ANZ Research

NZ Insight: The ups and downs of recovery

31 July 2020

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Stepping back and looking forward: A straight-line recovery looks unlikely

Summary

- Forward GDP indicators have bounced back vigorously out of lockdown. That's great news, and to some extent expected given the low base – but how long will it last?
- There are a number of temporary factors supporting the bounce, including pent-up demand, unseasonably strong domestic tourism during the colder months, and temporary income support and job retention measures.
- High-frequency economic indicators may remain on a stable to improving trajectory into September, but our analysis suggests that by November at the latest the mood is likely to turn. By then, some temporary supports expire and the impacts of a closed border will become more acute.
- Uncertainty is extreme. And while not our forecast, we think there is a material risk that the economy enters a double-dip recession from Q4 2020.
- Monetary policy should not be complacent; the costs of waiting to see how the economy muddles along are too large. The time to act is now. Fiscal policy has worked hard to fill the gap in GDP owing to lockdown, but stimulus measures beyond infrastructure projects will be needed.

The view

A number of timely economic indicators have bounced very sharply out of lockdown. That's not a surprise, given the abrupt halt the economy experienced. We always knew the data was going to be volatile. That said, we've been pleasantly surprised at the pace at which these indicators have recovered and the fact that it has been reasonably broad based. But we are also very cautious about taking too much signal from the bounce about where the economy is headed from here, as the impact of the closed border and wider recessionary dynamics are yet to be fully felt (not to mention global headwinds). The lockdown and the closed border are completely separate economic shocks. One is done; one is set to be with us for a while.

A few weeks back we warned that the recession is just beginning, and this view hasn't changed. However, the time it will take for economic fundamentals to be revealed in the dataflow has always been very uncertain. Economies can be slow ships to turn, but data volatility can mask that.

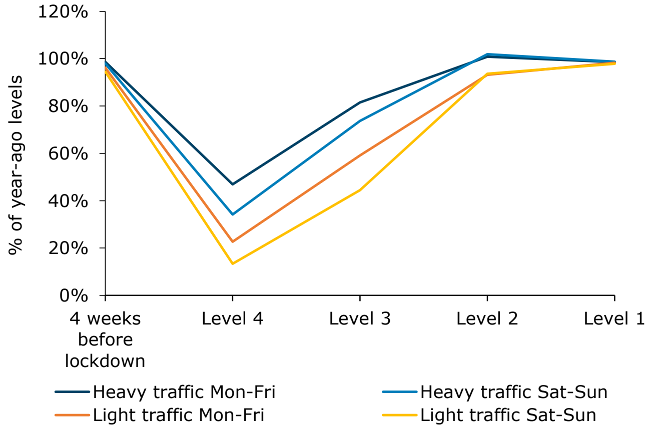
In this note we discuss some of the reasons why we think it may take a bit longer for the extent of the blow to become evident, and provide a timeline for how we think the vibe of the data is likely to evolve from here. Of course, no one is in a position to forecast leading GDP indicators, such as firms' hiring and investment intentions, but we can step back and question what's been supporting the recent bounce, and how sustainable some of these supports are likely to prove.

A number of timely indicators have rebounded vigorously out of lockdown

Economic indicators have rebounded sharply, albeit off an extremely low base:

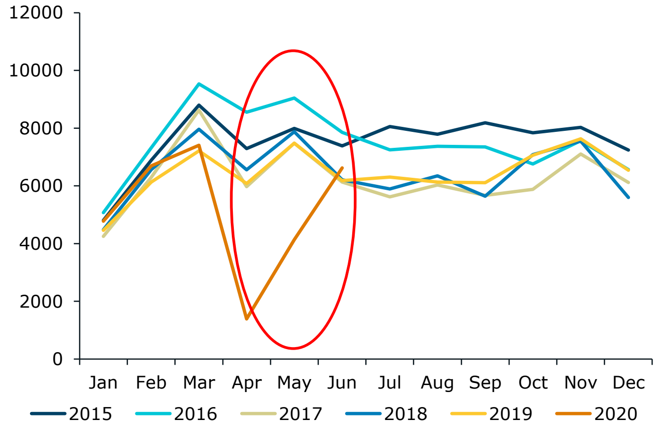
- Our Truckometer indices show heavy traffic has rebounded strongly, to be close to year-ago levels (Figure 1). However, light traffic is lagging, and remains relatively weak in the weekends, the most discretionary travel.
- Our Business Outlook bounced sharply out of lockdown. However, the full-month July read included some retracement from the preliminary, suggesting the recovery may already be topping out.
- After rebounding sharply out of lockdown, consumer confidence was broadly stable in July, well under its historical average but also well off recent lows.
- REINZ house sales recovered to year-ago levels in June (Figure 2), and house prices unwound prior monthly losses. See our latest Property Focus for our take on these data and the housing market more broadly.
- Both the BNZ-BusinessNZ PMI and PSI jumped into expansionary territory in June. However, the employment components remain in contractionary territory.
- Private car registrations rocketed in June, to be just 2.8% below the level recorded in the same month a year ago. Luxury car regos (which account for around 7.5% of total private regos) rebounded to be almost 30% above year-ago levels – a small portion of households appear to be in pretty high spirits, or perhaps they are spending their holiday savings on a fancy ride instead. Low financing rates will be helping too, no doubt.

Figure 1. Heavy and light traffic index



Source: NZTA, ANZ Research

Figure 2. House sales



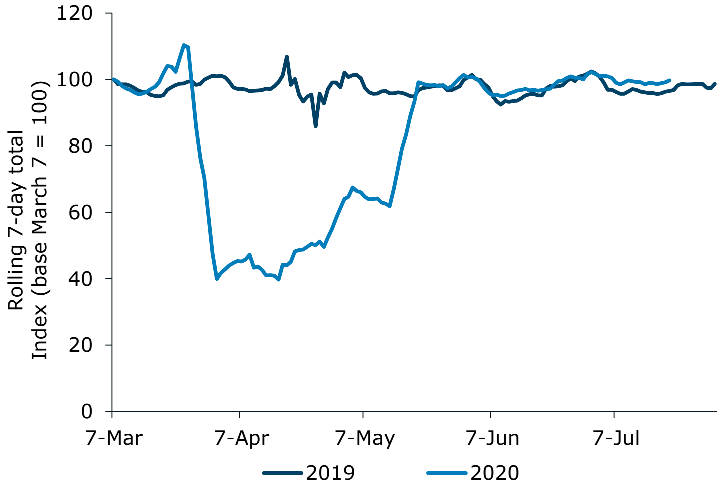
Source: REINZ, ANZ Research

This all sounds pretty good, right? And it is. But make no mistake, economic recovery from crisis is a marathon. And just because NZ has come out of the gates sprinting, it doesn't mean we can maintain that pace for the remaining forty-something kms.

Pent-up demand is supporting the bounce

It's difficult to quantify, but pent-up demand will be playing a role in the post-lockdown rebound. New Zealanders knocked a billion dollars off their credit cards during lockdown, and have been having a very happy time putting it back on. Delayed spending on non-essential items will still be working through, with involuntary savings during the lockdown burning a hole in some pockets.

