

WESTPAC WEEKLY ECONOMIC COMMENTARY

Building a mystery.

7 June 2022



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Demand for new builds, particularly housing, continues to run hot. But what should be a golden era for builders is turning out to be anything but, as they grapple with supply constraints, ballooning costs and increasing financial distress. That leaves an uncertain outlook for the industry for the year ahead.

One of the more notable findings of the latest ANZ business outlook survey is that confidence in the residential construction sector has fallen sharply in the last few months. A net 50% of firms expect conditions to worsen in the next year, almost as bad as the low point seen during the Covid lockdown in 2020. The responses from commercial construction were more balanced, though down from their recent highs.

That degree of pessimism is striking when you consider that the homebuilding industry is facing its highest demand in decades. More than 50,000 new homes have been consented over the last year, easily the highest on record – although when scaled to the size of the population, that takes us back to where we were in the mid-1970s.

That surge in consent numbers also reflects a change in the mix of what's being built, with a marked shift from low- to medium-density housing. Around a third of the homes built in the last year were townhouses, apartments or other units, with that share doubling over the last five years. The Government's moves to force councils to allow more intensification in the main centres (especially outside of Auckland, which has already seen a major shift in this direction with the Unitary

Plan in 2016) mean that there is scope for substantial further densification ahead.

The issues for the building industry lie in turning those consents into completed homes. Last week Stats NZ produced some new estimates of completion times for homebuilding. These are labelled 'experimental', and could be revised over time. Nevertheless, the pulling together of this data has helped to shed more light on the challenges.

Stats NZ estimates that almost 35,000 homes were completed (that is, they received a Code Compliance Certificate) in the year to March. However, the pace of completion has actually slowed in the last few quarters. In addition, the time from consent to completion has stretched out to almost a year and a half on average.

On the plus side, the conversion rate still looks quite high – the vast majority of consents result in a finished home. Assuming a lag of 18 months, around 37,000 homes were consented for the same period. This is understandable: it takes a lot of work to get to the consenting stage, so buyers (and builders) are generally pretty well committed by that stage.

What's missing from this data is the number of homes demolished to make room for new ones. That will be a particular issue in Auckland, where the Unitary Plan has greatly expanded the scope for 'brownfield' development – removing one house from a section and replacing it with several townhouses. As a result, the net addition to the housing stock – and therefore the headway we've made on addressing New Zealand's housing shortage – will be somewhere south of what these numbers suggest.

The strength of demand for new homes has exposed the capacity constraints in the building industry. Initially that seemed to be around labour, with the border closure and the loss of access to migrant workers aggravating an already-existing shortage of workers. But in the last year or so there have been growing issues with both the cost and availability of key building materials, with delayed deliveries further adding to the cost of a build. Quotable Value reports that prices alone for materials have risen more than 20% in the last year.

Despite these headwinds, building activity has continued to push forward. Building work put in place rose 3.2% in the March quarter, taking it to another new high for this cycle. That consisted of a 3.5% lift in residential work, as well as a 2.7% rise in non-residential building.

So what lies ahead for the building industry? Even with the progress to date on alleviating our housing shortage, it will take several more years of building at this pace before the demand could be considered satisfied. We think that this will provide some buffer against the forces of falling house sale prices and rising interest rates. But the risks are towards a lower conversion rate than we've seen so far, if cost becomes prohibitive for some planned projects.

We don't hear as much about the pressures in the non-residential construction sector, but there are certainly pockets of strong demand here as well. Covid has seen a hit to demand for office space and strip retailing, but there is still strong demand for industrial property and 'big box' retailing. There's also a large number of infrastructure projects planned or under way. We expect those trends to continue over the coming year, although with interest rates on the rise and economic growth set to cool over the coming year, it's likely that developers will be more cautious about bringing new projects to market.

