State of the Wellington City Economy Report

for Wellington City Council

August 2023

Infometrics

Economics put simply

Authorship

This report has been prepared by Principal Consultant Rob Heyes and Economist Sabrina Swerdloff with input from Brad Olsen and Gareth Kiernan.

Email:

Rob.Heyes@infometrics.co.nz

Sabrina.Swerdloff@infometrics.co.nz

All work and services rendered are at the request of, and for the purposes of the client only. Neither Infometrics nor any of its employees accepts any responsibility on any grounds whatsoever, including negligence, to any other person or organisation. While every effort is made by Infometrics to ensure that the information, opinions, and forecasts are accurate and reliable, Infometrics shall not be liable for any adverse consequences of the client's decisions made in reliance of any report provided by Infometrics, nor shall Infometrics be held to have given or implied any warranty as to whether any report provided by Infometrics will assist in the performance of the client's functions.

Table of contents

Executive summary 4

Global context 5

Inflation decelerates, interest rates remain high 5

Global growth to remain sluggish 5

Global trade seeks resilience 5

Services increasingly important in supply chains 6

Mixed risks for stable NZ dollar 6

Frugal consumers influence retail trends 7

National overview 8

Inflation back within target band by early 2025 8

Further interest rate increases unlikely 9

A mild economic contraction is expected 9

Migration falling back by 2025 10

Only limited job losses expected 10

Housing remains unaffordable 11

Construction activity expected to weaken 12

Consumer spending squeezed 13

Increased government spending? 13

Tourism recovery but outlook uncertain 13

Weak export volumes and prices 14

Affordability 15

A tough year for households 15

Businesses face weaker cost pressures and demand 15

Recession incoming 16

Slow recovery in consumer and business confidence 16

Some industries will fare better than others 16

Commuting into Wellington City increases 17

Migrants make a welcome return 19

The housing market to remain subdued 19

Weak global economy to undermine tourism recovery 19

Feasibility 20

Appendix 1. Forecasting methodology 23

Macro-economic forecast 23

Macro-economic model 23

General equilibrium 23

Regional Forecasting Model 24

Executive summary

Infometrics has been commissioned by Wellington City Council (WCC) to examine the economic outlook for households and businesses in Wellington City, to provide background context for the setting of the 2024/25-2034/35 Long Term Plan (LTP).

Infometrics has also been asked to examine the Wellington economy to inform decisions about affordability of non-residential and infrastructure investments in the LTP, and the Wellington construction sector's capacity to inform decisions about the feasibility of these investments. This report analyses the global, national, and regional context affecting the Wellington City economy, highlighting challenges and opportunities it faces going forward.

Globally, inflation looks to be easing from recent peaks in key economies, aided by high interest rates and sluggish global growth. Weak global demand, particularly from China, and renewed interest in the regionalisation of supply chains, will further dampen global growth. However, Wellington could benefit from global supply chains becoming increasingly knowledge-intensive, and digitalisation will support our ability to export these services.

Nationally, a relatively mild economic downturn is beginning, but there are signs that inflation will fall below 3%pa by 2025. Although we expect the employment rate to remain high, households will nonetheless feel the squeeze of lingering price inflation, high mortgage rates, housing affordability challenges, moderating wage growth, and softer labour market conditions over the next 1-2 years. Looking further ahead we expect a soft economic recovery as interest rates fall only gradually, net migration and visitor numbers remain below pre-pandemic levels, and lower commodity prices combined with a sluggish global economy reduce New Zealand's export revenue.

In terms of their ability to afford local council rates increases, Wellington households and businesses will find the coming 1-2 years economically challenging, and the subsequent recovery is likely to be gradual. Cost-of-living pressures will linger, especially for homeowners transitioning to higher mortgage rates, and many businesses will need to adjust to weaker demand conditions. However, with high employment levels, low unemployment, a relatively highly skilled (and therefore more highly paid) workforce, and economically resilient sectors such as professional services, healthcare and public administration, Wellington is arguably better positioned than most areas to weather economic headwinds.

A change of government is a key risk for Wellington City. There is considerable pressure on the fiscal accounts already as tax revenue runs below budget. Despite prior talk of spending restraint, the Government's Budget 2023 included increased spending and borrowing. A change of government following the General Election in October could see National cut central government staffing levels to rein in costs.

In terms of construction sector capacity, Wellington City's planned infrastructure and non-residential construction projects look feasible in the near term against the backdrop of a forecast of weakening on construction work across the Wellington Region.

Global context

Inflation looks to be easing from recent peaks in key economies, aided by high interest rates and sluggish global growth. Weak global demand, particularly from China, and renewed interest in the regionalisation of supply chains, will further dampen global growth. However, Wellington could benefit from global supply chains becoming increasingly knowledge-intensive, and digitalisation will support our ability to export these services.

Inflation decelerates, interest rates remain high

Inflation is easing in many key economies, including the United States, Australia, the United Kingdom, and the Euro Zone. However, persistently tight labour markets have caused price pressures to shift from food and energy components to wages and more broad-based inflation, encouraging central banks to continue raising interest rates or maintain them at high levels.

The outlook is for cost and demand pressures to weaken as international shipping costs return to pre-pandemic levels. We expect that supply chain disruptions, pandemic-period fiscal stimuli, and food and energy shocks will continue to ease as global growth weakens. All of which augurs well for inflation outcomes over the next 24 months. The International Monetary Fund expects global headline inflation (which sat between 2-4%pa over the five years prior to the pandemic) to ease from 6.8%pa in 2023 to 5.2%pa in 2024.