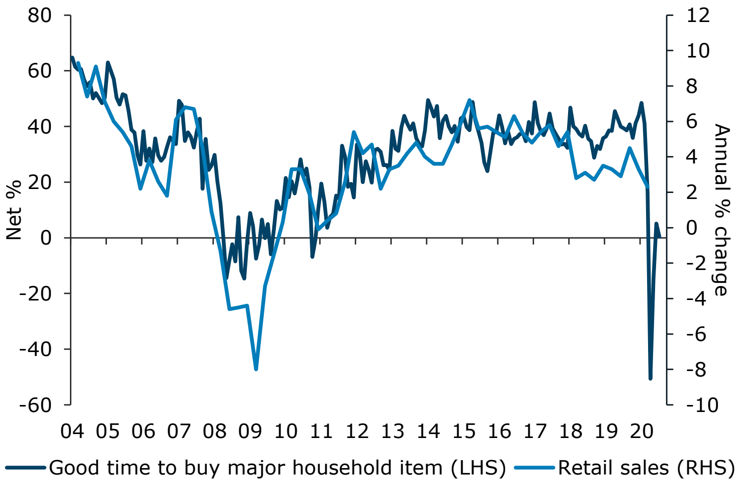
Figure 3. ANZ weekly spending data



Source: ANZ Research

What is telling in the consumer spending data is that while daily spending has returned to 2019 levels, there has been no significant overshoot (Figure 3). People have not made up for their lost shopping time in lockdown. We think the very recent data have been supported by the closed border during the school holiday period (more on closed border impacts below). As this unwinds and pent-up demand is exhausted, transactions could slip below year-ago levels once again. We'll be keeping a close eye on weekly transactions data over the coming weeks to get a gauge on the underlying spending impulse. Certainly consumers are wary, according to our consumer confidence survey (Figure 4).

Figure 4. ANZ Consumer Confidence "Good time to buy a major household item" and retail sales



Source: Statistics NZ, ANZ Research, Roy Morgan

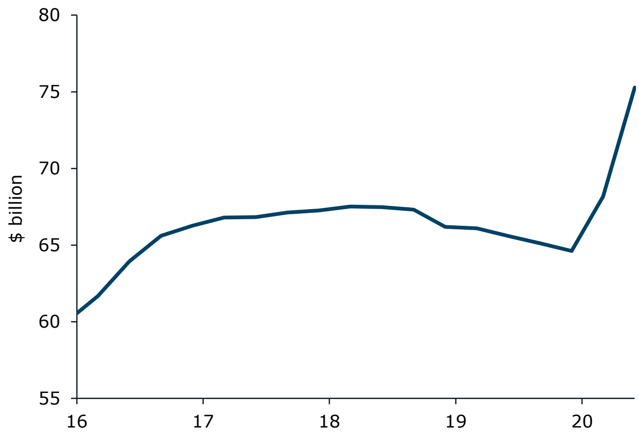
Stop-gap policy and temporary income support are also playing a role

Temporary support measures are providing a significant boost to incomes and cash flow, but the bulk of these will have expired by year end (see timeline on page 7).

- From late March, the wage subsidy and its extension have seen around $13bn transferred from the Government to businesses and households.
- From late March, mortgage holders who have taken a financial hit due to COVID-19 have been able to apply for a mortgage deferment of up to 6 months. Some other mortgage holders are choosing to go **interest only** as opposed to taking a full repayment holiday (Figure 5).

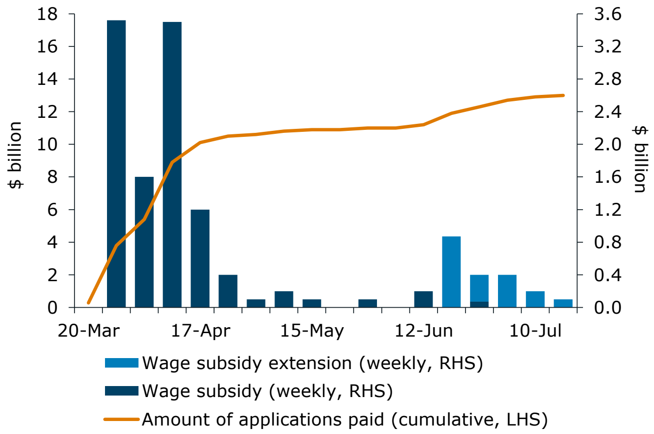
- For those who have lost or will lose their jobs due to COVID-19 between 1 March and 30 October, there's the COVID-19 Income Relief Payment – a temporarily (12 weeks) higher unemployment benefit for eligible applicants.
- Applications for the Small Business Cashflow Scheme opened in May and can be made until the end of the year. There is also the Business Finance Guarantee Scheme – but uptake has been significantly smaller.

