

# Auckland Economic Quarterly

Chief Economist's Newsletter



In this edition:

Auckland's housing choices:  
refocusing the debate

Solid 1st quarter – but  
questions over housing  
and migration



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## From the Chief Economist

Welcome to the latest edition of the Auckland Economic Quarterly. The latest GDP data shows that the Auckland economy experienced another solid quarter of growth, with activity 2.6% higher over the year to March. There are a few key points that I would like to highlight:

- 1 First, construction activity was – again – the key driver of economic growth in the March quarter; and with consent volumes continuing to climb through the first five months of 2014, it looks set to maintain this role over the second half of the year. In contrast to the strength of consenting activity, the rate of decline in house sales has steepened in recent months. Median house price growth remains solid, but we suspect that the data belies the extent of the slowdown in activity.
- 2 Alongside the construction sector, the retail sector has been an important contributor to recent output and employment growth. Retail volumes growth has been supported by falling tradeables inflation, a rise in tourism spending and high levels of net migration. At the same time, strengthening employment and income growth further bolstered confidence in the June quarter and consumers are finally starting to become less cautious with regards to spending decisions.
- 3 Auckland's unemployment rate remains elevated, despite a solid run of employment growth. High net migration levels have added to the supply of labour, while the stronger labour market conditions have also encouraged higher levels of participation. The increase in labour supply has helped keep wage inflation in check and eased skilled shortages in the construction sector. However, construction cost inflation in the Auckland region accelerated in the March quarter. A lack of scale in the sector has seen capacity constraints emerge at comparatively low levels of activity.
- 4 Last, the Reserve Bank lifted interest rates for the third time this year in June, taking the cash rate to 3.25 per cent. To date, Auckland's consumers have largely shrugged off the increases and have instead focused on the positive of a strengthening labour market. Housing demand and consumer spending have been receiving a boost from high net migration levels. However, growth in net migration now looks to be slowing. With house sales currently falling, the outlook for housing activity is unclear. The strength of activity will, however, impact on future interest rates.

With a range of recent research completed on the economic implications of the compact city model, this edition includes an article on some of the persistent issues overlooked in the debate on Auckland's urban footprint and housing affordability.

As always, we welcome your comments and feedback.

For more information including chart packs for this edition please visit [www.aucklandcouncil.govt.nz/chiefeconomist](http://www.aucklandcouncil.govt.nz/chiefeconomist)

Geoff Cooper  
Chief Economist

# Auckland's housing choices: refocusing the debate

## Introduction

In recent times there has been a surge in research completed on the economic implications of Auckland's spatial form. A common theme of this research has been Auckland's land use policy and the appropriate regulatory framework required to give residents greater choice in where they live and work, while managing the unintended consequences of these decisions.

The policies required to achieve such solutions are straight forward. They include removing the barriers to development, particularly in high demand areas but also on the periphery of the city; but if the policies are simple, the path to implementing such policy is far more complex.

The most notable obstacle is the divergence in interests between current and future residents. This is not unique to Auckland. Local governments around the world face this challenge, where residents first to an area make it difficult for others to move in. This comes about because of the perceived costs of additional people moving to an area. It is a challenge that requires far more thought by policy makers. A wider range of tools is clearly needed, including mechanisms by which existing residents can share in the benefits of population growth either through the provision of greater amenity and levels of services, financial compensation or both. It has become clear that if the value created by a growing population is not widely shared, then well directed urban policy will always be difficult, to the detriment of Auckland's competitiveness and economic potential.

## Cities are the new centrepiece – but they are not without costs

Cities have become a centrepiece of the global economy. For the first time in history, over 50% of the world's population is living in cities, generating more than 80% of global economic output<sup>1</sup>.

Cities have become more important because knowledge has become more important. Cities specialise in proximity, reducing the distance between people and in so doing, reducing the costs of moving ideas, people and goods throughout the economy. This is what makes cities more attractive, generating higher wages and more opportunities. It helps explain why Auckland is growing rapidly.

