THIRD QUARTER 2024

FORECAST REPORT 109

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

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Cover: Victoria Lane Remuera Apartments, Auckland

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 (RLB) is a leading independent organisation in cost management and quantity surveying, and advisory services.

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FORECAST 109

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 Oceania Market Intelligence Update 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

Construction demand remains weak, reflecting the impact of higher interest rates and uncertainty about the broader economic outlook. The latest NZIER *Quarterly Survey of Business Opinion* (QSBO) shows a further deterioration in sentiment, with the building sector remaining the most downbeat of the sectors surveyed.

Near term pipeline of construction work remains weak

Construction activity fell in the March 2024 quarter, reflecting a decline in both residential and non-residential construction. Activity indicators such as consent issuance and the NZIER QSBO measure of architects' activity in their own office point to a continued weak pipeline of construction across housing, commercial and Government work for the coming year.

Building sector firms remain very downbeat about the outlook

The building sector remains the most pessimistic of the sectors surveyed in the latest NZIER QSBO, with a net 58 percent of building sector firms expecting a deterioration in the general economic outlook over the coming months on a seasonally-adjusted basis.

Weak demand reduces pricing power in the sector

Cost pressures have reduced in the construction sector, and the weak demand environment is putting downward pressure on prices in the sector. This suggests further easing in construction cost inflation over the coming year.

Future outlook

The near-term outlook for construction demand outlook remains weak, but there are signs of some stabilisation. We forecast strong migration-led population growth and lower interest rates to support a recovery in construction demand later in 2025. An acceleration in the number of New Zealanders leaving the country presents downside risks to the construction outlook.

BUILDING ACTIVITY TRENDS

Stats NZ *Building Work Put in* Place showed a contraction in construction activity in the first quarter of 2024. Both residential and non-residential construction declined over the quarter as higher interest rates and heightened uncertainty over the economic outlook dampened construction demand.

There was a decline in construction activity across the regions. Auckland remains the dominant driver of construction activity, making up around 40 percent of nationwide construction activity (on a nominal basis). This reflects the continued concentration of migration-led population growth in the region. Meanwhile, Waikato's share of nationwide construction activity has eased in recent quarters and currently makes up 9 percent of nationwide construction activity.

Building activity indicators point to continued weakness in the construction pipeline in the near term. Dwelling consent issuance has continued to decline in recent months, with a reduction in demand across all types of dwellings since the beginning of the year. The annual number of dwelling consents issued eased below 35,000 for the year to May 2024.

In July, the Government announced its Going for Housing Growth policy,[1] which included plans to increase the supply of land available for housing development by removing restrictions on minimum floor area for apartments and rules to allow cities to expand outwards at the fringes. Making it easier to build new dwellings is an attempt to increase the housing supply in the market in order to improve housing affordability. The Government also introduced housing growth targets for Tier 1 and 2 councils, which would require councils to "live-zone" development capacity to provide at least 30 years of housing demand.

Although these changes have the potential to ramp up residential construction demand, the ability of infrastructure construction to keep up alongside the increased supply of housing, as well as where interest rates are headed, will be important influences on construction demand over the coming years. For now, the latest NZIER QSBO measure of architects' work in their offices shows continued weakness in residential construction for the coming year.

This measure shows what architects expect for the pipeline of construction for housing, commercial, and Government work specifically, based on the work they are undertaking in each of these areas in their own office. A positive result indicates architects expect an increase in the pipeline of construction work, while a negative result suggests architects expect a decline in the pipeline of construction work.

We ask architects for their views on the pipeline of construction work over the next twelve months as well as the next two years. Based on the work in their own office, our latest NZIER QSBO shows a substantial proportion of architects continue to expect a weaker pipeline across residential, commercial and Government construction over the coming year. Beyond that, there are signs of some stabilisation in demand, albeit still at weak levels.

This weak demand for construction is driving continued pessimism in the construction sector. A net 58 percent of building sector firms expect a worsening in general economic conditions over the coming months on a seasonally adjusted basis, well below the 35 percent of firms feeling downbeat across all the sectors.

1 https://www.beehive.govt.nz/release/going-housing-growth-stage-one-unveiled

Building sector firms report a continued deterioration in new orders and output, reflecting the weak demand environment. This weakness in the pipeline of construction work, particularly for the coming year, and uncertainty over when demand will recover is driving a sharp decline in investment intentions in the sector. A net 76 percent of building sector firms plan to reduce investment in buildings over the coming year, while a net 69 percent plan to reduce investment in plant and machinery.

