AucklandEconomicQuarterly

Chief Economist Unit

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Shane Martin – Chief Economist
shane.martin@aucklandcouncil.govt.nz
021 871 244

Government reforms:
ensuring good intentions become good practice

- The country has gone into COVID-19 Alert Level 4 lockdown again, which completely changes the way we live our lives. And even though lockdown is a massive interruption, all the normal functions of government are still at work.
- There are currently two major central government policies that directly impact local government.
- The National Policy Statement on Urban Development (NPS-UD) and the Three Waters Reform propose two massive changes to the way local governments operate.
- The impact from these reforms is going to be in the billions of dollars and across multiple generations. Therefore, it's absolutely necessary we get this right.
- While it is still somewhat early days, both central and local government are working hard to determine how the proposed reforms will work in practice and what the costs and benefits are likely to be.

The lowdown on the lockdown

While it's too early to say how this outbreak will shake out, we do have insights from the last time around. Estimates from the first 2020 lockdown suggest that COVID-19 Alert Level 4 decreases economic activity by 25-30%, in the range of $100 million of GDP per day. That said, it's important to remember, that number compares to business as usual and business as usual isn't a possibility right now.

Rather, the choice is between lockdown and uncontrolled spread of COVID-19 in Aotearoa, something nobody wants. Since we all hope that we can return to business as usual as quickly and safely as possible, let's do our part in the meantime – be good to each other, support local business where we can, and keep safe.

Life and legislation go on

Despite the latest COVID-19 outbreak and the associated Alert Level 4 restrictions, life and government move on in other ways. From a local government standpoint, some of the biggest challenges we have faced over the past year or so have been in addressing policies handed down from central government.

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The two biggest policies we're dealing with right now are the National Policy Statement on Urban Development (NPS-UD) and Three Waters Reform. At their heart, each of these has the goal of addressing long-standing issues facing New Zealand – housing unaffordability and water quality/management. And while these are commendable goals, they represent a massive undertaking, reimagining where and how infrastructure is provided, who pays for it and how, and determining the best way to accommodate massive population growth while improving social and environmental outcomes.

A lot of ink has been spilt on these initiatives, but much of the discussion in the press has been opinion-driven. Of course, this generates clicks and gets people thinking about the policies, but it does not always give readers a clear view of the facts surrounding the debate. For instance, an article that anecdotally describes one person's negative view of apartments does little to inform the greater public about the benefits and costs of increased density for the city.

Every single decision we make has costs and benefits. It's our job as a council and a society to make the best decisions so that the overall benefits outweigh the costs. And it's also on us to help the public understand those decisions.

NPS-UD? G-L-A-D to meet you

So, what does this mean for the NPS-UD? First, it is useful to outline what the NPS-UD is and what its goals are. According to the Ministry of Housing and Urban Development, the policy "aims to ensure that New Zealand's towns and cities are well-functioning urban environments that meet the changing needs of our diverse communities."

It does this primarily by directing planning authorities to enable an increase in housing supply and ensure that planning responds to changes in demand. It also requires the removal of overly restrictive rules that affect urban development outcomes.

For Auckland, the NPS-UD will likely result in massively increased density around our city centre, our metropolitan centres (for example, Albany, Henderson, Manukau), and the walkable catchments around our rapid transit network. At a base level, this makes sense – we should be enabling as many people as possible to have easy, walkable access to the places they are most likely to need to go. That is jobs, public transport, restaurants, and grocery/retail stores.

In theory, this achieves a couple of goals. First, it lessens the pressure for outward sprawl by allowing more people to live in already developed areas.

It also increases the viability of public transport and active modes of transport, as people are much more likely to walk to a store if it is less than a ten-minute walk from home or to take a bus if there is high-frequency service to many destinations.

Of course, increased density isn't free. From a financial standpoint, there is always a question about whether the existing infrastructure (roads, water pipes, etc.) can cope with increased load. Upgrading infrastructure is very expensive and much more complicated when compared with laying new infrastructure in greenfields areas.

Other costs are more difficult to identify. While NIMBYs often get criticised for their views, their concerns can be legitimate. Although it brings benefits, changing the character of a neighbourhood can also impose real costs on those who will be less happy living in the re-envisioned area. This is just further evidence that every decision that gets made involves a trade-off.

As Auckland Council and other councils around the country grapple with how best to implement the goals of the NPS-UD, we need to keep a couple of things front of mind. First, and most important, is to remember that all changes have costs and benefits. To make the best choice we must evaluate these rigorously and dispassionately. Second, we cannot be too precious about the decisions we have made in the past. There is always room for improvement, and we should welcome the opportunity to make things better whenever we can.