Density also creates costs however. Congestion, environmental degradation and high house prices are common ills of density. Such costs require careful management through a range of tools including prudent and well-targeted regulation, investment in infrastructure, a broader array of demand management tools and market based mechanisms that reflect development costs. The competitiveness and growth of Auckland will be defined in large part, through its ability to implement such tools and manage these costs of density.

## Urban policies to enable growth

Where you live and work matters. The role of urban policy is to ensure that people have choices over where they live and work, without compromising other urban priorities such as public space, heritage and the environment.

Urban economists broadly agree that people should be able to determine themselves, where they choose to live and work, except where other social costs are incurred by such decisions. If the first part of this sentence suggests a simple land use

planning rulebook, the second is reason to pause and reconsider. Greenfield development may be cheaper for an individual household but more costly for Auckland generally, since it often requires expensive infrastructure funded in part, through rates and commonly generates greater congestion costs.

In actuality, land use choices are riddled with externalities or unintended consequences, both positive and negative – meaning that the choices we make about where to live and work can have a wide range of impacts on others. An individual worried about how a neighbour's renovations will affect their view; the retiree concerned about the new liquor store in town; the homeowner desperate to sell with a neighbour who hasn't mowed their lawn in months. Each of these scenarios involves unintended consequences and costs (real or perceived) to seemingly innocent bystanders. Effects of this nature must be taken seriously by policy makers, planners and economists alike.

All of this makes urban planning complex. It is not just a masterplan, rather it is a considered and cohesive plan that tries to balance the needs of everyone, home owners and renters, young and old, to ensure a good living standard for residents across social, cultural, economic and environmental aspects.

It is wrong to boil urban planning down to up or out. It is both. It also much more. The proposed Auckland Unitary Plan is several volumes detailing thousands of different policies applying across Auckland. The level of consultation on the plan is unprecedented in the history of local government in this country. It is outside the scope of this article to describe even a fraction of the issues in question here. Instead, we focus on just three issues that are notable for their consistent absence in the wider debate on Auckland's land use planning and housing affordability; the political economy of urban policy, Auckland Council's proposed urban limit policy and the policies behind a compact city.

## The political economy of choice

'Auckland Unleashed' (the precursor document to the Auckland Plan), showed a significant amount of initial support for a compact city model. This resulted in an Auckland Plan and subsequently, a proposed Unitary Plan, laying out a model for urban development allowing for considerably more intensification in tandem with opportunities for dispersed urban development. Since this time, there has been a concerted push back against this vision with corresponding policy changes. Height limits have been reduced, density constraints tightened. Attractive suburbs (as measured through prices) have been made more difficult to build in. Homeowners in these areas stand to benefit with such constraints pushing house prices up further, but for the estimated one million new residents expected to arrive over the next 30 years or for those people from lower socioeconomic groups looking to locate closer to the city centre, the news is not so good.

Two important conclusions have emerged from the planning process. The first is that planners are wrongly vilified as the architects' of high house prices in Auckland. This view is not supported by the evidence and its continued insistence is unhelpful to the debate. Second, the political economy of urban policy plays a defining role in its final state. While significant gains for housing choice were made in the proposed Unitary Plan, much of this was lost as the plan progressed. The difference between the proposed and

notified plans was the incorporation of community consultation.

This is not to say that community consultation should be blamed, omitted or lessened in any way; it is the linchpin of local government and something to be protected. Community consultation has only served to emphasise the real costs of intensification that are enacted on existing residents. Asking residents to accept these costs for nothing in return has, unsurprisingly, yielded only incremental progress. There is no reason to think a repeat will deliver something different. If Auckland is to enable a quantum change in housing choice as envisaged in the Auckland Plan, new models of planning must be considered.

