FIRST QUARTER 2024

FORECAST REPORT 107

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

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Cover: Hillmorton Mental Health Care, Christchurch

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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 107

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 publication, the Australia Report and other country specific reports providing timely snapshots of market conditions and construction cost movements around the world, via commentaries from Rider Levett Bucknall directors in key locations.

KEY POINTS IN THIS ISSUE

A slowing in residential and non-residential construction, underpinned by broad-based economic contraction, is driving reduced activity in the sector. Although the pipeline of construction work points to further weakness over the coming year, strong migration-led population growth should underpin a recovery in construction demand over the longer term.

Construction pipeline remains subdued in the near term

Construction activity fell in the September 2023 quarter, reflecting a decline in residential and non-residential construction. Indicators such as the NZIER Quarterly Survey of Business Opinion (QSBO) architects' measure of work in own office, as well as building consent issuance, suggest weaker construction activity in the near term.

Building sector firms feeling more positive about outlook

Confidence amongst building sector firms improved despite subdued activity. The QSBO showed a net 8 percent of building sector firms expect better economic conditions over the coming months.

Despite weak pricing power

The decline in cost and pricing indicators in the latest QSBO indicates a further easing in construction cost inflation. We expect continued easing in capacity pressures in the construction sector will further soften construction cost pressures and escalation of costs.

Future outlook

We continue to expect strong migration-led population growth to support construction demand over the longer term. Uncertainty over whether interest rates will increase further or how long they will remain restrictive presents a downside risk to this outlook.


MBIE Wallaceville, Wellington

BUILDING ACTIVITY TRENDS

Stats NZ *Building Work Put in Place* showed a reduction in construction activity, in line with earlier weakness seen in construction indicators such as consent issuance. Activity over September 2023 quarter[1] fell across residential and non-residential construction, as the impact of higher interest rates and tighter access to finance weighed on construction demand.

Across the regions, Auckland continued to lead the way with construction activity. The increase in the value of construction work in Auckland, and to a smaller extent Waikato, contrasts with the contraction in other regions, including Wellington and Canterbury. Auckland now makes up around 41 percent of nationwide construction activity (on a nominal basis). The concentration of new construction work in Auckland reflects the strong migration-led population growth the region has experienced.

The production of ready-mixed concrete can provide useful information on broader construction activity, given it forms the foundation for most construction work. The latest data shows a decline in concrete production nationwide, reflecting broad-based softness across the regions, including Auckland.

Regarding residential construction demand, indicators such as dwelling consent issuance point to weak demand for the coming year. The annual number of dwelling consents issued fell further below 40,000 for the year to December 2023. The fall in residential construction demand has been broad-based across the building types, but particularly so for standalone houses. This weak demand for standalone houses likely reflects the constraints due to a scarcity of centrally located land and medium density development opportunities based on local authority district plan changes.

Weak residential construction demand has also been broad-based across the regions. The decline has been particularly marked in Auckland, following very strong growth in the region over 2021 and 2022. Annual Auckland dwelling consent issuance fell to just under 15,500 for the year to December 2023. This is 27 percent below year-ago levels. We expect higher interest rates and tighter access to finance will continue to weigh on residential construction demand over the coming year. However, we expect strong migration-led population growth will support residential construction demand from 2025, as a recovery in house prices encourages property developers to bring new housing supply onto the market.

Other construction indicators also point to a weak near-term pipeline of construction activity. The NZIER QSBO architects' measure of work in own office shows architects continue to expect a decline in housing, commercial and Government construction work over the coming year. In line with recent consent issuance, expectations for the pipeline of housing construction are particularly weak.

However, there are signs of an improvement in non-residential construction demand over the longer term. Although a net 12 percent of architects surveyed expect a reduction in commercial construction work over the coming year based on the work in their own office, looking further ahead a net 18 percent of architects expect an increase in this pipeline in around two years' time.

These emerging signs of an improvement in non-residential construction demand will likely support the recent confidence recovery amongst building sector firms. The NZIER QSBO shows that a net 8 percent of building sector firms expect better economic conditions over the coming months – a significant turnaround from the net 77 percent expecting a deterioration a year ago.

There are clear signs of an easing in construction cost pressures, with both cost and pricing indicators in the construction sector falling in the December 2023 quarter. In particular, a net 28 percent of building sector firms reported cutting prices over the quarter. Over the COVID-19 pandemic, a shortage of labour and materials has driven a significant increase in construction costs, the effects of which are now unwinding as these supply constraints ease. In line with the continued easing in capacity pressures in the construction sector, we expect a further moderation in construction cost inflation from high levels over the coming year.

