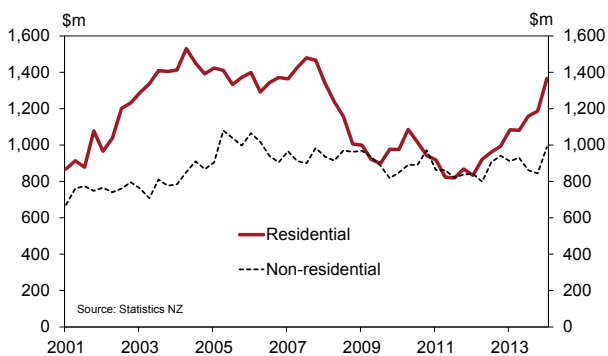


Everything is awesome

Q1 real building work rose 16%

- Building work put in place rose 16% in the March quarter, well ahead of our estimate of a 5% increase. There were large gains in both residential and non-residential construction.
- The gains were shared across the country, with Canterbury and Auckland continuing to lead the pack.
- This release was a major surprise, and on its own suggests upside risk to our already strong forecast of 1.1% GDP growth over the quarter.

Real building work put in place



Building activity in New Zealand went through a surprising flat patch over much of 2013, falling behind what the pipeline of consented work would have suggested. We suspected that this was largely a timing issue, and we expected to see a period of solid catch-up growth over the March quarter this year.

Instead, it appears that the country went on a building spree worthy of the characters in 'The Lego Movie'. Building work put in place saw the biggest quarterly increase on record (going back to 1990 by volume and 1981 by value). The level of activity is now about 5% below the peak reached in the middle of last decade's boom, and is on track to exceed those levels during this cycle, with the post-earthquake rebuild in Canterbury still ramping up.

This was a huge surprise relative to our forecast, with major implications for the March quarter GDP figures, to be released on 19 June. The construction sector contributes about 5% of GDP (though that includes infrastructure work, not covered in today's release), so a 10% upside surprise for the sector equates to a 0.5% upgrade to our GDP growth forecast, all else equal. Until now we felt that there were modest downside risks to our forecast of 1.1% GDP growth; now the risk appears to be to the upside.

The flipside of today's stunning result, though, is that it means a significant amount of the pipeline of consented building work has been cleared out, reducing the scope for the catch-up growth that we expected later in the year. We'll review our quarterly GDP forecasts next week, once the manufacturing and wholesale trade surveys for Q1 are available.

Turning to the details, the 16% increase in the total volume of building work put in place consisted of strong gains in both residential and non-residential construction. The 15.1% rise in residential work was substantially greater than the rise in building consents over the last few months – usually a good indicator for this series. That said, growth in residential building had been on the disappointing side over the previous few quarters, so today's figures could be attributed to a period of catch-up within an already-strong upward trend.

The 17.2% jump in non-residential work is somewhat easier to account for; this category tends to be lumpier than the residential side, with longer and more variable lags between consent and construction. We recognised that there was also a significant amount of catch-up to come here, but we had no strong reason to expect to be so concentrated in one quarter.

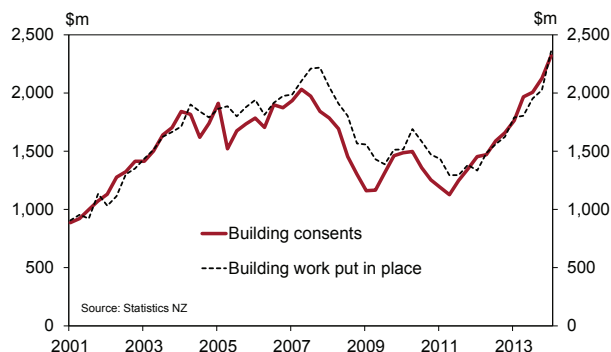
By region, it's no surprise that the star performer was once again Canterbury, with a 25% increase over the quarter (31% for residential and 16% for non-residential). The regional breakdown is only available by value, and there's no doubt that a fraction of Canterbury's 'outperformance' over the last couple of years reflects a steep rise in building costs in the region. But that doesn't alter the general story that the post-quake rebuild is now generating a significant amount of activity, and has yet to hit its peak.

The rest of the country also saw a substantial lift in building work (up 17% by value), though the fastest growth was seen in the top half of the North Island. Indeed, residential building work in Auckland now exceeds the previous decade's highs in terms of value (though probably not by volume). While the recent efforts to reduce the red tape involved in housebuilding in Auckland have been welcome we suspect that, more than anything, builders are responding to the signal generated by the steep rise in the prices of completed homes in the region.

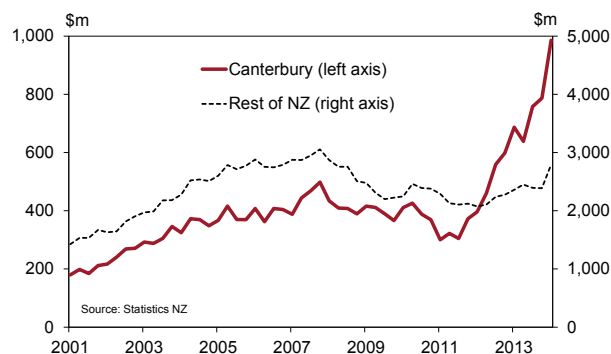
Note that today's survey only captures consented building activity. If we account for the substantial amount of repair work in Canterbury that doesn't require a consent, the nationwide level of building activity would be comfortably above the highs reached during last decade's construction boom. In that light, it's not surprising that we are seeing an acceleration in construction costs – starting in Canterbury but now increasingly spreading to the rest of the country. The Reserve Bank will no doubt remain wary of the potential for these cost pressures to spread into other parts of the economy as well.

Michael Gordon
Senior Economist

Value of residential building activity



Value of building work put in place



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Disclaimer continued

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