Auction schemes may form part of the solution, where community costs are priced through market mechanisms and facilitated negotiations rather than regulation. For instance, one would expect significant latent demand for housing in high demand areas in much the same way that we see this occurring through land banking on the periphery of the city. Such profits could be shared by developers and communities (perhaps facilitated through local boards) to ensure the returns to growth are shared by current and future residents.

### Moving on from urban limit debates

A lack of land supply is widely cited as a contributing factor in Auckland's rampant house price growth. Simple economics would support this view, as does the proposed Unitary Plan.

Auckland Council's proposed urban limit policy is to ensure an average of seven years infrastructure-ready, forward land supply. While there is a defined boundary in place (the "rural urban boundary"), there will always be 20 years' forward supply of development capacity meaning that the RUB will not constitute a binding constraint on supply.

Once implemented then, approximately 20% more urban zoned land will be available outside the current urban limit. This is an enormous amount of land, enough for 61,000-76,000 new dwellings or roughly equivalent in size to Hamilton. Embedded in this policy is a subtle but important deviation in the driver of Auckland's urban limit policy. Where previously it was used to actively create a 'compact city', the rural urban boundary is now designed to facilitate the efficient provision of infrastructure required for greenfield housing development.

Any calls for further land release on the periphery of Auckland should be done in the context of this proposed policy. Doing so should largely put an end to this debate, helping to refocus attention on more important issues.

**"Auckland Council's proposed urban limit policy is to ensure an average of seven years infrastructure-ready, forward land supply"**

### Rising to the challenge of housing affordability

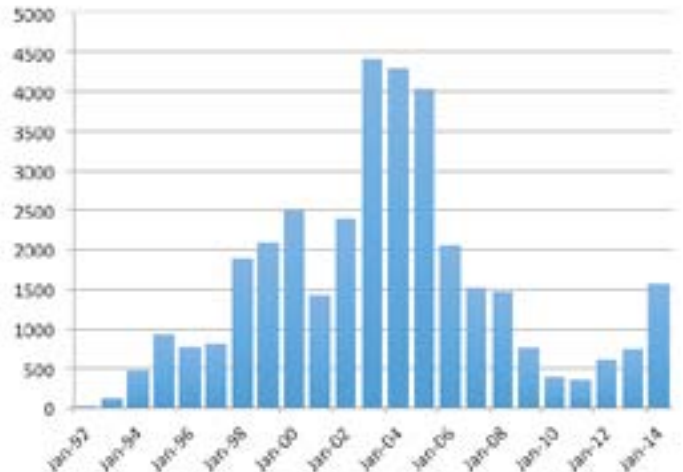
There is widespread misunderstanding as to the tools wielded by local government in New Zealand to achieve a compact city. Auckland Council is a regulatory authority; it is not a construction firm and has shown no appetite for forcing people to live in high density living. Further, there has been no discussion about large scale subsidies for high density living and no consideration given to introducing minimum height restrictions anywhere in Auckland.

The toolbox for intensification largely consists of releasing those regulations that have prevented people from living in higher density areas. It has become clear that far too little attention is given to assessing the economic benefits of such policy directives – and far too much on urban limit policy. Given that

land prices are highest on the isthmus – signalling high demand - and generally decline with distance from the city centre, this is puzzling.

A recent working paper by Melanie Luen, an economist at Auckland Council has shed light on this issue, showing evidence of a considerable 'regulatory tax' on housing development in the current urban limit. This implies that regulations are restricting supply so developers are unable to respond to rising prices, with house prices remaining at elevated levels as a result. These findings are all the more important as a new round of apartment and terraced development attempts to get traction (see Figure 1).

**Figure 1:** Annual consents for apartments and terraced housing in Auckland



Source: Statistics New Zealand

### Let Aucklanders decide urban form through housing choices

The intent of the proposed Unitary Plan is, in many ways, about letting Aucklanders decide how and where they want to live through markets, while managing the costs of these choices. It is clear however, that this 'intent' is heavily mediated by the political economy. The future development of urban policy must progress on this understanding in tandem with more rigorous cost benefit analysis of land use policy. Doing so would help reveal the true benefits of realising greater intensification, which we would expect to be significant.