Figure 5. Existing interest only residential mortgage lending



Source: RBNZ, ANZ Research

Figure 6. Wage Subsidy payments



Source: Ministry of Social Development

All up, these stop-gap measures are providing unprecedented support to households and firms via both supporting incomes and easing expenses. And they have certainly helped recover some of the hole in GDP left by the lockdown and closed borders. However, they are simply too costly (and in some cases too unfair on current and future taxpayers) to be maintained for an extended period. The economy will need to be weaned off this support eventually, and when that happens, the labour market, the housing market, and domestic activity more broadly will be weaker for it.

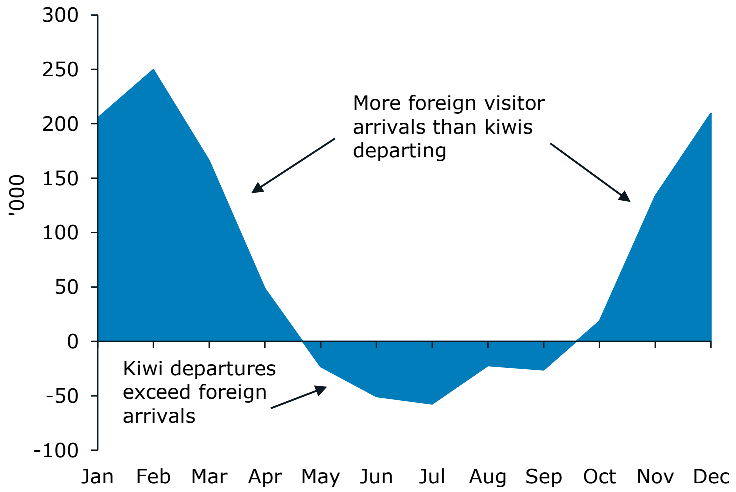
In the absence of further direct support measures to firms and households, a fairly substantial portion of support measures will have rolled off by year end. That will leave low interest rates and increased government spending on the likes of infrastructure projects as the main stimulus measures in town. So while the above temporary measures will certainly contribute to a stronger economy on the other side than otherwise, the data flow will be vulnerable to deterioration over the latter part of the year. New Zealand is not alone in this – 'fiscal cliff' debates are happening all over the world.

Positive offsets from a closed border in winter, but they won't last

Tourism is a very seasonal industry. Winter is the off-season, with fewer international visitor arrivals and more kiwis going on holiday abroad to escape the cold. Reflecting this, net visitor arrivals (foreign visitors to NZ less NZ resident departures) have a tendency to dip into negative territory between May and September, but then become strongly positive between October and April.

Figure 7 shows the typical seasonal pattern of net tourist arrivals. Thanks to a closed border, the few months just gone (and to a lesser extent the couple of months ahead) are the only time of the year when New Zealanders holidaying in Queenstown instead of Queensland have a shot at successfully filling the hole created by missing foreign tourists. But from October through to April, we will miss out on significantly more tourism income if the border remains closed – with more than 5.5 times as many net visitors lost than what's been gained during winter. November, when net visitor arrivals typically lift sharply into surplus, is when tourism-related businesses are likely to really notice the cashflow impacts of a closed border.

Figure 7. Net short-term visitor arrivals to NZ, 3-year average as at 2019



Source: Statistics NZ, ANZ Research

And there will be flow-on effects through the economy more broadly. We think the unusual profile for net visitor arrivals in 2020 could have a meaningful impact on the seasonally adjusted GDP figures via net services exports, boosting quarterly GDP on the off season (Q2 and into Q3), but weighing on it over the summer (Q4 and Q1 2021).