Global growth to remain sluggish

Consensus forecasts for global economic growth over 2023 have lifted from a low of 1.5%pa to 2.2%pa, while the outlook for 2024 has been downgraded from 2.5%pa to 2.2%pa. Weakening expectations for 2024 are driven by softening global demand and the effect that persistently high central bank interest rates will have on economic activity. China's reopening has provided a much-needed boost to global economic activity, but growth has been weaker than expected. Soft demand in China, which makes up around a third of New Zealand's primary industry exports, is expected to have a negative impact on key meat and forestry export prices in the near-term.

Ageing populations across both developed and emerging economies, weakening investment growth, and climate-change related challenges will weigh on global economic growth in the longer term.

Global trade seeks resilience

Growth in global trade has slowed significantly over the past decade after a period of rapid expansion between the 1970s and 2008. Supply chain growth, which supported this expansion, has largely run its course, which means global trade growth will be more limited going forward. A renewed interest in resilience in the wake of both the pandemic and an uncertain geopolitical environment has supported the regionalisation of supply chains, which will further dampen global trade growth.[1]

Although the rebound from the pandemic has been faster than the Global Financial Crisis, trade growth is still likely to weaken over the remainder of the 2020s, partly because of remnant COVID-19 disruption and the Russia-Ukraine conflict. Trends such as increasing economic digitalisation, which will spur weightless exports and development of emerging economies, add some upside to this outlook.

It is also worth noting that New Zealand is increasingly favouring free trade agreements (FTA's), which will support our exports even as global trade growth slows. In 2023, New Zealand signed onto FTA's with both the United Kingdom and European Union, which will make almost all exports to these areas tariff free. Chris Hipkins also recently agreed to free trade talks with Indian Prime Minister Narendra Modi, and National Party Leader Christopher Luxon has described a deal with India a "strategic priority", indicating an openness to free-trade on both sides of the aisle.

Services increasingly important in supply chains

Knowledge and skill-intensive services are expected to grow their share of global supply chains, a trend which New Zealand could benefit from even as global economic integration decelerates. Services have been the main source of global economic growth over the past thirty years. Highly skilled offshorable services such as ICT or professional services have grown rapidly in developed economies. Accelerated digitalisation due to the pandemic and emerging technologies such as cloud computing and AI have added upside to the long-term outlook for the global services sector.[2]

As climate-related challenges limit agricultural production, New Zealand could leverage its potential in knowledge-intensive services, with digitalisation enhancing our ability to export these services as weightless exports to overcome the tyranny of distance. Given that high-value services make up almost half of Wellington City's GDP, compared with 27% of national GDP, the city could gain an outsized benefit from this trend.

Mixed risks for stable NZ dollar

The New Zealand dollar is largely expected to hold its own over the next five years, but there are downside risks to this forecast in the near term. Weak export prices, sluggish economic growth, and the absence of any further interest rate rises could all discourage international investors from placing their money in New Zealand, pushing the exchange rate lower.

Perhaps the biggest downside risk for the New Zealand dollar is the large current account deficit, and negative commentary or a downgrade from a credit ratings agency. A depreciation of the NZ dollar, particularly against the Japanese Yen and the Chinese Yuan, would make it relatively more expensive for businesses in the construction and transport sectors to import supplies. But it would also make visiting New Zealand cheaper, which would assist the post-COVID tourism recovery.

---

[1] Source: Resilience of Global Supply Chains Challenges and Solutions, European Parliament

[2] Source: Falling Long-Term Growth Prospects, World Bank, (2023)

We believe the appreciation risk is somewhat balanced by the expectation that import price growth will remain relatively soft over the next few years. There is also some scope for appreciation to occur against the US dollar and the Euro over the next 2-3 years as both economies struggle with middling growth outlooks. Soft import price growth would support New Zealand's terms of trade (the ratio of export to import prices). A positive medium-term outlook for the terms of trade will mean New Zealand can maintain import volumes, even as export volumes remain subdued.

Frugal consumers influence retail trends

The pandemic accelerated consumer and business digital adoption. According to a 2022 study by the Institute for Business Value (IBV), a multinational business research organisation: "Today's consumers no longer see online and offline shopping as distinct experiences. They expect everything to be connected all the time."

Hybrid retail, which combines both brick-and-mortar stores with e-commerce, is expected to massively shape retail in the post-pandemic years. Having averaged around 13% of total retail spending in New Zealand over the two years before COVID-19, online spending now makes up around 16%. Hybrid shopping may intensify the need for highly skilled professionals in the retail sector (for example, ICT specialists and data scientists).

Consumers are expected to curtail their spending somewhat as the world enters a period of subdued economic growth. As tighter household budgets intersect with increasing concern about climate-change, consumers are expected to increasingly prefer products with longer, more sustainable life cycles. A 2021 survey by the IBV[3] indicated that the pandemic changed 93% of consumers' views on sustainability, and 22% more consumers said environmental responsibility was very important to them when choosing a brand compared with 2020.

The "circular economy" (which aims to transform traditional business and product models to gain maximum use from resources and generate minimal waste) will provide a framework for firms to appeal to sustainability-minded consumers. The implementation of circular economy objectives into the Wellington City's Council Economic Wellbeing Strategy highlights that the city is already responding to this trend. Businesses in Wellington could continue moving towards low-waste strategies, and there may be an increased uptake of repair and refurbishment services.

[3] Source: Sustainability at a turning point, Institute for Business Value

National overview

A relatively mild economic downturn is beginning, and there are signs that inflation will fall below 3%pa by 2025. Although we expect the employment rate to remain high, households will nonetheless feel the squeeze of lingering price inflation, high mortgage rates, less affordable housing, moderating wage growth and softer labour market conditions over the next 1-2 years. Looking further ahead we expect a soft economic recovery as interest rates fall only gradually, net migration and visitor numbers remain below pre-pandemic levels, and lower commodity prices combined with a sluggish global economy reduce New Zealand's export revenue.

