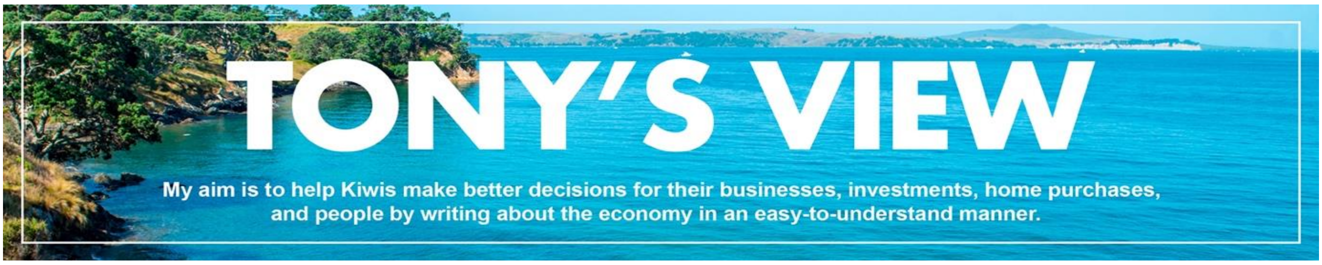

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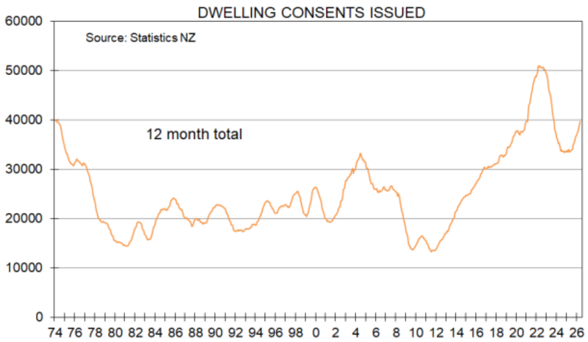
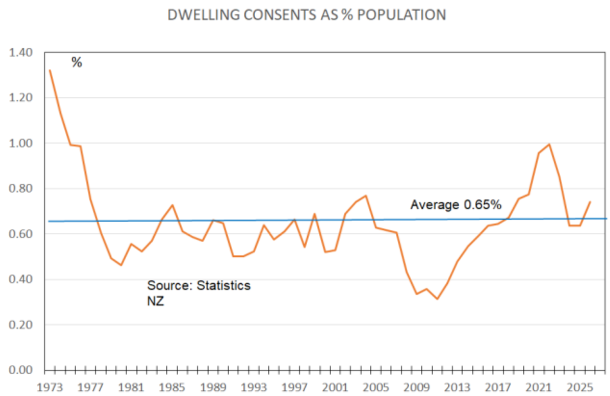
Outlook for house building

In the year to May the number of consents issued around the country for new dwellings to be built stood at just under 40,000. This is a 20.6% gain from the year to May 2025 which is impressive considering the shocks which have affected our economy.



It is especially impressive if we consider that excluding the weird period of the pandemic from 2020-22 this is the highest annual number of consents issued since the year to February 1974.

This becomes somewhat less impressive sounding if we look at the ratio of consents to population size. The ratio back then was about 1.3% and now it sits near 0.74%.

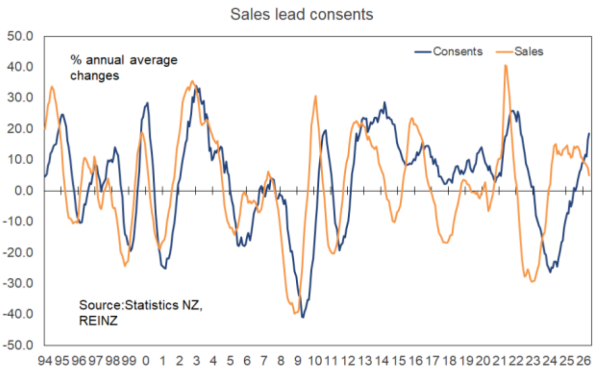


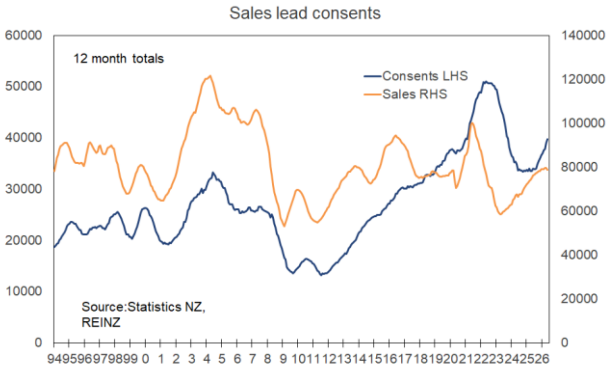
However, at 0.74% the current ratio of consents to population is unusually high considering the recent woe. My belief is that a structural shift in house construction has happened in New Zealand (and is still happening) reflecting a number of factors.

