



ECONOMIC BULLETIN

New Zealand residential construction update, March 2024.



15 Mar 2024 | **Satish Ranchhod**, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

We're going to need lots of houses

The big swings in New Zealand's population are having a major impact on housing market pressures. On top of existing shortages, New Zealand is going to need around 125,000 additional homes over the next five years to keep up with population growth. And that's assuming net migration slows from its current record highs. However, despite increases in the population, construction activity is turning down.

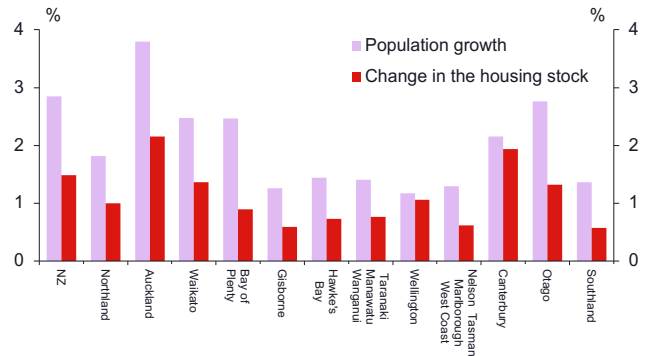
The past few years have shown that New Zealand can build houses at a rapid pace if economic conditions are supportive. But until interest rates decline and house price growth picks up again, developers will remain cautious about bringing new projects to market. In addition, with large scale home building needed, adequate infrastructure and a supportive planning environment will be necessary to encourage development activity.

Packing them in.

New Zealand has been building homes at a rapid pace, with over \$80b of residential building work completed since 2020. Although uneven across regions, that's allowed us to eat away at the housing shortages that had built up during the decade prior to the pandemic.

However, the pressure on New Zealand's housing stock is not going away. In fact, some of the progress we've made on housing shortages in recent years has been reversed. Over 2023, New Zealand's population grew by a massive 145,000 people, signalling the need for around 55,000 additional houses. However, we estimate that over the past year the number of homes in New Zealand only increased by around 30,000.¹

Housing and population changes (2023)



Source: Stats NZ, Westpac estimates

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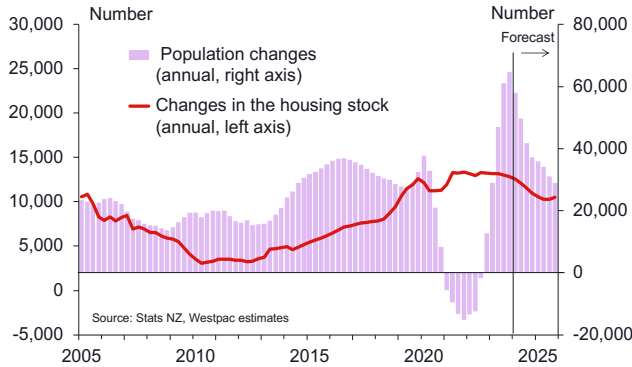
Taking a longer look back over the past five years, the region that has made the most progress on housing supply has been Auckland. Home building in our largest city has risen to elevated levels, with around 18,000 new homes completed in Auckland in the past year alone.

Crucially, Auckland has also seen much bigger swings in population growth than other regions. With around half of all migrants settling in Auckland, the pandemic-related closure of the border saw population growth in the region plummet in recent years. In fact, between 2020 and 2022, Auckland's population declined by nearly 22,000 people. That's allowed Auckland to catch up on the underbuilding of homes relative to population growth that we saw between 2011 and 2019. Even so, Auckland's housing market remains tight – for every 1000 people, there are around 50 fewer homes in Auckland than in other parts

¹ Westpac estimates of housing supply, including an adjustment for demolitions.

