Economic Note

Government Economic Response to COVID-19

17 March 2020

Fiscal fights back

- The $12.1 billion COVID-19 package is a good start in terms of magnitude, particularly considering how quickly this package was put together.
- The Government's books are in a good place to incorporate this spending and future COVID-19 packages.
- However, there is room for future improvement.
- Looking forward, we favour broader and simpler fiscal measures.
- A sharp contraction in the economy is unavoidable, but this package will soften the blow slightly.

Summary

The COVID-19 outbreak warrants a large first fiscal response. The $12.1bn package, worth 4% of GDP, is significant. We commend the Government on this basis and considering how quickly the package was put together.

It also pays to note that the Government's books are in good shape and can take the hit and others that are likely to follow. NZ is particularly well-placed globally in this regard.

Key Announcements	**NZ$bn**
Boost for health services	0.5
Wage subsidies	5.1
Leave and self-isolation support	0.13
Low income support	2.8
Redeployment assistance	0.1
Business tax relief	2.8
Aviation support	0.6
Other	0.1
Total	**12.1**

The effectiveness of the package is likely to be mixed, however. Wage subsidies will be helpful to keep people in jobs as the economy grinds to a halt, but the arguments for some other measures are less clear at this juncture. For example, the building depreciation measures seem to favour building owners, while tenants are likely to receive relatively less support.

Looking forward, we note that the Government has appropriately left the door open to additional fiscal support for the economy. For the future, **we favour broader and simpler fiscal measures**. For example, a temporary cut to the GST rate is one example of how the Government could give a broad and simple boost to the economy.

Even with the support package, a sharp contraction in the economy is unavoidable. This package will soften the blow somewhat and buy businesses and households some time. Ultimately though, more support will be needed.

Package centre piece - wage subsidy scheme

The Government's wage subsidy scheme is the centre piece of the support package, comprising 42% of the total spend. The idea is to support businesses to keep paying staff and keep them employed as we go through the harsh economic adjustment of the coming months. In this way, the Government hopes it can avoid what might otherwise be a material deterioration in the labour market with this loss of jobs/purchasing power adding a second round of

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negative economic effects onto the already-deteriorating outlook.

It needed to be big and it was. NZ$5.1 billion divvied up into lots of a maximum $150,000 per business. By construction then, the subsidies are targeted at SME businesses, not the top end of town. There are a bunch of criteria that businesses need to satisfy to quality which leaves the scheme open to gaming, but such is the reality of these types of targeted measures.

Other measures designed to support worker incomes included:

- a boost to main benefits of $25 per week ($2.4bn);
- a doubling of the Winter Energy Payment to support beneficiaries and super annuitants ($480m); and
- a range of measures of support those workers/businesses where workers are either ill, working from home, on sick leave or in self-isolation ($126m).

The latter two look eminently sensible to help minimise the incidence of illness. One gives the more vulnerable in society the means to keep themselves warm and healthy. The other reduces the disincentive for workers to continue working as normal and potentially harm the public health in doing so.

Businesses tax changes – hit and miss

The Government also announced a suite of business tax measures. In our view, **these measures were a mixture of good and less impactful**. These measures included:

- The reinstatement of depreciation deductions for commercial and industrial buildings at a 2% diminishing value;
- Increasing the threshold for writing off low value assets from $500 to $5,000 (and a permanent increase $1,000 in the longer term);
- Increasing the threshold for provisional tax from $2,500 to $5,000;
- Giving a time-limited discretion to Inland Revenue to remit use of money interest (the interest on tax debt) if a taxpayer is unable to pay on time due to the impacts of COVID-19.

We are least-enamoured with the building depreciation measures as this seems to target businesses in a way that is less-connected to the COVID-19 outbreak. For example, this measure will bypass tenants and it's not obvious to us why this should be the case. In contrast, the other three measures are broad and largely sensible in our view.

Boosting the public health sector

The Government's first response is addressing public health. The focus in the health aspects of today's announcements are to "continue that work to smooth the curve of the inevitable increase in infections". We see these measures as entirely appropriate.

The Government announced an additional $500m to boost the health system. Areas of focus are:

- Scaling up public communications to ensure people have practical advice and support to contain the virus, and on how to self-isolate;
- Strengthening ability to test and trace cases; and
- Strengthening ability to treat cases in both the community and in hospitals.

Immediate actions announced today include a public information campaign, upscaled testing, boosting Healthline, containment and isolation procedures, establishing Community Based Assessment Centres. Medium-term actions include further support for hospitals and community health providers to deal with the expected surge of patients, including further advice for caring for people at home.

Significant increases to the bond programme lie ahead

Today, **the NZ Debt Management Office (DMO) raised the 2019/20 New Zealand Government Bond (NZGB) programme to $13bn**, $3 bn higher than forecast at the Half Year Economic and Fiscal Update 2019. The DMO have also bumped up Treasury bill issuance by $1bn to $4bn.

While future government borrowing programmes are unchanged, **the DMO acknowledge increases in the borrowing**

programmes for future years will be necessary and it will provide updated forecasts in Budget 2020. We expect the DMO to significantly step up its issuance programme to fund the cost of the support package and to cover the hit to the fiscal position posed from the weaker NZ economic outlook.

What's next?

The Government made it clear that today's package was just the start. Ensuring that the health sector is as well-placed as it can be to deal with the outbreak and that lower-income households receive support are clearly key priorities. Minimising job losses and firm closures for small businesses looks to be a major aim of the package to ensure that the economy will still have foundations to drive an eventual upswing.

The jury remains out on whether the package in its current form will be best-suited to meet the evolving challenges posed by the COVID-19 outbreak. We look forward to seeing what support will be offered to larger firms. It is wise that the Government has kept its options open and has acknowledged that the policy response will need to evolve as the situation changes.

The NZ economy faces significant challenges ahead. It looks that the COVID-19 outbreak and the outlook for the economy will get worse before it gets better. Sharp recession lies ahead for NZ and many of our trading partners. The best that we can hope for is that the announced policy measures help soften some of the hit to the NZ economy, employment and firms.

Thankfully, NZ's fiscal position is currently on a strong footing and can weather a short period of (potentially large) fiscal deficits. **A more protracted economic downturn, in our view, would warrant a simpler and broader fiscal response in contrast to the more targeted measures announced today.** Over time, virtually every business and household will be affected in some way. It's laudable that the Government have kept an eye on the future by keeping the $12bn infrastructure package in play. However, when push comes to shove, some difficult policy choices may be required at some point.

In the coming weeks, we will be putting out a note that highlights our core macro view and highlights some of the pressure points in the outlook.

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