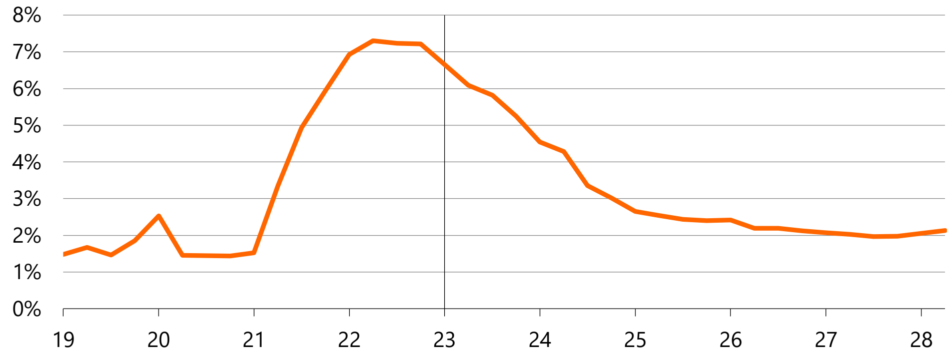
Inflation back within target band by early 2025

Annual inflation eased to 6.0%pa in the June 2023 quarter, which was the third consecutive quarter of decelerating inflation. This easing has been accompanied by a moderation in inflation expectations, as captured in the Reserve Bank's Survey of Expectations: two-year-ahead expectations moderated to 2.8%pa, the first time this measure was below 3.0% since June 2022. Our forecasts indicate that inflation will have eased to 5.2%pa by the end of this year, reaching 3.0% by the end of 2024 (see Chart 1).

Chart 1

Back in the target band by early 2025

Infometrics inflation forecast, Jul 23, annual rates



Despite headline inflation easing, many households are still feeling the pinch, with food prices up 12.3%pa and the household living-costs price indexes (HLPIs) coming in higher than the Consumers Price Index. The HLPI rose 7.2%pa across all households in the June 2023 quarter, with increases ranging from 6.9%pa for the lowest expenditure households to 7.8%pa for the highest expenditure households.

Inflation risks remain. The return of fuel excise duty at the start of July 2023 will keep consumer price inflation higher in the short term. More importantly, the restoration of full road user charges (RUCs) will place upward pressure on freight costs for all goods being transported around the country.

There is also a risk that demand pressures associated with the recent surge in migrant arrivals, especially in the housing market, could mean that inflation eases more slowly than expected.

Further interest rate increases unlikely

After 18 months of interest rate rises, the economic effects are starting to show in the easing inflation rate, weaker consumer spending, and slower GDP growth. At its Monetary Policy Review in May, the Reserve Bank signalled that the official cash rate (OCR) is now on hold at 5.5%. The Bank thinks it has done enough to quell inflation. Our central forecast is for no further increases to the OCR from its current level.

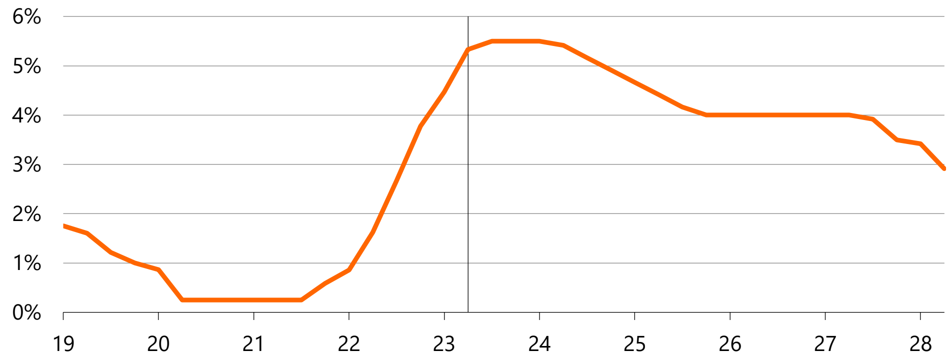
However, if inflation remains higher than expected, and these pressures are reinforced by other indicators, such as a lower-than-expected unemployment rate and higher-than-expected GDP growth, there is a risk that the OCR could be increased again, but not before November this year.

Beyond this peak in the OCR, we have pencilled in the first interest rate cut for May 2024, with the OCR gradually being lowered to 4% by the second half of 2025. The timing of the first interest rate cut depends on how comfortable the Reserve Bank is in reducing the OCR while inflation is still outside its 1-3%pa target band.

