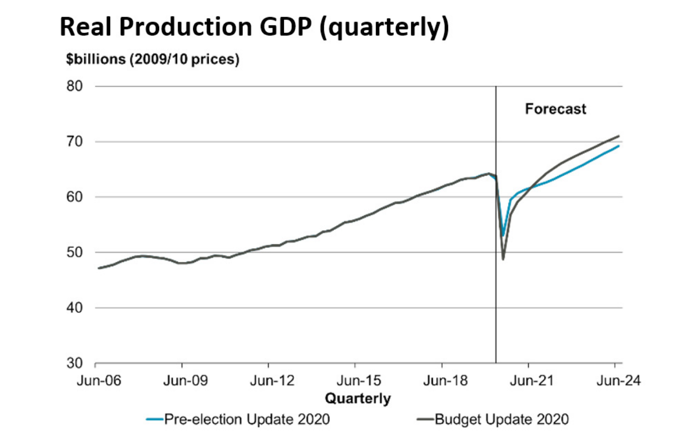
Source: Stats NZ

Figure 6



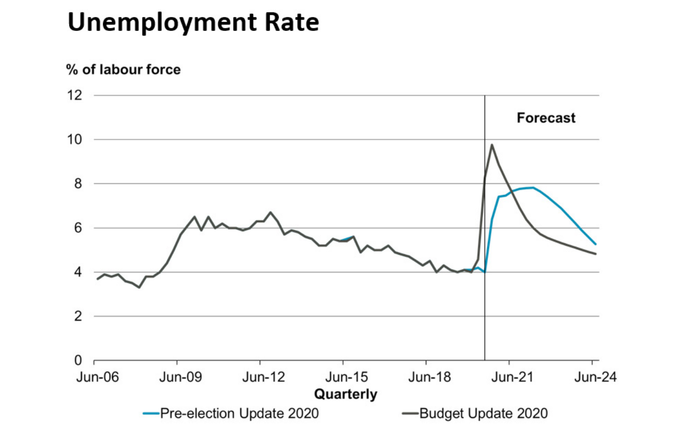
Source: Stats NZ

Figure 7



Source: Stats NZ, Treasury

Figure 8



Source: Stats NZ, Treasury

The survey gives us a hint of some of the problems businesses are facing now, and what their intentions are for things like hiring and investment

Business sentiment

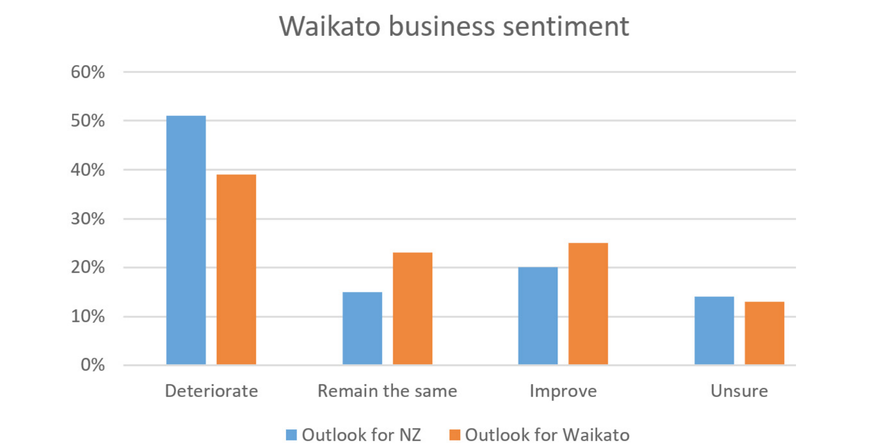
Of course, these projections are subject to a great deal of uncertainty. But in the short term at least, it is useful to get a sense of confidence from the business sector to gauge our immediate prospects. Te Waka recently released its first Business Sentiment Survey for the Waikato region which provides some insights on this. Statistics like GDP are useful, but we are looking over our shoulder at what was happening three months ago; Forecasts are all very well, but no economist's model is calibrated to the sort of shock we're in the middle of. The Te Waka survey gives us a hint of some of the problems businesses are facing now, and what their intentions are for things like hiring and investment in the near future.

Unsurprisingly, nearly 80 percent of Waikato businesses saw sales down over the March-May period, including 63 percent that saw a fall of more than 20 percent, and 28 percent with a fall of more than 50 percent. A bigger rise in unemployment has been staved off by use of the government's wage subsidy, with around 80 percent making use of this (and/or the extension to the subsidy).

Given that nearly 50 percent of respondents expect sales to fall further over the second half of 2020, it is somewhat surprising that less than 40 percent of Waikato businesses expect a further deterioration in the economic outlook for the region. Two-thirds of respondents thought their business prospects rated a seven or better out of ten, which suggests a reasonable confidence to invest and develop their business and take on staff. If they can find them that is – skill shortages remain a problem. These shortages are evident in many areas, but appear particularly acute in the construction sector, where 95 percent of respondents indicated that skills shortages were a problem.

The survey results also reflect the very high levels of uncertainty we all face. For instance, a majority of businesses across the region seem to have reasonable confidence in their own prospects, and yet most also see static or declining sales and a further deterioration in the wider economy. This is not surprising – while businesses may have a good sense of their own situation, nobody knows whether the virus will re-emerge, how much the weakness of the global economy will flow through to us here in the Waikato region, and what other 'unknowns' lie in wait for us.

Figure 9



Source: Stats NZ

Learning from the past

So, can previous recessions tell us anything about our prospects now? An article from the Reserve Bank Bulletin in 2008 by Michael Riddell and Cath Sleeman (available here) provides an excellent summary of past recessions. They show that there is no simple recipe – every recession is different. The record 1991 recession was a time of high real interest rates, financial fragility following the turbulence of the 1980s, high and rising public debt levels leading to the beginnings of a sharp government fiscal contraction, combined with a global economic downturn.

This time around, we have the deliberate shutdown of activity to avoid future costs in response to a public health crisis. The re-emergence of the virus in the community stands as a key risk to the type of recovery anticipated by the Treasury. Fortunately, thanks to successive governments' fiscal management, there has been, and remains, ample scope for higher government spending, without the need for contractionary fiscal austerity in the midst of the recession. And there is arguably considerably more that could be done with monetary policy, even though nominal interest rates are very low.

> The re-emergence of the virus in the community stands as a key risk to the type of recovery anticipated by the Treasury

A second critical risk is the possibility of ongoing weakness in the global economy undermining our export returns. Riddell and Sleeman note that "[m]aterial global slowdowns almost always lead to marked slowdowns in the New Zealand economy. The recent exception (2001) highlights the way in which pre-existing domestic conditions matter – undervalued exchange rates, healthy financial sectors, rising commodity prices and relatively low interest rates can provide meaningful buffers."

But before we get carried away with predicting the future, it's worth noting another common lesson Riddell and Sleeman drew from examining past recessions: "[f]orecasters... typically have little idea how deep any slowdown will be until we are well into it." •

25-240920