

Arataki – Covid-19 Economic Projections Update: Summary Report

April 2021

Introduction

In April 2020, Waka Kotahi commissioned MartinJenkins and Infometrics to report on the potential impacts of the Covid-19 pandemic on the national economy, industries and regions over ten years in order to inform potential impacts on and opportunities for the land transport system and to inform Arataki version 2.

The projections at the time suggested that New Zealand would be hit hard and there would be a significant medium term impact on GDP and employment across most industries and regions. Almost a year later, it is clear that New Zealand has fared much better than was expected in April/May 2020. It was acknowledged at the time that there was considerable uncertainty about the economic ramifications of the pandemic and that the projections should be revisited in future. Almost a year on from the first lockdown period, it is timely to update the projections.

Global economy

Global sentiment is more positive than projected in 2020. After an estimated 3.5 percent contraction in global GDP in 2020, the IMF projects world real GDP growth at 5.5 percent in 2021 and 4.2 percent in 2022. World GDP is expected to return to the pre-Covid level over 2021/22. The more positive projections reflect a combination of the faster economic turnarounds in several economies in the latter half of 2020 driven by high consumer spending (e.g., Australia, Japan, Korea), the better than expected adjustment by businesses to non-contact trade, the greater than expected stimulus packages in several large economies, and expectations for the widespread distribution of vaccines over the latter half of 2021 and into 2022.

Global trade volumes are estimated to have contracted by 9.6 percent over 2020. As expected, there was a significant decline in air freight over the year. Container port freight recovered and grew strongly in the latter part of 2020, in part substituting for air freight. Trade volumes are expected to grow strongly as an increasing number of economies recover, by around 8 percent in 2021 and over 6 percent in 2022.

The performance of the global economy over 2021-2022 will depend on a combination of the response and recovery packages adopted by economies, ongoing measures by countries to contain the spread of the virus, and the speed in which vaccines can be distributed widely as well as their effectiveness.

National economy

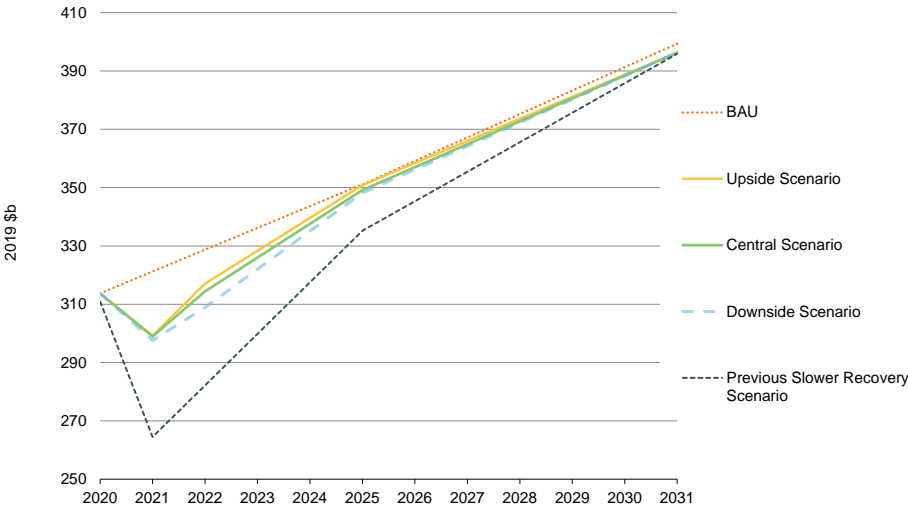
The effects of Covid-19 on the domestic economy have been much smaller than were initially projected. The three Treasury Budget Scenarios used in the May report for Waka Kotahi projected that GDP for the March 2021 year would decline by between 13.4 percent and 27.8 percent from the previous 12 months. However, the Scenarios published by Treasury in December 2020 at its Half Year Economic and Fiscal Update (HYEFU) show year-end declines of between 4.6 percent and 5.1 percent.



The better-than-expected results were due to a massive rebound in activity in the September 2020 quarter, with GDP growing by 14.0 percent in that quarter following the around 12.0 percent decline in GDP in the June 2020 quarter. The rebound is attributed to a combination of the success of the government’s fiscal support in keeping people in employment and businesses in operation and the release of pent-up consumer and business spending after the initial lock-down period.

