



# Rider Hunt

New Zealand trends in  
property and construction

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## Forecast<sub>43</sub>

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## General economic outlook

Real GDP grew by 2.2% in the year to March 2006, down from 3.7% in the year to March 2005. Economic growth is forecast to slow further to 1.5% in the March 2007 year, before a gradual export-led recovery to 1.8% in 2008, accelerating to 3.3% in 2009, 2.9% in 2010 and 4.0% in 2011.

Non-residential building investment is forecast to continue to grow for the next year, before declining in the 2008 and 2009 March years and rising again in 2010 and 2011. The recent slowdown in residential building has freed construction resources to meet deferred demand in the non-residential building sector. Consents data signal much work still to come, in the short run at least. In the medium run, investment in buildings, like other business investment, will be dampened by revenue uncertainty as economic growth slows further, pressures on profitability as costs rise faster than selling prices, higher costs of capital equipment due to depreciation of the New Zealand dollar and higher domestic construction costs, and higher borrowing costs. Exceptionally, infrastructure investment will continue to grow over the next two years with roll out of the government's roading programme.

## Key points in this issue

### • Building activity

Total non-residential building work put in place remained stable at the high of \$5.2 billion per year. In the year to June 2006, building work put in place grew most in the hotels and boarding houses sector and hospitals and nursing homes sector.

### • Building consents

Consents also remained stable around the high of \$4.1 billion per year, signalling a continuing high level of non-residential building work to be put in place over the next six to nine months.

### • Consents by sector

In the year to August 2006, consents growth was strongest in the hospitals and nursing homes sector and hotels and motels sector. After a number of prison projects around the country, consents fell sharply in the hostels and boarding houses sector.

### • Consents by region

Consents data suggest that non-residential building activity in the near future is likely to grow most rapidly in the West Coast, Taranaki and Bay of Plenty regions and to contract most markedly in Waikato, Nelson and Tasman.

### • Building costs

Non-residential building costs came under further pressure, with the Capital Goods Price Index for Non-Residential Buildings rising by 2.0% in the June 2006 quarter and 5.4% in the year to June 2006. Annual cost escalation is forecast to remain high until easing slightly from mid 2007, before rising again from mid 2008.

# Building activity trends

In the year to June 2006 (the latest quarter for which building activity data are available), the total value of non-residential building work put in place remained stable at the high of \$5.2 billion, as shown in **Figure 1**. This compares with \$4.6 billion in the year to June 2005. The June 2006 quarter saw \$1.3 billion of building work put in place, up 7% from the March 2006 quarter and only 5% lower than the record high

quarter of September 2005.

**Figure 2** shows the annual value of building work put in place by sector. Quarterly activity slowed in the hotels and boarding houses sector, education buildings sector and factories and industrial buildings sector, but all sectors saw higher levels of activity in the year to June 2006 than in the June 2005 year. In the year to June 2006, the hotels and boarding houses sector continued

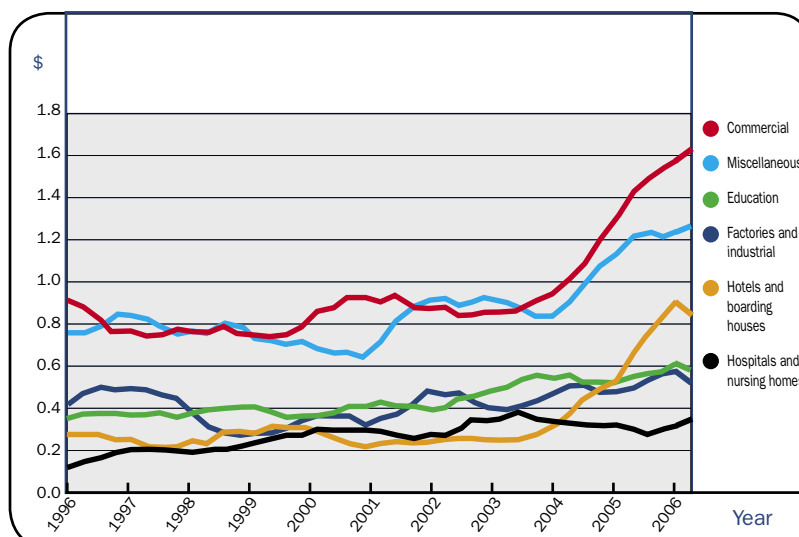
to grow fastest at 31%, although down from 84% growth in the June 2005 year. The hospitals and nursing homes sector grew at 18%, up from -9% in the June 2005 year. The commercial buildings and education buildings sectors grew at 17% and 11% respectively. Growth was lowest, but still significant, in the factories and industrial buildings sector and miscellaneous<sup>1</sup> buildings sector, at 6% and 5% respectively.