3 waters 2 be 1 big change

Three Waters Reform is a bit of a different animal. Unlike the NPS-UD, which is a policy directive, this reform proposes a full overhaul of the system that manages and delivers drinking water, stormwater, and wastewater (three waters) services to the residents of New Zealand.

The current system sees these services mainly provided by 67 different local authorities. According to the DIA, local government faces many challenges with the provision of these services – especially "funding infrastructure deficits, complying with safety standards and environmental expectations, building resilience to natural hazards and climate change into three waters networks, and supporting growth."

It is estimated that meeting these challenges will cost the country between $120 and $185 ***billion***, causing household water bills to be 7 to 13 times higher in the future.

As a solution, the government has proposed a complete restructuring of how three waters are delivered. Instead of 67 entities, only 4 entities would manage the country's water systems. Their balance sheets would be separate from councils, freeing them up to borrow enough money for infrastructure improvements. In addition, there would be a government regulator aimed at driving efficiency gains and holding the three waters providers accountable to consumers.

While all of this sounds good in theory (doesn't it always?) it is again imperative that we fully weigh the costs and benefits. For Auckland, it is unlikely that the proposed amalgamation with Northland will deliver efficiency gains on its own. Benefits will have to come instead from the increased borrowing capability and economic regulation.

On the other hand, the joining of Auckland and Northland will result in a push to extend service to more rural customers, which is likely to be incredibly costly. A robust analysis of these impacts is needed before we can confidently say what's best for Auckland.

What next for Auckland?

Each of these proposals has councils around the country in a mad dash to determine how, and to what extent, their regions will be impacted. Auckland is no different, and we are working hard to get those answers. Further, we are always focused on determining what costs will be imposed and what benefits are likely to be realised.

The good intention behind these policies can't be denied. However, it is necessary for both central and local governments – and the public – to be fully aware of the impact, beyond interviews with local special-interest groups. These decisions are too big and too important to get wrong.

Economic Commentary August 2021

Shyamal Maharaj – Economist
shyamal.maharaj@aucklandcouncil.govt.nz
021 583 785

- The delta variant has broken through and sent the country into level 4 lockdown, but we enter it on the back of a strong economic recovery.
- House prices are still elevated, but policies to curb the extreme heat appear to be beginning the cooling process.
- The decision to lockdown has disrupted the RBNZ's plan to hike interest rates by at least 25bp, but a signal for a higher OCR remains.
- The pipeline for Auckland's housing situation continues to show strength after strength. We expect that future policies will continue to support the density we need.

The economy is a fluid system of interactions, decisions, and outcomes. The scale of change(s) we experience depend on how people and businesses adjust to new paradigms of economic decision making around how to consume their resources (time, money and effort).

Suddenly, Auckland (along with the rest of the country) has been thrust into level four. Our estimates for the economic impact of level four lockdown on NZ is somewhere between $230-$290m per day, based on activity that would have happened during a time of business as usual.

For Auckland, we estimate around $100m (with a range of $85 - $110m). We think this could be an upper limit because this time around businesses and people know what to expect. And as we have seen in the past 18 months, consumers and businesses are finding ways to trade with little to no contact.

Retail trade has been consistently stronger than expected. This is probably because of the sheer increase in wealth some have experienced and/or that people have been simply putting off their purchasing decisions rather than it being cancelled outright.

It's all about the counterfactual

As is the case with any policy change, it is not the prevalence or absence of people's perception of things "working" as opposed to understanding what would have happened without the intervention. For example, if a policy is enacted to curb price growth in housing, such as extending the bright-line test from five to ten years, it is not whether the behaviour this policy is trying to curb can be seen to have an immediate impact on prices, but rather where prices could have been without.

Policies can take time to take effect, even if the day they go live people's decisions change at the margin. We have noted that these tools are just pseudo versions of what a Capital Gains Tax would serve to do, which is to discourage speculative behaviours.

That being said, prices in July were at 1,175 million, up 28% on the previous year and around 2.2% from the previous month. Every month headlines battle for the top spot for betting on the 'coming correction/crash or worsening wealth gap'. The reality is that it's a game of interest rates, a bank's willingness to lend and the of course supply and demand. However, as we approach some semblance of economic normalcy and navigate supply-side policies like the NPS-UD in the year to come, the rampant rate of growth we have seen over the past year is likely to slow.

Unsurprising

The Reserve Bank voted to keep the Official Cash Rate (OCR) on hold in its August Monetary Policy decision in the face of NZ's level 4 lockdown restrictions. There were strong market expectations before this for a 25 basis point hike. The RBNZ noted that the virus is unpredictable and disruptive and that monetary policy settings from the world's central banks remain highly accommodative.

