A bold response to an unprecedented situation

Key points
- The Government unveiled a broad $12.1bn (4% of GDP) COVID-19 response package. We expect about half of this before June 2020.
- This is a bold package, with more to come, in response to a shock that is expected to be greater than the global financial crisis. It won’t fix the problem and the Government knows that, but it all helps.
- DMO issuance will be higher from now until the end of June, with more guidance expected at Budget. Net debt will clearly be much higher.

The details
The Government unveiled a $12.1bn COVID-19 response package today. It is a bold and broad package in response to an unprecedented situation, with further phases expected to come.

The Government acknowledged that the outbreak will have "severe economic consequences". We are now in a global recession scenario, expected to be greater than the global financial crisis.

The package includes:
- wage subsidies for businesses affected by COVID-19 in all regions and sectors for 12 weeks ($5.1bn);
- increased benefit support of $25 per week and an increase in the Winter Energy Payment ($2.8bn) – both are permanent;
- business tax changes to free up cash flow ($2.8bn), including re-introducing building depreciation, a provisional tax threshold lift, and writing off interest on late tax payments;
- A boost to health spending ($0.5bn); and
- Smaller initiatives including a self-isolation support, a worker redeployment package, and an aviation support package.

The response is big by international standards at 4% of GDP. Of the $12bn, $6bn is expected to be spent to June 2020, with the remainder spread over the following three fiscal years.

To fund the package, for the remainder of this fiscal year (to June),
- DMO has announced an extra $3bn of issuance;
- T-bill issuance will increase $1bn to $4bn;
- there will be no buy-back of the 2021 bond, providing another $1.25bn; and
- the remainder will be funded out of current cash reserves.

For the following three fiscal years, the outlook for funding and the fiscal position will be announced at the Budget in May.
The Government has indicated that this is only the first tranche of the response. The Government is actively discussing working capital support for small and medium-sized business with banks, and is investigating tailor-made support for large and complex businesses. Budget 2020 will be a “recovery budget”. After this, fiscal rebuilding will be necessary.

Preliminary Treasury forecasts are for growth bottoming at -1% y/y in March 2021 (from 3% y/y at HYEFU). But with conditions evolving rapidly, the economic impact could clearly be worse than that.

The fiscal position will be significantly impacted and the Government will look through that. Net debt will increase beyond the 15-25% range, and not just by the 4% of GDP spending boost. Beyond this, the fiscal response is expected to increase as signalled, revenues will be lower and automatic stabilisers will kick in – all of this will inflate net debt further.

The Government’s response today dovetails the RBNZ’s announcement yesterday. A lower OCR will ease financial pressures, and quantitative easing is expected as soon as practicable. RBNZ purchases of government bonds will soak up increased bond supply and ease borrowing costs. While the package itself is impressive, there is no way to hide the fact that funding is a big ask. Bond spreads have widened, but we see QE in due course, which will ease that pressure. Additionally, the RBNZ’s delay to the bank capital increase will support credit provision, given the role banks will play naturally through the provision of credit.

Today’s package is only the start of an unprecedented policy response that will unfold over the coming year. We are in a fast-evolving situation, with severe economic consequences, and enormous uncertainty. The Government and the RBNZ have stepped up to the plate to help and are both expected to do more – that’s encouraging. But nonetheless, the shock is going to be painful and conditions will be difficult for some time. Our thoughts are with all those affected.
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