Te Waka
Anga Whakamua Waikato

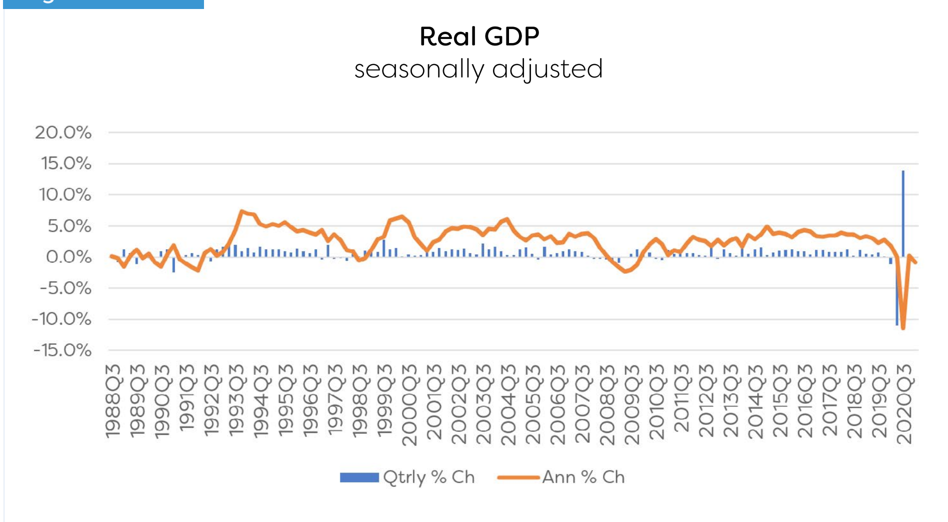
Quarterly Economic Update Q1 : 2021

A year is a long time in the economy

One year ago, on the edge of a public health precipice, the Waikato, along with the rest of the country went into lockdown. Essential workers and those who could work from home were still working, but large parts of the economy simply switched off. The risks of deflation, a downward spiral in demand, and mass unemployment loomed.

Going into 2020, GDP growth was already slowing, following a long, steady expansion dating back to the Global Financial Crisis in 2009. In the second quarter of 2020, the lockdown saw a very sharp fall in GDP, before snapping sharply back in the third when the economy was 'switched back on'. Most recently, we saw GDP fall 1 percent in the December quarter of 2020.

Figure 1



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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.

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Figure 2

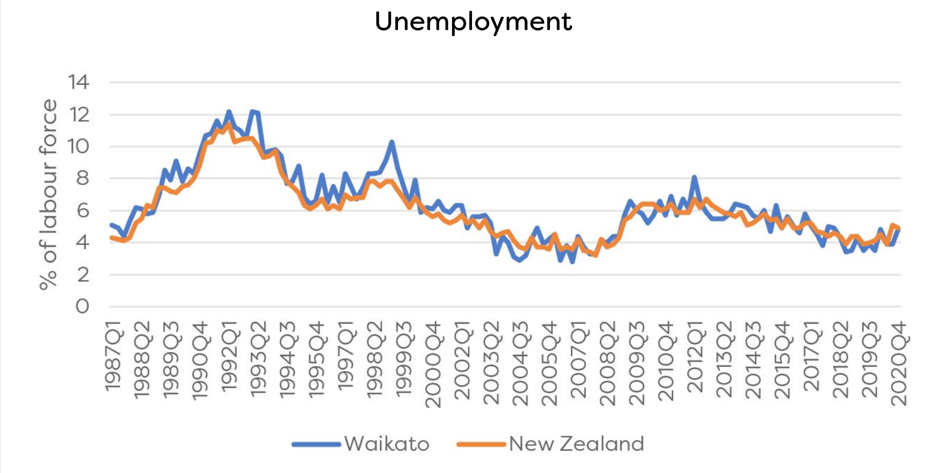
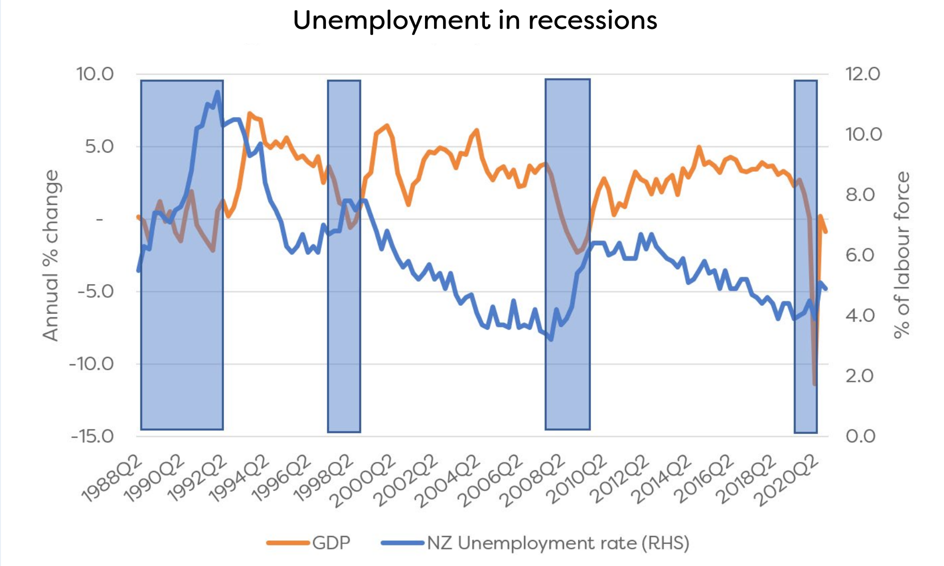


