Economic Note

Sector Impacts of COVID-19

29 April 2021

What happened in 2020 and could happen in 2021?

- The hit from COVID-19 does not look to have been as large and long-lasting as feared a year ago, with the level of economic activity and employment broadly back to pre-pandemic levels.
- Similarly, the sector impacts do not look to be as widespread as feared. Some sectors have clearly borne the brunt of the COVID-19 hit, but the majority have done well, with a few stellar performers.
- Going forward, we expect anaemic growth over 2021 although risks are tilting towards a stronger than expected rebound in economic activity and employment from sectors that copped the bulk of the hit in 2020.

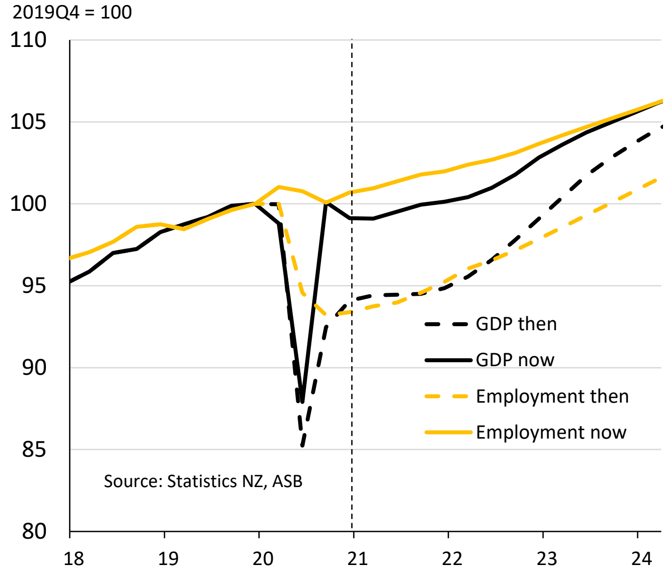
Summary

Economic forecasting is tricky at the best of times, downright impossible during a global pandemic. Sometimes it is good to be proven wrong, and it was pleasing to see the NZ economy get through 2020 in much better shape than we could have hoped for a year ago. Some sectors have copped a significant hit from lockdowns, physical distancing and the border closures, but the impact of COVID-19 does not look to have been as widespread as feared. Some sectors in fact have done very well. We attribute this to 3 key reasons: increased flexibility; the fact that most businesses could stay operational during low alert levels, and; policy actions/policy support that have helped to minimise the impacts of the global pandemic. What was also apparent, however, was that the early recovery was dependent on household and government spending, with the business sector generally scaling back investment plans and trimming discretionary expenditures. What about 2021? We expect anaemic economic and employment growth this year as policy support is unwound. It will take time for some hard-hit sectors (particularly tourism) to recover. However, with household and business balance sheets in good shape, risks are increasingly skewed towards a stronger rebound.

Sector Impacts of COVID-19 – a refresh

Last year it looked like the impacts on the NZ economy from COVID-19 would be sizeable and long lasting. Our forecasts at that time had suggest real production value-added GDP would likely contract 7% over 2020 and that it would not be until 2023 that the NZ economy would be back to pre-COVID-19 levels. Our view back then was that the direct impacts of COVID-19 are likely to be widespread across economic sectors with more than 60% of the economy expected to register larger percentage falls in value added than for overall GDP. Moreover, the outbreak was expected to result in sizeable and widespread job losses with the unemployment rate set to peak at around 9% by early 2021 and to gradually ease thereafter. We had also signalled that the employment-rich services sector was likely to cop substantial flow-on impacts from the initial hit.

