

Auckland Economic Quarterly

Chief Economist's Newsletter



In this edition:

High hopes for 2014;
Best outlook for Auckland
in 7 years

Interesting times across
the Tasman



Geoff Cooper – Chief Economist
geoff.cooper@aucklandcouncil.govt.nz
09 354 2012

Rachael Logie – Senior Economist
rachael.logie@aucklandcouncil.govt.nz
09 367 6923

Melanie Luen – Economist
melanie.luen@aucklandcouncil.govt.nz
09 354 2188

View the new *Business and Economy* section of our website at:

www.aucklandcouncil.govt.nz/businessandeconomy



From the Chief Economist

Welcome to the first edition of the Auckland Economic Quarterly for 2014 with most signs pointing to a strong start to the year for the Auckland economy.

Housing activity remains the key driver of growth and this is now creating considerable flow-on effects for the broader economy. There are a few key points to highlight from the recent data releases:

1

Housing activity continues to strengthen; annual new dwelling consents have surpassed 6,000 for the first time since 2008, boosted by a strong showing for the apartment sector. Building activity volumes are also gaining momentum, up 24.4 per cent year-on-year in the September quarter in real terms. Consenting activity typically leading building activity by about 6 months, so the strong run of consent issuance over the last two quarters of 2013 will lift building activity volumes further over the first half of 2014. While such housing activity is welcomed, significantly more is needed to make a dent on Auckland's housing affordability.

3

The September quarter GDP results highlight the importance that housing activity has played in underpinning recent economic growth; the construction, manufacturing and retail sectors were key contributors to growth in output and employment in the quarter. Business confidence is currently riding high on the back of the pick up in domestic demand, with investment and employment intentions both firming in the December quarter. This sense of cautious optimism was widely held, suggesting that growth might become increasingly broad-based in the near term.

2

Consumer confidence rebounded in the December quarter, most likely reflecting the resilience of the housing market. The retail sector experienced a strong run up to Christmas and business surveys show that retailers are increasingly optimistic about the outlook for trading conditions. The unemployment rate was unchanged at 6.7 per cent in the September quarter and employment growth remains sluggish. However, forward indicators point to an improved labour market performance in the first half of 2014 and real wages growth remains solid.

4

The slowdown in the Australian economy will be creating headwinds for some of Auckland's exporters. An upswing in domestic investment activity and a strengthening US economy will help cushion the impact on capital good and service exports. But the downturn in mining investment will prove a major challenge for the Australian economy. This has implications for Auckland not only through its impact on trade but also on net migration flows, which could partially reverse, boosting labour supply and also housing demand in Auckland. This is the topic of our featured article this quarter.

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

Geoff Cooper
Chief Economist

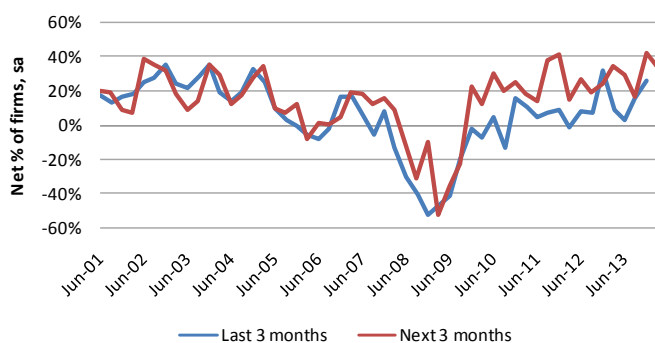
High hopes for 2014; Best outlook for Auckland in 7 years



The Auckland economy continued to gain momentum through the final quarter of 2013 and enters 2014 on a solid footing. The housing market remains the key driver of growth, but the latest NZIER Quarterly Survey of Business Opinions (QSBO) suggests that the outlook for business investment and employment is also strengthening. Employment growth underwhelmed through 2013, but job vacancies are on the rise and businesses are increasingly reporting difficulties in sourcing both skilled and unskilled workers. Labour turnover is also on the rise which suggests that employees are more confident about switching jobs.

