THIRD QUARTER 2023

FORECAST REPORT 106

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

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Cover: Te Wānanga o Raukawa campus buildings, Ōtaki

CONFIDENCE TODAY INSPIRES TOMORROW

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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.

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FORECAST 106

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 is slowing, and indicators show a reduction in the pipeline of construction work for the coming year. However, the strong rebound in net migration inflows with the reopening of international borders should support construction demand over the longer term.

Construction pipeline weaker in the near term

Construction activity was broadly flat in the June 2023 quarter, as growth in non-residential construction activity offset weaker residential construction. Near-term indicators such as consent issuance and architects' measure of activity point to further easing in construction activity over the coming year.

Building sector firms are feeling less downbeat

The latest NZIER Quarterly Survey of Business Opinion shows further improvement in confidence in the building sector. Nonetheless, the mood remained downbeat, given weaker construction demand.

Construction firms face reduced pricing power

Although cost pressures have eased in the building sector, they remain elevated. However, there has been a marked decline in the proportion of building sector firms that were able to raise prices in the face of weaker demand.

Future outlook

Although higher interest rates are presenting headwinds to the construction sector, we expect strong migration-led population growth will support construction demand over the longer term.

BUILDING ACTIVITY TRENDS

Stats NZ *Building Work Put in Place* showed a slowing in construction activity, reflecting the headwinds from higher interest rates. Activity over the June 2023 quarter was broadly flat, as growth in non-residential construction offset the decline in residential construction. Construction activity was led by Auckland, which made up 40 percent of construction activity in New Zealand on a nominal basis.

Concrete usage for the September 2023 quarter also provides a timelier indicator of construction activity across the regions. While there has been a decline in concrete being poured in New Zealand's largest city over the past year, the pick-up in the September quarter points to increased construction activity in the region more recently. In contrast, the decline in concrete usage in Wellington and Christchurch points to an easing in construction activity in these cities.

Dwelling consent issuance provides a useful indication of near-term residential construction demand. There has been an easing in dwelling consents issued over the past year, with the weakness broad-based across the regions. The decline dwelling consent issuance has been particularly marked in Auckland, reflecting the more severe downturn in the region's housing market. Nonetheless, annual dwelling consents issued for the year to September 2023 remain above 40,000, indicating a still robust level of residential construction for the coming year.

While the decline in dwelling consents issued has been broad-based across the different housing types, demand for standalone houses continues to fall particularly sharply. For the year to September 2023, consents issued for standalone houses fell below that for townhouses and flats. While there has also been a decline in consents issued for medium density housing, apartments and retirement villages, we expect housing construction demand will continue to shift towards higher density housing over the coming years, given the scarcity of centrally located land.

The Reserve Bank of New Zealand (RBNZ) data on credit conditions indicate that while banks' appetite to lend for property has improved, the appetite to borrow for property remains weak. This likely reflects the dampening effects of higher interest rates on the New Zealand economy, as higher borrowing costs reduce the attractiveness of property as an investment. However, growing confidence that the RBNZ will not increase the OCR further in this cycle has supported renewed interest in housing. This is despite increased retail interest rates as banks face higher funding costs.

Besides banks, the inception of retail funds by fund managers such as Simplicity to invest in residential property developments and home mortgages should encourage residential construction over the longer term. Such funds will invest in first-home residential mortgages and community housing bonds, which should increase the supply of housing on the market.

The NZIER *Quarterly Survey of Business Opinion* (QSBO) shows a mixed inflation environment in the construction sector. While construction cost pressures remain elevated, weaker construction demand means that fewer building sector firms have been able to pass on higher costs by raising prices.

We expect the dampening effects of higher interest rates on construction demand will further ease capacity pressures in the construction sector. Cost pressures are also expected to ease as the rebound in net migration inflows in the wake of the reopening of international borders helps to alleviate labour shortages in the construction sector. Meanwhile, the resolution of supply chain disruptions is driving a continued unwinding of building materials shortages.

Overall, this combination of softer demand and increased supply should lead to a continued slowing in construction cost inflation over the coming year.

BUILDING ACTIVITY OUTLOOK

For the near term, indicators point to a weakening in the pipeline of construction work. Besides the easing in building consent issuance, the NZIER QSBO architects' measure of activity in their own office indicates a reduced pipeline of construction across Government, commercial and housing work.