FORECAST VIEW OF GDP AND EMPLOYMENT



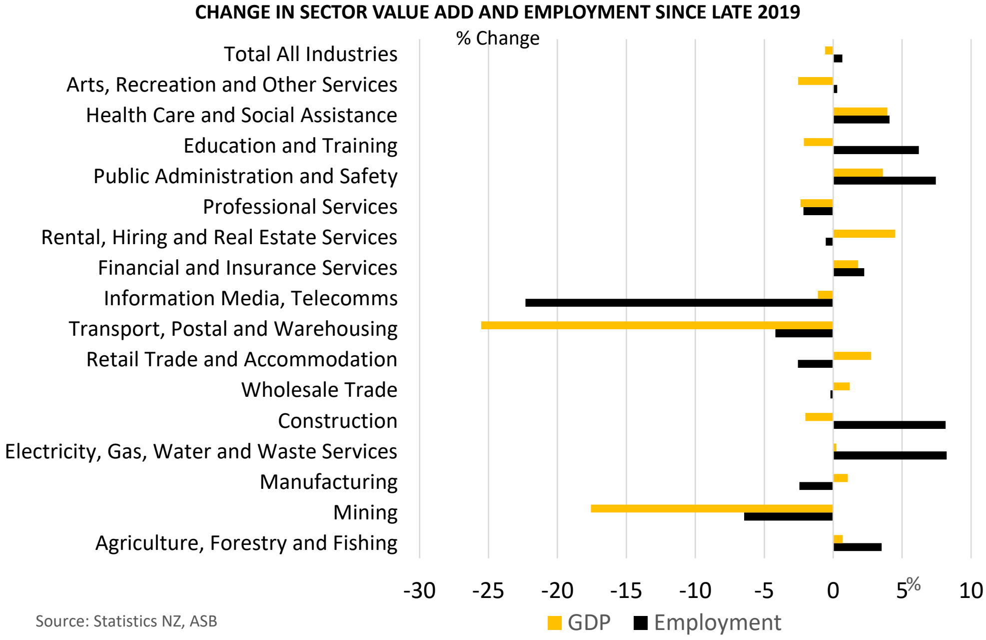
Fast forward to 2021 and the gloomy predictions have yet to arrive. NZ GDP contracted by just 1% over 2020 (a close to 3% contraction over the 2020 calendar year). The NZ economy ended 2020 with more jobs than pre-COVID-19 levels.

Mark Smith – Senior Economist (027 578 5635) mark.smith4@asb.co.nzj

How did NZ sectors fare?

As we had expected the hardest-hit sectors were those that have been directly impacted by the tighter border requirements and focus on physical distancing, and firms also trimming some discretionary expenditures. Conditions in the transport, advertising, hospitality, and arts and other services sectors look to have been particularly tough.

For most sectors in the economy, however, the hit from COVID-19 has turned out to be considerably less than earlier thought. Of the 16 industry sectors we have monitored (see chart), economic activity was below pre-COVID-19 levels in only seven (which together account for about one third of GDP). Employment in eight sectors (just under half of total employment) was below pre-COVID-19 levels by the end of 2020. NZ insolvency numbers/company liquidations remained low despite our expectation there would be a surge in business failures and redundancies.

