FORECAST REPORT 85

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

FOURTH QUARTER 2017

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Cover: AUT MH Building, Auckland

CONFIDENCE TODAY INSPIRES TOMORROW

RIDER LEVETT BUCKNALL

With a network that covers the globe and a heritage spanning over two centuries, Rider Levett Bucknall is a leading independent organisation in cost management and quantity surveying and advisory services.

Our achievements are renowned: from the early days of pioneering quantity surveying, to landmark projects such as the Sydney Opera House, HSBC Headquarters Building in Hong Kong, the 2012 London Olympic Games and CityCenter in Las Vegas.

We continue this successful legacy with our dedication to the value, quality and sustainability of the built environment. Our innovative thinking, global reach, and flawless execution push the boundaries. Taking ambitious projects from an idea to reality.

FORECAST 85

Prepared by the New Zealand Institute of Economic Research (Inc.) exclusively for Rider Levett Bucknall, Forecast is produced quarterly and provides detailed local construction market intelligence and knowledge.

CONSTRUCTION MARKET INTELLIGENCE

Forecast is supplemented by Rider Levett Bucknall's construction market intelligence publications: the International Report, regional (including the Oceania Report) and country specific reports.

KEY POINTS IN THIS ISSUE

Easing in construction activity over first half of 2017

There was a further easing in both residential and non-residential construction activity in the June quarter. Although underlying demand remains strong, capacity pressures in the construction sector are limiting the degree to which activity can ramp up.

But migration-led population growth will support demand

Continued strong migration-led population growth should underpin robust construction demand over coming years.

Strong tourism activity continues to drive demand for new hotels

A continued high inflow of tourists is supporting demand for new hotel developments.

Interest rates likely on hold until late 2018

The growth outlook remains positive. However, softer growth and inflation earlier this year, along with heightened geo-political tensions offshore, means little urgency for the Reserve Bank to lift interest rates. We expect the Official Cash Rate will remain on hold until late 2018.

Grand Central, Christchurch

BUILDING ACTIVITY TRENDS

Construction activity eased further in the June quarter. Although strong migration-led population growth is supporting underlying construction demand, there have been delays in some building developments given higher construction and funding costs and tighter access to credit.

On the supply side, capacity pressures are limiting the extent to which activity can ramp up.

Annual net migration into New Zealand continues to lift to record highs, reflecting New Zealand's more favourable labour market outlook relative to many of the major economies. The effects of strong population growth have been particularly evident in construction activity and retail spending. We expect net migration will remain high over the coming year, as improved job prospects continue to attract migrants to New Zealand.

Migrants have helped to ease labour shortages in capacity constrained sectors such as construction, with growth in work visas over the past year led by jobs in the trades. However, building sector firms continue to report difficulty in finding labour, with labour shortages for skilled workers as acute as that experienced in the previous building boom in 2004.

The relatively high construction cost inflation in Auckland indicates capacity pressures in the Auckland construction sector are more acute than in other regions.