Te Waihanga, the New Zealand Infrastructure Commission reported in its *Infrastructure Quarterly* for the June 2023 quarter[1], its recorded pipeline of infrastructure projects totalled $92.15 billion. This pipeline included $42.3 billion worth of infrastructure projects currently under construction, while $42.8 billion are in the planning phase. Across the sectors, transport infrastructure makes up the bulk of this pipeline at $38 billion, while water infrastructure makes up $19.2 billion of the pipeline.

For the 2023 year, Te Waihanga expects significant infrastructure spending in the social sector of $7.4 billion, comprising 42 percent on housing, 20 percent on health infrastructure, 20 percent on education facilities and 14 percent on community facilities.

Meanwhile, Infrastructure Partnerships Australia estimates there are 22 major infrastructure projects underway in New Zealand, including the expansion of Auckland Airport, the replacement of Interislander ferry infrastructure, and the redevelopment of Auckland, Nelson and Whangārei hospitals[2].

We also expect strong migration-led population growth to support construction demand over the longer term. There has been a strong recovery in net migration inflows since international borders reopened, with net inflows into New Zealand estimated to have surged above 120,000 for the year to September 2023.

This surge in net migration reflects a record number of people moving to New Zealand from other countries, more than offsetting the number of New Zealanders moving overseas. Besides increasing demand for housing, we expect this strong migration-led population growth will support increased demand for infrastructure.

ECONOMIC BACKDROP

The Stats NZ release of June 2023 GDP showed a solid 0.9 percent increase in New Zealand economic activity for the quarter. The upward revision to the March quarter GDP to a flat result (from the previous estimate of a 0.1 percent decline) meant New Zealand had not faced a technical recession (often defined as two consecutive quarters of a decline in GDP). Overall, the results suggest a more robust economy than initially expected.

However, there are clear signs that higher interest rates are having their intended effect in dampening demand in the New Zealand economy. Businesses surveyed in the NZIER QSBO report weaker activity, particularly in the retail and construction sectors. Retailers remained the most downbeat of the sectors surveyed, reflecting the headwinds faced by the household sector.

The combination of higher living costs and mortgage rates is weighing on consumer confidence, with households reducing their discretionary spending in the face of significantly higher mortgage repayments. We expect these headwinds and an easing in job prospects will slow retail spending further over the coming year.

Businesses remain cautious about investment, particularly when it comes to investment in buildings. A net 35 percent of businesses surveyed in the NZIER QSBO planned to reduce investment in buildings over the coming year, while a net 20 percent planned to reduce investment in plant and machinery. Heightened uncertainty before the October general election and softer demand are likely to be key drivers of this caution amongst businesses to invest.

1 https://media.umbraco.io/te-waihanga-30-year-strategy/4safm4uy/pipeline-snapshot-april-june-2023.pdf

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

INTEREST AND EXCHANGE RATES

There is a wide range of views over what the RBNZ will do with the Official Cash Rate (OCR) over the coming year. In keeping the OCR on hold at 5.5 percent, the RBNZ noted at the October OCR Review its expectation that the OCR would have to remain on hold "for a more sustained period of time" in order to bring annual CPI inflation back down towards its 1 to 3 percent inflation target band over the coming years.

While it acknowledged the near-term risk that high inflation will remain more persistent than it forecast, the RBNZ saw downside risks to the New Zealand inflation outlook over the medium term should there be a significant deterioration in global economic demand.

We expect the RBNZ will keep the OCR on hold at 5.5 percent until early 2025 before it embarks on an easing cycle. While inflation remains elevated, there are clear signs of capacity pressures easing in the New Zealand economy. The full impact of the OCR increases to date will also continue to dampen demand in the New Zealand economy. These factors should drive a continued easing in inflation pressures over the coming year.

Many analysts and the RBNZ expect the next move in the OCR to be down, but some analysts believe there will still be a further increase in the OCR over the coming year. This divergence in views regarding the direction of the OCR highlights the heightened uncertainty over the interest rate outlook.

Offshore developments also influence the New Zealand interest rate outlook, particularly for longer-term interest rates. The US Federal Reserve has left the door open to further interest rate increases, given the resilience of the US economy, particularly in the labour market. This resilience presents a risk that US inflation will take longer to return to the US Federal Reserve's 2 percent inflation target band than initially forecast. Nonetheless, signs of easing inflation pressures mean that the central bank will likely take a cautious approach to further tightening.

