focus

Lockdown déjà vu, **but not for the NZX**

Here we go again

After 102 days of no community transmission of COVID-19 in New Zealand, our largest city Auckland, with around a third of the country's population and about 38% of GDP, is back in lockdown. Clearly this will come as a bitter disappointment to most, but isn't really a huge surprise.

Later today, government will update us. Unfortunately, given the number of new cases in recent days including outside Auckland, and the lag between infection and symptoms, an extension and potentially geographical expansion of alert level 3 seems likely.

The cost of New Zealand's zero tolerance approach

Countries around the world are grappling with the trade-off between suppressing COVID and the economic damage containment measures cause. The United States, United Kingdom, Germany, Australia, and China (amongst others) have seen COVID-19 cases rise after restrictions were reduced. We only have to look across to Melbourne to see how quickly new cases can escalate.

New Zealand's approach to containing COVID-19 is more extreme than most. Our government's aim is eradication over containment. The economic impact of the latest lockdown will depend on its length and breadth. ASB's "rough estimates" are a -0.2% hit to GDP for each week of lockdown. Whilst these numbers may appear small, they will accumulate if the lockdown is extended or widened.

The re-emergence of community transmission in New Zealand is a reminder that it's going to be a long road to successfully overcome COVID. There remains a lot of uncertainty ahead. Other countries are learning to live with the virus (many didn't have a choice), steadily opening their economies and borders. This has come with health and social costs.

New Zealand's hard-line means it's less clear what our exit path will be. An effective vaccine or medical treatment would provide a solution, but there's no guarantee if and when this will transpire. The head of the World Health Organisation (WHO) recently said there is "no silver bullet at the moment – there might never be". How we will proceed if a medical solution is not found remains unclear.

The economic impact of the latest lockdown will depend on its length and breadth

Lockdown hurts face-to-face businesses the most

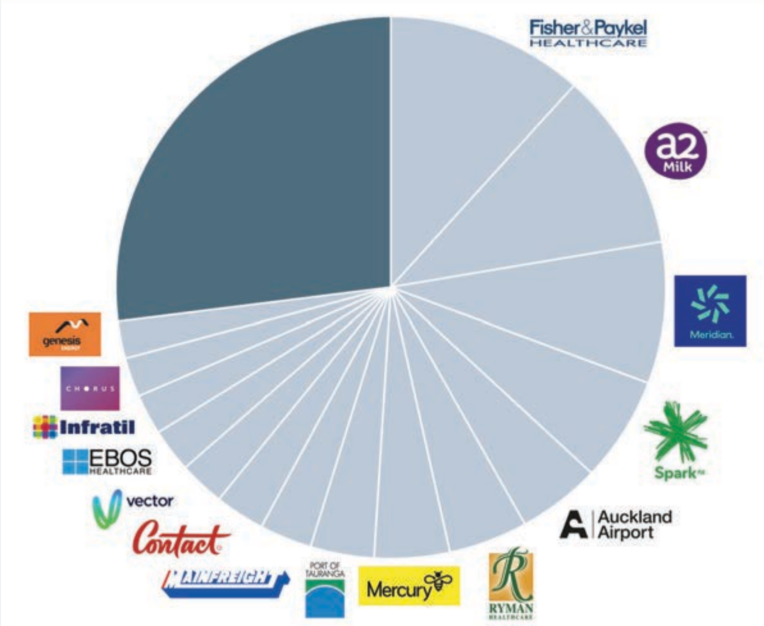
The impact of renewed lockdown measures on businesses varies. Many will have learned a lot from their previous experience, and will adjust more quickly this time round. Those that can't operate easily with physical distancing will be hurt the most. Accommodation and food services will once again suffer. Retailers (with the exception of necessities such as supermarkets and pharmacies) are restricted to delivery or click-and-collect. Non-essential medical treatments, such as dentists, will largely be closed. Physical distancing requirements severely impacts productivity on construction and some manufacturing sites. More broadly, the dent to business and consumer confidence may generally soften demand across the economy.

Markets can remain resilient in the face of COVID-19 challenges

Whilst the re-emergence of COVID is both an economic and social knock for the country, we do not expect it to have a broad-based impact on the New Zealand share market for a number of reasons.

First and foremost, the NZX is not the New Zealand economy. It is dominated by defensive sectors including healthcare, consumer staples, electricity utilities, and telecommunications which operate in international markets and/or are all more resilient to economic swings than most businesses.

DEFENSIVE COMPANIES DOMINATE THE NZX: NZX50 WEIGHTINGS



Source: Refinitiv, Forsyth Barr analysis

Secondly, share prices of the more impacted companies remain sharply down from where they were at the beginning of the year. Many have already raised new equity to help them navigate COVID and the uncertainty ahead.

Thirdly, policymakers (governments and central banks) in New Zealand and around the world have shown they are prepared to react rapidly and aggressively to support economies. Again this week, the Reserve Bank of New Zealand discussed the possibility of taking the cash rate below 0%. Ultra-low interest rates also make it very expensive for investors to hibernate in low-risk assets like bonds or term deposits, and encourage investment in equity markets.

And fourthly, share prices reflect the long-term earnings companies will generate over the years and decades ahead, not just the next six to 12 months.

Markets around the world have shown they're able to remain resilient in the face of recurring COVID-19 waves

This is not to say we are ignoring the impact of the latest shutdown and further COVID risks. We continue to monitor the implications for markets and businesses, and evaluate where investment opportunities and challenges may arise. But markets around the world have shown they're able to remain resilient in the face of recurring COVID waves. We do not expect New Zealand's latest COVID outbreak will derail the NZX market.

Investors have reacted to the COVID pandemic and its impact on financial markets in different ways. Periods of heightened market volatility provide an opportunity to reflect on your investment risk tolerance and, where necessary, adjust your portfolio strategy. We encourage you to continue to discuss your thoughts with us. Understanding your financial circumstances, investment goals and tolerance for risk, forms the basis of our service to you.

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