

Economic Bulletin.

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What Covid-19 means for New Zealand's rental and leasing industry.

- The impact of Covid-19 on New Zealand's rental and leasing sector has been unprecedented.
- Smaller firms that focus on short-term rentals have been the most heavily affected.
- Rental and leasing activity is likely to remain subdued for some time, but a recovery has already begun and is set to outpace the wider economic recovery.
- Longer term, the industry is set for big structural changes shaped by new technologies. This will be accelerated by Covid-19 and will reset the competitive playing field.
- Dis-intermediation through peer-to-peer networks will grow and many firms will shift from being product pushers to solution providers.

Dominick Stephens, Chief Economist

+64 21 262 5569

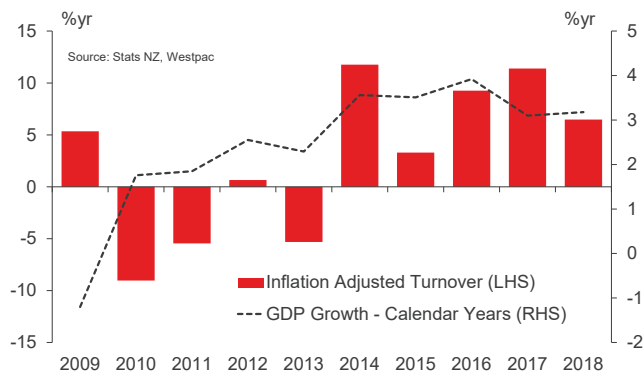
Paul Clark, Industry Economist

+64 21 713 704

Downstream impacts.

Measures taken to combat Covid-19 have severely curbed activity in many downstream industries served by New Zealand's rental and leasing sector. With some of these measures now being relaxed, this bulletin takes a closer look at how rental and leasing firms are coping and what this might mean for the sector's future.

Figure 1: GDP versus rental and leasing sector turnover



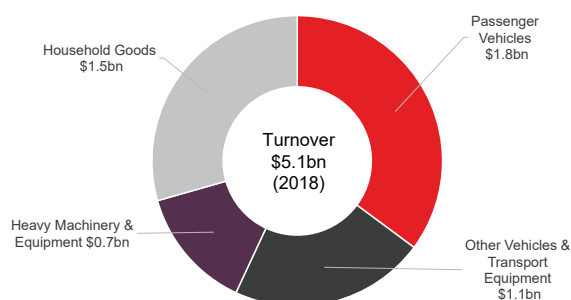
Like all industries, rental and leasing has been impacted directly by the lockdown. But it has also been indirectly impacted via the effect on consuming industries. Effectively shutting down tourism, for example, led to plummeting demand for passenger and recreational vehicle rentals, the largest market segment in the rental and leasing sector. Ditto, for machinery and equipment rentals, which have been adversely affected by reduced activity in the construction, manufacturing and services sectors. Household good rentals were similarly affected, although rental demand for items deemed essential received a boost.

More recent developments, however, suggest an improvement in operating conditions. With Covid-19 infection



rates now reduced to single figures, and restrictions on activity partially lifted, some parts of the rental and leasing sector have started to re-open. This is particularly true of machinery and equipment rentals, with industry sources suggesting that rental activity has already picked up as firms restart operations and workers return to work. By contrast, growth in rental demand for passenger vehicles remains subdued, in large part because of the ban on visitors from abroad visiting the country.

Figure 2: Turnover by rental and leasing market segment



Source: Stats NZ, Westpac

Impact on firms.

Very few firms in the rental and leasing sector have been left unscathed by events over the past couple of months. Some will have folded as a result of sharply lower demand. It could have been a lot worse had it not been for government's wage subsidy scheme providing some breathing space for firms teetering on the brink. Most vulnerable are likely to be the numerous small firms that depend heavily on cash running through their books. A disproportionate number of these are involved in renting household goods, although there are also many small firms that rent out equipment and passenger vehicles. Also vulnerable are the many aging proprietorships that operate in this sector, a large number of whom have no succession plans in place, and so are more likely to close.

Those least affected by recent developments are likely to be firms that had long-term lease agreements in place prior to the onset of Covid-19. That includes larger firms that provide passenger and commercial vehicles and those that hire out machinery and equipment to other businesses for an extended length of time.

These firms also provide a range of specialised support services, from fleet management to the repairing and maintaining of assets under lease. Many of these require skilled labour, which under normal circumstances would be hard to find. However, with unemployment already on the rise, leasing firms are likely to find it much easier to find the labour they need to support these operations.