September quarter data highlights importance of housing activity to recent growth

Figure 1: Domestic trading activity



Source: NZIER

Economic activity in the Auckland region was 3.0 per cent higher year-on-year in the September quarter of 2013 and annual growth edged up to 2.8 per cent, from 2.6 per cent in the June quarter.

Housing activity was the key driver, underpinning strong growth in the construction and manufacturing sectors. The retail trade and healthcare and social assistance sectors also posted solid contributions to annual growth.

The importance of housing activity was also reflected in the employment data with the construction sector again a key driver of annual growth, alongside the professional services sector. The manufacturing, administrative and retail sectors also registered solid year-on-year gains in the September quarter.

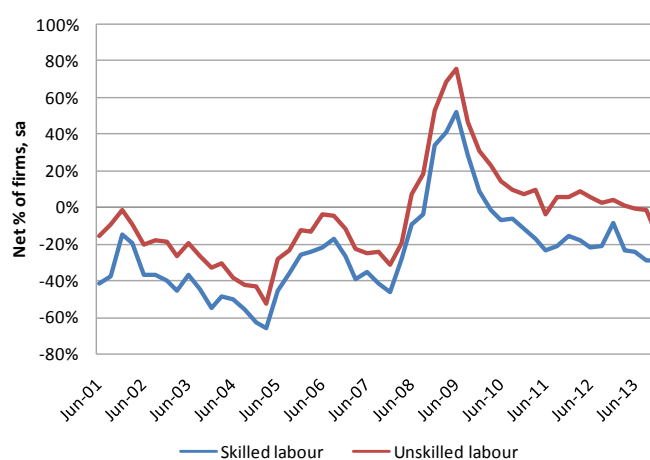
The unemployment rate was unchanged in the September quarter at 6.7 per cent (not seasonally adjusted). Employment growth as recorded by the Household Labour Force Survey (HLFS) increased 18,900 between the June and September quarters, while employment was 8.0 per cent higher than the same quarter of 2012.

An alternative survey, the Quarterly Employment Survey, recorded a quarterly rise of 6,500 filled jobs, equating to a 1.5 per cent increase over the September quarter of 2012, which is more in line with the

evidence from the QSBO, the Ministry of Business, Innovation and Employment's (MBIE) skilled job vacancy series and the underlying strength of economic activity.

Improving outlook for labour markets in 2014

Figure 2: Ease of finding labour: skilled vs unskilled



Source: NZIER

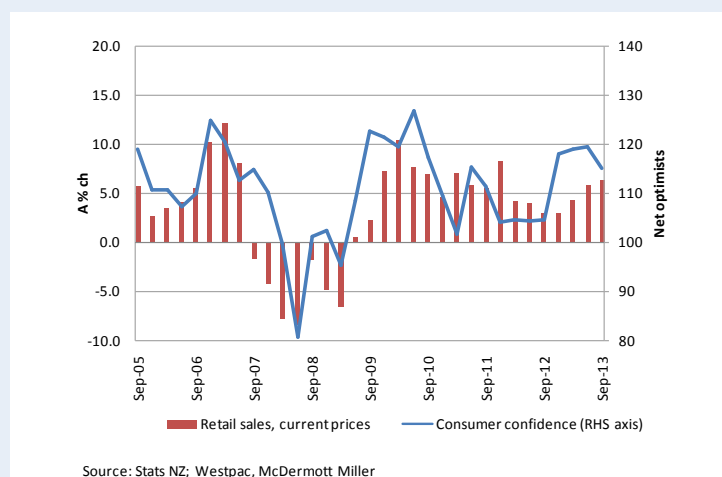
However, there is reason to be optimistic that we will see a better labour market performance through 2014. After going sideways for much of 2012, skilled job vacancies in Auckland picked up through 2013. It was not the rebound that was hoped for as slack in the labour market was taken up by a shift from part-time to full-time work and increased hours, dampening employment growth. However, forward indicators suggest that this process is now largely complete; job vacancies gained momentum over the second half of 2013 with the MBIE index up 13.1 per cent year-on-year in December, at its highest level since October 2008. Job vacancies typically lead employment growth by around six months and this bodes well for employment growth over the first half of 2014.

