SECOND QUARTER 2023

FORECAST REPORT 105

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

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Cover: Pā Reo Campus, Ōtaki

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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 105

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

Although construction activity remained solid in the first quarter of 2023, there are increasing signs of slowing demand ahead. The decline in building consent issuance points to easing construction activity over the coming years, even with the post-storm rebuilding in 2024.

Reduced construction pipeline

Construction activity picked up in the first quarter of 2023, driven by continued growth in non-residential construction. Meanwhile, there was another easing in residential construction, and indicators point to a further decline in the pipeline of residential construction work.

Building sector firms still feeling downbeat

The latest NZIER Quarterly Survey of Business Opinion shows some improvement in confidence in the building sector, but overall, firms still remain downbeat.

Easing cost pressures

Cost and pricing indicators in the construction sector point to further moderation in construction cost inflation from elevated levels. The easing in capacity pressures means cost pressures are less intense, but slowing construction demand is also limiting pricing power for firms.

Future outlook

Although the Reserve Bank has indicated it does not expect to raise the Official Cash Rate (OCR) any further, we expect the impact of the interest rate increases to date will continue to dampen construction demand. Over the longer term, we expect migration-led population growth to continue supporting infrastructure construction demand.

Tākina Wellington Convention & Exhibition Centre, Wellington

BUILDING ACTIVITY TRENDS

Stats NZ Building Work Put in Place showed construction activity picked up slightly in the first quarter of 2023 on the back of growth in non-residential construction. In contrast, residential construction continued to ease.

Across the regions, construction activity continued to grow strongly in Auckland and Canterbury but was subdued in Wellington and Waikato. However, more forward-looking indicators suggest construction demand will soften later in the year.

In particular, consent issuance continued to ease from high levels, with new dwelling consent issuance for the year to May 2023 falling to 45,159 – markedly lower than the record high of 51,015 in the previous year. The decline over the past year has been particularly apparent in Auckland, reflecting the region's more severe housing market downturn.

This easing in residential construction demand has broadened to townhouses and flats. Over the past year, the decline in dwelling consent issuance had been concentrated in standalone houses as demand shifted towards medium-density housing, given the scarcity of centrally located land.

However, there has also been a decline in consent issuance for townhouses and flats in recent months, reflecting the broad-based decline in demand for house-building as financial conditions in New Zealand tightened. Higher interest rates, tighter access to finance and lower house prices have reduced the incentive for property developers to bring new housing supply onto the market.

However, demand for the construction of social housing from Kāinga Ora remains solid, with plans for public housing to be built in regions, including the Bay of Plenty and Nelson[1]. We expect tighter financial conditions will drive a continued shift in construction demand from the private sector to the public sector, as the easing in capacity pressures from softer private sector demand allows more public sector investment to progress.

The latest NZIER *Quarterly Survey of Business Opinion* (QSBO) showed some improvement in building sector confidence in the June quarter. Nonetheless, a net 59 percent of building sector firms surveyed are feeling downbeat about the general economic outlook.

Building sector firms report continued softening in forward-looking orders, with the weaker demand driving a marked easing in cost and pricing pressures in the construction sector. A net 67 percent of building sector firms reported increased costs in the June quarter – much lower than the recent peak of 92 percent of building sector firms which faced higher costs back in the September 2022 quarter.

Profitability in the construction sector continues to deteriorate in the weaker demand environment. A net 61 percent of building sector firms surveyed reported a worsening in profitability in the June quarter, given the reduced ability to pass on higher costs to customers by raising prices.

Reflecting the tougher trading conditions, building firm liquidations have increased over the past year. Credit reporting agency Centrix highlighted in its Credit Indicator Report that the number of company credit defaults in the construction sector rose by 16 percent in June from a year ago[2]. The flow-on impacts of the closure of main building contractors to trade suppliers and sub-contractors who cannot be paid have reverberated across the construction supply chain.

The NZIER QSBO measure of architects' work in their own office points to a decline in the pipeline of construction work across residential, commercial and Government work in June. The further contraction in the pipeline of residential construction work is particularly stark, reflecting the impact of lower house prices, which is discouraging property developers from bringing new housing supply onto the market.