Even during the height of the restrictions, most leasing firms would still have been able to generate an income, with lease agreements effectively providing a hedge against sharply lower activity in downstream consuming industries. That said,

like their rental counterparts, leasing firms would have also struggled to write new business during this period. They also face the possibility of their lessees not being able to meet their lease payment obligations, with this risk increasing during times of inactivity. That includes firms that provide commercial vehicles under long-term lease arrangements to others that rent out these assets on a short-term basis.

Near-term outlook.

Looking forward, it's likely that activity in the rental and leasing sector will remain subdued due to the general recessionary economic environment. However, rental and leasing is likely to outperform the overall economy, and some sub-sectors may do quite well.

This is especially true for machinery and equipment rentals. Growth in demand is likely to be driven by new customers who previously would have invested in new machinery and equipment, but are unable to do, either because their own financial circumstances have deteriorated due to Covid-19 or because the availability of new assets or parts used to maintain existing assets have been constrained by disruptions to global supply chains. However, opportunities like these are also likely to attract new market entrants, among them non-traditional firms involved in peer-to-peer sharing across digital platforms, often at highly competitive rental/lease rates. To this end, Covid-19 is likely to accelerate the greater use of digital solutions across this sector.

Much the same can be said for renting of household goods. Weak household balance sheets, damaged consumer confidence and constrained income growth will all deter households from buying and instead encourage them to rent. Again though, the potential for growth will not have gone unnoticed, and given relatively low barriers to entry, it is likely that new firms will enter this market segment, replacing some of those lost in the immediate aftermath of Covid-19.

The renting/leasing of heavy earthmoving and lifting equipment is set to benefit from an expected rise in publicly funded civil construction investment. How much though will depend on how quickly the government is able to initiate projects deemed to be "shovel ready". While there is already a large pipeline of planned work, it's likely that many will be slow to get off the ground.

However, other market segments will struggle over the coming year. Indeed, rental demand for passenger and recreational vehicles is likely to remain under the cosh due to the lack of international visitors, although an increase in domestic tourism and a mooted relaxation of border controls with Australia might offer some relief later this year. Worst hit will be small vehicle rental firms, with some joining those already closed. Vehicle leasing firms should be better positioned, although competition is likely to increase as customers in downstream industries, facing their own competitive challenges in an environment of slow economic growth, start reviewing their procurement practices to reduce costs. Some larger vehicle leasing firms are likely to experience additional pressures, not least of which is

the possibility of reduced buy back payments on vehicles previously purchased from global vehicle manufacturers/distributors, who themselves are likely to be under pressure as a result of the crisis.

Long-term outlook.

Further out, the rental and leasing sector should recover much of its lustre, although like the economy overall, activity levels are likely to be permanently lower than would have been the case had it not been for Covid-19.

Covid-19 will also leave its mark on the rental and leasing industry in other ways. Crises tend to accelerate trends already under way and this current pandemic is no different. The most obvious of these has been the increased use of digital technologies as people have looked to get around the constraints posed by physical and social distancing. Online retail has boomed as a result, flexible work options have been more widely adopted, and firms have expressed a greater openness to new ways of doing business, including peer-to-peer sharing. More is likely to come in this regard, as 4th industrial revolution technologies come to the fore.

These trends will have far reaching implications for the rental and leasing sector. Increasing barriers to trade and the domestication of supply chains will, for example, make it more difficult to import the latest machinery and equipment in a post-Covid-19 world, effectively undermining one of the rental and leasing industry's much touted advantages, which is to be able to deliver the latest equipment at lowest cost at a time when needed. While firms selling the same equipment will face similar difficulties, the erosion of this key advantage suggests a loss of relative competitiveness, which could result in declining rental/lease rates, tighter margins and possible closures.

At the same time, the accelerated adoption of digital technologies spurred on by Covid-19 is likely to further reduce barriers to entry and encourage many new participants into the sector. Peer-to-peer lending, already on the rise as a result of Covid-19, will gain further impetus, resulting in even more disintermediation of traditional rental and leasing activity. Established firms are likely to respond by actively participating in these networks, creating their own where necessary. Those that do not are likely to struggle.

Contact the Westpac economics team.

Dominick Stephens, Chief Economist

+64 9 336 5671

Michael Gordon, Senior Economist

+64 9 336 5670

Satish Ranchhod, Senior Economist

+64 9 336 5668

Paul Clark, Industry Economist

+64 9 336 5656

Any questions email:

electronics@westpac.co.nz

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