

Purpose

This paper was prepared by the Ministry of Business, Innovation and Employment to provide incoming Ministers with high-level key messages about Aotearoa New Zealand's current economic context.

IMPACTS OF COVID-19

New Zealand's economy is in recession

- › The COVID-19 crisis has generated the largest recession in the New Zealand economy in a generation. Restrictions on domestic activity under higher Alert Levels, border restrictions, and the weakened global economy have had a significant impact on economic activity and created widespread uncertainty.
 - Figure 1 shows the sharp drop in economic activity (consumer spend) at Alert Levels 4 and 3, and recovery at lower Alert Levels.
- › New Zealand's economy declined 12.2% in the June 2020 quarter, the largest quarterly decline on record.
 - The decline has been largely driven by services and goods-producing industries, with retail, accommodation and restaurants the largest contributor to the decline.

Our trading partners have also been hit hard

- › Key trading partners have experienced record quarterly declines in economic activity in 2020.
 - China's economy saw a record quarterly decline in the March 2020 quarter and returned to growth in the June quarter, more quickly than expected.
 - Australia, the USA and the UK saw record quarterly declines in GDP in the June 2020 quarter.
- › While service exports that rely on international people flows (i.e. tourism and international education) have been hit hard, many of our key commodity exports have held up well. Overall goods exports fell 2.4 per cent in the June 2020 quarter compared with the June 2019 quarter.
 - Dairy, meat and fruit exports were all higher in the year to September 2020 than last year, but there were large falls in exports of logs, seafood, and mechanical machinery.

The impacts are not evenly distributed across the economy

The impacts are different across regions, sectors, and groups of people.

- › **Sectors:** Sectors reliant on international people flows have been more affected, including tourism and international education, and those reliant on temporary migrant workers e.g. in primary industries.
 - Impacts will become more acute moving into peak season for some of these sectors, for example the tourism sector over summer months, and workforce pressure in industries like horticulture and viticulture moving into peak harvest in March/April.
- › **Regions:** All regions have been impacted in different ways. Places more reliant on affected sectors (e.g. the West Coast, Central Otago) and/or where there has been more time at higher Alert Levels (Auckland) are more impacted.
- › **People:** Affected occupations and industries have a high representation of Māori, Pasifika, women and young people. We know from previous recessions that New Zealanders suffer from relatively severe wage scarring during downturns.

The full impact is yet to play out and is highly uncertain

- › The timing of the emergence of COVID-19 in New Zealand softened the impact, being outside of peak activity in key sectors, and support measures (e.g. wage subsidy) have cushioned the blow.
- › Treasury forecasts suggest the downturn will be not as deep as early as expected given relative advantage of going hard and early, but will be a longer duration (refer figure 2) with unemployment expected to peak at 7.8% in the March 2022 quarter (refer figure 3).
- › There are a range of possible scenarios, and high uncertainty around a number of factors (e.g. timing of a vaccine, resurgence of COVID-19 in New Zealand, ability of firms and communities to adapt). We need to be prepared for a scenario in which COVID-19 will continue to negatively affect economic activity for some time to come.