Inflation pressures have also fallen sharply in the construction sector. This reflects a decline in both construction cost and pricing indicators. In particular, a net 34 percent of building sector firms cut prices in the June quarter. Cost pressures have also eased, although a net 47 percent of building sector firms reported increased costs over the quarter. The inability of firms to pass on higher costs by raising prices is continuing to weigh on profitability in the construction sector. These indicators suggest a further easing in construction cost inflation over the coming year.

Developments in the Capital Goods Price Index (CGPI) have been mixed across the construction sectors. Although CGPI residential costs increased 0.9 percent over the March quarter, the 3.9 percent annual increase for the year to March represents a substantial easing from the annual growth of 11 percent a year ago and the peak of 16.6 percent over the first half of 2022. This easing in residential construction cost inflation reflects the weak residential construction demand seen over the past year.

Meanwhile, the 0.8 percent increase in CGPI non-residential construction costs in the March quarter brought annual growth to 4.6 percent. The relatively higher growth in non-residential construction cost inflation reflects activity being more resilient in this sector compared to residential construction.

Despite the strong pipeline of infrastructure construction, there has been a sharp easing in civil construction cost inflation. The 0.1 percent increase in CGPI civil construction brought annual growth to 2.1 percent.

We forecast further easing in construction cost inflation over the coming year, reflecting the easing in capacity pressures in the sector. A large part of this reflects the significant turnaround in labour shortages in the construction sector over the past year. In particular, a net 73 percent of building sector firms report it is easier to find semi-skilled and unskilled labour.

BUILDING ACTIVITY OUTLOOK

The outlook for construction remains weak in the near term. Building activity indicators such as the NZIER QSBO measure of architects' work in their own office, along with consent issuance, point to a weak pipeline of construction for the coming year. Beyond that, we expect the combination of lower interest rates and migration-led population growth to support a recovery in construction demand from 2025.

Non-residential consent issuance has been mixed across the regions. Demand has weakened across most regions over the past year, with Auckland being the exception. Stronger demand for the construction of industrial and storage facilities has driven the growth in non-residential consent issuance in Auckland over the past year.

This growth has been more than offset by weaker demand in the other regions, especially Waikato and Canterbury. Uncertainty over the global demand outlook for our primary products, such as dairy, may be contributing to this decline in non-residential construction demand in these regions. There has been a particularly sharp drop in consent issuance for storage buildings in Waikato, while consent issuance for industrial buildings in Canterbury has also fallen sharply.

Looking ahead, the continued contraction in manufacturing activity reported in the latest BNZ *Business NZ Performance of Manufacturing Index* (PMI) in June suggests demand for industrial buildings should slow over the coming year. With manufacturing activity reported to be particularly weak in the North Island, we expect this will weigh on construction demand for industrial buildings in Auckland.

Te Waihanga, the New Zealand Infrastructure Commission, reported in its *Pipeline snapshot*[2] for the March 2024 quarter that infrastructure projects totalled $121.2 billion in value. Of this, around $44 billion is estimated to be under construction and $11 billion in procurement.

The $12.7 billion increase in the value of infrastructure projects in the pipeline over the March quarter reflects a combination of new infrastructure projects (worth $11.4 billion), increases in the value of existing projects, and new contributors to the pipeline. Transport infrastructure continues to be a dominant part of the pipeline, with the value of transport projects totalling $61.9 billion. Meanwhile, the value of water infrastructure in the pipeline totalled $20.6 billion.

In terms of projected spend over the coming years, $12.1 billion of infrastructure investment from the pipeline is expected to take place in 2024, while expectations for infrastructure investment for 2025 remain at $11.6 billion. Over the near term, infrastructure investment in the transport, social, which includes community facilities and housing, and water sectors is expected to dominate the pipeline.

ECONOMIC BACKDROP

The Stats NZ release of March 2024 GDP showed a 0.2 percent increase in New Zealand economic activity for the quarter. This pickup in activity follows contractions in the previous two quarters, thus ending the technical recession. However, annual GDP growth remained subdued at 0.3% for the year ended March 2024, pointing to continued weakness in the overall economic performance over the past year. The result suggests the economy may be slowly emerging from the recent weakness, but the recovery remains fragile and uneven across sectors. Weak demand is still broad-based across the sectors, reflecting the headwinds faced by households and businesses in the current environment of high interest rates and heightened uncertainty.

2 https://tewaihanga.govt.nz/the-pipeline/pipeline-snapshot

The NZIER QSBO showed a net 28 percent of firms reported a decline in activity in their own business over the June quarter. The proportion of firms reporting weak demand as a key concern continues to increase, with 61 percent of firms now reporting this being the primary constraint on their business. In contrast, the proportion of firms reporting finding labour as the primary constraint on their business continues to fall, reflecting the sharp turnaround in labour shortages over the past year.

