Impact of COVID-19 on the Arts and Creative Sector

Ministry of Culture and Heritage

April 2020

Infometrics
Economics put simply

Authorship

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Executive summary

This report provides an overview of the anticipated effects of COVID-19 pandemic for the arts and creative sector in New Zealand.

COVID-19 presents the greatest economic shock in living memory, and although the full extent of the shock is still to play out, it is clear is that the economy will be irrevocably changed by this pandemic.

According to modelling undertaken by Infometrics, the arts and creative sector will be hit hard by the COVID-19 recession. We are forecasting a decline of 11.7% in employment in the sector and a 16.4% contraction in GDP in the year to March 2021. This compares to declines of 9.8% in employment and 8.0% in GDP across the New Zealand economy.

GDP is therefore forecast to decline significantly further than employment. This is due in part to the fact that the arts and creative sector contains a high percentage of people who are self-employed, and to the fact that many people working in the sector do so on a part-time basis, or rely on financial 'safety nets' to fund their activities. This implies that many people are likely to continue working in the arts and creative sector even though the amount of work available (measured in hours worked) will decline.

A number of factors will contribute to the decline in demand for arts and creative services, including declining household incomes, the collapse of foreign tourism and the likelihood of behaviour changes on the part of consumers.

Introduction

This report provides an overview of the anticipated effects of COVID-19 pandemic for the arts and creative sector in New Zealand.

Econometric modelling and forecasting used in preparing this report is based on Infometrics' central view of the economic outlook for New Zealand over the year to March 2021. The principal assumptions of this view are outlined below, and a detailed forecast story is provided in Appendix III.

A definition of the arts and creative sector is provided in Appendix II.

The greatest economic shock in living memory

COVID-19 presents the greatest economic shock in living memory, and although the full extent of the shock is still to play out, it is clear is that the economy will be irrevocably changed by this pandemic. The speed with which the economic outlook changed during March far exceeded anything experienced during the Global Financial Crisis (GFC) of 2008/09.

Infometrics is currently forecasting a 13% contraction in economic activity between the December 2019 and June 2020 quarters, with most of the decline occurring in the June quarter due to the current lockdown. This contraction is set to be at least four times larger than anything seen before, so there is understandably considerable scope for error in this estimate. Over a slightly longer time horizon, our forecast is for an 8.0% contraction in economic activity over the year to March 2021.

By March 2022, we expect quarterly GDP to be 6.6% below its December 2019 level.

Our estimate is for unemployment to peak at 9.5%, and to remain above 8% until the December 2023 quarter. In addition, underemployment is set to rise, while some of the unemployed will drop out of the labour force or seek out education opportunities in order to reskill. These factors will contribute to a decline in the labour participation rate, which we predict could fall from 71% to 66%, its lowest level since 2001.

The arts and creative sector will be hit hard

According to modelling undertaken by Infometrics, the impacts of the COVID-19 recession on the arts and creative sector are as follows:

GDP and employment declines in 2021

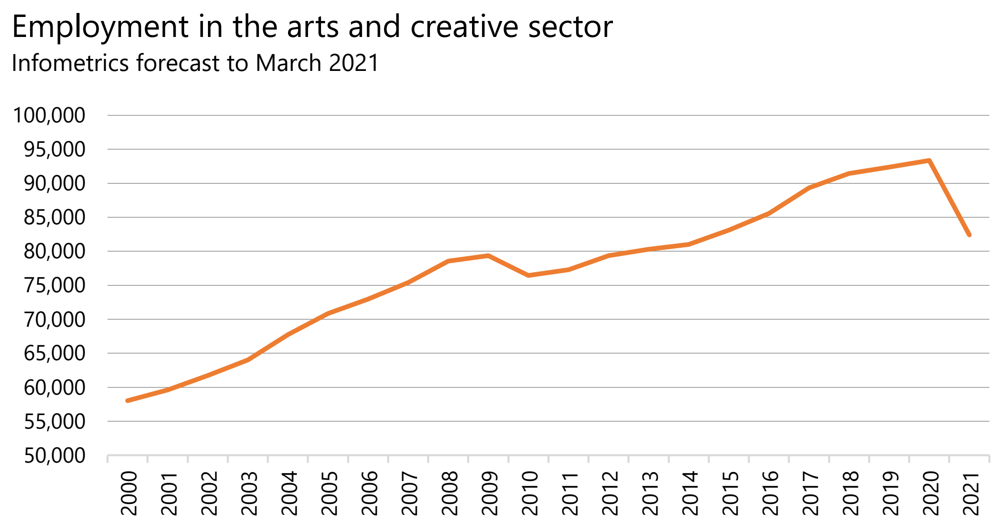
Infometrics forecast to March

	GDP ($ million)			Employment (jobs)		
	2020	2021	% change	2020	2021	% change
Arts and creative sector	$11,168	$9,341	-16.4%	93,364	82,397	-11.7%
New Zealand economy	$301,171	$277,077	-8.0%	2,569,221	2,317,437	-9.8%