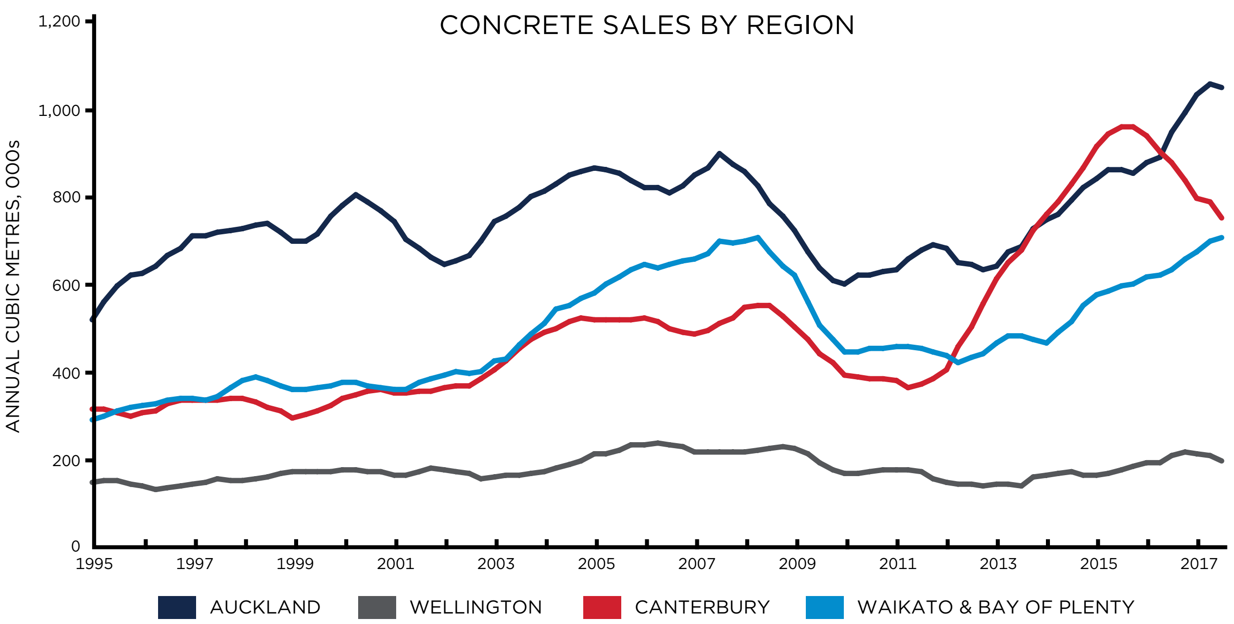
Annual growth in Auckland residential construction costs remained steady at just over 8 percent, in contrast to the moderation in construction cost inflation in the other regions.

With stronger population growth in Auckland likely to support construction activity at high levels, we expect construction cost inflation in the region will remain relatively high.

FIGURE 1

Construction activity slowed over the first half of 2017

Annual volume, thousand cubic metres



Source: Statistics NZ, NZIER

BUILDING ACTIVITY OUTLOOK

Although relatively strong population growth in Auckland points to solid underlying construction demand, higher construction and funding costs and capacity pressures will likely limit the extent of growth in construction activity.

Non-residential construction eased over the first half of 2017. This contraction in construction activity is likely to be temporary. Continued strong tourist inflows are driving demand for new hotel developments, while employment growth underpins further demand for new office space.

ECONOMIC BACKDROP

Although growth and inflation softened in early 2017, more recent activity indicators point to a pick-up in activity from the second half of 2017. Besides growth in construction activity, the outlook for the rural sector has improved with the recovery in global dairy prices. We expect improved rural profitability will support a recovery in on-farm investment over 2018.

The global landscape remains highly uncertain, especially around Brexit, the renegotiation of the North American Free Trade Agreement and the United States' approach to trade with China and South Korea. However, the effects on real activity have been muted so far, with growth lifting (albeit slowly) in the major economies.

For a small open economy such as NZ, the combination of low global inflation and high NZ dollar has put downward pressure on the price of its imported goods. This, along with capacity pressures outside of the construction sector remaining contained, has contributed to low inflation in NZ.

INTEREST AND EXCHANGE RATES

Recent developments indicate little urgency for the Reserve Bank to lift interest rates. We now expect the Reserve Bank will leave the OCR on hold until November 2018, with risks towards a later start to its tightening cycle.

The risk of inflation remaining persistently low has dissipated, but there are also few signs inflation will accelerate. Monetary policy remains very accommodative, and interest rates will have to rise eventually.

However, balanced risks to the growth and inflation outlook afford the Reserve Bank time to be confident inflation is moving towards its 2 percent mid-point target before it commences a measured tightening.

Nonetheless, mortgage rates have increased since the beginning of the year, reflecting higher funding costs and a lift in global interest rates. Higher mortgage rates have dampened interest in the housing market, with house price inflation slowing in recent months.