Markets are also expecting a cautious approach from the European Central Bank (ECB), given signs of a weakening in the European economy. The escalation in geopolitical conflict in the Middle East and Ukraine is driving increased risk aversion in markets. However, the net impact on inflation is unclear, given the potential for the wars to increase energy prices.

Meanwhile, the Reserve Bank of Australia resumed its tightening cycle with a 25 basis point increase to its cash rate. The interest rate increase in its November meeting was the first by the central bank in five months. The increase was in response to signs that inflation remained persistently high and may take longer to return to its 2 to 3 percent inflation target band.

BUILDING INVESTMENT

Businesses remain cautious when it comes to investment plans. This is particularly the case for investment in buildings, with around a quarter of businesses surveyed in the NZIER QSBO planning to reduce this form of investment over the coming year. We continue to expect this caution to weigh on private sector demand for construction in the near term.

This easing in private sector construction should reduce capacity pressures in the construction sector and allow Government construction activity to ramp up.

BUILDING CONSENTS

Over the past year, increased demand for social buildings has driven growth in non-residential construction demand. Despite the slowing in retail spending as households face headwinds from higher living costs and interest rates, growth in both alterations and construction of new retail outlets was the second-highest driver in non-residential construction demand for the year to September 2023.

Increased demand for the construction of healthcare facilities also contributed to the growth in non-residential construction demand over the past year.

In contrast, there has been reduced demand for the construction of office buildings and education buildings.

Building consents by sector

There has been a strong increase in consent issuance for social and cultural buildings over the past year. This reflected growth across many regions, but particularly in Canterbury. Strong growth in demand for social and cultural buildings was also recorded in Wellington and Otago.

The strong growth in demand for the construction and refurbishment of retail outlets over the past year has been driven primarily by demand in Auckland. While multi-national retail brands are interested in creating a presence in New Zealand's largest city, we expect that as households pare back on discretionary spending in the face of higher mortgage repayments, this will weigh on construction demand for retail outlets.

Meanwhile, strong demand in Otago, Canterbury and the Bay of Plenty were the key contributors to the growth in consent issuance for healthcare facilities over the past year. We expect the growing and ageing New Zealand population will support demand for new healthcare facilities over the longer term.

The weaker global growth outlook and softer economic activity more broadly will likely weigh on demand for industrial and storage buildings over the coming year.

Building consents by region

Over the past year, growth in non-residential construction consent issuance has been concentrated in Otago, Canterbury and the Bay of Plenty. In Otago, this growth in non-residential construction demand largely reflects growth in demand for healthcare facilities.

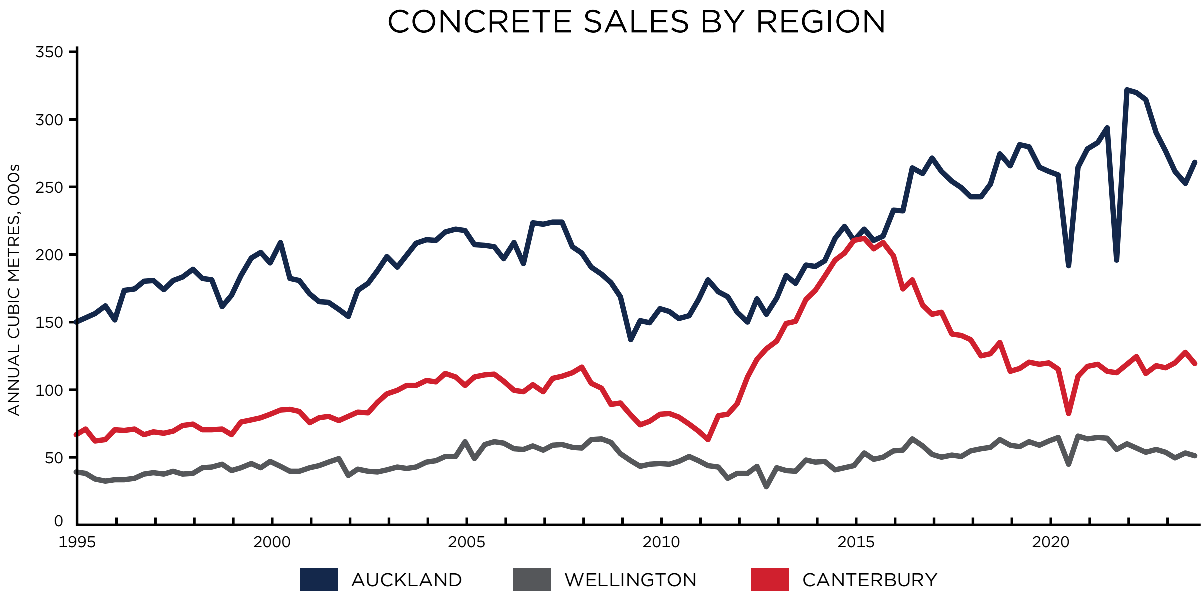
In Canterbury, stronger construction demand for healthcare facilities and cultural buildings were the key drivers of growth in non-residential construction demand over the past year.

