ANZ Research

NZ Insight: Lockdown and the economic outlook

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Lockdown and the economic outlook

Crossroads

The NZ economy feels like it's at a crossroads between two rather extreme states of the world. Of course, in practice it's been at this crossroads for 18 months, but now the materialisation of COVID risks brings it front of mind.

One road leads to successful virus elimination, with the economy back at Alert Level 1 or 2, or at least on a clear path to it, within a few weeks. The other leads to a much darker place: despite our best lockdown efforts the Delta variant proves very hard to contain, strict social distancing measures are required well into 2022 to alleviate pressure on the health system, confidence tanks, economic momentum wanes, and more macroeconomic stimulus is needed (but this time, housing policies are unlikely be loosened for investors!). Those are the two extreme ends of the spectrum, but the reality is, everything in between is also possible.

Economic forecasters have a number of ways of dealing with this unusually pronounced uncertainty:

- We can produce a central forecast somewhere in the middle of these two extremes that in our view makes the risks "balanced" (though the central forecast itself may well be far from the likeliest single outcome).
- We can produce a range of forecasts (scenarios) and ask you to choose your own adventure.
- We can pick what we view as the single likeliest outcome, and talk about the risks (which will be firmly skewed in one direction or the other).

The latter is essentially what we're doing for now. That's partly because we haven't yet got enough information about this outbreak to sensibly update our economic outlook. But also, importantly, provided the health response is successful at eliminating COVID-19 once more and heightened Alert Level restrictions turn out to have a similar profile to March/April last year, we don't think the economic outlook will change meaningfully (beyond the immediate volatility in spending and activity).

In a nutshell, we're currently assuming a successful health response, that pent-up demand dynamics are similar to previous lockdowns, that fiscal stimulus works just as well as before, and that any deterioration in economic confidence is short lived. Provided all that comes to pass, we don't expect to see significant impacts in the aggregated quarterly economic data flow. But it's fair to say, risks are firmly skewed to the downside! And of course there are always other risks – the global growth outlook is currently looking a bit iffy. But in this note we focus on the COVID outbreak.

The hurdle for changing our forecasts (and OCR call) and what we're watching

First, we should highlight that even if we do move our forecasts over the coming weeks, they will remain extremely uncertain. Even though we've been through this before, it's reasonable to assume that no two lockdowns are the same. We have more to say on this later, but first here are a few things we'll be watching:

- **COVID developments** are obviously top of the list. Case numbers, traceability of cases, compliance with lockdown measures, testing rates, mask wearing, and places of interest (particularly high-capacity ones that have been frequented by out-of-towners) are some of the early indicators that may affect the probability of eliminating this outbreak promptly (or indeed at all). But we are not epidemiologists, and will not be producing any forecasts or expectations of such variables. Like everyone else, we will just have to wait and see how things evolve. Government officials have signalled they expect to see more cases over the coming days, but luck will play a huge part. The news that the introduction appears to be quite recent is very encouraging, but we clearly have potential super-spreader events to worry about.
- Assuming COVID elimination is successful and NZ is back at Alert Level 1 or 2 within a few weeks (or at least on a clear path to it), we'll be keeping a close eye on our own **internal card spending data**. We know Alert level 4 is going to see spending fall off a cliff, but the lesson from past lockdowns is that the extent of the decline is less important than the size of the rebound (at an aggregate level). Of course, some businesses (particularly hospitality) really suffer because of lockdowns, and don't make that back on the other side. And we also need to be aware that the longer restrictions are in place, the more businesses (and therefore households) are going to hurt. But figure 1 shows how quickly spending bounced back last time.