The national skilled vacancy series shows increasing demand for skilled workers across the majority of sectors and that businesses are also beginning to experience difficulties in sourcing unskilled labour. This is particularly the case for the construction sector. Residential activity is very labour intensive and utilizes both skilled and unskilled labour. With construction shortages nationally as a result of the Canterbury rebuild, it would not be surprising that the resurgence in the Auckland housing market is creating difficulties for employers finding workers in this sector.

The Auckland economy is currently still carrying plenty of capacity in its labour markets and wage pressures are contained. Annual growth in average weekly earnings for full-time equivalent employees picked up to 3.7 per cent in the September quarter, from 3.1 per cent in the June quarter. The national labour cost index, which strips out compositional effects, was broadly unchanged from the previous quarter, posting annual growth of 2.2 per cent in the September quarter.

A strong end to the year for consumer spending

Figure 3: Retail sales vs. consumer confidence



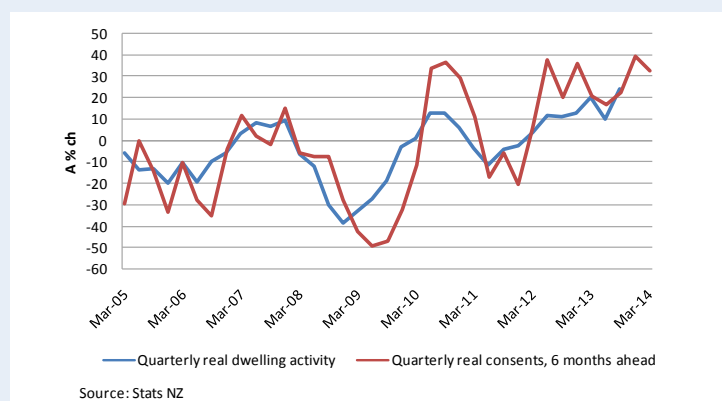
After losing ground in the September quarter, consumer confidence rebounded in the December quarter to its highest level since the March quarter of 2007. It's not clear why there would be such a strong rebound; there hasn't been a marked improvement in economic conditions, but consumers may have been reassured by the fact that housing activity has not been derailed by the introduction of loan-to-value limits and that rising residential building activity is beginning to stimulate employment and spending.

Total retail spending rose 0.8 per cent in the September quarter (in seasonally adjusted terms) and was 5.0 per cent higher than the same quarter of 2012. This was lower than the 5.8 per cent annual growth achieved in the June quarter, which saw an exceptionally strong quarter for the food and beverages sector at the national level.

National electronic card spending data shows that retailers experienced a strong run up to Christmas, with spending in core retail industries posting quarterly growth of 2.6 per cent in the three months to December, in seasonally adjusted terms; and total retail spending up 1.9 per cent. As the largest retail market, and given the strength of the rebound in consumer confidence, Auckland's retail sector was likely to be a key contributor to this strong result.

Housing activity continues to build

Figure 4: Consent volumes ahead 6 months, vs. building activity volumes



The Real Estate Institute of New Zealand's (REINZ) measure of the Auckland median house price jumped to \$620,000 in November, up \$38,000 on the October figure and 14.8 per cent higher than the November 2012 result, but subsequently fell back to \$600,000 in December. Median house price growth trended down between June and October and the strong November result likely reflects compositional effects, with fewer houses sold at lower price brackets.

Nationally, the share of high loan-to-value loans in total home lending dropped to 7 per cent in November, down from 26.5 per cent

in August; while the number of loans approved in the 13 weeks to January 10, 2014 was 10.6 per cent lower than the same 13 weeks of the previous year. House price growth lags sales volumes and it would be expected that activity at higher price points will be increasingly constrained by the impact of the LVR limits on activity at lower price brackets going forward. However, rising net migration levels could counteract much of this effect; net monthly migration flows averaged just under 1500 over the five months to November, compared to an average of 420 over the first six months of the year. A lack of transparency over the outlook for the Australian economy makes it hard to predict if these numbers will be sustained (see feature article).