Source: Infometrics and Statistics NZ

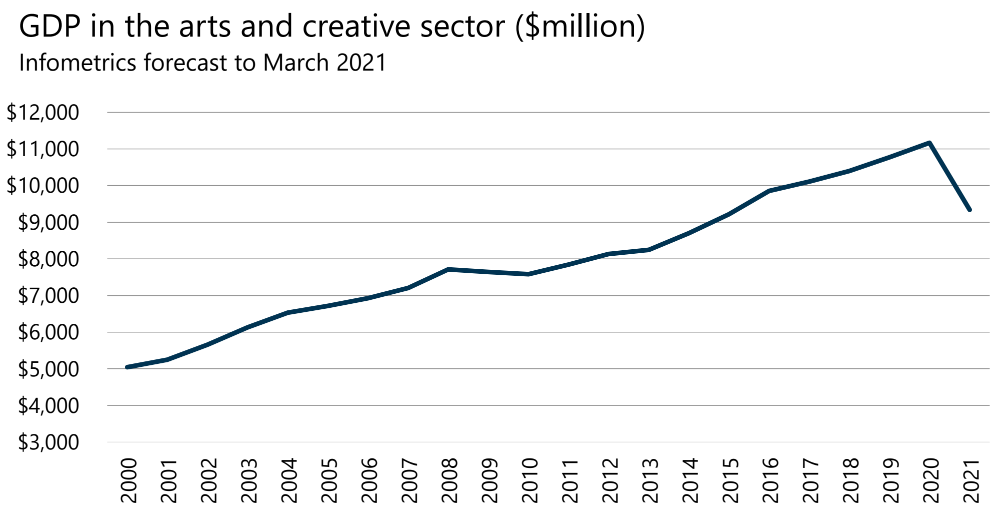
Employment in the sector is set to decline by 11.7% in the year to March 2021, as compared to a forecast employment decline of 9.8% across the New Zealand economy.

Chart 1



The sector's contribution to GDP is forecast to decline by 16.4%, as compared to the projected economy-wide contraction of 8.0% over the same period.

Chart 2



GDP is therefore forecast to decline significantly further than employment. Part of the reason for this is the high level of self-employment in the sector. According to the Infometrics sector profile for the arts and creative sector, in the year ended March 2019 more than a third of people in the sector were self-employed, compared to 16% across the New Zealand economy. Furthermore, many people working in the sector do so on a part-time basis, or rely on financial 'safety nets' such as a partner's income, savings or employment in other industries. These factors imply that many people are likely to continue working in the arts and creative industries, even though their hours worked and incomes will decline due to reduced demand.

Drivers of decline

There are a number of contributors to the forecast decline in demand for arts and creative services, including the following:

- Declining household incomes arising from job losses – the arts and creative sector has a high demand elasticity, meaning that demand for these services falls faster than the decline in household income. Under recessionary conditions, individual or household expenditure declines due to either real declines in incomes, or perceived risk of future incomes declines. As a result, spending on discretionary activities such as arts and creative services is one of the first areas of spending to be eliminated.
- The collapse of foreign tourism into New Zealand, as a result of border closures under the COVID-19 Level 4 response conditions, and the 14-day quarantine for any international arrivals for the foreseeable future, will result in a collapse in overseas tourist demand for New Zealand's arts and creative services. Similarly, border restrictions in other countries will limit the opportunities for New Zealanders to attend international arts and culture events.
- COVID-19 is likely to bring about significant behaviour changes by consumers. Until an effective vaccine becomes widely available, or the human health threat presented by the virus is eliminated in some other way, it is likely that individuals will be somewhat reluctant to attend large gatherings. This is likely to dampen the demand for arts and creative services for the foreseeable future.

Underlying assumptions

The forecast declines in employment and GDP in the arts and creative sector were modelled according to Infometrics' current assumptions regarding the impacts of the COVID-19 recession on the New Zealand economy.

These assumptions include the following:

- The Level 4 lockdown will be fully in place for four weeks. However, significant restrictions (Level 3) are likely to remain across much of the country for another 3-4 weeks. Considerable uncertainty exists regarding the scope and duration of extended or subsequent lockdowns, or post-lockdown restrictions.
- Limitations on economic activity are expected to remain in place over the next 6-9 months, although the scope or extent of these restrictions is unclear. Our expectations include borders that remain closed to non-New Zealanders for some time, with a possibility of a 14-day quarantine for foreign arrivals over time. While either of these measures remain in place, they will significantly inhibit overseas spending in the arts and creative sector.
- Infometrics estimates that the economy is operating at about 65% of capacity during the Level 4 lockdown, based on estimates that approximately 42% of output can be generated by people working from home and another 23% from essential services. Once the Level 4 lockdown ends, our allowance for further significant restrictions is equivalent to Level 4 conditions remaining in place for a further fortnight.

- Further government support and stimulus for the economy will be forthcoming in coming months, most notably in the 2020 Budget. Other announcements are expected in December's Half-Year Economic Update or the 2021 Budget, as the shape and magnitude of the required response from government becomes clear.

- Businesses that survive the lockdown and are not directly affected by the collapse in tourism will remain under pressure throughout the following 12-18 months. A tighter rein on both business and household budgets will negatively impact demand, particularly for discretionary activities such as arts and creative services.

Appendix I – Our approach

In developing this report, Infometrics has deployed its full range of econometric and statistical modelling capabilities. The models used to forecast changes to employment and economic activity in the arts and creative sector have been developed and refined over many years.

These include the Infometrics Regional Forecasting Model, which provides employment forecasts by industry, Input-Output (I-O) Multiplier Models, and the ESSAM (Energy Substitution, Social Accounting Matrix) general equilibrium model of the New Zealand economy, developed by Infometrics' Chief Economist Dr. Adolf Stroombergen.

The ESSAM general equilibrium model has been used to develop a number of scenarios for New Zealand arising from COVID-19. These scenarios account for the shocks experienced by the economy, including the almost complete elimination of international tourism, and model the impact of various government intervention measures.