In this context, the renewed focus on Auckland's urban issues is welcomed. The recent work by NZIER, MRCagney, Demographia and others, examining the trade-offs of urban policy are important and constitutes a much needed addition to what is an ever-evolving field of study in Auckland.

**Table 1:** Recent empirical work on Auckland's urban form

| Study                                                                                                  | Organisation/authors                                   |
|--------------------------------------------------------------------------------------------------------|--------------------------------------------------------|
| Big City Life: Challenges and trade-offs for Auckland City                                             | New Zealand Institute of Economic Research             |
| Residential building heights in Auckland                                                               | Melanie Luen, Auckland Council                         |
| The economic impacts of minimum parking requirements in Auckland                                       | Stuart Donovan (lead author), MRCagney                 |
| International Housing Affordability Survey: 2014                                                       | Demographia                                            |
| Housing Finance International (forthcoming)                                                            | Journal of the International Union for Housing Finance |
| Location affordability in New Zealand cities: An intra-urban and comparative perspective               | Peter Nunns, MRCagney                                  |
| Residential Satisfaction, Crowding and Density: Evidence over Different Geographic Scales in Auckland. | Eilya Torshizian, University of Auckland Phd candidate |
| Housing and transport expenditure: Socio-spatial indicators of affordability in Auckland               | Mattingly and Morrissey                                |

# Solid 1st Quarter - but questions over housing and migration



The latest data releases show that the Auckland economy posted solid growth through the first quarter of 2014. The unemployment rate remained elevated, at 7.3 per cent, but this belied a strong employment growth performance. Forward indicators suggest that the economy is carrying good momentum into the second half of the year.

## Construction activity continued to underpin growth in the March quarter

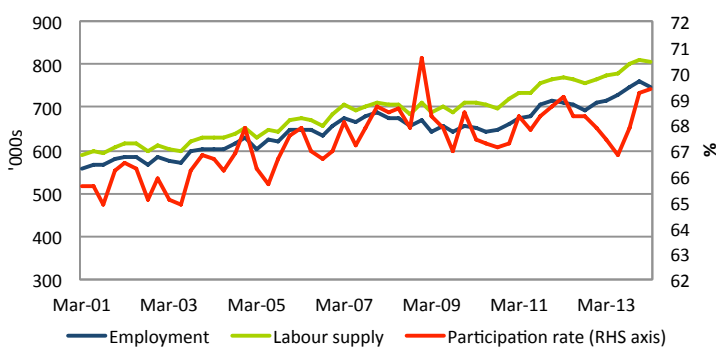
The Auckland economy grew 2.6 per cent in the year to March 2014 and output was 2.3 per cent higher year-on-year in the March quarter. The construction sector was the main contributor to growth, with solid support from the manufacturing, finance and insurance, retail, and health care and social assistance sectors. The major drag on growth came from the property and business services sector, which had previously been a growth stalwart.

## A further sizeable jump in labour supply precluded a fall in the unemployment rate

The unemployment rate in the March quarter of 2014 was 7.3 per cent, the same as a year earlier. However, this reflected strong growth in both employment and the supply of labour, each up 4.3 per cent over the March quarter of 2013. A further pick up in net migration levels in the March quarter boosted labour supply, particularly amongst men aged 20 to 39, and the labour force participation rate rose to 69.4 per cent, its highest level since the December quarter of 2008.

The retail sector was a key driver of employment growth through the year to March, alongside construction, and has been a key driver of both part-time and female job growth.