Stronger construction demand for healthcare facilities was also the key driver of non-residential construction demand in the Bay of Plenty, with construction demand for office buildings in the region also adding support.

FIGURE 1

Auckland leads construction activity

Annual cubic metres (000s)

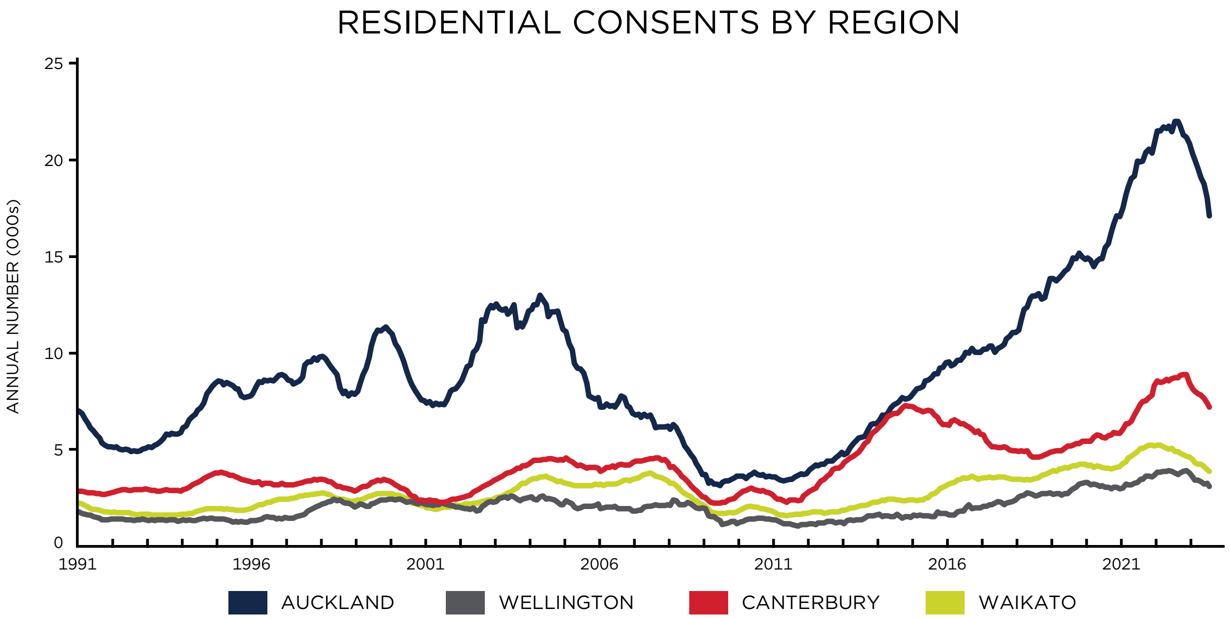


Source: Stats NZ

FIGURE 2

Construction demand easing over the coming year

Annual number of consents

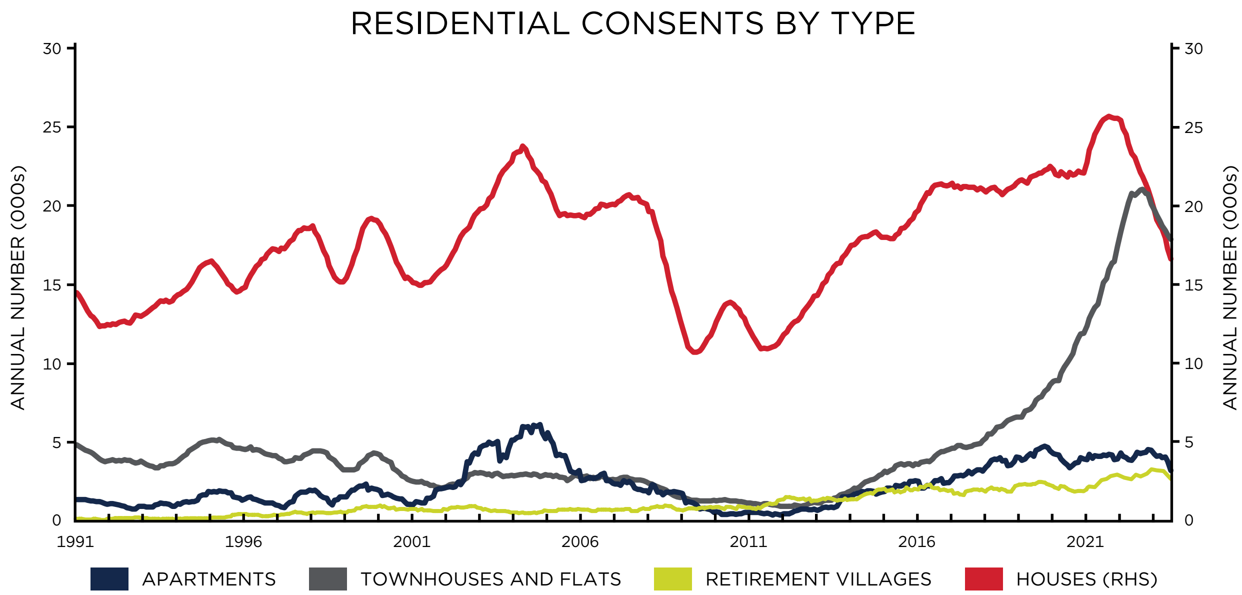


Source: Stats NZ

FIGURE 3

Broad-based easing in residential construction demand

Annual number of consents

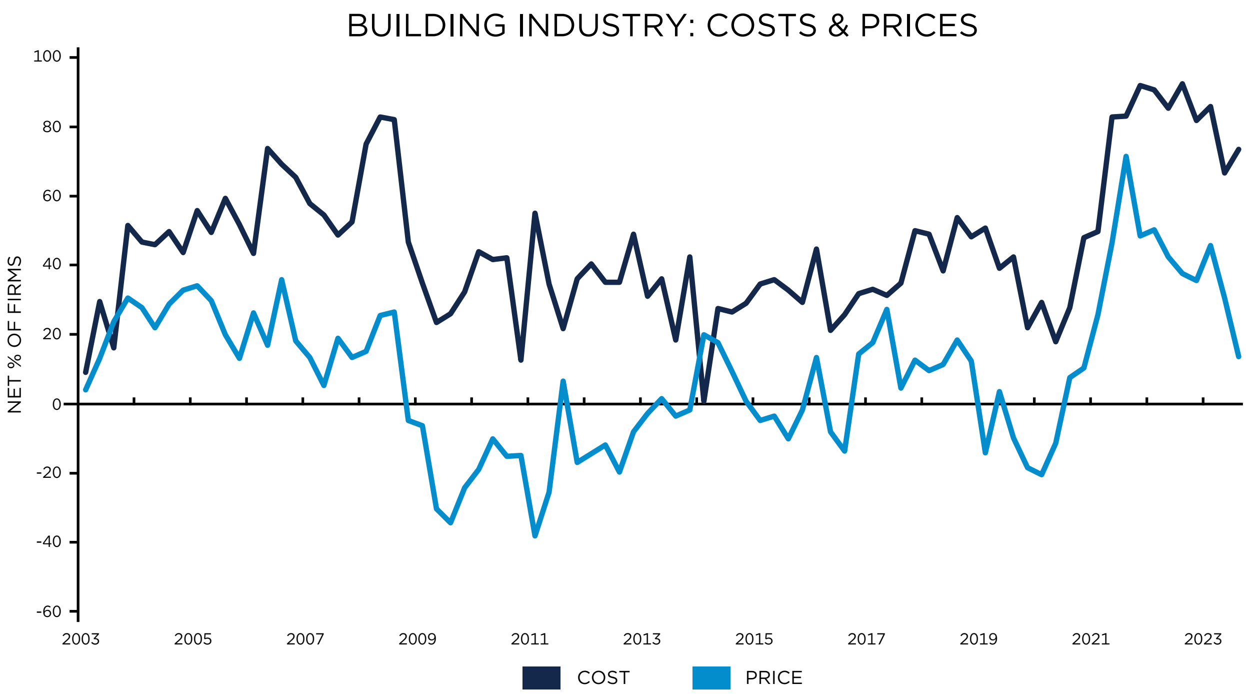