The combination of weaker demand and continued uncertainty over the new Government's priorities around spending and public sector cutbacks remains the key factor driving caution amongst businesses. A quarter of firms reduced staff numbers in the June quarter. Firms have also become a lot more cautious when it comes to investment plans, with a net 27 percent of firms planning to reduce investment in plant and machinery over the coming year, while a net 35 percent plan to reduce investment in buildings.

We expect that with over 60 percent of mortgages due for repricing over the coming year, many households will continue to rein in spending, given higher mortgage repayments. This should continue to weigh on economic activity despite strong migration-led population growth.

INTEREST AND EXCHANGE RATES

The slowing in economic activity and weak sentiment amongst businesses and households have intensified speculation about whether the Reserve Bank of New Zealand (RBNZ) will reduce the official cash rate (OCR) by the end of this year. The dampening effects of higher interest rates on demand have become much more apparent, and inflation pressures are easing as a result.

This easing in inflation pressures is seen across a broad range of measures, including the NZIER QSBO cost and pricing indicators, as well as the RBNZ Survey of Expectations, which shows a continued easing in inflation expectations in the June quarter.

The RBNZ, in its July Monetary Policy Review (MPR), acknowledged the impact of higher interest rates in reducing inflation and reaffirmed its expectation that annual CPI inflation will return to within its 1 to 3 percent inflation target band over the second half of this year. The central bank highlighted the uncertainty around the inflation impacts of the upcoming tax cuts. Given the heightened uncertainty and environment of higher interest rates, we expect the inflation impact will be muted as households put the tax cuts towards savings or paying down debt.

The central bank noted that monetary policy will remain restrictive, with the extent of this restraint reduced over time as inflation pressures continue to ease. Financial markets have interpreted this as paving the way for an OCR cut by the end of the year.

How domestic inflation pressures evolve through non-tradable inflation will be a key influence on the timing of when the RBNZ will commence its easing cycle. We expect the RBNZ will cut the OCR in February 2025, given it will want to be confident it has anchored inflation back to within its inflation target band.

The focus on other central banks has also been on when they will cut interest rates. In particular, the US Federal Reserve's recent focus on the softening of the US labour market has intensified speculation that it cut interest rates soon. In his address to the Senate Banking Committee, Fed Chair Powell's acknowledged that easing monetary policy "too late or too little could unduly weaken economic activity and employment". The comments supported expectations of a rate cut from the Fed in September this year.

We expect currency movements will continue to be influenced by interest rate differentials. Given expectations of an earlier start to the easing cycle for the US, this should make the New Zealand dollar more attractive from a yield perspective and support and appreciation in the NZD/USD.

BUILDING INVESTMENT

Businesses have become much more cautious about investment, reflecting continued uncertainty over the new Government's spending plans and cutbacks in the public sector.

BUILDING CONSENTS

A sharp decline in consent issuance for education buildings continues to be a key driver of the weakness in non-residential construction demand for the year to May 2024. There has also been a substantial decline in demand for the construction of health facilities and retail outlets nationwide. The decline in demand for health facilities has followed strong demand in recent years. Meanwhile, we expect demand for new retail outlets will remain weak, given households are reining in discretionary spending in the face of higher mortgage repayments and softening in the labour market.

In contrast, there has been an increase in demand for the construction of industrial buildings, driven by strong growth in Auckland. We expect the robust demand for warehouses to ease over the coming year, given the broad-based softening in demand.

Building consents by sector

Overall, non-residential construction demand has been weak, with growth for new construction (as opposed to alterations) only for industrial buildings. Besides strong growth in Auckland, there was also increased demand for the construction of industrial buildings in Wellington.

Across all other non-residential building types, there was a decline in consent issuance for new buildings. Besides health facilities and education buildings, there has also been a substantial decline in consent issuance for new office space over the past year. This was partly offset by an increase in office space alterations.

The outlook for office construction demand is mixed. The softening labour market and the continued trend towards hybrid working (i.e. a combination of working from the office and working from home) should weigh on demand for office space. However, this is likely to be offset by strong migration-led population growth, particularly over the longer term.

Building consents by region

Over the past year, growth in non-residential consent issuance has been concentrated in Auckland. This was driven by strong demand for the construction of storage and industrial buildings.

There was also growth in non-residential consent issuance in the Bay of Plenty, although to a much smaller degree. This growth was largely driven by increased demand for the construction of office space over the past year.

