FOURTH QUARTER 2022

# FORECAST REPORT 103

## NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

RLB Rider Levett Bucknall

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## FORECAST 103

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 Australia Report) and country specific reports.

# KEY POINTS IN THIS ISSUE

Construction activity remained strong in the second half of 2022, and consent issuance points to a solid pipeline of construction for much of 2023. However, forward-looking indicators suggest a weakening in construction demand which we expect will become more apparent from the second half of this year.

### Solid construction pipeline for now

Recent indicators point to the construction outlook being split into two halves: solid activity for the first half of 2023 but declining from the second half of this year. The high level of consent issuance should underpin construction activity at a high level for much of 2023. In particular, there continues to be a shift towards demand for the construction of medium-density housing.

### But building sector firms feel very downbeat

However, the latest NZIER Quarterly Survey of Business Opinion shows building sector firms are feeling very downbeat amidst signs of weakening demand. Cost pressures in the construction sector remain intense, but fewer firms were able to increase prices.

### The rapid increase in interest rates weighing on construction demand

The Reserve Bank of New Zealand (RBNZ) released a more hawkish than expected November *Monetary Policy Statement* (MPS) to accompany its 75 basis point increase in the Official Cash Rate (OCR). The central bank indicated it expected to increase the OCR to 5.5 percent to dampen demand and bring inflation down towards its 1 to 3 percent inflation target band.

### Future outlook

The sharp increase in interest rates is weighing on the construction outlook and confidence. With businesses feeling much more cautious about investment, particularly in buildings, the longer-term private sector construction outlook is weaker. However, we expect a recovery in migration-led population growth to underpin infrastructure construction demand.

Dark Sky Project, Tekapo

# BUILDING ACTIVITY TRENDS

Stats NZ Building Work Put in Place shows construction activity remained strong heading into the second half of 2022. Residential construction increased by 3.1 percent, while non-residential construction increased by 4.9 percent in the September 2022 quarter. The result continues the solid recovery in construction activity since lockdown restrictions were relaxed in December 2021.

While COVID-19 infections continued to cause disruptions in building activity and the supply of building materials, construction has generally been rising over the past year. This growth in construction has been broad-based across the regions but was particularly strong in Auckland. This reflects strong growth in both residential and non-residential construction in the region. With annual dwelling consent issuance in Auckland totalling over 21,000 in recent months, we expect construction activity will remain strong over much of this year.

The continued high level of dwelling consent issuance should underpin strong residential construction activity over the first half of 2023. There continues to be a shift in demand towards medium-density housing, with a continued surge in consent issuance for townhouses and flats in recent months. This is in contrast to the decline in consent issuance for standalone houses. We expect this trend to continue over the coming years as urban densification continues to increase against a backdrop of population growth and a shortage of centrally located land.

However, there are signs of a weakening in construction demand over the longer term. The latest NZIER Quarterly Survey of Business Opinion (QSBO) showed the building sector was the most downbeat of the sectors surveyed in the December 2022 quarter. A net 77 percent of building sector firms expect general economic conditions over the coming months to deteriorate. Firms reported a decline in new orders and output, consistent with anecdotes of an easing in the number of enquiries for new construction work.

The NZIER QSBO architects' measure of work in their own office also points to a softening in the longer-term pipeline of construction activity. In particular, a greater proportion of architects report a decline in the pipeline of housing and commercial construction over the coming year. Although architects report growth in the pipeline of Government construction work, this growth has slowed. We expect the weakening in residential and non-residential construction activity will become more apparent from the second half of 2023.

As private sector construction eases, we expect this will free up capacity for infrastructure construction to ramp up further. Te Waihanga, the New Zealand Infrastructure Commission estimates the National Infrastructure Pipeline increased to $76.9 billion in the third quarter of 2022, with $12.9 billion of this forecast to be spent in 2023.[1] Much of this infrastructure spending in the near term is expected to be focused on social housing, education, health and community facilities.

Building sector firms face many headwinds. Demand is starting to soften, but firms face continued intense cost pressures in the construction sector, with over 80 percent of building sector firms reporting higher costs in the December 2022 quarter. However, only 36 percent of building sector firms raised prices that quarter, suggesting a further squeezing of operating margins as softer demand limit the ability of firms to pass on higher costs. However, a net 65 percent of building sector firms are expecting to increase their prices in the March 2023 quarter.

The Stats NZ Capital Goods Price Index (CGPI) across the different construction sectors also show a mixed picture for construction cost escalation. Residential construction cost inflation continued to moderate, albeit from record-high rates of growth, in the September quarter. Annual growth in non-residential construction costs also eased in the September quarter but remained elevated at 10.5 percent.