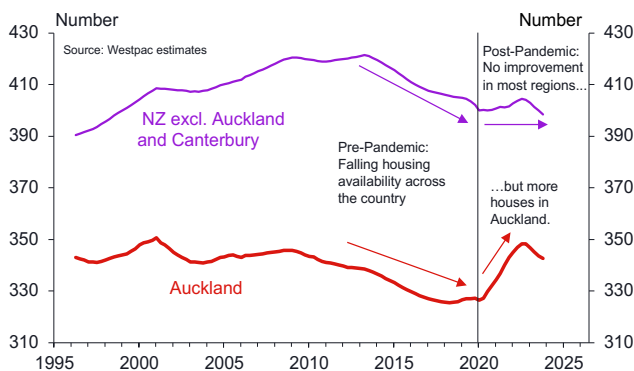
of the country. That's similar to the pattern seen in other countries like Australia, with major metropolitan areas typically having higher population density, as well as higher housing costs.

Auckland home building and population changes



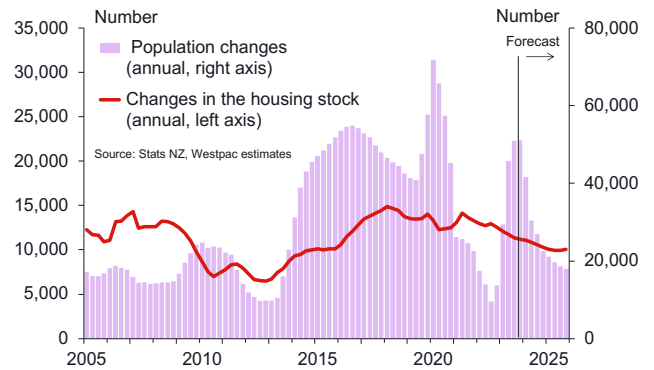
In most other parts of the country, progress on housing supply has been much slower. Far fewer new migrants tend to settle in the regions. As a result, the closure of the borders did not cause regional population growth to turn down like it did in Auckland. In fact, regions such as Northland, Waikato and the Bay of Plenty have all seen stronger than usual population growth in recent years. That's also meant that, even with high levels of home building, we haven't managed to work off the underbuilding of homes relative to population growth that developed in the years prior to the pandemic. We estimate that in areas outside of Auckland and Canterbury we're still short around 20,000 homes. Put differently, for every 1000 people in those regions, we now have 20 fewer homes for them to live in.

Population density by region – houses per 1000 people



The exception to this pattern is Canterbury, where a supportive planning environment in the wake of the devastating earthquakes in 2010 and 2011 has helped to underpin an extended period of rapid home construction. Notably, that large increase in housing supply has been associated with lower house price growth than in other major centres, with a related lift in housing affordability.

Home building and population changes – regions outside of Auckland and Canterbury



For every 1000 people in areas outside of Auckland and Canterbury, we now have 20 fewer homes for them to live in.

The population boom is starting to cool, but we're still seeing strong increases.

Annual net migration inflows actually peaked at 141,000 back in November, and they have already eased to 134,000 in the year to January. Those numbers are set to continue falling over the coming years. New Zealand's labour market is cooling, and over time that will make us less attractive to new migrants. The Government has also signalled its intentions to tighten entry requirements for migrants.

At the same time, the number of people leaving our shores is pushing higher. Many young New Zealanders who delayed travelling abroad during the pandemic are now packing their bags. On top of that, over the next few years many of the migrants who entered the country on temporary visas will start to return home (though large numbers will also make the jump to permanent residency).

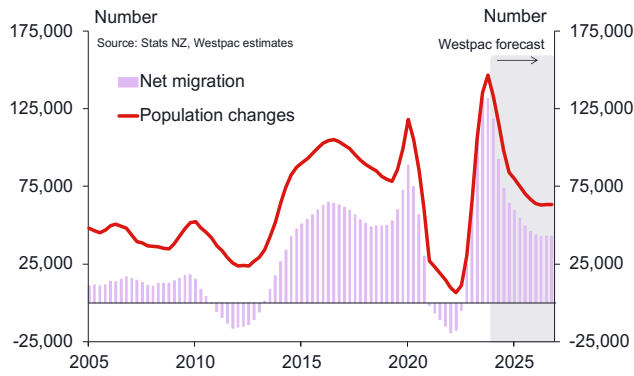
The above trends are likely to see net migration easing back over time. However, we could still see some strong inflows in the near term.