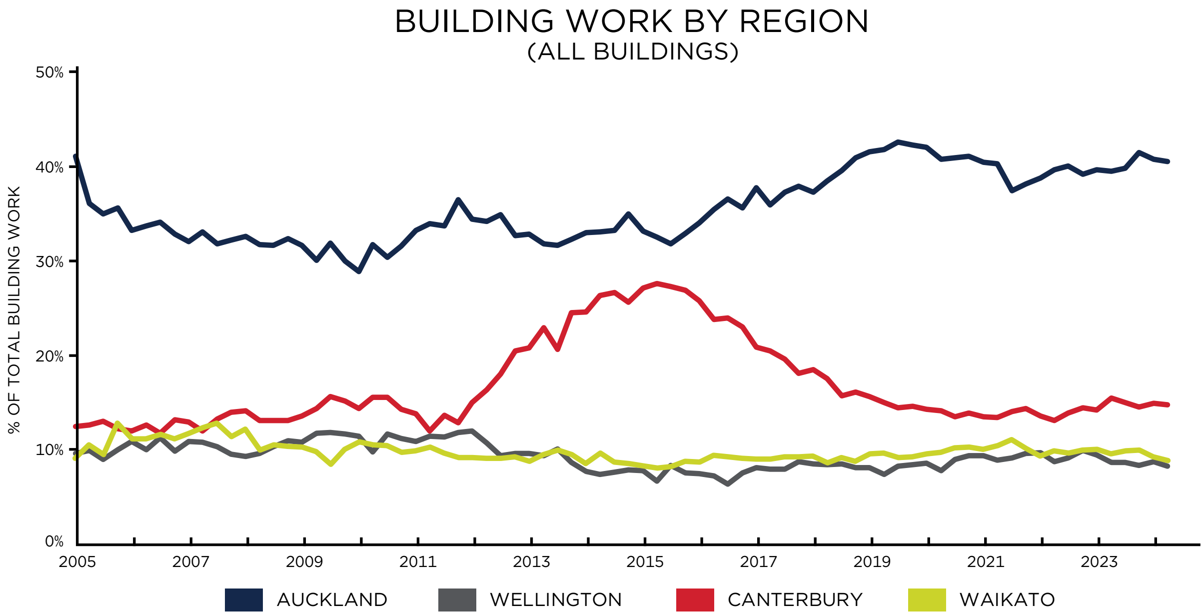
In contrast, non-residential consent issuance fell sharply in Waikato and Canterbury over the past year. In Waikato, this was driven by reduced demand for storage buildings, while in Canterbury, demand for the construction of education and industrial buildings, as well as health facilities, decreased.

