

Auckland Economic Quarterly

Chief Economist's Newsletter



In this edition:

Employment growth regains momentum: Can it be sustained?

As domestic demand gains momentum, attention switches to inflation



Geoff Cooper – Chief Economist
geoff.cooper@aucklandcouncil.govt.nz
09 354 2012

Rachael Logie – Senior Economist
rachael.logie@aucklandcouncil.govt.nz
09 367 6923

Melanie Luen – Economist
melanie.luen@aucklandcouncil.govt.nz
09 354 2188

View the new *Business and Economy* section of our website at:

www.aucklandcouncil.govt.nz/businessandeconomy



From the Chief Economist

In this edition of the Auckland Economic Quarterly we focus on the rebound in employment growth and what the key drivers of growth will be going forward. We also look at the latest data releases, which highlight that the economy entered 2014 on a solid footing:

1

The unemployment rate dropped to 6.3 per cent in the December quarter, its lowest level since 2008. Employment growth was broad-based with housing activity a key driver of demand. The strong result came despite a significant boost to the working age population from record net migration numbers and a pick up in the participation rate, which is now back around its long term average rate.

The process of absorbing excess capacity that constrained employment growth through 2012 appears largely complete and job vacancies and surveyed hiring intentions point to a further strengthening in labour demand in the near term.

3

Housing activity has continued to gain momentum, with volumes of work 17.9 per cent higher year-on-year in the December quarter of 2013. In the first two months of 2014, house price growth remained solid, but house sales continued to weaken. The LVR limits have significantly reduced demand for housing but solid activity at the upper end of the market has propped up house price growth. Meanwhile, rental inflation remains contained, running at 2.9 per cent in February 2013. High net migration numbers are boosting housing demand and household incomes are also strengthening, but the combination of the LVR limits and rising interest rates will have a dampening effect.

2

Consumer confidence picked up again in the March quarter of 2014, following a strong gain in the December quarter; and although the annual pace of retail spending growth moderated, activity gained momentum through the year.

There are signs that consumers are loosening their purse strings, but consumer spending levels have also received a significant boost from high levels of net migration.

The extent to which consumer spending strengthens through 2014 will have a major influence on employment and investment outcomes.

4

Net migration in February, at 2,502 persons, was the strongest monthly result since 2003. Rising unemployment across the Tasman continues to deter would-be emigrants, but January and February were also exceptionally strong months for net migration from outside of Australia. In the 12 months to February net migration totalled 13,709, a decade high.

The strength of net migration through 2014 will be an important influence on economic growth. The boost to population has immediate implications for housing demand, labour supply and consumer spending and will also put additional demand on the region's physical and social infrastructure.

For more information including chart packs for this edition please visit www.aucklandcouncil.govt.nz/chiefeconomist

Geoff Cooper
Chief Economist

Employment growth regains momentum: *Can it be sustained?*

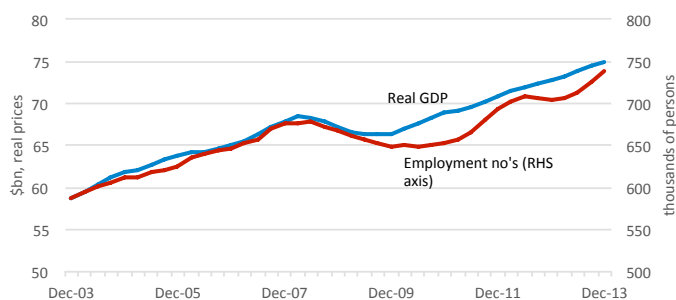


In the year to December 2013, Auckland employment rose by 48,000 people, a gain of 6.7 per cent. The unemployment rate stood at 6.3 per cent in the December quarter, down from 7.2 per cent a year earlier and the employment rate (share of the working age population in employment) was at its highest level since the December quarter of 2008. These are impressive statistics considering the sluggish employment performance in the six months to June and the significant additions to the working age population through the year.

The apparent strength of employment growth through the second half of 2013 raises a number of questions: Why has the recovery been so protracted? Does it add up? What is driving growth? And can it be sustained?

