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Auckland Economic Quarterly

Chief Economist's Newsletter

Auckland Council
Te Kaunihera o Tāmaki Makaurau

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From the Chief Economist

Welcome to our final economic update of the year. Economic growth firmed at 2.9 per cent in the year to June compared to 7.2 per cent in Christchurch and 1.5 per cent in the rest of New Zealand. Auckland's dairy related manufacturing, transport and storage sectors slowed over the last two quarters following the drought earlier in the year. This temporary blip is set against an otherwise strong backdrop for Auckland, notwithstanding external risks from abroad.

There are four key highlights from this edition:

1. Unemployment fell to 6.7 per cent, its lowest level since 2011. Employment growth continues to broaden with both construction and manufacturing sectors now seeing a lift. Despite moving in the right direction however, employment growth remains sluggish and low numbers of job vacancy listings suggest more of the same in the months to come.

2. Consumer confidence dipped in the September quarter, although Aucklanders remain among the most optimistic in the country. Uncertainty about the impact of loan-to-value ratios by the Reserve Bank, a soft jobs market and the impact of slow trading partner growth could all have weighed on confidence. Nevertheless, the financial situation of those employed has improved with solid wage growth, weak inflation and rising asset prices. Meanwhile, business confidence improved even as activity slowed, buoyed by high commodity prices, a strengthening housing sector and a tapering in the effects of the drought.

3. Two important housing related policies have progressed. First, the Reserve Bank introduced restrictions on loan-to-value home lending for banks on 1 October. Some buyers will now take longer to raise a deposit or perhaps, will look at borrowing from the non-bank sector. The extent to which potential buyers are able to circumvent the restrictions will influence their effectiveness in reducing home lending and house price growth.

   Second, the initial batch of Special Housing Areas was announced under the Auckland Housing Accord, which will bring 2,000 new homes to market over the next three years. These areas will have special consenting and approval processes to speed up development, such as proactive council pre-application processes, fast-tracked consenting and limited notification and appeals. These policies will be the topic of our new biannual housing publication due out in December.

4. Lastly, a number of external risks persist. Australia is experiencing a downturn in mining investment that, together with a fall in the value of the Aussie dollar against the Kiwi, will hurt Auckland's important machinery and equipment export sector. Meanwhile the latest US fiscal deadlock has ended, but the closure of the federal government for over two weeks will drag down US growth in the fourth quarter. The impact of the shutdown on financial markets was limited, as markets expected a resolution before the debt ceiling deadline was reached. The latest deal saw federal government funding extended to 15 January and the debt ceiling deadline pushed back to 7 February.

This edition features an article on activity in the non-residential construction sector, including some of the big construction projects on the horizon for Auckland.

For more information including chart packs for this edition please visit www.aucklandcouncil.govt.nz/businessandeconomy

Geoff Cooper

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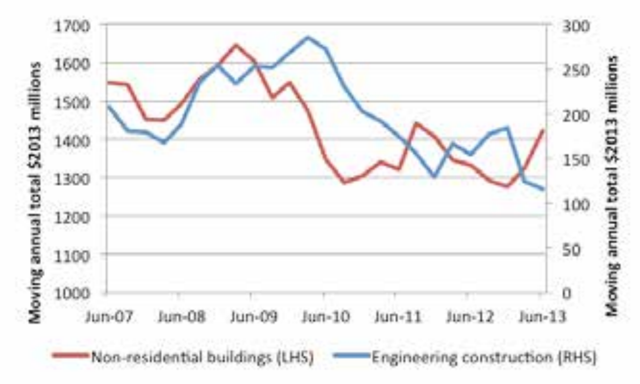
Infrastructure investment set to drive future non-residential construction activity

By Melanie Luen, Economist, Auckland Council

While Auckland's hot property market has taken the spotlight off other parts of the construction sector, the non-residential building and engineering construction aspects of the construction sector are too important to dismiss. Investment in non-residential buildings such as office buildings, shops and factories, social infrastructure like hospitals and schools and transport infrastructure such as the City Rail Link are needed to support economic activity and Auckland's growing population. After initially rising following the onset of the global financial crisis (GFC), consenting activity in non-residential building construction and engineering construction fell below pre-recession levels and has fluctuated but remained fairly flat overall (refer Figure 1 and Figure 3). This is set against a generally sluggish economy, with employment growth of 50,000 since June 2007 well behind population growth of over 111,000.