Source: Stats NZ

FIGURE 4

Reducing pricing pressures in the construction sector

Net % of firms

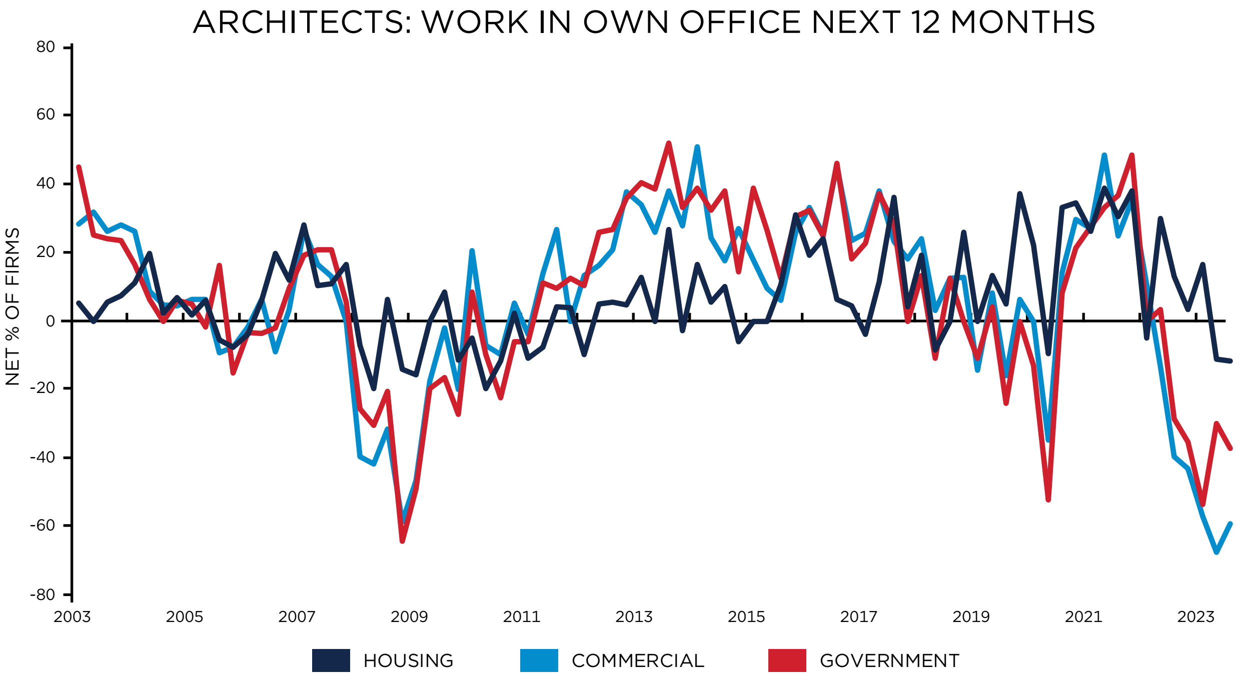


Source: NZIER

FIGURE 5

Architects also report a reduced pipeline of construction

Net % of firms

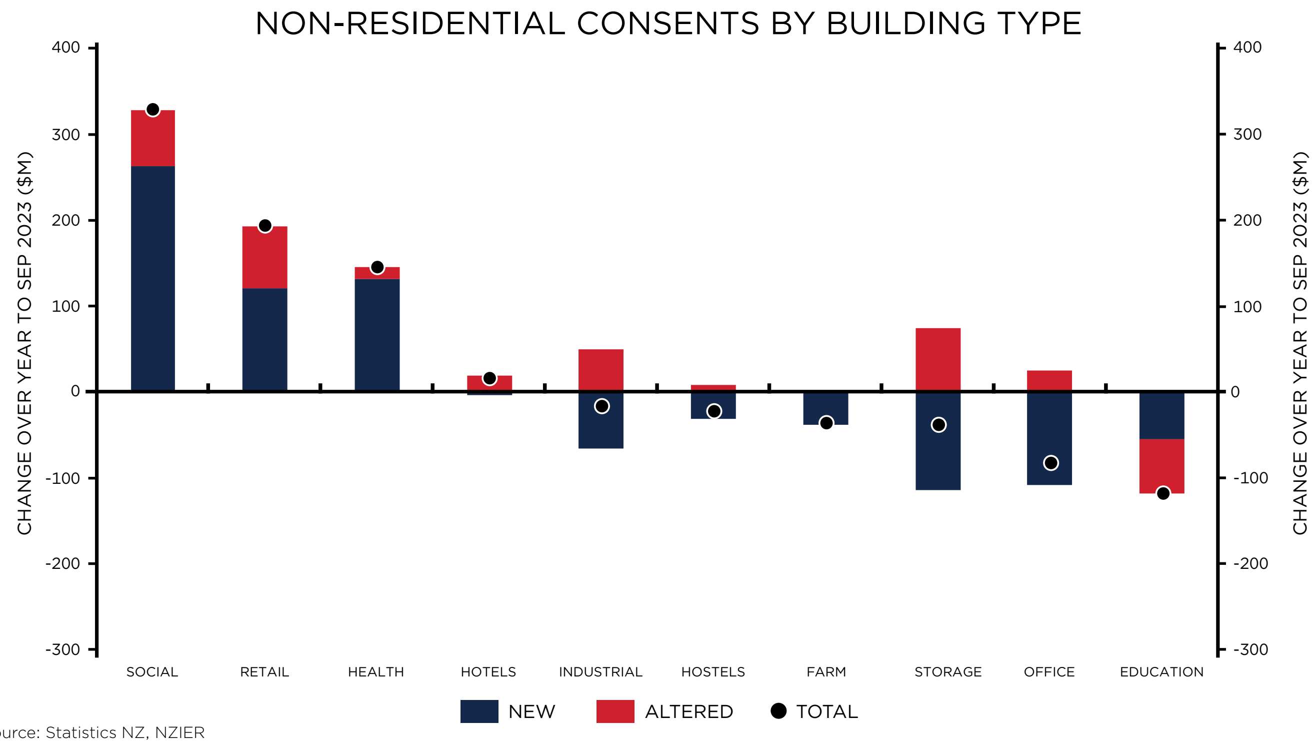


Source: NZIER

FIGURE 6

Demand for social buildings and retail outlets leads non-residential construction demand

Change over year to September 2023



Source: Statistics NZ, NZIER

TABLE 1

Non-residential building consents by region and sector

$m of consents for the year ending September 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	0.0	4.1	63.1	45.7	21.2	15.9	18.1	19.7	21.3	10.7