Chart 2

Further interest rate increases unlikely

Infometrics Official Cash Rate forecast, Jul 23, qtly averages



A mild economic contraction is expected

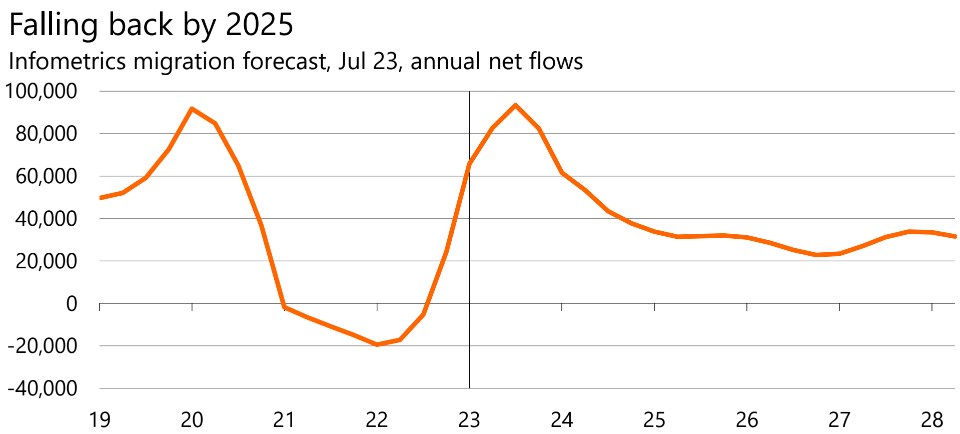
We continue to expect quarterly GDP growth to average close to zero over the next year, meaning the economy will continue to feel recessionary until about mid-2024. The economy might flirt with negative growth between now and late 2024, but the contraction will appear to be mild compared with the one following the Global Financial Crisis (GFC). The return of stronger population growth will boost economic growth, masking the economy's struggles over the next 18 months.

Migration falling back by 2025

The massive migration influx has led to an improvement in the availability of workers, with the critical skills shortages that constrained business growth during 2021 and 2022 starting to ease. Less tightness in the labour market should naturally start to act as a dampener on migrant arrival numbers throughout the next year. After topping 20,000 in both February and March, monthly arrival numbers pulled back to just below 17,000 in April before rising above 18,000 again in May and June.

It's hard to be overly certain (especially given regular revisions to the data), but the April to June numbers might signal that the rush of foreign hiring following the border reopening in mid-2022 is now starting to moderate. As skill shortages are filled and the labour market weakens, the prevalence of fewer job opportunities is expected to moderate annual net migration to around 30,000 by early 2025.

Chart 3



The departure of New Zealand citizens overseas also surged in the first half of 2023, reaching over 18,000 in the June 2023 quarter - the highest quarterly outflow since 2012, most likely driven by the release of pent-up demand that accumulated during the border closure.

Pre-pandemic, New Zealand's migration flows had settled into a pattern of departing Kiwis being more than offset by arrivals of migrants from overseas resulting in positive net inward migration. But net inflows can't be taken for granted. That peak in New Zealand citizen departures in 2012 resulted in a net outflow of migrants. Economic conditions in key receiving countries such as Australia and the UK relative to New Zealand, as well as Kiwi's natural inclination to travel will partly determine the trajectory of net migration in coming years.

Only limited job losses expected

Probably the most significant part of the economy that has shown few signs of turning yet is the labour market. The unprecedented surge in migrant arrivals this year should help to slow wage growth and support an increase in the unemployment rate in coming quarters. Although we forecast the unemployment rate to rise from 3.6% currently to 5.0% by September 2024, this increase is a result of job creation not keeping pace with population growth, rather than a large increase in redundancies. We expect job losses to be limited, but for there to be a faster increase in people looking for work compared to job availability, lifting unemployment.

Employment growth has accelerated since the start of this year as firms have filled longstanding vacancies, even as employment intentions and job ad growth have weakened. With job ads 26%pa lower in July 2023,[4] we expect employment growth to slow during the second half of this year as the catch-up in hiring is superseded by employers' caution around future demand conditions.

Wage growth will moderate – the biggest pay increases have been associated with headhunting and worker poaching, which is already becoming less commonplace. As cost-of-living pressures become less acute workers' expectations of pay increases will lessen.

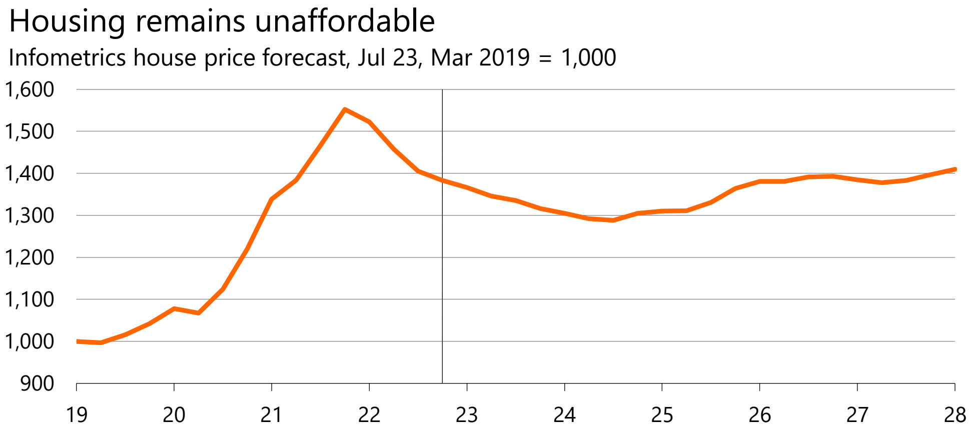
Housing remains unaffordable

Despite house price falls, rising interest rates mean that housing remains highly unaffordable. The Real Estate Institute's index shows that house prices have retreated 17% from their peak in November 2021, but are still 21% higher than at the end of 2019. The rapid turnaround in population growth stemming from the recent influx of migrants threatens to put a floor under house prices sooner than would otherwise have occurred.

Some analysts are already talking about the housing market bottoming out, backed up by sales volumes in April and May this year that have been somewhat stronger than the prior six months. Given the current strength of net migration, there is potential for a short-lived bounce in house prices of around 5% over the next year, with potential for demand to also be boosted by more buyers entering the market if they believe house prices have reached their low point. However, any short-term lift in prices is likely to be unsustainable and not be justified by fundamentals. Mortgage rates will continue to be a significant constraint on the borrowing and debt-servicing ability of potential buyers, so we do not expect house prices to be bid up significantly from current levels, with house price inflation averaging just 2.2%pa between mid-2024 and 2028.