**Figure 1: Annual non-residential building work put in place (\$ billion)**



Source: Statistics New Zealand

**Figure 2: Annual non-residential building work put in place by sector (\$ billion)**



Source: Statistics New Zealand

<sup>1</sup> In building work put in place data, miscellaneous buildings include social, cultural, religious, recreational and farm buildings.

# Building activity outlook

## Building consents

The total value of non-residential building consents issued changed little between August 2005 and August 2006, remaining around the high of \$4.1 billion per year, as shown in **Figure 3**. Over 17,000 non-residential building consents were granted in the year to August 2006 at an average value per consent of \$234,000,

5% higher volume but 5% lower average value than in the year to August 2005. The high level of consents suggests a continuing high level of non-residential building work to be put in place into 2007, given a time lag of typically six to nine months for trends in consents issued to feed through to work put in place.

**Figure 3: Annual non-residential building consents (\$ billion)**



Source: Statistics New Zealand

**Table 1: Value of consents by sector in the year to August 2006**

Sector	Annual value (\$ million)	Share of total (%)	Annual change (%)
Offices and administration buildings	672	17	-4.3
Shops, restaurants and taverns	627	15	-4.0
Education buildings	471	12	9
Storage buildings	455	11	9
Factories and industrial buildings	440	11	-14
Hospitals and nursing homes	366	9	81
Social, cultural and religious buildings	299	7	13
Hotels and motels	276	7	61
Farm buildings	195	4.8	10
Hostels and boarding houses	177	4.4	-63
Miscellaneous buildings	77	1.9	34
<b>Total</b>	<b>4,057</b>	<b>100</b>	<b>-0.2</b>

Source: Statistics New Zealand

## Consents by sector

**Table 1** shows the value of consents issued by sector<sup>2</sup>. Consents grew fastest in the hospitals and nursing homes sector and hotels and motels sector, at 81% and 61% respectively in the year to August 2006. This suggests that these sectors will continue to be very active and have strong demand for labour and other resources over at least the next six to nine months. Meanwhile, after a number of prison projects around the country, consents fell sharply in the hostels and boarding houses sector from the high of \$476 million in the year to August 2005 to \$177 million in the August 2006 year. Consents also fell in the factories and industrial buildings sector and in the two largest sectors of offices and administration buildings and shops, restaurants and taverns. Growth slowed further but remained strong in the miscellaneous buildings sector<sup>3</sup>, the smallest sector. All other sectors saw modest growth in the August 2006 year.

## Consents by region

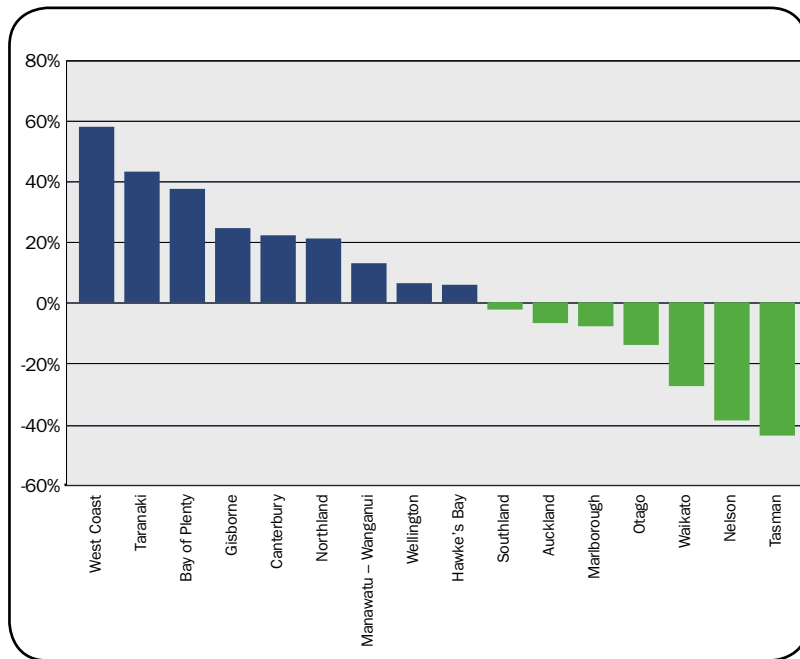
Although Statistics New Zealand data on non-residential building activity are not available at a detailed regional level, it is possible to use consents data by region to identify likely areas of greatest future growth and therefore most pressure on costs of labour and other resources.