Architects have also started to note a decline in the pipeline of Government construction work. A net 11 percent of architects expect reduced Government construction work over the coming year base on work in their own office. Nonetheless, the New Zealand Infrastructure Commission Te Waihanga reported in its Infrastructure Quarterly in March a continued solid pipeline of infrastructure construction for the coming years, particularly in transport and water infrastructure[3]. The Commission reports infrastructure projects currently under construction total $47.9 billion, while there are a further 152 shovel-ready projects totalling $3.9 billion in the pipeline. The solid demand for social housing is also reflected in this making up 17 percent of the $5.9 billion of total forecast spend in the social sector in 2023.

Meanwhile, the deterioration in the pipeline of commercial construction appears to have stabilised. However, we expect firms' caution about investment in the higher interest rate environment and ahead of the upcoming general election will continue to weigh on demand for private sector non-residential construction.

1 https://kaingaora.govt.nz/news/plans-underway-for-26-new-public-homes-in-nelson/
2 https://www.centrix.co.nz/wp-content/uploads/2023/07/Centrix-Credit-Indicator-Report_June-2023_Final.pdf
3 https://www.tewaihanga.govt.nz/assets/Uploads/Infrastructure-QR-March23.pdf

BUILDING ACTIVITY OUTLOOK

Indicators point to further easing in private sector construction demand over the coming years, reflecting the headwinds from higher costs and interest rates. Banks also remain cautious about lending for both residential and commercial property. Although consent issuance shows a solid pipeline of construction work for the remainder of 2023, the decline in new orders and building enquiries suggests the softening in activity will become more apparent from 2024.

Partly offsetting this decline in demand over 2024 will be the rebuilding after the damage inflicted by severe weather events in the upper and central North Island earlier this year. While this rebuilding will provide some support to construction activity, we continue to expect overall construction activity to decline over the coming years. Over the longer term, we expect the recovery in migration-led population growth will support construction demand. This is particularly the case for residential construction, as population growth drives a recovery in housing demand.

Against this backdrop of weakening construction demand, building sector firms report an easing in both cost and pricing pressures. On the supply side, the reopening of international borders has made it easier for firms to bring in workers from overseas. This has helped to alleviate labour shortages, and along with the easing in material shortages as supply chain disruptions are resolved, capacity pressures have eased in the construction sector. Construction cost inflation has already started to ease from historically high annual growth of over 10 percent last year due to this easing in capacity pressures, and we expect further easing over the coming year.

ECONOMIC BACKDROP

The Stats NZ release of March 2023 GDP showing a 0.1 percent decline in New Zealand economic activity put the economy in a technical recession, given the (downwardly revised) 0.7 percent decline in the December 2022 quarter. The disruptions from the severe weather events in the upper and central North Island make it difficult to gauge the underlying state of the economy, with the potential for this decline in the March quarter to be revised in subsequent GDP releases as more updated and better information is received.

Nonetheless, the New Zealand economy clearly continues to face many headwinds, particularly in households. Although the labour market remains solid, households face continued high living costs and higher mortgage repayments. RBNZ data shows around half of mortgages will come up for repricing over the coming twelve months, and many of these households face a significant increase in mortgage repayments.

These effects are particularly apparent for the retail sector, which was the most downbeat of the sectors surveyed in the NZIER QSBO in the June quarter. We expect higher mortgage repayments will crowd out household discretionary spending and further weigh on retail spending over the coming year.

Businesses are also more cautious regarding investment, reflecting the uncertainty around the upcoming general election and softer demand environment. A net 27 percent of businesses plan to reduce investment in buildings, while investment intentions for plant and machinery have also declined, with a net 26 percent of firms planning to reduce investment in this area over the coming year.

INTEREST AND EXCHANGE RATES

The RBNZ again surprised markets at the May *Monetary Policy Statement*, but this time by indicating it did not expect to increase the OCR any further in this cycle. The central bank increased its policy rate by 25 basis points to 5.5 percent. More importantly, its accompanying statement noted that recent developments leave the RBNZ comfortable that it has undertaken enough monetary policy tightening to bring annual CPI inflation back towards its 1 to 3 percent inflation target band over the coming years.

Given the RBNZ's larger-than-expected 50 basis point OCR increase at the April meeting, the 25 basis point OCR increase and calling of the peak in the OCR at 5.5 percent at the May meeting surprised many in the financial markets. This was particularly given the earlier release by the Treasury of the Budget 2023, which suggested Government spending and post-storm rebuilding would add more to inflation pressures in the New Zealand economy than previously expected.