1 September 2023 quarter is the latest available data on GDP and construction activity.

BUILDING ACTIVITY OUTLOOK

The near-term outlook for construction is subdued. However, there are signs of an improvement in demand over the longer term. Non-residential consent issuance indicates a plateau in demand in Auckland, albeit at a high level. Over the past year, the Bay of Plenty has led the growth in non-residential consent issuance, reflecting a stronger demand for healthcare facilities, as well as office and social buildings in the region.

Te Waihanga, the New Zealand Infrastructure Commission, reported in its *Infrastructure Quarterly* for the September 2023 quarter[2] infrastructure projects totalling almost $95 billion in value. To the extent that proposed initiatives such as the Auckland Light Rail and Lake Onslow projects were not at a stage with enough funding certainty for inclusion in the National Infrastructure Pipeline, the new Government's scrapping of these projects has no impact on the Pipeline.

The $2.8 billion increase in the value of infrastructure projects in the Pipeline over the September quarter reflects a combination of new infrastructure projects, increases in the value of existing projects, and new contributors to the Pipeline. Transport water infrastructure makes up over half of this Pipeline, and an estimated $42.7 billion of projects are under construction. In terms of forecast infrastructure spending for the next five years, this is dominated by spending in the transport, water and social (including housing) sectors. Te Waihanga forecasts an annual spend of $14.3 billion for the 2023 year.

Meanwhile, Infrastructure Partnerships Australia estimates there are currently 20 major infrastructure projects underway in New Zealand[3]. However, Infrastructure Partnerships Australia acknowledges the more recent changes with the cancellation of four projects under the new New Zealand Government: Lake Onslow Pumped Hydro, Auckland Light Rail, Let's Get Wellington Moving and the Interislander Ferry Replacement Project. Besides these changes, the expansion of Auckland Airport, roading investment in the East West Link and the redevelopment of Nelson and Auckland hospitals are other key projects included in the Infrastructure Partnerships Australia estimates of infrastructure projects in New Zealand.

ECONOMIC BACKDROP

The Stats NZ release of September 2023 GDP showed a 0.3 percent decline in New Zealand economic activity for the quarter. The contraction was broad-based across household consumption, business investment and exports. The result brought annual average growth to 1.3 percent for the year to September 2023.

There are signs that the impact of higher interest rates on dampening demand is gaining traction. Although the latest NZIER QSBO shows an improvement in both business confidence and activity in their own business, lack of demand has replaced finding labour as the top primary constraint for businesses. This indicates that the key concern for businesses has shifted from one of supply to demand.

The combination of higher living costs and mortgage rates is continuing to weigh on consumer confidence. With around half of mortgages due for repricing over the coming year, many households will be paring back on discretionary spending in the face of higher mortgage repayments.

However, labour market data for the December 2023 quarter indicates the household sector might be more resilient than expected, with employment growth of 0.4 percent over the quarter driving a smaller-than-expected tick-up in the unemployment rate. Hiring intentions in the NZIER QSBO indicate firms feel positive about hiring in the coming months.

When it comes to investment intentions, firms are feeling less cautious. In particular, a net 2 percent of firms plan to increase investment in plant and machinery over the coming year.

2 https://media.umbraco.io/te-waihanga-30-year-strategy/njypem24/pipeline-snapshot-july-september-2023.pdf

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

INTEREST AND EXCHANGE RATES

The mixed nature of recent data has led to a wide range of views on what the RBNZ will do with the Official Cash Rate (OCR) over the coming year. Although recent developments point to a continued easing in inflation pressures in the New Zealand economy, there is uncertainty over whether the RBNZ is comfortable with the pace at which inflation is falling and whether it will be enough to bring annual CPI inflation back towards its 1 to 3 percent inflation target band over the medium term.

The resilience of labour market data, which showed a 0.4 percent increase in employment in the December quarter, led some economists to expect further OCR increases from the RBNZ. The pick-up in the unemployment rate from 3.9 percent in the previous quarter to 4 percent in December was smaller than many were expecting, given other signs of slowing in the New Zealand economy.

