

Navigating the COVID-19 crisis

**Update on the trajectory of New Zealand's
economic recovery**

24 April 2020

**STAKEHOLDER
STRATEGIES**

INTRODUCTION

COVID-19 is a rapidly developing crisis that is already having a large impact on our lives and economy

We are working with the leaders of several New Zealand organisations on COVID-19 issues. Our work spans the public and private sectors, so we are well placed to help navigate through the uncertainty created by unfolding events, impacts on businesses and other organisations, and the policy responses by governments

We are sharing this pack to contribute to understanding and conversations about the likely trajectory of New Zealand's economic recovery

The content presented should be considered “draft” and “work-in-progress”

- It is not complete without accompanying verbal commentary
- The situation is changing rapidly, and our thinking is evolving. It is likely that some content in this version will be out of date quickly

Our work on who will be most affected by the crisis and on “new normal” scenarios for New Zealand will be shared soon

NEW ZEALANDERS SHOULD PLAN FOR A LONG AND SEVERE ECONOMIC DOWNTURN

We can think about the economic impact in three phases: Crisis, Recession, New Normal

Recessions are described as V, U, or L-shaped

The shape of New Zealand's recovery depends on four drivers

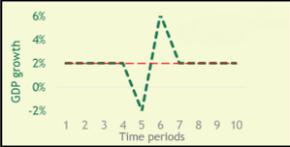
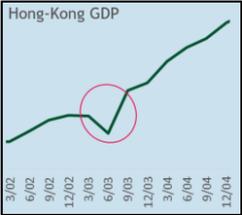
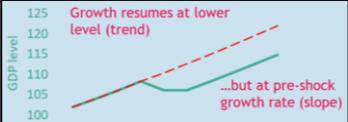
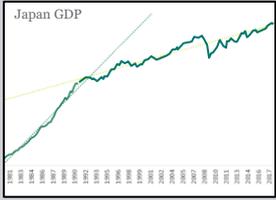
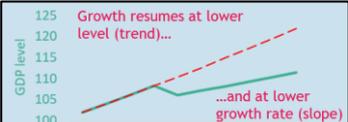
A V-shaped recovery for New Zealand is unlikely

- New Zealand seems well placed to manage the epidemic and economic situation
- However, the economic outcome in NZ will depend on what happens in the rest of the world
- Our conclusion is that the global economic downturn will be long and severe