In contrast, annual growth in civil construction costs increased to 14.6 percent. These differences in construction cost inflation across the sectors reflect their differing outlooks. The easing in private sector construction demand is helping to alleviate capacity pressures in the residential and non-residential construction sectors, thus driving a moderation in construction cost inflation. However, stronger demand for infrastructure construction is exacerbating capacity pressures in this sector and driving a continued pick-up in civil construction cost escalation.

1 https://www.tewaihanga.govt.nz/assets/Uploads/Infrastructure-Quarterly-November-2022-v2.pdf

# BUILDING ACTIVITY OUTLOOK

The outlook for the construction sector is split into two halves: we expect solid activity in the near term but a softening in construction activity to become more apparent from the second half of 2023. Although a high level of consent issuance should underpin robust construction activity over the first half of this year, the slowing in building enquiries and drop in new orders and output point to weakening activity from the second half of 2023.

Rising interest rates and tighter access to credit are key factors weighing on construction demand. Interest rates have risen sharply over the past year, which is reducing the amount borrowers can borrow. Added to that, banks have become more cautious when it comes to assessing the serviceability of debt for lending on property. The RBNZ Survey of Credit Conditions shows banks' appetite for residential and commercial property lending has reduced over 2022. We expect this caution towards lending for property to remain over the coming year.

The most apparent impact of higher interest rates has been on the housing market, with house sales and prices falling over 2022. Real Estate Institute of New Zealand (REINZ) housing market data for December 2022 shows the number of house sales nationwide fell almost 40 percent from the same month a year ago. The decline in house prices over the past year was more muted at 13.7 percent, according to the REINZ House Price Index (HPI). Despite this fall in house prices over the past year, prices are still almost 20 percent above pre-COVID-19 levels at March 2020. We expect a further decline in house prices in the face of further interest rate increases and as some sellers adjust their house price expectations.

Lower house prices should also reduce the incentives for property developers to bring new housing supply onto the market. This should also contribute to weaker residential construction demand later this year.

## ECONOMIC BACKDROP

The New Zealand economy is facing increasing headwinds, primarily from higher costs and interest rates. The latest NZIER QSBO showed business confidence at a new record low in the December quarter (since the survey measure first started in March 1970), with a net 73 percent of businesses expecting general economic conditions to worsen over the coming months. Added to that was the decline in activity in firms' own business, which suggests a weakening in economic activity in the final quarter of 2022.

Businesses face increased uncertainty over the economic outlook. Along with rising costs and interest rates, the COVID-19 pandemic continues to cause disruptions, particularly in China, as it navigates its pivot away from its zero-COVID strategy. Meanwhile, the ongoing war in Ukraine is underpinning higher energy prices globally and adding to the uncertainty.

This uncertainty is leading businesses to become more cautious about hiring and investment. A net 2 percent of businesses reduced staff numbers in the final quarter of 2022, a net 28 percent planned to reduce investment in plant and machinery, while a net 39 percent planned to reduce investment in buildings for the coming year.

The building sector is particularly downbeat against this backdrop of increased aversion towards investment in buildings. A net 77 percent of building sector firms expect a deterioration in the general economic outlook over the coming months, given the decline in output and new orders they are experiencing.

Despite increasing signs of a downturn in economic activity, cost and pricing measures remain elevated. Over 80 percent of firms surveyed reported they faced higher costs, while the proportion of firms which raised prices in the December quarter increased to 67 percent. These developments suggest that high inflation will likely persist in the New Zealand economy despite softening demand over 2023.

## INTEREST AND EXCHANGE RATES

The continued intensity of inflation in the New Zealand economy means the RBNZ would have to increase interest rates further to dampen demand to bring inflation down towards its 1 to 3 percent inflation target band. Nonetheless, the RBNZ surprised many with its much more hawkish than expected November MPS. In addition to its 75 basis point OCR increase, the central bank indicated in its accompanying statement that it expected to raise interest rates by much more than it had previously indicated. Alongside its projections for a shallow recession for the New Zealand economy was its forecast OCR peak of 5.5 percent.

We expect a lower OCR peak of 5 percent, given the lagged effects of higher interest rates which have yet to fully pass through the New Zealand economy. With almost half of mortgages due for repricing over the coming year, many of these households will be rolling off historically low fixed term mortgage rates of 2 to 3 percent onto significantly higher rates of 6 to 7 percent. We expect households will rein in discretionary spending in the face of the substantial increase in mortgage repayments. This should slow retail spending and flow through to broader economic activity. We expect this slowing to become more apparent in the second half of this year. Nonetheless, the lagged transmission of monetary policy onto the broader economy heightens the risk of over-correction for the RBNZ.

Offshore developments also suggest the RBNZ will become more cautious in its tightening of monetary policy over the coming year. Markets have pared back interest rate expectations for the US Federal Reserve, given signs of a slowing in inflation, with markets now expecting a 25 basis point increase in its policy rate in the February meeting.