**Figure 4** illustrates the change in value of consents issued by region. This provides an indication of which regions are likely to show the greatest growth in building activity into 2007.

<sup>2</sup> These consents sector categories are unfortunately not equivalent to, and therefore not directly comparable with, the categories of building work put in place, illustrated in Figure 2 due to how Statistics New Zealand collects these data.

<sup>3</sup> In consents data, miscellaneous buildings is a residual category for non-residential building construction not covered by other sector categories (e.g. public toilets and car parks).

**Figure 4: Annual change in value of consents by region in the year to August 2006**



Source: Statistics New Zealand

**Figure 4** suggests that non-residential building activity is likely to grow most rapidly in the West Coast, Taranaki and Bay of Plenty regions and to contract most markedly in Waikato, Nelson and Tasman. Note, however, that regional consents data tend to be very volatile month to month and, for small regions in particular (including West Coast, Taranaki, Nelson and Tasman, identified above), can be significantly affected by just one or two large projects.

The Auckland region, which accounted for 35% of all consents, experienced a 6% fall in consents in the year to August 2006, compared with 20% growth in the year to August 2005. Monthly data, however, reveal a recent upturn after low levels of consents in the months of December 2005 to April 2006. Wellington continued to grow modestly at 6% in the year to August 2006, albeit well below the 52% growth experienced in the August 2005 year. Canterbury has seen a significant increase from 4% growth in consents in the year to August 2005 to 23% growth in the August 2006 year.

### Building industry confidence

Business confidence is measured in terms of reported expectations of changes in general business conditions over the next six months. The building industry remained the least pessimistic sector in NZIER's September 2006 Quarterly Survey of Business Opinion. A net<sup>4</sup> 15% of building industry firms stated that they expect business conditions to deteriorate over the next six months. This is a significant improvement from 38% in the June 2006 survey and the December 2005 survey's record 52% expecting business conditions to deteriorate over the following six months.

A net 7% of building industry firms reported an increase in output in the September 2006 quarter, compared with 5% in the June 2006 quarter. Furthermore, a net

9% reported an increase in new orders, in contrast to a net 18% reporting a fall in new orders in the June 2006 quarter. Only a net 2% of firms reported that they had shed labour in the three months to September 2006, after 11% in the June 2006 quarter, and a net 5% stated that they expect to increase staff numbers in the next three months, especially building materials firms. Unskilled labour became easier to find than previously. Although expectations of cost increases fell, intentions to increase selling prices rose. An increase in overdue debtors was reported by a net 24% of building construction firms, compared with a net 4% of building materials firms. On balance, a net 20% of firms reported a decline in profitability in the September 2006 quarter, a significant improvement from 42% in the June 2006 quarter.

### Interest rates and monetary policy

The Reserve Bank's benchmark interest rate, the Official Cash Rate (OCR), has remained at 7.25% since December 2005. Economic growth has not slowed, nor resource pressures eased, as rapidly as anticipated, sustaining the Reserve Bank's fears of inflation. Household consumption and the housing market have not yet cooled as much as expected. Net exports and government spending have added to economic activity. Annual inflation has now exceeded the Reserve Bank's target for four consecutive quarters and is expected to continue to do so for at least another year.

<sup>4</sup> The number of firms expecting conditions to deteriorate minus the number of firms expecting them to improve or at least get no worse.

