The national economy

	Latest	Dec 2017	Dec 2018
Gross domestic product[1]	3.0%	2.7%	3.1%
Residential consents[1]	10.5%	7.0%	19.2%
Non-residential consents[1]	1.7%	8.1%	4.6%
House prices[2]	13.5%	5.8%	-4.6%
Unemployment rate[3]	5.2%	4.7%	4.6%
Net migration[4]	70,588	69,703	60,067

(1) Year-end % change (2) Annual % change
(3) Quarterly level, seasonally adjusted (4) Annual total
Data source: Statistics NZ, Infometrics forecasts

Economic growth accelerated to 3.0%pa in the September 2016 quarter and is likely to push up to around 3.5%pa by March 2017. Stronger growth in household spending was a key component of the economy's performance, with the 5.5% increase in private consumption between September 2015 and September 2016 the fastest growth in 11 years. This willingness to spend comes on the back of increasing tightness across the labour market, with capacity pressures spreading beyond the construction and tourism sectors. In this environment, attracting and retaining staff will become more difficult for businesses, and we expect wage inflation to pick up during 2017 and 2018. There are also early signs of some re-emergence of broader inflationary pressures, both domestically and internationally. No further reductions in the official cash rate are expected, but we anticipate it will be mid-2018 before the Reserve Bank starts to tighten monetary settings.

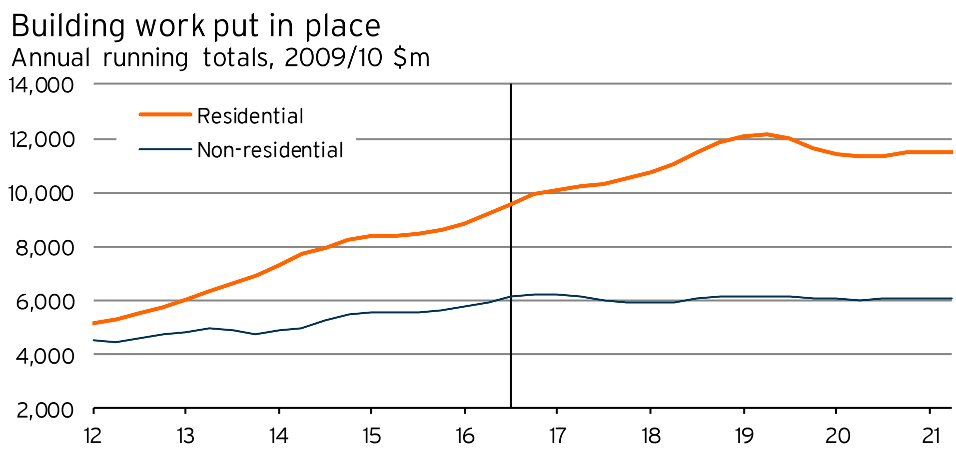
The construction sector

Both residential and non-residential consents recorded a soft finish to 2016. Residential consent numbers in December were down 13% from December 2016, the biggest annual decline in over five years. A 22% decline in consents for Auckland was particularly disappointing, while Waikato and Canterbury also recorded significant falls.

The drop-off in Auckland is reflective of the slowdown in the region's housing market in the wake of the latest loan-to-value restrictions announced by the Reserve Bank in July last year, with sales activity and house price inflation both softening in subsequent months. However, the latest house price data shows a renewed rally in house price growth, particularly outside Auckland, suggesting the effects of the LVR changes will once again be short lived.

Another factor undermining residential construction activity in Auckland is capacity pressures and rapid building cost inflation. These pressures are also spreading beyond the residential sector, increasing the lag between non-residential developments being consented and completed, and discouraging developers from pushing ahead with new projects. Nationwide year-end growth in non-residential consents for 2016 was just 1.7%.

We expect persistently strong net migration and the ongoing undersupply of housing in Auckland to drive further growth of 27% in residential work put in place by June 2019. However, these increases will be harder to achieve than in previous years, and we see a risk that capacity constraints in the industry will limit the extent of future growth.



Special topic: Migration's rule changes and its role in the construction industry

Prior to 2013, the record net migration inflow of construction-related workers during any 12-month period was 969 people in 1995/96 (our data goes back to 1992). But with a massive lift in labour requirements due to rebuilding work after the Canterbury earthquake, annual net migration of construction-related workers surged from −1,068 in January 2012 to +2,390 by November 2014.

With building activity continuing to expand over the last couple of years, particularly in Auckland, the net inflow of construction-related workers lifted to **a new record high of 2,672 by the end of 2016.**

The announcement by the government in October last year that it was tightening residency requirements raised questions about the outlook for migration flows, especially in view of the strong labour market and skills shortages being experienced in growth areas such as construction. Our initial instinct was that the rule changes would lead to a decline in net migration this year, although there might be a compositional shift with fewer people arriving on residency visas and more coming here on temporary work visas. Having delved into the numbers more closely, we have actually revised our net migration forecasts substantially upwards compared with our 2016 predictions.

Arrivals on residency visas made up only 13% of inward migration in 2016. Resident approvals since the rule changes have dropped dramatically, particularly for the parent and family-related categories. So far, the increase in points requirements appears to have had a limited effect on the number of skilled migrants being approved, which had already declined slightly from its peak prior to the rule change. This last subcategory is probably the most important of the residency visas in terms of the labour supply.

In 2016, the number of people arriving on work visas was up 10% from a year earlier and has more than doubled since 2011. Although it is too early to see whether there has been a lift in work visa applications in response to the tighter residency requirements, if the number of people arriving on work visas increases at the same pace as it has over the past year, we can anticipate an additional 8,000 people arriving on work visas within the next two years. This increase would more than offset the targeted decline in residency visa approvals.

The push towards work visas ensures that migrants will still come here when work is available, but also reduces the risk of having too much spare capacity in the labour market during a slowdown in the economy. Immigration NZ has flexibility to force temporary workers to leave again if they are not meeting their visa requirements (eg no longer working at the stated place of employment). Obviously there is no such flexibility to send away people who have previously been granted residency.

For the construction industry, the news that the tap of potential foreign-sourced workers is not being turned off will be welcome. The industry experienced intense capacity pressures during 2016, with both skilled and unskilled workers reportedly extremely tough to find. Tightness in the labour market is spreading beyond the construction and tourism-related service sectors, the difficulty of attracting and retaining staff looks set to persist for at least the next 2-3 years.

With the volume of total construction work forecast to increase another 9.3% over the two years to March 2019, demand for workers within the industry will remain strong. Foreign workers arriving on temporary work visas provide an important temporary solution while the industry moves to boost the supply of skilled workers domestically. However, overreliance on foreign workers also risks masking longer-term workforce development issues in the sector, such as an aging workforce and the need to upskill young workers.

Arrivals soar in response to demand for labour

Construction-related workers, annual international migration flows