The easing in capacity pressures and, with it slowing in inflation, support our expectations of the OCR peak being at 5.5 percent. The NZIER QSBO shows the firms' primary constraint has shifted from finding labour to sales, indicating that softer demand is increasingly becoming a key concern for many businesses. We expect the lagged transmission of the OCR increases to date, as households reprice onto much higher mortgage rates, will further slow economic activity over the coming year.

There is greater uncertainty over the extent of further tightening by other central banks. In particular, continued strength in the US labour market raises the chances of further monetary policy tightening by the US Federal Reserve. Strong hiring demand and wage growth suggest higher interest rates are warranted to dampen demand enough to bring annual inflation in the US economy back towards the central bank's target of 2 percent.

There is also uncertainty over the extent of further monetary policy tightening by the Reserve Bank of Australia (RBA). The RBA had resumed its tightening cycle with another 25 basis points policy rate increase at each of its May and June meetings after signs of inflation pressures picking up again.

With other major central banks likely to continue increasing their policy rates as the RBNZ remains on hold, this reduces the yield attractiveness of the New Zealand dollar. These factors are weighing on the New Zealand dollar, but we expect a modest appreciation in the currency over the coming years as other central banks reach their terminal policy rates.

BUILDING INVESTMENT

Businesses have become more cautious when it comes to investment, particularly when it comes to buildings. A net 27 percent of businesses surveyed in the NZIER QSBO planned to reduce investment in buildings over the coming year. We expect this caution to weigh on private sector demand for construction.

The Australian New Zealand Infrastructure Pipeline, which is released by Infrastructure Partnerships Australia, shows 31 major infrastructure projects underway in New Zealand[4]. Projects under procurement include the Northern Pathway, which will form a walking and cycling connection between Auckland City and North Shore, as well as the replacement of the Interislander ferry terminals. Meanwhile, projects that have been announced include the expansion of Auckland Airport, redevelopment of Auckland hospitals and the New Zealand Housing Acceleration Fund.

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

BUILDING CONSENTS

Over the past year, growth in non-residential construction demand has been driven by increased demand for new healthcare facilities. Demand for office buildings and retail outlets also drove the increased demand for non-residential construction but to a much smaller extent.

In contrast, demand for industrial buildings and accommodation contracted over the past year.

Building consents by sector

There was very strong growth in demand for the construction of new healthcare facilities over the past year. This was driven by increased demand in Auckland, Otago and Canterbury. We expect the growing and ageing New Zealand population will support robust demand in construction in this sector over the coming years.

Meanwhile, demand for the construction of new office space was also robust on the back of demand in Wellington and Otago. We expect earthquake-strengthening requirements in Wellington will continue to underpin demand for office construction over the coming year. However, tighter financial conditions should weigh on demand and provide some offset.

Although demand for the construction of new retail outlets and refurbishments was solid over the past year, we expect that as households pare back on discretionary spending in the face of higher mortgage repayments, this should weigh on construction in the retail sector.

Tourism activity has recovered strongly with the reopening of the international borders following the COVID-19 pandemic. We expect this should drive a recovery in the demand for the construction of accommodation buildings over the coming years.

Building consents by region

Growth in non-residential construction consent issuance has been concentrated in Canterbury, Waikato and Otago. In Waikato, this demand has been driven by strong growth in construction demand for storage buildings.