Although risk aversion has reduced some enthusiasm for the NZ dollar, the more positive outlook for the NZ economy relative to major economies is continuing to support the currency at a high level. We expect that as the prospects for the other major economies improve and the interest rate differential narrows this will drive an easing in the NZ dollar.

BUILDING INVESTMENT

Although construction activity softened over the first half of 2017, the NZIER *Quarterly Survey of Business Opinion's architects'* measure of own activity showed a pick-up in the construction pipeline across residential, non-residential and Government work.

We expect strong population growth and tourism activity will remain key drivers of non-residential construction demand over the coming years.

BUILDING CONSENTS

Demand for new hotel developments remains the top driver of growth in non-residential construction demand. Demand for industrial and social buildings, as well as new office developments, has also been robust over the past year.

The average value per square metre consented has eased from very high levels in recent months, suggesting some moderation in non-residential construction cost inflation.

Building consents by sector

We expect strong population growth will underpin many of the longer-term trends:

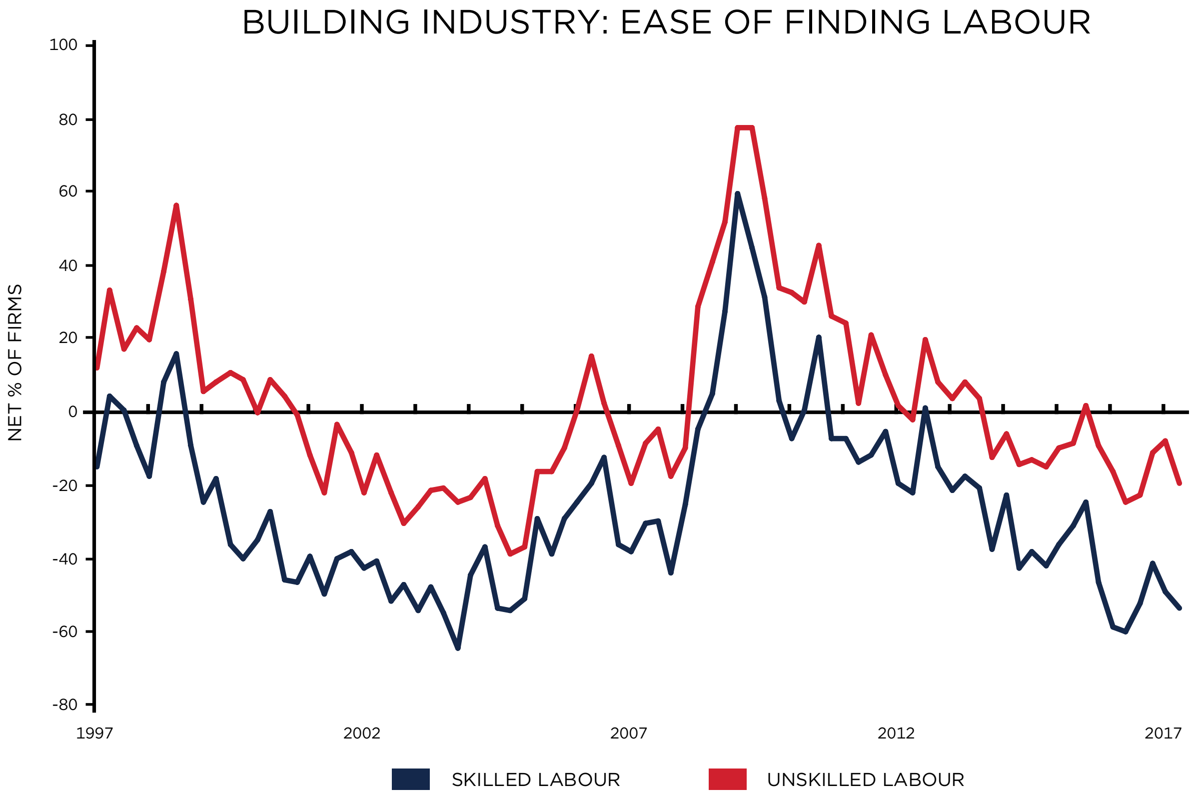
- Office growth to accommodate the higher number of white collar workers.
- Increased public sector spending on education and healthcare facilities.
- New accommodation buildings as supply responds to continued high numbers of international visitors.

