Te Waka
Anga Whakamua Waikato

Quarterly Economic Update Q1 : 2020

For whom the bell tolls...

The Waikato Region is finding out what it means to be part of an interconnected world. As the COVID-19 virus sees more and more of the global economy seizing up, it has become clear that the effects will be serious, and we will not be immune.

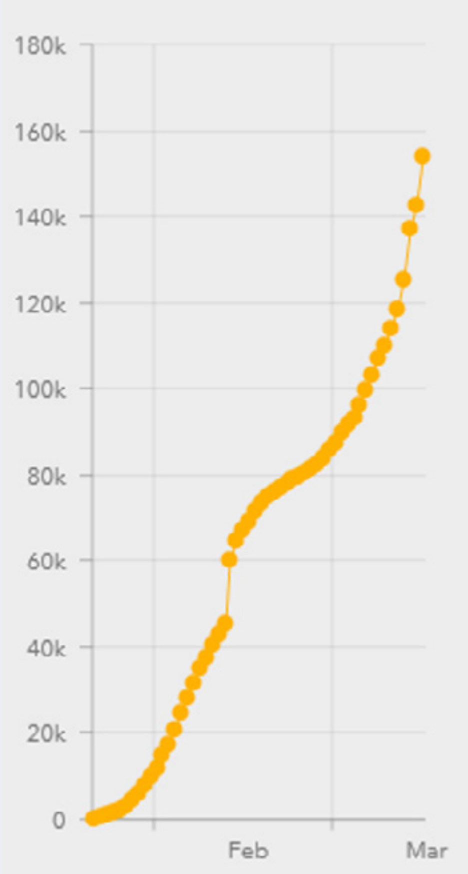
THE EARLY DAYS

When news reports started coming from China of a new strain of corona virus, the initial economic effects followed quickly after. Travel restrictions had potentially significant implications for Chinese tourists coming to New Zealand, and disrupted the tertiary education market, with many Chinese students unable to arrive for the new academic year. In these sectors, the Waikato region's exposure to the Chinese market is relatively small. Tourism in the Waikato is dominated by domestic, rather than international markets – Chinese tourists are estimated to make up only 2.5 percent of the total tourism spend in the region. Some education businesses may be dependent on Chinese students, but this is a small part of the wider economy.

The Waikato region's main commodity exports are highly exposed to the Chinese market. Closure of Chinese ports also disrupted merchandise trade. The work for logging crews dried up as trees, destined for the Chinese market, were left in the ground. Dairy (which is estimated to make up 46 percent of Waikato exports) and meat products (another 13 percent) sell one-third and a half of their products to China.

Figure 1

Cumulative COVID-19 Cases
World Health Organisation



Dairy... and meat products... sell one-third and a half of their products to China

Blair Keenan

PRINCIPAL ECONOMIST, WAIKATO REGIONAL COUNCIL & ECONOMIC ADVISOR TO TE WAKA

Blair Keenan has an undergraduate degree from the University of Otago. Keenan worked at ANZ as a macro-economist and industry analyst for five years before heading overseas as a researcher for Japan's External Trade Organisation in the UK. While in the UK, he also received his Master's degree in applied environmental economics from the University of London and was an economist at the National Farmers Union of England and Wales.

Back in New Zealand, he held several policy roles at Landcare Research, Department of Internal Affairs and Housing New Zealand before his current role as principal economist at Waikato Regional Council. He also continues to collaborate on projects with the University of Waikato, CRIs, central and local government, and a variety of industry groups.

Making matters worse, these risks were overlaid across the difficulties of drought. A lack of feed, leading to de-stocking, meant freezing works were at full capacity, and farmers were faced with having to buy-in feed for stock while they waited to go to the works. Further disruption to supply chains was the last thing those sectors needed.

A less immediately obvious effect was the disruption to integrated supply chains. For example, many modern manufacturing processes span borders, relying on parts or other inputs from other countries such that the comparative advantage of different economies can be exploited.

Towards the end of February, the measures taken in China to contain the spread of the virus were taking effect. But by then, the proverbial cat was out of the bag, with South Korea, Iran and Italy being the first dominoes to fall. The odds on a recession were shortening quickly.

AND THEN...