The impact isn't trivial. We estimate seasonally adjusted GDP could be around 1% higher than otherwise over Q2 and Q3. But the boost will be temporary, unwinding in Q4 and Q1. So come summer, GDP could be hit from both the absolute impact of a closed border (which we estimate is leaving around a 5% hole in the economy) plus the additional volatility from these seasonal impacts (perhaps detracting an additional 1%).

In reality, it will be very difficult to disentangle these different impacts, but it does reinforce our view that the recovery won't be a straight line. In particular, the strong seasonality of tourism will push some of the weakness into Q4 and Q1 GDP. We already expect a small moderation in Q4, but if this extends into Q1 it would mark a double dip recession.

Signal vs noise and implications for the outlook

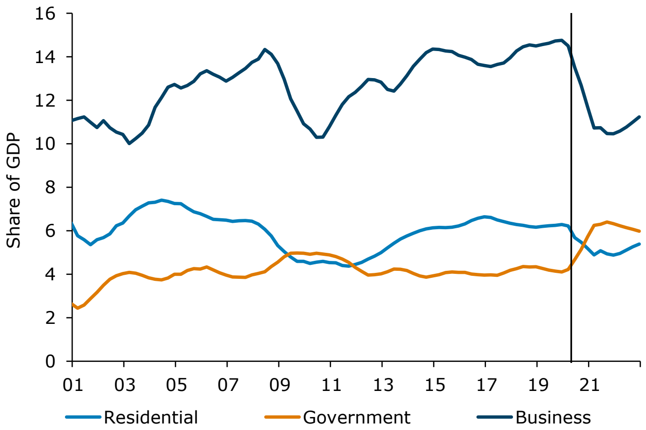
By year end, the underlying signal in the timely data should be clearer as the temporary factors supporting the bounce subside. While we can't rule out the possibility that the data flow plateaus or deteriorates sooner than we expect (both our Business Outlook and consumer confidence suggests it's already happening), we think it will be particularly vulnerable to deterioration later in the year. But of course, the degree of deterioration will depend on how much the data recovers beforehand. In other words, volatility is yet to subside.

Looking through the noise, we believe underlying economic momentum is travelling well below pre-crisis levels. We expect to enter 2021 with GDP around 5% lower than end-2019 levels (Figure 9), regardless of how volatile the next few quarters are. Fiscal and monetary stimulus is working hard, but can't provide a full offset:

- The peak impact of a lower OCR on activity generally takes around 12-18 months. But conventional monetary policy ammunition was limited going into this crisis. Further, monetary stimulus generally works in part via a lower exchange rate, and that's been stubbornly high recently. We think the RBNZ will need to do more in time but the remaining options have their trade-offs.

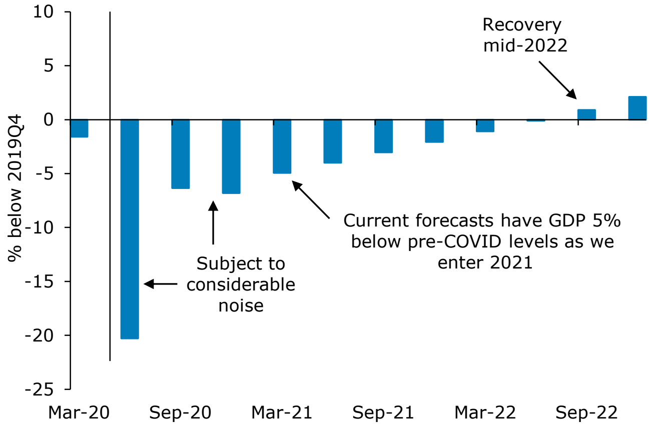
- Fiscal policy has done a lot already! But most of the fiscal response has been focused on filling in the hole in GDP (incomes) left by the lockdown. While this provides a better starting point for recovery than otherwise, it was never going to be enough to replace lost GDP while the border remains closed. Yes, increased infrastructure spending will help, but it takes time, and its small share of the economy makes it an unlikely candidate to turn broader economic momentum on its own (Figure 8). We suspect the Government will make further announcements on macro stimulus once it's confident that virus risks are well and truly contained. Until then, however, fiscal policy will need to remain attuned to the possibility of a second wave of infection. Pressing pause on the fiscal spending side for now will at least provide an opportunity to focus on implementing what's already been announced, and to prepare for all eventualities. But there's more to fiscal policy than spending; stimulus can also be provided through the supply side – such as RMA and labour market regulation reform. It's just politically harder than throwing money around.