Across the Tasman, the Reserve Bank of Australia (RBA) has already slowed its pace of policy rate increases, with the discussion shifting to expectations of a peak in the policy rate below 4 percent. The relatively greater proportion of Australian mortgages on floating mortgage rates means that the transmission of monetary policy onto the broader Australian economy has been much quicker. With the slowing in the Australian economy underway, the market is considering a halt to further monetary policy tightening as early as its February meeting.

The hawkish tone of the RBNZ November MPS and expectations of slowing in monetary policy tightening by other major central banks have increased the yield attractiveness of the New Zealand dollar. These developments have underpinned an appreciation in the NZD/USD to 65 cents since the start of 2023, despite ongoing concerns about the global economic outlook and heightened geopolitical tensions.

## BUILDING INVESTMENT

Increased caution about business investment has weighed on private sector demand for construction. We expect a continued divergence between slowing demand for residential and commercial construction and continued growth in Government spending on infrastructure construction.

The Australian New Zealand Infrastructure Pipeline released late last year shows 37 major infrastructure projects underway in New Zealand,[2] with A$5 billion under procurement and A$3 billion awarded.

## BUILDING CONSENTS

Over the past year, growth in non-residential construction demand has been driven by stronger demand for office and storage buildings. Demand for the construction of health facilities also increased over the past year, although to a much lesser extent. This growth contrasts with the reduced demand for the construction of accommodation buildings over the past year, reflecting the effects of international border restrictions in recent years.

2 https://infrastructurepipeline.org/charts/location-sector

Wakefield Hospital, Wellington

### Building consents by sector

Stronger demand for the construction of office buildings led to an increase in non-residential construction demand over the past year. This largely reflected demand for new office buildings, although consent issuance for alterations to office buildings also increased over the past year. While this should support a solid pipeline of construction work, we expect increased caution amongst businesses will weigh on demand for new office buildings over the longer term.

Demand for the construction of storage buildings also grew strongly over the past year, reflecting the renewed focus amongst businesses to bolster the resilience of their supply chains. This is in response to the disruptions in manufacturing and logistics arising from the COVID-19 pandemic. We expect demand for construction in this sector to remain strong over the coming year.

Growth in demand for the construction of health facilities has slowed, although it remains in the top three drivers of growth in non-residential construction. The COVID-19 pandemic increased the demand for healthcare. Over the longer term, we expect the ageing New Zealand population to support continued demand for healthcare facilities.

As many households face higher mortgage repayments over the coming year with the repricing of fixed term mortgage rates, the slowing in retail spending should weigh on demand for new retail outlets.

Meanwhile, demand for accommodation buildings has declined over the past year, reflecting the effects of weaker tourism spending and population growth due to international border restrictions. We expect a recovery in international tourism will support increased demand for accommodation buildings over the coming year. This recovery will be tempered to some degree by the effects of rising interest rates globally, which would likely see households rein in discretionary spending.

### Building consents by region

Non-residential construction consent issuance was mixed across the regions, with growth largely concentrated in the main centres. Auckland led the way with strong growth in consent issuance over the past year, particularly for healthcare facilities, office and storage buildings. This growth more than offset reduced demand for the construction of accommodation buildings and retail outlets, reflecting the impact of the relatively weak Auckland housing market on the household sector. We expect non-residential construction demand in the region to slow over the coming year as the impact of interest rates and weaker housing market flow through to broader economic activity.

Growth in non-residential consent issuance in Waikato was a distant second, with stronger demand for healthcare facilities and education buildings driving this growth over the past year.