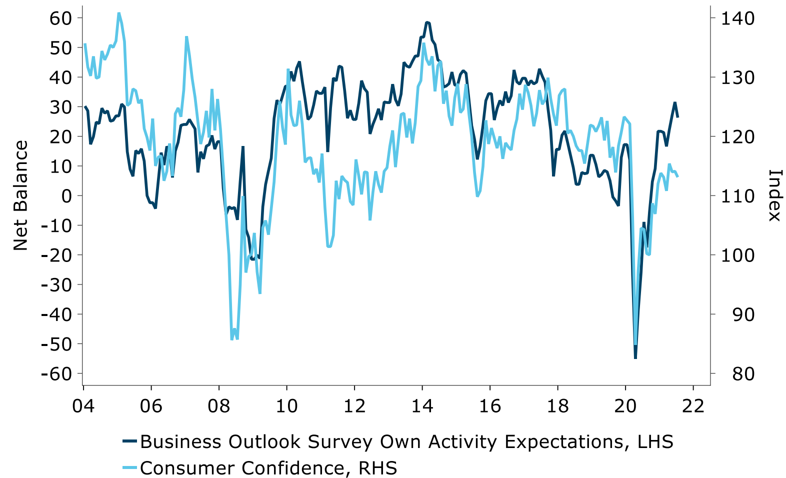
Figure 1. ANZ card spending, selected categories

Source: ANZ Research, Macrobond

- The next best timely indicators we have to test if renewed lockdown measures have altered underlying economic momentum is **business and household survey data**. Here, our Business Outlook and ANZ Roy-Morgan consumer confidence surveys are very useful. But it's also important to note that one data point doesn't make a trend. A lockdown-induced drop is naturally very likely, so it'll be a sustained deterioration we'll be on the lookout for. We certainly didn't see that last

time (figure 2). But businesses will be looking at the example of Sydney with alarm. We will consider once more producing a preliminary Business Outlook (ie two reads per month) should lockdown restrictions look like they will be in place for a prolonged period.

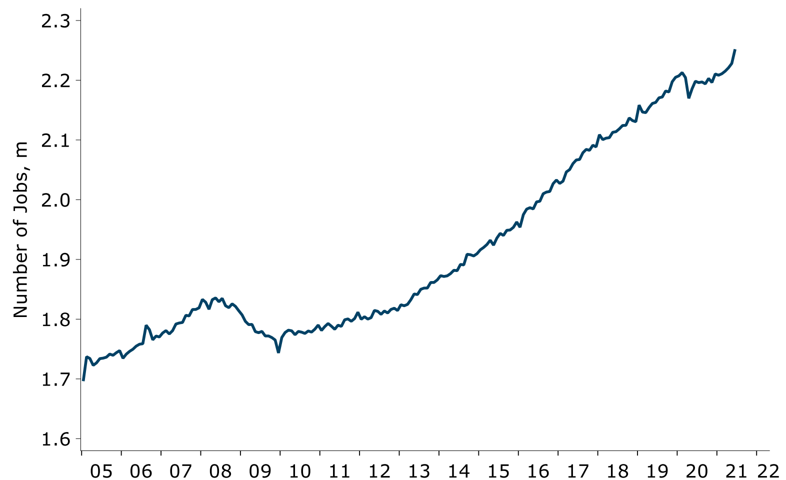
Figure 2. ANZ own activity expectations and consumer confidence



Source: ANZ, Roy Morgan, Macrobond, ANZ Research

- Job seeker support data and the monthly employment statistics will be some of the timeliest **labour market indicators**. However, the former hasn't provided a good steer on the official labour market statistics. The latter is released with a bit of a delay (the last data point is June) but these data have provided a decent steer. What we saw during the last lockdown was a sharp fall, followed by a strong, but partial, retracement (figure 3).

Figure 3. Monthly filled jobs



Source: Stats NZ, Bloomberg, Macrobond, ANZ Research

So what would take an October OCR hike off the table?

While the RBNZ argued this week that the pause was more about comms than economics, there's no question that COVID developments matter! It's not really feasible to estimate a precise lockdown scenario that would flick the switch, however. In practice, it's going to depend on how economic actors are responding to it. Clearly, if we head into more than four weeks of Alert level 4 lockdown, and are still facing bad news on the case numbers front, then one would naturally become less certain that the lockdown experience last year (and in particular the ferocious bounce on the other side) is going to be a good guide to outcomes this year.