**Table 2: Interest rates (% per year, average for quarter)**

Year	Quarter	90 day bank bill	10 year govt stock	First mortgage	Base rate
2004	March	5.5	5.9	7.4	9.8
	June	5.9	6.2	7.8	10.1
	Sept	6.4	6.2	8.3	10.6
	Dec	6.7	6.0	8.7	11.0
2005	March	6.9	6.0	8.8	11.2
	June	7.0	5.8	9.0	11.4
	Sept	7.0	5.7	9.0	11.8
	Dec	7.5	5.9	9.3	12.1
2006	March	7.6	5.7	9.5	12.3
	June	7.5	5.8	9.4	12.3
Forecast					
2007	Sept	7.5	5.9	9.6	12.3
	Dec	7.5	6.1	9.4	12.1
	March	7.3	6.1	9.2	11.9
	June	7.3	6.1	8.9	11.7
2008	Sept	6.8	6.2	8.7	11.4
	Dec	6.3	6.2	8.2	10.9
	March	5.6	6.2	7.5	10.2
	June	5.5	6.2	7.4	10.1
2009	Sept	5.7	6.3	7.6	10.3
	Dec	6.1	6.3	8.0	10.7
	March	6.5	6.3	8.4	11.1
	June	6.9	6.3	8.8	11.5
2010	Sept	7.1	6.4	9.0	11.7
	Dec	6.7	6.4	8.6	11.3
	March	6.1	6.4	8.0	10.8

Source: Reserve Bank of New Zealand, NZIER forecast

**Table 2** presents NZIER’s interest rate forecast. NZIER predicts that the Reserve Bank will feel able to begin to ease monetary conditions around mid 2007 as economic growth continues to slow.

## Building costs

This section focuses on movements in an official cost measure – the Capital Goods Price Index for Non-Residential Buildings (CGPI-NRB).

As indicated in previous issues of *Forecast*, Rider Hunt has been commissioned by Statistics New Zealand to provide detailed costing information on a range of model buildings, which will be updated each quarter. This work, which is part of Statistics New Zealand’s review of the Producer Price Index, will provide more accurate information with which to calculate inputs that comprise the Capital Goods Price Index. This will lead to a more accurate indexation for the CGPI-NRB, which *Forecast* reports.

Readers should note that the CGPI-NRB, current and forecast as reported below, is a national average, which does not

differentiate between regions or building types. We therefore advise caution in applying the increase in the CGPI-NRB as a measure of cost escalation for specific building projects.

The Rider Hunt publication *Cost Commentary* provides a tender price relativity between the main New Zealand and Australian centres. This publication is available on request from any Rider Hunt office.

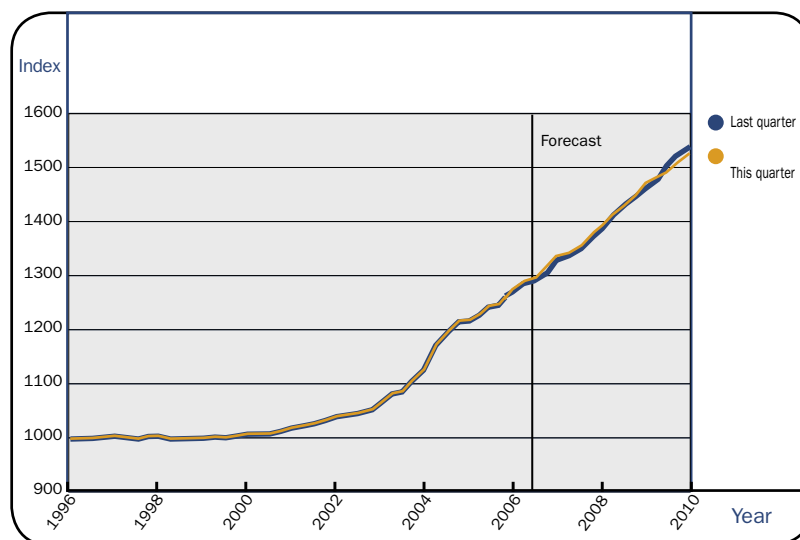
## Recent trends

Non-residential building costs came under further pressure in the June 2006 quarter (the latest quarter for which data are available). The CGPI-NRB rose 2.0% in this quarter, up from 1.7% in the March 2006 quarter and 0.4% in the December 2005 quarter. June 2006 saw the highest quarterly increase since June 2004. Statistics New Zealand attributes the latest quarter’s increase to rising costs of construction components and raw materials. In annual terms, non-residential building cost escalation, as measured by the increase in the CGPI-NRB, rose from 4.5% in the year to March 2006 to 5.4% in the year to June 2006. This also exceeds the 4.8% increase of the June 2005 year, but remains well below the 8.6% increase of the June 2004 year.