[4] Source: Seek NZ Employment Dashboard, July 2023

Chart 4

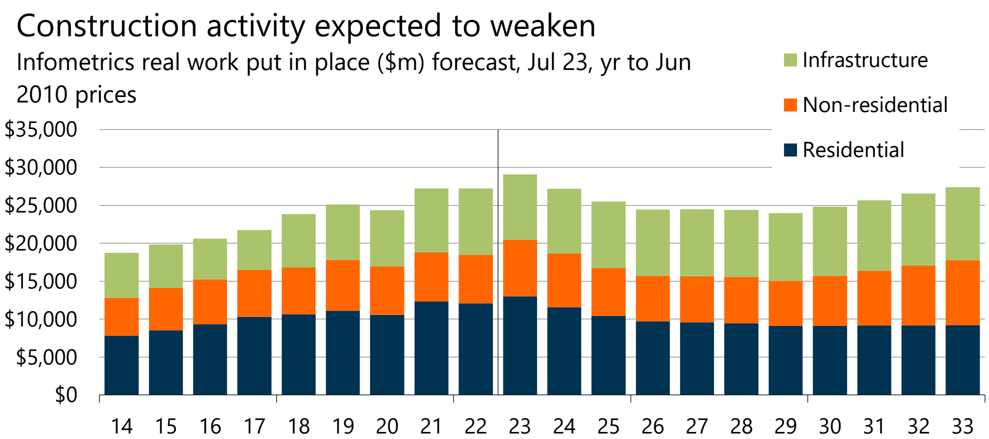


Construction activity expected to weaken

We expect construction activity will finish 2023 1.0% below where it was at the end of 2022. Non-residential work is a key contributor, with activity going through a catch-up period after being constrained by labour and capacity shortages during 2021 and 2022. However, after this year's record high, less favourable economic conditions are expected to cause a 22% decline in non-residential activity over the three years to September 2026.

Residential activity is also forecast to contract by 19% between mid-2023 and mid-2026. Strong net migration presents an upside risk to this outlook. The baseline of infrastructure work is also more positive than we had previously allowed for, following the Government's Budget in May. The Feasibility section later on looks at Wellington Council's planned non-residential and infrastructure construction programme against the backdrop of the broader construction sector's capacity.

Chart 5



Consumer spending squeezed

Consumer spending will be squeezed by higher mortgage rates, continued cost-of-living pressures, and a softening labour market. Rising unemployment tends to make households more cautious in their spending behaviour, as will moderating wage growth. The return of full road user charges (RUCs) and fuel excise duty at the start of July will increase consumers' fuel costs at the expense of other spending.

Household spending grew 9.0% over the last year, but much of that increase in spending has been solely driven by price rises. Once inflationary effects are stripped out of the numbers, consumer spending volumes have increased by a more modest 2.4%. Recently, growth in consumer spending has been artificially boosted by more people coming into the country.

By mid-2024, we forecast that the volume of household spending per person will have shrunk by 2.2%pa. This figure is a worse per-capita contraction than occurred during the Global Financial Crisis and provides the clearest indication of the reversal in households' fortunes as economic conditions become more challenging.

Increased government spending?

Business investment is set to be sluggish over the next 18 months, as firms take advantage of improved labour supply conditions and shy away from committing to major capital expenditure given higher interest rates. However, our outlook for government consumption spending under the current Government is less downbeat.

There is considerable pressure on the fiscal accounts already as tax revenue runs below budget. Yet despite prior talk of spending restraint and reprioritisation, the government's Budget 2023 included increased spending and borrowing. As a result, we expect a 1.4% increase in government consumption during 2024.

A change of government following the October 2023 General Election could change the outlook. National are keener than Labour to reduce the size of government. This reduction will be difficult to achieve through reduced spending on health or infrastructure. Health sector shortages have received plenty of media attention recently.[5] Significant pay equity settlements as well as the recently accepted Te Whatu Ora hospital nurses and midwives collective pay offer will also add to the health bill. Infrastructure priorities may shift with a change of government, but the overall fiscal commitment is unlikely to decline.

Therefore, the most obvious way for a National Government to cut costs is staffing numbers in government departments, perhaps similar to the sinking lid policy we saw between 2008 and about 2013/14 under the previous National administration.

Tourism recovery but outlook uncertain

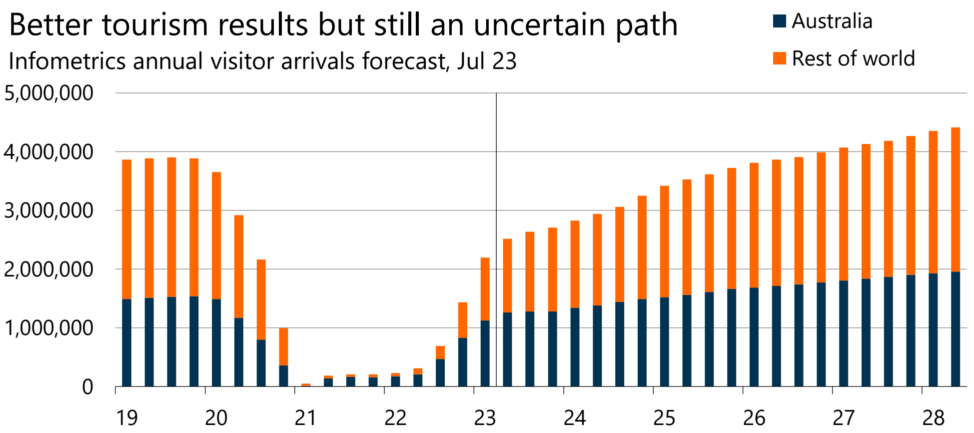
The subdued global economy will continue to act as a drag on the recovery in international tourism. Momentum in Australian arrivals has been slowing, but there is

[5] For example: ambulance ramping at Waikato Emergency Department

continued strength in North American visitor numbers and there are signs of an emerging rebound in visitor numbers from Asia, especially China. Recent announcements of more direct flights between New Zealand and China will help the recovery gather pace.