We expect earthquake strengthening activity will continue to also contribute to non-residential construction demand.

FIGURE 2

Building sector labour shortages as acute as 2004

Net % of firms reporting ease in finding labour



Source: Statistics NZ, NZIER

Mason Brothers, Wynyard Quarter, Auckland

Building consents by region

Although Auckland continues to lead the way in non-residential construction demand, there has been some easing in non-residential consent issuance in the region in recent months. Non-residential construction has grown very strongly in Auckland over the past year, and capacity pressures have built up as a result.

These capacity pressures are limiting the extent to which construction activity can increase further. Nonetheless, demand remains strong, underpinned by the continued surge in net migration into the region.

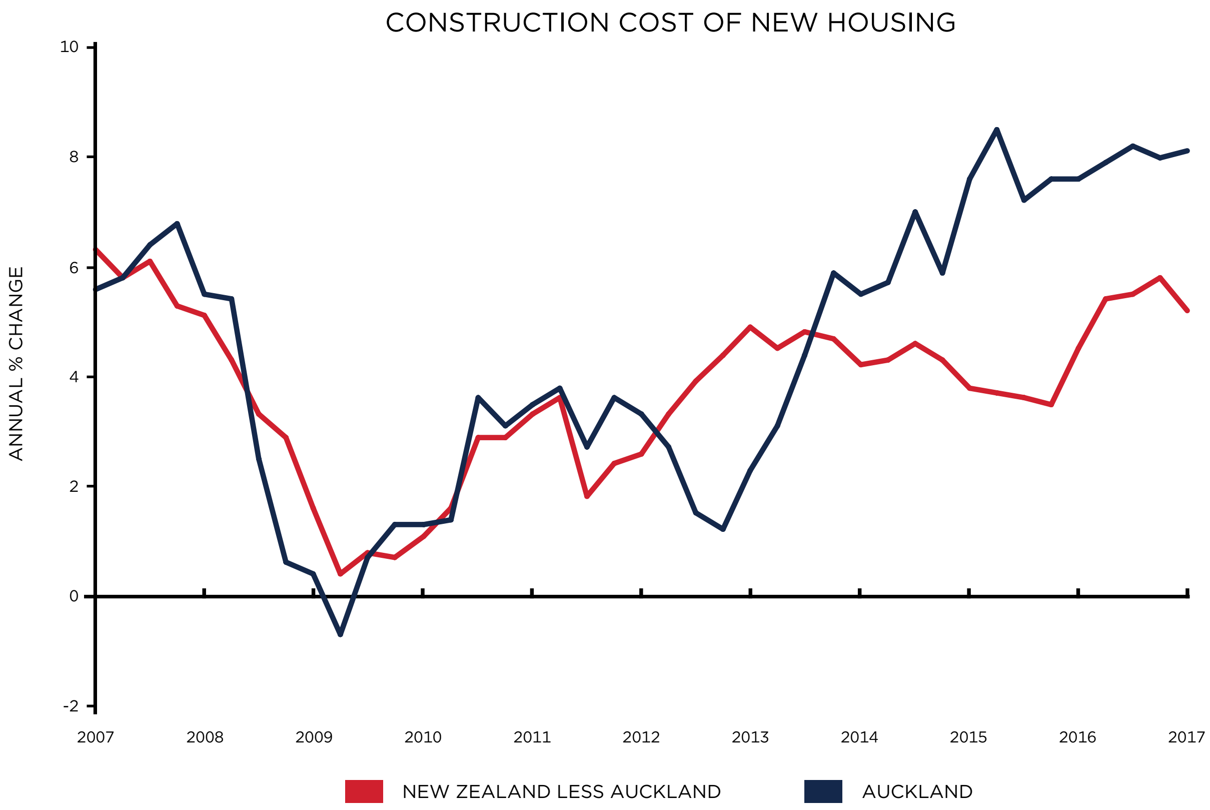
There has also been some easing in non-residential consent issuance in other regions such as Wellington and Otago. Although demand for new hotels and retail outlets in Wellington has been robust over the past year, this has been offset by lower demand for office buildings and industrial buildings. In Otago, the demand for new hotels and retail outlets has fallen over the past year.