## Forecast

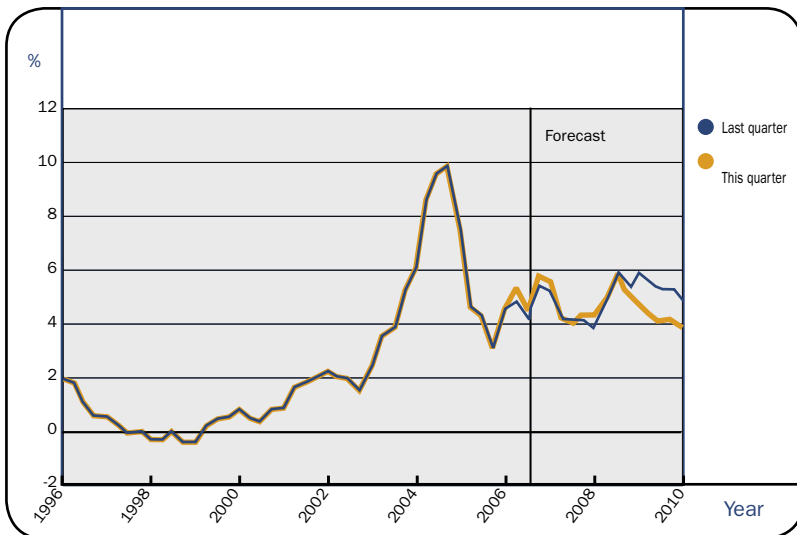
**Figure 5** shows our latest forecast of the CGPI-NRB and **Figure 6** its percentage change. See also **Table 3**. Note that in **Figure 6** the downward slope from the start of 2005 does not indicate that non-residential building costs fell (see **Figure 5**), but simply that they rose less than in late 2004.

**Figure 5: Non-residential building cost index (CGPI-NRB)**



Source: Statistics New Zealand, NZIER forecast; index based to 1000 in September 1999 quarter

**Figure 6: Non-residential building cost escalation  
(annual percentage change in the CGPI-NRB)**



Source: Statistics New Zealand, NZIER forecast

**Table 3: The CGPI-NRB**

Year	Quarter	Index	Quarterly change (%)	Annual change (%)
2004	March	1,126	2.3	6.2
	June	1,172	4.1	8.6
	Sept	1,190	1.5	9.8
	Dec	1,211	1.8	10.0
2005	March	1,214	0.2	7.8
	June	1,228	1.2	4.8
	Sept	1,243	1.2	4.5
	Dec	1,248	0.4	3.1
2006	March	1,269	1.7	4.5
	June	1,294	2.0	5.4
Forecast				
2007	Sept	1,299	0.4	4.5
	Dec	1,320	1.6	5.8
	March	1,340	1.5	5.6
	June	1,350	0.7	4.3
2008	Sept	1,352	0.2	4.1
	Dec	1,378	1.9	4.4
	March	1,399	1.5	4.3
	June	1,414	1.1	4.8
2009	Sept	1,432	1.2	5.9
	Dec	1,449	1.2	5.2
	March	1,467	1.2	4.9
	June	1,476	0.7	4.4
2010	Sept	1,491	1.0	4.1
	Dec	1,510	1.3	4.2
	March	1,524	0.9	3.9

Source: Statistics New Zealand, NZIER forecast

We update our forecast each quarter as new data become available, including any revisions to the predicted size and timing of future changes in macroeconomic conditions. Our latest forecast (solid line) of the CGPI-NRB and its movements is broadly similar in the medium run to our previous forecast published in the July issue of *Forecast* (blue line). Our latest forecast suggests an earlier slowdown in cost escalation in 2009, although we highlight that longer run forecasts are less reliable and more subject to change. The difference in longer run forecasts is attributed in part to Statistics New Zealand's recent revision of historical data on non-residential building investment, under the specification of lagged effects in our forecasting model. These data have been revised upwards, suggesting that observed levels of cost escalation were consistent with higher levels of non-residential building investment than previously reported.

Consents data, as described above, suggest continuing high levels of building work put in place and demand for construction resources in the remainder of 2006 and into the first half of 2007. Non-residential building cost escalation is expected to remain high until easing slightly from mid 2007, before rising again from mid 2008. At an average of 4.7% per year to 2010, this is well below the peak of 10.0% reached in the year to December 2004.

**Notes:**

The current and forecast CGPI-NRB is a national average, which does not differentiate between regions or building types, and we therefore advise caution in applying the increase in the CGPI-NRB as a measure of cost escalation for specific building projects.

# Rider Hunt

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