

Quarterly Economic Update Q2 : 2021



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Blair Keenan has an undergraduate degree from the University of Otago. Keenan worked at ANZ as a macro-economist and industry analyst for five years before heading overseas as a researcher for Japan’s External Trade Organisation in the UK. While in the UK, he also received his Master’s degree in applied environmental economics from the University of London and was an economist at the National Farmers Union of England and Wales.

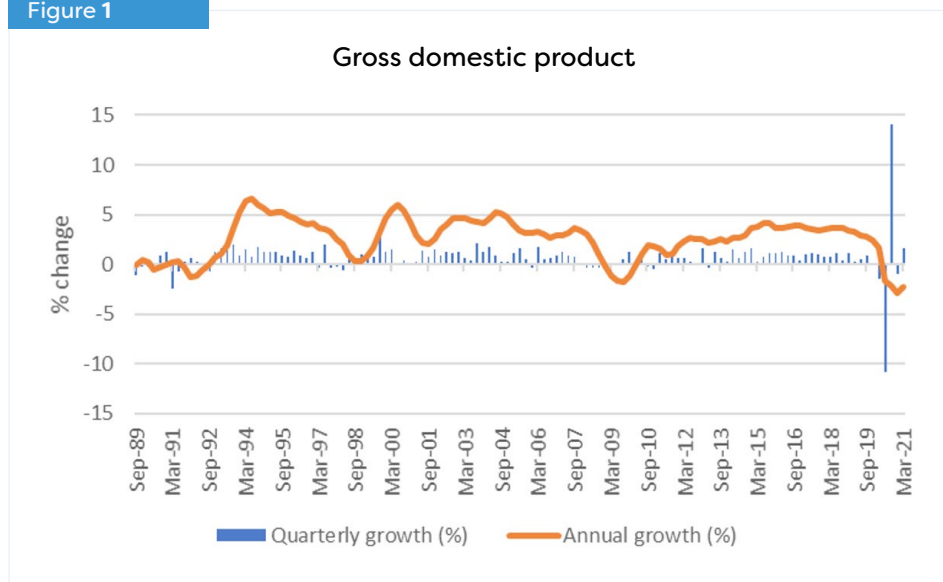
Back in New Zealand, he held several policy roles at Landcare Research, Department of Internal Affairs and Housing New Zealand before his current role as principal economist at Waikato Regional Council. He also continues to collaborate on projects with the University of Waikato, CRIs, central and local government, and a variety of industry groups.

(Re) building the Waikato economy

The Waikato region, along with the rest of the economy, continues its somewhat wobbly path to recovery following the Covid-induced recession of 2020.

In the March 2021 quarter, New Zealand’s GDP rose 1.6 percent – equivalent to an annual growth rate of 6.5 percent. Some commentators, surprised at the speed of growth in the quarter, took this as a sign of an unexpectedly healthy recovery. This may indeed be true, but it should also be taken in the context of the previous quarter (when GDP fell by one percent – an annualised rate of four percent).

Figure 1



One approach taken by the government to stimulating the economy in 2020 was to make funding available to assist with ‘shovel-ready projects’ – infrastructure projects that could be brought forward at short notice to get people working and dollars flowing. The idea was that this would soak up the large increase in unemployment that was expected due to the Covid-induced shutdown.

The construction sector has been a leading light in the recovery

But the fears of mass unemployment have not been realised (at least, not yet!), in no small part due to another key government policy – wage subsidies, which enabled many businesses to get by without the need to layoff as many staff as they otherwise would have. Moreover, many of these projects were not quite so ‘shovel-ready’ as had been hoped, and scaling up has been slow.

CONSTRUCTION LEADS THE WAY

And yet, the construction sector has been a leading light in the recovery, and contributed more to GDP growth than any other industry in the past year. Over the March quarter, this was even more pronounced, with more than one-third of GDP growth for the quarter attributable to the construction industry. Nationally, around half of all capital investment came from the construction sector in the past year.

In the Waikato region, the value of building activity in the past year reached \$2.5 billion with two-thirds of that in the form of residential building. Since bottoming out in 2011 following the Global Financial Crisis (GFC), the nominal value of building activity has risen by 176 percent in the region, or about 12 percent per annum over nine years. The value of residential building work has increased by 225 percent over the same time (14 percent per year). Compared to the effect of the GFC, when a decline in the availability of credit saw a sustained decline in activity, the Covid-recession appears to have been a small blip (so far).

BUT LAGS AT THE SAME TIME

But the rise in the value of building work in the Waikato over the past 10 years hides a couple of important points. First, residential building costs have also increased by nearly 50 percent since 2011¹.