Non-residential consent issuance in Canterbury continues to decline, reflecting lower demand for health and education facilities. Although earthquake rebuild activity has peaked, non-residential construction demand in the region should remain at a relatively high level over the next year given population growth and continued improvement in rural sector profitability.

FIGURE 3

Construction cost inflation higher in Auckland

Annual % change in residential construction cost

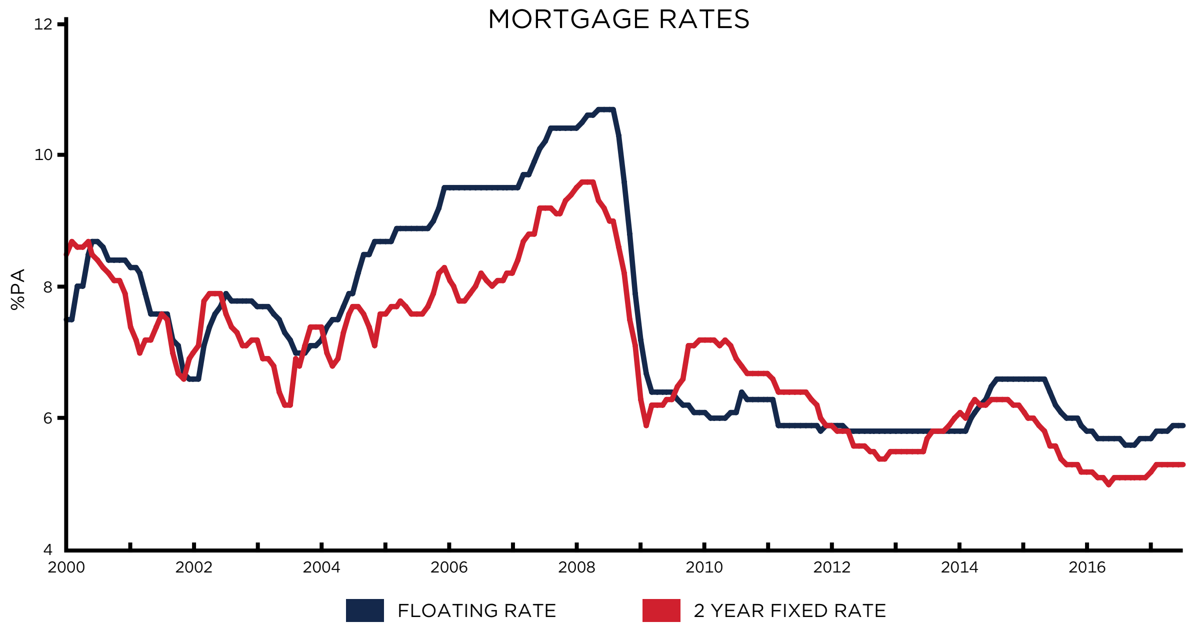


Source: Statistics NZ, NZIER

FIGURE 4

Higher mortgage rates have dampened construction demand

%pa in floating and two year fixed mortgage rates

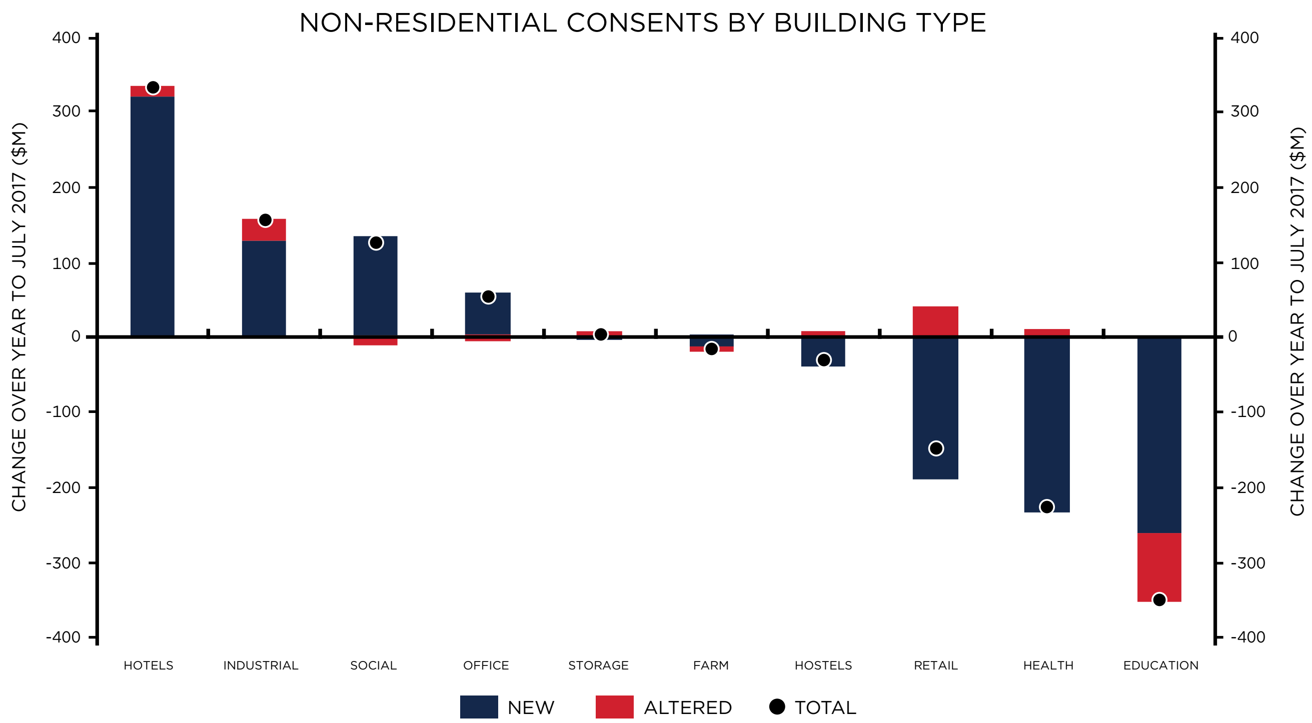


Source: Statistics NZ, NZIER

FIGURE 5