Employment and economic activity impacts at industry level are modelled by the Infometrics Regional Forecast Model. This model assesses potential impacts from both an industry and an occupation perspective, to derive forecasts of changes to economic activity and employment in the arts and creative sector up to March 2021.

Appendix II – Definition of the arts and creative sector

Official employment data sources are typically divided by either industry or occupation but by themselves neither is satisfactory for defining the arts and creative sector. We have consequently used a combination of industries and occupations to define the sector.

Industries: the arts and creative sector is made up of employment in all occupations in the following industries:

Name	ANZSIC Industry Code
Jewellery and Silverware Manufacturing	C259100
Magazine and Other Periodical Publishing	J541200
Book Publishing	J541300
Other Publishing (except Software, Music and Internet)	J541900
Motion Picture and Video Production	J551100
Motion Picture Exhibition	J551300
Postproduction Services and Other Motion Picture and Video Activities	J551400
Music Publishing	J552100
Music and Other Sound Recording Activities	J552200
Libraries and Archives	J601000
Architectural Services	M692100
Other Specialised Design Services	M692400
Advertising Services	M694000
Professional Photographic Services	M699100
Museum Operation	R891000
Performing Arts Operation	R900100
Creative Artists, Musicians, Writers and Performers	R900200

Occupations: the arts and creative sector is made up of employment in all industries in the following occupations:

Name	ANZSCO Occupation Code
Advertising and Public Relations Manager	131111
Actor	211111
Dancer or Choreographer	211112
Entertainer or Variety Artist	211113
Actors, Dancers and Other Entertainers	211199
Composer	211211
Music Director	211212

Name	ANZSCO Occupation Code
Musician (Instrumental)	211213
Singer	211214
Music Professionals	211299
Photographer	211311
Painter (Visual Arts)	211411
Potter or Ceramic Artist	211412
Sculptor	211413
Visual Arts and Crafts Professionals	211499
Artistic Director	212111
Media Producer (excluding Video)	212112
Radio Presenter	212113
Television Presenter	212114
Author	212211
Book or Script Editor	212212
Art Director (Film, Television or Stage)	212311
Director (Film, Television, Radio or Stage)	212312
Director of Photography	212313
Film and Video Editor	212314
Program Director (Television or Radio)	212315
Stage Manager	212316
Technical Director	212317
Video Producer	212318
Film, Television, Radio and Stage Directors	212399
Copywriter	212411
Newspaper or Periodical Editor	212412
Print Journalist	212413
Radio Journalist	212414
Television Journalist	212416
Journalists and Other Writers	212499
Architect	232111
Landscape Architect	232112
Fashion Designer	232311
Industrial Designer	232312
Jewellery Designer	232313
Graphic Designer	232411
Illustrator	232412
Multimedia Designer	232413
Web Designer	232414
Interior Designer	232511

Name	ANZSCO Occupation Code
Art Teacher (Private Tuition)	249211
Dance Teacher (Private Tuition)	249212
Drama Teacher (Private Tuition)	249213
Music Teacher (Private Tuition)	249214
Architectural Draftsperson	312111
Jeweller	399411
Broadcast Transmitter Operator	399511
Camera Operator (Film, Television or Video)	399512
Musical Instrument Maker or Repairer	399515
Signwriter	399611
Photographer's Assistant	399915
Model	639111
Motion Picture Projectionist	711912

Appendix III – The Infometrics macroeconomic forecast, April 2020

Biggest hit to economy since the Great Depression

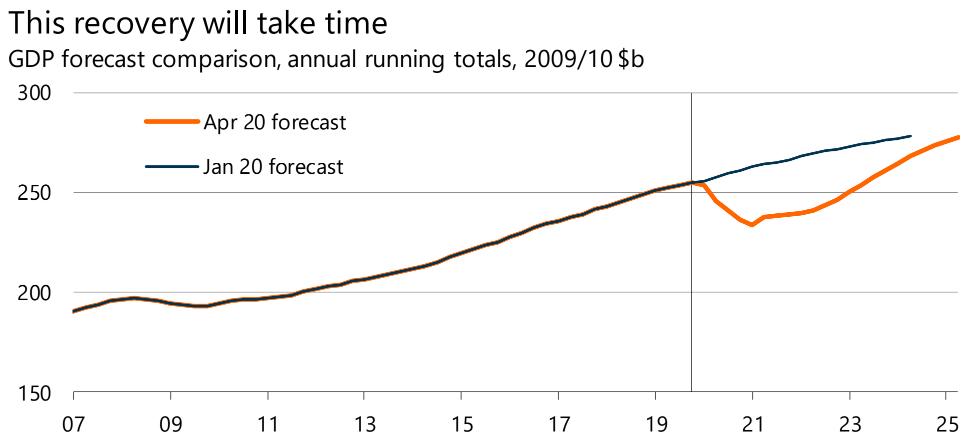
COVID-19 presents the greatest economic shock in living memory, and although the full extent of the shock is still to play out, it is clear is that the economy will be irrevocably changed by this pandemic. These times are highly uncertain, as we communicated in Well, that escalated quickly! The speed with which the economic outlook changed during March far exceeded anything we experienced during the Global Financial Crisis (GFC) during 2008/09, which itself felt particularly fast-moving at the time.