Figure 1: Real value of building consents by type in Auckland



Source: Statistics New Zealand, Auckland Council estimates

Public investment in social infrastructure supporting Auckland's population growth

Population growth places pressure on all forms of infrastructure but in particular, schools and health facilities are constantly in demand. Between 2006 and 2012, the number of Auckland residents aged between 0 and 14 grew by 13,000 adding to school rolls across Auckland, filling the equivalent of 27 new schools over the last six years.[1] Budget 2013 included investment worth $134 million over the next four years to expand the capacity of the New Zealand school network by providing new schools as well as adding new classrooms on existing sites across New Zealand. At the other end of the age spectrum, Statistics New Zealand projects that the number of Aucklanders aged over 65 will double between 2011 and 2031 to reach 330,000 residents. This is expected to increase demand on Auckland's current health system but also increase demand for retirement villages and aged care facilities. This is captured in the residential building statistics.

Pipeline of transport infrastructure build set to boost engineering construction activity in Auckland.

Auckland is proposing to invest heavily in its infrastructure over the next ten years, which will provide a significant boost to activity in the engineering construction sector. Some of this infrastructure is needed to maintain existing service levels as Auckland's population has grown to over 1.5 million. Investment in other projects, such as the Waterview Connection and the City Rail Link, will contribute to non-residential construction activity and by doing so add significantly to Auckland's infrastructure landscape.

Key Auckland capital projects over the next 10 years	
Network planning and stormwater catchment to manage the detrimental effects of stormwater	$604m
Construction of a 35km trunk water main between the Redoubt North and Khyber Pass reservoirs to meet increasing demand for water	$339.1m
Huia Water Treatment Plant upgrade to increase plant capacity	$232.9m
North Harbour Water Main Duplication to meet demand in North Western Auckland and Albany	$208m
Construction of a new interceptor from Western Springs to Mangere treatment plant to free up capacity for growth in the central and western areas	$797.1m
City Rail Link	$2.8b
Electrification of the rail network	$494m
Develop integrated multi-modal infrastructure between Glen Innes and Manukau (AMETI)	$716.6m
Library collection renewals	$149.2m

Source: Auckland Council Long Term Plan 2012-2022

With the exception of the Waterview Connection, which is currently under construction, the City Rail Link will be the single most significant construction project for Auckland over the next decade. Earlier this year the government indicated its financial commitment to a 2020 start date, but stated construction could begin earlier if rail passenger trips and employment growth targets are met sooner.

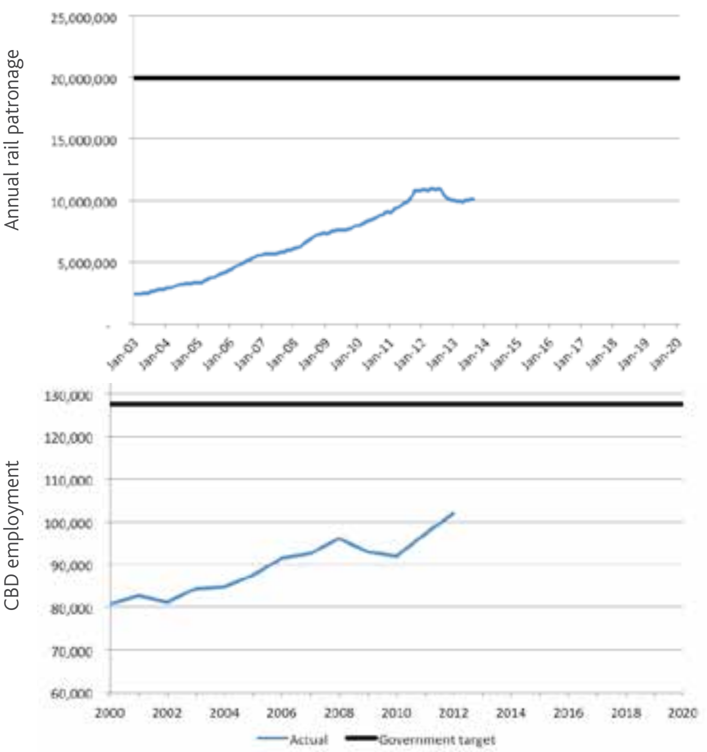
The first growth target is 20 million passengers using the Auckland rail network annually, double the current patronage number (refer Figure 2). While this seems like a considerable jump, Auckland looks likely to meet this target around 2018 based on the annual growth rate of 14.2 per cent achieved over the last decade. Various improvements to the public transport network, including rail

[1] Calculated using Ministry of Education data on the total number of students in the Auckland region on 1 July 2012 and the number of schools in Auckland in 2012.

electrification, integrated ticketing and the redesign of the bus network to integrate with rail, give some reason to believe this target could be reached sooner than 2018.