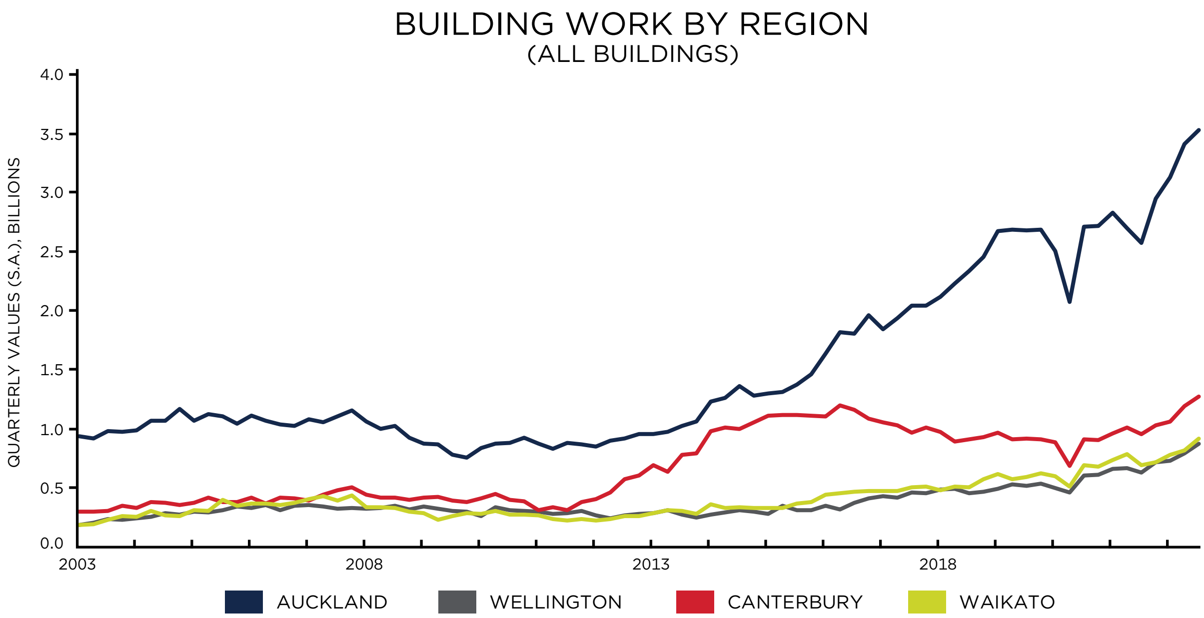
Meanwhile, Canterbury continued to see stronger demand for non-residential construction largely because of increased demand for storage and social buildings. This more than offset weaker demand for accommodation buildings and healthcare facilities over the past year.

In contrast, there was a substantial decline in non-residential consent issuance in Taranaki over the past year. This largely reflected reduced demand for the construction of healthcare facilities in the region.