We are rewriting our economic manuals due to the overwhelming combination of body blows to the economy. We are currently forecasting a 13% contraction in economic activity between the December 2019 and June 2020 quarters, with most of the decline occurring in the June quarter due to the current lockdown. This contraction is set to be at least four times larger than anything we've seen in living memory, so there is understandably considerable scope for error in this estimate.

Our expectations for the economy are considerably more pessimistic than many other forecasters, with the real divergence among forecasts arising not in the extent of the short-term hit to the economy but, instead, about how quickly the economy recovers again. By March 2022, we expect quarterly GDP to be still 6.6% below its December 2019 level. In comparison, the trading banks' forecasts for March 2022 range from BNZ's prediction of 7.0% smaller to Westpac's rosy outlook of 3.2% bigger. Forecasts of the unemployment rate also capture this spread: we are picking a 9.4% unemployment rate in March 2022, compared with a range of 8.4% (BNZ) to 5.2% (Westpac) for the trading banks.

In short, we view the current repercussions for the economy to not only be significantly worse than others expect, but also to endure for longer as structural adjustments are forced on the economy. Our view is that the New Zealand economy is entering a U-shaped downturn (see Graph 1) rather than the more optimistic V-shaped recovery being picked by Westpac and, to a lesser extent, ANZ and ASB. Although the government has stepped in quickly to try and help businesses through the lockdown, the wage subsidy and other measures will not be enough to keep all businesses going. The tourism and hospitality sectors will be particularly heavily affected by extended border restrictions and will not recover to pre-pandemic levels within the foreseeable future. Many business failures are inevitable, and it will take time for the surplus labour and capital resulting from this downturn to be redeployed by other businesses.

Graph 1



Our key assumptions around the economy's outlook are as follows.

- We expect the Level 4 lockdown to be fully in place for only four weeks. However, significant restrictions (Level 3) are likely to remain across much of the country for another 3-4 weeks. Of course, there is considerable uncertainty about the scope and duration of extended or subsequent lockdowns, or post-lockdown restrictions.

- We expect some limitations on economic activity to remain in place over the following 6-9 months. At this stage, it is unclear exactly what or how stringent these restrictions might be. However, they are most likely to include borders that will be closed to non-New Zealanders for some time, easing back to a 14-day quarantine for foreign arrivals over time. While either of these measures are in place, they will prevent international tourist numbers from picking back up.

- We estimate that the economy is operating at about 65% of capacity during the Level 4 lockdown, based on our estimates that approximately 42% of output can continue to be generated by those people working from home and another 23% from essential services. Once the Level 4 lockdown has ended, our allowance for further significant restrictions is equivalent to Level 4 conditions remaining in place for a further fortnight.

- Further government support and stimulus for the economy will be forthcoming in coming months. Next month's 2020 Budget is likely to contain the biggest initiatives. However, we would expect other significant announcements at December's Half-Year Economic Update or the 2021 Budget, as the shape and magnitude of the required response from the government becomes clearer.

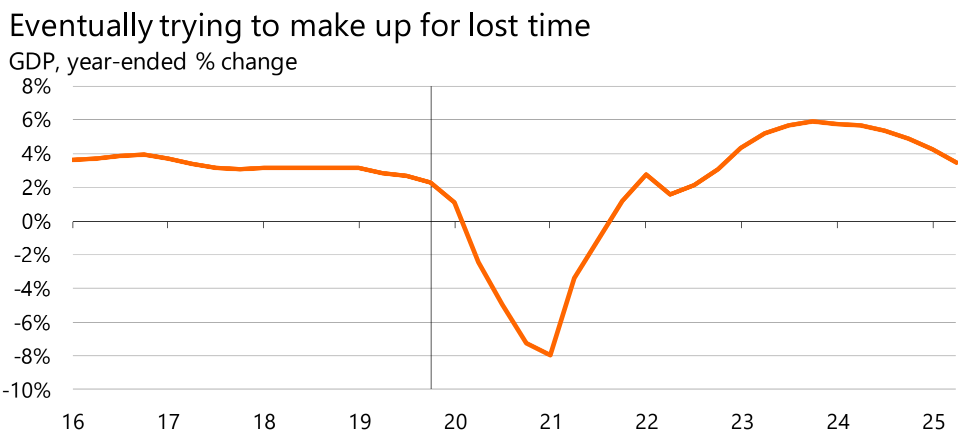
- The six-month mortgage holiday scheme arranged between the government and the trading banks will only delay an inevitable downturn in the housing market. We predict the number of forced sales will increase substantially once the scheme expires in September, particularly given our expectation that unemployment will continue rising until the second half of 2021. Downward pressure on property prices will be exacerbated by an overhang of newly constructed houses that were started prior to the pandemic, which developers will struggle to sell. We expect an 11% fall in house prices between June 2020 and December 2021.

- Businesses that have survived through the lockdown and are not directly affected by the collapse in tourism will remain under pressure throughout the following 12-18 months. A tighter rein on both business and household budgets will have a negative effect on demand conditions for many firms. Although the number of business failures is likely to be at its highest within the next 3-6 months, we expect to see a continuing stream of above-average insolvency numbers throughout 2021 as well.

Given these assumptions, we forecast that GDP growth will remain patchy until the first half of 2022. By that stage, COVID-19 is likely to have been controlled by a vaccine and overseas economies will be on the long road to recovery. International tourism will start to reappear and demand conditions for other exports will also improve, particularly those exports that are reliant on markets other than China. Government stimulus, in terms of both cash for households and spending on infrastructure, will also support accelerating economic growth. Businesses will become more confident about their own revenue prospects, leading to increased investment and hiring. Signs of a tightening labour market will also improve consumers' confidence and willingness to spend.