Strong tourism activity continues to drive demand for accommodation buildings

Annual change in consents, $m, year ended July 2017

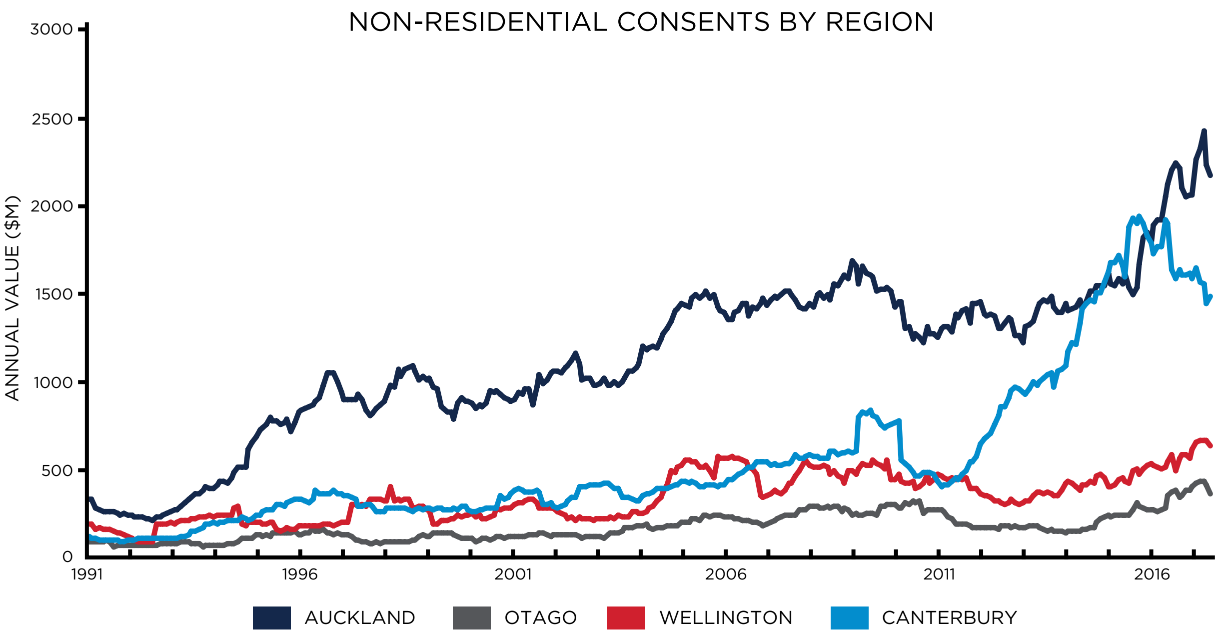


Source: Statistics NZ, NZIER

FIGURE 6

Construction demand eased in recent months

Annual value, $ million



Source: Statistics NZ

TABLE 1

Non-residential building consents by region and sector

$m of consents for the year ending April 2017; red colour shading for decline in consents from previous year

	SECTOR									
REGION	HOSTELS, PRISONS ETC	ACCOMODATION	HEALTH	EDUCATION	SOCIAL, CULTURAL, RELIGIOUS	RETAIL	OFFICE	STORAGE	INDUSTRIAL	FARM
NORTHLAND	0.1	9.4	8.4	25.5	9.3	8.5	8.7	4.8	7.3	10.2
AUCKLAND	114.6	258.3	150.9	294.6	149.3	257.3	540.5	246.9	141.8	23.4