Michael Gordon, Acting Chief Economist

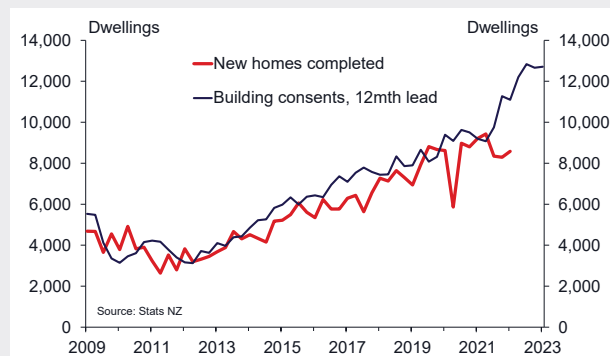
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Chart of the week

The pace of completed new homes remains strong, but has slowed in the last few quarters. Most likely this reflects a lengthening in completion times, as shortages of building materials have been an increasing problem. A sizeable pipeline of building work lies ahead if these supply constraints can be alleviated.

Homes consented and completed

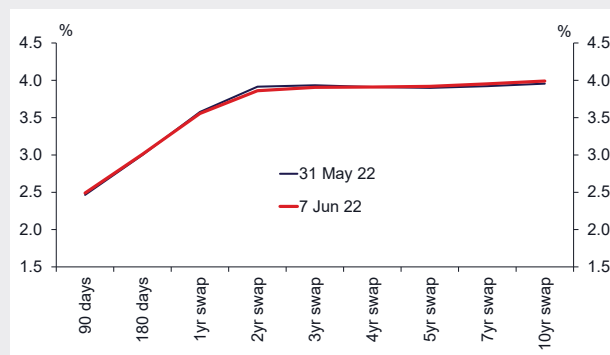


Fixed vs floating for mortgages

Wholesale interest rates remain above our forecast of a 3.5% peak in the Official Cash Rate this year. That suggests to us that there is no cost advantage to fixing for longer terms.

While a one-year mortgage rate is likely to rise further in the year ahead, fixing and rolling for this term is likely to produce a lower borrowing cost on average over the next few years. Longer fixed terms would be more suited to those who want certainty in their repayments.

NZ interest rates



The week ahead

NZ GlobalDairyTrade auction, whole milk powder prices

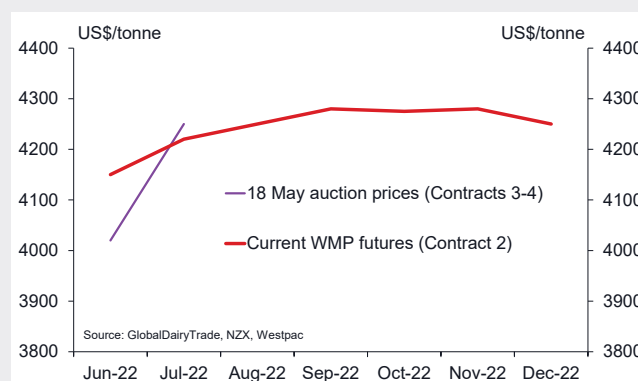
Jun 8, Last: -4.9%, Westpac: +2%

We expect whole milk powder prices (WMP) to lift by around 2% at the upcoming auction. Prices have been slumping over the past few months, so a result in this vein will signal the start of a price turnaround.

The Covid outbreak in China, the collapse of the Sri Lankan dairy market and a temporary surge auction volumes have accounted for the price slide.

However, heading into this auction, the news has been more positive for prices. Covid restrictions have begun to ease in China, an infant formula shortage in the US has boosted demand and a normalisation of auction volumes should all support prices. Indeed, we expect a run of positive results over the next few auctions.