After an 8.0% contraction in the economy during the March 2021 year, we expect year-end growth to turn positive again by the end of 2021. There will be considerable underutilised resources in the economy that, in tandem with highly stimulatory fiscal policy, are likely to drive strong growth results in subsequent years. We forecast that GDP growth could get as high as 5.9%pa in 2023 (see Graph 2).

Graph 2



Over the three years to June 2025, we are predicting economic growth to average 4.8%pa. However, it is also worth noting that average growth between June 2019, before the pandemic, and June 2025 will only be 1.6%pa. Even with rapid growth in the later years of our forecast period, we still predict the economy will be 1.8% smaller in 2025 than we were anticipating before COVID-19 came along.

The details of our forecast outlook

The remainder of our Forecast Story discusses our expectations for specific subcomponents of the New Zealand economy, and the key issues and risks we see for each of these variables.

Unemployment to threaten double digits

We are assuming that the COVID-19 pandemic will have massive consequences for the labour market. These effects will come through several channels and will result in a variety of different outcomes over an extended period.

Firstly, there will be job losses in industries that were being directly affected by COVID-19 before the lockdown occurred, such as tourism and hospitality. The government has signalled that New Zealand's borders are likely to remain largely shut until either a vaccine is available or until the risk of reimporting new cases of COVID-19 from overseas has diminished. But even if Europe and North America get their COVID-19 outbreaks under control sooner rather than later, issues for the tourism sector will remain. Airline capacity will be significantly below previous levels, people are likely to be cautious about long-haul travel, and the global economic downturn will limit tourism-related spending. In short, we could easily see employment declines of 25-40% in industries that are heavily reliant on tourism.

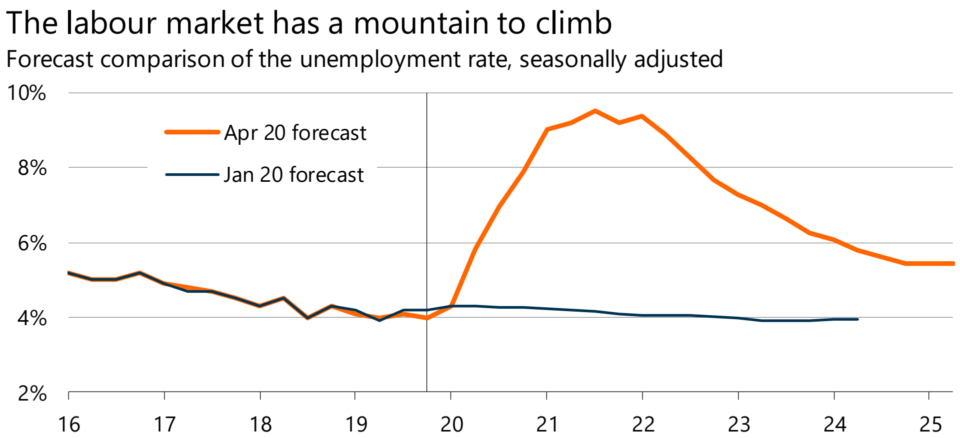
Secondly, there will be closures of firms that are not able to remain solvent throughout the lockdown. These businesses will typically be unable to generate revenue during this time, but will still face costs such as rent, wages, interest, or other fixed costs. The government has alleviated some of the pressure on firms with its wage subsidy scheme and business lending package. However, there will be many businesses that were only marginally financially viable before the pandemic, and their owners will choose to cut their losses by closing down. These firms could include many small businesses owned by baby boomers who are close to retirement, who will see little sense in pumping more money into their business to keep it afloat with limited future payoff.

The longer the lockdown continues, the greater the number of business failures is likely to be.

Even once the lockdown ends, the flow-on effects of these initial job losses and business failures will cause problems for other firms. Reduced levels of business investment and household spending will force less directly affected businesses to cut back staff hours or reduce employee numbers. Business and consumer confidence levels are likely to stay persistently low throughout 2020 and 2021, with job losses and business failures a continuing theme. A cascading effect of business closures is expected, with immediately unaffected firms facing lower activity levels over time as their customers stop trading.

The labour market outcomes clearly show through in our forecasts. We are predicting a 12% fall in total employment between December 2019 and September 2021, including a 6.6% decline in the June 2020 quarter alone. The unemployment rate is forecast to climb from 4.0% to 9.5% by September next year (see Graph 3).

Graph 3



But even these stark numbers mask the full effect of the recession. Some workers will be forced to cut back their hours, reducing overtime or shifting from full-time to part-time work. In other words, underemployment or underutilisation of labour will rise in tandem with unemployment. Furthermore, some of those people who are no longer employed will not be counted as unemployed. Instead, some will simply drop out of the labour force as new jobs become too difficult to find, while others will seek out education opportunities to enable them to reskill. Both subgroups will contribute to a fall in the participation rate, which we predict could fall from 71% to 66%, its lowest level since 2001.

We anticipate that the rise in unemployment could take time to filter through into the economy as a result of the government's wage subsidy. Some firms that would otherwise have laid off staff will struggle through in the near term, with wage costs being largely borne by taxpayers. However, once the wage subsidy ends, further job losses will occur, with firms that are no longer viable operations becoming exposed by the lack of continued government support.