Notably, our economic backdrop has the markers of supporting higher interest rates, i.e. reduced monetary stimulus. With inflation expectations firmly anchored around the 2% midpoint over the medium term and a tightening labour market, it would seem evident the RBNZ has not ruled out an OCR increase(s) in the months to come.

Nevertheless, the RBNZ has provided further context on its responsibilities. They, like us, expect that inflation pressures are largely one-offs that are elevating prices through transitory COVID-19 supply chain pressures. While the data reported by Stats NZ on unemployment is questionable given evidence from jobseeker data that suggests the unemployment rate could be higher than reported, we think that the general trend in the tightening of the labour market is a strong reflection of the firmer economic backdrop from NZ's handling of COVID-19.

The nature of monetary policy from the RBNZ is not intended to be reactionary. Instead, it is meant to be proactive in times of economic disruptions. And while the situation did not end up as bad as initially expected, the better economic outlook has not eventuated independent of the stimulus that has come from both the government and RBNZ.

The question people should ask is what would have happened without it and if we are willing to make that trade-off. If COVID-19 variants continue to impact economic activity through the possibility of future lockdowns, it can be expected that the RBNZ will be prepared to inject further stimulus if required.

The pipeline of construction

The pipeline of housing to be delivered is at record levels with over 19,000 residential dwellings consented in Auckland. A significant portion – 64% over the past 12 months – of this continues to be in the multi-unit category. 70% of the attached dwellings consented over the past 12 months are for townhouses which remain the popular option for developers.

It would seem townhouses are popular for the areas that have THAB (Terraced House and Apartment Building) zoning at present, where there has been a 74% increase over the past year. In contrast, the rate of change in single houses consented remains roughly flat.

As we have presented before, land values are a strong driver of commercial viability, especially where density is needed. Indeed, townhouses are a form of denser living by New Zealand's standards, but globally, they are at the lower end of the spectrum of denser housing typologies. But townhouses are also a product of what is easier to build, market and sell.

However, work is underway on the NPS-UD, which signals the popularity of apartments is likely to favourably change. Unlocking the density where land values/demand are the highest (closer to the city centre) is a strong commercial incentive for developers to build the high-quality density Auckland has been needing for a long time.

The last time we had a significant shift in the density enabled in Auckland was when the Unitary Plan went live. The reality is high-quality density will not only solve our housing problems but also has significant implications on our climate in terms of where and how we choose to live, work and play.

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

Indicator	Jun-21 quarter	Mar-21 quarter	Jun-20 quarter	5-year average	Rest of New Zealand Jun-21 quarter
Employment indicators					
Jobseeker support recipient growth (%pa)	3.0%	44.7%	46.5%	13.0%	-1.6%
Annual employment growth (%pa)	3.1%	0.4%	0.6%	2.7%	1.0%
Unemployment rate (%)	4.1%	5.3%	4.0%	4.8%	3.8%
Unemployment rate among 20 to 24 year olds (%)	7.4%	11.1%	8.5%	9.8%	5.6%
Unemployment rate among 15 to 19 year olds (%)	17.5%	20.8%	13.5%	20.1%	18.0%
Earning and affordability indicators					
Monthly Employment Indicator earnings growth (%pa)	7.0%	10.1%	2.1%	3.2%	5.4%
Annual geometric mean rent growth (%pa)*	1.1%	1.8%	2.2%	2.9%	6.5%
Geometric mean rent to median household income ratio (%)*	27.0%	26.5%	28.8%	27.7%	25.8%
Annual median house price growth (%pa)*	25.0%	18.5%	8.2%	6.7%	28.7%
Mortgage serviceability ratio (relative to Dec-06)*	-6.6%	1.8%	6.0%	-0.3%	1.1%
Construction					
Annual new residential building consents growth (%pa)	28.8%	-5.5%	5.3%	14.6%	10.6%
Annual m2 non-residential building consent growth (%pa)	17.1%	-43.6%	-42.8%	-0.6%	-15.6%
International connections					
Annual Auckland Airport int'l passenger movements (%pa)	-92.8%	-97.0%	-26.3%	-42.3%	*NA*
Confidence					
Annual retail sales growth (%pa)	11.5%	-18.6%	0.4%	5.0%	13.2%
Quarterly Survey of Business Opinion (net optimists)	9.7%	-12.2%	-59.0%	-15.8%	5.6%
Westpac Consumer Confidence*	108.6	103.9	96.0	106.9	107.1

*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.*

Find out more: visit the Auckland Council Chief Economist Page
or contact us: chief.economist@aucklandcouncil.govt.nz

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