November was also a stand-out month for dwelling consent approvals—779 new dwelling consents were approved, the highest monthly figure since 2006. Consents in the three months to November were 11.5 per cent higher than the three months to August; while annual consents surpassed 6,000 for the first time since 2008. Of the 779 new building consents in November, 278 were for flats and apartments. There were 1156 consents issued for new apartment builds over the 12 months to November, again a figure not achieved since 2008.

Residential building activity was 29 per cent higher in the September quarter of 2013, compared to the same quarter of 2012. Residential building consent issuance tends to lead building activity by around 6 months; the strong growth in consents over the second half of 2013 will translate into higher building activity over the first half of 2014, further stimulating employment and spending.

Mixed external conditions, but overall outlook for 2014 positive

The Auckland economy is carrying significant momentum entering 2014. The housing market remains the key driver of growth with building activity now having significant flow-on effects for output and employment in the construction, manufacturing and retail sectors. Consumer confidence is also riding high; and following a strong end of year performance, retailers will be hoping that consumers remain sanguine about the prospects for the economy. The sluggish performance of the labour market to date has played a key role in households' circumspection with regard to their finances, but employment growth is set to strengthen through 2014.

The slowdown in Australian demand will continue to create headwinds for Auckland's exporters through 2014; although the recovery in US demand will provide some offset. Global conditions more generally are expected to improve through 2014; and, with no repeat of the summer 2013 drought conditions, the national outlook for dairy production is favourable. Economists are factoring in interest rates increases from the second quarter of 2014. Alongside the Canterbury rebuild, the extent of the recovery in Auckland's labour markets and the momentum the housing sector is carrying will be key influences on the timing and extent of these moves.

Overall, there are plenty of reasons to be optimistic about Auckland's near term growth outlook. However, as always, there are also risks.

Externally, for most economies, the risks appear broadly balanced, but there is considerable uncertainty over how the Australian mining downturn will play out and what the impact will be on employment outcomes in Australia, migration flows between Australia and Auckland, and demand for Auckland's exports. The exchange rate is, of course, a perennial risk.

The strength of these migration flows also creates some uncertainty around housing market activity going forward. The impact of the LVRs should see a broader slowdown in price growth through the start of 2014; however, the boost to demand from higher net migration may counteract this effect.

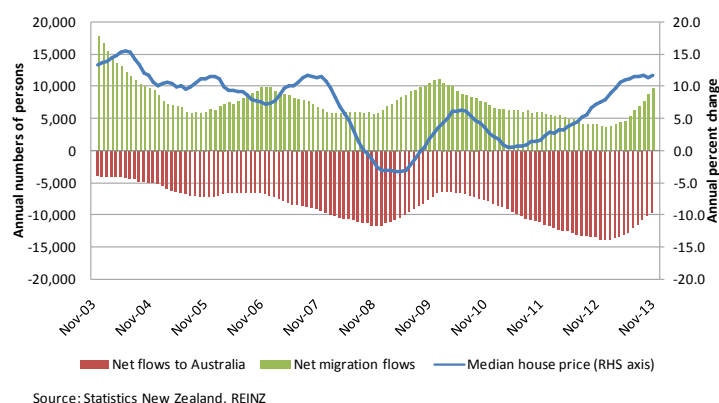
Consumer confidence has been riding high and retailers experienced a solid end to 2013. If house price growth were to slow markedly, this could weigh on confidence and spending; conversely, a strengthening employment and incomes outlook, and higher migration figures, may lead to lower savings and a stronger than expected spending outcome.

Interesting times across the Tasman

Figures from the 2013 Census reveal Auckland's annual average population growth halved from 2.4 per cent between 2001 and 2006, to 1.2 per cent between 2006 and 2013. The root cause of the slowdown was net migration flows to Australia: on average, a net 5,400 persons a year migrated from Auckland to Australia between 2001 and 2006, but this figure jumped to 10,000 a year between 2006 and 2013.

Since the census in March, we've actually seen a sharp slowdown in net flows to Australia: a net 4010 persons left in the first three months of 2013, but only 4270 people left over the subsequent eight months. The slowdown has mirrored a slowdown in Australian employment growth; it's comparatively easy for economic migrants to move between countries as conditions change and Australia does not provide reciprocal social security arrangements for all New Zealand citizens, so those with loose ties to Australia will often return home if they experience difficulties finding employment.