WAIKATO	3.7	18.3	23.1	48.6	26.1	74.0	63.3	51.7	93.9	55.8
BAY OF PLENTY	0.0	3.5	23.0	76.4	23.9	45.0	36.3	50.1	35.6	9.4
GISBORNE	0.0	0.1	1.1	4.6	6.3	0.1	9.6	0.6	2.4	1.4
HAWKE'S BAY	11.5	0.2	12.1	11.1	2.9	11.7	10.9	18.4	46.8	7.2
TARANAKI	0.0	1.3	3.9	16.2	10.9	3.1	10.1	5.3	39.5	20.2
MANAWATU-WANGANUI	6.0	2.4	4.0	20.1	10.5	30.8	14.9	5.7	17.8	15.8
WELLINGTON	14.0	57.2	29.0	112.3	76.3	81.5	217.6	20.6	19.9	7.4
NELSON	0.1	0.0	2.9	2.4	1.3	3.9	27.3	22.7	4.8	0.8
TASMAN	0.0	0.4	0.7	3.8	0.1	1.0	3.8	10.4	7.6	3.5
MARLBOROUGH	7.6	0.1	1.6	6.9	4.1	0.9	7.1	4.0	15.5	5.3
WEST COAST	0.0	8.7	53.4	0.6	2.2	1.8	0.5	0.8	0.2	2.8
CANTERBURY	27.2	99.5	123.4	265.6	163.6	154.1	248.3	254.2	97.8	47.7
OTAGO	21.7	32.7	17.2	113.8	28.1	45.7	34.6	16.9	30.6	16.9
SOUTHLAND	5.2	1.1	1.2	6.6	0.7	6.9	3.8	7.4	32.1	11.4

