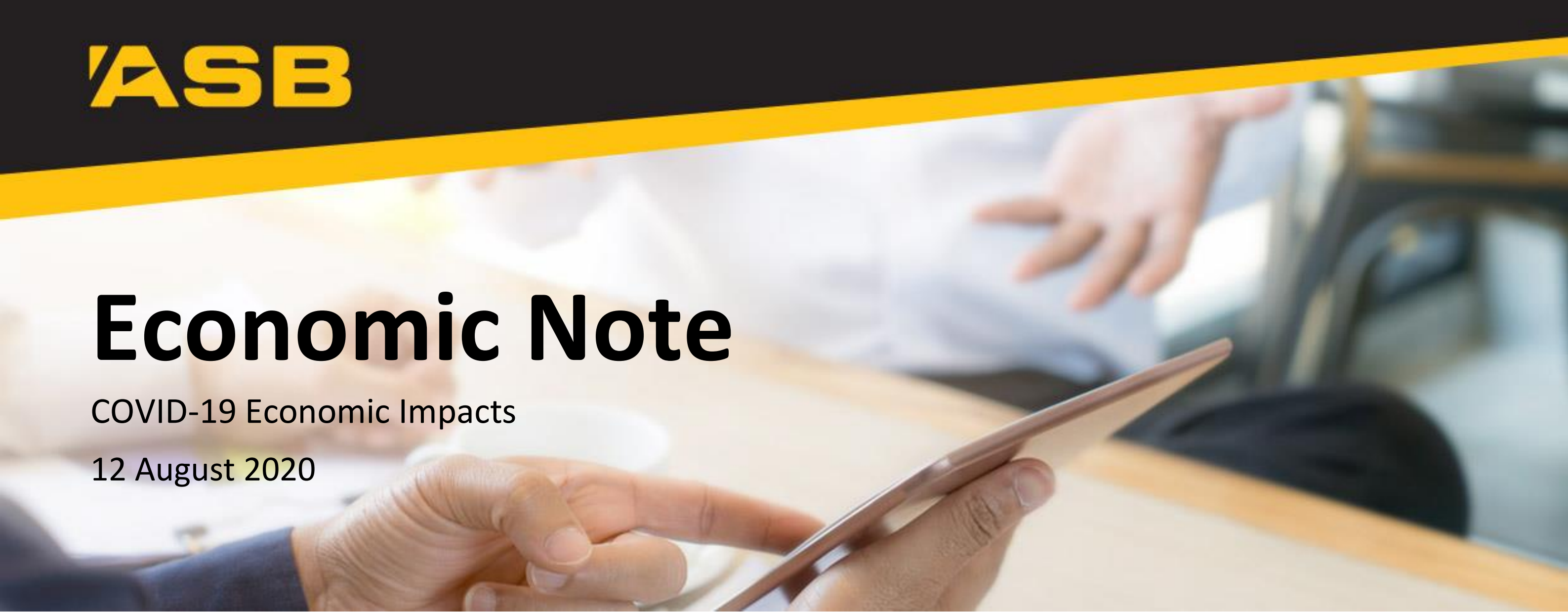

# Economic Note

COVID-19 Economic Impacts

12 August 2020

## Running the COVID-19 Marathon

- The economic impact of the fresh outbreak of COVID-19 in NZ is highly uncertain and will depend on the severity and duration of the outbreak, actions taken to contain it, and the ability of the economy to adapt.
- Our estimates suggest a modest impact on NZ's GDP, but this could easily grow.
- COVID-19 looks like it will be around for a while. Now would be a good time to plan ahead to see if we can refine how we cope with COVID-19 so as to minimise the economic and social burdens posed by the outbreak.

**Summary**

Last night's confirmation of community transmission of COVID-19 in NZ after a 102-day hiatus would have come as a shock to many. It shouldn't. We have stressed that tackling COVID-19 will be a marathon and not a sprint, that firms and households need to be prepared and maintain vigilance.

Hopefully, the economic hit from this latest outbreak will prove short-lived, but the short answer at present is that we really don't know. We have sketched out some rough estimates which point to a 0.15% to 0.5% hit to GDP (per week of lockdown), but this could get much larger if the outbreak has more enduring impacts.