Figure 1: Total Week Consumer spend change vs. 2019

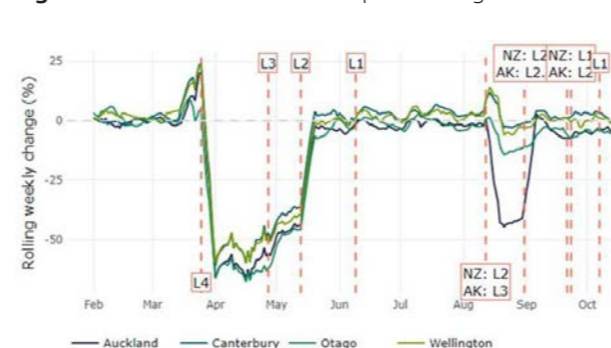
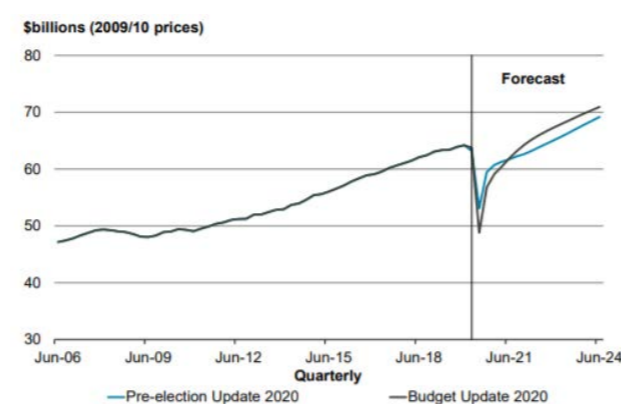
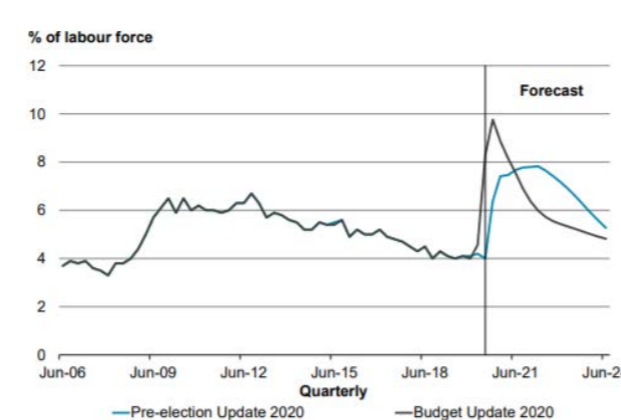


Figure 2: Real production GDP



Sources: Stats NZ, the Treasury

Figure 3: Unemployment forecast



Sources: Stats NZ, the Treasury

PRE-COVID PERFORMANCE

Pre-COVID-19, the economy has been performing well on some measures, but with long-standing challenges to current and future wellbeing.

New Zealand has performed well in many measures of wellbeing, ranking above OECD average in measures including subjective wellbeing, perceived health, civic engagement, education and skills, and social connections but below average in disposable income, housing affordability and work-life balance.

Pre-Covid, New Zealand's economy was experiencing strong growth, employment and labour force participation and improving outcomes for Māori and Pasifika.

However, there are long-standing challenges to current and future wellbeing:

- › **Productivity performance** has fallen short of that seen in other OECD countries for many years, impacting on income growth. The causes of New Zealand's poor productivity performance are well understood. We have a small domestic market, weak international connections, a lack of large firms, under investment in knowledge assets and infrastructure, weak technology and knowledge diffusion, and skills mismatch in our labour market.
- › **Environmental costs** have not all been factored into economic activity, resulting in unsustainably high emissions intensity, waste and impacting on water quality and native biodiversity.
- › **Economic outcomes are not evenly distributed** across groups of people and regions. There are significant opportunities to support improvements in economic outcomes in Māori and Pasifika communities.

Focus has been on building a more productive, sustainable and inclusive economy.

Progress has been made towards understanding and acting to address these challenges, but it will be a long-term transition.

COVID-19 has compounded these challenges.

GLOBAL DRIVERS OF CHANGE

Global megatrends continue to present new opportunities and challenges

Alongside COVID-19, New Zealand is subject to global trends and other disruptive events, adding to the complexity of the current environment and emphasizing the importance of our ability to adapt and seize emerging opportunities.

- › The climate is changing, with increased frequency of floods, droughts and extreme weather events. We need to take significant action to adapt to the effects of climate change, and massive investment is required in order to reach net zero emissions by 2050.
- › Technology is advancing rapidly – there are opportunities to develop and adopt new technologies, and risks that will need to be managed.
- › The global population is growing and aging, and urbanisation and greater ethnic diversity is increasing in countries like New Zealand.
- › The geopolitical environment is changing, with a rising focus on national interests in recent years and the COVID-19 crisis reinforcing a shift towards regionalism.

A PRODUCTIVE, SUSTAINABLE AND INCLUSIVE RECOVERY

In our economic response to the impacts of COVID-19, we have a unique opportunity to build on New Zealand's strengths and reset the New Zealand economy towards a high value, high quality employment and low emission society. Seizing the opportunity to reset requires strategic decisions to align recovery measures with longer term objectives.