Clearly, the increased infectiousness of Delta makes this a much higher-risk situation than otherwise. But there are other factors that work in our favour this time: the contact tracing system is up and running; we have over 20% of the population vaccinated (better than nothing!); testing and genome sequencing is much more organised than last time; we have one source case, not hundreds; and level 4 lockdown was implemented as rapidly as possible. And as for the economic fallout, we also have a head start: the rollout of fiscal support will be seamless rather than a mad scramble; business balance sheets are in good shape after a period of very strong demand; and households will be much more confident about their employment prospects.

The other reason that even a more prolonged lockdown might not shut down the case for OCR hikes (even quite soon) is the fact that they have not tended to be deflationary. And when it comes to the crunch, the RBNZ is an inflation targeter, with the rest being nice-to-haves. Supply restrictions only intensify with lockdowns as labour mobility and productivity plummets. For it to become a net deflationary event, household incomes (and demand) would need to deteriorate markedly, and businesses would have to delay and/or cancel their investment plans (ie not just a lockdown-induced delay).

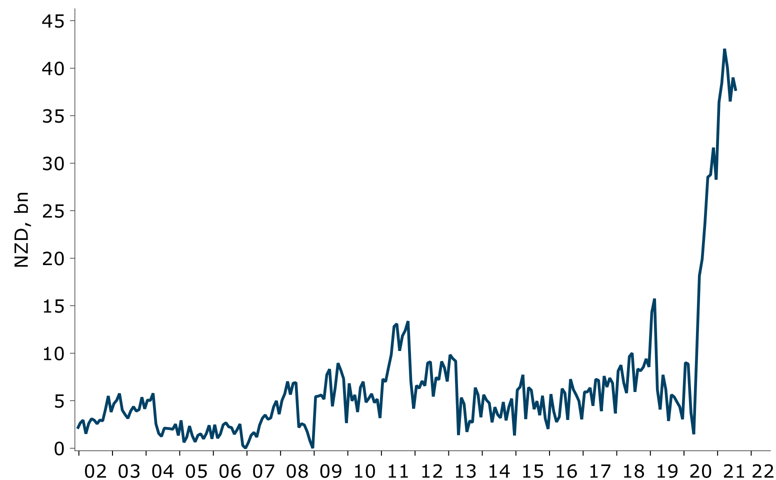
What about the housing market? It's famous for having nine lives, of course, but with house prices up 30% y/y, it may have fewer than that currently. However, provided we avoid a significant income or employment shock, housing market momentum is unlikely to be adversely affected. In the last read, households house price expectations actually lifted from 5.8% to 6.4% – not a particularly useful series for forecasting house prices, to be fair, but certainly evidence that households consider the housing market to be alive and well. In the near term, listings are likely to decline alongside sales, keeping the market tight. And it appears that further mortgage rate increases just got delayed by six weeks, which, all else equal, is a marginally more persistent tailwind than otherwise. So we're not currently seeing a need to make lockdown adjustments to our house price forecast.

Are there limits to fiscal support?

Yes, there is a point where the Government's ability to borrow will be curtailed by its projected ability to pay that money back. But with core Crown net debt projected to peak below 50% of GDP (based on the Treasury's now too-pessimistic Budget forecasts) we're not even close to that scenario. The Government is well placed to respond to this.

While there's only around $5bn remaining in the COVID Response and Recovery Fund, this figure shouldn't be viewed as a constraint should more support be needed. The latest snapshot of the Government's books showed tax revenue running ahead of the Treasury's forecast in the eleven months to May, to the tune of $4.1bn. And the economy has only continued to outperform the Treasury's forecast since. We estimate there could be an additional $10bn in the Government's kitty just on positive economic surprises alone. In other words, additional debt probably won't need to be raised for the fiscal response, even if that response ends up exceeding $5bn. From a funding perspective, the $38bn or so sitting in the Crown Settlement Account shows New Zealand Debt Management are more than well placed to facilitate whatever the Government needs to do (figure 4).

