HUGOvision

Assessing the economic and political environment in New Zealand

Covid-19 economic package - Extra | March 17 2020 | **Confidential to HUGO members**

How deep will the recession be?

Saturday's travel restrictions, Monday's RBNZ OCR cut and bank capital relaxations, and today's $12.1b emergency fiscal stimulus package should be seen as a whole.

Travel restrictions that will kill off previously shaky parts of the tourism sector, almost certainly require a capital injection from the Crown that will increase its current 52% shareholding in AirNZ, and all but end business travel offshore for the foreseeable future were profound shocks that prompted the RBNZ to act.

The central bank also knew other central banks were about to cut benchmark rates, so to have stood proud would have made no sense. Note, though, RBNZ governor Adrian Orr's comments that the **OCR cut is less significant than his explicit encouragement to trading banks to dip into their capital buffers,** if necessary.

Normally, trading banks would have to ask permission to do so. Hence their preference in normal times to keep their balance sheets well-padded above official minimum requirements.

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The Hugo Group and Covid-19

As a trusted source and clearinghouse for information and insights on the New Zealand political economy for New Zealand corporate leaders, The Hugo Group is especially valuable at times of national crisis.

That is why we are currently working on major changes to the way that we will continue to deliver that service while the global covid-19 crisis plays out.

It is clear that our primary means of meeting as a community of leaders – our regular breakfast programme – cannot continue while the country takes the measures required if the covid-19 outbreak is to be successfully contained in New Zealand.

Accordingly, **this week's breakfasts in Wellington today and in Auckland on Friday will be the last we hold in that format until the covid-19 crisis passes**. For both events, we have taken additional measures to ensure the health and safety of our members. Communicable diseases expert and government adviser on covid-19 response, Professor Michael Baker, will still brief on Friday, along with Paula Bennett.

For the future, however, we are planning to move swiftly to a new format that will include:

- **Two monthly web-based meetings**, most likely hosted on the Cisco Webex platform. Members will be able to watch and to interact both verbally and by written questions;
- **Each meeting will be of 40-50 minutes duration and open to all members**;
- Both meetings will include slightly **extended roundtable reportback sessions**, as these are of particular value at times such as this when shared experience of unprecedented, fast-changing events can yield important lessons and insights;
- One meeting will feature a briefing from a senior politician. We will continue with David Parker in April and will send details for this briefing shortly;
- A second monthly briefing will cover political and economic insights and trends, especially important in election year with the non-pandemic business of govt continuing;
- Briefings will continue to be on a Chatham House Rule basis;
- Having established online briefing capability, we anticipate being able to offer ad hoc briefings in response to major events and from pertinent experts;
- Hugovision will continue to be published fortnightly. Over the next few months, we intend to undertake website development that will allow deeper and more sophisticated delivery of Hugovision content and updates;
- Hugovision Extra editions, such as this one, will continue to be produced in response to major events;
- The Hugo Panel Members are all available for phone and face-to-face briefings on current issues in the political economy, at no fee, for Hugo Group members.

Unprecedented events can be worrying and costly, and full of critical decisions involving circumstances that leaders have never previously faced. We believe The Hugo Group helps with those decisions, and that such events can also be opportunities to innovate.

That is the attitude we are taking at this unusual and challenging time. We look forward to continuing to serve you.

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- We would value your feedback and suggestions on these initiatives. Please do not hesitate to contact us.

However, Orr has told them "you've got an enormous amount of headroom. **You can already go down to your buffer minimum and you can dig into your buffer minimum if you need to.**"

Even without breaching those buffers and by pushing out new capital requirements by a year, conditions have been created for banks to offer close to $50b of additional credit lines.

The implied quid pro quo, outlined by deputy governor Geoff Bascand, is a less strident approach to AML and other compliance requirements, which some banks are struggling to meet.

"We've got a number of things we're looking at from reporting mechanisms, or we've been consulting on some of the details of the reporting on breaches right through to reporting on a bigger range of things. So we will update in the next few days and will issue a statement of what we can and can't defer," said Bascand.

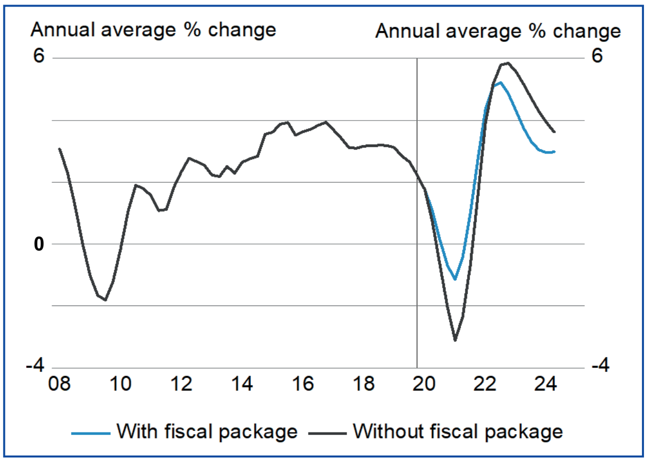
Or, as Orr put it in his special way: "Don't be muppets."

The acid is on the banks now to do the right thing by their business customers, although the PM and Finance Minister repeatedly included references this week to the fact that **not all jobs and businesses can be saved.**

Phase 1 response

Accordingly, today's fiscal package, while enormous at 4% of GDP-equivalent, is still only large enough to prevent what Treasury projected would have been a roughly 5-6% recessionary plunge to 3% economic shrinkage in the year ahead, compared with around 2.2% forecast last Dec for the year to June 2020.

Economic Outlook – GDP Growth



Instead, the projections released today and summarised in the graph below show a recession bottoming out at 1% shrinkage.

That is almost certainly optimistic, particularly as there can be no certainty that NZ will not move from the current 'containment' phase to 'community transmission', which will far more severely curtail social contact and normal activity.

Phase 2

That is where a Phase 2 response will clearly be required, and is being signalled.

The admirably simple wage subsidy and sick leave support packages announced today are ripe for extension beyond their current June 30 cut-off.

Robertson hinted that if school closures occur, leave subsidies for parents required to look after homebound children are likely.

Measures to assist large-scale and complex businesses are yet to come.

It is clear the benefit and winter energy payment boosts announced today were simply down payments on the May 14 Budget, which is being extensively reworked.

Reprioritisation of money unspent in the PGF has to be on the cards, while there was a signal today that NZTA's investment programme will be fast-tracked, to the extent possible.

One implication of the much larger govt debt programme today's announcements will require is that it gives the RBNZ more scope to buy govt bonds - the path it has said it will pursue rather than head into negative interest rates.

Overall, today's package is an investment in securing cashflow, confidence and jobs, but there will likely be much more. The only silver lining for NZ is that the Crown accounts are well able to bear considerably greater stress than is already contemplated.

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