We see the risks to our labour market forecasts as balanced. Over the next two years, we might have overestimated the scale of likely business failures and job losses, which would suggest that the peak rate of unemployment could be lower than 9.5%. However, there is also a chance that an unemployment rate of close to 10% could take longer to recover from than we have allowed for, as people struggle to retrain or find new job opportunities. These sorts of structural issues could result in unemployment still being above our projection of 5.4% by the end of our forecast period in 2025.

Household caution set to stay

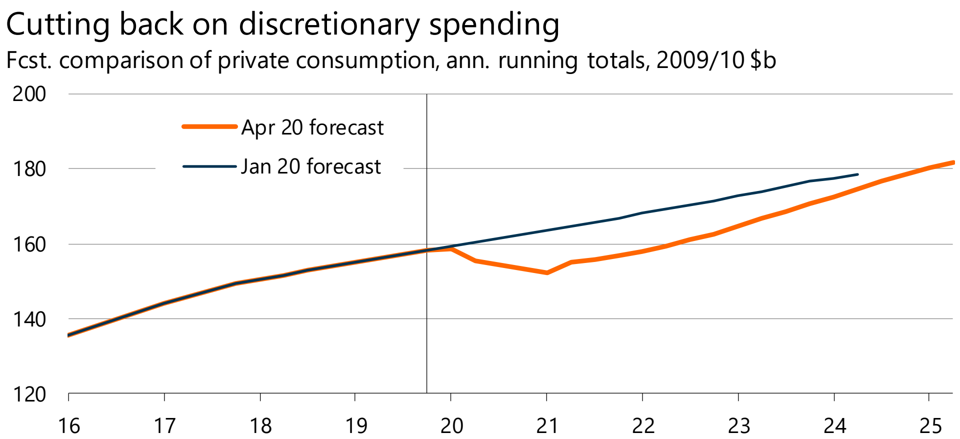
Consumer confidence was abruptly lower in March, but there will still be further significant drops to come as the effects of the lockdown on businesses become clearer and job losses mount. Household spending activity will fall sharply in the June quarter, primarily because consumers are unable to spend on many of the goods and services they would regularly purchase. We have allowed for a quarterly drop of almost 9%.

Spending will bounce back from this negative supply shock in the September quarter, but the extent of this rebound will be limited by the job losses and reduced incomes that have transpired in the meantime. And with unemployment continuing to climb until a forecast peak of 9.5% in September 2021, a full recovery in household spending will take some time to occur.

Discretionary spending will bear the brunt of more frugal household spending as consumers watch costs much more closely. Outside of food, housing costs, and other necessary goods and services, a humbler spending profile is likely to emerge. Even for those households who don't see hours cut or jobs lost, the severe downturn and threat of rising unemployment will see them conserve more of what they earn to provide a buffer if the worst occurs.

By mid-2022, we expect total household spending to be back at its pre-crisis levels, although there will still be ground to make up for the lost growth since early 2020 (see Graph 4). We expect spending growth to average 4.5%pa over the three years to June 2025 as the labour market tightens, household incomes recover, and population growth picks up.

Graph 4

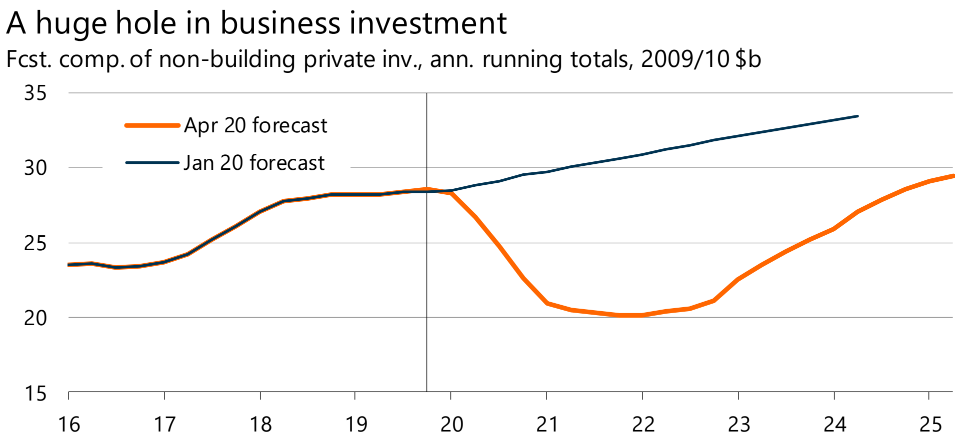


We see two key risks to our spending forecasts. Firstly, in the near-term, the negative shock to household spending could be greater than we have allowed for – both in the June quarter, but also in the following year as unemployment rises. Secondly, from 2021 onwards, there is potential for additional government stimulus to boost household spending, via measures such as tax rebates or additional social welfare payments beyond what we have currently allowed for, to boost household spending. Any larger-than-expected government action to expedite the recovery in consumption during 2021 and 2022 would reduce the scope for such fast growth in spending later in the forecast period.

Cutting unnecessary business spending to preserve cashflow

With firms under severe cashflow pressure in the near-term, and business confidence likely to hit record lows, business investment will plunge over the coming year. We are predicting a 26% reduction in spending over the year to March 2021, surpassing the 24% decline that occurred in 2009. Smaller falls are likely to continue throughout most of 2021, as the flow-on effects of the COVID-19 lockdown and the collapse in tourism and hospitality activity keep weighing on demand conditions, business activity, and confidence levels (see Graph 5).