1. According to Statistics NZ's capital goods price index.

Figure 2

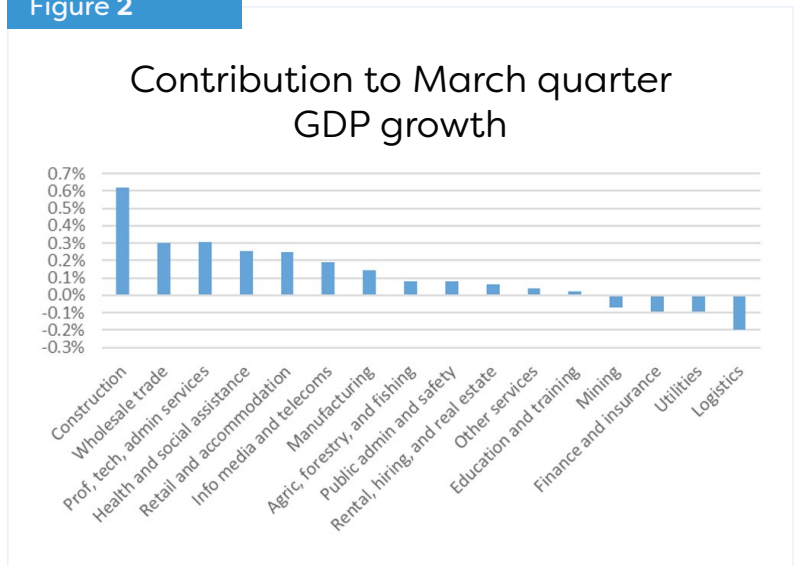
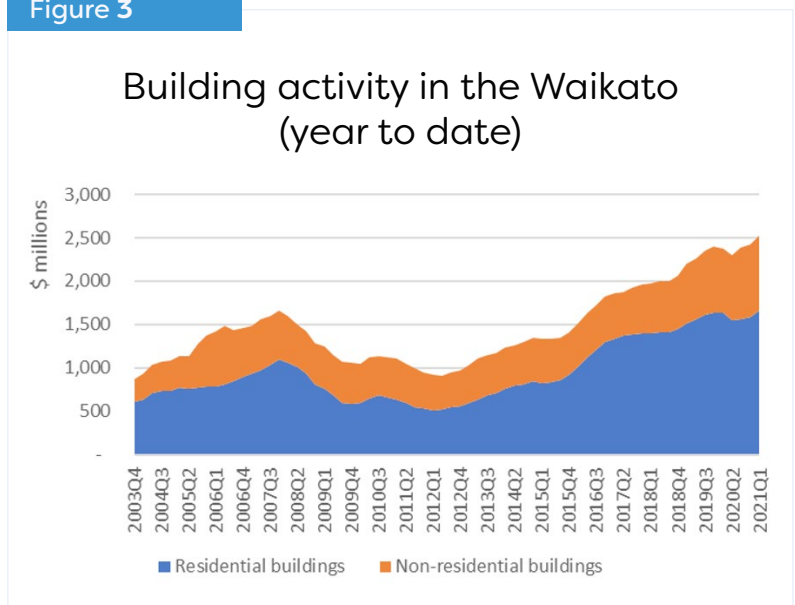


Figure 3



(Non-residential and civil construction costs have also increased, by 40 and 22 percent respectively). New Consumer Price Index data indicates the cost of building a new house rose by 7.4 percent just in the last year (and 4.6 percent in the June quarter alone). So, a large proportion of the apparent increase in value was simply a reflection of higher costs, although that still suggests a very large increase in real activity.

The second point is that the real value added by the construction industry has been matched (or possibly even exceeded) by labour inputs. On the upside, the construction sector added nearly 12,000 jobs in the Waikato region between 2000 and 2020, with its share of the regional job market increasing from 7 to 10 percent. On the downside, this suggests an underwhelming record in productivity. Statistics NZ data suggests that value added per hour of work in the construction sector is lower now than it was 30 years ago.

This is neither new, nor a particularly New Zealand phenomenon. A 2017 report from McKinsey & Company found that, in the US "...productivity in manufacturing, retail, and agriculture has grown by as much as 1,500 percent, but productivity in construction has barely increased at all."²

