Westpac Institutional Bank

3 June 2016

Building steam: construction accelerates

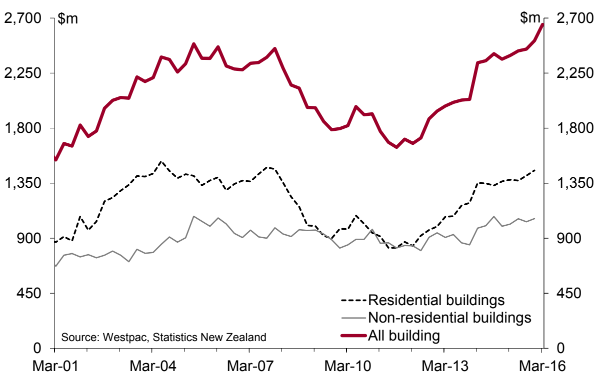
March 2016 quarter building work put in place

- Total building work put in place rose very strongly in the March quarter, up 5.3% in volume terms.
- This was even faster than growth in the December quarter, taking building work put in place to another record high on a quarterly basis.
- Residential building consent growth has slowed in Auckland in particular over the last five months. This may be as developers await the finalised Unitary Plan, which will likely allow more intensive development of land-holdings.
- As a result, near-term construction activity may be affected over the second half of this year.
- Still, building work put in place is expected to continue growing year-on-year until mid-2018.

The big picture

Total building work put in place grew by 5.3% in the March 2016 quarter. To put this in perspective, this was stronger even than our bullish forecasts of 2.1%, and well ahead of the consensus forecast of 1.0%.

Building work put in place, quarterly volumes

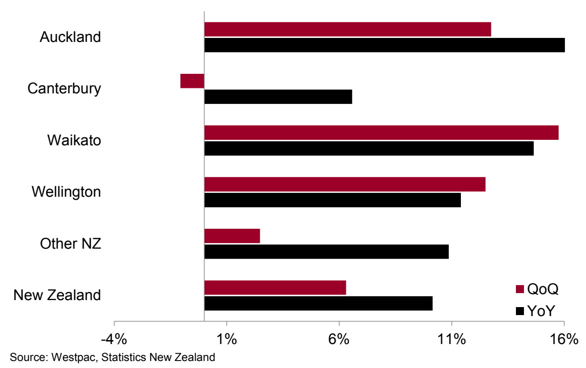


The March growth rates were almost equally strong across residential and non-residential building work. Residential work put in place rose 5.5%, while non-residential increased by 5.0%. Year-on-year volumes were up 6.4% for residential building and 4.3% for non-residential building compared to the same quarter a year ago. In other words, construction has been a pillar of the economic picture over the last year.

The story at the sub-national level is mixed, as it has been for some time. Growth has been very much about Auckland for some time, and that has continued unabated. In value terms, residential activity grew 13% in the city in the March quarter, and non-residential building was up 7.2%.

But some other parts of the country have joined the construction boom. The Waikato saw total building activity leap 16% in value terms in the latest quarter, and year-on-year growth has reached nearly 15%. And in Wellington, year-on-year growth in values was 11%.

Growth in building work put in place



Meanwhile, the slow-down in Canterbury residential activity we have been forecasting since mid-2015 has materialised. In the latest quarter, both residential and non-residential activity was down. Year-on-year, residential activity is down 2.4%.

A lot of commercial work remains to be done, and our forecasts show the non-residential component of the rebuild continuing to grow through 2016. Although the March quarter was actually down a fraction, non-residential building activity value in Canterbury grew 21% year-on-year.

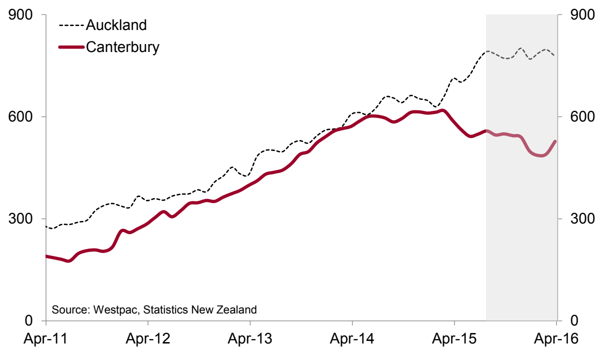
Short-term easing is possible

Today's strong building work put in place result is not expected to be the peak. In last quarter's bulletin, we pointed to a strong pattern of consent approvals at a national level, particularly on the residential front. That is still the overall trend we expect to continue over the next 12 to 18 months.

However, we now expect that in the short-term, we may see a bit of weakness in Auckland. Consents over the last six months have clearly flattened in the country's largest city. At the same time, the decline in residential consents in Canterbury appears to have been arrested, at least temporarily.

A casual observer would struggle to explain this change in Auckland. Net migration remains strong, and we estimate a shortfall of around 30,000 dwellings in Auckland today. The local economy is strong, and house prices have rebounded.

Residential consents, six-month trend



Our increasing suspicion is that many developers are holding off redeveloping land purchased within the areas earmarked for intensification under the proposed Unitary Plan.

Land in many parts of the city that is currently zoned for low density development (and typically already have a stand-alone house on them) will, if the Plan passes in anything like its current form, be capable of more intensive (and therefore profitable) development.

Hearings on the proposed Plan have now closed, and the central government is putting pressure on Auckland Council to deliver a Plan that will meet the city's long-term housing needs. It stands to reason that developers are holding off lodging their resource consent and then building consent applications until the Plan is finally operative, and they are allowed to develop more intensively.

We have entered a period where, in the short-term, we may see weak consents as developers await the green light for higher levels of development.

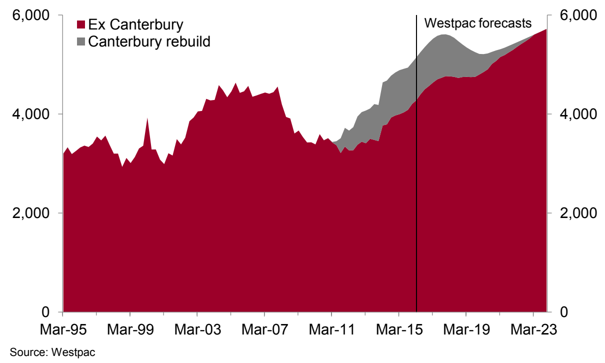
Meanwhile in Canterbury, residential consents are off the peaks of 2015, but in recent months the decline has been less marked. In April, 180 retirement village units were consented, which will support residential building work over the next several quarters.

Over the longer-term, however, we do expect Auckland residential consents to rise again, and building work put in place to head toward the peak we're expecting in mid-2018. Similarly, we expect Canterbury residential consents (and building activity) to continue to track down longer term.

What this means for GDP growth

Today's data was materially stronger than expected, and therefore suggests that March quarter GDP growth could be stronger than our current forecast, which is 0.7%.

Residential and non-residential gross fixed capital formation, $m



Overall, this strong building work put in place result is another sign that the economy is ticking over nicely, despite the dairy downturn.

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