

Auckland Economic Quarterly

Chief Economist's Newsletter



In this edition:

Interview with Edward Glaeser

Auckland Economic
Commentary

Auckland Economic Scorecard



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From the Chief Economist

Welcome to our fourth edition of the Auckland Economic Quarterly and perhaps our most optimistic one yet. The Auckland economy is showing signs of a more sustained and broad based recovery with GDP growth of 3.2% in the year to March. There are a few key points that I would like to highlight:

- 1** First, Auckland house prices continue their upward march, buoying consumer confidence and further stimulating demand for housing. The real boost to building activity is yet to come, but we're already seeing a pick up in demand across the finance, property & real estate and construction services sectors. As building work gathers pace it will act as a catalyst for growth in various downstream sectors, particularly domestic manufacturing and retail.
- 2** Second, the upswing in residential consents shows a housing supply response on the way. The number of residential consents over the last year was 4,764; still well below the 10 year average of 6,631, but its trend is unmistakably on the rise. The recently signed housing accord targets consenting of 9,000 in 2014 ramping up to 17,000 in 2016. This will be challenging for the industry, especially given the simultaneous rebuild effort in Christchurch.
- 3** Although the economy is carrying considerable spare capacity that would provide room for Auckland's housing upswing, it may yet be dampened by the Reserve Bank. Auckland's median house price increased by 12.5% over the last 12 months, underpinned by the combination of strong demand, cheap credit and limited supply. The Reserve Bank has strongly signalled its intent to use new policy tools to influence demand, reflecting a concern about the risks associated with a build-up of household debt off the back of historically low interest rates.
- 4** Lastly, the Auckland economy looks considerably better for those on the economic ladder with some wage growth coming through, while those looking for jobs continue to experience a static labour market. However, employment confidence levels are a source of optimism. While we have seen such employment confidence before without job growth, we are now seeing concrete signs of economic activity alongside hiring confidence. In this light, there is some reason to believe that a turnaround in the labour market is not far off.

With the draft Unitary Plan process in full swing, urban economist and Harvard Professor Edward Glaeser recently visited Auckland as the 2013 Sir Douglas Myers Visiting Professor. Edward is a global commentator on the economics of cities. In 2011 he published the book *Triumph of the City: How our greatest invention makes us richer, smarter, greener, healthier, and happier*. In this edition, we include an interview with him on a range of topics including education, land use policy, road pricing and poverty.

Geoff Cooper

On the 1st July, Edward Glaeser visited Auckland to talk about the economics of cities and why they are our greatest invention.

We sat down with him to talk about some of his work on cities and his thoughts on Auckland.



Geoff Cooper: It is often thought that technology and the 'death of distance' would be the end of cities; that one day we would all stay at home and work remotely. Yet this does not look to be happening. In what way are social media and other technologies changing the way cities around the world work?

Edward Glaeser: It is a great question. There was a thought 30 years ago that new technologies would work to de-concentrate population. We would all be telecommunicating in, rather than locating near one another in cities. It is now obvious that the reality is far more nuanced. There are a large number of these innovations that seem to expand the potential of the urban core. Think about apps that enable you to figure out the best restaurant you want to go to. Think about uber that enables you to get cars to take you to places. Think about the streaming of when the bus is going to arrive, or think of even more important forms of new technology that can really radically increase the rate of change in a city.

So it is now far from clear that social media makes cities less important. Indeed in many ways connecting electronically and connecting face to face go together and both become more powerful by their combination.

GC: You often talk about road pricing as being a no-brainer for the city. Can you describe why you think taxing people to use road space can lead to better outcomes?

EG: I don't like the word 'tax' in this context. I just think people should pay for the costs of their actions, or else they don't make the right choices. When I drive on a road and I slow people around me down, should I get a free lunch there? Should I be able allowed to cause pain and suffering to people stuck behind me on a highway without cost. No! People should pay for the cost of their actions, otherwise they will drive too much. That is basically what I am arguing for. It is an old argument and, I think, we have now learned that we just can't build our way out of traffic congestion. The work Duranton and Turner shows that vehicle miles travelled increase basically one-for-one with highway miles built. More highways just mean more and more drivers and more and more suburbanisation. If you build it, they will drive. We really do need to have something more rational - at least to impose congestion charges on new highways that are being built.

