AucklandEconomicQuarterly

Chief Economist Unit

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Observations on cities and Auckland

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Tēnā koe, I started in the role of Chief Economist in late 2021. Originally from Murihiku, I've called Auckland home for the past decade. I'm pleased to join Auckland Council for the chance to contribute economic advice and to help improve the prosperity and wellbeing of Tāmaki Makaurau.

Prior to joining Auckland Council, I worked as a consulting economist at Sapere, advising clients on policy trade-offs through the application of cost benefit analysis. Auckland-focused assignments included a cost benefit analysis of options to relocate the freight operations of the Ports of Auckland, the use of private capital to finance infrastructure, and the shift to a circular economy. Prior to consulting, I worked at the Treasury on fiscal strategy and the value for money of public services.

Informing advice and building understanding

The Chief Economist Unit is a small team within Auckland Council that undertakes economic analysis to assist colleagues and advise elected members on the implications of policy or investment proposals. This means assessing the likely impacts on society's resources and wellbeing over time – including the economic, social, environmental and cultural aspects. We promote cost benefit analysis as a systematic way to identify those impacts, estimate net benefit, and show the trade-offs. I'd like to acknowledge the contributions of my predecessors and to commit to furthering their good work.

The Chief Economist also has a role in building wider understanding of Auckland's economic issues and their implications for resources and wellbeing. This includes macroeconomic conditions and the trade-offs of our urban policy choices, particularly around land use, housing, and transport. Communicating the story involves bringing together evidence on an issue, and highlighting the costs and benefits of possible options, while acknowledging uncertainty.

In starting out, I'd like to offer some initial observations on cities and on Auckland.

Cities create value through proximity and density

Cities, from an economic perspective, are places to co-locate to exchange labour, capital and ideas, and to produce, trade and consume. The concentration of people and businesses in proximity can deliver productivity gains known as agglomeration benefits. Simply, proximity promotes ease of access, lower transport costs, and knowledge sharing. Higher population density enhances proximity benefits by supporting deeper labour pools and specialisation among suppliers. As a result, cities can offer higher-paying jobs, as well as more choices in consumption and leisure.

To be successful in enhancing living standards for residents, including future generations, cities need to get a couple of foundations right.

- Making efficient use of land. The most valuable land has proximity to things people want, such as employment opportunities, good transport links, and amenities. Higher values indicate higher demand – more people want to live there. Enabling more people to live in these locations improves choice, efficiency of movement, and makes better use of a valuable and limited resource.
- Accessibility. As cities grow, transport demand rises and roads tend to be congested at peak times, adding time and uncertainty to trips. Urban transport networks can provide alternatives to allow people to choose what suits them. This includes fast, frequent public transport separated from general traffic.

Doing well on these fundamentals can help a city to retain its people, attract talent, and boost productivity.

Acknowledging Auckland's recent progress

Auckland has taken important steps forward with its land use and transport links. The Auckland Unitary Plan 'upzoned' much of Auckland's residential land in late 2016, enabling more opportunities to build multi-unit dwellings such as townhouses and apartments. Research shows the Unitary Plan led to a material increase in the construction of dwellings from 2017 to 2021, beyond what would have plausibly occurred in its absence. It's not unreasonable to conclude that this building of more homes helped meet demand and contributed to the stabilisation of Auckland house prices from 2017 to 2019.

Auckland's rapid transit network is providing a choice, for an increasing number of residents, to swap road congestion during peak periods for shorter and more certain trips. The Northern Busway has had patronage far exceeding expectations and is being extended. The rail network continues to be upgraded and the City Rail Link will add significant capacity, reach and time savings. The Eastern Busway further extends the rapid transit network to offer more households an alternative to car-based trips.

Presenting issues – liveability and productivity

Despite this progress, Auckland has been losing more residents to elsewhere in New Zealand than it has gained, with net losses in internal migration in 2019 (11,400 people), 2020 (11,100) and 2021 (13,500). Incomes in Auckland tend to be higher than other regions and we would expect the opportunities of a large and successful city to attract a net gain in residents. Yet these net losses show that plenty of people judge they would be better off living in other regions. This raises the question of whether Auckland's overall liveability is as good as it could be.