However, forward-looking indicators point to an easing in labour market pressures. The NZIER QSBO shows businesses are now reporting they are finding it easier to find both skilled and unskilled labour. In addition, firms are now reporting (lack of) demand as the main constraint on their business – in contrast to finding labour being the main constraint for firms during the height of the COVID-19 pandemic. The strong rebound in net migrant inflows since international borders reopened is helping to alleviate labour shortages. This is contributing to an easing in capacity pressures more broadly.

There are other signs of inflation pressures easing, with the RBNZ Survey of Expectations showing a further easing in inflation expectations. Importantly, the two-year-ahead inflation expectations measure eased from 2.8 percent to 2.5 percent in the March 2024 quarter.

We forecast the RBNZ will keep the OCR on hold until mid-2025 before it embarks on an easing cycle. We believe recent developments should provide the central bank with comfort that inflation will return to its target band over the coming year. We expect many households will rein in discretionary spending as they roll off historically low fixed-term mortgage rates and face significantly higher mortgage repayments. Over the longer term, we expect this slowing in demand to be offset by the increased demand that comes with strong migration-led population growth. The continued divergence in views regarding the direction of the OCR highlights the high degree of uncertainty over the interest rate outlook.

Offshore developments influence longer-term New Zealand interest rates. Recent communications from the US Federal Reserve indicate that a decrease in interest rates is unlikely until later this year. The growth outlook of the European Central Bank (ECB) is also cautious, given the high degree of geopolitical uncertainty but persistent price pressures in the Eurozone.

Across the Tasman, expectations for monetary policy easing have been pushed out to the end of this year, given signs of inflation remaining persistently high. The RBA noted in its statement accompanying its January rate announcement that there remained the potential for another interest rate increase. However, overall expectations are for the next move in the Australian cash rate to be down.

BUILDING INVESTMENT

Businesses have become less cautious about investment. The NZIER QSBO shows a net 2 percent of firms plan to reduce investment in buildings over the coming year – a much smaller proportion than the 39 percent of firms with such intentions a year ago. We expect that beyond the soft near-term outlook for non-residential investment, private sector demand for construction will pick up from later in 2025.

BUILDING CONSENTS

For the year to December 2023, reduced demand for non-residential construction has been driven by a sharp drop in demand for new office buildings and education facilities. This has been offset to a slight extent by demand for alterations to office buildings.

In contrast, there was stronger demand for new and alterations to social buildings, retail outlets and industrial buildings over the past year.

We expect that as households continue to reduce discretionary spending in the face of significantly higher mortgage repayments, demand for the construction of retail outlets will ease.

Over the longer term, we expect strong population growth, and the ageing population will support demand for new healthcare facilities.

Building consents by sector

Consent issuance for social and cultural buildings[4] has been strong over the past year. This has been driven by increased demand in Wellington, and, to a smaller extent, Waikato and the Bay of Plenty.

When it comes to construction demand for retail outlets, growth in consent issuance has been particularly strong in Auckland over the past year. While the impact of higher interest rates on households would weigh on retail demand, with the strong net migration inflows concentrated in Auckland this is likely to support demand in this region.

Auckland was also the key driver of stronger demand for the construction of industrial buildings over the past year. This is also likely to reflect the impact of the region's relatively strong population growth in boosting activity.

Building consents by region

Over the past year, growth in non-residential construction consent issuance has been concentrated in the Bay of Plenty, Otago and Taranaki. In the Bay of Plenty, growth in non-residential construction demand largely reflects stronger demand for the construction of healthcare facilities, office buildings and social and cultural buildings.