Whole milk powder prices



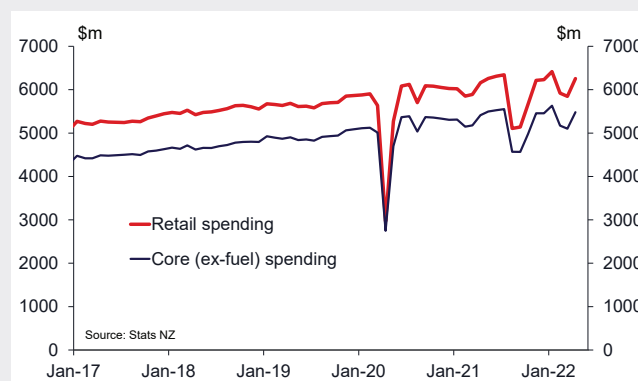
NZ May retail card spending

Jun 10, Last: +7.0%, Westpac: +1.0%

Retail spending levels continued to climb through April, rising by 7%. Helping to boost spending appetites was the easing in health restrictions, which saw a solid rise in hospitality spending over the Easter/school holidays period. However, the rise in spending was widespread. While nominal spending has been firm, some of the strength we've seen has been due to price rises (rather than increases in the volume of goods sold).

We're expecting to see a further modest rise of 1% in retail spending in May. Consumers are increasing their spending on activities like dining out. However, the prices for many goods (including fuel and food) have risen rapidly in recent months. Mortgage rates have also been pushing higher. The related pressure on households' budgets has constrained the overall increase in spending.

NZ retail card spending



Aus RBA policy decision

**Jun 7, Last: 0.35%, WBC f/c: 0.75%
Mkt f/c: 0.75%, Range: 0.60% to 0.85%**

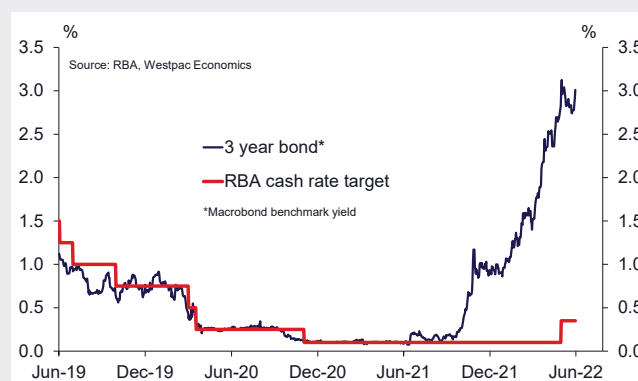
The RBA hiked rates in May, lifting the base rate by 25bps to 0.35%. That was the first increase in official rates since 2010.

The earlier easing of policy in response to the pandemic, a shock which sent the unemployment rate up to 7.5%, was successful. The unemployment rate has fallen to 3.9%, the lowest level since 1974. Inflation has jumped from below the target to be well above.

The RBA, following other central banks around the world, needs to not only unwind the Covid stimulus measures, but to combat a significant inflation challenge - in a world of supply headwinds, including disruptions from the Russia / Ukraine conflict.

The enormity of the challenge, including risks that inflation expectations could decouple, points to a front loading of rate hikes. Westpac expects a 40bps move in July, with the cash rate climbing to 1.75% by year-end and to peak at 2.25% by mid-2023.