GC: You often comment on the importance of education as a driver of city competitiveness. Do you think cities around the world really understand the importance of education and maintaining competitiveness and should we be investing more in our education system?

EG: It's not obvious that we need to be investing more cash. We almost surely need to invest more energy, innovation and mind share in this problem. Often just throwing more money at the problem doesn't actually achieve much that's good, in terms of being captured by special interest groups. I think education is often underestimated, particularly in the jobs front. City governments often think that they have some direct role in creating the economic conditions for success. City governments have very limited ability to directly impact next year's economy. This thing is chugging along, either its chugging along well or its chugging along poorly. Yet governments are very focused on this and that moves attention away from the one thing that is really a crucial determinant of economic success, which is the schools of the area. You see this at the country level as well. It's easy to constantly have a jobs dialogue about national policy, whereas it is not at all clear what the Federal Government in the US, or many other countries, should be doing in terms of generating more jobs. National education discussion is almost impossible to hold. In the long run, education is going to be far more important to the economic competitiveness of all of our countries than any short-term job make-work programme that may be conjured out of the national capital.

GC: In your book *Triumph of the City*, you challenge the notion that cities foster poverty. How do cities help people get out of poverty?

EG: They allow people who come with little physical capital, maybe even limited human capital, to partner with others. You traditionally think of a poor kid who comes to a city to work in a factory. That meant that he was merging his human capital with someone else's physical capital and, often, with someone else's know-how as well. People very rarely find their way out of poverty on their own. They need access to capital, access to collaboration in various forms. They need access to mentorship or new forms of knowledge; cities make that happen. For centuries, there have been pathways for individuals looking for a path out of poverty and they continue that role today. The fact that you see so many poor people in cities doesn't mean that cities are failing. It often means the cities are succeeding and are attracting poor people and providing a better standard of living than they could have elsewhere.

GC: There is a discussion in Auckland at the moment on how we are using our land use policies to allow for more density. A tension between local interests (what is often called NIMBYism) and regional interests often emerges in such debates. Can you describe what the economic consequences of NIMBYism are for the wider city in this context?

EG: When cities end up saying no to everything, and they refuse to build and refuse to change, they become excessively expensive if demand is high. They become increasingly elite cities that are affordable only to the wealthy. They lose the dynamism that comes both from the people and new activities. They can even become boring to look at aesthetically. While people hate change, often some of the most special urban spaces are places that have a dialogue between architects living between new and old styles. I don't think it is obvious that architectural uniformity is always great and that having a dance between different geniuses is to be desired. I think there are many reasons why you want to make sure that cities continue to grow and change and they are not museum pieces. They were never meant to be museum pieces. They were meant to be living organisms that can provide incredible benefits for people living in them, but the people can't experience those benefits unless the cities deliver enough real estate so new people can come to the city.

GC: Auckland has a lot going for it, but at a broad level, where could a city like Auckland go wrong?

EG: It can become too expensive and too restrictive in terms of building. It can squander on unwise infrastructure. That is something that is quite easy to be done. It can screw up on basic public services. It can screw up on crime for example, screw up on policing. With an absence of non-street alternatives, it can let the traffic congestion