Land zoned for residential use has legislatively become more readily available and that is clearly a key requirement for building a dwelling. Alongside this rules have been changed to foster greater housing intensification in cities.

But a structural shift in house supply growth relative to population does not explain the strong 20.6% jump in consent numbers over the past year. The strength of this rise seems to be at odds with consumer confidence levels and the flatness of house prices broadly on average since early-2024.

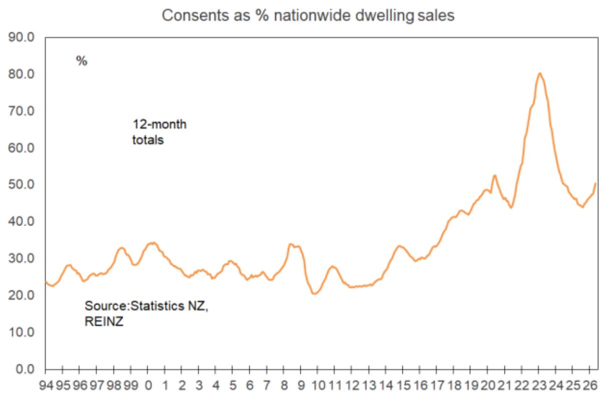
However, there is a reasonably close correlation through time between changes in dwelling sales as measured by REINZ and changes in consent numbers. The first graph following shows this relationship since 1994 and the second shows the annual levels of both variables.





We can say three things. First, the recent boom in consent numbers is consistent with the recovery in dwelling sales since mid-2023.

Second, the structural relationship between consents and total sales has moved upward since soon after the commencement of Auckland's Unitary Plan in late-2016.

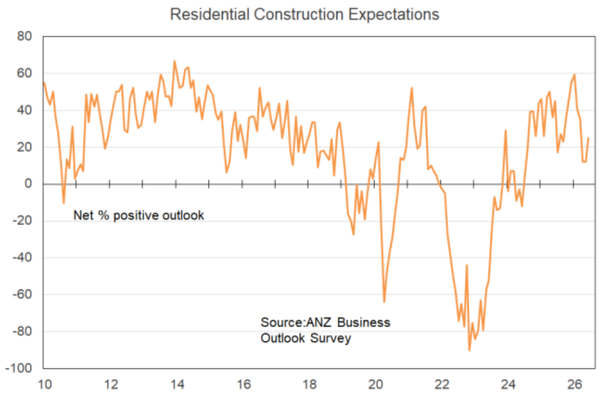


Third, the rate of growth in dwelling sales has fallen from an annual average peak of 14.4% late last year to now 4.9%. Sales in the three months to June were down by 3% on a year ago. This tells us that sometime in the next few months, maybe before the end of the year, issuance of new dwelling consents will flatten out and maybe turn negative for a while.

So, much as some of us have some concerns about whether the near 40,000 consents issued this past year will translate into actual construction as usually happens, chances are they will.

To back this somewhat optimistic view up consider results from the ANZ's monthly Business Outlook survey. Amongst other things they ask builders about their expectations for residential construction activity.

On average over the past three decades a net 9% of builders have had a positive outlook and the ten year average has been 5%. The latest reading is a net 25% positive from 41% before the US attacks on Iran and a low of 12% over April and May.

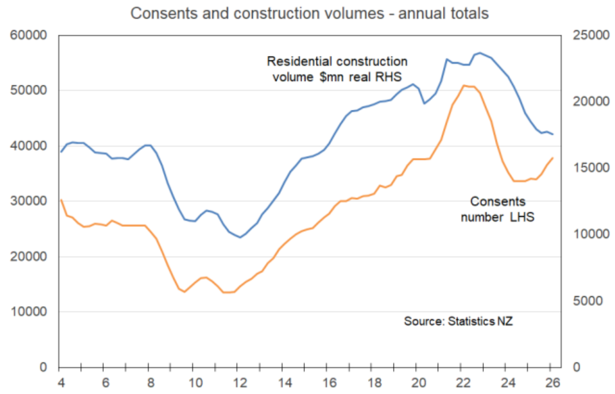


Contrary to the oft-expressed scepticism, builders are in fact optimistic that the high number of consents will translate into work being undertaken.

