

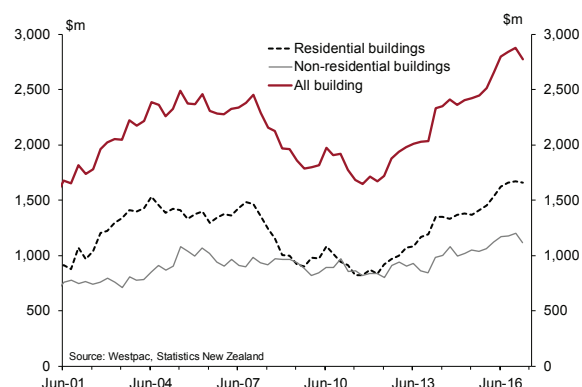
# A temporary pause

## Building Work Put in Place: March 2017 quarter

6 June 2017

- Building activity fell 3.5% in the March quarter, mainly due to a pull-back in non-residential construction in Auckland.
- Residential construction also softened in the March quarter.
- March's softness in construction activity is likely to be a temporary slowdown. There is a large amount of work planned over the coming years. However, capacity constraints have emerged and cost pressures in the sector are continuing to build. This may provide a brake on activity over the coming years.

**Building work put in place, quarterly volumes (seasonally adjusted)**



### Non-residential work accounts for most of the Q1 weakness

Construction activity fell by 3.5% in the March quarter. This follows gains in previous quarters, and leaves the level of construction activity up 4.3% over the past year.

The main reason for the weakness in Q1 building activity was a 7.2% decline in non-residential construction activity. Underlying this was a sharp pull back in commercial building centred on Auckland. Spending on public projects was firmer.

Work on non-residential projects can be lumpy on a quarter-to-quarter basis, and it's not unusual to see large temporary swings. Indeed, the Q1 decline in commercial work completed followed a large increase last quarter. We expect non-residential construction spending to trend higher over the coming years, underpinned by increasing infrastructure spending.

### Residential work down slightly

Residential building activity fell by 0.8% over the quarter. Growth in residential construction has been slowing for several quarters now. This may reflect the emergence of capacity constraints in the construction sector, particularly with regards to the availability of skilled labour. Earlier uncertainty around Auckland's Unitary Plan and poor weather in the March quarter may also have contributed to the recent slowing in construction activity.

### Regions

Looking at the value of building by region, March's weakness was centred on Auckland where there was a 5.5% decline in overall building levels. This was related to work on non-residential projects, which was down by 17% over the quarter. March's decline followed a sharp increase in the December quarter. We expect non-residential building activity to pick up again next quarter.

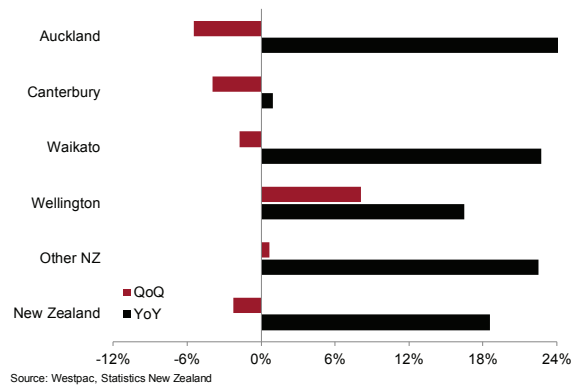
In terms of residential construction, March saw only a modest 0.5% rise in Auckland building levels. The past year has seen the momentum in Auckland home building fade. Consent issuance has essentially been flat for around a year now, and remains below the levels needed to keep up with population growth. We do expect that building levels in the

region will climb over the coming year. But with population growth remaining strong, tightness in Auckland's housing market is likely to get worse before it gets better. This will be an important area to watch going forward.

Conditions in Canterbury are continuing to evolve. Six years on from the devastating February 2011 quake, planned rebuild activity is now past its peak. In fact, in March we saw both residential and non-residential work declining for their third consecutive quarters. Reconstruction activity, particularly in the non-residential space will continue for some time yet. However, spending will trend down over time.

Construction activity continued to climb modestly in most other regions.

### Growth in total building work put in place, value terms



Note: YoY measures growth over the past four quarters compared to the same four quarters in the previous year.

### Costs

With construction activity having risen strongly in recent years, we are hearing increasing anecdotes about growing pressure on capacity and difficulties sourcing labour. This

is being reflected in rising costs. In the year to March, building costs are estimated to have risen by 6.2% - their fastest pace since 2005. Costs have been rising for both residential and non-residential work. With a strong outlook for construction activity over the coming years, we expect cost pressures to be sustained for some time.

### Outlook

We expect continued strength in construction activity over the coming years, with a large pipeline of work planned. Much of this is centred on Auckland, where around a decade of strong building is required to address the existing shortfall of housing and keep up with surging population growth. Residential construction has also been increasing strongly in areas such as Northland, Nelson, the Manawatu and Otago.

On top of this, there is a large amount of non-residential work planned nationwide, including a substantial amount of infrastructure spending.

In addition to the above work streams, reconstruction activity following the Canterbury and Kaikoura earthquakes will continue for several more years. However, in the case of the Canterbury rebuild, planned spending is well advanced and has started to gradually wind down.

But while there is a large amount of work planned, the construction sector is encountering some growing pains. Building costs have been rising, with capacity in the sector already stretched and construction firms reporting increased difficulty finding suitable staff. In addition, increases in borrowing rates and tighter bank lending standards for property developers will provide some brake on how quickly building activity ramps up. Combined, these conditions mean that the existing housing shortage will be eroded only gradually.

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