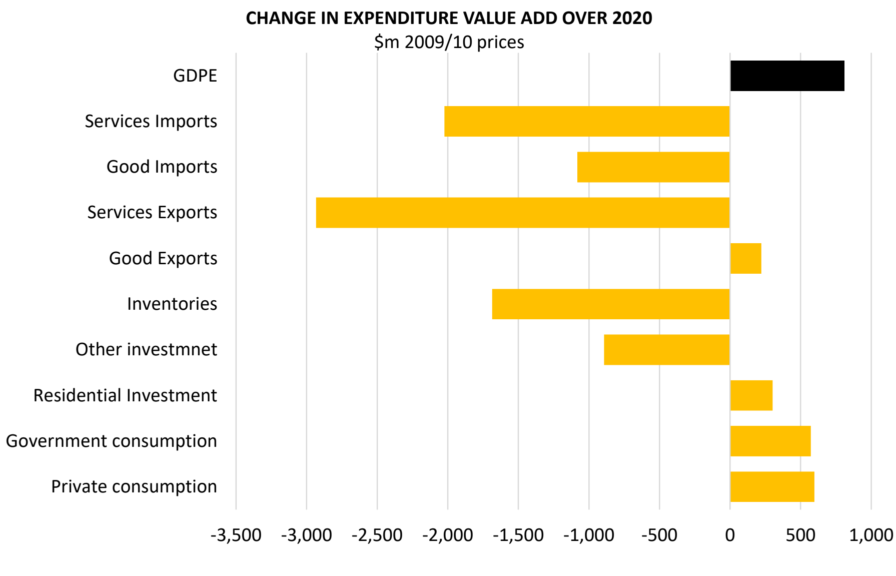


Source: Statistics NZ, ASB

What was also surprising was that activity and employment in a number of sectors did really, really well. Interest-rate sensitive pockets did particularly well. Value added in the rental, hiring and real estate services, public administration & safety, and health care & social assistance saw larger increases than usual over 2020. Employment for construction, public administration, education & training and healthcare saw more sizeable than usual increases.

Looking through an expenditure GDP lens (see chart) shows that household spending and higher economic activity from the Government sector were notable standouts over 2020. Goods export activity was also resilient.

However, most components of aggregate demand actually weakened over 2020. Business spending looks to have taken a backseat, with our analysis suggesting that the bulk of the contraction in non-residential capital spending was due to weaker business investment. Consistent with this was the contraction in business lending from the credit aggregates (down 3.5% over 2020). Inventory levels were sharply lower, although this could partly be the result of freight disruptions rather than lower business spending. The impact of the border restrictions saw a sizeable contraction in services trade, more so for exports (driven by lower tourism spending by overseas visitors in NZ) than imports (including overseas trips by resident new Zealanders). The hit to NZ GDP was mitigated by weaker good imports, likely linked to the lower business spending.



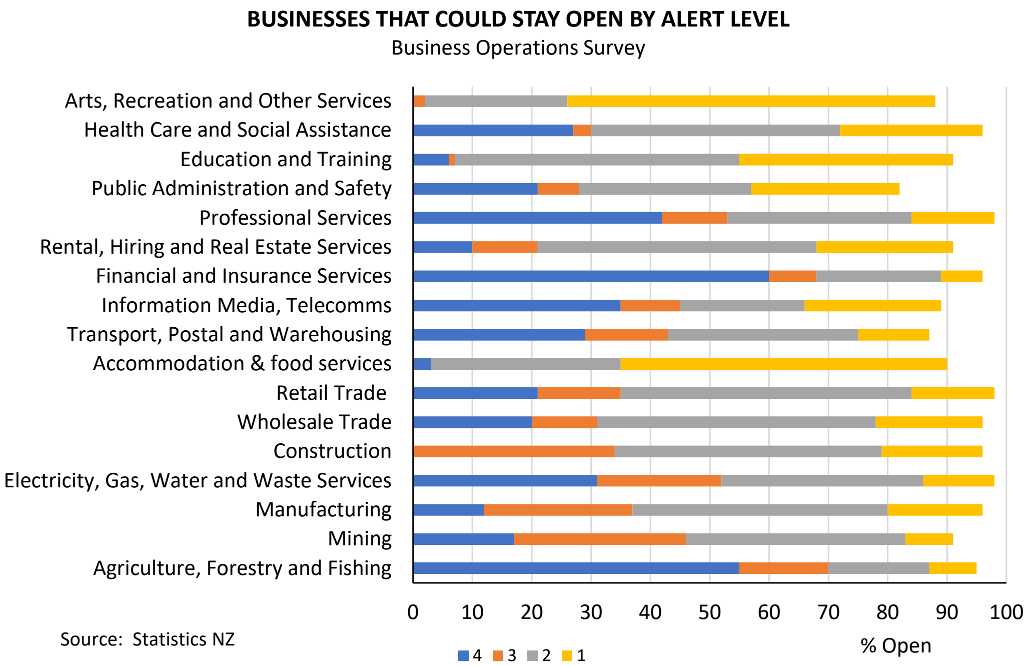
Source: Statistics NZ, ASB

Why didn't the economy and employment tank?

There are a number of contributory factors that could account for the impact of COVID-19 not being as significant and widespread as we feared.