But optimism does not necessarily activity make and scope for doubt as to the strength of activity this coming year can most legitimately be seen in this next graph.

It shows as the orange line the annual number of dwelling consents issued. Note the good upturn from mid-2025 already seen in other graphs here. Now note the blue line which shows the actual volume of house building undertaken on an annual basis.

Actual work done has yet to turn upward and in fact it fell 2.2% seasonally adjusted in the March quarter of this year. The gap between the upturn in consents and construction so far is a tad longer than usual.



Maybe this reflects the impact of the Middle East war. But that did not start until February 28, very late in the March quarter. Maybe it reflects rising mortgage interest rates from late-October last year. But those rates are still relatively low by historical standards.

It seems fair to say that as yet the actual level of house building has not lifted in response to the strong rise in consent numbers from almost exactly a year ago.

But it also seems fair to say that the new uncertainties about costs and material supplies caused by the war, plus the upcoming NZ general election could easily see the recovery in house construction delayed until very late this year. If this happens then it would be consistent with the general economic theme of us macroeconomists at the moment which is that growth in the NZ economy has not been stopped but instead pushed out slightly in time because of the war and soaring energy prices in particular.

Does a boom then await us in 2027? That does not seem likely.

Above we noted the correlation between changes in dwelling sales and changes in consent issuance. Dwelling sales in rough seasonally adjusted terms fell almost 5% in the three months to June after falling near 8% in the three months to March.

If dwelling sales are not continuing to grow, then it would be unreasonable to expect much more growth in annual consent numbers.

But could dwelling sales be about to recover firmly? No.

Interest rates are rising, net migration inflows are running at less than half the ten year average, FOMO is weak, real estate agents report that house prices are falling, and some investors have backed away from the market again.

The only real hope of a decent upturn in dwelling sales is if the second biggest factor of importance after interest rates turns firmly upward – employment.

In that regard there is in fact some hope for good jobs recovery and therefore higher feelings of job security and debt-servicing ability come 2027.

This optimism is based on three things.

First, there are many factors which will propel the overall rate of growth in our economy over the coming couple of years including higher farm incomes, infrastructure spending, and recovering tourism and export education.

Second, in the ANZ Business Outlook survey a net 9% of businesses say that they plan boosting staff numbers in the coming year. This is above the 7% ten year average and the -3% result in April when worries about the impact of the war were at their greatest.

Third, over the three quarters to March this year average hours worked increased on average by 1% a quarter whereas employment numbers only gained 0.5% for the whole nine month period. Businesses have been working their people harder as they exercise caution about what lies ahead.

But history tells us that once this caution eases there arises a period of firm employment catch-up and that is probably going to be what happens over 2027-28.

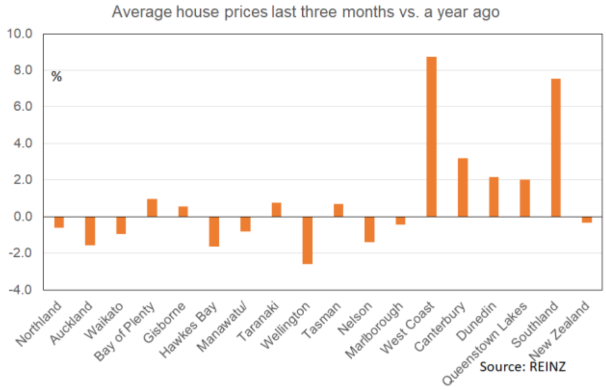
So in summary what we have is this. The firm upturn in dwelling sales explains the firm growth in consent numbers but the mediocre outlook for real estate sales in the near future suggests not much more growth in consent numbers lies ahead.

The lag between the rise in consent numbers and a lift in actual construction seems longer than usual. But this may just be because of some high uncertainty about operating environments and once we get past the general election (assuming a reasonable government is formed), construction is likely to start improving.

Construction levels are likely to grow through 2027 and 2028 with some mild assistance eventually from some extra dwelling sales growth as the labour market improves. There is no boom in the offing. But expecting recovery from late this year does seem to be a reasonable position for building firms to take.

