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RESEARCH NOTE

How bad might the lockdown be for jobs and income?

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Background

The Covid-19 pandemic has triggered a long-anticipated financial and economic cardiac arrest in heavily indebted Europe and the US. How bad will this affliction be and how long will it last?

The short answer is that will be bad for New Zealand regardless of what happens overseas. This week the Minister of Finance Grant Robertson told Parliament's Epidemic Response Committee that economists' estimates of looming unemployment range from 8% to 30%.[*] New Zealand's highest unemployment rate since the 1930s was in 1991, at 11%.

In the best of all worlds, the country would quickly bounce-back to near-full employment after the lockdown period. But this is not an ideal world. International tourism will only recover slowly. World trade has collapsed. New Zealand's major trading partners will be in recession to varying degrees. Europe is financially weak and divided and the future of the euro is in doubt. The US is also hard hit. Its Treasury Secretary anticipates 20% unemployment before this is over.[†]

The scale of what has occurred is unprecedented in living memory. In the words of Nouriel Roubini, Professor of Economics at New York University's Stern School of Business, "[n]ot even during the Great Depression and World War II did the bulk of economic activity literally shut down, as it has in China, the United States and Europe today".[‡] Share prices and economic activity have fallen faster than in either of those two historical episodes.

About halfway through March, Goldman Sachs forecasted a 24% drop in US GDP in the June quarter 2020. Up until now, the largest quarterly drop was 10% in 1958. The multinational investment bank anticipates a 9% unemployment rate in the next six months. Deutsche Bank is forecasting the US economy to shrink by 4.2% this year, the worst since the Great Depression.

In a nutshell, policy responses to Covid-19 across the Western world have given normal commerce a heart attack. Governments will emerge even more crippled by debt than before while their central banks' balance sheets will look even more bloated.

Extremely high unemployment rates will lead to big falls in income per capita. In 1933, average income per capita in the US (real GDP per capita) suffered a heart attack and slipped 31% lower compared with 1929. It took 12 years (until 1941) for US GDP per capita to "convalesce" and surpass the 1929 level. New Zealand fared better at the time. Its real GDP per capita bottomed in 1932 at 82% of its 1929 level, according to US economist Angus Maddison's estimates.

It is fashionable in some circles to downplay the connection of health and well-being with national income. Of course, materialism is not everything. But people need income. The pressure on

[*] https://www.health.govt.nz/publication/covid-19-modelling-reports
[†] https://www.nbcnews.com/politics/congress/coronavirus-trump-administration-warns-20-percent-unemployment-rate-n1162601, also the US Treasury Secretary https://www.project-syndicate.org/commentary/coronavirus-greater-great-depression-by-nouriel-roubini-2020-03
[‡] https://www.project-syndicate.org/columnist/nouriel-roubini

Government to provide money is relentless. Schoolteachers, nurses and beneficiaries always need more money and the minimum wage is never high enough. Media couldn't survive without frequent news items about some individual or group asking for more cash.

The higher the national income the easier it is for Governments to afford good things, including better quality housing, safer roads, better health systems and a cleaner environment.

Money transfers are not income

National income is the sum of the value of the production of its people. When the Government pays $9 billion in wage subsidies, it is not adding to national income. It is merely shuffling who will spend or save that $9 billion. If one group is now $9 billion better off, everyone else is $9 billion worse off, although they might not know it. For some it is a signal to spend up, for others it is a signal to tighten their belts.

Fifty years ago, national income was commonly approximated by Gross National Product – the value of global production before depreciation accruing to residents. Today the measurement is Gross Domestic Product (GDP) – the value of domestic production before depreciation whether it accrues to residents or non-residents. Both GNP and GDP tend to track national income closely enough for most purposes.

GDP Forecasts

New Zealand Treasury

Parliament's Epidemic Response Committee was told this week that modelling from the Treasury predicts a 10-15% drop in GDP over the June quarter due to the lockdown, equivalent to about $8-12 billion. Presumably if the lockdown extends the lost production will be commensurately greater.

IMF and OECD in early March

The IMF and OECD are the heavyweight official forecasters of world economic growth prospects. Both have been slow to adjust to the gravity of this situation.

In early March, the OECD said the pandemic will weaken global GDP this year to be only 2.4% higher than in 2019, down from its earlier forecast of 2.9%. It also said Australia's growth would be 1.8%, rebounding to 2.6% in 2021.

In late February, the IMF shaved a mere 0.1 percentage points from its global GDP growth forecast of 3.3%. By March 3 it had increased the estimate to 0.4.[§] The virus has since caused major economic mayhem.

OECD – March 30

At the end of March, the OECD released a note assessing that "the initial direct impact of the shutdowns could be a decline in the initial level of output of between one-fifth to one quarter in many economies, with consumer spending potentially dropping by one third."

That is consistent with fears of very high rates of unemployment or underemployment in New Zealand and in many other OECD member countries.

[§] https://www.theguardian.com/business/live/2020/mar/04/government-spending-interest-rate-cuts-slowdown-coronavirus-risks-world-bank-financial-news-business-live

The biggest falls across the OECD would be in retail and wholesale trade, professional services and real estate services. New Zealand can add tourism, transport, restaurants, cafes and sports to the list. The OECD's report puts New Zealand's decline at about 28% of real GDP.

The impact in lost income depends on how long the downturn lasts and the magnitude of second round effects. When retail shops stop buying product, their suppliers will cut back too. This in turn affects their workers and suppliers, and so on across the system, like a chain reaction.

New Zealand GDP is about $80 billion each quarter, so a fall of 28% would painfully slice away nearly $24 billion in income, or $10,000 per household. Treasury's indicative fall of 10-15% in the June quarter presumably assumes a shorter lock down period. Either way, the Government can only ease some people's suffering by making the discomfort worse for others over time – whether it prints money or doesn't.

IMF - March 27 and 30

On March 27, the IMF conceded the global economy was in a recession "as bad or worse than in 2009."[**] It projected recovery in 2021. The global economic situation became so weak that some 80 countries have already applied to the IMF for financial assistance. More requests are expected.

The crisis continues growing. Europe is in real trouble. An IMF blog on March 30 opined that "[a] deep European recession this year is a foregone conclusion."[††]

Conclusion

Official economic forecasts are now more realistically negative. But there is a lag in their adjustments compared to observations and a tendency to be optimistic for 2021 and beyond, without explaining how the deep problems in Europe might be resolved.

The good news is that many Asian countries are doing relatively well economically, as will Australia and New Zealand if they pull out of the economic holes they are digging sooner rather than later. If New Zealand fails, output losses at a level of the 1930s (see above) are entirely plausible.

[**] https://www.imf.org/en/News/Articles/2020/03/27/sp032720-opening-remarks-at-press-briefing-following-imfc-conference-call

[††] https://blogs.imf.org/2020/03/30/europes-covid-19-crisis-and-the-funds-response/