Housing affordability is a challenge for many households. Auckland house prices have tended to increase faster than incomes – a simple measure of market conditions. Auckland is not alone in this, but its case is pronounced in a New Zealand context. While the introduction of the Unitary Plan in 2016 was followed by three years of stable prices, Auckland house prices have increased by approximately 40% over the past two years. Lower interest rates were a key factor, allowing buyers to bid higher. For people seeking to buy a first home, who may be renting or living with family, surging prices have outpaced household income growth and made it harder to accumulate a deposit.

Despite public transport improvements, many residents still rely on private vehicles for most of their trips, with growth in transport demand leading to peak period congestion spreading beyond the city centre vicinity, and through the day and into weekends. Recent disruption from the pandemic is unlikely to halt this trend. Alongside this, there is evidence that Auckland fares less well in terms of job accessibility by public transport than some comparably sized cities (e.g. Brisbane and Perth). A case can be made that much of our urban environment does not support people to walk or cycle.

There is also the issue of whether Auckland is as productive as it could be. Workers in Auckland tend to be more productive and Auckland's GDP per capita is higher than that of the rest of New Zealand. Yet commentators have noted that this city 'premium' is materially lower than that observed in other countries, including developed nations with one relatively large city. This raises the question of whether Auckland is underperforming economically, relative to what may be possible. This matters for New Zealand, as Auckland is the commercial centre that provides services to the rest of the economy.

Liveability and productivity depend on many factors, but it is reasonable to ask whether Auckland can do better on the fundamentals of land use and transport networks.

Managing future growth well

Despite the net loss of residents to other places in New Zealand, Auckland's population is projected to continue to grow as pandemic restrictions ease – fuelled by net international migration being positive. This long-run trend has seen Auckland generally grow faster than the rest of New Zealand.

While Auckland Council's Housing Capacity Assessment finds there is sufficient capacity for projected demand over 30 years, there has been public debate over the distribution of that capacity. There are relatively central areas close to jobs, transport links and amenities – where many people prefer to live, as indicated by higher land prices – that have not had much upzoning to accommodate more people.

There is also the challenge of reducing our carbon footprint. Auckland's Climate Plan, *Te Tāruke-ā-Tāwhiri*, models a 64% reduction in transport emissions as part of its pathway to a 50% reduction in overall emissions by 2030.

Achieving this will mean changes in how we get around. A shift away from carbon intensive modes will need to be supported by alternatives, including better public transport and active mode infrastructure that supports commutes and local trips. It will also require Auckland's future growth to be oriented towards a more compact urban form that will help reduce reliance on the private car. A more compact future urban form would be consistent with efficient land use and more people having better proximity to jobs, transport links and amenities.

On the horizon

Looking ahead, government policies to enable more density are to be implemented in New Zealand's five largest cities in August this year.

- The National Policy Statement on Urban Development enables higher density around the city centre, metropolitan centres and the walkable catchment of rapid transit stops – permitting residential developments of at least six storeys.
- Medium Density Residential Standards will permit up to three homes with three storeys on most residential sites, without the need for a land use resource consent.

These policies will enable more residential development opportunities across Auckland. While their reach is widespread, a case can be made that opportunities in places that offer the benefits of proximity – as seen in higher land values – will be in demand and so more likely to be taken up.

Of course, there are trade-offs; the urban environment will continue to evolve and there will be localised costs (e.g. loss of some views, partial shading). There will also be challenges in responding to the pressures on supporting infrastructure that may triggered, and to ensure that the beneficiaries contribute to funding the cost of upgrades.

However, the cost benefit analyses accompanying these policies suggest that, over the long term, society as a whole is likely to be better off, with estimated benefits (more homes for people to buy, improved accessibility to employment and productivity gains from density) outweighing the costs.

Enabling more homes to be supplied may also be expected to support the future affordability of housing being better than otherwise.

Alongside these policies, an extension of the rapid transit network from the City Centre to Māngere has potential to attract future development to locate along that corridor, given the benefit of proximity to a fast and frequent transport network. In turn, this would support patronage and viability. Such transit-orientated developments would build on the City Rail Link – being co-funded by Auckland Council – and the opportunities it will offer for more people to live near its stations.

Taken together, it is worth considering how these changes on the horizon could help Auckland improve on the urban fundamentals of efficient land use and transport accessibility. On a macroeconomic scale, doing better would mean retaining more people, attracting more talent, and boosting productivity. In liveability terms, doing better could mean more choices for current and future residents – and future generations – who wish to live in locations with better access to jobs, transport links and amenities.