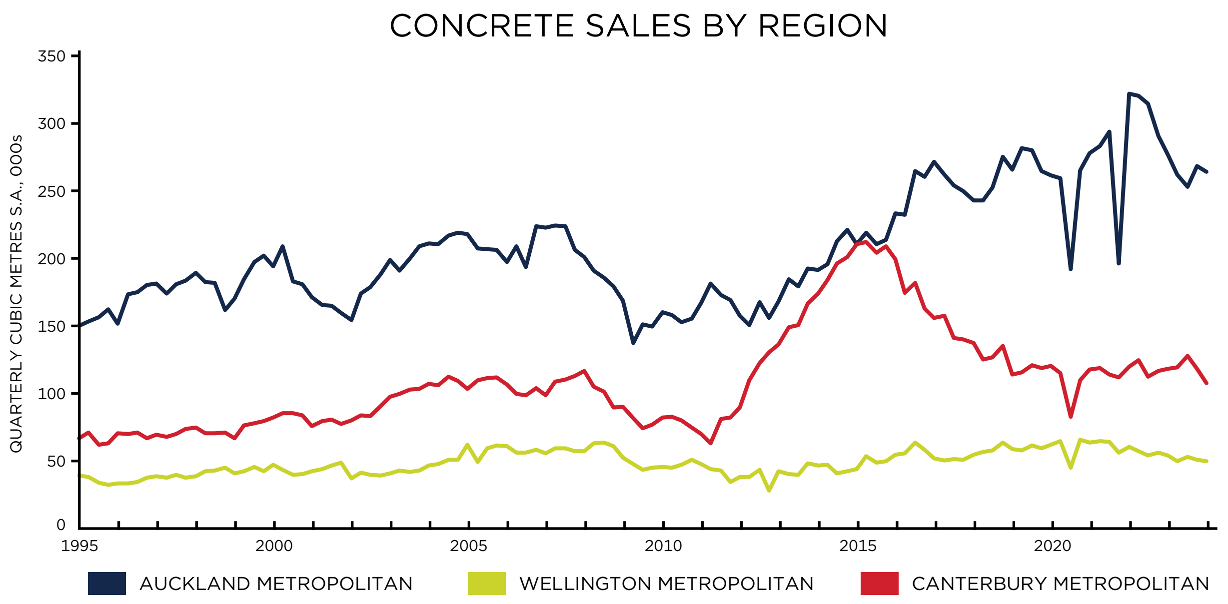
Meanwhile, the growth in Otago has been driven by an increase in consent issuance for healthcare facilities and accommodation. We expect the strong recovery in international tourism activity with the reopening of international borders will remain a key support for the construction demand of new accommodation buildings in the region.