Source: Statistics NZ, NZIER

Terminal South Extension, Wellington International Airport, Wellington

BUILDING COSTS

The Capital Goods Price Index for Non-Residential Buildings (CGPI-NRB) (the Index) is an official measure of cost movements in the sector. The Index excludes GST. We use the Index as an indicator of cost escalation.

The Index is a national average across all building types. We therefore advise caution in applying the increase in the CGPI-NRB as an indicator of cost escalation for specific projects.

The Rider Levett Bucknall Third Quarter 2017 Oceania Report provides local regional comment and tender price relativity between the main New Zealand and Australian centres. This publication is available at www.rlb.com or on request from any Rider Levett Bucknall office.

We forecast construction cost inflation to moderate to below 5 percent by the end of this year. Beyond 2017, we expect annual construction cost inflation to remain relatively high at over 4 percent through to 2019.

Despite the solid construction growth outlook for the next three years, we do not expect the inflation to be as sharp as the mid-2000s given that the lower inflation environment limits the extent to which rising costs can be passed on quickly, and strong net migration is helping to mitigate skills shortages in the building sector.

FIGURE 7

Non-residential building cost escalation

CGPI-NRB index, annual % change

Source: Statistics NZ, NZIER forecasts

TABLE 2

Non-residential building cost index

YEAR	QUARTER	INDEX	QUARTERLY % CHANGE	ANNUAL % CHANGE
2012	MARCH	1351	0.1	1.3
	JUNE	1352	0.1	0.7
	SEPTEMBER	1354	0.1	0.5
	DECEMBER	1358	0.3	0.7
2013	MARCH	1365	0.5	1.0
	JUNE	1372	0.5	1.5
	SEPTEMBER	1383	0.8	2.1
	DECEMBER	1402	1.4	3.2
2014	MARCH	1413	0.8	3.5
	JUNE	1429	1.1	4.2
	SEPTEMBER	1440	0.8	4.1
	DECEMBER	1456	1.1	3.9
2015	MARCH	1471	1.0	4.1
	JUNE	1480	0.6	3.6
	SEPTEMBER	1494	0.9	3.8
	DECEMBER	1502	0.5	3.2
2016	MARCH	1514	0.8	2.9
	JUNE	1529	1.0	3.3
	SEPTEMBER	1548	1.2	3.6
	DECEMBER	1586	2.5	5.6
2017	MARCH	1595	0.6	5.4
	JUNE	1613	1.1	5.5
	SEPTEMBER	1633	1.2	5.5
	DECEMBER	1654	1.3	4.3
2018	MARCH	1673	1.2	4.9
	JUNE	1692	1.1	4.9
	SEPTEMBER	1709	1.0	4.7
	DECEMBER	1727	1.1	4.4
2019	MARCH	1745	1.0	4.3
	JUNE	1762	1.0	4.2
	SEPTEMBER	1779	1.0	4.1
	DECEMBER	1796	0.9	4.0
2020	MARCH	1812	0.9	3.9
	JUNE	1829	0.9	3.8
	SEPTEMBER	1846	0.9	3.7
	DECEMBER	1863	0.9	3.7
2021	MARCH	1881	0.9	3.8
	JUNE	1898	0.9	3.8
	SEPTEMBER	1916	0.9	3.8
	DECEMBER	1933	0.9	3.7

Notes: The current and forecast CGPI-NRB is a national average, which does not differentiate between regions or building types. We therefore advise caution in applying the increase in the CGPI-NRB as a measure of cost escalation for specific building projects.

Source: Statistics NZ, NZIER forecasts

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