Figure 5: Net migration flows vs house prices, annual average per cent change



The Australian economy has registered 22 years of continuous expansion. Annual growth averaged 3.0 per cent over the decade to 2013 underpinned by an unprecedented minerals investment boom, but mining-related investment activity has now peaked and is set to fall sharply over the next few years.

The extent of the slowdown and the shift in economic drivers underpinning the subsequent recovery will have ramifications for the Auckland economy.

Even super-cycles come to an end – has the lucky country run out of luck?

The Australian economy grew 2.4 per cent through the year to the September quarter of 2013, down from 3.6 per cent over the previous 12 months. The Reserve Bank of Australia slashed its official cash rate 175 basis points between October 2011 and December 2012 and reduced it a further 50 basis points between April and September 2013, to its current low of 2.5 per cent.

Australia has a broad-based economy, but experienced two-speed growth for much of the last decade: the high interest rate and exchange rate environment needed to accommodate the mining investment boom effectively constrained other sectors of the economy, including the housing sector, and encouraged import substitution.

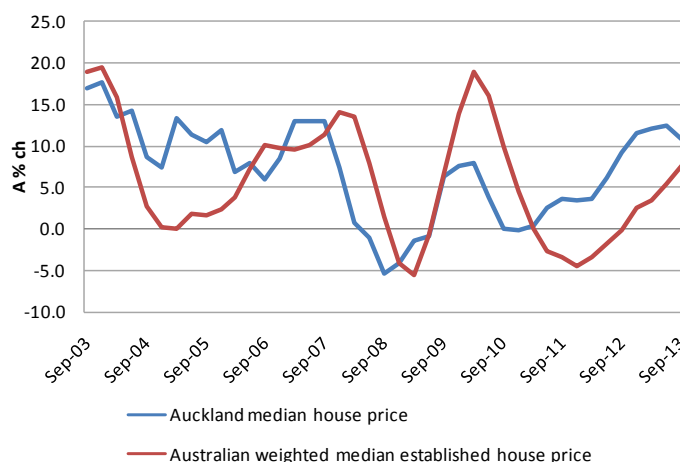
The low interest rate environment underpinned a resurgence in housing activity through 2013, particularly in the Sydney

market which recorded annual house price growth for established dwellings of 11.4 per cent in the September quarter. Nationally, the number of new dwelling units approvals stood 22 per cent higher year-on-year in November 2013, with Sydney again accounting for the lion's share of the gain.

The New South Wales economy accounts for nearly a third of the national economy, similar to the contribution Auckland makes to the New Zealand economy. Until recently, the New South Wales economy has been a laggard in terms of employment and output growth as it has played only a peripheral part in the resources boom and its major sectors have been constrained by the high interest rate, high exchange rate environment.

Sydney's housing market, like Auckland's, is supply constrained and is ranked as even less affordable according to the 2014 Demographia International Housing Affordability Survey with an index of 9.0, compared to an index of 8.0 for Auckland.

Figure 6: Annual percent change in median house prices: Australia vs. Auckland



As the mining cycle turns down the economy needs to rebalance towards other sources of growth and a major round of housing activity is in many ways welcome given that some markets are undersupplied. However, Australia, like New Zealand, maintains very high levels of household debt as a share of household incomes and the Reserve Bank of Australia is wary of a build up of highly interest rate sensitive debt in the current low interest rate environment and the risks it poses to financial stability.

Reversal of direction of migration flows to create opportunities and challenges for Auckland

The outlook for the Auckland and New Zealand economies is favourable, underpinned by continuing strong external demand for dairy production and a major phase of construction activity centred on Auckland and Canterbury. The relative strength of the domestic economy, together with the restrictions on accessing Australian unemployment benefits, could see the recent slowdown in net migration flows sustained if there is a sharp pick up in Australian unemployment. And Auckland, as the major destination for migrants and the largest labour market in New Zealand, could experience a significant short term boost to its population numbers and labour supply.