4 This includes sports facilities, museums, libraries and galleries, maraes and religious buildings.

FIGURE 1

Concrete production points to weak construction activity

Quarterly cubic metres s.a., 000s

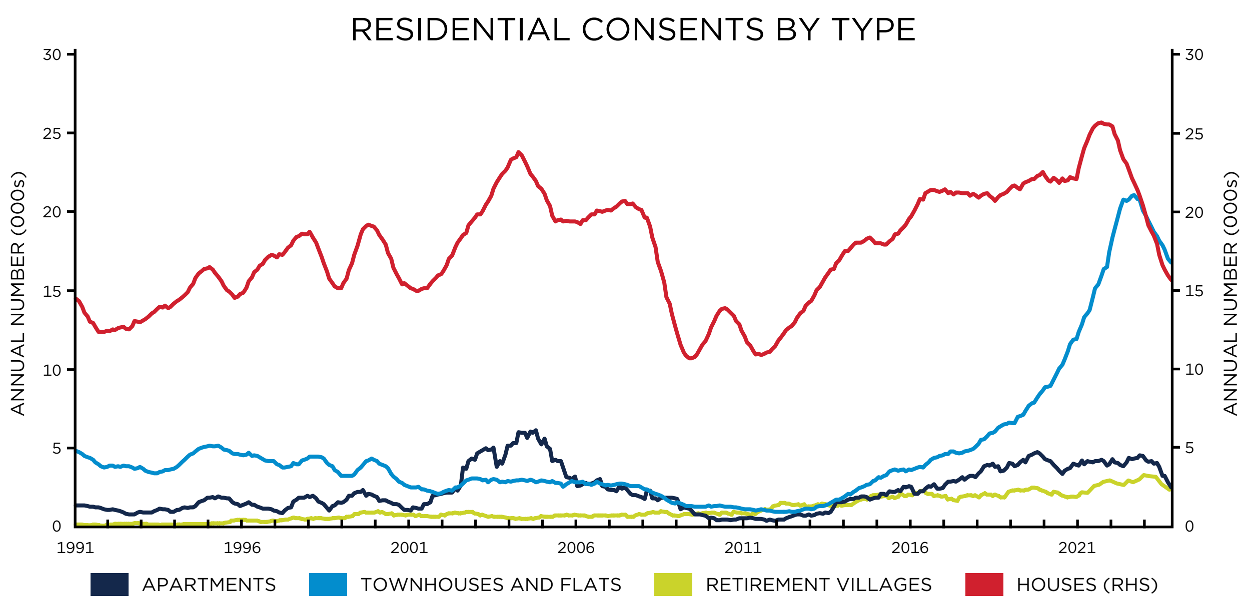


Source: Stats NZ

FIGURE 2

Sharp easing in the pipeline of residential construction

Annual number of consents

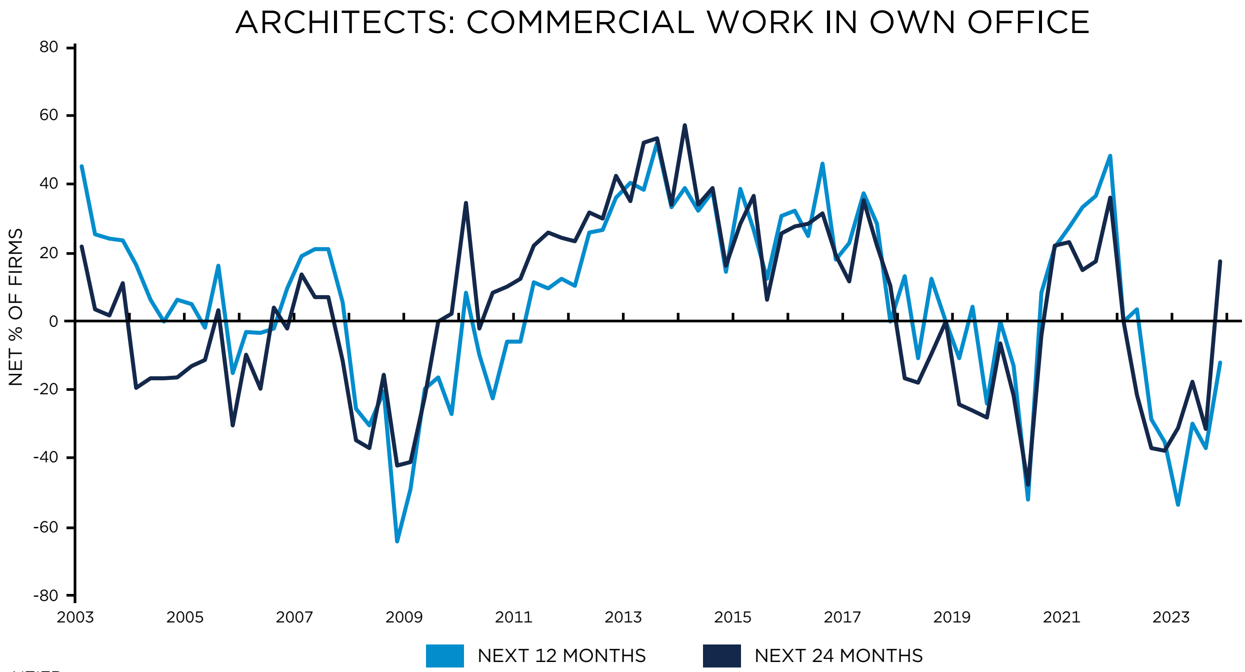