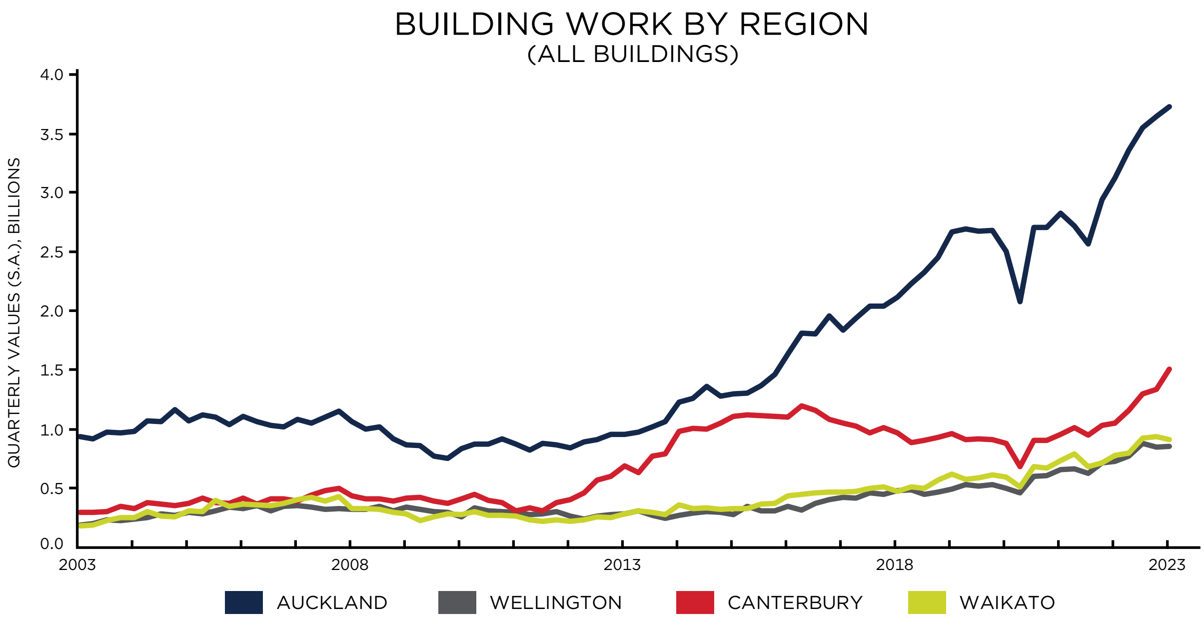
In Canterbury, growth has been broad-based across many sectors, including social buildings, healthcare facilities and education buildings.

Meanwhile, in Otago, increased demand for the construction of healthcare facilities and office buildings more than offset weaker demand for education buildings over the past year.