(continued on reverse)

There are both pros and cons to a significant shift in population numbers. Firstly, there has historically been a strong relationship between swings in net migration and house price growth in Auckland; although this was not the key driver of the latest run-up in prices. Net migration to Australia from Auckland for the year to November 2013 was 9,652 persons, down from 13,420 over the previous 12 month period. This equates to an additional 1250 households (based on the Census 2013 average household size) looking to rent or a buy a house, or 20 per cent of dwelling consents issued over the 12 months to November 2013.

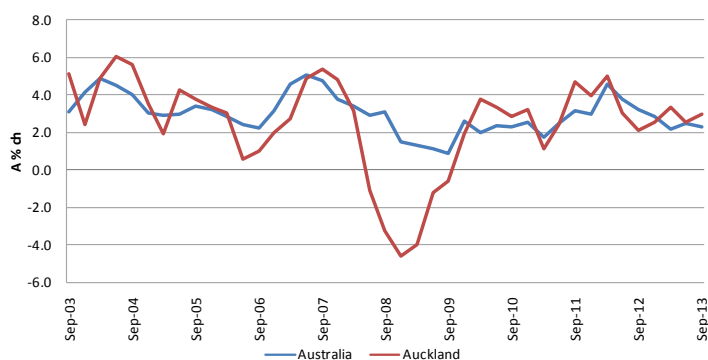
Migrant households differ from the average household; nevertheless, given the shortage of housing stock and constraints faced by the construction sector in bringing on new supply, a sustained fall in net migration to Australia would put additional pressure on an already tight housing market.

Auckland's labour market could receive significant boost from returning kiwis

The mining investment boom has been a key driver of Australian employment growth. Construction activity is labour intensive and has significant flow-on effects for output and employment in other sectors. Over the last decade, since the first leg of the minerals investment boom, construction employment in Australia has increased by over 270,000; in comparison, construction employment in Auckland has increased by 16,000 and in the rest of New Zealand by 40,000.

Australian construction employment eased backed slightly during the global economic downturn as financial constraints and uncertainty held up work on resource projects, but there was not a significant downturn as was the case for Auckland and the rest of New Zealand—construction employment in Auckland only recovered its 2008 peak in the first quarter of 2013; the Canterbury rebuild pulled forward demand for the rest of the country.

Figure 7: Real annual growth in GDP: Australia vs. Auckland



Source: Stats NZ, ABS

However, Australia's investment boom has now peaked; activity is currently plateauing, supported by work on existing projects, but is expected to fall sharply over the next few years given the shortage of projects of significant scale in the pipeline. The Reserve Bank of Australia is projecting growth to remain below its long run average through 2014, with stronger growth emerging through 2015 as non-mining growth drivers kick into gear. However, a lack of transparency on how the downturn in mining investment is set to pan out creates considerable uncertainty over growth projections and there is a risk that there will be a deep downturn in mining investment at a time when other parts of the economy are not carrying sufficient momentum to take up the slack in demand, which would have significant consequences for the Australian labour market and potentially for the Auckland labour market too.

Auckland's labour market performance disappointed in 2013, but recent lead indicators suggest that employment growth

will strengthen through the first half of 2014. Nevertheless, a substantial increase in the labour force as a result of a reversal in flows to Australia could see Auckland's unemployment rate stay higher, for longer.

On the plus side, some of the people returning will have been employed directly or indirectly in work related to the mining investment boom and have skills for which there is currently a shortage in New Zealand as a result of high demand from the Canterbury rebuild and Auckland housing market recovery.

But downturn in Australian investment creates headwinds for exporters

Alongside China, Australia is New Zealand's largest trading partner. China imports New Zealand's dairy and wood products; but Australia is the country's largest market for capital goods and professional services, both key export markets for Auckland.

Sustained strong demand from mining related activities in Australia helped support New Zealand exports of manufactures in the wake of the global downturn when exports to other major markets were constrained by a combination of weak demand and an uncompetitive New Zealand dollar.