After a plateau in tourist numbers in 2023/24 induced by the global slowdown, we continue to expect tourism to recover to pre-pandemic levels by the summer of 2026/27. However, we're still uncertain about the longer-term pathway for tourism, and much will depend on how individual markets evolve beyond the next 1-2 years.

Chart 6



Weak export volumes and prices

Commodity prices and goods exports have been weaker than expected with the ANZ Commodity Price index down 14%pa in July 2023.[6] New Zealand's exports will continue to be hampered by the effects of a subdued global economy, especially China. Our goods exports will remain vulnerable to higher cost structures, more stringent environmental requirements, and the vagaries of Chinese demand.

[6] Source: ANZ Commodity Price Index, 3 August 2023

Affordability

In terms of their ability to afford local council rates increases, Wellington households and businesses will find the coming 1-2 years economically challenging, and the subsequent recovery is likely to be weak. Cost-of-living pressures will linger, especially for homeowners transitioning to higher mortgage rates, and many businesses will need to adjust to weaker demand conditions. However, with high employment levels, low unemployment, a highly skilled (and therefore highly paid) workforce, and economically resilient sectors such as professional services, healthcare and public administration, Wellington is arguably better positioned than most areas to weather economic headwinds.

A tough year for households

Like the rest of the country, Wellington households have been feeling the squeeze of rising cost-of-living pressures. Housing and rental affordability have come off recent highs, but housing affordability remains elevated by pre-pandemic standards. Economic and employment growth in Wellington City stuttered through the pandemic. However, high employment levels and rising wages have made cost-of-living pressures easier to bear for many households, with consumer spending volumes rallying so far this year.

Job growth is expected to be weak in the coming two years and we expect an uptick in the unemployment rate. But high employment levels will persist, Cost-of-living pressures will start to ease over the next two years. But the coming year will be particularly difficult for homeowners who transition to higher fixed mortgage rates. By mid-2024 households should be through the worst, but we expect only a gradual recovery in economic fortunes.

Businesses face weaker cost pressures and demand

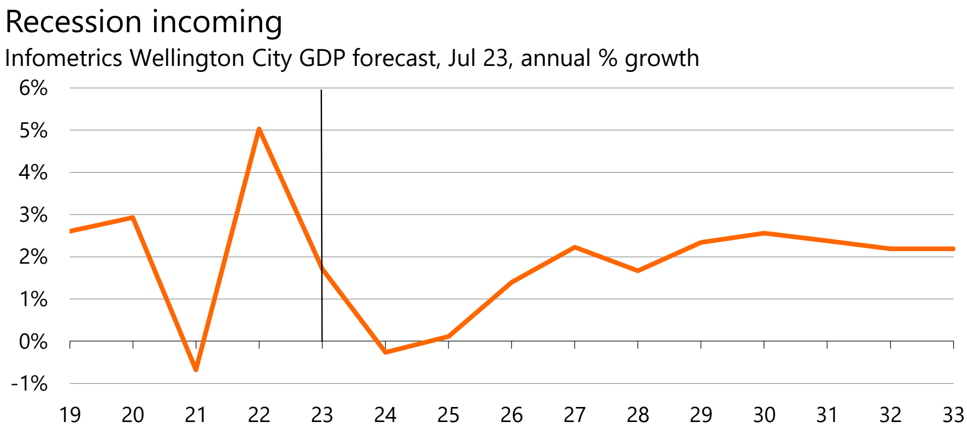
Our discussions with businesses suggest that, although cost pressures have not completely disappeared, they are less acute than they were even at the end of 2022. Many businesses are now more concerned about the expected weakening in demand conditions than about the continuous cycle of cost increases they had been grappling with. If anything, the advent of weaker demand is making it more difficult for firms to pass on cost increases to their customers and, in the retail sector, is leading to a pick-up in discounting compared to what has been seen throughout the last three years.

The effects on businesses of each of their customers spending less will be mitigated by an increase in customer numbers associated with strong net migration. In Wellington City, we expect population and household growth to resume next year, and population increases across the broader Wellington Region will bring more commuters into the city even as some of those consumers spend part of their week working from home.

Recession incoming

On an annual basis, Wellington GDP is forecast to contract 0.3% in the year to March 2024, followed by a weak recovery. The expected contraction in 2024 is relatively shallow compared with the recession that followed the Global Financial Crisis when Wellington's GDP fell 1.1% in the year to March 2012. However, coming at a time of high interest rates and lingering cost-of-living pressures, the year to March 2024 is going to be challenging for both households and businesses.

Chart 7



Slow recovery in consumer and business confidence

Wellington City's high employment levels, highly skilled workforce, as well as several growth or economically resilient sectors, put it in a stronger economic position than many other local economies. If government spending continues to grow (depending on who is in government after the October 2023 General Election), this spending will benefit many parts of the local workforce. However, these local factors will be offset by continued cost-of-living pressures in the near term, the potential for a change of government to usher in cuts in central government staffing levels, and a weak economic recovery further out. Together, this mix of issues points to subdued outlook for consumer and business confidence.