Figure 3



While the unemployment rate did rise in 2020, the increase was certainly much less than the projections from a year ago. In April 2020, amidst the level 4 lockdown, Treasury scenarios forecast unemployment reaching double-digits, peaking at more than 25 percent in the worst case (which involved a much more extended period of lockdown than actually occurred). Even the most optimistic scenario (which included significant additional fiscal support) unemployment was projected to peak at 8.3 percent – well above the current 5 percent.

It seems clear now that the wage subsidy and other business supports put in place by the government have helped many businesses bridge the gap in revenues without having to resort to mass layoffs of staff. But we're not out of the woods yet. Unemployment is typically a lagging indicator of changes in GDP, and significant recessions typically see large increases in unemployment (see the shaded areas in figure 3). With all the 'noise' in the data from last year's events, it remains to be seen whether we are on the verge of increasing unemployment over 2021, or if, thanks to a strong policy response and a healthy dose of good fortune, we have largely avoided this.

The Waikato has had several key advantages when faced with the events of the past year. First, the construction sector has remained relatively steady – at least in terms of residential building. This additional supply of housing is still struggling to keep up with demand though, with median house prices shooting up by 23 percent (more than $130,000, from $580,000 to $713,500) in the last year, according to REINZ. Median prices rose by more than 30 percent in five different districts (Thames-Coromandel, South Waikato, Taupō, Waipa and Matamata-Piako).

The effect of the government's housing policy changes in recent weeks remains to be seen, but affordability is likely to remain a problem for many.

Exports of meat and dairy products were another thing helping the Waikato economy through 2020. However the value of products exported tailed off and was weaker over the end of 2020 and early 2021 than a year earlier. Dairy volumes have been trending lower since last September, while falls in meat exports have been price driven. Nevertheless, dairy prices (measured by the GDT index) remain at their highest since the early part of 2014, prompting increased estimates for the dairy payout this year.

While tourism-related businesses have suffered from pandemic-related travel constraints, and this is no different in the Waikato, the region is less exposed to the loss of international tourists than some other parts of the country.

PROSPECTS FOR THE YEAR AHEAD

One thing that the events of the past year have made clear is that models used to forecast the economy have struggled to predict developments. (In contrast, the policy advice that has come from economic analysis is arguably one of the key reasons that we have avoided a much worse downturn).