FIGURE 1

Construction growth in the March 2023 quarter

Quarterly values (s.a.), billions

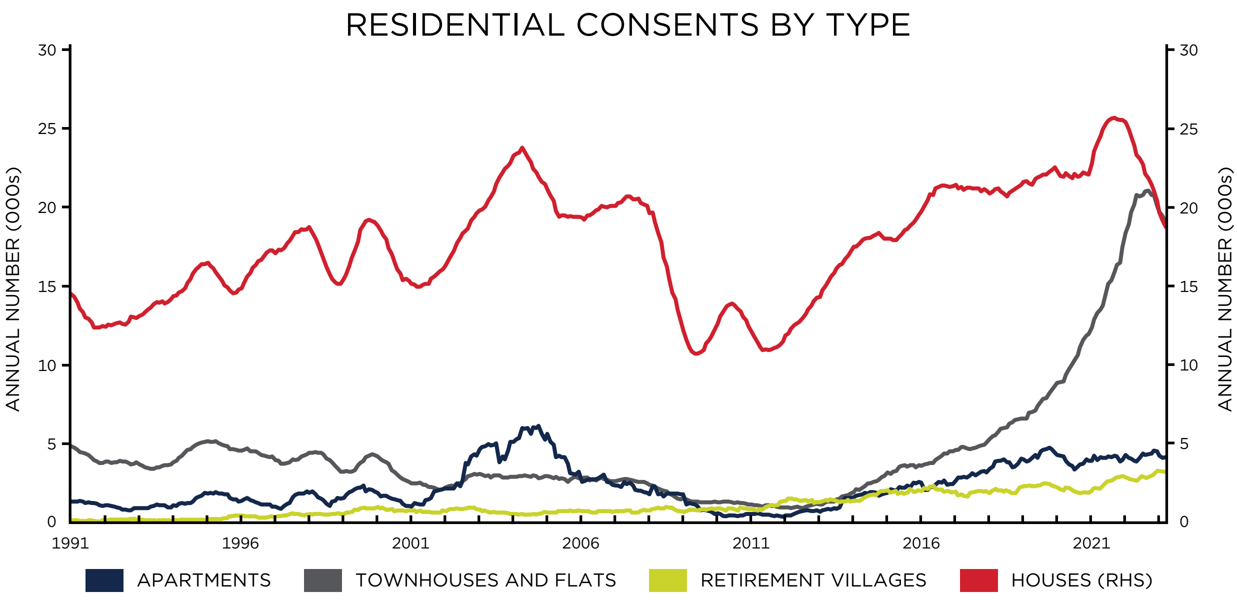


Source: Stats NZ

FIGURE 2

Demand for residential construction continues to decline

Annual number of consents



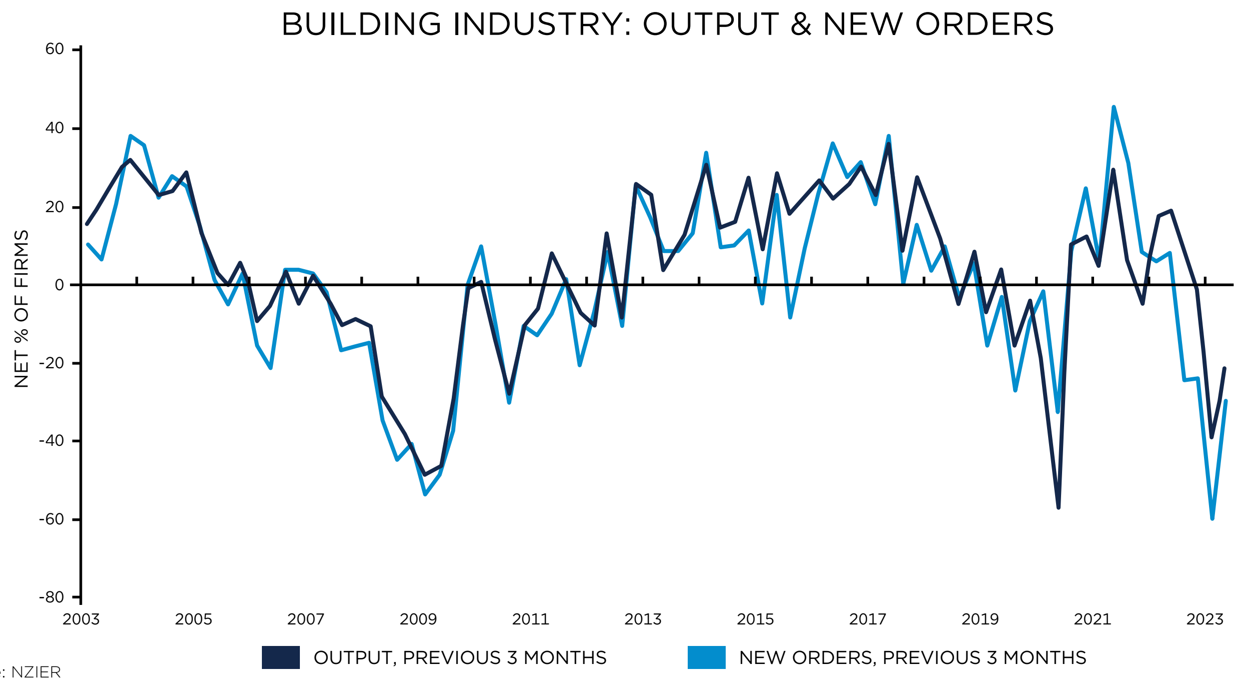