## FIGURE 1

**Construction activity still strong in the second half of 2022**

Quarterly values, $ billions

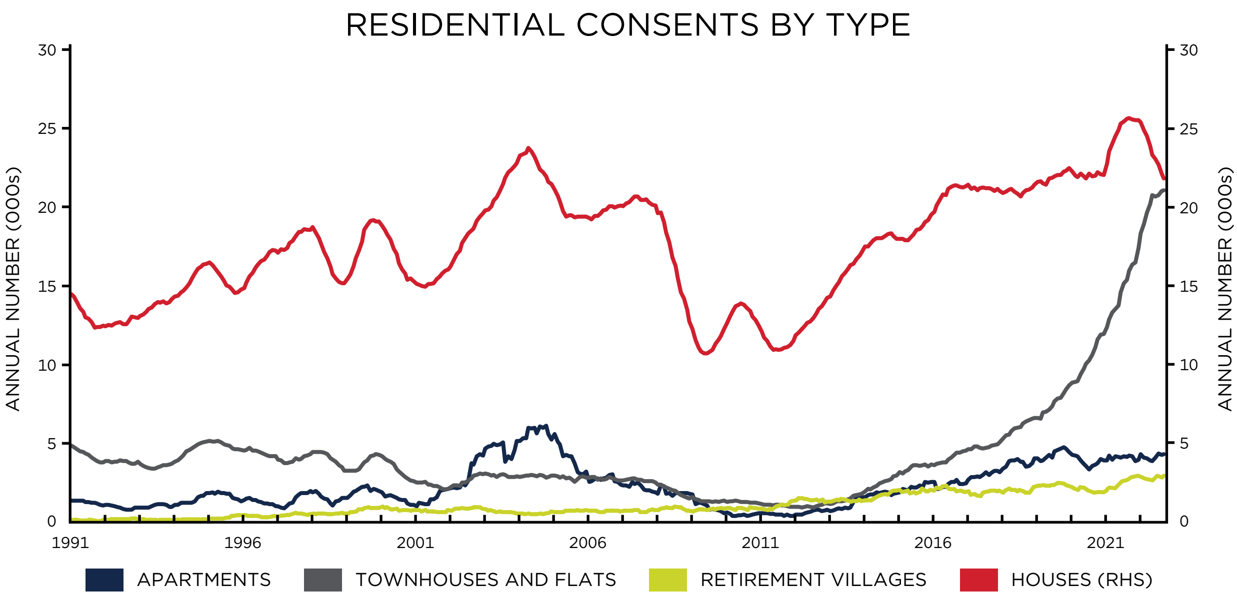



Source: Stats NZ

## FIGURE 2

**Solid pipeline of work for much of 2023**

Annual number of consents

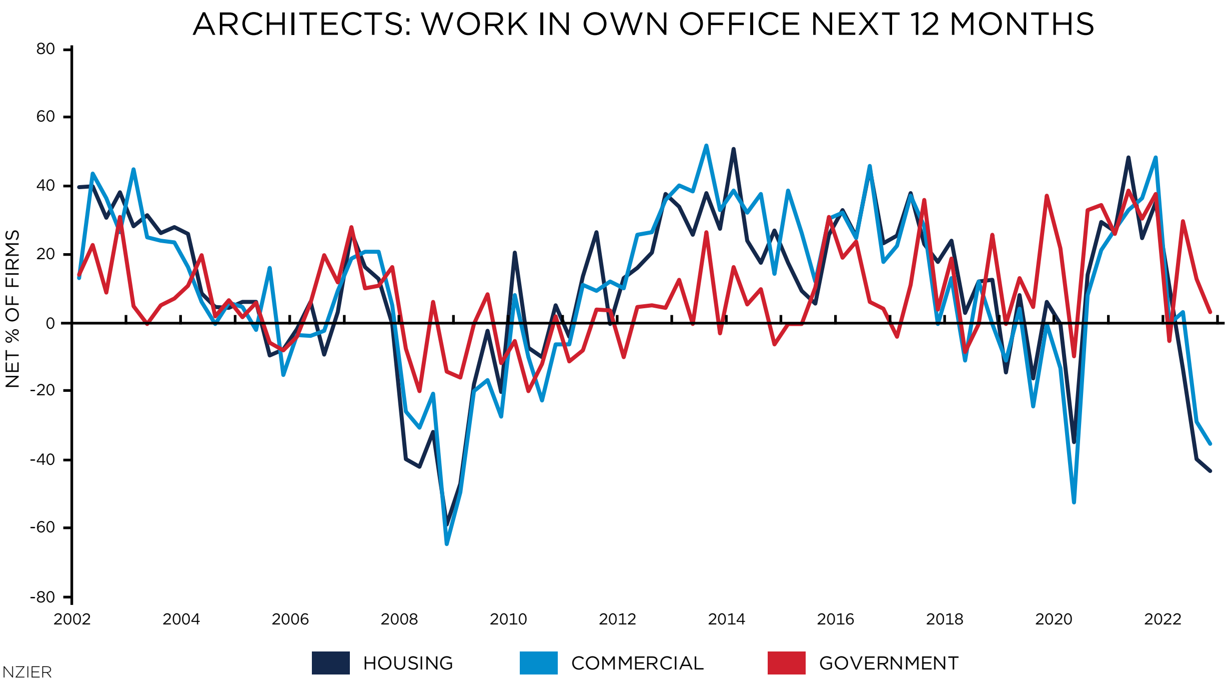



Source: Stats NZ

## FIGURE 3

**Weakening in construction activity should be more apparent in late 2023**

Net % of firms