Parliament Executive Wing Facade, Wellington

FIGURE 1

Auckland remains the key driver of construction demand

% of total building work

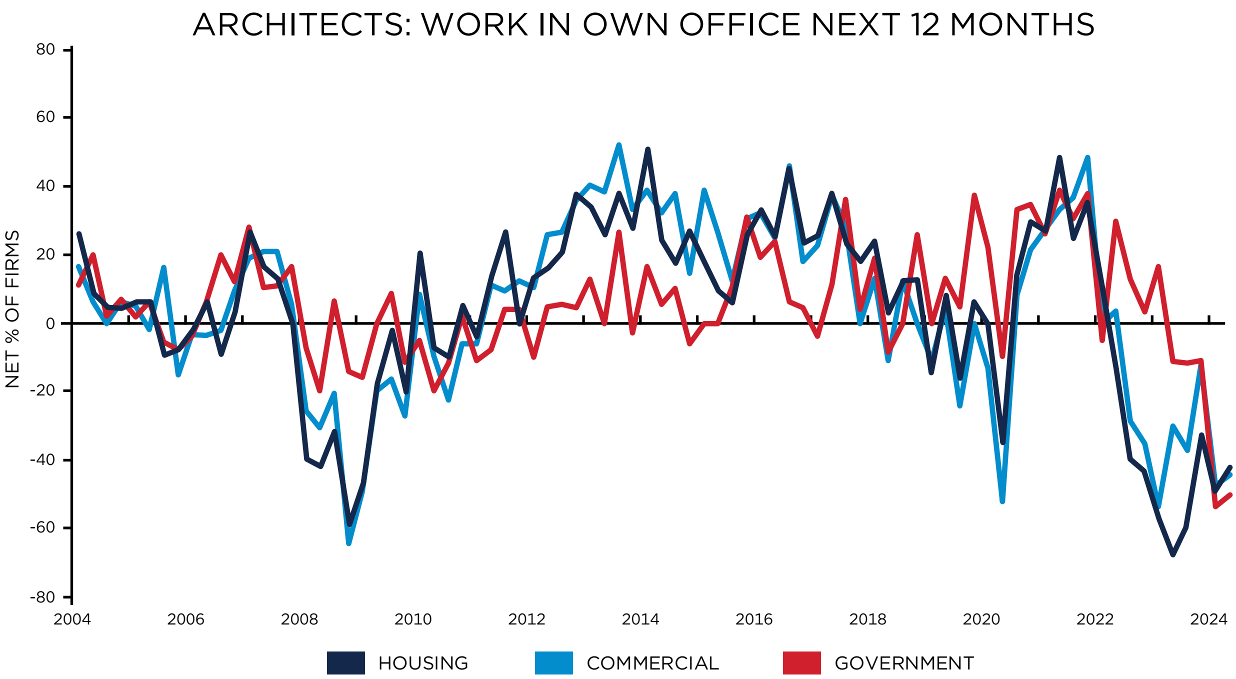


Source: Stats NZ

FIGURE 2

Pipeline of construction work remains weak

Net % of firms

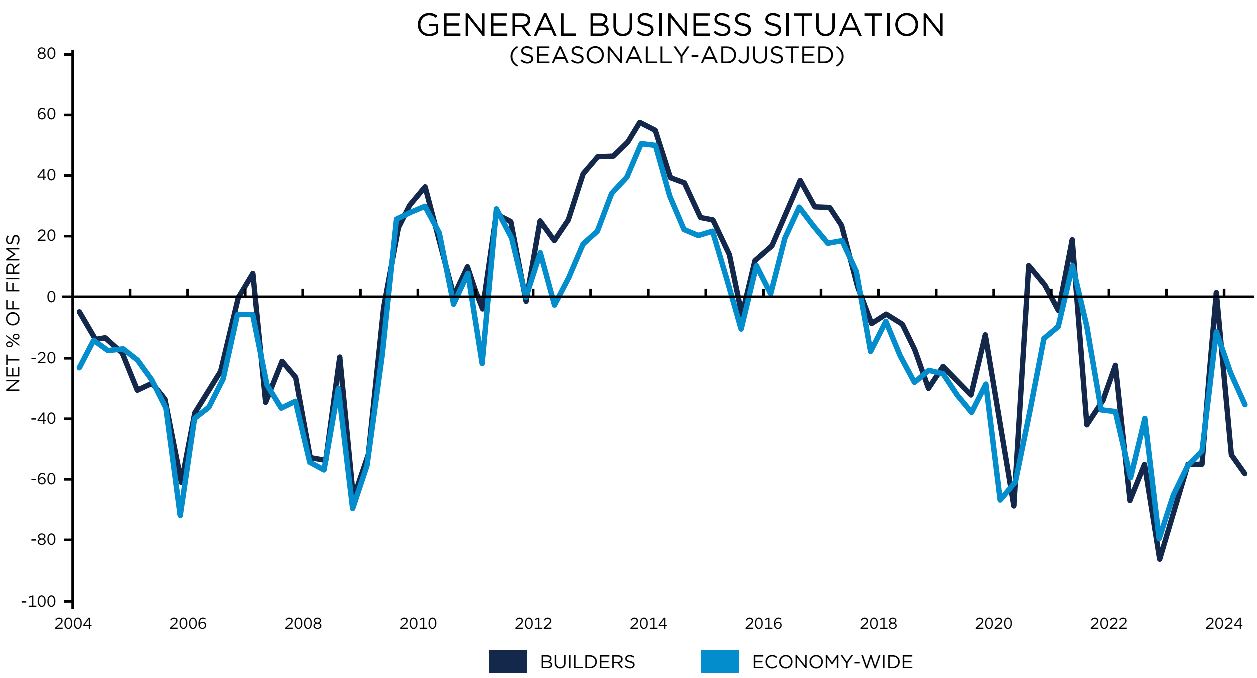


Source: NZIER

FIGURE 3

Building sector firms remain the most downbeat