AUCKLAND	11.1	178.2	427.2	446.2	92.2	514.5	755.4	619.8	468.5	20.4
WAIKATO	10.5	9.9	135.5	83.3	96.3	53.5	68.3	316.5	155.4	58.2
BAY OF PLENTY	7.9	10.7	130.5	101.2	87.8	86.2	99.8	32.5	57.2	14.0
GISBORNE	0.1	0.3	32.3	11.8	6.8	2.1	5.6	1.9	3.8	1.8
HAWKE'S BAY	14.6	1.4	47.5	24.0	22.0	47.1	18.4	64.0	60.0	5.8
TARANAKI	0.0	8.0	3.3	13.9	51.6	15.8	22.7	6.7	38.4	15.6
MANAWATŪ-WHANGANUI	2.8	0.0	46.0	57.2	23.1	21.2	30.6	52.9	38.6	30.8
WELLINGTON	2.1	0.8	99.0	168.7	169.4	35.2	226.6	45.9	51.5	11.4
NELSON	0.0	0.0	10.8	9.8	2.0	18.6	6.4	0.3	2.2	0.0
TASMAN	2.8	0.9	3.3	11.6	0.4	5.0	0.9	11.3	24.0	4.5
MARLBOROUGH	2.1	0.0	1.6	19.0	2.5	19.8	3.5	2.0	48.8	6.2
WEST COAST	0.0	1.1	4.5	3.7	8.9	2.3	3.7	4.7	4.6	3.9
CANTERBURY	22.1	16.0	248.6	345.5	301.8	107.8	85.0	247.9	188.0	60.9
OTAGO	4.1	63.4	219.7	54.6	89.6	63.7	117.9	29.2	35.4	24.6
SOUTHLAND	0.3	4.3	18.7	15.2	3.6	7.3	22.0	17.7	32.8	16.9

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 September 2023, reflecting the easing in capacity pressures in the construction sector. The 1.2 percent increase in non-residential construction costs over the quarter saw annual non-residential construction cost inflation ease to 6.5 percent for the year to September 2023.