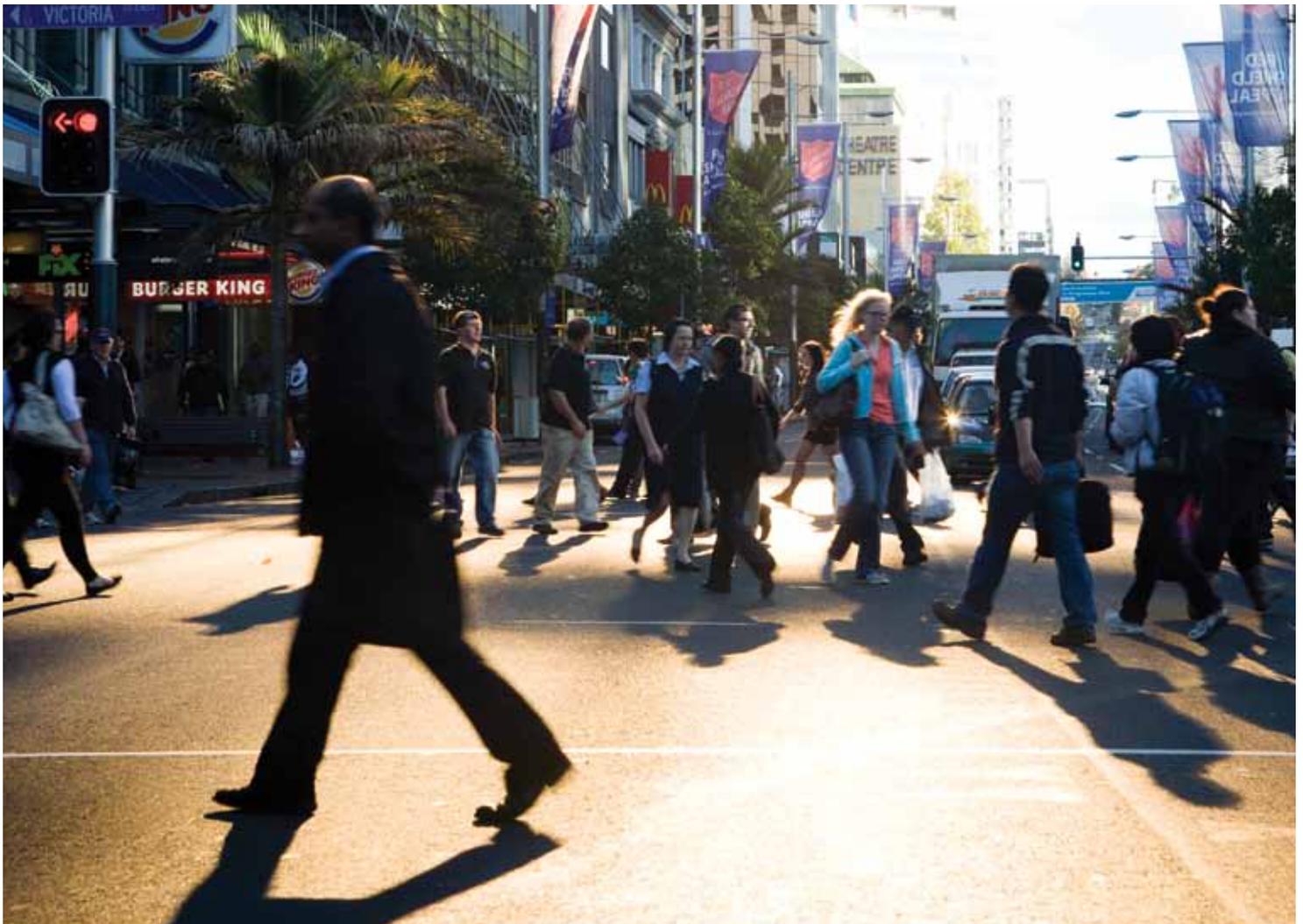
get out of hand. These are all areas I would worry about. The most important job of the city government is to battle the demons of density: crime, congestion, high cost of living. These are all areas in which the government needs to take proactive steps; in some cases, making sure there is land available to build, and in other cases making sure that the basic services of government work well.

GC: One of the more controversial land use policies in Auckland is the urban limit policy. What is your opinion of this policy and would you ever consider it as an effective policy to try and limit some of the externalities around congestion and environmental costs that are associated with people living further out?

EG: It does feel like a very blunt tool, but I certainly understand the desire for green space close to the city. It is not a crazy view. You just have to apply cost benefit analysis to it in a sensible way. I personally tend to think there can be a lot of building within an urban limit if the density levels are sufficiently raised and I think we need to think about different policy alternatives, as well as potentially easing the urban limit. In every direct policy question, you need to assiduously apply cost-benefit analysis to each one rather than thinking that you can magically think out what the right answer is.

GC: Thanks for your time Ed. It has been great having you in Auckland and we hope you enjoy the rest of your time in New Zealand.

EG: Thank you sir, this has been great fun.



Auckland Economic Commentary

Confidence in the economy underpinned by housing market

Economy expanded by 3.2% in the year to March

The Auckland economy posted a solid result of 3.2 per cent annual growth in the year to March 2013. This result was due to broad based growth, with 17 out of 20 sectors recording gains. Leading the way was the construction sector with construction services and consents up, precursors that paint a rosy picture for the still-to-come build phase.