Net % of firms

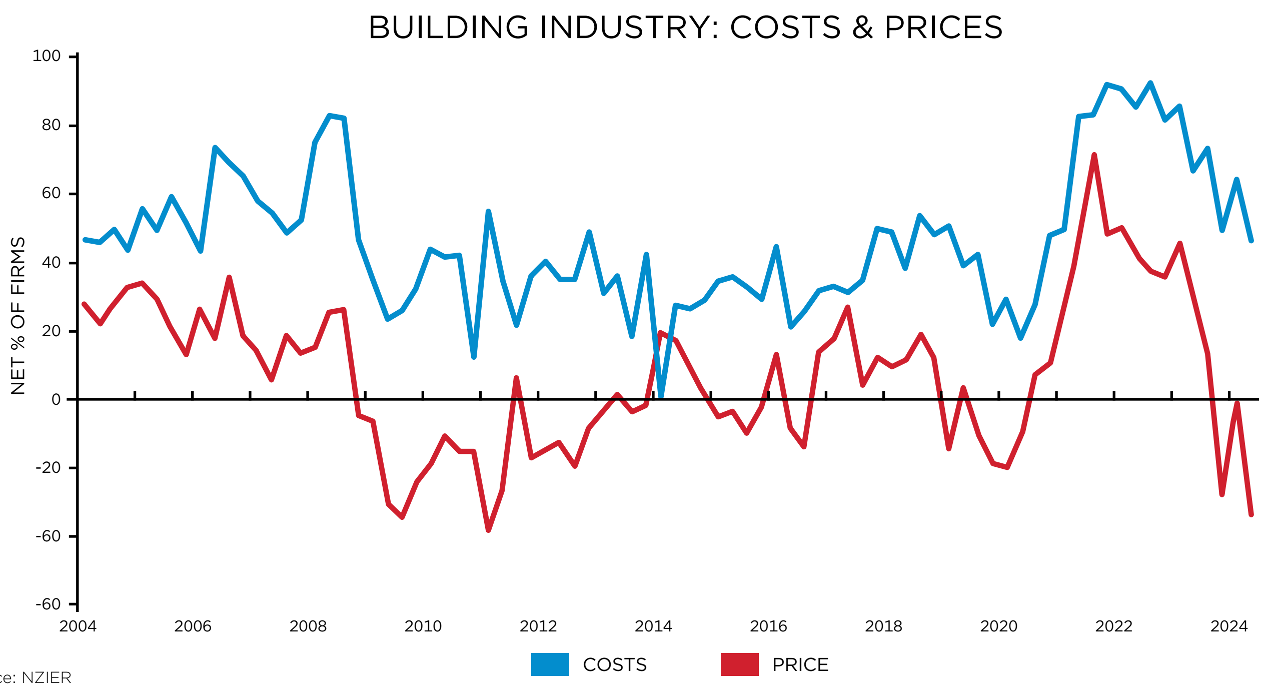


Source: NZIER

FIGURE 4

Cost and pricing indicators ease in a weak demand environment

Net % of firms



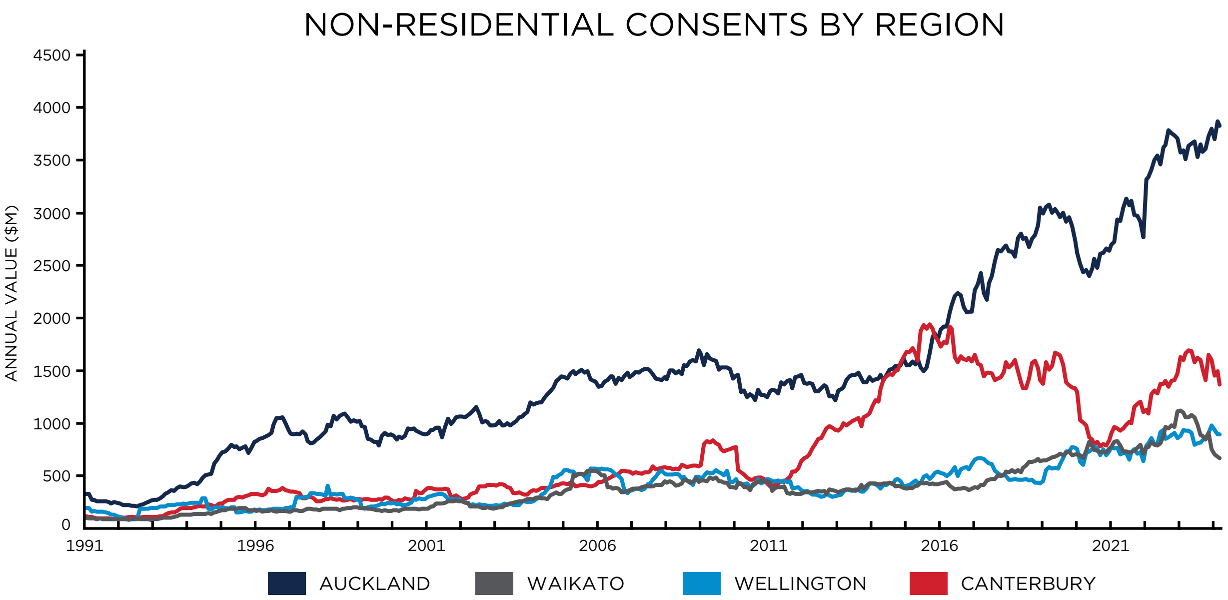
Source: NZIER


TŌTARA
HAUMARU

FIGURE 5

Growth in Auckland construction demand offsetting weakness in other regions

Annual value ($ million)