Figure 1: Components of labour market activity



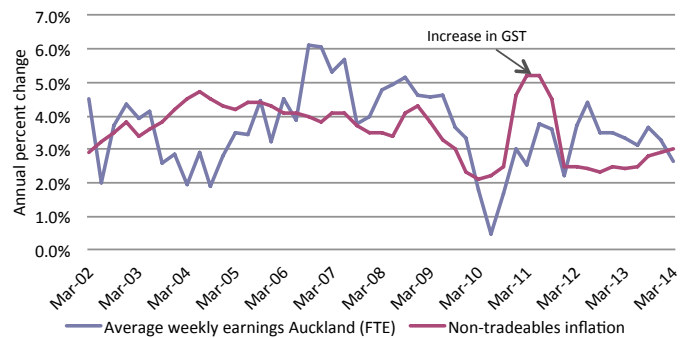
Source: Stats NZ

## Wage pressures remain muted as a pick up in labour supply eases skills shortages

Annual growth in average wages for FTEs slowed in the March quarter of 2014. The weakening in growth largely reflected compositional effects, with the strength of the contribution to employment from the retail sector pulling down average growth.

That said, annual growth in the national labour cost index (which takes into account compositional effects) also moderated in the March quarter. The boost from net migration has helped alleviate skills shortages and labour shortages more generally (particularly construction workers in Auckland and Canterbury) and taken pressure off wages. Also, annual CPI inflation was running at just 1.5 per cent in the March quarter and household inflationary expectations remained contained.

Figure 2: Wages growth vs non-tradeables inflation



Source: Stats NZ

## Net flows from Australia at 10 year highs, but migration growth looks to be slowing

The three month rolling average of net migration fell in May – net migration from Australia increased slightly (became less negative), but net migration from other countries weakened. The net flows from Australia in April and May were at their highest levels since 2003.

The outlook for the Australian economy remains uncertain. It is going through a process of rebalancing but growth in the near term is expected to remain sluggish. There has been a pick up in residential construction activity, but overall construction activity continues to decline. With construction activity in both Auckland and Canterbury strengthening it is likely that net migration to Australia will remain soft in the near term.

However, growth in net migration looks to be flattening out. It's difficult to predict what the non-Australian component will do, but

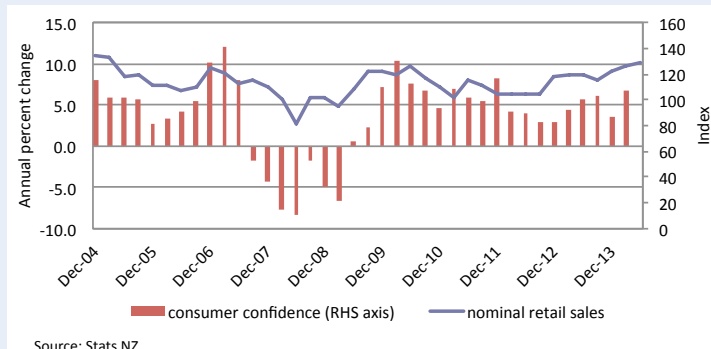
it is unlikely that the pace of growth seen through 2013-14 will be sustained. This will take pressure off the housing market, but it will also mean weaker growth in labour supply and consumer spending.

### Retail activity strong, supported by weak import price growth, strong net migration and tourism

Retail spending was 6.7 per cent higher, in nominal terms, in the March quarter of 2014 compared to the same quarter of 2013. Growth was strong also in real terms, at 5.1 per cent. Retailers have been passing on savings from falling import prices to consumers. (Tradeables inflation fell 0.6 per cent in annual terms in the March quarter). Retail spending has also been boosted by strong net migration numbers and solid growth in guest nights.

Consumer confidence edged up in the June quarter to stand at 128.3, its highest level since the March quarter of 2005. With employment and output growth both robust, consumers appear increasingly confident in the outlook for their finances and are more willing to spend. And it appears that the moderation in house price growth and declining house sales haven't dampened their enthusiasm.