Despite the economy’s fast bounce back from the initial Covid-19 lockdown, there is still likely to be some lingering effects of the pandemic that persist in keeping activity below previous expectations of its potential between now and 2024. However, the gap between current GDP projections and pre-Covid expectations of the economy’s size is forecast to have closed almost to zero by 2025, even for the new Treasury Downside Scenario (see Figure 1).

Figure 1. GDP projections by scenario (March years)



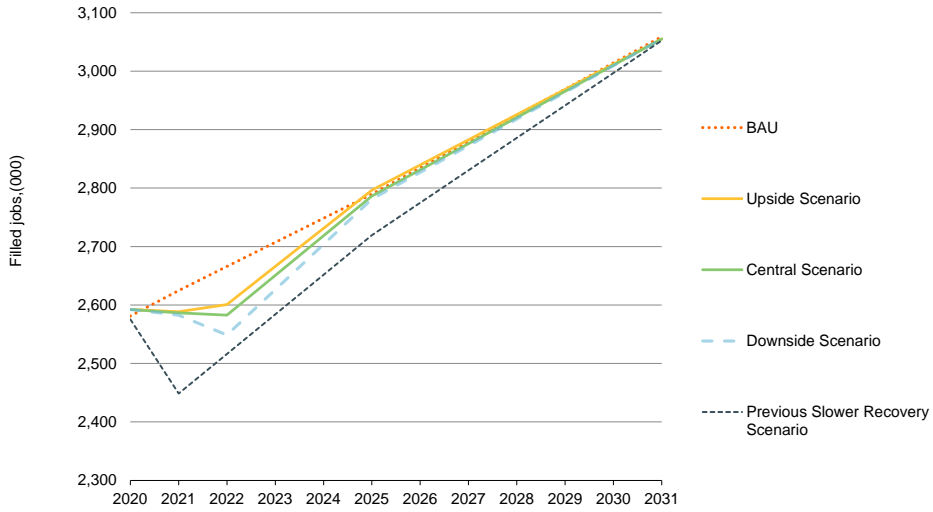
Source: Infometrics

There is a similar story for employment. The unemployment rate in the March 2021 year was forecast to average between 11.6 percent and 19.7 percent across the three scenarios modelled for Waka Kotahi in May. However, the quarterly unemployment rate only got as high as 5.3 percent in September 2020 and reduced to 4.9 percent in the December quarter. Note, however, that the under-utilisation rate increased significantly to over 13 percent in the September 2020 quarter and the number of job seeker (work ready) recipients has increased over the year by almost 50,000 people.

Infometrics modelling suggests that average employment in the March 2022 year will be between 0.3 percent above and 1.7 percent below its March 2020 year-end level and, by 2025, Figure 2 shows that it is now expected there will be minimal differences between the employment outcomes across Treasury’s new scenarios and pre-Covid BAU expectations of employment.



Figure 2. Employment projections by scenario (March years)



Source: Infometrics

In terms of transport related measures, domestic and trade indicators proved relatively resilient while international travel into New Zealand, not surprisingly, largely stalled. The cumulative value of exports did not change appreciably over the year ended December 2020 compared to 2019, increasing by \$24 million or (0.04 percent). The value of good imports fell by 11 percent over 2020 compared to 2019, by \$7.4 billion. Imports fell in part because of the restrictions on travel, resulting in large falls in the annual imports of fuel and cars.

One of the key assumptions in the previous modelling in May 2020 was that negative impacts would be relatively widespread across the economy. Although industries such as accommodation and food services; rail, water, air and other transport; and arts and recreation services were clearly going to be directly affected by border closures and lock-down measures, there was a general expectation that all other industries would be affected to varying degrees. However, some industries have been much less affected due to large amounts of fiscal and monetary stimulus and a public health response that has generally been effective.

For example, the outlook for the construction industry is considerably brighter given the booming housing market and additional government funding for infrastructure. Similarly, the trend towards online shopping has been accelerated by the lock-downs, driving positive outcomes for supermarkets and non-store-based retailing as well as postal and courier services.