There will be regional and sector dimensions. Currently Auckland is the epicentre, and with the region accounting for roughly one third of economic activity, employment and population the nationwide impacts will be non-negligible. Containing the spread south of the Bombay hills will likely lessen the short-term economic hit but it could challenge NZ's economic cohesion. Sectors that rely on person-to-person contact and the movement of people will face greater challenges.

COVID-19 looks like it could be around for a while, potentially until a workable vaccine is found. This could be years away. Firms and households will need to remain vigilant and resilient. The NZ economy is in a weaker position than it was pre-COVID-19. A considerable amount of policy ammunition has already been spent. Let's hope our earlier lockdown experience has taught us a thing or two about adaptability.

It would also be a good time for the Government to consider refining what sectors are allowed to operate under the more restrictive Alert Levels. A lot of the economic damage from lockdowns will occur at Alert Levels 3 and 4 for non-essential businesses. A greater focus on industries that can work safely under prescribed conditions would help to reduce the economic cost of fighting COVID if this lockdown is more enduring or if future lockdowns become more common.

**Here we go again**

COVID-19 is proving to be a tough nut to crack. Confirmed cases have topped 20 million globally with close to 750,000 deaths. Fears of a 2nd wave remain. The outbreak has resurfaced in Australia and Melbourne remains under lockdown.

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*Please refer to the important disclosures at the end of this document.*

Last night's announcement by the PM that community transmission of the virus had been detected in Auckland was a reminder that the battle against COVID-19 is going to be a marathon rather than a sprint.
NZ Authorities have moved swiftly and have ratcheted up the Alert Level restrictions.
As of midday Wednesday August 12:

- The Auckland region will move to level 3;
- The rest of the country will move to level 2.

The restrictions are set to end on midnight this Friday, but the future course of restrictions looks to be tied to the course of the outbreak, which is inherently uncertain.
Uncertainty is the key word on what the healthcare and economic impacts of the recent outbreak are likely to be. The latter will depend on key determinants including:

- The severity/duration of the outbreak – the more severe and long-lasting the outbreak and the more difficult to contain it, the larger the subsequent economic disruption and likely cost.
- Containment actions taken – the longer lasting and more widespread actions taken, including physical distancing, to prevent the spread of the outbreak, the larger the economic cost.
- Policy offset – the more effective the actions by authorities (including central banks) to mitigate the impacts of the outbreak, the lower the economic cost. With the fiscal and monetary policy settings already close to full throttle there is less scope to provide further support than there was pre-COVID.
- Economic structure, adaptability and flexibility, including how seamlessly the economy can transition to remote working and physical distancing.

In short, the briefer the disruption, the less dependent the economy on physical contact, the more flexible and adaptable the economy to cope with the changed landscape posed by COVID-19, the better the economy will be able to cope and the lower and less protracted the economic hit.

**Impacts of the higher Alert levels of economy-wide capacity utilisation**

The return to higher alert levels will have uneven impacts throughout the economy. NZ was operating at about 95% of capacity at Level 1, with the shift to Alert Level 2 and 3 seeing capacity utilisation fall to anywhere from 80% to 92% of economy wide capacity. Sectors that will be particularly impacted by a shift down alert levels include accommodation & food services, and those where it is not easy to operate without physical distancing (see table below).

**Capacity utilisation while COVID-19 Alert Levels are in place**

| | ASB | | | | Treasury | | | | RBNZ | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Level 4** | **Level 3** | **Level 2** | **Level 1** | **Level 4** | **Level 3** | **Level 2** | **Level 1** | **Level 4** | **Level 3** | **Level 2** | **Level 1** |
| Primary | 81 | 88 | 98 | | 71 | 81 | 90 | | 75 | 93 | | |
| Manufacturing | 56 | 77 | 91 | | 44 | 72 | 90 | | 48 | 85 | | |
| Construction | 20 | 70 | 90 | | 10 | 60 | 90 | | 19 | 85 | | |
| Electricity, gas, water and waste | 83 | 87 | 90 | | 80 | 90 | 90 | | 80 | 85 | | |
| Transport & storage | 60 | 75 | 90 | | | | | | 58 | 76 | | |
| Retail trade | 45 | 75 | 90 | | | | | | 38 | 56 | | |
| Accomodation & food services | 20 | 40 | 50 | | 20 | 20 | 50 | | 11 | 20 | | |
| Other Services | 67 | 77 | 92 | | 58 | 75 | 83 | | 68 | 74 | | |
| Govt (local, central, education & health) | 93 | 95 | 97 | | 90 | 93 | 95 | | 90 | 90 | | |
| **Total** | **67** | **80** | **92** | **95** | **61** | **76** | **87** | **92.5** | **63** | **81** | **91.2** | **96.2** |