Figure 3: Consumer confidence vs retail sales



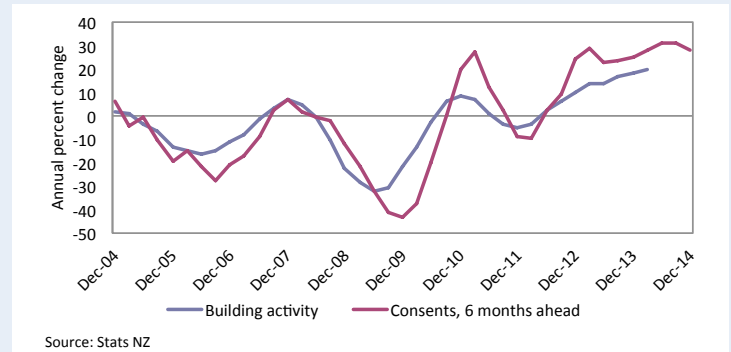
### Downturn in housing sales deepens, but demand for new build continues to rise

Despite the boost from net migration, the pace of decline in housing sales has accelerated in recent months. House price growth has jumped around, but remains solid. It's likely that the median house price measure is being skewed by the lack of lower priced houses for sale - a result of the LVRs restrictions. Given that sales activity has been declining through the first half of 2014, you would normally expect to see an accompanying moderation in house price growth.

Building consent activity remains strong. Annual consent numbers flattened in May to 6,779, down from 6,796 in April, but consents for the three months to May were 28.7 per cent higher than the same quarter in 2013. Both April and May consent numbers included a significant share for apartment buildings.

Construction cost inflation in the Auckland region accelerated in the March quarter of 5.5 per cent, up from 4.9 per cent in the December quarter of 2013. Conversely, construction cost inflation moderated in the Canterbury region.

Figure 4: Consents vs building activity, real prices



### Tourists - both domestic and international - have been splashing the cash

The tourism sector has benefited from an increasingly confident New Zealand household sector and a recovery in US and European tourism, which has lifted spending per guest night. Domestic guest nights in the three months to April were 6.2 per cent higher than in same three months of 2013, while international guest nights were 2.9 per cent higher.

New Zealand's national accounts showed that there was a significant jump in spending per tourist in the March quarter and that this was driven by a pick up in tourists from rich nations, including the US and Western Europe. The Ministry of Business, Innovation and Employment's Regional Tourism Indicators (RTI) show a pick up in spending in recent months in the Auckland region by US and European tourists.

### Leading indicators point to solid growth, but also to rising interest rates

Looking ahead, with consent volumes continuing to build through the first five months of 2014, construction activity is set to remain a key driver of growth through the second half of the year. The impetus to demand (and to labour supply) growth from net migration looks set to weaken from here, but net migration levels are expected to remain elevated given the current labour market weakness in Australia.

The latest QSBO data suggests businesses expect conditions to continue to improve in the near term, with hiring and investment intentions both solid. However, with construction costs pressures building and excess capacity elsewhere in the economy also now largely absorbed, further interest rates increases are expected over the second half of the year.



# Auckland Economic Scorecard

| New Zealand Economic Indicators        |                  | Date | NZ        |
|----------------------------------------|------------------|------|-----------|
| Inflation <sup>1</sup>                 | Annual % change  | Q1   | 1.5%      |
| Official Cash Rate <sup>1</sup>        | %                |      | 3.25%     |
| NZD/USD <sup>1</sup>                   | Month average    | June | 0.8621    |
| TWI (5 currency) <sup>1</sup>          | Month average    | June | 80.31     |
| ANZ Commodity Price Index <sup>2</sup> | Annual % change  | June | -7.8%     |
| Current account as % of GDP            | %                | Q1   | -2.8%     |
| NZ population                          | at 31 March 2014 |      | 4,524,900 |
| Auckland population                    | at 30 June 2013  |      | 1,529,400 |