Industry impacts – Central Scenario

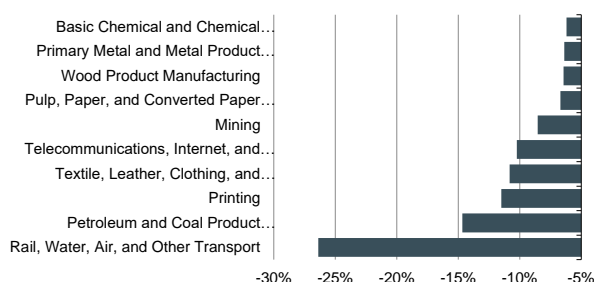
Figure 3 and Figure 4 show projected employment outcomes under Treasury’s new Central Scenario between 2020 and 2022 for the 10 best-performing and worst-performing industries. Key points are:

- The effects of fiscal stimulus and the government’s broader response to Covid-19 show through in strong growth in government administration and health care employment.
- Supermarkets have benefited from being one of the few store types able to trade at Alert Level 4.
- High levels of construction activity are reflected in strong employment growth for building construction, construction services, and utilities industries.



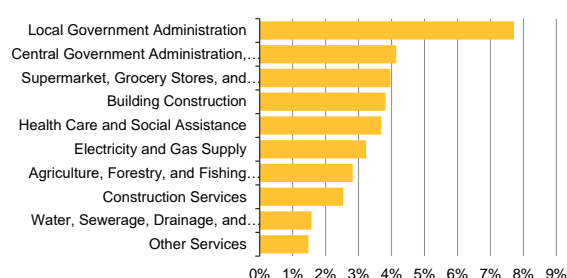
- The effect of Covid-19 on the agricultural sector has been relatively limited, and relatively good export volumes and prices are underpinning growth in agricultural services employment.
- Rail, water, air, and other transport is in the bottom 10 performers. The job losses in this industry will be mostly concentrated in air transport.
- Most other industries appearing in the bottom 10 performers by 2022 are manufacturing industries, many of which are experiencing a long-term downward trend in employment anyway. As a result, some of the forecast declines are not simply due to Covid-19.

Figure 3: Employment growth 2020-2022 – 10 worst performing industries, Central Scenario



Source: Infometrics

Figure 4: Employment growth 2020-2022 – 10 best performing industries, Central Scenario

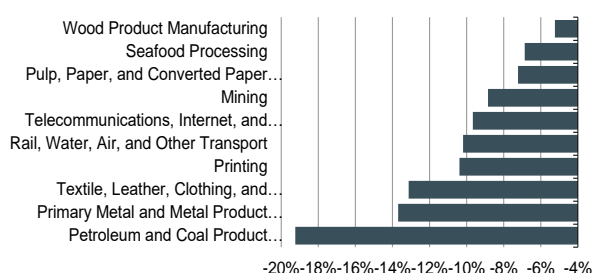


Source: Infometrics

The results for employment growth by industry under the Central Scenario between 2020 and 2025 are shown in Figure 5 and Figure 6. Many of the industries represented in the top and bottom 10 are the same as for the 2020-22 period, noting that:

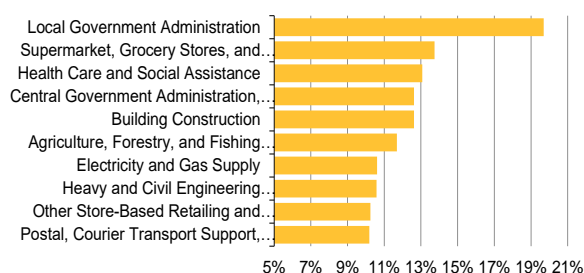
- The strong position of supermarkets in the retail sector is backed up with the emergence of other store-based retailing and non-store retailing, underpinned by growth in the non-store component of this industry. Increased employment for postal, courier transport service, and warehousing services emphasises the continued expansion of online retailing's share of total household spending.
- The government's significant plans for infrastructure investment in the New Zealand Upgrade Programme show through in heavy and civil engineering construction employment.
- Rail, water, air, and other transport employment is still forecast to be around 10 percent below its 2020 level by 2025.

Figure 5: Employment growth 2020-2025 – 10 worst performing industries, Central Scenario



Source: Infometrics

Figure 6: Employment growth 2020-2025 – 10 best performing industries, Central Scenario



Source: Infometrics



Key transport industries

Under the Central Scenario, there is a reasonable initial shock across several key industries that rely heavily on transport in the first two years due to the lockdowns and loss of output. Compared to the pre-Covid BAU, the largest negative value impacts occur in non-food manufacturing, food manufacturing, mining and road transport. Mining, food manufacturing, non-food manufacturing and road transport continue to underperform the BAU by 2025. Conversely, construction is projected to experience a higher level of growth than the BAU over the short- and medium-term.