The second target is a 25 per cent increase in Auckland's CBD employment. This looks considerably more challenging (refer Figure 2). Using the city centre growth rate over the past decade as a guide, this target would be reached around 2023. The City Centre Masterplan outlines a significant programme of investment in the years to come for the city centre as a hub for office based employment and business and financial services. The success of these investments together with global conditions of economic growth will be critical to reaching this target earlier.

Figure 2: City Rail Link: patronage and employment growth targets

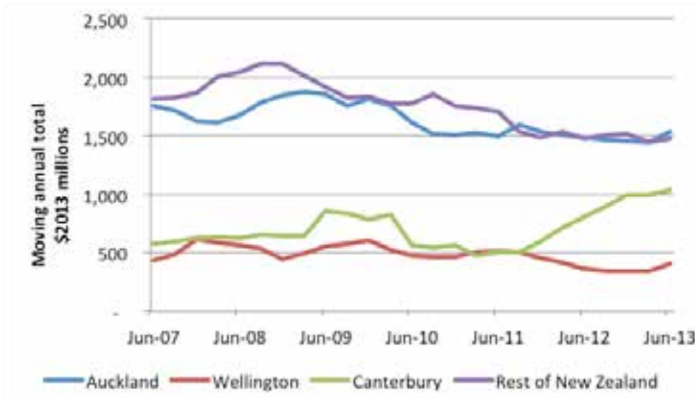


Source: Statistics New Zealand, Auckland Council estimates

Canterbury rebuild dominates the national non-residential picture

Across the nation, the Canterbury rebuild dominates an otherwise uninspiring story of flat or declining non-residential activity (refer Figure 3). Capital investment has been diverted to Christchurch for the rebuild which the New Zealand Treasury estimates could cost a total of $40 billion.

Figure 3: Regional breakdown of non-residential building and engineering construction



Source: Statistics New Zealand, Auckland Council estimates

The rebuild provides risk and opportunities for Auckland. As resources migrate to Canterbury, Auckland and Christchurch construction projects will likely compete for capital and labour, which could push up prices in the construction sector if capacity constraints are reached.

However, the rebuild also presents opportunities for Auckland as firms could provide engineering and architectural services directly to the rebuild as well as fulfilling upstream and downstream demand (such as supplying inputs for construction as well as finance and banking services.)

Commercial building activity weak but confidence indicators point towards increased investment

Commercial investment in non-residential building construction took a hit after the GFC. Outside of Rugby World Cup building activity, businesses had little need to expand or upgrade their premises as they struggled through New Zealand's worst recession experienced in 80 years.

However, there are signs of renewed demand for new commercial buildings. Businesses expect domestic trading activity to firm over the next three months, investment intentions have strengthened and private sector employment has returned to pre-recession levels. Additionally, consumer spend continues to strengthen and over the last six months, vacancy rates for premium office space in the CBD have fallen. Businesses will fill up existing space before new office buildings are constructed.

Commercial investor confidence has been tracking upwards in Auckland (refer Figure 4), setting the foundations for increased investment in commercial properties. Although interest rates are at historically low levels, access to credit remains a headwind to new building activity. Firms are reporting that access to finance has become easier over the last two years but lending remains tighter than before the GFC. Construction firms are finding it particularly difficult to access credit, relative to other industries in Auckland. Non-bank business lending has plummeted since the GFC and shows no signs of reversing this downward trend.

The sector's outlook is promising

While there has been a significant upswing in residential building activity in the Auckland region over the past year, non-residential construction work has been broadly flat. However, non-residential property market conditions are firming along with economic output and employment, which will underpin a recovery in these markets over the next few years. Further out, a major round of infrastructure work are set to get underway providing a promising outlook for the sector.

Figure 4: Commercial property investor confidence in Auckland, Wellington and Christchurch

Source: Colliers International Research

Auckland Economic Commentary

Economy faces headwinds in the June quarter

The June quarter was a subdued one for the Auckland economy: the level of construction work slowed (construction services activity remained strong), while lower dairy production and a slowing Australian economy weighed down on activity in the manufacturing and logistics sectors.

But unemployment rate falls

On the plus side, employment was 2.8 per cent higher compared to a year earlier and has expanded modestly in each of the last three quarters. The unemployment rate dipped below 7 per cent, while the participation rate was little changed from the March quarter.