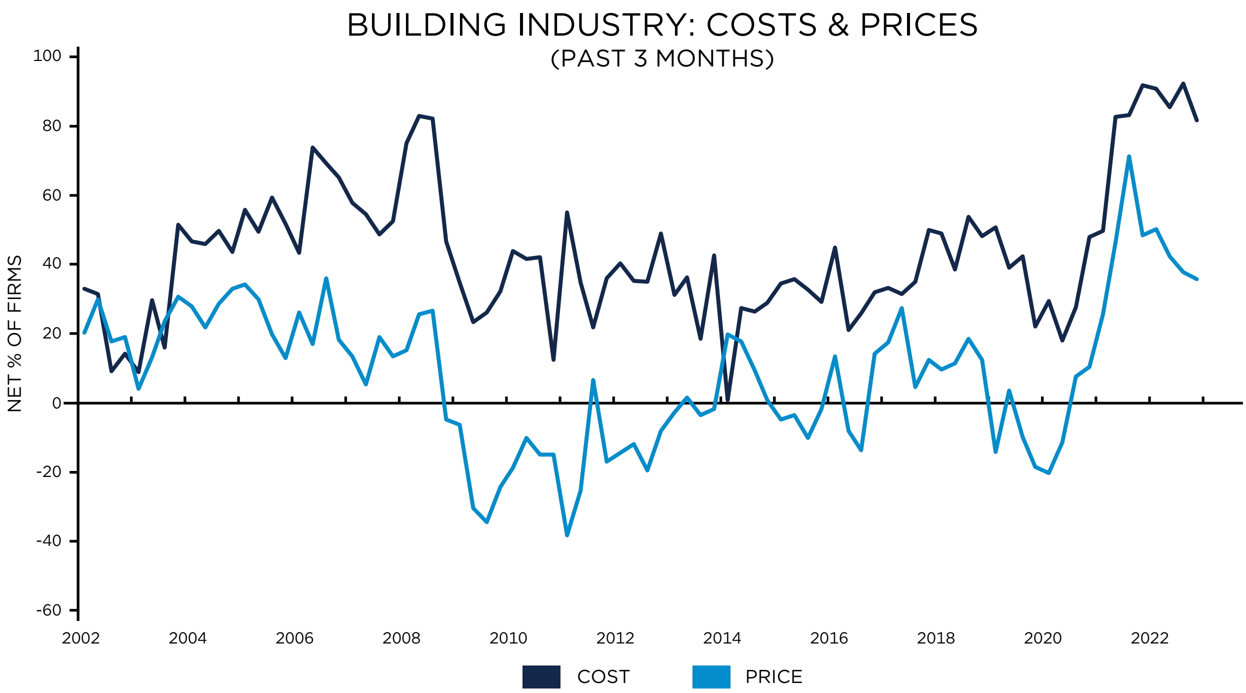



Source: NZIER

## FIGURE 4

**Cost pressures remain intense, but fewer firms are increasing prices**

Net % of firms



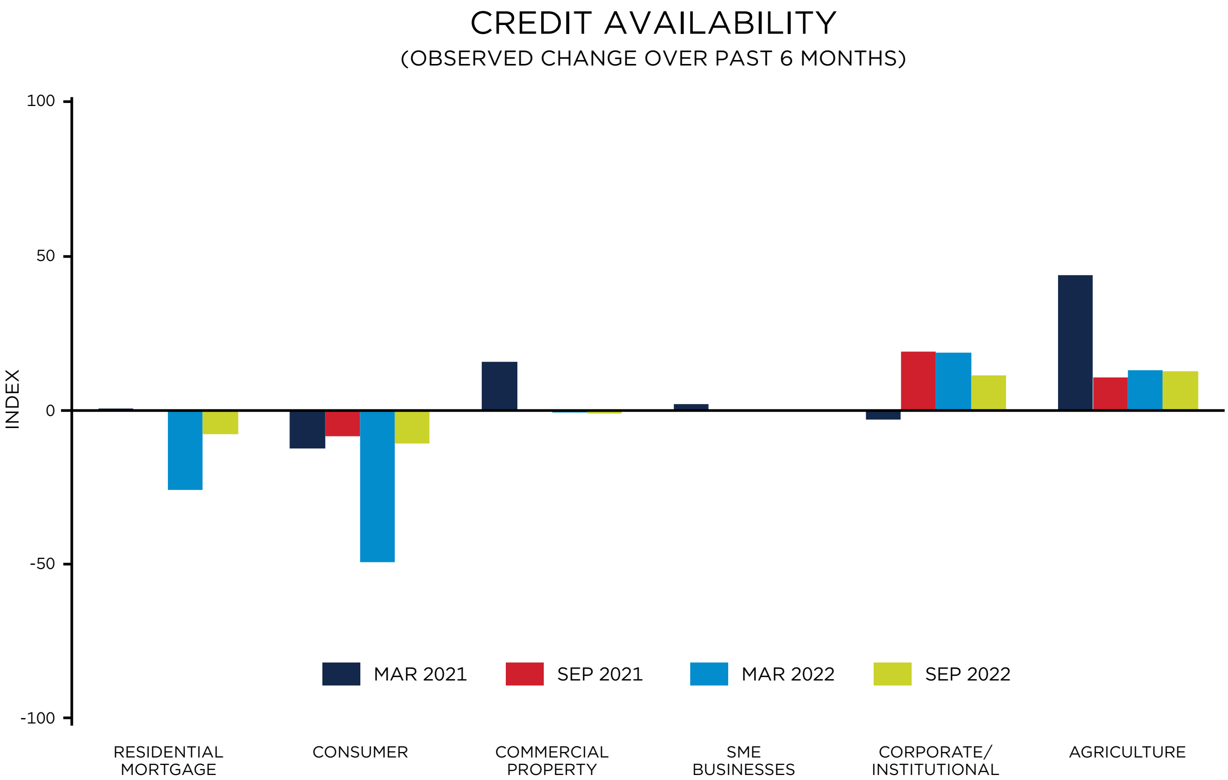

Source: NZIER


Christchurch International Airport Limited Agri Export Precinct, Christchurch, New Zealand

**FIGURE 5**

**Banks remain cautious about lending for property**

Index (change from 6 months ago)