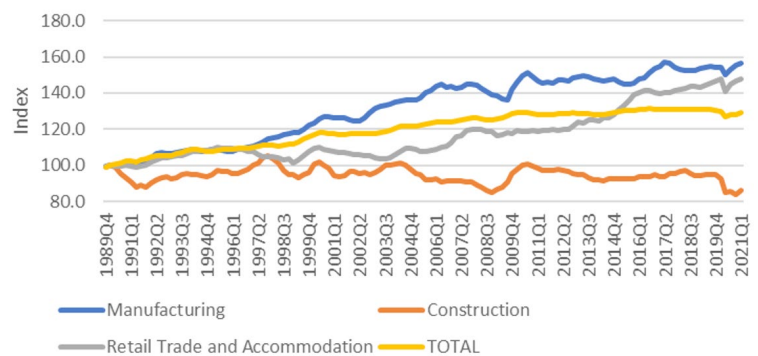
Two-thirds of activity (around \$1.7 billion by value) over the past year has been driven by residential building

According to Statistics New Zealand, there were around 6,500 'geographic units'³ in the Waikato Region in 2020, with an average employee count of a little under three people (a total of 17,700 employed in these businesses in the region). The predominance of relatively small, labour intensive, businesses arguably limits the productivity in the construction sector. Value added per construction worker is estimated at \$85,000 per annum, well below the regional average of \$121,000 per worker across all industries⁴.



Figure 4

Productivity in selected industries - value added per hour worked



2. See [MGI-Reinventing-Construction-Executive-summary.pdf \(mckinsey.com\)](#).

3. A separate operating unit engaged in New Zealand in one, or predominately one, kind of economic activity from a single physical location or base.

4. Based on Infometrics Ltd estimates.

Quality, affordable housing is necessary for a healthy, productive workforce

HOUSING MATTERS

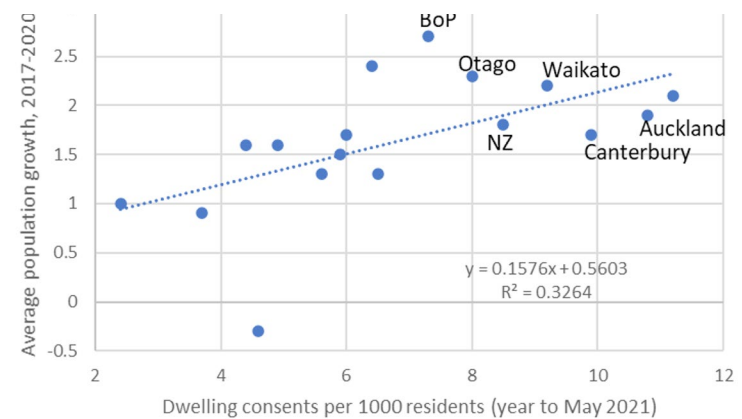
Two-thirds of activity (around \$1.7 billion by value) over the past year has been driven by residential building⁵. The number of dwelling consents processed relative to the population in the past year is high compared to many regions, but it needs to be, given the increasing population of the Waikato.

As yet, we seem to be making limited in-roads into the shortfall in housing supply. In its 2018 stocktake, the Waikato Region Housing Initiative estimated a shortfall of 7,500 homes, with more than half of those in Hamilton⁶. The consequent rapid escalation in house prices has far outstripped average income growth, resulting in sharply deteriorating housing affordability. The present very low level of interest rates is currently disguising some of these affordability issues, but this could quickly reverse if generalised inflation begins to emerge. Indeed, while it is too early to judge whether such inflationary pressures reflect an entrenched trend (as opposed to short-term effects), several banks began increasing retail interest rates even before the Reserve Bank announced the outcome of its latest Monetary Policy Committee meeting on 14 July or the June quarter CPI result on 16 July.

An adequate stock of decent quality homes is not just important for the wellbeing of the population of the Waikato region – it is also an important foundation of the Waikato economy. Quality, affordable housing is necessary for a healthy, productive workforce. It is also necessary for creating the conditions in which children can learn and

5. Of the remainder, industrial (factories, storage and other industrial buildings and commercial (shops, restaurants and bars, office, administration and public transport-related buildings) are the largest categories.
6. [See Waikato Housing Initiative](#)
7. [6320-Housing-Initiative-Summary-Report_WR.pdf\(squarespace.com\)](#)
8. [Waikato+Regional+Housing+Strategy.pdf\(squarespace.com\)](#)

Figure 5



flourish, and become the next generation on which the economy will depend.

Unfortunately, we seem to be a long way from that. Without a shock fall in prices (which would come with its own economic consequences), houses seem set to remain unaffordable for many in the region for a long time to come. The regional housing stocktake found that around one-fifth of homes in the region were damp or mouldy⁷. We all have a stake in seeing the Housing Initiative and its strategy⁸ succeed.

And yet, there is a sting in the tail. To address the wider economic issues for the economy, we must allocate a significant proportion of our regional resources to a construction industry that has a relatively poor track record in terms of productivity. Understanding and finding ways to address this issue would be a useful way to boost the industry and speed up our response to the housing issues we face. •



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