Construction sector signals big upswing to come

House prices rising faster than overall consumer prices

The housing market is set to be the key driver of Auckland's growth in the near to medium term. The median Auckland house price was \$562,000 in March 2013, up 12.5 per cent from March last year. House price pressures have built up over time; since the end of 2002, Auckland house prices have risen at a much faster rate than the consumer price index (see Figure 1).

Residential consents continue upward trend

Confidence in the construction sector has grown as the sector continues to play catch up to underlying demand. Q1 residential consents, at 1,238 consents, were 17.2 per cent higher than Q1 last year, but remain well below historic levels, and the level which is required to ensure the housing supply keeps up with new household formation (see Figure 2). About 10,000 new homes are needed each year, but the market is providing well below half of that figure.

Upswing in migration ensures house prices are well supported

House price growth continues despite historically low migration inflows. Signs that migration is heading upwards off the back of a slowing Australian economy suggests that house prices are well supported in the medium term (see Figure 3). Annual net migration was 4,080 people in the year to March 2013, well above the rest of the country.

Growing business confidence in Auckland

Firms optimistic about the future

Auckland firms remained optimistic, on balance, with more firms expecting conditions to improve over the next six months, compared to last quarter. Firms' future expectations for domestic trading activity and hiring intentions have been higher than actual results suggesting firms have been overly-optimistic since the start of the recovery from the 2008 recession. However, with the construction sector experiencing an upturn, firms can be optimistic about a rise in activity levels over the coming months.

Labour market outlook remains weak

Jobless recovery continues as firms use up excess capacity

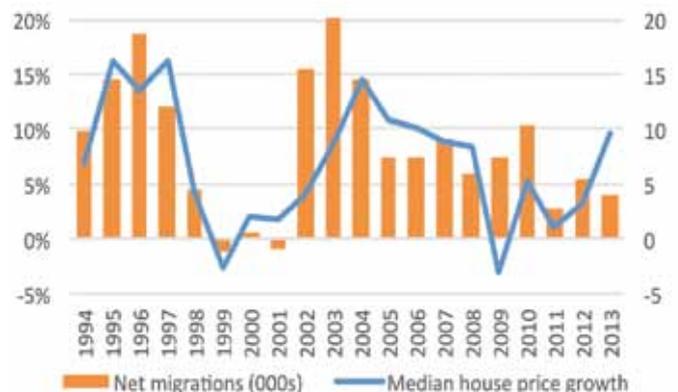
Annual growth in the ANZ job ads series for Auckland dipped back into negative territory, dragged down by low newspaper ads and flat internet ads. Job ads are a short-term leading indicator for employment growth, which suggests that the immediate outlook for employment looks much like much of the same. The labour market remains weak as firms use up spare capacity before they take on more staff; only 4.0 per cent of firms surveyed reported capacity as the main constraint to expanding output in 2013 Q1, compared to 73.8 per cent who reported demand as the main constraint.

Figure 1: Auckland House Price and NZ Consumer Price Growth



Source: QV, Statistics New Zealand

Figure 2: Auckland Median House Price Growth and Net Migration (000's)



Source: Real Estate Institute of New Zealand, Statistics New Zealand

Unemployed workers drop out of the labour force

Unemployment remains at a higher-than-historic level

Employment expanded by about 8,000 jobs compared to Q1 last year, driven by increases in selected business services and health care and social assistance. The absence of appreciable job growth hinders Auckland's recovery as unemployment, while down on last year's Q1 result, remains elevated compared to the 10-year average and was 7.3 per cent in Q1.

Consumer confidence up, retail sales up, new car registrations up

Consumers spend away...

Auckland consumers are among the most optimistic in New Zealand, spurred on by activity in the housing market. Westpac McDermott Miller reports a consumer confidence score of 119.0 for Auckland, well ahead of the national average (110.8) and up 13.7% on Q1 of last year. It follows that retail sales were up 1.1 per cent from the last quarter and new car registrations increased again in Q1. New car registrations were just shy of its 10-year average.