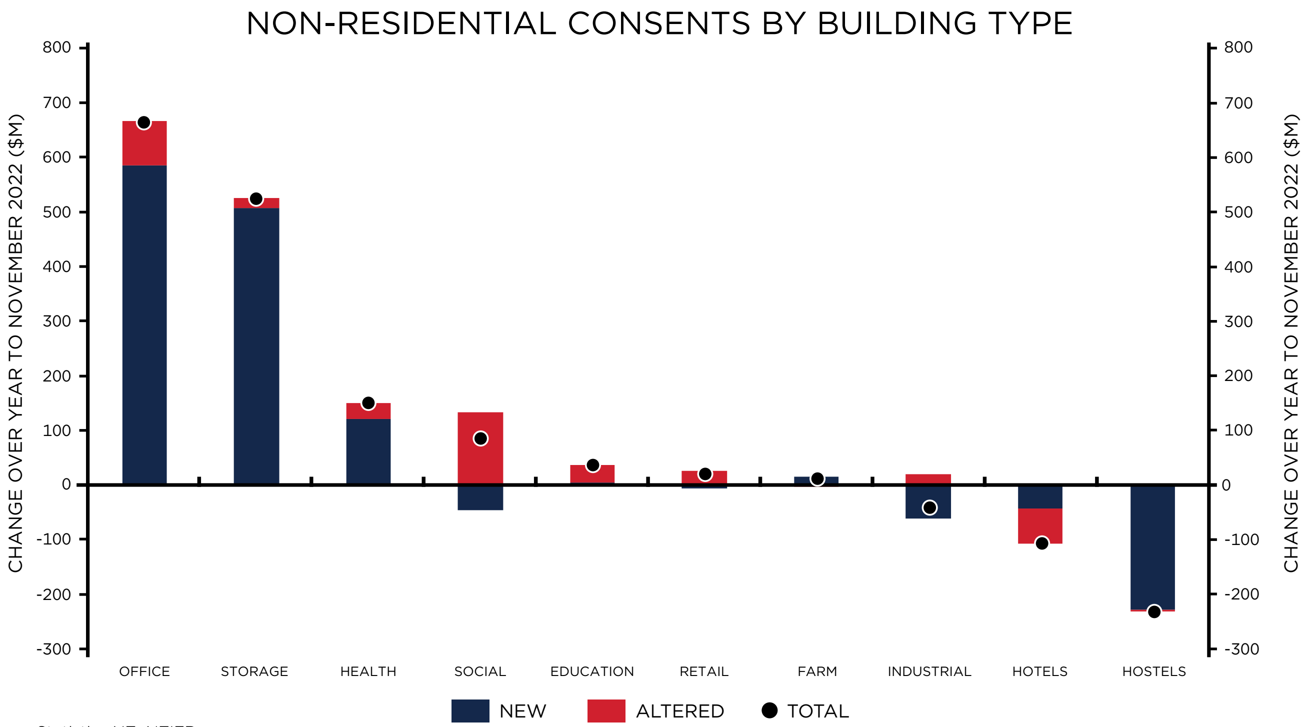



Source: RBNZ

## FIGURE 6

**Demand for office and storage buildings leads the way in growth in non-residential construction demand**

Change over year to November 2022




Source: Statistics NZ, NZIER

## TABLE 1

**Non-residential building consents by region and sector**

$m of consents for the year ending November 2022; 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** | 11.7 | 8.9 | 61.2 | 29.4 | 21.8 | 43.6 | 16.8 | 13.1 | 14.1 | 17.5 |
| **AUCKLAND** | 34.8 | 159.2 | 700.0 | 604.7 | 110.0 | 247.9 | 870.3 | 695.2 | 338.6 | 22.3 |
| **WAIKATO** | 0.5 | 12.4 | 91.4 | 133.4 | 44.4 | 68.8 | 113.1 | 232.3 | 182.7 | 75.5 |
| **BAY OF PLENTY** | 0.9 | 16.2 | 34.8 | 110.3 | 39.1 | 79.1 | 50.3 | 74.7 | 52.8 | 15.3 |
| **GISBORNE** | 0.6 | 0.2 | 0.6 | 8.9 | 48.2 | 2.8 | 2.6 | 5.9 | 14.9 | 2.8 |
| **HAWKE'S BAY** | 3.6 | 14.9 | 30.5 | 74.2 | 15.7 | 18.2 | 20.8 | 70.7 | 80.2 | 5.3 |
| **TARANAKI** | 0.0 | 0.0 | 8.0 | 10.9 | 9.2 | 4.3 | 13.4 | 23.4 | 16.8 | 17.9 |
| **MANAWATU-WANGANUI** | 3.4 | 5.1 | 14.0 | 59.9 | 23.8 | 27.7 | 39.8 | 30.9 | 119.3 | 30.2 |
| **WELLINGTON** | 21.8 | 29.4 | 40.3 | 119.1 | 95.9 | 42.1 | 403.3 | 69.6 | 30.6 | 11.9 |
| **NELSON** | 0.0 | 0.5 | 5.0 | 9.2 | 1.3 | 6.2 | 2.5 | 2.4 | 3.0 | 0.2 |
| **TASMAN** | 2.5 | 0.7 | 3.7 | 29.3 | 4.9 | 5.0 | 3.6 | 10.0 | 20.6 | 4.5 |
| **MARLBOROUGH** | 2.0 | 0.0 | 1.8 | 5.6 | 1.4 | 19.1 | 2.8 | 7.2 | 16.8 | 4.2 |
| **WEST COAST** | 0.0 | 1.5 | 2.9 | 2.0 | 18.3 | 10.9 | 0.6 | 2.1 | 4.0 | 11.1 |
| **CANTERBURY** | 2.2 | 15.3 | 107.4 | 260.6 | 231.4 | 150.9 | 58.6 | 261.3 | 213.4 | 44.0 |
| **OTAGO** | 14.6 | 19.5 | 109.6 | 57.9 | 19.6 | 83.9 | 93.4 | 31.5 | 55.3 | 29.3 |
| **SOUTHLAND** | 1.1 | 4.8 | 2.0 | 9.3 | 5.6 | 11.7 | 19.7 | 12.7 | 37.4 | 25.3 |