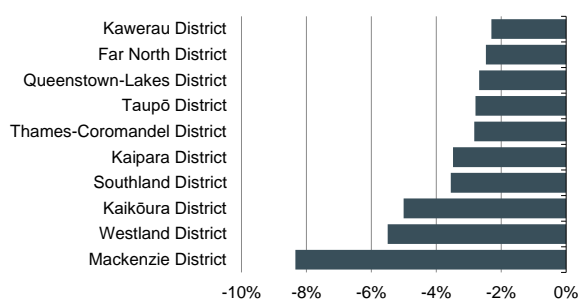
Regional impacts – Central Scenario

Consistent with the known impacts of Covid-19, tourism and migrant dependent regions are projected to be particularly affected under the Central Scenario in the first two years, such as Otago, Northland, Tasman, the West Coast and Canterbury. Wellington fares the best and grows employment over the two years, likely due to being shielded by the large public sector. Less affected provincial regions include Taranaki, Hawke’s Bay and Gisborne.

Figure 7 and Figure 8 show forecast growth in employment under the Central Scenario between 2020 and 2022 for the 10 best-performing and worst-performing local authorities. The best performers tend to be dominated by areas where significant construction projects are planned to take place during the coming year: Ōtorohanga, Waimakariri, Ōpōtiki, Manawatū, New Plymouth and Invercargill. The effects of these major projects on construction employment tends to dominate any weakness in employment across other industries in these areas.

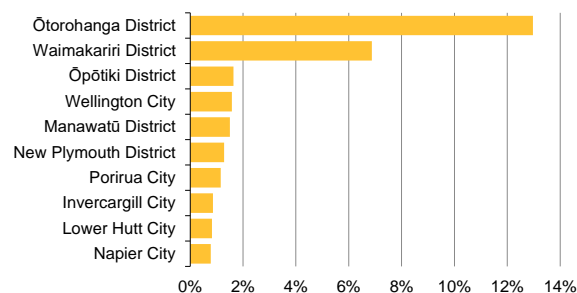
Some Wellington region TAs are also shielded through the public service base. Indicators of public sector employment have been strong during recent months, and this trend is expected to persist over the next year.

Figure 7: Employment growth 2020-2022 – 10 worst performing districts, Central Scenario



Source: Infometrics

Figure 8: Employment growth 2020-2022 – 10 best performing districts, Central Scenario



Source: Infometrics

As was the case with the previous modelling in May 2020 and reflecting the regional results, TAs that are highly dependent on tourism dominate the worst employment performers in the near term, with employment in Mackenzie, Westland and Kaikōura expected to experience the largest negative growth. However, the magnitude of these declines in employment are significantly smaller than was previously predicted. Some domestically focused holiday destinations such as Thames-Coromandel and Taupō also feature in the bottom 10. These results suggest that some of the initial buoyancy in domestic travel spending that occurred during the second half of 2020 will wear off over the coming year.

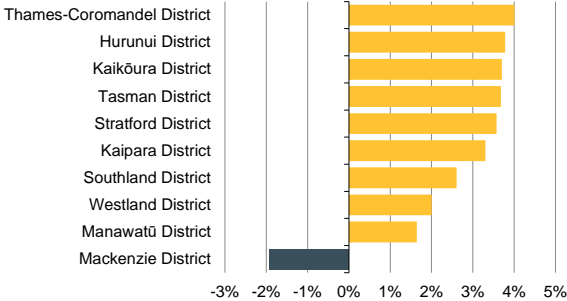


Over the medium-term, several regions that were particularly affected in the short-term are expected to bounce back. For example, relatively strong job growth is forecast for Marlborough, Canterbury and the West Coast over 2022 to 2025.

It is notable that all districts other than MacKenzie are expected to achieve positive job growth over 2020 to 2025 (Figure 9). The previous modelling of the Slower Recovery Scenario in 2020 had shown eight areas with a forecast drop in job numbers over the medium-term.

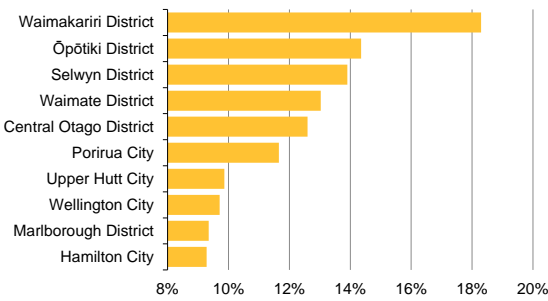
Several of the better performing districts in the medium-term are in the lower North Island (Figure 10) and this result is likely to be a continued effect of public sector resilience in Wellington. Reflecting a projected rebound in Canterbury, some districts in that region also achieve relatively strong job growth.