Businesses remain upbeat about outlook

Auckland business confidence firmed in the September quarter – a net 15 per cent of respondents reported trading conditions improved in the three months to September, and a net 35 per cent expected conditions to improve in the 3 months to December.

Hiring and investment intentions firm

Hiring intentions also rose, with a net 20 per cent of respondents expecting to increase employment in the December quarter. Meanwhile, investment intentions remained moderately upbeat.

NZIER's national figures suggest that the service sector is becoming increasingly confident about the outlook for trading conditions, which is key for Auckland's labour markets.

Employment up, but it's a slow grind

The economy added 10,600 jobs in the June quarter: 20,100 more people were employed compared to same period in 2012, and the unemployment rate dropped to 6.7 per cent (in seasonally unadjusted terms).

Employment growth continued to broaden. Job growth in the quarter was concentrated amongst older males, with the manufacturing and construction sectors both adding significant numbers of jobs in the quarter. The health, property and business services sectors remained key drivers of employment growth, as they have been over the past three years.

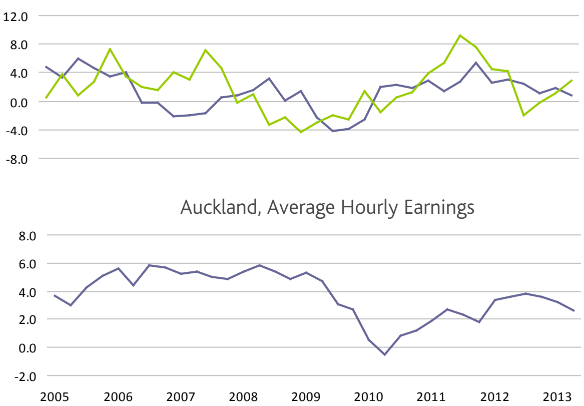
Data from the Household Labour Force Survey (the official source of labour statistics) remains volatile, but looking at the data in combination with job vacancy numbers and alternate labour surveys suggests that the retail and communications sectors remain the main areas of employment weakness.

Manufacturing employment is well down on pre-crisis levels, but appears to be strengthening alongside construction activity.

Figure 1: Net Optimistics, 3-month-ahead expectations for Equipment Investment and Employment

Source: NZIER

Figure 2: Auckland, year-on-year employment growth (household vs. business survey estimates)



Source: Statistics New Zealand and Westpac McDermott Miller

Wages growth solid

The median income of Auckland households in employment was 2.2 per cent higher in the June quarter, compared to a year earlier; and average weekly ordinary time earnings growth averaged 2.6 per cent over the past 12 months, in real terms. In contrast, the average weekly income of all Auckland households was 1.3 per cent lower.

The national data shows that the wage performance varied considerably between industries, with non-business services faring considerably worse than the average. For low income households, a cost-of-living index is more appropriate to assess spending power; living costs have been rising at a faster pace than the overall CPI index.

While it's not the case for all Auckland households, there has been an improvement in the health of household finances over the past 12 months – a trend which has been highlighted in consumer confidence.

Consumer confidence eases back

The Westpac McDermott Miller consumer confidence index for Auckland slipped 3 per cent in the September quarter but remains solid. Rising long term interest rates and uncertainty over the impact of Loan to Value Ratio (LVR) restrictions are likely to have dented confidence in the housing market, while the rise in petrol prices, weak jobs market and concerns about overseas demand could also have weighed on some respondents minds.

But more willing to loosen purse strings

Consumers reported an improvement in their current financial situation, their assessment of the outlook for the economy and their willingness to spend on discretionary items. Retail sales growth in the June quarter was 1.6 per cent higher year on year, and 5.9 per cent higher over the June quarter of 2012, in nominal, seasonally adjusted terms.

However, consumers were more cautious about spending on big ticket items compared to the previous quarter. At a national level consumer credit growth remains weak. Consumers have built up a considerable savings buffer, but remain circumspect.

House price growth slows – but too early to be LVRs

House price growth played a key role in driving the rebound in consumer confidence. It's too early to see the impact of the LVR restrictions on house price growth and lending. The Real Estate Institute of New Zealand's (REINZ) measure of the median house price in September was $570,000, up from $563,000 in July and 10.7 per cent higher than September2012. Annual house price growth has eased back since May, but the data suggests that this reflects an increase in listings, and more listings in lower price brackets, rather than a reduction in demand. While there is considerable variability month to month, sales volumes have remained strong.

New consent numbers have been slow to build and remain well below levels required to meet population growth, let alone address pent-up demand. Consents for a 100 new apartments were issued in August, taking the number of apartment consents issued since May to 465. 403 new house consents were also issued.