Source: Stats NZ

FIGURE 3

Longer-term outlook for non-residential construction more positive

Net % of firms

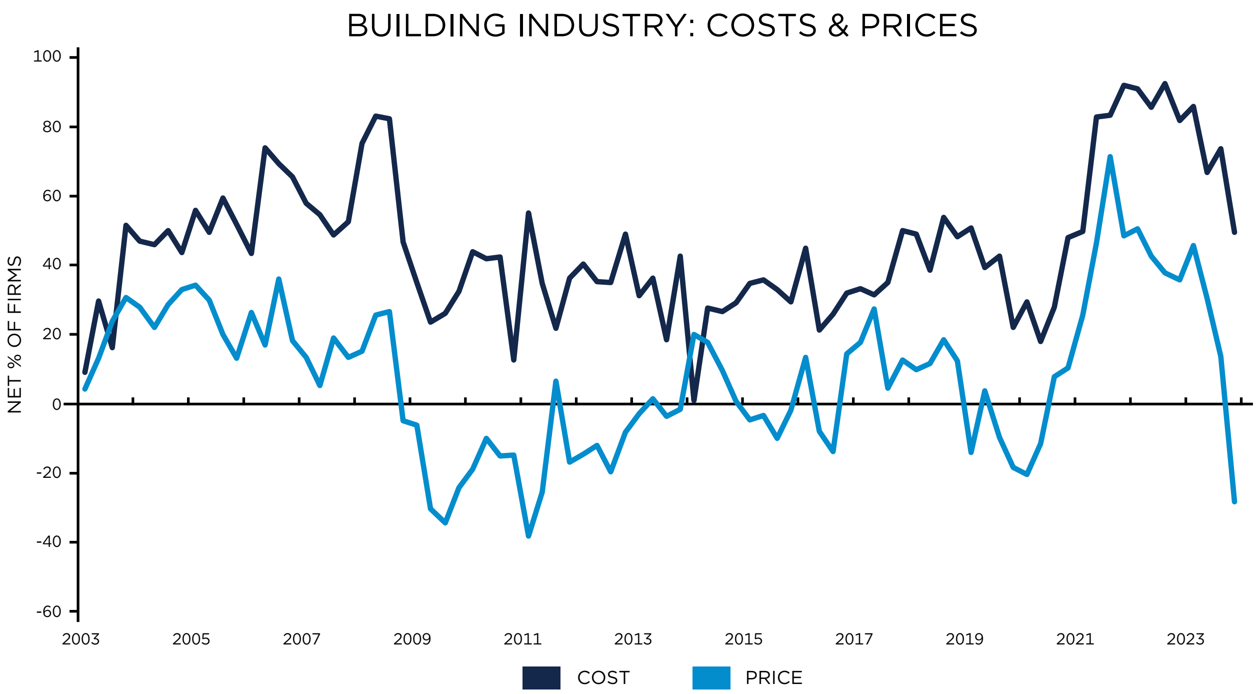


Source: NZIER

FIGURE 4

Sharp easing in pricing pressures

Net % of firms

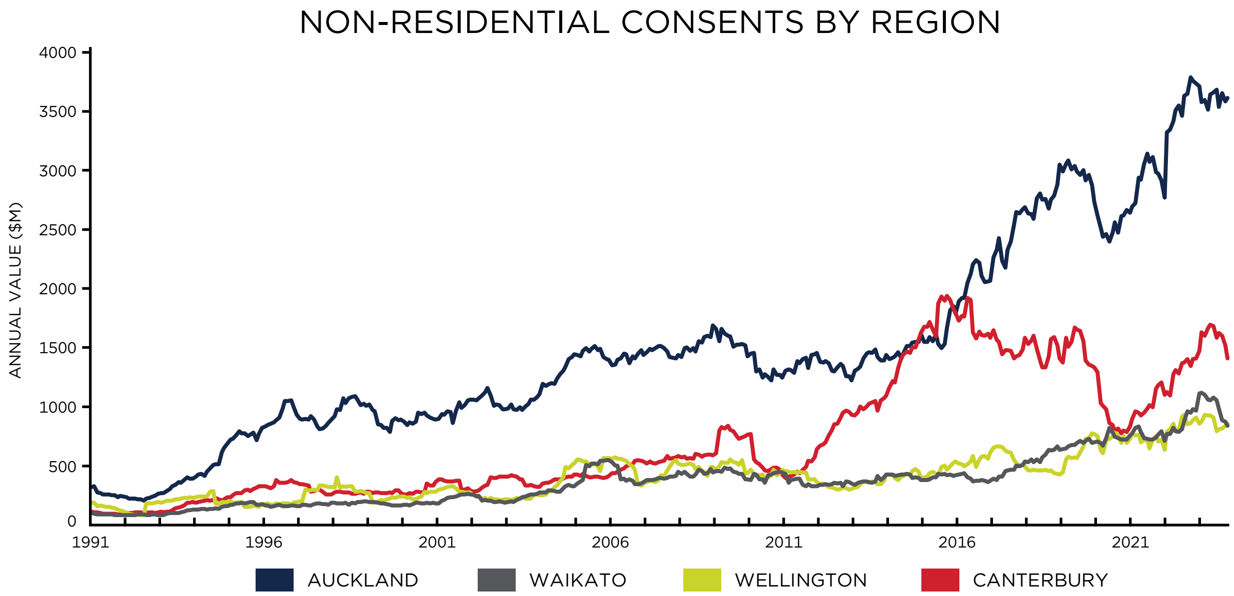


Source: NZIER

FIGURE 5

Near-term pipeline of non-residential construction subdued

Annual value of consents ($ millions)