Economy has been absorbing slack, but businesses are increasingly gearing up for growth

Figure 1: Annual GDP vs. Year-average employment



Source: Statistics NZ, Infometrics

The data has been volatile, but alternative indicators agree employment has gained momentum

The unemployment rate has jumped around over the past three years: it stood at 6.7 per cent in the December quarter of 2011, down from 7.8 per cent in the December quarter of 2010, but jumped back up through 2012, ending the year at 7.2 per cent.

The unemployment rate is based on the results of the quarterly Household Labour Force Survey (HLFS). Alternative employment measures suggest a less volatile profile for employment growth; however, the surveys agree that employment growth slowed through the year to June 2013, before regaining momentum over the second half of 2013.

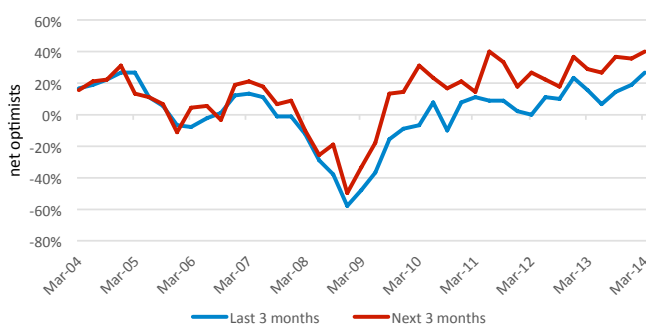
Composition of employment growth reflects increasingly broad-based economic growth

Auckland's economic growth has become increasingly broad-based. The upswing in housing construction is now having significant flow-on effects for other sectors in the economy, particularly manufacturing. The external sector is also faring well: tourism numbers are strong, boosted by the growing Chinese market; and although we don't have separate data for Auckland, national exports of manufactures have—to date—been resilient in the face of weakening Australian demand. Fiscal consolidation continues to weigh on public sector spending; but, overall, businesses have reported an improvement in trading conditions over the past 12 months.

The broadening in economic growth has been reflected in the employment figures: the health and social assistance, accommodation and food services, and other business services sectors continue to be key drivers of growth, but through 2013 they were increasingly supported by the construction, retail and manufacturing sectors.

Consumer confidence reaches new high, but will it translate into stronger spending?

Figure 2: Domestic trading activity, net optimists (%)



Source: NZIER

Looking ahead, forward indicators point to a strengthening in employment and investment outcomes in the near term; however, looking back at the responses of businesses over the past couple of years, it's apparent that demand fell short of expectations. In particular, despite the strength of consumer confidence, it transpired that consumers were happier with their hands in their pockets.

Consumer confidence in the March quarter of 2014 was at its highest level since 2005. Strong house price growth was a key driver of the run-up in confidence through 2013, but the latest up-tick most likely

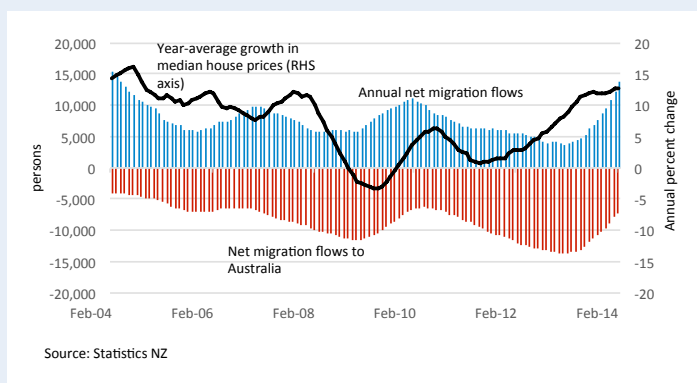
reflect consumers' upbeat assessment of the economy, particularly the improvement in the labour market.

There is scope for households to loosen their purse strings: stronger wage growth will emerge as the economy strengthens and the labour market tightens; and debt servicing ratios are low compared to the pre-crisis era. However, consumers may remain reluctant to supplement incomes by running down their savings or increasing debt levels; and the Reserve Bank, wary of a build-up in debt-to-income ratios, may be reluctant to let them try.

Household spending has also received a boost from high net migration levels. Assuming monthly net migration numbers average 1,000 persons a month for the four months to June, the pick up in net migration over the year to June 2014 would have contributed an additional 0.7 percentage points to nominal retail spending growth (assuming constant 2013 per capita spending levels).

