



More intensity

The construction cycle is shifting into a new phase

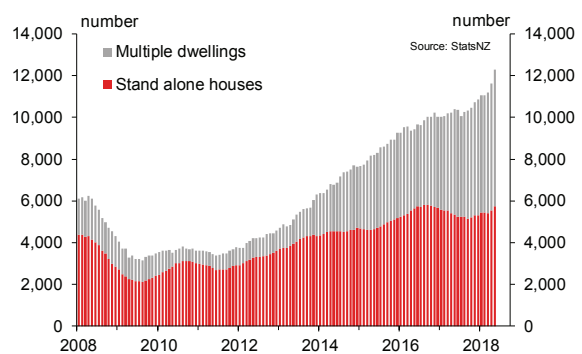
- Recent dwelling consent figures point to a significant increase in medium density home building over the coming year, centred on Auckland. As a result, we've revised up our forecast for residential construction.
- Auckland is now entering a new phase of its construction cycle. The acceleration in home building is occurring at the same time as net migration is cooling. Consequently, the shortage of houses in Auckland that has been growing for years has now started to flatten off. And looking ahead, we expect that Auckland will soon be building enough homes to start gradually eating into its housing shortage.
- Auckland is still looking at a protracted home building cycle, with around a decade of strong construction needed.

Medium density home building is ramping up in Auckland

Through 2017 and early-2018, home building activity in New Zealand stalled. The number of new houses being built flattened off, and consent issuance essentially tracked sideways. That was despite continued strength in population growth and a growing shortage of housing, particularly in Auckland. Among the factors constraining building activity were stretched capacity and challenges accessing finance. The slowing housing market in Auckland may also have prompted some developers to delay projects. These developments prompted us to revise down our forecast for construction, although we still expected gradual increases in activity over the coming years.

To our surprise, however, the number of dwelling consents issued has broken higher again in recent months. In fact, the number of consents issued in the May month was the highest since 2004. And this isn't just a case of one unusually strong month; consent issuance has been running at solid levels since March.

Annual residential dwelling consents – Auckland



Author:

Satish Ranchhod
Senior Economist

Phone: +64 9 336 5668

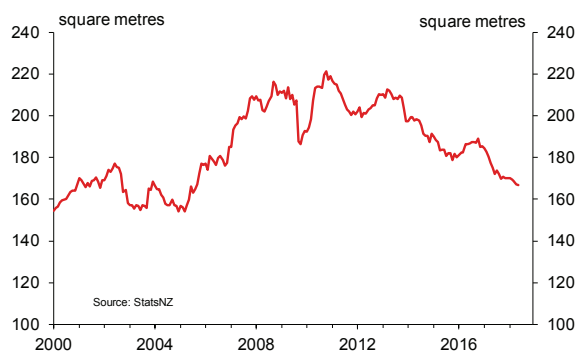
Email: satish.ranchhod@westpac.co.nz



The recent uplift in dwelling consents has been centred squarely on the Auckland market, and has been underpinned by a 30% increase in 'multiple' consents (which includes apartments and medium density houses). With around 6,500 new units consented over the past year, the multiple category now accounts for more than half of all new housing in Auckland. In contrast, consents for stand-alone homes in Auckland remain at solid levels, but have been fairly stable in recent years.

The large increase in multiple consents in Auckland has been supported by regulatory changes, including 2016's Unitary Plan, which allow for a significant increase in housing density in Auckland. It has taken some time for projects under the new regulations to come to market. However, we are now seeing a substantial lift in new housing developments, including a significant increase in 'brown fields' construction. In addition, with a shift to higher density dwellings, the size of homes that are now being consented has been trending downwards. Over time, this could help to improve housing affordability.

Average size of dwellings consented in Auckland



In most other parts of the country, we're still consenting a large number of new dwellings, however issuance has remained fairly steady over the past year. The notable exception to this pattern is Canterbury, where consent numbers have been trending down as post-earthquake reconstruction has been completed.

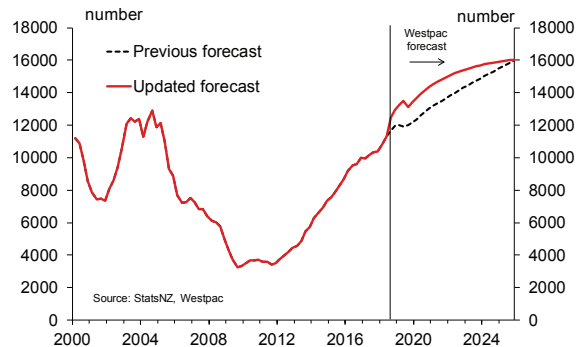
Auckland home building to increase, pushing the construction cycle into a new phase

Consents are often issued in 'lumps.' That's because a single housing development can include a large number of units. With this in mind, it wouldn't be surprising to see a bit of a pullback in consent numbers over the next few months. However, smoothing through such month-to-month volatility, we expect that most of the recent increase in medium-density consent numbers will be sustained.

