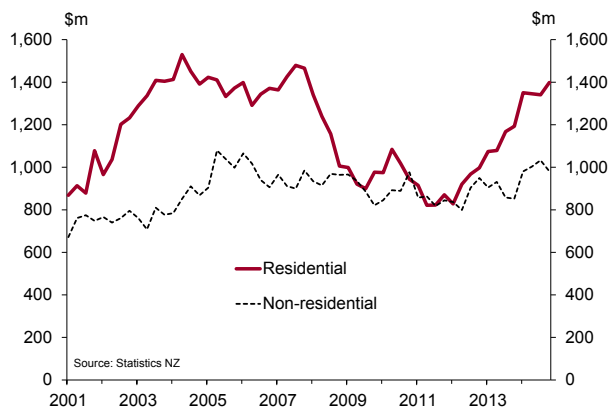


Strong foundations

December quarter real building work up 0.3%

- Building work put in place rose 0.3% in the December quarter, capping off a 17% increase over 2014.
- Residential building work rose 4.3%, dominated by the Auckland and Canterbury regions where supply shortages are most prominent.
- We expect construction to remain a significant driver of GDP growth over the next two years.

Real building work put in place



Building work in inflation-adjusted terms rose 0.3% in the December quarter, after a similarly subdued 1.1% increase in the September quarter. However, the recent figures belie the strength of the trend in building activity: rather than a steady climb over the course of the last year, the level of building activity jumped by a near-record 14% at the start of last year and has more or less maintained that level since. Building work over 2014 as a whole was up 17% on the previous year – the strongest annual pace of growth in nearly 15 years.

The construction sector has been the biggest single contributor to GDP growth over the last couple of years as a whole. However, the pattern has been choppy from quarter to quarter, and has borne little resemblance to the quarterly growth rates for total GDP. Hence, while today's figures fell short of our estimate of a 1.5% increase, we remain comfortable with both our long-run projections for construction activity and our forecast of a 1% rise in December quarter GDP.

Residential building work rose by 4.3% in the December quarter, reaching a new seven-year high. This was stronger than our forecast, although we noted that there was some upside risk to this component. The housing market appeared to go quiet ahead of last September's election; the level of construction was softer than we expected given the pipeline of consented work. With the election – and the risk of a change to the tax treatment of property – now in the rear-view mirror, the stage was set for a catch-up in building activity in the December quarter.

The rise in residential construction was dominated by Auckland and Canterbury. After adjusting for increases in the cost of building (which are now becoming quite significant nationwide), we estimate that construction was up 9% in both regions, with the rest of the country down slightly. That's to be expected given the relative pressures on the housing stock across regions. The post-earthquake rebuild in Canterbury is still in its growth phase, and Auckland's housing supply is clearly being squeezed by strong population growth and a particularly low level of homebuilding in previous years.

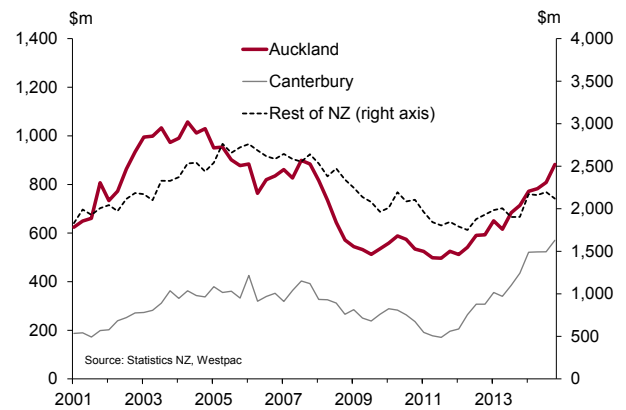
Indeed, despite the level of homebuilding in Auckland reaching a seven-year high, it has continued to lag behind demand. Consequently, we've seen a further increase in 'crowding' in Auckland over the last year – that is, the average household size has continued to rise, in contrast with the gradual downward trend seen in the rest of the country.

Non-residential construction was down 5% for the quarter. This was softer than we forecast, but we're less concerned about a 'miss' on this component. The time lag between consent and construction can be long and highly variable, but the strong upward trend in consents shows that there is a significant amount of work in the pipeline for the next few years.

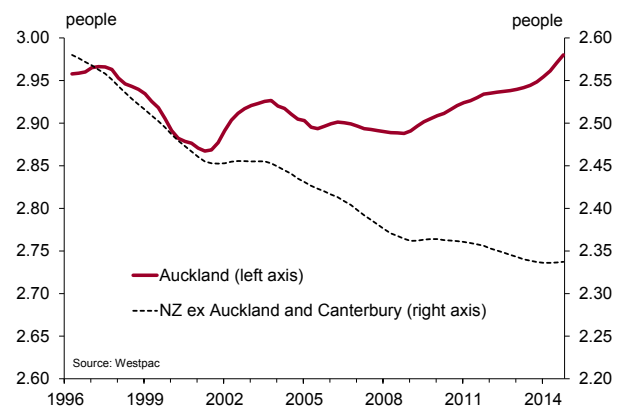
As we detailed in our latest quarterly *Economic Overview*, we expect nationwide construction spending to continue to underpin economic growth over 2015 and 2016. While quake-related activity in Canterbury is expected to peak and start to tail off by 2016, non-quake building work – especially the drive to build more houses in Auckland – will continue to rise for a while longer than that. The building industry has now come to a very similar view to us.

Michael Gordon
Senior Economist

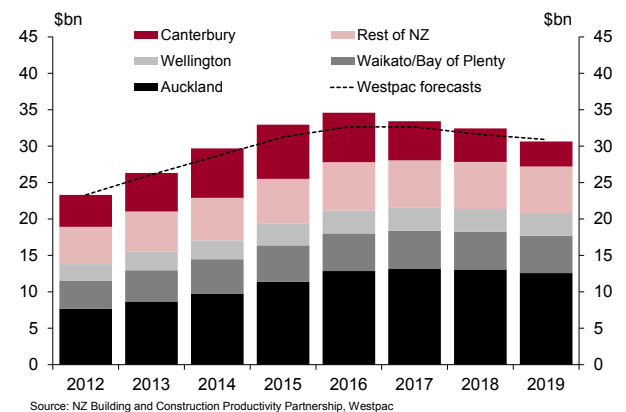
Real residential building work by region



People per house



Westpac and industry forecasts of construction



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