Outlook for housing sector will also be a key influence on growth and employment

Figure 3: Annual migration flows and house price growth



Although employment growth has become more broad-based, the upswing in housing activity has been key to driving the upturn. Housing activity is labour-intensive and has a high economic multiplier effect as a consequence of its large value chain. The LVR limits have significantly dented demand since their introduction and it looked as though the contribution to economic growth from housing activity through 2014, compared to 2013, would be much smaller—as would the multiplier effects.

However, as with consumer spending, net migration could prove to be the major swing factor for housing activity in 2014. There were 9,785 additional net migrants in the year to February 2014 compared to the previous 12 months, which equates to around 3,000 additional households (based on average household size from the 2013 census) or half of the 6,361 consents issued over the same time period. The additional stimulus—if high net migration levels are sustained—will significantly bolster housing demand through 2014.

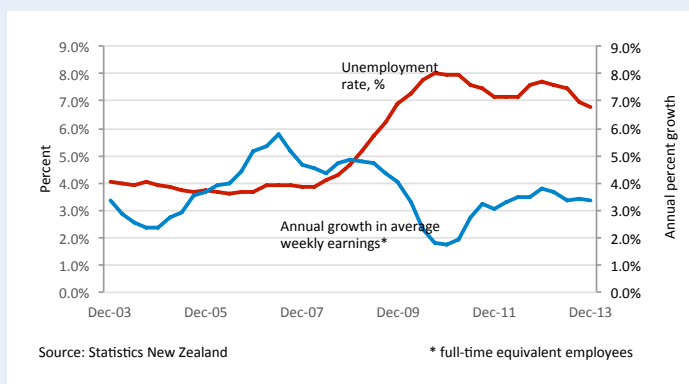
Trajectory of unemployment rate depends on labour supply as well as employment growth

Auckland's unemployment rate stands at 6.3 per cent; but the unemployment rate could fall quickly if employment growth were sustained above 3 per cent and there wasn't a concomitant pick up in labour force growth—unemployment in the December quarter stood at 51,400; in comparison, the economy added 31,900 jobs over the second half of 2013.

Net migration will not only be a key influence on employment demand, but also labour supply. The boost from net migration—along with rising participation rates—underpinned labour force growth of 3.6 per cent through 2012. There is some scope for a further increase in participation rates, particularly among the young, but it's unlikely that this growth in labour supply can be sustained without a further significant pick up in net migration levels.

The near term employment outlook is solid, but there are a number of swing factors at play

Figure 4: Year-average unemployment rate vs. annual growth in average weekly earnings



Looking ahead, the strong employment growth result for 2013 comes off the back of a particularly weak 2012 outcome (as registered by the HLFs data) and was underpinned by a strong upturn in housing activity and a firming in household spending. Excess capacity has now been largely absorbed and businesses have been taking on additional labour to cater for projected demand, but the outlook for employment growth is very much dependent on the strength of domestic activity—particularly housing activity and consumer spending—going forward. Three factors which will play a key role in determining the strength of employment and economic activity through 2014 will be net migration, consumer confidence and inflation: sustained high migration levels and a less cautious household sector could drive strong spending and employment outcomes but, with inflationary pressures on the rise, this could well trigger a more aggressive interest rate tightening phase.

On balance, the outlook is for solid employment growth and a further decline in the unemployment rate through 2014 back towards 5 per cent. However, there are plenty of upside and downside risks to this outlook—both domestic and external.





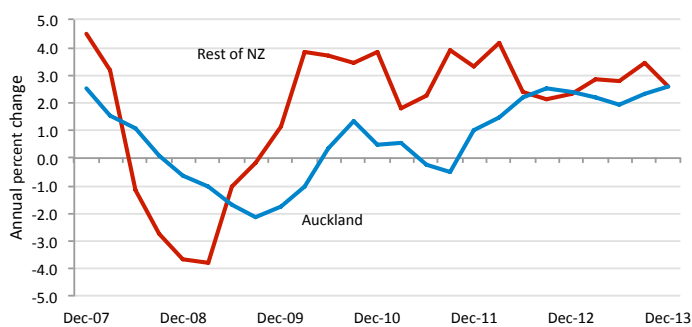
As domestic demand gains momentum, attention switches to inflation

The Auckland economy gained momentum over the second half of 2013 and has entered 2014 on a strong footing, with the unemployment rate at its lowest level since 2008, annual net migration levels at their highest levels in 10 years and both consumer and business confidence riding high.