In light of the uptick in consents, we have revised up our forecasts for Auckland home building over the coming year. We also expect that the underlying trend in consents will continue to grind higher over the coming years. However, with limits on capacity, further increases will likely be

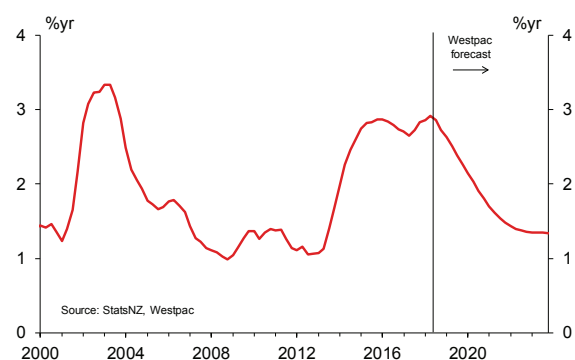
gradual. Construction firms are continuing to highlight significant challenges sourcing skilled labour and rising costs. In addition, many building firms are reporting difficulties accessing finance.

Westpac forecasts for Auckland dwelling consent issuance (annual)



At the same time as construction activity is starting to lift, population growth has started to slow. In recent years, rapid increases in the population outpaced home building and saw a significant shortage of housing develop in Auckland. That was reflected in a large increase in the average number of people per dwelling. But while population growth remains strong, it has levelled off as new arrivals into the country have moderated, and the number of departures has picked up. With economic growth in New Zealand cooling as conditions in other regions have firmed, we expect that recent trends in migration will continue and that population growth will fall to below average levels over the coming years.

Population growth Auckland



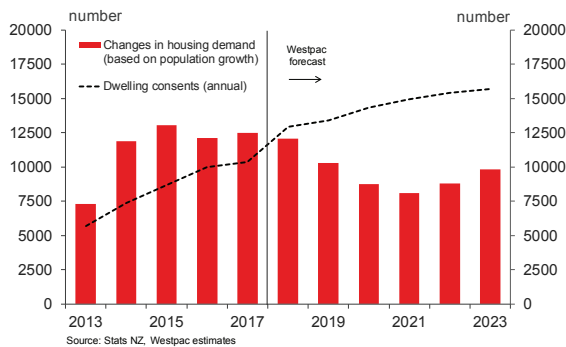
This combination of increasing home building and slowing population growth means we are now entering into a new phase of the construction cycle. The shortage of houses in Auckland that has been growing for years has now started to flatten off, and rental inflation has also cooled. Looking ahead, we expect that Auckland will soon be consenting enough homes to start gradually eating into its housing shortage. We estimate that Auckland needs to build an average of 14,000 houses a year¹. And while we're not there just yet, the underlying monthly trend in consents is

¹ This estimate includes an allowance for replacement homes (i.e. when one home is demolished to make way for two or more new homes).

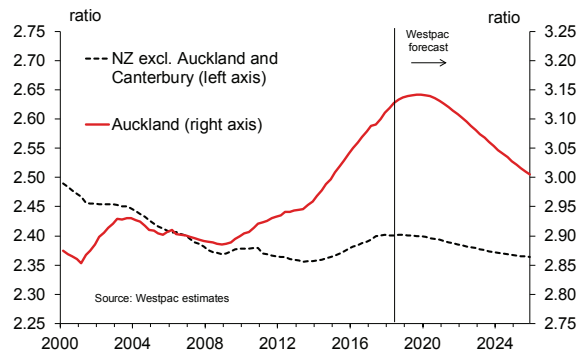
getting close and should reach the required level over the coming year.

Auckland may be close to building enough houses to keep pace with population growth. However, the region will still need a protracted period of rapid home building to address the shortage of houses that has built up in recent years. Auckland currently has a shortfall of close to 30,000 houses. And even allowing for a slowdown in net migration, the population is set to grow by around 300,000 people over the coming decade. To address the existing shortfall and meet the needs of its growing population, Auckland will need around a decade of strong construction activity. Even then, we wouldn't expect that the availability of homes will return to the sorts of levels we saw over the past decade. It's normal for larger centres to have higher levels of population density than other regions. The employment, educational and social opportunities that larger centres tend to offer attracts large numbers of people. And Auckland is no exception. However, with limits on land supply, the resulting pressure on rents and house prices means that many people end up living in larger households, be that with flatmates or extended family.

Auckland housing demand and consents



People per dwelling



With a faster pick up in construction activity, we will be watching for related changes on some other important fronts. First is the labour market. As noted above, shortages of skilled labour are already a key challenge for the building industry. Further increases in activity are likely to add to the competition for labour, and that could spill over to other sectors of the economy or regions outside of Auckland. This could also see associated pressure on wages in some sectors.

We could also see important changes in inflation. Construction plays a key role in determining the level of domestic inflation, and we were already assuming firm levels of construction activity over the coming years. A stronger construction outlook would imply even more pressure on costs. As a comparison, the last time we saw the sort of pace in home building that is now needed was in the late 1990s / early 2000s. Even though that was a much shorter building cycle than we now require, it was associated with large increases in building costs.

Satish Ranchhod
Senior Economist

Contact the Westpac economics team

Dominick Stephens, Chief Economist +64 9 336 5671

Michael Gordon, Senior Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Anne Boniface, Senior Economist +64 9 336 5669

Paul Clark, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

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