Source: Stats NZ

3 Kehu Way, Auckland

FIGURE 3

Building sector firms still reporting soft demand

Net % of firms

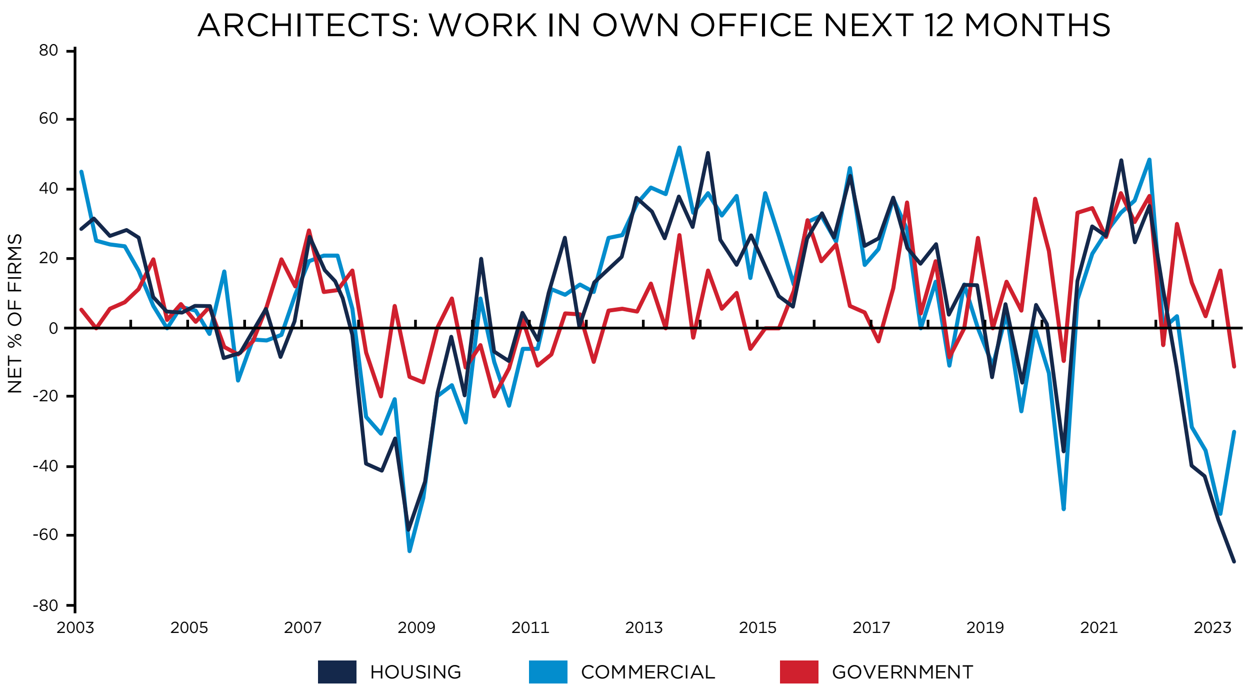


Source: NZIER

FIGURE 4

Architects report continued softening in the construction pipeline

Net % of firms