The Auckland economy maintained a solid pace of growth through the December quarter of 2013: activity was 2.6 per cent higher than the December quarter of 2012 and grew 2.9 per cent through the year; similar to the 2.7 per cent and 2.8 per cent growth averaged over 2012 and 2011 respectively.

Housing activity was the key driver of growth through the quarter underpinning solid contributions from the construction; rental, hiring and real estate services; and construction-related manufacturing sub-sectors. Housing demand will also have contributed to the sustained strong performances from the financial and insurance services, and professional, scientific and technical services sectors.

Figure 5: Auckland vs. rest of New Zealand GDP growth: annual percent change



Source: Statistics NZ, Infometrics

The retail, wholesale, and transport, storage and warehousing sectors all put in solid performances over the quarter: annual retail sales growth moderated in the December quarter, but trading conditions firmed through 2013; while the wholesale sector and the transport, storage and warehousing sector have benefited from a pick up in

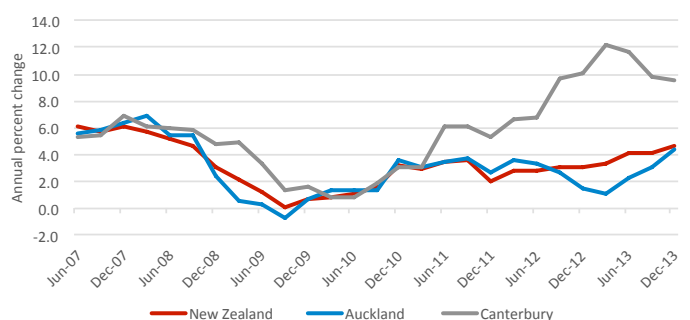
domestic demand, the high number of arrivals and departures, and the strength of throughput at Auckland's ports.

Conditions remained mixed for trade-exposed sectors: the accommodation and food services sector has benefited from the high levels of both short and long term arrivals and stronger retail spending; sectors involved in dairy production continue to benefit from high world prices and strong demand; and parts of the manufacturing sector have benefited from the upswing in housing activity. However, the high NZ dollar and the downturn in Australian business investment continue to create headwinds for some businesses.

The labour market regains momentum, but wage pressures remain contained

The unemployment rate dropped to 6.3 per cent in the December quarter of 2013, its lowest level since the December quarter of 2008. Wage pressures remain contained: average weekly earnings growth for full time equivalent employees (FTEs) moderated from 3.5 to 3.3 per cent, partly reflecting compositional effects—however annual growth in the labour cost index, which takes into account changes in industry and occupation shares, also moderated at 1.6 per cent. Household inflationary expectations have been well anchored but are starting to rise, reflecting strong house price growth, the tightening in labour markets and the perceived improvement in the economic outlook.

Figure 6: Annual Construction Cost Inflation

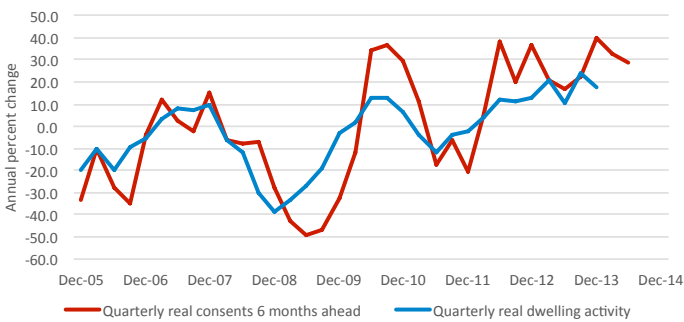


Source: Statistics NZ

Wage pressures are the main component of non-tradeables inflation, but the key driver of the pick up in non-tradeables inflation over the second half of 2013 was the household and utilities component, specifically the cost of purchasing new housing, actual rentals and property maintenance. Supply shortages in Canterbury are driving the higher rental and property maintenance components, but construction cost pressures have started to spill over into Auckland and will have been a significant factor in the Reserve Bank's decision to raise the cash rate 25 basis points in March. With building activity continuing to strengthen in both Auckland and Canterbury, construction cost pressures remain a threat.