Economic Commentary March 2022

Shyamal Maharaj – Economist, Chief Economist Unit

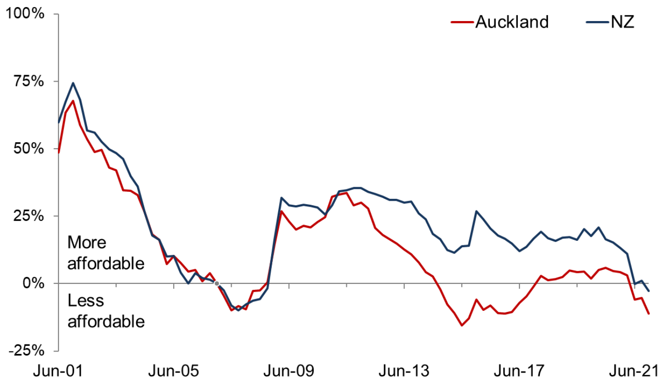
- The economy has held up fairly well, all things considered.
- Housing affordability has considerably worsened since April 2020, prices remain elevated, and our Serviceability Affordability Model confirms this.
- The pipeline for housing has more than 20,000 dwellings consented for delivery over the next few years, although delivery is subject to capacity constraints.
- The RBNZ increased the OCR by 25 basis points in February to 1.0%. Further hikes are likely, with the OCR forecasted to peak at 3.4% by late 2024.
- Credit and financial constraints are a concern for many, as the cost of staving off the brunt of the pandemic's impacts becomes increasingly evident.

Auckland's economic outlook is a mixed bag, with a range of headwinds and tailwinds persisting. COVID-19 has continued to affect confidence, with evolving variants, supply chain constraints, inflation pressures, higher finance costs, and lower demand in some sectors. Conversely, overall consumer spending has held up well and the pipeline for construction remains strong. With border restrictions set to ease, this might provide some reprieve for some sectors.

Omicron cases have surged nationwide, forcing many to again contend with its economic impacts. The Westpac McDermott Miller survey of consumer confidence gauges the degree of pessimism and optimism, with a score above 100 being an optimistic economic outlook. The March quarter result fell 7 points from the prior quarter to 92 – lower than the long-term average of 110. This points to household expectations being affected by the Omicron outbreak, rising inflation and higher interest rates.

Housing affordability has continued to deteriorate in Auckland, along with the rest of the country, as mortgage interest rates have risen, with prices remaining elevated. Our Serviceability Affordability Model (SAM) estimates that housing affordability has worsened by 11% in our index point of December 2006. Notably, since March 2020, housing affordability has fallen by 15.4%. Our assessment is that rampant house price growth during this period has far exceeded the rate of income growth, driven by the significant fall in interest rates at the onset of the pandemic. Auckland house prices remained elevated, with the median price being $1,190,000 in February 2022.

SAM median house price affordability relative to December 2006



Source: Chief Economist Unit, Auckland Council; Real Estate Institute of New Zealand; Reserve Bank of New Zealand

While some observers suggest house prices are beginning to fall, it may be too soon to confirm a trend, given January results tend to ease a bit. Further rises seem unlikely in the near term. Over the last year, mortgage rates have risen in response to three hikes to the OCR, and further increases have been signalled. The average 1-year fixed rate, as of 25 March 2022, has increased 69% from 2.26% to 3.82% from the prior year. As interest rates rise, we tend to see a slowing in house price growth.

Meanwhile, housing supply is set to rise, with more than 20,000 additional dwellings consented for delivery in the past 12 months. Auckland's built form continues to evolve, with consent data showing that townhouses continue to dominate, followed by houses and apartments. While supply is increasing, Auckland still has a housing shortfall at least 13,000, by our estimate. This figure is likely on the low side, given the potential impact of capacity constraints (labour and building materials availability) on completion rates and conservative assumptions about redevelopment demolitions.

With open borders we are likely to see population growth resume, potentially creating pressures if the pace of supply cannot keep up. It is possible that there may be a lull in consenting activity later this year, prior to and possibly just after the implementation of the government-mandated National Policy Statement on Urban Development and the Medium Density Residential Standards in August 2022. When the Unitary Plan went live in 2016 we saw a drop-off, and sudden resurgence six months, later in consenting activity as the development community factored in the new rules.