While incomes grow

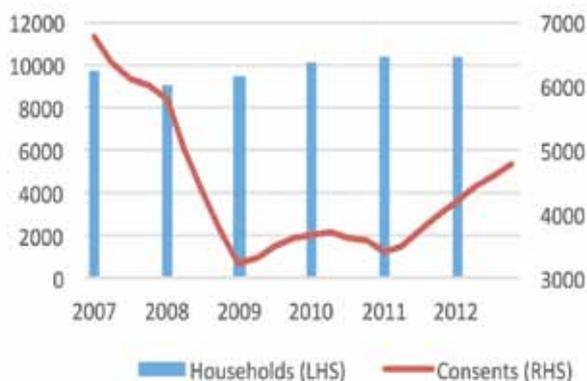
Real average weekly earnings have increased by 2.8% in the year to March, which, along with a wealth-effect from the housing market, cheap credit, a favourable exchange rate and discounting by retailers is fuelling the boost to retail sales.

NZ economy boosted by Canterbury rebuild

Inflation pressures remain low; rest of NZ matches Auckland growth

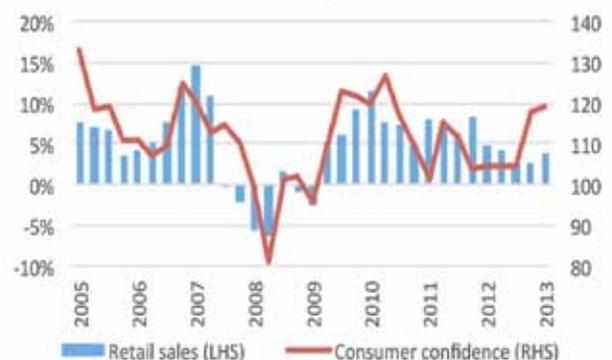
The Canterbury rebuild has stimulated growth in the construction sector, creating regional pressures on rental prices and building costs. However, its effect has been contained within the Canterbury region. We are yet to see any evidence of these price pressures spilling over into the Auckland economy. Canterbury's regional GDP expanded by 5.8% in the year to March 2013 while the rest of NZ, excluding Auckland and Canterbury, grew by 2.4% over the same period. Across the NZ economy headline inflation remains low at 0.9 per cent. The exchange rate, competitive pricing and firms' excess capacity are key factors keeping consumer price inflation subdued.

Figure 3: Annual consents and new Household Formation

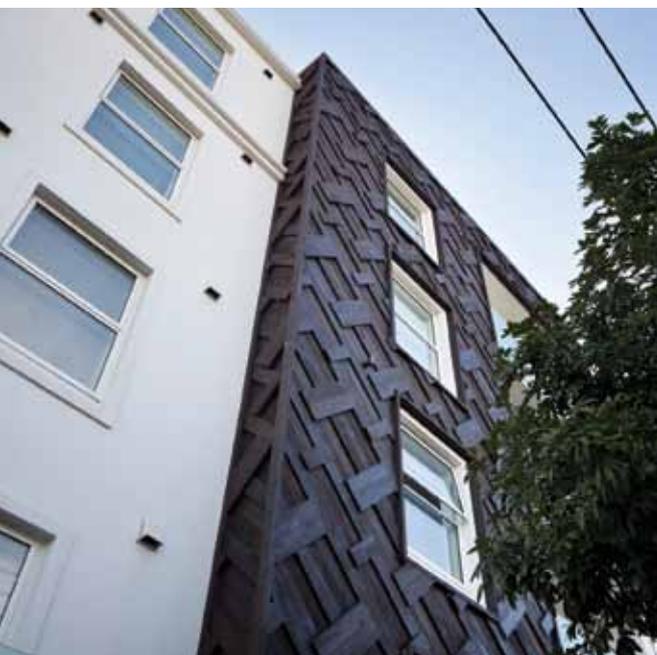


Source: Statistics New Zealand

Figure 4: Annual Retail Trade Growth and Consumer Confidence



Source: Statistics New Zealand Retail Trade Survey, Westpac - McDermott Miller Consumer Confidence Survey Survey



Affordable home ownership forum



Join some of the country's top politicians, housing advocates and researchers to examine the policies and challenges affecting affordable home ownership in New Zealand.