Some industries will fare better than others

Prior to the pandemic, public administration, professional services, and finance and insurance services were the pillars of Wellington City's job growth. During the pandemic, despite overall weak employment growth, Wellington City managed to maintain high employment levels and low unemployment. Compared with pre-pandemic levels, the Wellington construction, healthcare, and public administration industries have seen significant job gains as the local economy adapted to dealing with the pandemic and the housing market experienced a short-lived boom. Most other sectors saw weaker job growth. In contrast, the hospitality and education industries experienced significant job losses and have yet to recover to pre-pandemic levels.

The outlook is for continued job growth in healthcare due to widespread staffing shortages, in public administration and professional services on the back of growth in government spending under the existing Government, in administrative services (which includes travel agencies) and hospitality as the tourism sector continues its gradual recovery and in education as international student numbers gradually recover and Wellington's universities benefit from increases in government funding. All of which will offset smaller declines in finance and insurance, and media and telecommunications – industries which have been shedding jobs for several years now.

As noted earlier, the outlook for public administration could depend on which government is elected in October 2023. A National Government might cut Government spending by reducing central government staffing levels. Such a policy would disproportionately affect the Wellington region, cause uncertainty, lower household confidence, and undermine economic growth prospects for Wellington City. There has also been talk for several years of a regional hubs initiative which would shift public sector jobs away from Wellington to other regions. However, to date only Upper Hutt Regional Campus has been earmarked for delivery in late 2023.[7]

More broadly, with Wellington job ads down 24%pa in July 2023,[8] a rise in the City's unemployment rate may occur in the coming year as weak employment growth is unable to keep pace with a resumption in population growth.

Commuting into Wellington City increases

Wellington City has experienced population decline in recent years partly because workers (and their families) who work in Wellington City are choosing to live elsewhere in the Wellington Region. Improvements to roads and public transport, as well as an increase in working from home means this shift in population to the broader region is unlikely to be reversed.

Pre-pandemic, Wellington City drew in commuters particularly from Kāpiti Coast, Lower Hutt, Porirua City, South Wairarapa, and Upper Hutt. The next direct measurement of commuting flows occurred in the 2023 Census, which has yet to be released. However, between 2018 and 2023 across every District in the Wellington Region bar Wellington City, the number of employed residents rose more than the number of local jobs, which suggests that commuting into Wellington City has increased in recent years.

Increases in commuting into the city have been most likely offset to a degree by an increase in people working from home compared with pre-pandemic levels. In 2006, 23% of people in employment nationally were either able to or were already working from home, rising to 29% in 2018.[9] New Zealand's move to Alert Level 4 on 25 March 2020 led to a spike in 42% working from home in the June 2020 quarter. Post-pandemic, the proportion of people in employment nationally who work from home has remained at around 34% for the past five quarters.[10]

---

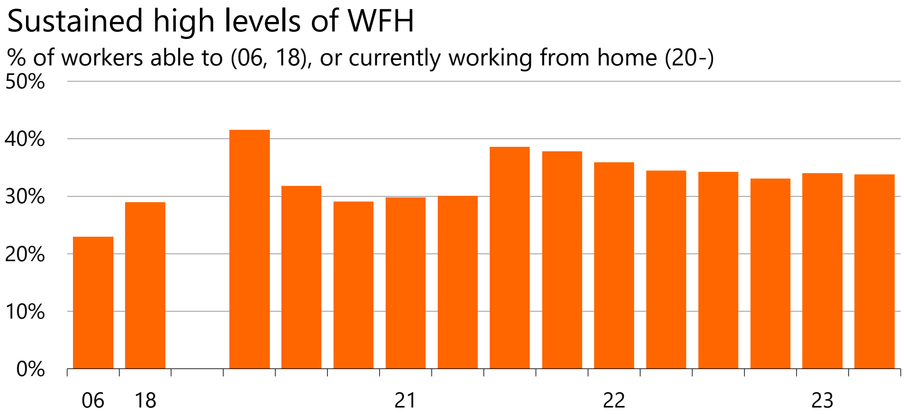
[7] Source: 2022 Government Property Group Satisfaction Survey, Government Property Group, (2022)

[8] Source: Seek NZ Employment Dashboard, July 2023

[9] Source: 2006 and 2018 Census, Stats NZ

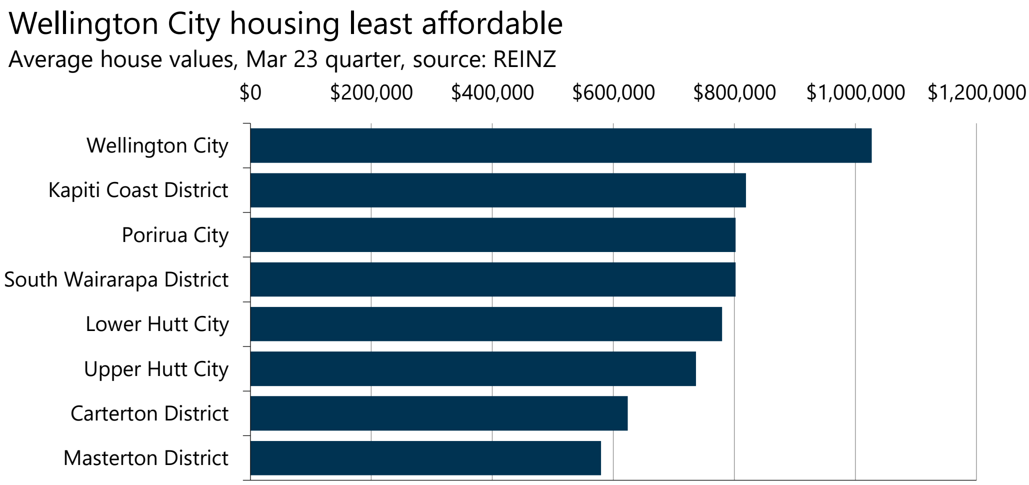
[10] Source: Household Labour Force Survey, June 2023 quarter, Stats NZ. Data from 2006 and 2018 is not strictly comparable with later data as they are from two different sources.