Graph 5



We expect a recovery in business investment by late 2022, with growth holding in double digits during 2023 and 2024. This pick-up will be underpinned by improving demand conditions both domestically and internationally. It will also signify a reallocation of resources within the New Zealand economy away from businesses and industries that have suffered during the pandemic. New firms will be able to take advantage of stimulatory monetary and fiscal conditions to target new areas for growth. Demand for capital equipment by these businesses will be matched by their demand for workers, so the pick-up in investment spending is likely to coincide with the early stages of the labour market recovery.

Our projected decline in business investment over the next 1-2 years is not much larger than the one that occurred following the GFC, so the near-term risks to our forecast are on the downside. We have allowed for a relatively long trough in investment activity, and we see some scope for spending to pick up sooner if fiscal policies are successful in stimulating domestic demand and boosting confidence earlier during 2021.

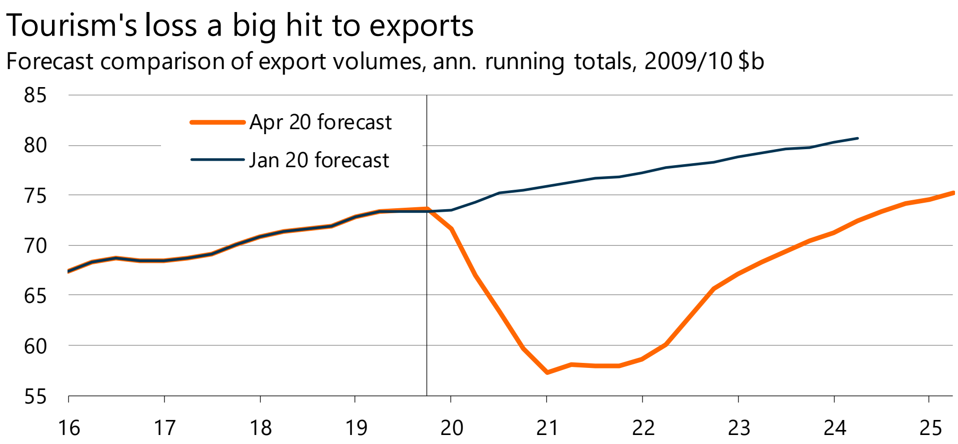
A hit to trade, both in and out

New Zealand's tourism exports totalled $16.2b during 2019, representing about 19% of total goods and services exports. As outlined above, we expect international inbound tourism is likely to be virtually non-existent for the next 12 months, with 14-day quarantine requirements or closed borders likely to discourage or prevent visitors from coming here. As a result, we are forecasting a 20% contraction in export volumes over the year to March 2021.

Most of our commodity exports will be less heavily affected, notwithstanding a decline in trade volumes with China in early 2020 as their ports were largely shut down. The biggest exception will be forestry, with backlogs at ports and softer demand due to the global economic downturn expected to cement weaker export volumes. Non-food manufactured exports are also likely to temporarily dip thanks to a hiatus in production during the lockdown.

Although we are forecasting growth of up to 15%pa in export volumes during 2022 and 2023, we still expect volumes by mid-2025 to be about 9% below the levels they would have otherwise reached (see Graph 6). This result will be due to the lingering effects of the pandemic on international tourism, with reduced willingness to travel and less capacity in the airline industry. With overseas economies set to shrink this year, the current global downturn will also have a dampening effect on international demand and lead to softer export volumes, even over the medium-term.

Graph 6



Travel of New Zealanders overseas will be similarly affected to inbound tourism: non-existent for the next 6-12 months, followed by a gradual return towards "normal" as borders are reopened, quarantine restrictions are lifted, airline capacity is rebuilt, and lingering traveller concerns about COVID-19 fade.

Tourism imports are much smaller than exports, totalling $6.7b over the last year, and representing 7.8% of total goods and services imports. Consequently, the direct effect of COVID-19 on imports will be smaller. These figures also demonstrate that increased spending on domestic holidays by Kiwis will be unable to fully make up for the decline in revenue due to the loss of foreign tourists.

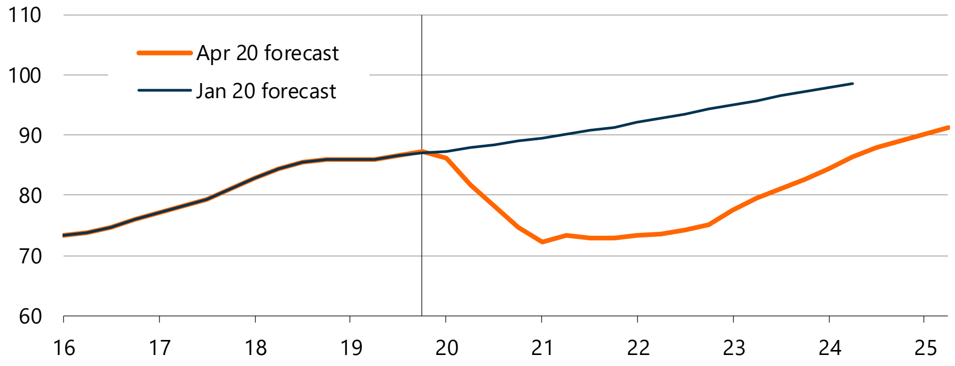
Alongside changing travel patterns, the downturn in New Zealand's domestic economy will also weigh on import volumes. Lower household spending will reduce demand for consumption good imports (21% of total imports). Capital equipment imports are also likely to take a big hit (15% of total imports). In the wake of the GFC, the annual total of capital imports plunged 33% over an 18-month period. Given our anticipated decline in business investment spending, we are likely to see an even sharper fall in capital imports than we did during 2009.