WE CAN THINK ABOUT THE ECONOMIC IMPACT IN THREE PHASES

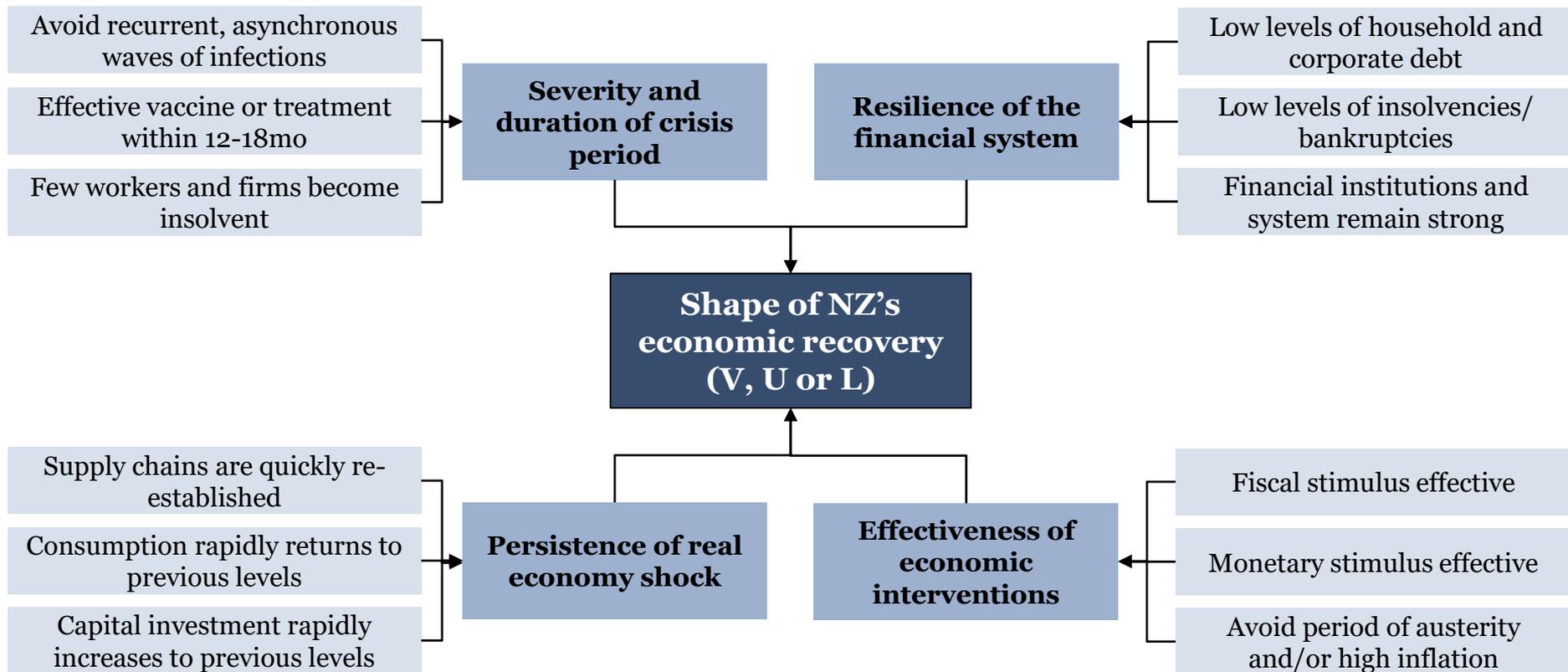
Phases	Description	Possible impacts	Response
Crisis	<ul style="list-style-type: none"> • Next 12-18 months • Until strict elimination, vaccine or treatment success, or worst case the virus becomes endemic 	<ul style="list-style-type: none"> • Social distancing • Redundancies and insolvencies of most vulnerable • Asynchronous supply chain disruptions 	<ul style="list-style-type: none"> • Lockdowns and other public health restrictions • Direct funding of firms and households most affected
Recession	<ul style="list-style-type: none"> • Following 1-5+ years • Until pre-crisis real GDP/ unemployment regained 	<ul style="list-style-type: none"> • Depressed consumption and investment • Potential for financial crisis, leading to breakdown of credit intermediation • Risks of constrained monetary policy options national defaults, and reduced ability for governments to fund recovery 	<ul style="list-style-type: none"> • Fiscal stimulus via investment in infrastructure and transfer payments • Monetary stimulus • Possible switch to austerity • Inflation and hyperinflation possible
New Normal	<ul style="list-style-type: none"> • 3-5+ years from now 	<ul style="list-style-type: none"> • Greater importance of public health and resilience • Shift in balance of global powers and govt roles in economy • More work and consumption occurring within homes 	<ul style="list-style-type: none"> • Refocus government investment (e.g. health infrastructure) • Diversify supply chains • Restructuring of economy and business interactions

RECESSIONS ARE DESCRIBED AS V, U OR L-SHAPED

Type	Description	Duration	Illustration		Example
V-shaped	Temporary shock leading to short-term reduction in demand, which is quickly recovered once shock alleviates	~12 to 24 months	Growth rate		2003 SARS (and other epidemics) 
			Abs. GDP		
U-shaped	Shock breaks the growth trend leading to suppressed growth for a few years but ultimately recovery	~2 to 10 years	Growth rate		2008 GFC 
			Abs. GDP		
L-shaped	Shock that perpetually breaks growth trend. Involves a structural change in the economy that shifts future growth trend	More than 10 years	Growth rate		1990 Japan asset bubble 
			Abs. GDP		

THE SHAPE OF NEW ZEALAND'S RECOVERY DEPENDS ON FOUR DRIVERS

Drivers of New Zealand's recovery trajectory



NEW ZEALAND SEEMS WELL PLACED TO MANAGE THE EPIDEMIC AND ECONOMIC SITUATION

Best case, New Zealand might have the virus contained and be able to stamp it out where it re-emerges