## Disclaimer

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|                                                                          |                         | 10 yr trend | Date  | Auckland  | Year-on-Year change | Rest of NZ     |
|--------------------------------------------------------------------------|-------------------------|-------------|-------|-----------|---------------------|----------------|
| <b>Headline Indicators</b>                                               |                         |             |       |           |                     |                |
| Employment                                                               | Number (000s)           | 670         | Q1    | 748       | ↑                   | 1,579          |
|                                                                          | Annual % change         | 2.2%        | Q1    | 3.9%      | n/a                 | 3.7%           |
| Unemployment                                                             | %                       | 5.7%        | Q1    | 7.3%      | •                   | 5.7%           |
| Real GDP (expenditure) <sup>3</sup>                                      | Annual average % change | 2.4%        | Q1    | 2.6%      | ↑                   | 2.4%           |
| Real wages                                                               | \$ / week (average)     | \$1,091     | Q1    | \$1,154   | ↑                   | \$1,064        |
| <b>Jobs</b>                                                              |                         |             |       |           |                     |                |
| Youth unemployment – 15-19 year olds                                     | %                       | 22.2%       | Q1    | 27.7%     | ↓                   | 20.6%          |
| Youth unemployment – 20-24 year olds                                     | %                       | 10.2%       | Q1    | 15.3%     | ↑                   | 11.8%          |
| <b>Industries</b>                                                        |                         |             |       |           |                     |                |
| Manufacturing (employment counts)*                                       | Number (000s)           | ..          | Q1    | 76        | ↓                   | 170            |
| Financial and insurance services (employment counts)*                    | Number (000s)           | ..          | Q1    | 35        | ↑                   | 37             |
| Retail sales                                                             | Annual % change         | 1.2%        | Q1    | 5.1%      | n/a                 | 0.3%           |
| <b>Housing and construction</b>                                          |                         |             |       |           |                     |                |
| House sales – dwellings <sup>4</sup>                                     | Annual total sales      | 27,996      | May   | 30,055    | ↓                   | 45,948         |
| Real average private rent <sup>5</sup>                                   | \$ / week               | \$427       | May   | \$463     | ↑                   | \$330          |
| Rent to wage ratio <sup>5</sup>                                          | %                       | 39.1%       | Q1    | 39.5%     | •                   | 31.8%          |
| Real median house sale price <sup>4</sup>                                | \$                      | \$500,331   | May   | \$625,000 | ↑                   | \$430,000 (NZ) |
| Residential building consents – new dwellings                            | Annual total            | 5,918       | May   | 6,778     | ↑                   | 16,069         |
| Non-residential building consents – new floor area approved (sq. metres) | Annual total            | 809,345     | May   | 772,689   | ↑                   | 2,190,438      |
| <b>Global connections</b>                                                |                         |             |       |           |                     |                |
| Tourism – guest nights                                                   | Annual total            | 5,719,000   | April | 6,754,000 | ↑                   | 26,765,000     |
| Net migration                                                            | Net annual flow         | 7,647       | May   | 16,965    | ↑                   | 19,432         |
| Arrivals                                                                 | Annual flow             | 33,920      | May   | 40,821    | ↑                   | 59,043         |
| Departures                                                               | Annual flow             | 26,274      | May   | 23,856    | ↓                   | 39,621         |
| Real exports (\$2013)                                                    | Annual total            | \$12.5b     | May   | \$11.4b   | ↑                   | \$41.0b        |
| Real imports (\$2013)                                                    | Annual total            | \$25.8b     | May   | \$29.6b   | ↑                   | \$19.6b        |
| <b>Confidence surveys</b>                                                |                         |             |       |           |                     |                |
| QSBO - General business situation <sup>6</sup>                           | net %                   | -1.6%       | Q2    | 33.5%     | ↓                   | 30.5%          |
| Westpac – Regional consumer confidence <sup>7</sup>                      | Index                   | 113.8       | Q2    | 128.3     | ↑                   | 121.2 (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 - Quarter-4 - 1)\*100 or (Month - Month-12 - 1)\*100; Annual average % change is calculated as (Year/Year-1 - 1)\*100  
 \* Growth in the manufacturing and financial and insurance services sectors is proxied by growth in employment counts in these industries.

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

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