Retail spending continues to surprise to the upside. In the December quarter, nationwide consumer spending was up 10% on the previous quarter. Data from NZ Post reports online spending as growing year on year, likely supported by behavioural changes in response to the pandemic. Auckland GDP has fallen, but this was expected. Even the March quarter is likely to be subdued by Omicron impacts. However, some sectors continue to show resilience while others continue to struggle, depending on how sensitive they have been to closed borders, public health restrictions and remote working. With borders opening up and restrictions set to ease, affected sectors and businesses will be hopeful of a boost.

While the economy has shown resilience in demand, COVID-19 pressures on the supply side have contributed to record high domestic inflation, with a 5.9% increase in general prices in the year to the December 2021 quarter. Higher inflation is a pain point for many households, with people feeling poorer as everyday items become costlier – even more so when the cost of necessities far outstrips wage growth. Inflation is an issue globally. Supply chain disruptions continue to reverberate across the global economy, while the *Russia-Ukraine conflict* is triggering inflationary pressures on world prices for oil, wheat and some raw materials.

The RBNZ has a mandate to maintain stable prices, and assesses the balance of risks around persistent and transitory factors and how they may eventuate. One of the biggest risks to inflation going forward will be the rapid rise in oil prices, although some of this rise may prove transitory. The RBNZ has begun a phase of monetary tightening and has hiked the OCR three times in the last year from a record low of 0.25% to 1.0%. Furthermore, this is just the beginning. Further hikes are on the cards if things eventuate as expected, with the OCR forecasted to peak at 3.4% by late 2024.

With interest rates rising and credit becoming harder to source via amendments to the Credit Contracts and Consumer Financing Act (CCCFA), the mix of economic factors acting in favour of recovery have an uphill battle ahead.

Nevertheless, the current environment warrants a change of tack from the last few years of monetary policy. Our economy has held up well despite Covid-19 economic impacts, but the costs of staving-off the risk of collapse are due.

Data summary provided by Ross Wilson – Economic Analyst, Research & Evaluation (RIMU)

Indicator	Dec-21 quarter	Sep-21 quarter	Dec-20 quarter	5-year average	Rest of NZ Dec-21 quarter
Employment indicators					
Jobseeker support recipient growth (%pa)	-11.2%	-2.8%	57.7%	12.3%	-11.7%
Annual employment growth (%pa)	4.8%	7.0%	-0.6%	2.1%	3.1%
Unemployment rate (%)	3.0%	3.1%	5.3%	4.6%	3.2%
Unemployment rate among 20 to 24 year olds (%)	4.9%	7.0%	11.6%	9.4%	5.9%
Unemployment rate among 15 to 19 year olds (%)	14.3%	13.2%	21.0%	19.4%	14.2%
Earning and affordability indicators					
Monthly Employment Indicator earnings growth (%pa)	7.6%	5.9%	5.9%	4.7%	7.9%
Annual geometric mean rent growth (%pa)*	5.0%	8.4%	5.0%	3.3%	9.7%
Geometric mean rent to median household income ratio (%)*	26.6%	28.3%	27.3%	27.5%	25.2%
Annual median house price growth (%pa)*	24.9%	20.2%	15.7%	8.4%	20.8%
Mortgage serviceability ratio (relative to Dec-06)*	-11.1%	-5.3%	4.2%	0.1%	-2.7%
Construction					
Annual new residential building consents growth (%pa)	23.3%	-26.1%	9.9%	15.4%	24.6%
Annual m2 non-residential building consent growth (%pa)	27.6%	-40.5%	-32.0%	6.6%	6.9%
International connections					
Annual Auckland Airport int'l passenger movements (%pa)	-74.8%	-87.8%	-75.2%	-41.1%	NA
Confidence					
Annual retail sales growth (%pa)	10.4%	-36.7%	0.1%	4.6%	11.4%
Quarterly Survey of Business Opinion (net optimists)	-35.4%	-3.3%	-18.2%	-20.4%	-25.8%
Westpac Consumer Confidence*	102.7	101.4	106.9	105.8	99.1

Sources: Chief Economist Unit, Auckland Council; Statistics New Zealand; Ministry of Business Innovation and Employment; Real Estate Institute of New Zealand; New Zealand Institute of Economic Research; Westpac; Reserve Bank of New Zealand; Ministry of Social Development. * Rest of New Zealand figures are for all of New Zealand including Auckland. Data is not seasonally-adjusted.

Disclaimer

Find out more: visit the Auckland Council Chief Economist Page
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