House building activity strong and price growth resilient, but pressure from RBNZ mounting

Figure 7: Consent volumes (ahead 6 months) vs building activity volumes



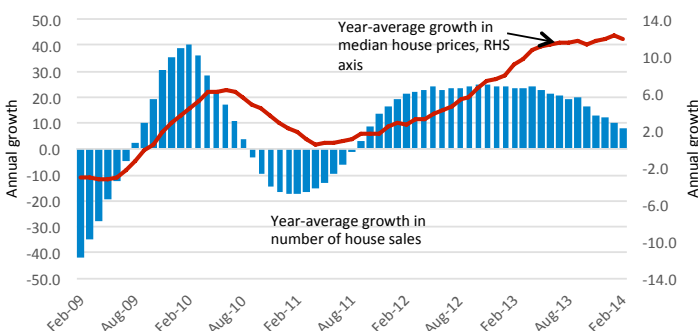
Source: Statistics NZ

There were 464 new residential consents issued in February 2014, 1.9 per cent off the February 2013 level. Annual consents also moderated, from 6,370 in January, to 6,361 in February. The dip reflects weaker apartment consents, while consents for detached dwellings continued to strengthen. However, apartment building consents are lumpy and there are still a significant numbers of large-scale consent applications in the pipeline.

The volume of residential building activity was 17.9 per cent higher year-on-year in the December quarter and annual growth was also running a shade over 18 per cent. As a rough approximation, there is a lag of around six months between dwelling consents movements being reflected in the building activity data. Building consents continued to strengthen through the second half of 2013 and this points to a further pick up in building activity over the first half of 2014.

The REINZ median house price measure for January 2014 was 11.7 per cent higher year-on-year, while the three-month moving average was 12.9 per cent higher. House price growth picked up in the three months to December, but this largely reflected compositional effects; annual growth in house sales continued to moderate. Meanwhile, rental inflation remains contained, running at 2.9 per cent annually in February 2014.

Figure 8: House sales growth vs. median house price growth, annual percent change



Source: Real Estate Institute of New Zealand



The LVR limits have dampened price growth, but solid demand at the top of the market has precluded a more marked slowdown. However, the limits have significantly reduced demand for housing finance (high-LVR loans accounted for just 4.2 per cent of mortgages in February). The effect of the LVRs has been most evident in regional sales growth, but have also had a marked impact on prices in areas popular among first home buyers.

The Reserve Bank lifted the cash rate 25 basis points in March, to 2.75 per cent, and the market is pricing in a full 100 basis points by the end of the year. The LVR limits are a temporary measure and could be lifted if their effect—in combination with that of rising interest rates—was weighing excessively on housing demand, and if there was sufficient slack in the economy to accommodate stronger housing activity.

Consumer confidence riding high—retail spending gaining momentum, boosted by net migration

Consumer confidence rose from 122.6 in the December quarter of 2013 to 126.5 in the March quarter of 2014, an increase of 3.8 per cent. The strong employment outcome and the stimulus from housing activity are likely to have been significant contributing factors.

Annual growth in quarterly retail spending slowed in nominal terms in the December quarter of 2013, but was largely unchanged in real terms. Growth gained momentum through the year after what had been an extended soft patch for retailers. The pick up in retail spending reflects both a more confident household sector and also the boost to population numbers from stronger net migration.

Strong activity through Auckland's ports...both people and goods

Guest nights were 5.2 per cent higher year-on-year in January 2014. Following a strong run of growth, guest nights appear to be levelling out. Growth in 2013 was largely underpinned by international visitors, while growth in domestic nights moderated. This is a reverse of the pattern of growth seen through 2012.

The net migration figure for February 2014 was 2,502 persons, the strongest monthly result since 2003. Over the 12 months to February net migration bolstered Auckland's population by 13,709 persons, the strongest annual result since 2004. The bulk of the boost to annual figures has come from fewer people emigrating to Australia (and some returning), but January and February also witnessed a jump in migrants from other countries—February's figure of 3,004 was the highest in a decade.

All up, the Auckland economy has entered 2014 carrying significant momentum. However, with the process of absorbing excess capacity now largely complete, inflationary pressures are on the rise.