We are forecasting a 16% contraction in total import volumes over the year to March 2021. We anticipate that the subsequent recovery in imports during 2022 and 2023 (see Graph 7) could be more muted than export growth for two reasons. Firstly, we expect a sustained change in New Zealanders travel patterns, with more holidays taken domestically and international travel taking a long time to return towards pre-pandemic levels. Secondly, business' willingness to invest could remain weaker than normal for some time, dampening the recovery in capital imports.

Graph 7

Imports are pulled lower as well

Forecast comparison of import volumes, ann. running totals, 2009/10 $b



The risks to our forecasts for both exports and imports lie, if anything, on the upside, particularly over the medium term. Given that we are currently in the midst of the pandemic, it is unclear how sustained an effect current events will have on international travel behaviour.

Government to the rescue

Fiscal policy has the biggest role to play in cushioning the economy's downturn and then generating momentum heading into the recovery. In broad terms, this support and stimulus can happen via three channels.

- Increased government spending on purchasing goods and services (government consumption)
- Transfers of money to individuals or businesses (which shows up in private consumption or business investment)
- Increased government spending on assets such as infrastructure (government investment)

Notwithstanding the fact that the overall size of government would normally be expected to expand more quickly under a Labour administration than under National, we don't anticipate any step change in government consumption. The most obvious area of potential increase in spending is the health sector, where more funding will obviously be needed in the short term to facilitate the response to the COVID-19 pandemic.

The government's wage subsidy package and welfare benefit increases come within the transfers category, increasing the government's outlays, but with the money not being used to purchase goods or services. Similarly, any future tax cuts, rebates, or handouts of money to households will also come within this category. This money does not show up in government consumption, but it will affect the government's financial position and results in a larger fiscal deficit in coming years.

The government's current focus is, rightly, on trying to reduce the financial stress on households and businesses caused by the initial economic shock of the lockdown – in other words, smoothing the downturn path. Limiting business insolvencies or failures will make it easier for the economy to recover once trading conditions start returning to normal.

Once the worst of the shock is over, then the government's efforts must turn to measures that will help rekindle aggregate demand and stimulate a pick-up in growth. We expect these measures to concentrate on shoring up households' financial positions, which will be negatively affected in the meantime by job losses, other temporary reductions in income, and hits to wealth caused by falling house prices, KiwiSaver balances, and other investor losses.

The government should also consider measures that encourage businesses to commit to new investment and hiring. Stimulus measures for households and businesses will need to kick in during 2021, although it could be 2022 before we start to see the real fruits in terms of better economic outcomes.

Finance Minister Grant Robertson has also emphasised the potential role that infrastructure has to play in the recovery. We understand the government is looking for a wide range of infrastructure projects that it can fund over coming quarters to boost economic activity, including projects that would normally be funded by local government or the private sector. The focus is on "shovel-ready" projects, with particular attention being paid to smaller projects, so that work can be undertaken across a wide range of areas to try and generate a reasonably broad-based recovery.

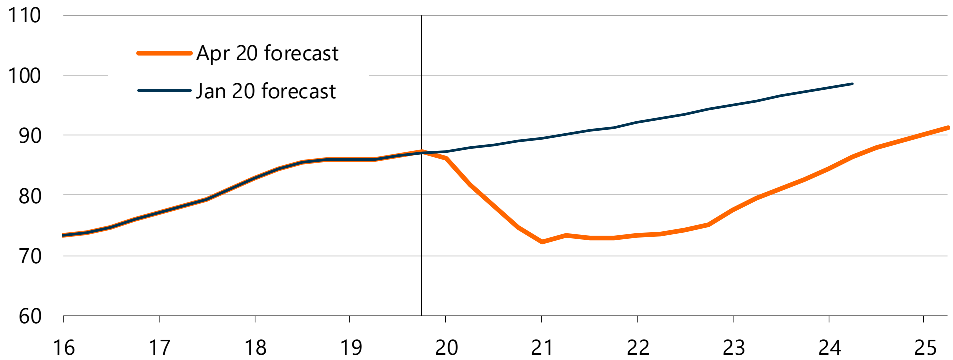
This spending by central government shapes as a timely injection of cash for local councils that have been struggling to fund their required infrastructure investment. Central government money will help expand network infrastructure to meet the strong population growth of recent years, as well as replace critical network assets that have reached the end of their working life.

In the short-term, government investment will be constrained by the hiatus in projects caused by the lockdown. We predict that growth in spending will then accelerate towards 5%pa during 2021, with growth averaging 4.5%pa over the four years to June 2025. By the end of the forecast period, we expect the volume of government investment to be almost 10% greater than we had allowed for in our January forecasts.

Graph 8

Imports are pulled lower as well

Forecast comparison of import volumes, ann. running totals, 2009/10 $b



Evolving our forecasts as decisions play out

We will continue to track the COVID-19 pandemic and response throughout the next few months, providing our views as circumstances change and decisions are made by key local, national, and international leaders.

For New Zealand, understanding when the lockdown will end, and how businesses can operate under lower COVID-19 alert levels, will provide greater clarity about the economy's near-term direction.

Internationally, developments in both the health and economic responses to COVID-19 will allow us to better determine the global growth path and how it will affect New Zealand.

Our regular weekly commentaries and economic data release notes to clients will provide our most up-to-date views on how the economy is continuing to evolve.