Figure 4. Crown settlement account balance



Source: RBNZ, Bloomberg, Macrobond, ANZ Research

The art of forecasting

It's pretty clear that central forecasts are particularly uncertain right now. While some might say, "but you know what happened last time, surely you can copy-paste", it's important to note that no two lockdowns are the same, even if we were to miraculously know their duration in advance. But what we do know is that economic robustness through past lockdowns surprised us (and the RBNZ) on the upside, and for better or worse, that's informing our judgements now, and the decision not to update out forecasts just yet.

Here are a few things that make calibrating precise economic lockdown impacts difficult:

- The starting point matters – a lot! Had we gone into this lockdown with broad economic momentum waning and firms' balance sheets stretched (which some will be), then the impacts of lockdown would be very different. But virtually all cyclical indicators were pointing to a very robust economic backdrop. In fact, the economy was looking overheated! However, despite having some very strong aggregate data, we just don't know if this lockdown will end up affecting businesses enough to weigh on the business cycle. We suspect it won't, but the composition of the economy is very different today to pre-COVID.
- Efficacy of the policy response. Government support was never meant to fully offset the impacts of lockdown – that would be too costly for the taxpayer and not fair on future generations stung with the bill, either through higher taxes or lower-than-otherwise Government services. But the Wage Subsidy Scheme (which has been lifted to reflect wage growth despite restrictions on public sector wages) and the Resurgence Support Payment are still very sizable. We have no reason to think the efficacy of these policies will be different this time, but we can never be 100% sure about that assumption. There is also no additional stimulus being added by monetary (and macro-prudential) policy this time around, but that's a good thing, given current inflation and capacity pressures – we don't want a boom-bust economy. But while it's true that monetary stimulus acts with a lag (implying some past monetary stimulus is still washing over us) the housing market cycle looks mature. While we think we'll come out of a relatively short lockdown with a still-tight housing market, we're not expecting the housing cycle to pick up steam from here – the housing-induced economic tailwind has largely been spent.

- Households' and firms' ability to adapt. Firms now know how to apply for Government support and have a better idea of what support is available and what it means for their business. They have also had ample time to plan for this eventuality. Knowing the drill may offset confidence impacts associated with heightened uncertainty that comes with the question "how long will this lockdown last?". Households, having gotten through the last one, may also have a touch more certainty than they did during the Great Lockdown of 2020. Importantly, many know that previous rounds of wage subsidies was highly successful in terms of protecting their job. Indeed, the recently released quarterly income GDP data showed household net disposable income fell just 0.1% in Q2 2020 compared to an 10.8% decline in production GDP. Job security is worth a lot when it comes to households' decisions to spend versus save, and our best guess is job security will hold up a little better (for a given lockdown intensity and duration) this time.
- Then there's the degree of panic buying and preparation spending going into lockdown, and the extent of pent-up demand coming out. Anecdote suggests the inexplicable demand surge for toilet paper (more on this below) and booze was alive and well this time around, but we're unlikely to see the same degree of spending on the likes of home office and exercise equipment, given many of us are now set up. All up, it's relatively simple to crunch a few numbers and say the lockdown is costing the economy $300 million a day – and that makes for some pretty decent click bait. But the reality is, the economy is a lot more complicated than that. Underlying momentum (and the rebound) matters. Difficult-to-observe factors such as compositional changes and "animal spirits" really matter, but there simply isn't any good (usable) data for some of this stuff. That makes macro-economic forecasting a bit of a mug's game in this environment, and a lot more art than science. Begging your forgiveness in advance for our forecast revisions.

Special topic: Toilet Paper – on a roll

What is it about lockdowns and toilet paper? Is it rational to buy up all the TP at the supermarket as soon as the Government announces we're going into lockdown?