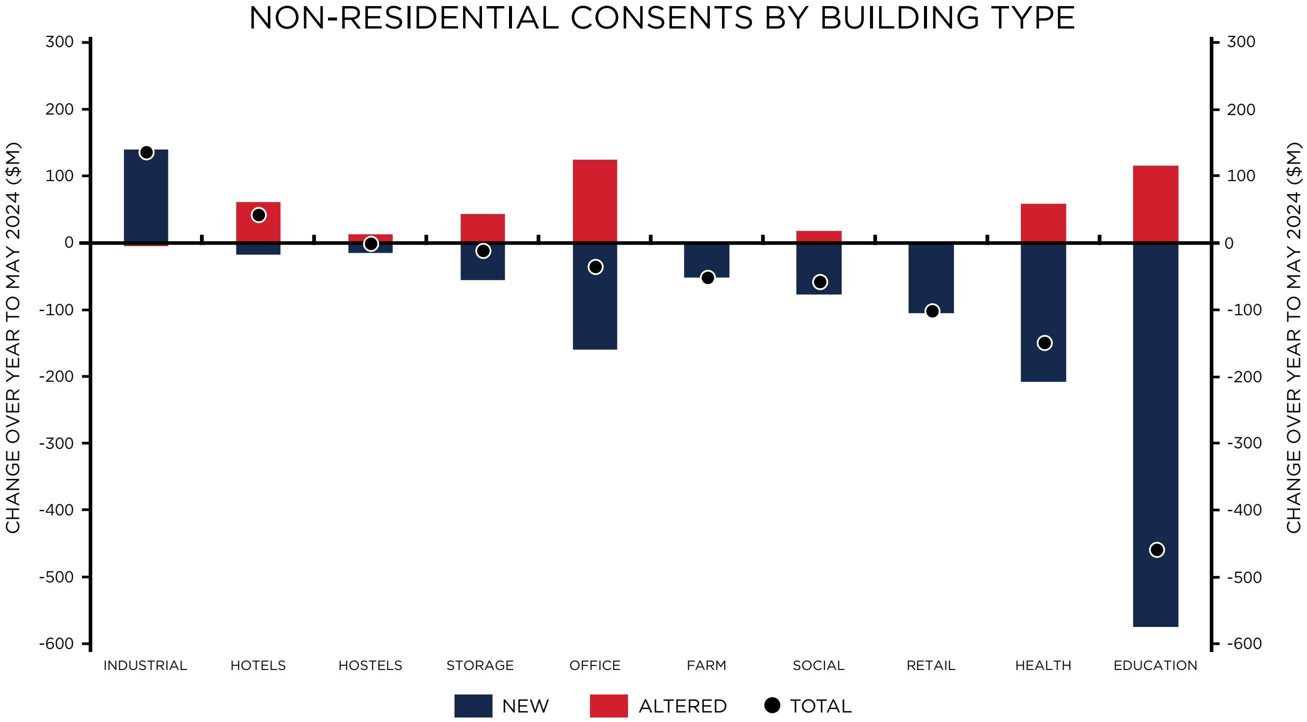
Source: Stats NZ

Tōtara Haumaru Hospital, Auckland

FIGURE 6

Sharp decline in demand for education buildings drives weakness in non-residential construction demand

Change over year to May 2024



Source: Statistics NZ, NZIER

TABLE 1

Non-residential building consents by region and sector

$m of consents for the year ending May 2024; 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	1.5	13.6	76.0	43.9	29.9	11.8	14.3	17.1	20.8	14.5
AUCKLAND	62.7	164.8	618.0	358.8	105.8	384.0	737.9	773.6	600.6	23.3
WAIKATO	4.1	22.4	159.0	62.0	32.9	49.0	60.4	105.0	116.5	56.6
BAY OF PLENTY	2.4	7.0	99.7	66.8	41.5	70.5	184.5	71.1	51.9	13.6
GISBORNE	0.9	0.0	30.0	6.0	8.5	13.9	2.0	1.1	1.2	2.2
HAWKE'S BAY	5.4	3.2	19.0	32.4	31.3	31.0	25.1	34.7	64.4	7.2
TARANAKI	0.0	0.2	4.8	16.8	17.6	11.3	10.2	21.2	14.4	11.3
MANAWATŪ-WHANGANUI	4.0	3.4	29.4	19.1	9.2	30.0	18.0	56.3	28.0	13.4
WELLINGTON	0.9	5.3	85.5	110.6	171.3	55.2	284.3	36.7	136.7	10.7
NELSON	0.0	0.1	14.0	8.1	2.7	4.8	5.4	5.0	10.4	0.1
TASMAN	3.1	1.7	2.7	9.5	3.1	3.4	15.2	5.9	19.9	5.8
MARLBOROUGH	0.8	1.5	5.7	18.2	0.7	5.6	4.2	11.9	29.7	6.8
WEST COAST	0.0	0.2	0.0	4.3	4.7	2.3	3.9	2.2	7.8	1.6
CANTERBURY	2.1	22.1	141.5	196.0	347.7	131.4	86.2	295.3	102.6	46.8
OTAGO	4.5	69.4	140.3	79.6	75.8	64.7	82.7	24.1	50.7	24.4
SOUTHLAND	0.3	15.5	15.1	36.9	2.4	5.3	9.5	11.5	20.7	14.2