Even assuming population growth slows back to historic averages of around 1.2% per annum, we would still see our population growing by around 60,000 to 70,000 people each year. And that means New Zealand is going to need a lot more houses.

On top of the existing housing shortfall, we'll need an additional 125,000 homes over the next five years to keep up with population growth. And since many of the homes that are being built are 'replacements' (where an existing home is demolished to make way for two or more new dwellings), the amount of new homes we'll need to build will be even higher – likely closer to 150,000.²

² Those estimates assume population growth slows to around average rates of 1.2% per annum. We also assume an average of 2.9 people per dwelling in Auckland and an average of 2.4 people in other parts of the country.

Population changes and net migration (annual)

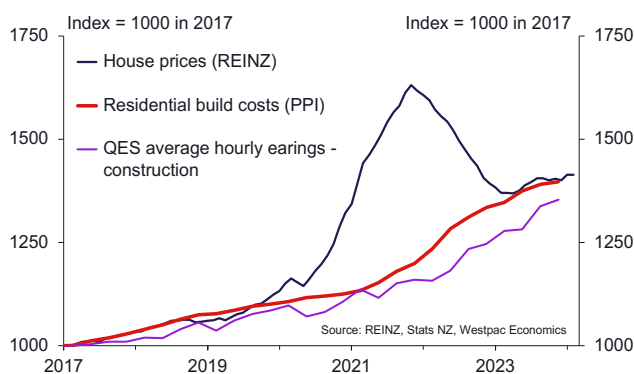


Construction activity slowing in the face of financial headwinds.

Despite rapid population growth, construction activity is actually turning down. Dwelling consent numbers have fallen nearly 30% over the past year and many businesses in the construction sector have reported a drop in forward orders.

Underlying that downturn in building activity are tougher financial conditions in the building sector. Most importantly, the past couple of years have seen the housing market going from red-hot to ice-cold, with sales low and prices down 13% from their peaks in 2021. At the same time, interest rates, labour costs and the cost of materials have all risen sharply. Combined, those conditions mean that developers are reluctant to bring new projects to market. It also means that we're likely to see a higher than usual proportion of planned projects being cancelled.

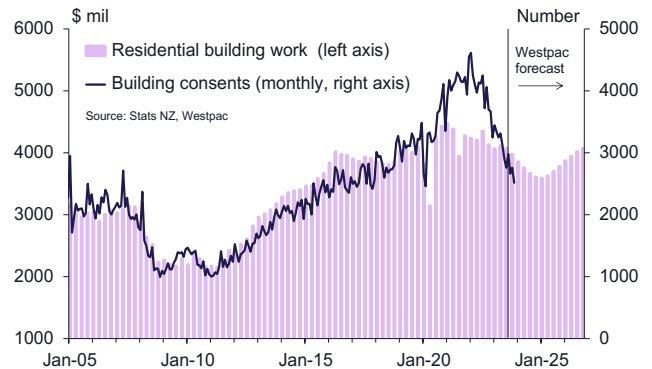
House prices and residential building costs



We don't expect that actual home building will fall as sharply as consent issuance has. That's because earlier shortages of materials and staff, as well as stretched capacity more generally, acted as a brake on how much work could be completed in recent years. As a result, although consent issuance rocketed higher over the past few years, building activity rose much more modestly. Now, while forward orders are declining, many firms are still working through existing pipelines of planned work. Even so, New Zealand is still likely to see a sizeable

slowdown in home building activity over the next few years. We've already seen residential construction levels falling nearly 10% from their peaks, and over the coming year, we're forecasting a further 10% decline. That would be the sharpest slowdown since the Global Financial Crisis in 2008/09 when residential construction activity fell by 30%.