That would allow resumption of normal activities in New Zealand, contributing to economic recovery, and a V-shaped event

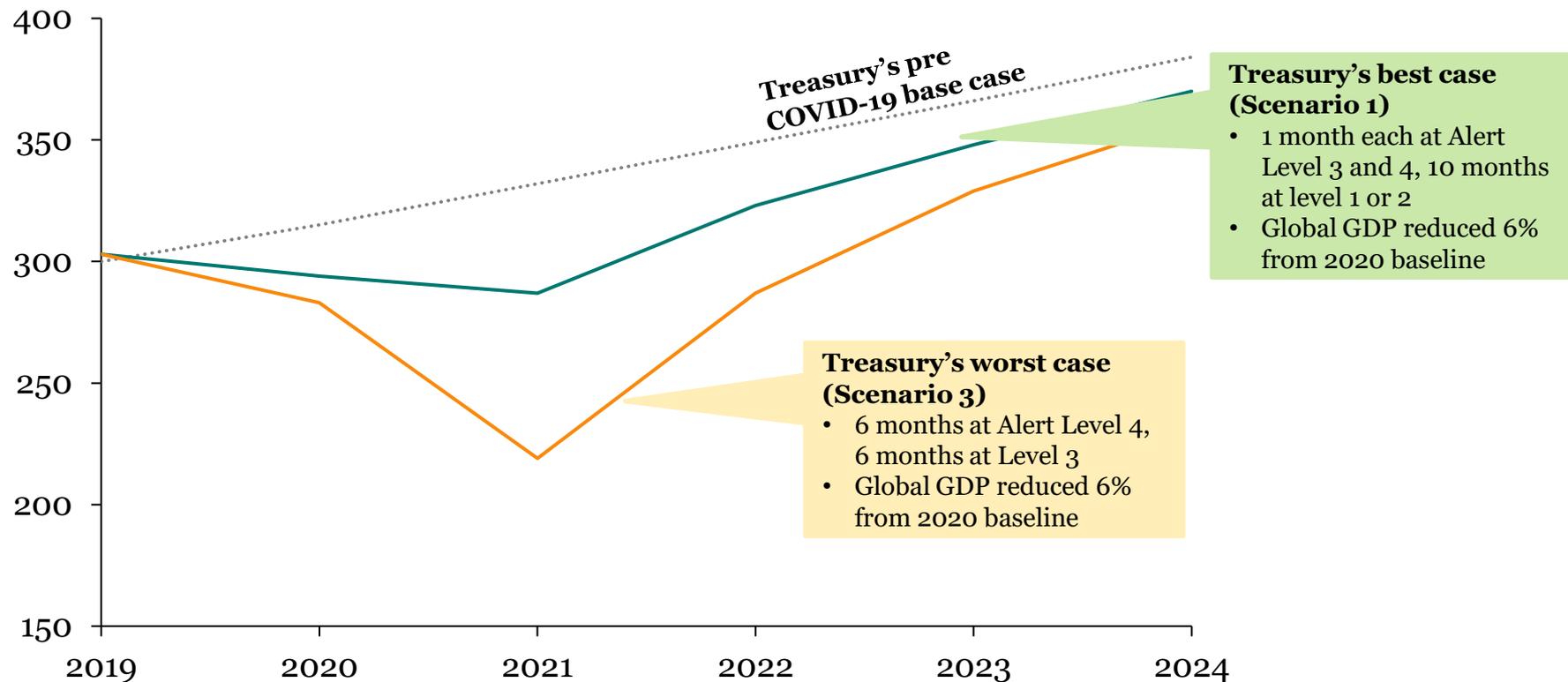
New Zealand's government has debt capacity for fiscal stimulus

Treasury's recent forecasts are consistent with a severe V-shaped event

- Anticipate a range of frequencies and durations of lockdowns over the next 12 months
- Mostly assume a “V-shaped” 6% drop in Global GDP for 2020, followed by recovery

