

Don't stop me now

Building Work Put in Place: December 2016 quarter

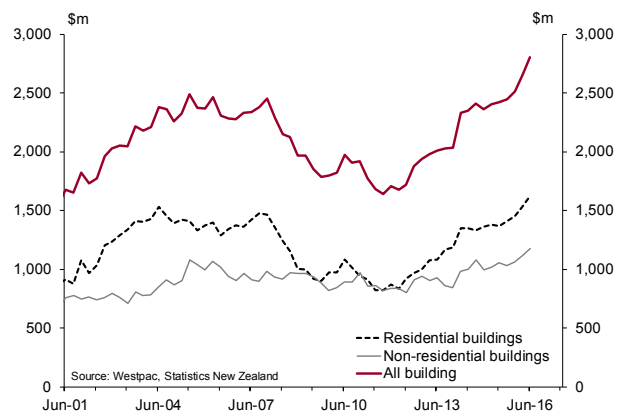
- Building activity rose 1.9% in the December quarter, and is up 14.5% over the past year.
- December's increase was due to gains in both residential and non-residential building activity.
- There were strong gains in activity in Auckland and Wellington. At the same time, we have continued to see activity in Canterbury easing back.
- The outlook for construction activity is strong. However, cost pressures in the construction sector are continuing to build (excuse the pun).

Overview

Construction activity continued to increase in December quarter, with gains widespread across regions. Over the quarter, overall building levels were up 1.9%, supported by increases in residential (+1.1%) and non-residential (+3%) activity. This continued strength is all the more impressive given the significant disruptions to activity in parts of the country as a result of November's Kaikoura earthquake. Over the year, building levels were up a solid 14.5%.

Looking at residential building, December's 1.1% gain is a bit of step down from the rates that we had seen in recent quarters. However, gains in recent years have been very strong - residential building levels have risen by around 15% over the past year, and they're up a whopping 93% since December 2011 when the Canterbury rebuild was in its early stages. This strong activity in recent years has seen the construction sector becoming stretched. Businesses we've spoken to have highlighted difficulties finding skilled labour, which may provide a brake on growth over the coming years. We're also likely to see increased pressure on costs.

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



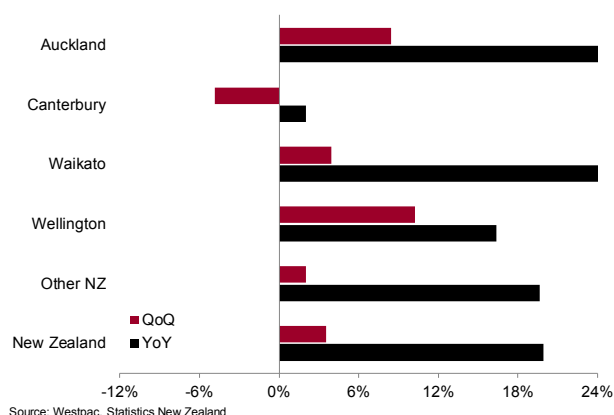
On the non-residential front, December's 3% gain leaves building levels up close to 14% over the past year. That's been supported by strong increases in office construction and spending on education assets.

Regional breakdown

Looking at the regions, we've seen widespread gains in building activity. There have been particularly strong gains in residential construction in Wellington, with a 10% gain in December, coming on top of a 13% increase in September. That leaves residential construction levels up nearly 32% over the past year. Wellington hasn't seen the same significant underbuilding of homes that Auckland has. Nevertheless, the Capital has seen pressures emerging in its housing market, which is spilling over into increased pressure on prices and rents. Consequently, these increases in building levels are a welcome development. Non-residential building in the Capital has been softer (down 6% over the past year), but we should see it climb over 2017, supported by earthquake related repairs and strengthening work.

Building levels are also rising in Auckland, with a 4.5% gain in residential building over the December quarter, and a 30% increase over the year. But there's still a long way to go before the significant underbuild of homes in Auckland is addressed. Auckland currently needs to be building upwards of around 11,000 homes a year. But over the past year, only 10,000 new homes were consented, and even fewer were completed. We do expect that building levels will rise over the coming years, especially as many of the teething issues around the Unitary Plan have been resolved. However, undersupply of housing in Auckland will likely get worse before it gets better. Non-residential building in Auckland is continuing to charge ahead, with building levels up around 40% over the past year.

Growth in total building work put in place, value terms



In contrast to the rest of the country, residential building activity in Canterbury has been declining and is down 6% over the past year. That was to be expected. It's been six years since the major quakes that struck the region. And while there's still a lot to do, reconstruction is well advanced. What we're seeing is a normal easing back after strong activity in recent years. There has been a reorientation of construction activity in Canterbury away from residential work towards non-residential activity. Walking around Christchurch this

week and talking to businesses, the tone is very positive. Completions are increasing and businesses are moving back into the central city. At same time, the drivers of activity in the region are shifting from reconstruction work and towards demand in other areas like services and tourism.

Costs

With strong gains in activity, it is unsurprising that we have seen costs rising. Construction costs rose by an estimated 5.9% over the year to December - their fastest pace since 2005. Costs have risen in both the residential and non-residential space.

With a strong outlook for construction activity over the coming years, we expect cost pressures to be sustained for some time, and risks are to the upside.

Outlook

We expect construction levels will remain strong for some time. There is a large pipeline of work spread across the country. This includes very strong residential demand in Auckland and elsewhere, as well as a large amount of planned infrastructure work nationwide, and continuing reconstruction activity in Canterbury (though this has started to ease back). On top of these factors, reconstruction following the recent earthquakes near Kaikoura reinforces a strong outlook for the construction sector over the coming years. However, emerging capacity constraints may provide some brake on growth.

Satish Ranchhod

Senior Economist

Contact the Westpac economics team

Michael Gordon, Acting Chief Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Sarah Drought, Economist +64 9 352 0057

Any questions email: economics@westpac.co.nz

Disclaimer

Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac'). This information is correct as at 1 July 2016.

Disclaimer

This material contains general commentary, research, and market colour. The material does not constitute investment advice. The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product

or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking licence and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

Disclaimer continued

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation (EU) 596/2014).

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ("WCM"), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

Investment Recommendations Disclosure

Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts of interests associated with the provision of investment recommendations.

- (i) Chinese Wall/Cell arrangements;
- (ii) physical separation of various Business/Support Units;
- (iii) Strict and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) reasonable steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.