Source: RBNZ, NZ Treasury, ASB

There are regional dimensions given the regional nature of the restrictions. More stringent restrictions in Auckland will mean perhaps 20% of its regional economy will be off-line during level 3 as opposed to the 8% or so for the rest of the country.

Auckland may be just one of the 16 major regions in NZ, but it has significant economic weight. According to official estimates, Auckland accounts for broadly 38% of NZ's GDP and around 33% of employment and one-third of out nationwide population. The economic structure of Auckland differs from that nationwide, with the primary sector (2% of regional GDP) constituting a smaller proportion of nominal GDP than the nationwide average, with proportionately more economic activity concentrated in the goods (27%) and services sectors (71%).

**Sketching out potential economic impacts**

It is very early days and the severity of the economic impacts are unclear and will depend on some major unknowns. Shifting up the alert levels means that proportionately more economic activity will be disrupted.

The tables below sketch out some potential impacts. They show the weekly cost to nationwide GDP from moving up alert levels relative to our forecast baseline. The move to a nationwide Alert Level 3 would see economic activity throttled back to 84% of its operating capacity (compared to what would have taken place in Q3 otherwise). For every week NZ stays in Alert Level three, it would cut 0.3% off NZ's annual GDP (Dec year 2020). Meanwhile, for every week the whole of NZ is in Alert level 4, we estimate a reduction of annual GDP by 0.5%. The longer the economy remains at a higher alert level, the greater the economic hit.

Here we also outline some potential impacts where COVID-19 Alert Levels differ by region. The higher the Alert level and the more regionally broad-based the impact, the greater the hit to NZ's GDP. Assuming the Current Level 3 Auckland/Level 2 rest of NZ Alert levels remains in place, the weekly hit is approximately 0.15% of annual GDP. The shift to Alert Level 4 for Auckland but Level 2 elsewhere pushes up the impact to roughly 0.25% of annual GDP per week.

| **Weekly GDP cost of lockdown in Q3 2020** | $ 000's | % of weekly GDP | % of ann GDP |
|---|---|---|---|
| Countrywide L2 | 166,018 | 3% | 0.06% |
| Countrywide L3 | 885,428 | 16% | 0.30% |
| Countrywide L4 | 1,604,838 | 29% | 0.54% |

| **Weekly GDP cost of NZ L2, Auckland L3 or L4:** | $ 000's | % of weekly GDP | % of ann GDP |
|---|---|---|---|
| Auckland L3, NZ L2 | 439,393 | 8% | 0.15% |
| Auckland L4, NZ L2 | 712,769 | 13% | 0.24% |

Source: ASB

**Our thoughts**

While it may feel like we are back to square 1, the lockdown in March provided us with a crash course in doing things differently. New Zealanders and businesses have learnt a lot from the previous lockdown experiences and should be more resilient to this latest wave. That will particularly be the case for businesses outside of Auckland, which are still able to operate albeit with distancing restrictions.

This latest lockdown is a firm reminder that we do need to be well set up to conduct our usual commercial interactions under a range of operating conditions. Being able to readily adapt workplaces to enable distancing and switch to digital channels where feasible are important parts of this. Contingency planning remains important.

It would also be a good time for the Government to consider refining what sectors are allowed to operate under the more restrictive alert levels. A lot of the economic damage from lockdowns will occur at Alert Levels 3 and 4 for non-essential businesses. A greater focus on industries that can work safely under prescribed conditions would help to reduce the economic cost of fighting COVID if this lockdown is more enduring or if future lockdowns become more common. NZ does not have the same financial strength it had going into the first lockdown. Refining our approach will help ease the burden.

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