TREASURY'S RECENT FORECASTS ARE DRIVEN BY LOCKDOWNS AND A SHORT-TERM GLOBAL RECESSION

Treasury's estimated impact of COVID-19 on NZ GDP by scenario¹
((\$B, nominal))



HOWEVER, OUR CONCLUSION IS THAT THE GLOBAL ECONOMIC DOWNTURN WILL BE LONG AND SEVERE

It is likely there will be rolling lockdowns in developed economies during the crisis phase to avoid overwhelming healthcare systems

Asynchronous lockdowns will exacerbate supply chain disruption

- Easy to shut-down plants but difficult to restart

Many developing economies will struggle to contain the virus

- Epidemic likely to disrupt production and therefore exports of raw materials and components, as well as demand for imported finished goods and equipment

Business failures will take time to work through the system

Many governments do not have the macro-economic capacity and capability for ongoing fiscal stimulus, or for printing money without triggering high inflation

Stressed states will struggle to provide food and forced migrations will increase

SO DESPITE OUR ADVANTAGED POSITION, A V-SHAPED RECOVERY FOR NEW ZEALAND IS UNLIKELY (1)

	Driver of V	NZ outlook	Rationale
Severity and duration of crisis period	Avoid recurrent, asynchronous waves of infections	Likely	<ul style="list-style-type: none"> Moved fast and aggressively to control infection Public health restrictions expected to be retained and health system is ready now
	Effective vaccine or treatment within 12-18mo	Uncertain	<ul style="list-style-type: none"> Vaccine effort is high, outcome still uncertain Early international tourism recovery depends on vaccine; also some export volumes
	Few workers and firms become insolvent	Unlikely	<ul style="list-style-type: none"> Layoffs and insolvencies happening already Wage subsidies and payment deferrals helpful but may lead to distressed balance sheets
Persistence of real-economy shock	Supply chains are quickly re-established	Unlikely	<ul style="list-style-type: none"> Global supply chains disrupted by asynchronous disease waves and hard to restart Potential for stronger global trade barriers
	Consumption rapidly returns to previous levels	Unlikely	<ul style="list-style-type: none"> Potential for sustained unemployment High household debt with incomes reducing Changes in consumption patterns (e.g. less luxury)
	Capital investment rapidly increases to previous levels	Uncertain	<ul style="list-style-type: none"> Private sector failures and deleveraging reduce capex Partially offset by increase in public investment

SO DESPITE OUR ADVANTAGED POSITION, A V-SHAPED RECOVERY FOR NEW ZEALAND IS UNLIKELY (2)

	Driver of V	NZ outlook	Rationale
Resilience of the financial system	Low levels of household and corporate debt	Unlikely	<ul style="list-style-type: none"> High levels of private debt before the crisis Payment deferrals (e.g. mortgage payments) increase debt while incomes are reducing
	Low levels of insolvencies/bankruptcies	Unlikely	<ul style="list-style-type: none"> Lockdowns and global trade disruptions likely to drive insolvencies Nationalisation possible but unlikely for SMEs
	Financial institutions and system remain strong	Uncertain	<ul style="list-style-type: none"> Relatively sound financial system Exposed to global financial institutions Exposed to domestic insolvencies and lower household incomes
Effectiveness of economic interventions	Fiscal stimulus effective	Likely	<ul style="list-style-type: none"> Relatively low levels of public debt Capacity to fund current interventions for >2yrs
	Monetary stimulus effective	Uncertain	<ul style="list-style-type: none"> Robust and well-timed intervention so far Little room to lower interest rates, considering negative rates; QE and bank capital ratio easing underway
	Avoid period of austerity and/or high inflation	Uncertain	<ul style="list-style-type: none"> Material headroom available before high levels of public debt achieved (although local government austerity may be required) Hyperinflation possible if ongoing monetary easing is required to resolve public debt crises

FURTHER INFORMATION

For further information on how we can help you, please contact:

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More information on Stakeholder Strategies can be found at www.stakeholderstrategies.co.nz and you can sign up to receive future updates at <https://stakeholderstrategies.co.nz/covid-contact/>

Thank you,

The Stakeholder Strategies team