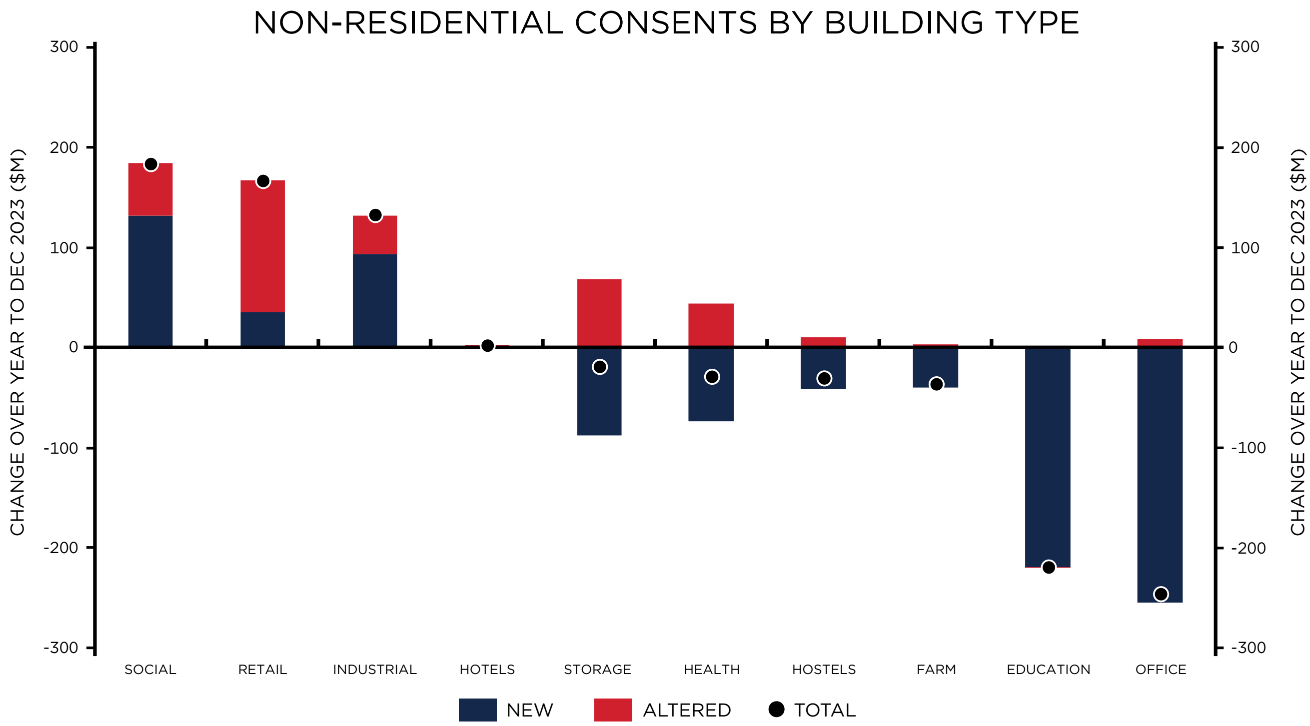


Source: Stats NZ

FIGURE 6

Demand for social buildings and retail outlets continues to lead non-residential construction demand

Change over year to December 2023



Source: Statistics NZ, NZIER

TABLE 1

Non-residential building consents by region and sector

$m of consents for the year ending December 2023; red colour shading for a decline in consents from the previous year

	SECTOR									
REGION	HOSTELS, PRISONS ETC	ACCOMODATION	HEALTH	EDUCATION	SOCIAL, CULTURAL, RELIGIOUS	RETAIL	OFFICE	STORAGE	INDUSTRIAL	FARM
NORTHLAND	0.0	4.7	56.2	46.1	38.4	13.5	14.9	16.1	23.4	9.3
AUCKLAND	17.9	175.7	409.2	446.3	81.6	508.3	759.7	670.7	521.1	18.7
WAIKATO	9.9	9.0	86.6	60.1	96.6	49.8	77.0	246.0	148.2	60.3
BAY OF PLENTY	8.0	10.4	131.1	72.0	81.7	101.2	103.7	41.3	47.1	11.8
GISBORNE	0.7	0.3	31.8	9.0	8.3	1.5	2.8	0.4	0.4	2.2
HAWKE'S BAY	13.1	2.0	49.9	24.4	23.5	47.8	18.8	41.8	70.2	5.1
TARANAKI	0.0	0.2	3.2	16.9	50.2	14.7	20.8	8.6	34.6	16.0
MANAWATŪ-WHANGANUI	2.4	2.3	55.9	57.7	17.0	27.8	22.6	68.0	39.3	21.6
WELLINGTON	2.0	1.5	104.3	137.2	202.3	43.4	247.4	45.1	63.8	11.1
NELSON	0.0	0.0	14.4	10.5	3.6	2.9	6.4	0.5	4.0	0.0
TASMAN	0.0	1.0	2.8	13.5	3.4	5.0	6.1	13.8	16.2	4.4
MARLBOROUGH	0.0	1.5	6.6	18.0	2.3	8.1	3.5	2.3	47.0	6.6
WEST COAST	0.0	1.1	1.7	5.1	9.9	1.8	5.4	2.8	5.7	2.2
CANTERBURY	17.1	17.6	157.3	318.4	251.8	101.1	87.8	267.5	135.4	55.1
OTAGO	3.3	100.5	195.0	61.6	55.2	54.7	85.9	30.5	39.4	27.1
SOUTHLAND	0.3	2.1	15.1	19.7	1.8	6.2	13.2	12.4	24.0	16.0