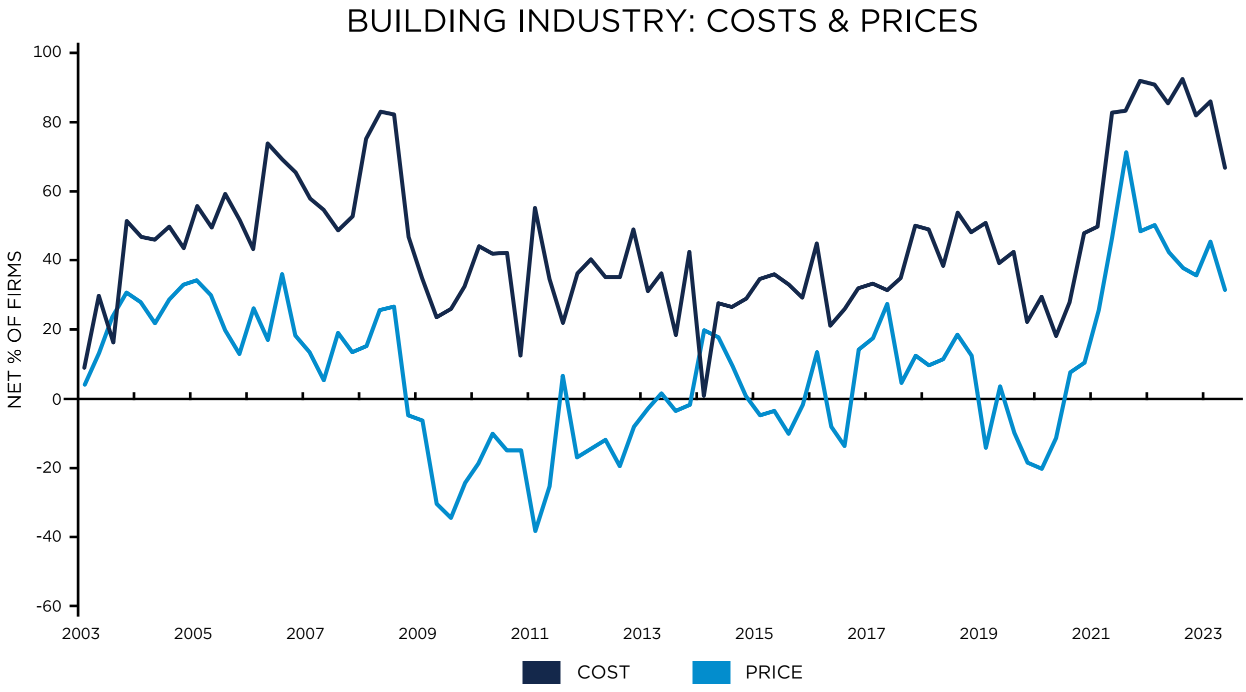


Source: NZIER

FIGURE 5

Cost and pricing pressures ease in a softer demand environment

Net % of firms

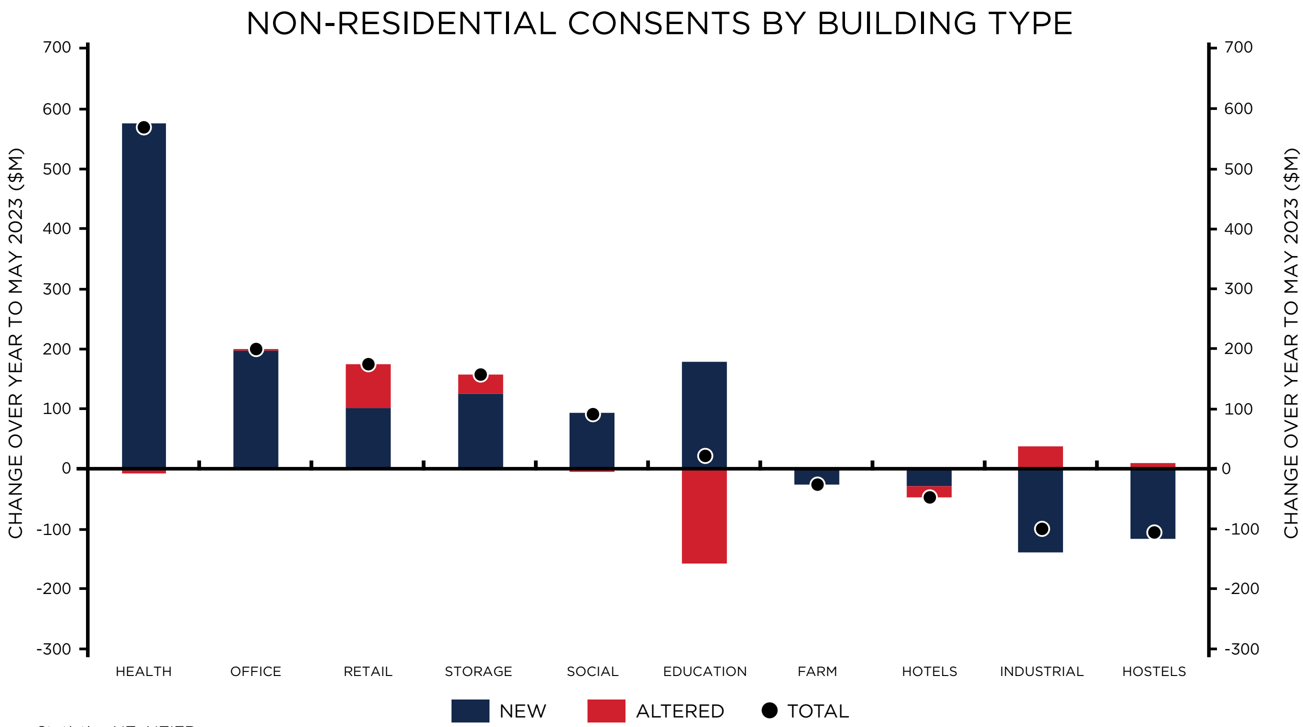


Source: NZIER

FIGURE 6

Demand for new healthcare facilities leads the growth in non-residential construction demand