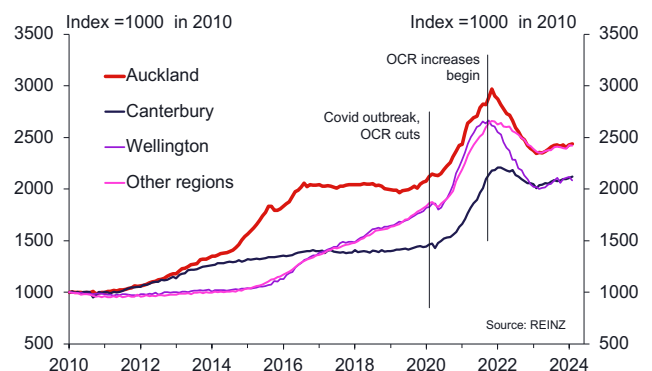
Residential building and consent numbers



Weak house price growth will be a drag on new housing supply.

The strength of the housing market will be crucial for determining the extent and duration of the downturn in residential construction. Despite the large increases in the population over the past year, to date conditions in the housing market have remained subdued. In addition to earlier uncertainty about last year's election, that softness in the housing market has been due to the high level of interest rates and related weakness in economic activity, which together have seen buyers remaining on the sidelines. Until house price growth picks up, it's likely that developers will remain cautious about bringing new projects to market.

House prices by region



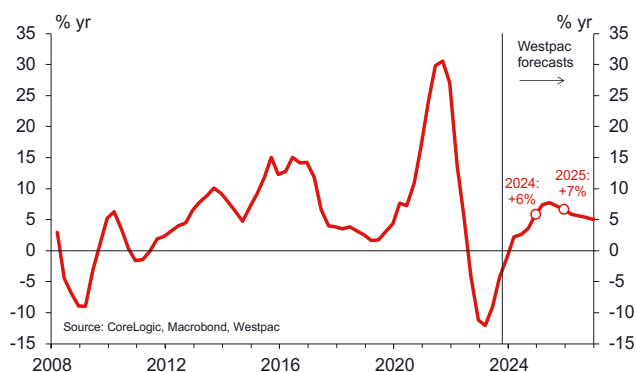
We expect that house price growth will pick up through the back part of this year as we get closer to an eventual easing in interest rates by the RBNZ (Westpac expects that the RBNZ will begin to cut the OCR from early 2025). That will be reinforced by the large increases in the population over the past few years. House price growth is

also likely to be boosted by the reintroduction of interest deductibility for rental properties and the reduction in the 'bright line' holding period for taxing capital gains, both of which are likely to boost demand by investors.

As the eventual recovery in the housing market begins to take hold, we expect that construction activity will also start to turn higher. However, building levels will need to remain elevated for several years to keep up with the needs of our growing population. And continued rapid home building means we're unlikely to see much (if any) relief in terms of build costs, which have risen by more than 25% since 2020.

Even with net migration slowing, New Zealand's population is set to grow by around 60,000 to 70,000 people per annum. That means we'll need around 125,000 additional homes over the next five years just to keep up with population growth.

House price growth



We're going to need more than just houses.

A complicating factor for increasing housing supply is the state of our infrastructure. And on this front, there are no easy – or cheap – solutions. The pressure on our existing infrastructure is continuing to mount as our population grows. Recent work from the New Zealand Infrastructure Commission has highlighted that renewal spending may be falling behind depreciation costs for many assets, including local roads, electricity and gas distribution networks, and water networks. That means these assets may be wearing out faster than they are being renewed.³

Similarly, for many greenfields development substantial horizontal infrastructure is needed, including water, transport and power networks. Getting that in place can be a protracted process and can significantly add to costs.

Regardless of whether increased housing supply comes about through greenfields development or greater densification, we're going to face challenges to build liveable cities. In addition to adequate infrastructure, we'll need a concerted focus on meeting the growing social needs of our communities, including the provision of health services, schools and green spaces.

³ New Zealand Infrastructure Commission, "Build or maintain? New Zealand's infrastructure asset value, investment, and depreciation, 1990–2022," February 2024.

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