First point: Avoid crowds. So, no.

Second point: Toilet paper is made in New Zealand, mostly out of trees grown here. It is shielded from global shipping disruptions. New Zealand fortunately has excellent toilet paper security (TPS).

In broad terms, there are two TP markets: the home market (the good stuff), and the work/office/restaurant/public toilet market supplied in bulk, generally by wholesalers (generally not as nice, though certainly in the case of public toilets, an awful lot nicer than it used to be).

Then lockdown comes along, and workplace consumption is transferred to the home market. However, the typical household doesn't have access to TP wholesalers, nor do they tend to prefer the cheaper and lower-quality TP often found in the workplace. Thus, lockdown distorts the TP market.

But TP production can be ramped up if needed. Workers can work overtime and machinery can be run for longer, and plant and machinery can be retooled from workplace market production to the home market stuff. Unless the population changes, New Zealand's overall toilet paper needs seem unlikely to undergo a permanent lift, but if it did, then production capacity could be lifted through investment.

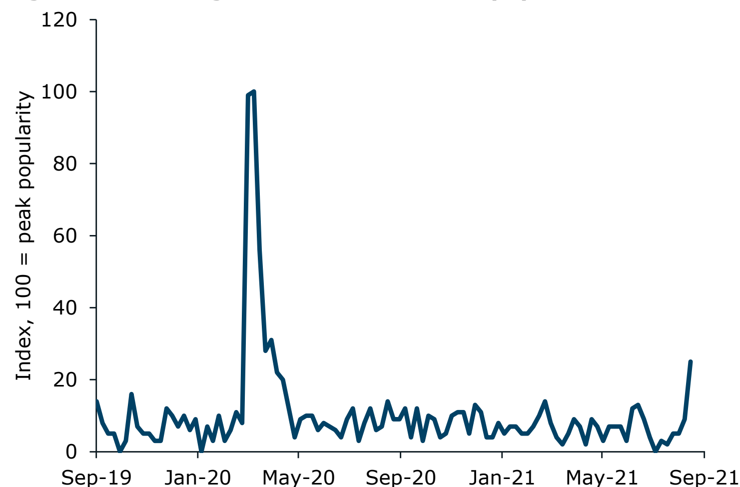
In the shorter run, there may well be input constraints (eg wood pulp), and that can affect the supply response. But assuming there's sufficient overlap between what goes into home market TP and what goes into workplace market TP, then this shouldn't be too much of a concern. Labour constraints are likely to be more binding in the short term, particularly if firms need to add new workers during a lockdown.

Bottom line, there might be some genuine short-term supply constraints when it comes to ramping up home market TP production, but provided inventories are high enough to facilitate the transition, these constraints shouldn't be a material issue – particularly given TP producers have been through lockdown demand surges before and now know what to expect.

All up, the risk of actually running out of TP seems pretty low. In fact, the only real risk is that irrational consumers stockpile so much of it that the market is caught short, adding to the perception of scarcity and causing runs such that TP distribution goes down the toilet. Indeed, if we take it to the extreme, we can draw some parallels between the modern day TP market and the bank runs of the Great Depression. The lesson that central banks learned from that? Signal to the market that you have the public's back in the event of a failure and that their money (or in this case, future TP needs) is secure. And that's exactly what supermarkets and the like have been doing. (While the RBNZ has been printing money, it's electronic, so of little practical help in this instance).

If you're looking for a signal that it's time to get flush with your favourite TP brand, keep an eye out for workplace market product turning up on the supermarket shelf. But it's comforting that even if the home product becomes hard to get, wholesalers will likely be more than happy to start supplying households – just as dairies started bagging up commercial bags of flour last lockdown. The wonders of capitalism. So yes, stockpiling TP is irrational. If Google searches are anything to go by, it's encouraging to see NZ is, so far at least, less toilet paper obsessed than last time.

Figure 5. NZ Google searches for "toilet paper"



Source: Google

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