Figure 4

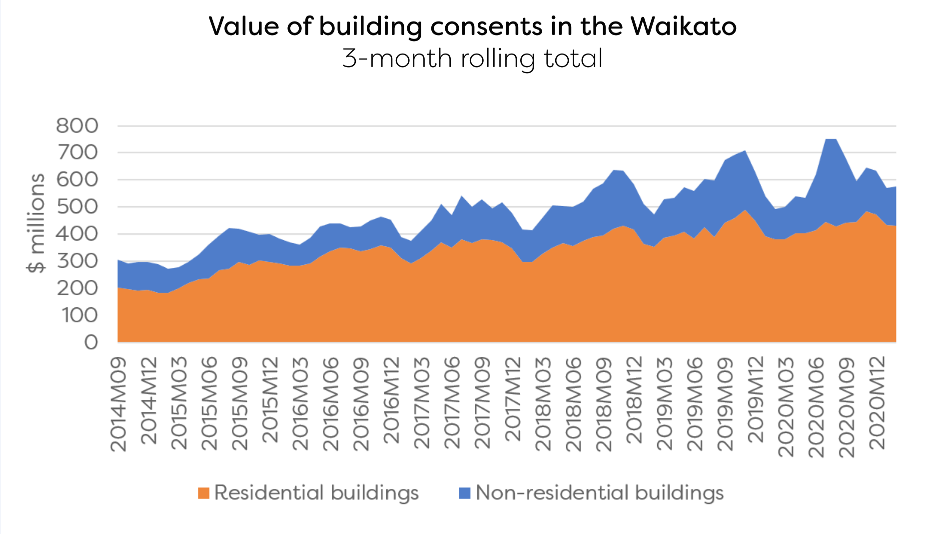


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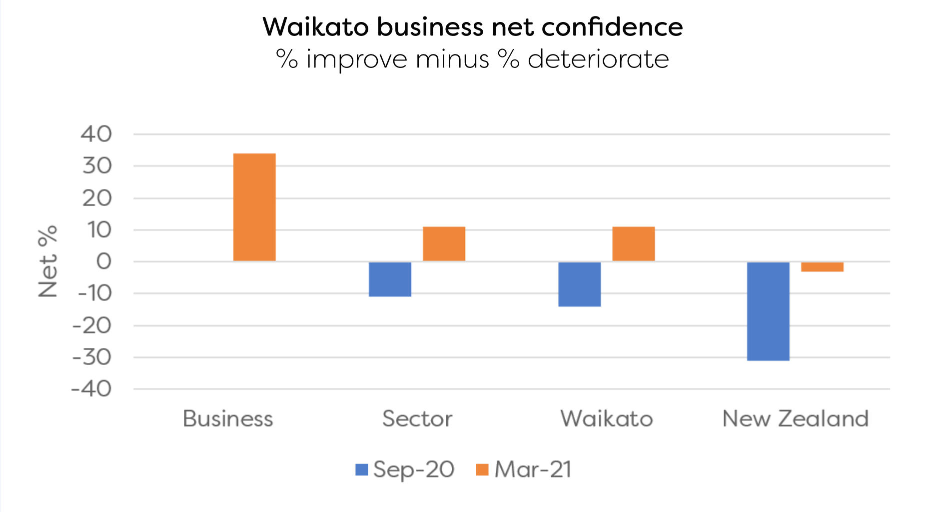
Figure 5



Note: Net confidence is calculated by taking negative responses from positive responses

58% of respondents are also considering raising their prices in the next 12 months

What can we say about where things are going? In the short-term, at least, the confidence of businesses in the region is a key determinant of their spending, hiring, and investment. In Te Waka's second six-monthly confidence survey 35 percent of respondents were positive about the prospects for the Waikato economy, compared to 24 percent expecting a deterioration.

On the face of it, this may not seem like an overwhelming vote of confidence in the regional economy, but it is a significant improvement on the last survey when 39 percent expected things to get worse in the Waikato, and just 25 percent expected an improvement. Better yet, businesses expectations about their own outlook was even more positive, with 46 percent expecting an improvement and just 12 percent thinking things will get worse. Waikato expectations for the wider New Zealand economy remain negative overall, but significantly better than they were last September.

These optimistic expectations are also reflected in businesses hiring intentions. Thirty percent of smaller businesses (with 1-10 full-time equivalent employees) expect to increase their workforce in the next 6 months, while only 6 percent expect to downsize their workforce. Fifty-two percent of businesses with more than 10 workers expect to hire more, and just 11 percent expect to reduce their workforce.

ROADBLOCKS AHEAD

As the fall in GDP at the end of 2020 shows, the recovery is both patchy and lukewarm. Moreover, the survey has also highlighted a number of potential bumps in the road ahead.

Two-thirds of Waikato businesses consider that a shortage of appropriate skills affects their ability to hire new employees. Nearly half (48 percent) consider this is due to a lack of skills amongst New Zealand residents, compared to just 4 percent who think it is a lack of skills amongst immigrants. Clearly this problem already existed and is not just one caused by pandemic-related border restrictions. Better identifying exactly what skills are lacking and working to develop them are important steps in making sure the Waikato has a labour force that can match the aspirations of its businesses.

Disruptions to supply chains have also been identified as a problem by 58 percent of survey respondents, including issues both cross-border and within New Zealand. Given the supply-side issues affecting the costs of labour, materials, energy and other inputs, it is not surprising that 58 percent of respondents are also considering raising their prices in the next 12 months.

The 'catch-22' is that, unless they increase prices, many businesses margins will be squeezed – but increasing prices may be difficult while aggregate demand remains weak (obviously this will depend on the type of business). A stronger recovery in demand that enables businesses to rebuild margins may also lead to a re-emergence of inflation concerns and bring forward the time when the Reserve Bank begins to raise interest rates again. •