Change over year to May 2023



Source: Statistics NZ, NZIER

TABLE 1

Non-residential building consents by region and sector

$m of consents for the year ending May 2023; 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	6.5	83.8	45.5	30.1	35.3	18.6	16.2	15.1	12.9
AUCKLAND	3.3	187.8	650.7	510.1	86.6	435.8	738.5	589.5	288.8	19.4
WAIKATO	9.8	7.6	102.7	117.4	88.6	57.2	86.4	354.4	174.2	61.7
BAY OF PLENTY	7.5	9.2	101.1	76.3	12.8	103.1	56.9	24.2	62.6	11.6
GISBORNE	0.1	0.4	2.3	14.1	9.6	2.2	4.8	6.0	10.3	2.6
HAWKE'S BAY	11.6	1.4	59.6	47.8	5.5	34.1	22.0	69.5	59.7	5.6
TARANAKI	0.0	7.8	0.7	9.3	40.3	8.2	23.4	13.1	37.8	17.4
MANAWATŪ-WHANGANUI	4.0	0.3	46.7	92.9	33.2	19.6	41.6	39.0	49.2	33.9
WELLINGTON	2.8	1.0	99.0	166.1	162.0	33.3	362.7	51.2	39.4	12.0
NELSON	0.0	0.5	6.1	12.6	1.9	19.7	5.6	2.4	3.9	0.1
TASMAN	2.8	0.1	3.8	7.7	1.8	4.4	2.4	12.8	25.2	2.9
MARLBOROUGH	2.5	0.0	1.9	4.8	2.2	21.7	2.6	4.1	39.4	6.1
WEST COAST	0.0	2.0	4.5	1.5	8.2	3.3	3.0	3.0	3.1	11.7
CANTERBURY	21.7	13.0	217.2	363.2	301.0	132.7	83.6	241.0	232.8	58.1
OTAGO	15.4	42.9	205.6	48.5	96.9	57.0	108.9	46.3	52.8	24.9
SOUTHLAND	1.1	6.3	4.7	11.1	3.6	10.3	20.5	9.4	43.8	21.0

Source: Statistics NZ, NZIER

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 continued to ease on an annual basis in March 2023, despite remaining steady on a quarterly basis. The 1.9 percent increase in non-residential construction costs over the quarter saw annual non-residential construction cost inflation moderate to 9 percent for the year to March 2023.

We expect construction cost inflation will continue to ease from current high levels over the coming years, reflecting the easing in capacity pressures in the construction sector. The reopening of international borders has alleviated labour shortages, and supply chain disruptions continue to be resolved. We expect this easing in capacity pressures will continue to reduce cost pressures in the construction sector.

We forecast annual non-residential construction cost inflation to ease towards 4 percent in mid-2024. Beyond 2024, we expect a continued easing in capacity pressures in the construction sector will drive annual non-residential construction cost inflation to below 3 percent in late 2025, before edging up slightly in the subsequent years as demand for construction recovers.

FIGURE 7

Non-residential building cost inflation

CGPI-NRB index, annual % change

Source: Statistics NZ, NZIER forecasts

TABLE 2

Non-residential building cost index[5]

YEAR	QUARTER	INDEX	QUARTERLY % CHANGE	ANNUAL % CHANGE
2019	MARCH	807	0.9	4.6
	JUNE	813	0.9	4.3
	SEPTEMBER	831	2.1	5.1
	DECEMBER	843	1.4	5.4
2020	MARCH	849	0.7	5.2
	JUNE	850	0.2	4.5
	SEPTEMBER	851	0.1	2.4
	DECEMBER	859	0.9	1.9
2021	MARCH	862	0.4	1.6
	JUNE	889	3.1	4.6
	SEPTEMBER	905	1.8	6.3
	DECEMBER	925	2.2	7.7
2022	MARCH	951	2.8	10.3
	JUNE	985	3.6	10.9
	SEPTEMBER	1000	1.5	10.5
	DECEMBER	1018	1.8	10.1
2023	MARCH	1037	1.9	9.0
	JUNE	1053	1.5	6.8
	SEPTEMBER	1065	1.2	6.5
	DECEMBER	1077	1.1	5.8
2024	MARCH	1087	1.0	4.9
	JUNE	1097	0.9	4.2
	SEPTEMBER	1106	0.8	3.8
	DECEMBER	1115	0.8	3.5
2025	MARCH	1123	0.7	3.3
	JUNE	1131	0.7	3.1
	SEPTEMBER	1139	0.7	2.9
	DECEMBER	1147	0.7	2.8
2026	MARCH	1155	0.7	2.8
	JUNE	1163	0.7	2.9
	SEPTEMBER	1172	0.8	2.9
	DECEMBER	1181	0.8	3.0
2027	MARCH	1191	0.8	3.1
	JUNE	1200	0.8	3.2
	SEPTEMBER	1210	0.8	3.2
	DECEMBER	1219	0.7	3.2

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

5 Stats NZ has reweighted and rebased capital goods price indexes in the December 2022 quarter. The update includes structural changes to better align with the national accounts. As a result, there has been historical revisions to the index levels. This does not affect the percentage changes each quarter. Further detail on these historical revisions can be found at: https://www.stats.govt.nz/methods/price-index-methods-updates-for-the-december-2022-quarter/

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