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 2024 as capacity pressures continued to ease in the construction sector. In particular, there has been a remarkable turnaround in labour shortages in the construction sector. The 0.8 percent increase in non-residential construction costs over the quarter saw annual non-residential construction cost inflation fall to 4.6 percent for the year to March 2024.

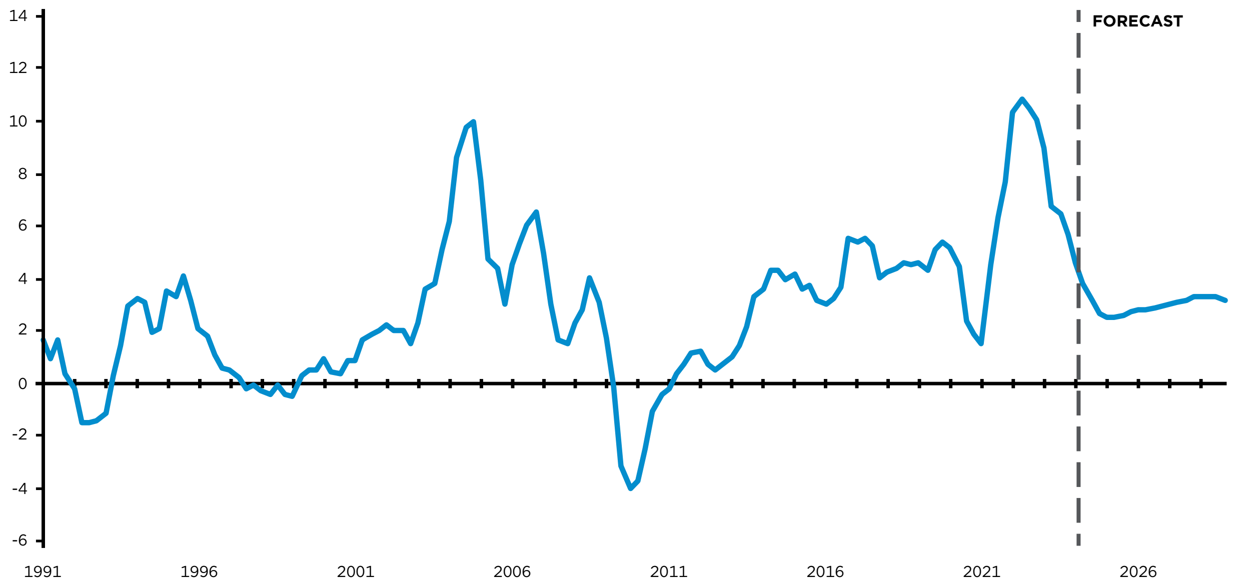
We expect construction cost inflation will continue to ease over the coming years, reflecting the continued easing in capacity pressures in the sector. The NZIER QSBO shows an easing in cost and pricing indicators in the construction sector, with weak demand reducing pricing power amongst building sector firms. This supports our view of further slowing in construction cost inflation.

We forecast annual non-residential construction cost inflation to ease to 2.5 percent in early 2025. Beyond that, we expect a recovery in construction demand will underpin a lift in construction cost inflation from the second half of 2025.

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
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	0.8	4.6
	JUNE	1092	0.7	3.8
	SEPTEMBER	1099	0.6	3.2
	DECEMBER	1105	0.6	2.7
2025	MARCH	1112	0.6	2.5
	JUNE	1120	0.7	2.5
	SEPTEMBER	1128	0.7	2.6
	DECEMBER	1136	0.7	2.7
2026	MARCH	1144	0.7	2.8
	JUNE	1152	0.7	2.9
	SEPTEMBER	1160	0.7	2.9
	DECEMBER	1169	0.8	3.0
2027	MARCH	1178	0.8	3.0
	JUNE	1188	0.8	3.1
	SEPTEMBER	1198	0.8	3.2
	DECEMBER	1208	0.9	3.3
2028	MARCH	1218	0.8	3.4
	JUNE	1228	0.8	3.4
	SEPTEMBER	1238	0.8	3.3
	DECEMBER	1247	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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