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 December 2023, reflecting the easing in capacity pressures in the construction sector. The 1.0 percent increase in non-residential construction costs over the quarter saw annual non-residential construction cost inflation ease to 5.7 percent for the year to December 2023.

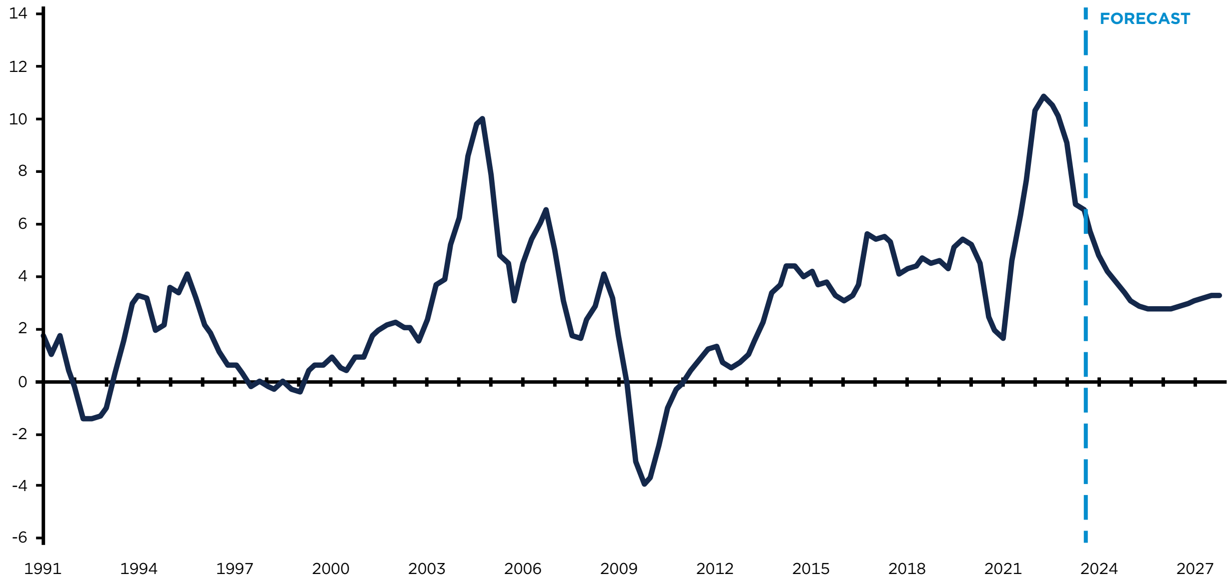
We expect construction cost inflation to continue to ease over the coming years, reflecting the continued easing in capacity pressures in the sector. Building sector firms report a continued easing in labour shortages. In particular, unskilled labour is now easier to find. The drop in pricing indicators reported by firms in the NZIER QSBO points to further easing on construction cost inflation over the coming year.

We forecast annual non-residential construction cost inflation to ease to just under 3.5 percent by the end of this year. Beyond that, 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 a recovery from late 2026 due to stronger construction demand over the longer term.

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	1086	1.0	4.8
	JUNE	1096	0.9	4.2
	SEPTEMBER	1105	0.8	3.7
	DECEMBER	1113	0.7	3.4
2025	MARCH	1120	0.7	3.1
	JUNE	1128	0.7	2.9
	SEPTEMBER	1135	0.7	2.8
	DECEMBER	1143	0.7	2.7
2026	MARCH	1151	0.7	2.7
	JUNE	1159	0.7	2.8
	SEPTEMBER	1168	0.7	2.9
	DECEMBER	1177	0.8	3.0
2027	MARCH	1186	0.8	3.1
	JUNE	1196	0.8	3.2
	SEPTEMBER	1205	0.8	3.2
	DECEMBER	1214	0.8	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

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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