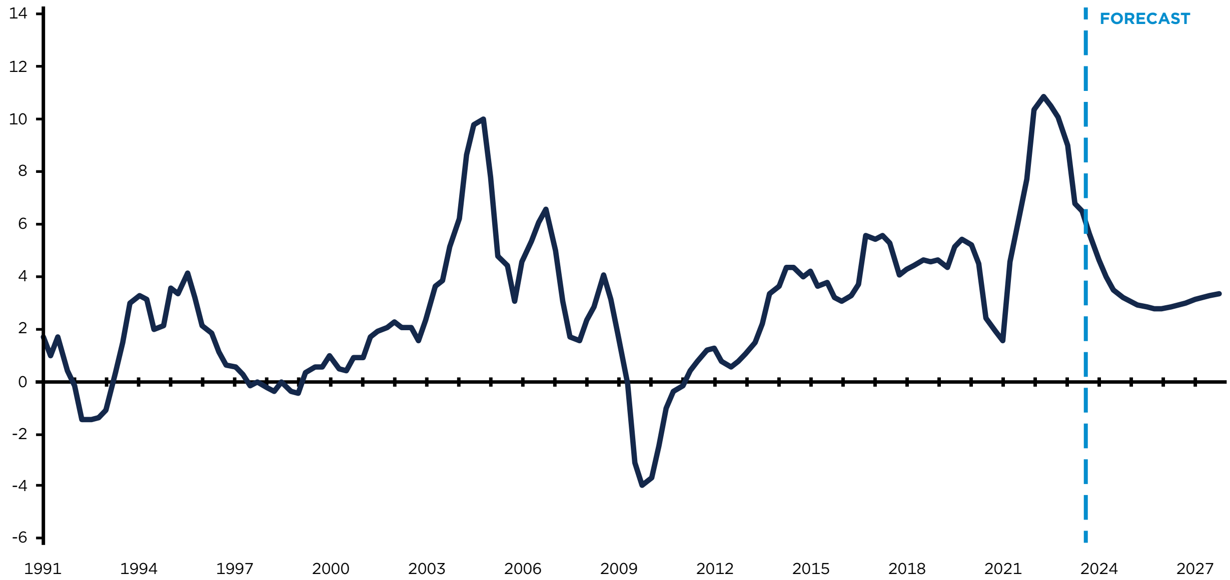
We expect construction cost inflation will continue to ease over the coming years, reflecting the continued easing in capacity pressures in the sector. Building sector firms report an easing in labour shortages as the reopening of international borders allows firms to bring in workers from overseas, while construction demand is easing (albeit from high levels). We expect this easing in capacity pressures will reduce cost pressures in the construction sector, and building sector firms are already finding it harder to pass on higher costs to customers by raising prices.

We forecast annual non-residential construction cost inflation to ease to 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 over 2025 before picking up 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[3]

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	1052	1.4	6.8
	SEPTEMBER	1065	1.2	6.5
	DECEMBER	1076	1.0	5.7
2024	MARCH	1085	0.9	4.6
	JUNE	1094	0.8	4.0
	SEPTEMBER	1102	0.8	3.5
	DECEMBER	1110	0.7	3.2
2025	MARCH	1118	0.7	3.0
	JUNE	1126	0.7	2.9
	SEPTEMBER	1133	0.7	2.8
	DECEMBER	1141	0.7	2.8
2026	MARCH	1149	0.7	2.8
	JUNE	1157	0.7	2.8
	SEPTEMBER	1166	0.8	2.9
	DECEMBER	1175	0.8	3.0
2027	MARCH	1185	0.8	3.1
	JUNE	1194	0.8	3.2
	SEPTEMBER	1204	0.8	3.3
	DECEMBER	1214	0.8	3.3

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

3 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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