Economic Bulletin.

18 August 2021

New Zealand goes hard, goes fast…and goes back into lockdown.

- New Zealand has moved back into Alert Level 4 lockdown after the emergence of new cases of Covid-19 in the community.
- While there will be a clear hit to activity in the short term, early decisive action remains the least-cost option in terms of both economic and health outcomes.
- Fiscal support, including the reinstatement of the wage subsidy, will again help to limit economic scarring.
- We expect the RBNZ to leave the OCR unchanged this afternoon. Interest rates will head higher in time, but when so little is known about the current outbreak, the best option right now is to wait and see.

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On Tuesday evening the New Zealand economy was pushed back into Alert Level 4 lockdown (New Zealand's strictest level of restrictions). That followed the discovery of a Covid-19 case in the community. At the time of writing, four related cases had been confirmed, and no definitive link between the cases and the border had been established.

Level 4 restrictions will remain in place for the next seven days in Auckland and the Coromandel Peninsula, while the rest of the country will be at Level 4 for the next three days. After this time, Alert Level settings will depend on whether further cases are discovered, and if the source of the infection can be established.

Past experience with Covid lockdowns and restrictions gives us a reasonable sense of their economic impact. We've previously estimated that at Alert Level 4, the value of lost activity is around $1.5bn per week (about 0.6% of annual GDP). The impact at Alert Level 3 is significantly lower at around $600m per week, while the effects of Alert Level 2 restrictions are small overall and limited to a few sectors.

It's not quite as straightforward as this, as the impact also depends on the time spent at each alert level. In a short, successful lockdown, a large proportion of spending ends up being delayed rather than lost altogether. But the longer the lockdown, the less likely that lost activity will be caught up at a later date.

Whatever the cost of early action may be, it pales in comparison to the potential cost of a slow response that results in a longer period of restrictions. This highlights a point we have often made: In the long run, there is not a trade-off between public health and the economy.

The Government has already reintroduced the wage subsidy programme and support for affected businesses. This was an important part of limiting the longer-term economic scarring from last year's Level 4 lockdown, by helping to keep people attached to the workforce. The cost of this to the Government will be large but manageable, as tax revenue is already several billion dollars ahead of what was projected in the May Budget.

The reimposition of lockdown conditions means that we no longer expect an OCR hike at today's RBNZ policy review. This would be a matter of tactics rather than strategy. The economic case for higher interest rates has become apparent over recent months, and the same issues will emerge again once the restrictions are lifted. But right now, with such a wide range of possibilities as to how this outbreak could play out, there is nothing to be gained from pushing the OCR higher now, rather than waiting for the next review date in seven weeks' time.

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