The week leading up to Friday the 13th of March saw a series of blows that rocked the global economy. On March 6th, falling demand for oil sparked a price war between Russia and Saudi Arabia; on March 11th, US President Trump suspended most travel from Europe. The end of the week saw many financial markets record their largest one-day falls in recent history, with the NZX Top 50 index having lost a quarter of its value since its peak in February. Over the weekend, conferences and sporting events were being cancelled as travel bans, self-isolation requirements and measures to avoid crowds were

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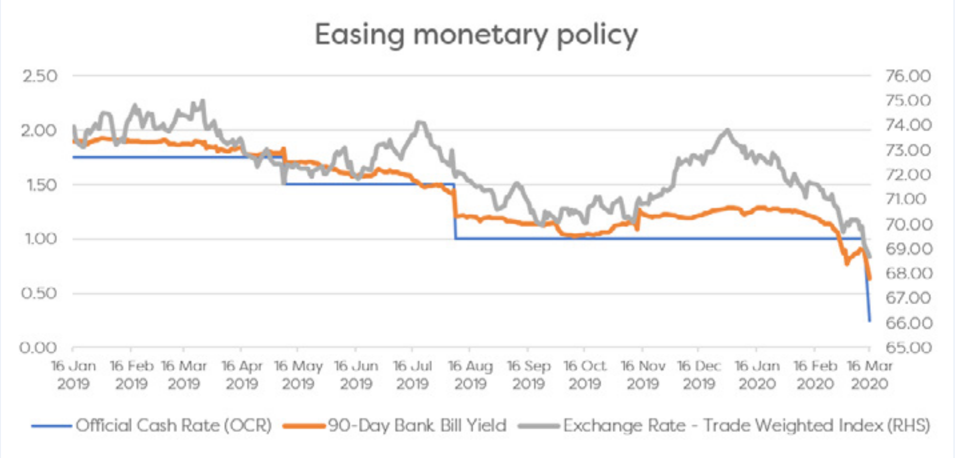
announced or put in place. Whole countries were effectively put in 'lock-down'.

Spending by international tourists, worth an estimated $679 million in the Waikato region in 2019 (a quarter of the regional tourist spend), can be expected to effectively disappear for the time being. Some of this loss in revenue for tourism sector businesses may be made up by domestic tourists who have cancelled overseas trips. But the uncertainty of a pandemic may just as likely lead to falling aggregate demand and the risk of a deflationary spiral. This means the policy response to COVID-19 is absolutely critical. Arguably, the government (and certainly the Reserve Bank) have been somewhat sanguine up to this point, but on March 16th and 17th, substantive new policy responses have been announced.

POLICY RESPONSE

On March 16th the Reserve Bank of New Zealand cut the overnight cash rate from 1 percent to 0.25 percent, followed by the retail banks cutting their own lending rates. The Reserve Bank also indicated it would buy government bonds as a means of injecting cash into the economy, and postponed changes to capital reserve requirements for financial institutions until 2021. The effects on commodity prices is uncertain, but the seven percent decline in the NZ dollar since the beginning of the year may also help exporters to some extent, providing the effect isn't swamped by falling demand from export markets.

Figure 2



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On March 17th the government flagged a $12.1 billion package to support businesses through this period. The bulk of the package ($8.7 billion) is aimed at supporting businesses and providing resources to minimise job losses. There is also a substantial proportion allocated to 'income support' which aims to underpin consumption spending – or at least, stop it from falling as much as it otherwise would.

This comes on top of the $12 billion dollar infrastructure package announced at the end of January (although that spending will be longer term, and less focused on bridging the gap in aggregate demand). At around 4 percent of gross domestic product, the package is possibly the largest response to the pandemic of any country. Fortunately, successive governments' financial management means there is plenty of room to increase debt to help offset falls in aggregate demand.

MANAGING RISK

At this stage, it is impossible to know how long the pandemic, and its economic consequences will last. Hence, it is impossible to know whether the measures announced in recent days will be sufficient. At the time of writing, US equity markets had just closed on their worst day since 1987.

In any case, the risk of doing too much is not the same as the risk of doing too little. If the pandemic fades away relatively quickly and confidence returns (though there is little sign of this happening), there may be aspects of the policy package that prove to have been unnecessary. But the risk that the pandemic is the trigger that leads to a deflationary spiral would have dire consequences right across the economy, and justifies the greater effort now.

Figure 3