RBA cash rate and 3 year bonds

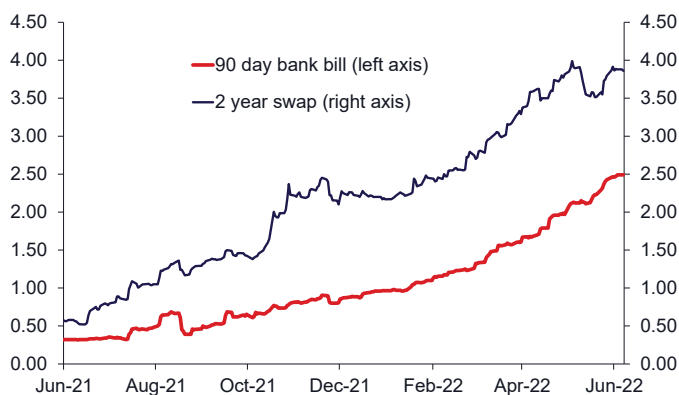


New Zealand forecasts

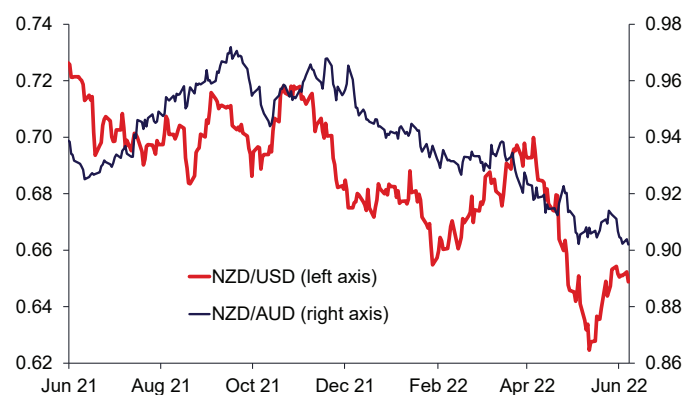
Economic forecasts	Quarterly				Annual			
	2021	2022						
% change	Dec (a)	Mar	Jun	Sep	2020	2021	2022f	2023f
GDP (Production)	3.0	0.6	0.3	1.0	-2.1	5.6	2.7	3.3
Employment	0.0	0.1	0.3	0.2	0.6	3.5	0.8	0.9
Unemployment Rate % s.a.	3.2	3.2	3.1	3.0	4.9	3.2	3.0	3.3
CPI	1.4	1.8	1.1	1.2	1.4	5.9	4.5	2.7
Current Account Balance % of GDP	-5.8	-5.9	-6.8	-6.9	-0.8	-5.8	-6.6	-5.6

Financial forecasts	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Cash	2.00	3.00	3.50	3.50	3.50	3.50	3.50
90 Day bill	2.70	3.40	3.60	3.60	3.60	3.60	3.60
2 Year Swap	4.00	4.00	3.90	3.70	3.50	3.30	3.10
5 Year Swap	4.10	4.00	3.90	3.70	3.50	3.35	3.20
10 Year Bond	3.80	3.70	3.50	3.30	3.20	3.10	3.00
NZD/USD	0.65	0.67	0.69	0.70	0.71	0.72	0.72
NZD/AUD	0.90	0.91	0.91	0.91	0.91	0.91	0.90
NZD/JPY	83.9	85.8	86.9	87.5	88.0	87.2	87.1
NZD/EUR	0.61	0.62	0.63	0.63	0.63	0.63	0.63
NZD/GBP	0.52	0.53	0.54	0.55	0.55	0.54	0.54
TWI	71.3	72.6	73.8	74.0	74.4	74.4	74.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 7 June 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	2.00%	1.50%	1.50%
30 Days	2.03%	2.00%	1.80%
60 Days	2.26%	2.16%	1.98%
90 Days	2.49%	2.32%	2.15%
2 Year Swap	3.86%	3.55%	3.83%
5 Year Swap	3.92%	3.62%	4.03%

NZ foreign currency mid-rates as at 7 June 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6488	0.6438	0.6318
NZD/EUR	0.6067	0.6012	0.5987
NZD/GBP	0.5175	0.5146	0.5116
NZD/JPY	85.57	82.06	82.19
NZD/AUD	0.9020	0.9094	0.9081
TWI	72.12	71.66	70.96