Auckland Economic Scorecard

New Zealand Economic Indicators		Date	NZ
Inflation ¹	Annual % change	Q4	1.6%
Official Cash Rate ¹	%	latest	2.75%
NZD/USD ¹	Month average	Mar	0.8517
TWI (5 currency) ¹	Month average	Mar	79.68
ANZ Commodity Price Index ²	Annual % change	Mar	11.6%
Current account as % of GDP	%	Q4	-3.4%
NZ population	at 31 Dec 2013		4,504,600
Auckland population	at 30 June 2013		1,529,400

Disclaimer

This newsletter provides general information on the Auckland economy, and is not intended to be used as a basis for any particular course of action or as a substitute for financial advice. The views and opinions expressed are those of the relevant author, and do not necessarily reflect the views of Auckland Council. Auckland Council disclaims all liability in connection with any action that may be taken in reliance of this newsletter, and for any error, deficiency, flaw or omission contained in it.

		10 yr trend	Date	Auckland	Year-on-Year change	Rest of NZ
Headline Indicators						
Employment	Number (000s)	666	Q4	760	↑	1,551
	Annual % change	2.3%	Q4	6.7%	n/a	3.9%
Unemployment	%	5.6%	Q4	6.3%	↓	5.7%
Real GDP (expenditure) ³	Annual average % change	2.5%	Q4	2.9%	•	2.3%
Real wages	\$ / week (average)	\$1,083	Q4	\$1,144	•	\$1,044
Jobs						
Youth unemployment – 15-19 year olds	%	21.9%	Q4	27.2%	↓	22.8%
Youth unemployment – 20-24 year olds	%	10.0%	Q4	11.4%	↓	10.6%
Industries						
Manufacturing (employment counts)*	Number (000s)	..	Q4	79	↓	176
Financial and insurance services (employment counts)*	Number (000s)	..	Q4	37	↑	37
Retail sales	Annual % change	1.1%	Q4	2.0%	n/a	2.5%
Housing and construction						
House sales – dwellings ⁴	Annual total sales	28,270	Feb	31,463	↑	47,929
Real average private rent ⁵	\$ / week	\$425	Feb	\$458	↑	\$344
Rent to wage ratio ⁵	%	39.2%	Q4	39.2%	•	30.9%
Real median house sale price ⁴	\$	\$491,650	Feb	\$592,000	↑	\$415,000 (NZ)
Residential building consents – new dwellings	Annual total	6,059	Feb	6,361	↑	15,481
Non-residential building consents – new floor area approved (sq. metres)	Annual total	818,291	Feb	686,963	↑	2,125,293
Global connections						
Tourism – guest nights	Annual total	5,678,000	Jan	6,702,000	↑	26,264,000
Net migration	Net annual flow	7,592	Feb	13,709	↑	15,313
Arrivals	Annual flow	33,786	Feb	39,343	↑	57,509
Departures	Annual flow	26,194	Feb	25,634	↓	42,196
Real exports (\$2013)	Annual total	\$12.6b	Feb	\$11.1b	↑	\$40.0b
Real imports (\$2013)	Annual total	\$25.8b	Feb	\$28.8b	↑	\$19.8b
Confidence surveys						
QSBO - General business situation ⁶	net %	-5.3%	Q1	60.7%	•	51.7%
Westpac – Regional consumer confidence ⁷	Index	113.7	Q1	126.5	↑	121.7 (NZ)

Notes:

All data is from Statistics New Zealand and is not seasonally adjusted, unless otherwise specified. Other sources of data: Reserve Bank of New Zealand (1) ; ANZ (2) ; Infometrics, Regional Economic Database (3) ; Real Estate Institute of New Zealand (4) ; Ministry of Business, Innovation and Employment (5) ; New Zealand Institute of Economic Research (6) ; Westpac (7). Data presented with the assistance of the Research, Investigations and Monitoring Unit, Auckland Strategy and Research Department .. denotes data not available. GDP data is not available due to revisions in methods employed by Statistics New Zealand.

Calculations: Annual % change is calculated as (Quarter – Quarter⁴ – 1)*100 or (Month – Month¹² – 1)*100; Annual average % change is calculated as (Year/Year¹ – 1)*100

* Growth in the manufacturing and financial and insurance services sectors is proxied by growth in employment counts in these industries.

6 - Figures presented are the net percentage of respondents that believe the general business situation will improve in the next six months

7 - Figures greater than 100 represent optimism at the consumer/household level.