The LVR restrictions are aimed at slowing demand; the Auckland Housing Accord – with the recent announcement of 6,000 homes to be fast-tracked – is aimed at boosting supply. The undersupply of housing facing Auckland could have been much worse were it not for the significant slowdown in population growth revealed in the new census numbers. Statistics New Zealand have not yet estimated the final population count (to take account of residents temporarily overseas), but the pace of growth halved between 2001 and 2006 and 2006 and 2013, from 2.4 per cent to 1.2 per cent.

Estimates of household formation will be revised down along with estimates of pent-up demand for housing. Nevertheless, supply-side constraints remain a major problem for Aucklavtnd's housing market.

Rental inflation remains subdued

One of the most intriguing aspects of Auckland's housing market is that rental inflation remains contained. While median house prices in the three months to September were 10.8 per cent higher than the same period of 2012, rents rose just 3.4 per cent over the same period and there is no sign, as yet, that rental inflation is gaining momentum. It's not entirely clear why, given we've seen a sustained shortfall in housing supply relative to population growth, that there is not more pressure on rents. It does suggest that there has been a considerable speculative element to the recent run-up in house price growth. It's also possible that recent sales activity has added to the rental stock, which would have taken some pressure off rents.

Figure 3: Nominal Retail Sale Growth (Year on-Year) vs. Consumer Confidene Index

Source: Statistics New Zealand

Figure 4: Rental Inflation vs. Median House Price Inflation (Year-on-year quarterly average growth)

Source: Statistics New Zealand

Auckland Economic Scorecard

New Zealand Economic Indicators	Notes		June
Inflation	1	Annual % change	0.7%
Official Cash Rate	1	%	2.5%
NZD/USD	1	June average	0.7908
TWI (5 currency)	1	June 1979 = 100	74.00
ANZ Commodity Price Index	2, m	Annual % change	22.5%
Current account as % of GDP		%	-4.3%
NZ population	estimate	at 30 June 2013	4.471m
Auckland population	estimate	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.

			Auckland			Rest of NZ
		Notes	10 yr trend	Q2	Quarterly change	Q2
Headline Indicators						
Employment	Number (000s)		659	728	↑	1,509
	Annual % change		2.5%	2.8%	↑	-0.3%
Unemployment	%		5.5%	6.7%	↓	6.0%
Real GDP (expenditure)	Annual average % change	3	2.3%	2.9%	•	2.6%
Real wages	$ / week (average)		$1,067	$1,135	•	$1,016
Jobs						
Youth unemployment – 15-19 year olds	%		21.3%	22.4%	↓	24.6%
Youth unemployment – 20-24 year olds	%		9.5%	11.7%	↑	10.9%
Industries						
Manufacturing (employment counts)	Number (000s)	**	..	83	↑	160
Financial and insurance services (employment counts)	Number (000s)	**	..	28	↓	42
Retail sales	Annual % change	*	1.0%	5.1%	↑	1.3%
Housing and construction						
House sales – dwellings	Annual total sales	4	28,871	30,577	↑	47,512
Real average private rent	$ / week	5	$419	$449	↑	$317
Rent to wage ratio	%	5	39.0%	39.0%	•	31.2%
Real median house sale price	$	4, m	$477,100	$555,000	↓	$394,000
Residential building consents – new dwellings	Annual total		6,452	5,343	↑	13,440
Non-residential building consents – new floor area approved (sq. metres)	Annual total		831,734	698,091	↑	1,939,739
Global connections						
Tourism – guest nights	Annual % change	m	3.7%	-2.4%	↓	4.1%
Net migration	Net annual flow		8,233	5,286	↑	2,621
Arrivals	Annual flow		33,901	35,293	↑	52,942
Departures	Annual flow		25,668	30,007	↓	50,321
Exports (value)	Annual % change	m	0.0%	6.2%	↓	-2.5%
Imports (value)	Annual % change	m	1.6%	-4.4%	↓	-11.1%
Confidence surveys						
QSBO – General business situation	net %	6	-7.7	42.27	↑	32.97
Westpac – Regional consumer confidence	Index	7	114.30	119.40	•	116.6 (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, Investigations 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 (Quarter - $Quarter_{-1}$ - 1)x100; Annual % change is calculated as (Quarter - $Quarter_{-4}$ - 1)x100 or (Month - $Month_{-12}$ -1)x100; Annual average % change is calculated as (Year/$Year_{-1}$ -1)x100

m - Data relates to the month of June, 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 will improve in the next six months.

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