Figure 8. Investment share of GDP



Source: Statistics NZ, ANZ Research

Figure 9. GDP forecast percent of pre-crisis level



Source: Statistics NZ, ANZ Research

At this stage, we're not changing our forecasts on the back of the vigorous bounce out of lockdown, though we do see risks as more balanced. However, it's very likely that we'll end up tweaking our quarterly growth profile as more information comes to light via the Q2 partial GDP indicators (such as retail sales volumes) and as the timely data evolves through Q3. These quarters are subject to considerable uncertainly, but the near-term ups and downs in the GDP data are unlikely to change our medium-term view significantly. As things stand, a weaker (stronger) Q2 implies a stronger (weaker) Q3. And to the extent that Q3 has some unseasonal support (ie positive closed border offsets), then Q4 and Q1 are likely to include some retracement – a double-dip recession is not our forecast, but it certainly is a risk.

Timeline

Alert levels

1	9 June - assumed until end of year at minimum
2	14 May-8 June
3	23 March-25 March, 28 April-13 May
4	26 March-27 April
None	

Jan 2020

Economic momentum was building.

Feb 2020

COVID-19 a now a substantial shock in China, expected to impact trade with NZ.

Mar 2020

NZ closes borders to non-NZers 20 March. There will be a hole in GDP until they are reopened.

Timely data flow plummets into extremely negative territory (many new historic lows recorded).

Apr 2020

Wage subsidy introduced late March, around $10bn paid out by mid-April.

May 2020

Small Business Cashflow Scheme applications open 12 May.

Pent up demand dynamics out of lockdown begin. Positive domestic tourism offsets kick off.

Jun 2020

Timely data flow rebounds vigorously, particularly retail spending and housing.

Jul 2020

School holidays a life raft for tourism – supporting the rebound.

Business and consumer sentiment showing signs of peaking.

Aug 2020

Q2 labour market data released 5 August. Unemployment rate to lift, but unlikely to reflect severity of the situation.

Sep 2020

Q2 GDP released 17 September. Probably the worst quarterly contraction we'll ever see. Little signal here. A larger (smaller) contraction implies smaller (larger) Q3 rebound.

Temporary relief starts to unwind in September: wage subsidy extension application period ends; 6 months since the 6-month mortgage holiday scheme began; the first COVID Income Relief Payments reach their 12-week limit.

Oct 2020

Vibe of the timely data flow vulnerable to deterioration.

Nov 2020

Impact of closed border felt more acutely.

Q3 labour market data released 4 November. Expect sharp rise in unemployment rate, but risks skewed towards this occurring later.

Dec 2020

Q3 GDP released 17 December. Probably the strongest quarterly lift we'll ever see. Some temporary strength in the bounce is expected to unwind from Q4.

Small Business Cashflow Scheme applications close December 31.

Good news on vaccine development possible, and could change sentiment quickly, but impact on activity (visitor flows) could be some months away.

Jan 2021

Feb 2021

Q4 labour market data released early February. These data should now be reflecting the underlying state of the labour market. Residual measurement issues have washed out and the wage subsidy is no longer delaying job losses.

Timely data flow expected to show signs of gradually recovering momentum - in line with typical recessionary dynamics.

Mar 2021

Q4 GDP released mid-March – some payback from Q3 rebound expected. Risk that this continues into Q1, marking a double dip recession.

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