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Tue 07					
NZ	May ANZ commodity prices	-1.9%	-	-	Dairy prices were notably weak over the month.
Aus	RBA policy decision	0.35%	0.75%	0.75%	Back-to-back rate hikes – debate on likely size of July move.
Chn	May foreign reserves \$bn	3119.7	3110.0	-	Little need for authorities to be active in market in 2022.
Eur	Jun Sentix investor confidence	-22.6	-21.7	-	Outlook clouded by conflict.
UK	May S&P Global services PMI	51.8	51.8	-	Final estimate for the month.
US	Apr trade balance US\$bn	-109.8	-89.2	-	Deficit to remain wide on demand and inventory rebuild.
	Apr consumer credit	52.4	32.8	-	Credit growth slowing from a historically-elevated level.
Wed 08					
NZ	GlobalDairyTrade auction prices (WMP)	-4.9%	-	2.0%	Dairy prices to start recovery after recent slump.
Eur	Q1 GDP, final	0.3%	0.3%	-	Final estimate to confirm a slow start to 2022.
US	Apr wholesale inventories	2.1%	2.1%	-	Final estimate; restocking at a robust pace.
Thu 09					
Chn	May trade balance USDbn	51.1	58.0	-	Trade has been a key support through the pandemic.
	May new loans, CNYbn	645.4	1,211.5	-	Credit momentum is building...
	May M2 money supply %yr	10.5%	10.1%	-	... thanks to support from authorities.
Eur	ECB policy decision	0.0%	0.0%	-	End of asset purchases; focus on forecasts and guidance.
US	Initial jobless claims	200k	-	-	To remain at a low level.
Fri 10					
NZ	May card spending	7.0%	-	1.0%	Demand firming, rising prices a drag.
Chn	May PPI %yr	8.0%	6.5%	-	Producer inflation remains elevated...
	May CPI %yr	2.1%	2.2%	-	... with limited pass through to consumers.
US	May CPI	0.3%	0.7%	-	Annual inflation looks to have crested.
	Jun Uni. of Michigan sentiment	58.4	58.9	-	Inflation and rate concerns still front of mind.

International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021f	2022f	2023f
Australia						
Real GDP %yr	2.8	2.0	-2.2	4.7	4.0	2.0
CPI inflation %yr	1.8	1.8	0.9	3.5	5.6	2.6
Unemployment rate %	5.0	5.2	6.8	4.7	3.2	3.5
Current account % of GDP	-2.1	0.7	2.6	3.5	1.9	-1.8
United States						
Real GDP %yr	3.0	2.2	-3.5	5.7	2.6	1.8
CPI inflation %yr	2.4	1.9	1.3	7.1	3.7	2.3
Unemployment rate %	3.9	3.7	8.1	5.4	3.7	4.1
Current account % of GDP	-2.3	-2.6	-2.5	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	0.6	0.3	-4.8	1.8	2.2	1.4
Euro zone						
Real GDP %yr	1.9	1.3	-6.6	4.9	2.2	1.5
United Kingdom						
Real GDP %yr	1.3	1.4	-9.9	7.2	3.7	0.0
China						
Real GDP %yr	6.7	5.8	2.3	8.1	5.3	5.5
East Asia ex China						
Real GDP %yr	4.4	3.7	-2.4	4.2	4.5	4.7
World						
Real GDP %yr	3.6	2.8	-3.3	5.5	3.4	3.3

Forecasts finalised 3 June 2022

Interest rate forecasts	Latest	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Australia								
Cash	0.35	0.75	1.25	1.75	2.00	2.25	2.25	2.25
90 Day BBSW	1.24	1.20	1.70	2.05	2.30	2.45	2.45	2.45
10 Year Bond	3.52	3.30	3.15	2.90	2.65	2.50	2.40	2.30
International								
Fed Funds	0.875	1.375	2.125	2.625	2.625	2.625	2.625	2.625
US 10 Year Bond	2.92	2.90	2.80	2.60	2.40	2.30	2.20	2.10

Exchange rate forecasts	Latest	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
AUD/USD	0.7260	0.72	0.74	0.76	0.77	0.78	0.79	0.80
USD/JPY	129.84	128	127	126	125	124	122	121
EUR/USD	1.0750	1.07	1.08	1.09	1.11	1.13	1.14	1.15
GBP/USD	1.2570	1.25	1.25	1.26	1.28	1.30	1.32	1.34
USD/CNY	6.6600	6.65	6.50	6.35	6.25	6.20	6.15	6.15
AUD/NZD	1.1070	1.11	1.10	1.10	1.10	1.10	1.10	1.11

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