Date: Tuesday 16 July 2013

Time: 8.30am - 12.30pm

Cost: \$50 per person. Free to full-time students and University staff

Venue: The University of Auckland Business School
Decima Glenn Room, Level 3, Owen G Glenn Building,
12 Grafton Road, Auckland

Auckland Economic Scorecard

New Zealand Economic Indicators	Notes		March
Inflation	1	Annual % change	0.9%
Official Cash Rate	1	%	2.5%
NZD/USD	1	March average	0.8278
TWI (5 currency)	1	June 1979 = 100	76.14
ANZ Commodity Price Index	2, m	Annual % change	2.2%
Current account as % of GDP		%	4.8%
NZ population		at 31 March 2013	4.464m
Auckland population		at 30 June 2012	1.508m

Disclaimer

This newsletter provides general information on the Auckland economy, and is not intended to be used as a basis for any particular course of action or as a substitute for financial advice. The views and opinions expressed are those of the relevant author, and do not necessarily reflect the views of Auckland Council. Auckland Council disclaims all liability in connection with any action that may be taken in reliance of this newsletter, and for any error, deficiency, flaw or omission contained in it.

		Notes	Auckland			Rest of NZ
			10 yr trend	Q1	Quarterly change	Q1
Headline Indicators						
Employment	Number (000s)		655	717	•	1,523
	Annual % change		2.2%	1.1%	↑	0.1%
Unemployment	%		5.4%	7.3%	•	6.1%
Real GDP (expenditure)	Annual average % change	3	2.4%	3.2%	↓	3.1%
Real wages	\$ / week (average)		\$1,063	\$1,124	•	\$1,021
Jobs						
Youth unemployment – 15-19 year olds	%		21.0%	28.6%	↓	24.4%
Youth unemployment – 20-24 year olds	%		9.4%	11.1%	↓	10.7%
Industries						
Manufacturing (employment counts)	Number (000s)	**	..	80	↑	166
Financial and insurance services (employment counts)	Number (000s)	**	..	30	↓	44
Retail sales	Annual % change	*	3.5%	4.3%	↑	2.7%
Housing and construction						
House sales – dwellings	Annual total sales	4	29,042	29,601	↑	46,521
Real average private rent	\$ / week	5	\$418	\$442	↑	\$324
Rent to wage ratio	%	5	39.3%	39.4%	•	31.7%
Real median house sale price	\$	4, m	\$471,700	\$562,000	↑	\$400,000 (NZ)
Residential building consents – new dwellings	Annual total		6,631	4,764	↑	12,633
Non-residential building consents – new floor area approved (sq. metres)	Annual total		840,133	647,578	↑	1,843,051
Global connections						
Tourism – guest nights	Annual % change	m	2.5%	5.6%	↑	12.0%
Net migration	Net annual flow		8,664	4,080	↑	-1,538
Arrivals	Annual flow		34,055	34,824	•	51,202
Departures	Annual flow		25,391	30,744	•	52,740
Exports (value)	Annual % change	m	2.0%	80.1%	↑	-11.5%
Imports (value)	Annual % change	m	2.4%	10.1%	↑	-23.3%
Confidence surveys						
QSBO – General business situation	net %	6	0.7%	39.1%	↓	22.8%
Westpac – Regional consumer confidence	Index	7	114.5	119	↑	110.8 (NZ)

Notes:

All data is from Statistics New Zealand and is not seasonally adjusted, unless otherwise specified. Other sources of data: Reserve Bank of New Zealand (1) ; ANZ (2) ; Infometrics, Regional Economic Database (3) ; Real Estate Institute of New Zealand (4) ; Ministry of Business, Innovation and Employment (5) ; New Zealand Institute of Economic Research (6) ; Westpac (7). Data presented with the assistance of the Research, Investigation and Monitoring Unit, Auckland Strategy and Research Department. .. denotes data not available. GDP data is not available due to revisions in methods employed by Statistics New Zealand.

Calculations: Quarter % change is calculated as $(\text{Quarter} - \text{Quarter}_{-1}) \times 100$; Annual % change is calculated as $(\text{Quarter} - \text{Quarter}_{-4} - 1) \times 100$ or $(\text{Month} - \text{Month}_{-12} - 1) \times 100$; Annual average % change is calculated as $(\text{Year}/\text{Year}_{-1} - 1) \times 100$

m - Data relates to the month of March, not quarter.

* Due to data availability, a 9 year trend is presented instead of a 10 year trend.

** Growth in the manufacturing and financial and insurance services sectors is proxied by growth in employment counts in these industries.

6 - Figures presented are the net percentage of respondents that believe the general business situation.

7 - Figures greater than 100 represent optimism at the consumer/household level.