More Flexibility. The economy was able to roll with the COVID-19 punches, absorb the lock-down disruptions and make adjustments to future plans. According to the 2020 Business Operations survey (BOS) conducted by Statistics NZ, 84% percent of businesses made changes to their finances to respond to the impacts of COVID-19. Forty percent of businesses arranged rent reductions or deferment with their landlord. Businesses that could utilise internet technology and employ remote working (around half of all businesses) tended to fare better. Firms were also able to reconfigure their businesses to the new operating environment, with almost two-thirds of businesses postponing or cancelling any planned new capital investment. Half of businesses reduced work hours for existing staff, with one quarter reducing salaries/wages. Only 17% of businesses laid off staff, with 14% actually hiring more staff. Resources were also able to shift across sectors, with employment gains in some sectors (including construction and in the public sector) partly due to fewer job opportunities/layoffs in other sectors.

More of us were essential and stayed open during the lockdowns. The BOS showed that almost half (46%) of the 47,000 NZ businesses employing six of more employees were classified as essential services during the COVID-19 pandemic response. Almost one-third of these businesses were fully operational during Alert Level 4, while one-half were partially operational. Once New Zealand changed to Alert Level 3 more businesses were able to open. Larger firms tended to have proportionately more of their operations deemed to be essential (71% for enterprises hiring more than 100 staff), much less so for smaller firms. There were also differences by sector (see chart) with proportionately fewer firms in the arts & recreation sector and in accommodation & food services able to stay open during higher Alert levels. More firms in the agricultural sectors and in finance/insurance were able to remain operational under lockdown conditions.



Policy actions/support. With hindsight, the actions by the NZ Government to 'go hard and go early' and to try and eliminate COVID-19 in NZ looks to have been the right call. Lockdowns in NZ were mercifully short compared to those overseas. Policy support has also played a key role. The bulk of the $50 billion COVID-19 Response and Recovery Fund (CRRF) has already been used up. The wage subsidy has proved to be a master stroke, keeping people in jobs when they would otherwise have been laid off. What's more, this support was deployed throughout much of the business community. According to the BOS, around 77% of businesses received government financial assistance in 2020, such as wage support and business loans. The RBNZ also played a key role. The 0.25% OCR, quantitative easing and other measures kept the economy running and financial system ticking over.

So where to from here?

Admittedly these figures are historical and will likely sugar coat the experience of many firms who are now facing tougher times. The phasing out of the wage subsidy, the running down of cash reserves for some businesses and the intensifying summer headwinds from few inbound overseas tourists suggest that the environment for businesses is unlikely to swiftly turn around. The announcement of a trans-Tasman bubble from April 19 this year provides some respite for the beleaguered tourism sector, although we do not expect a return to the tourism boom of old.

All up, our macro forecasts have little, if any growth in the NZ economy and employment over 2021 although, due to the vagaries of annual averaging ,calendar year growth for 2021 looks to be around 3%. Uncertainty is still rife. Will the NZ economy continue to surprise with its resilience or are we due for a long and hard slog ahead?

More timely indicators point to mixed fortunes:

- Tax revenues are comfortably tracking above December Treasury forecasts. Strength was broad-based across tax types (GST, Source Deductions and Company Tax) suggesting some resilience in domestic spending.
- NZ Business sentiment has remained resilient, with employment and investment intentions on an upward trajectory. Profitability remains under pressures given rising costs. These trends are commonplace across economic sectors, with the construction and manufacturing sectors typically the more optimistic, with the agriculture and services sectors not as upbeat.
- The fallout in the labour market looks to have been limited. Figures from MSD have shown a steady decline in the number of Jobseeker benefits since the start of the year.
- The housing market had been going gangbusters, but the moves by Government to slow investor demand have seen some downward tweaks to our forecast view. At the margin these have prompted downward revisions to our outlook for housing construction and durables consumption.
- Consumer confidence has remained weaker than historical averages, but households have retained a positive outlook for their own finances. Other indicators, including strengthening car registrations do not point to a retrenchment in household spending.
- Population growth is slowing, courtesy of easing net immigration (the 18k annualised inflow over the 3 months to February 2021 was the lowest since 2013). This will hit the more cyclical industries including construction and could dampen durable goods spending. It could also exacerbate labour shortages, which could weigh on expansion plans.
- There has been a reported climb in business closures from late 2020 onwards, but we consider this to be more of a lagging indicator.