Source: Statistics NZ, NZIER

Tamaoho School, Auckland

# 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, and 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.

Non-residential construction cost inflation eased in the September 2022 quarter. The 1.5 percent increase in non-residential construction costs over the quarter saw annual non-residential construction cost inflation moderate from its record high to 10.5 percent for the year to September – still very elevated from a historical perspective.

We expect quarterly increases in non-residential construction costs to persist near current levels for the first half of 2023, reflecting the lingering effects of intense cost pressures in the construction sector. In annual growth terms, this will mean further moderation in non-residential construction cost inflation. We expect capacity pressures to ease over the coming years as the relaxation of immigration settings helps alleviate labour shortages while the easing in global shipping costs reduces other costs.

Nonetheless, we expect annual non-residential construction cost inflation to remain above 5 percent at the end of this year, reflecting the construction sector's high inflation environment. Beyond 2023, we expect further easing in capacity pressures in the construction sector will drive annual non-residential construction cost inflation to below 3 percent later in 2026.

**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 |
|---|---|---|---|---|
| 2017 | MARCH | 1601 | 0.6 | 5.4 |
| | JUNE | 1618 | 1.1 | 5.5 |
| | SEPTEMBER | 1635 | 1.1 | 5.3 |
| | DECEMBER | 1656 | 1.3 | 4.1 |
| 2018 | MARCH | 1670 | 0.8 | 4.3 |
| | JUNE | 1689 | 1.1 | 4.4 |
| | SEPTEMBER | 1711 | 1.3 | 4.6 |
| | DECEMBER | 1731 | 1.2 | 4.5 |
| 2019 | MARCH | 1747 | 0.9 | 4.6 |
| | JUNE | 1762 | 0.9 | 4.3 |
| | SEPTEMBER | 1799 | 2.1 | 5.1 |
| | DECEMBER | 1825 | 1.4 | 5.4 |
| 2020 | MARCH | 1838 | 0.7 | 5.2 |
| | JUNE | 1841 | 0.2 | 4.5 |
| | SEPTEMBER | 1843 | 0.1 | 2.4 |
| | DECEMBER | 1860 | 0.9 | 1.9 |
| 2021 | MARCH | 1867 | 0.4 | 1.6 |
| | JUNE | 1925 | 3.1 | 4.6 |
| | SEPTEMBER | 1960 | 1.8 | 6.3 |
| | DECEMBER | 2003 | 2.2 | 7.7 |
| 2022 | MARCH | 2060 | 2.8 | 10.3 |
| | JUNE | 2134 | 3.6 | 10.9 |
| | SEPTEMBER | 2166 | 1.5 | 10.5 |
| | DECEMBER | 2198 | 1.5 | 9.8 |
| 2023 | MARCH | 2229 | 1.4 | 8.2 |
| | JUNE | 2260 | 1.4 | 5.9 |
| | SEPTEMBER | 2289 | 1.3 | 5.7 |
| | DECEMBER | 2317 | 1.2 | 5.4 |
| 2024 | MARCH | 2344 | 1.2 | 5.1 |
| | JUNE | 2371 | 1.2 | 4.9 |
| | SEPTEMBER | 2397 | 1.1 | 4.7 |
| | DECEMBER | 2423 | 1.1 | 4.6 |
| 2025 | MARCH | 2448 | 1.0 | 4.4 |
| | JUNE | 2472 | 1.0 | 4.2 |
| | SEPTEMBER | 2493 | 0.9 | 4.0 |
| | DECEMBER | 2514 | 0.8 | 3.8 |
| 2026 | MARCH | 2533 | 0.7 | 3.5 |
| | JUNE | 2551 | 0.7 | 3.2 |
| | SEPTEMBER | 2567 | 0.6 | 2.9 |
| | DECEMBER | 2583 | 0.6 | 2.7 |

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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