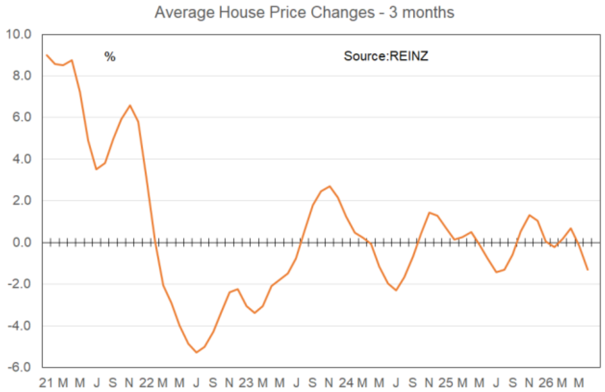
House price changes

REINZ released their monthly data yesterday and I've chosen to present the price information in terms of the change between the June quarter of 2025 and June quarter this year. Graphically it looks like this.



Prices are up 3.3% in Canterbury, and 7.9% in Southland but down 3.5% in Wellington and 2.2% in Auckland.

For the country overall prices have fallen 0.7% this past year. Buyers feel no need to hurry their purchase and pay up to do so. Time remains on their side and that is likely to remain the key perception of purchasers well into next year.



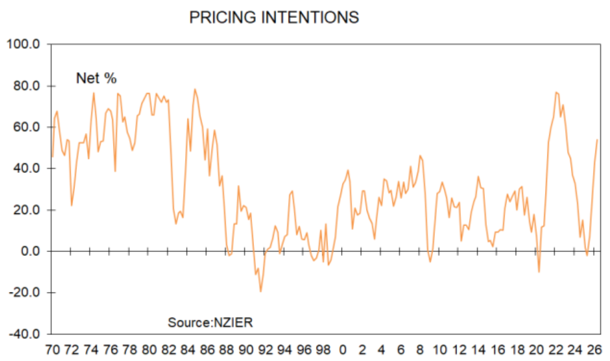
If I were a borrower, what would I do?

Wholesale interest rates have moved higher this week amidst a fresh surge in global concerns about inflation following the resumption of hostilities between the US and Iran and closing of the Strait of Hormuz. Oil prices have jumped higher and the US Federal Reserve have warned about the need to tighten monetary policy.

Locally we saw some mild extra upward pressure on rates come about after results of the NZIER's latest Quarterly Survey of Business Opinion were released. While most readings of sentiment and activity expectations improved slightly (responses came in from early June to early-July), there were noticeable deteriorations in cost and pricing measures.

Whereas in the March quarter survey a net 45% of respondents said they expected their costs to rise in the next three months, in this survey the result was 54%. The average since 1992 has been 29%.

Expectations for selling price increases rose from 43% also to a net 54% with an average since 1992 of 21%.



The results do not bespeak of any need for panic from the Reserve Bank. But the Reserve Bank Chief Economist on Tuesday made comments regarding inflation risks which suggest that maybe the institution is aware of the business pricing risks I have been warning about since late-2024. He noted a tendency for businesses to change their prices more often, the inflation coming from areas immune to monetary policy such as council rates, the tendency for service sector companies to raise prices but not lower them, and business margin rebuilding risk.

The speech is a welcome indication from the Reserve Bank that their inflation approach is no longer lax, and we should expect 0.25% cash rate rises in both early-September and late-October.

Perhaps the old Reserve Bank mistake of tightening too late then tightening too much is set to be avoided this cycle. But uncertainties about where exactly inflation is headed are high and for the moment most businesses do not have a lot of pricing power because of buyer wariness and hesitancy to make decisions.

Monetary policy tightening this cycle is impossible to accurately predict and borrowers should factor this uncertainty in when considering their interest rate risk management strategies.

Today the 90-day bank bill yield was sitting near 2.9% from 2.76% last week and 2.6% three months ago. The three year swap rate relevant to bank funding costs for three year fixed rate lending now sits near 3.71% from 3.53% last week and 3.64% three months ago.

Bank fixed rate lending margins have become newly compressed, and a round of rate rises could easily occur in the near future.

If I were borrowing at the moment, I would still favour fixing three years.

To see the interest rates currently charged by major lenders go to www.mortgages.co.nz

Nothing I write here or anywhere else in this publication is intended to be personal advice. You should discuss your financing options with a professional.


TONY'S VIEW
My aim is to help Kiwis make better decisions for their businesses, investments, home purchases, and people by writing about the economy in an easy-to-understand manner.