There are signs for cautious optimism:

- The direction of revisions to the global growth forecast view has remained upward. In April, the IMF revised up its forecasts for global growth to 6% for 2021, the strongest in four decades, with growth for 2022 (4.4%) expected to remain above trend. This rebound will boost sectors with global exposures, including primary and manufacturing exports and chunks of the services sector.
- The trans-Tasman bubble has just opened. Historically, around 40% of overseas tourism arrivals to NZ are from Australia. With not many travel options available, NZ could see a surge in Australian tourists, although during the winter months, a few areas (Central Otago, Canterbury, Auckland, Wellington) may benefit. Travel, accommodation and hospitality will be the major beneficiaries. Offsetting this will be reciprocal flows of kiwis overseas, particularly with a likely extension of travel bubbles to the Pacific Islands. Durable spending in NZ would likely bear the brunt as NZ households swap durable purchases for travel.
- Business balance sheets look to have got through the global pandemic in reasonable shape. There is clear light at the end of the COVID-19 tunnel. Deleveraging and cost cutting have the business sector primed and able to act upon improving employment and investment intentions.
- NZ households have a small saving buffer ($740m in the March 2020 year), but since then have likely built up more saving, providing more leeway for future spending. Household deposits have climbed by $16.6bn since the end of 2019 and consumer credit has shrunk by close to $2.8bn over than period. In combination, this is equivalent to about 6% of annual GDP. Household credit card balances are also below pre-pandemic levels.
- RBNZ figures confirm that rising asset prices have boosted household balance sheets, with NZ net household wealth approaching $2 trillion. Some of this may be converted into household spending as some households run down savings.

All up, there are reasons for cautious optimism. Beyond what we expect will be a slow start to 2021, risks are increasingly skewed towards a stronger outlook for economic activity and employment. We expect the growth baton to be passed from households/government to businesses and for non-residential investment activity to firm.

Sector outlook for 2021

What about the sector implications**? The table at the end of this note summarises our best guess on which sectors/forms of economic activity are likely to register stronger growth relative to our economy-wide view and which are likely to be relative underperformers.** This is an illustrative list. Events over the past 12 months have shown that outcomes can turn out quite differently from expectations.

Sectors that bore the brunt of the COVID-19 hit in 2020 are expected to bounce back given the easing of border restrictions (including the Trans-Tasman bubble), the return to more typical work and leisure patterns, and the unleashing of further pent-up demand by firms and households. These include the tourism-influenced sectors (e.g. hospitality, accommodation), although outright levels of activity in these sectors are expected to remain well below pre-pandemic levels by year end. Firms that are aligned to business spending may also benefit as corporate spending picks up and firms reconsider expansion plans.

Expected underperformers include those that had a good 2020 but for various reasons are unlikely to do as well over 2021. These reasons include growth-inhibiting capacity constraints and rising costs (construction), direct policy measures to slow residential property market buoyancy (residential construction, durable consumption and real estate and related services) the return of more normal work and leisure patterns, and the fact that consumers have largely had their fill of consumer durables.

Table 1: 2021 growth outlook by sector

Out performers	Steady	Underperformers
Tourism, Hospitality/ Accommodation Transport Discretionary business spending, activities aligned with business expansion Arts/recreation services Non-primary manufacturing. Education & training	Primary manufacturing Wholesale trade Agriculture Finance & Insurance Public administration Utilities, Mining Media & Telecoms, IT consultants Healthcare	Consumer durable spending Rental, hiring & real estate services Construction activity Other retail trade

Source: ASB

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Nat Keall	nathaniel.keall@asb.co.nz	(649) 301 5720
Publication & Data Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

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