Figure 9: Employment growth 2020-2025 – 10 worst performing districts, Central Scenario



Source: Infometrics

Figure 10: Employment growth 2020-2025 – 10 best performing districts, Central Scenario



Source: Infometrics

Key urban areas

The most pronounced change in the forecasts for New Zealand’s main urban areas post-Covid aligns with the rest of the country, i.e., much less of a hit in the near term. However, there are some nuances:

- Auckland’s economy has been more heavily affected by Covid-19 than many other parts of the country due to its role as the main gateway for international travel, being subjected to additional periods at Alert Level 3, and a reduction in consumer spending in the CBD due to the increased incidence of working from home. Auckland’s employment is projected to contract by -0.2 percent per year over 2020-2022 before recovering to 2.4 percent growth per year over 2022-2025. However, greater levels of remote working and high housing costs (and consequent higher levels of outward migration) are expected to see Auckland’s employment at 2.5 percent below BAU in 2025 and more than 5 percent below BAU in 2031.
- There is an improved outlook for Hamilton, with employment in March 2022 now forecast to be just 0.3 percent below BAU levels. This is largely due to the flow-on impacts of the broader Waikato economy, which has a significant agricultural component and a low reliance on international tourism. The 2025 and 2031 forecasts suggest that Covid-19 is unlikely to have any long-lasting effects on the Hamilton economy and, indeed, Hamilton is expected to achieve slightly better employment outcomes than the BAU under the Central Scenario.
- Throughout most of the forecast period, Tauranga’s employment outcomes remain lower, relative to BAU, than Hamilton’s outcomes. This gap reflects the border closures and slower population growth, which will have a more pronounced effect on Tauranga than on Hamilton.



- As the home of central government, Wellington has been more sheltered than many other parts of the country from the effects of Covid-19. Growth in public sector employment during recent quarters has been remarkably strong, as the government has increased its hiring to implement its public health response and major fiscal stimulus initiatives. This is reflected in the area's medium and long-term projections, with employment expected to hold slightly above BAU in 2025 and 2031.
- Christchurch's role as the main gateway for international tourists to the South Island has meant that the Covid-19 pandemic has affected employment in the city. However, the short-term trough in the city is considerably less negative than expected previously and, under the Central Scenario, employment in Christchurch is projected to be a moderate 2.0 percent below BAU in 2022. Christchurch is also expected to emerge essentially unscathed from Covid-19 over the medium to long-term, with the projections of employment in 2025 and 2031 now above pre-Covid forecast levels. An increased incidence of remote working could work in Christchurch's favour, although could also change the shape of development by reinforcing the growth of satellite towns.
- The revised projections suggest that employment in Queenstown-Lakes in March 2022 could be as little as 3-5 percent below BAU levels. This assumes that a Trans-Tasman bubble is implemented from April 2021 and that borders start to reopen more fully early in 2022. However, job numbers in Queenstown-Lakes are still expected to be 5-6 percent below BAU levels by 2025. Growth in the District's employment will be constrained over the next few years by international travel volumes remaining below their pre-pandemic levels. More positively, the projections suggest there will be no permanent scarring of the economy over the long-term, with Queenstown forecast to enjoy faster employment growth from 2025 onwards as the town makes up for lost time.

Conclusion

In broad terms, the updated projections suggest there is likely to be much less permanent scarring to specific industries or regions than was expected when Treasury released its 2020 Budget forecasts. This does not imply that there will be no areas or industries still feeling the after-effects of Covid-19 by 2025, with Mackenzie District and air transport the most obvious examples. However, these outcomes are expected to be less common.

The substantial fiscal support for the economy has been one of the key factors behind this outcome, alongside the domestic economy's ability to largely function as "normal" after the first lockdown. Many businesses have been able to adapt to the new operating environment and pivot their operations to target new and different markets where necessary. In addition, the substitution of New Zealanders' spending from international travel towards domestic holidays, the housing market, home-related spending, and other major purchases has had more marked effects than forecasters initially anticipated.

Note that the most recent spending indicators suggest that conditions during 2021/22 could be tougher than many businesses have enjoyed over the last eight months. However, even a softening in spending from current levels would still result in better demand conditions for the coming year than were forecast in May last year.