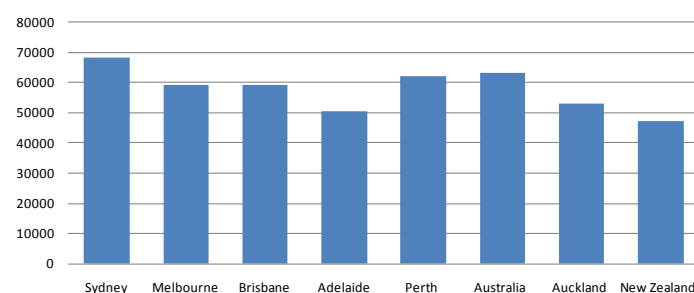
However, the slowdown in mining demand, with currently little offsetting impetus from other sectors of the Australian economy, together with the appreciation in the New Zealand dollar against its Aussie counterpart, has created headwinds for Auckland's exporters.

Reducing productivity divide remains long term challenge to attracting and retaining workers

In the short term, the Auckland and New Zealand labour markets will benefit from the downturn in the Australian economy. However, Australia has a much larger domestic market than New Zealand offering more numerous, varied and specialised job opportunities in most industries.

The Australian economy will recover and the lure of higher wages across the Tasman will quickly re-emerge as an obstacle to sourcing and retaining labour. GDP per capita in Auckland is around 17 per cent lower than the Australian average. In the long run, if Auckland wants to be able to compete with the major Australian cities for workers it needs to lift its productivity.

Figure 8: Australia vs. New Zealand: GDP per capita 2011-12, NZ\$ at current PPP



Source: SGS Economics & Planning; Infometrics Regional GDP Database; OECD



Auckland Economic Scorecard

New Zealand Economic Indicators	Notes		September
Inflation	1	Annual % change	1.4%
Official Cash Rate	1	%	2.5%
NZD/USD	1	Sept Average	0.8125
TWI (5 currency)	1	June 1979=100	76.22
ANZ Commodity Price Index	2, m	Annual % change	23.4%
Current account as % of GDP		%	-4.1%
NZ population	estimate	at 30 Sept 2013	4,478,900
Auckland population	estimate	at 30 June 2013	1,529,400

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	Q3	Quarterly change	Q3
Headline Indicators						
Employment	Number (000s)		663	746.8	↑	1,515
	Annual % change		2.2%	8.0%	↑	-0.1%
Unemployment	%		5.6%	6.7%	•	5.9%
Real GDP (expenditure)	Annual average % change	3	2.4%	2.8%	↑	2.5%
Real wages	\$ / week (average)		\$1,080	\$1,145	•	\$1,036
Jobs						
Youth unemployment – 15-19 year olds	%		21.6%	22.5%	•	23.7%
Youth unemployment – 20-24 year olds	%		9.8%	14.6%	↑	10.6%
Industries						
Manufacturing (employment counts)	Number (000s)	**	..	83	•	165
Financial and insurance services (employment counts)	Number (000s)	**	„	34	↑	34
Retail sales	Annual % change	*	0.8%	4.8%	•	2.2%
Housing and construction						
House sales – dwellings	Annual total sales	4	28,664	31,833	↑	48,707
Real average private rent	\$ / week	5	\$424	\$448	•	\$314
Rent to wage ratio	%	5	39.2%	39.1%	•	30.3%
Real median house sale price	\$	4, m	\$487,010	\$570,000	↑	\$400,000 (NZ)
Residential building consents – new dwellings	Annual total		6,286	5,647	↑	14,138
Non-residential building consents – new floor area approved (sq. metres)	Annual total		828,319	714,728	↑	2,076,948
Global connections						
Tourism – guest nights	Annual % change	m	3.6%	11.1%	↑	3.1%
Net migration	Net annual flow		7,874	7,680	↑	7,494
Arrivals	Annual flow		33,789	36,286	↑	54,901
Departures	Annual flow		25,914	28,606	↓	47,407
Exports (value)	Annual % change	m	0.1%	10.4%	↑	16.5%
Imports (value)	Annual % change	m	1.7%	10.9%	↑	-12.0%
Confidence surveys						
QSBO - General business situation	net %	6	-6.7%	43.9%	↑	37.7%
Westpac – Regional consumer confidence	Index	7	113.9	115.1	↓	115.4 (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 September, 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.