Chart 8



In choosing where to locate, workers (and their families) trade off the cost of housing, amenities, and transport. The average house price in Wellington City is the highest across the Wellington Region (see Chart 9) and the average rent in Wellington City is second highest behind Porirua City. However, commuters from these other parts of Wellington Region face higher travel costs getting into work.

Chart 9



The ability to work from home for at least part of the working week has changed this calculus by reducing the travel costs associated with living outside Wellington City and working in the city. Improvements to SH1, such as the opening of Transmission Gully, have reduced travel times. Plans for additional trains on the Wellington to Masterton and Wellington to Palmerston North lines, as well as station and line upgrades, will reduce congestion on those lines. All of which makes living outside Wellington City more attractive.

Migrants make a welcome return

The recent surge in international migration will have benefitted Wellington industries such as hospitality and administrative services that, pre-pandemic, had a significant migrant workforce. We think the recent surge will be short-lived, with weaker economic conditions translating into more restrained international migration from 2024 onwards. We also expect New Zealand citizens, particularly younger people, living in Wellington to continue to move overseas with economic conditions in countries such as Australia and the UK relative to New Zealand driving the extent of this brain drain.

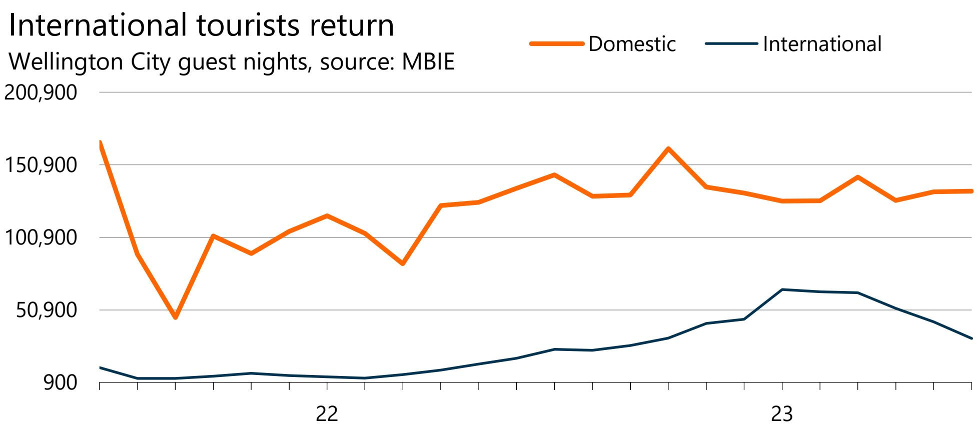
The housing market to remain subdued

House price growth in Wellington is expected to remain subdued for the foreseeable future. High interest rates are expected to forestall any recovery in the housing market in the near term, after which population growth will be offset by continued residential construction and a weak economic recovery.

Weak global economy to undermine tourism recovery

Over the past year there has been a partial recovery in the number of international tourists staying in Wellington City (compared with pre-pandemic levels) while domestic tourism has held firm, leading to a rise in tourism expenditure (see Chart 10).

Chart 10



International visitor numbers have fallen away from their summer highs but as of June 2023, international guest nights in the city were up 78%pa (albeit from a very low base) and domestic guest nights were down only 1.5%pa. We expect the recovery in international tourism to continue through the 2023/24 summer, although weak global economic conditions and continued cost-of-living pressures in key visitor source countries mean it will be several years before international visitor numbers return to pre-pandemic levels.

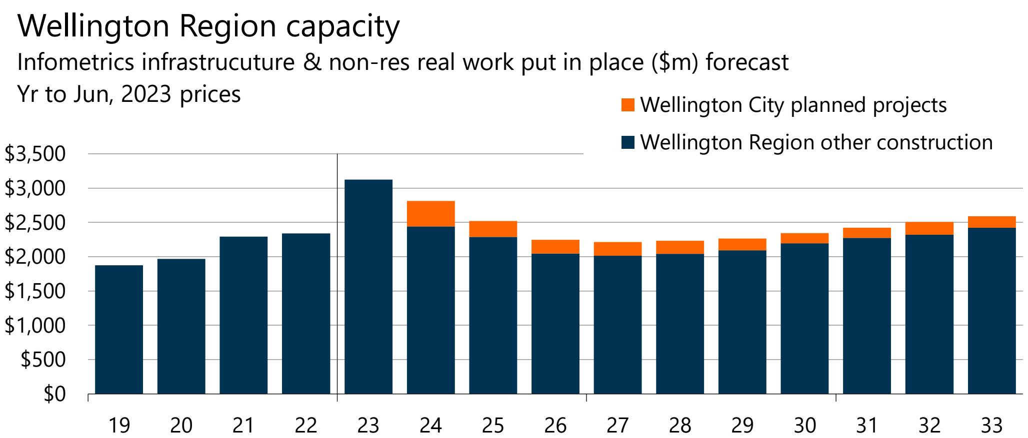
Feasibility

In terms of construction sector capacity, Wellington City's planned infrastructure and non-residential construction projects look feasible in the near term against the backdrop of a forecast of weakening of construction work across the Wellington Region.

Wellington City Council plans to spend just over $2bn (in 2023 prices) on infrastructure and non-residential construction projects over the next 10 years. Here, we look at the City Council's spending in the context of infrastructure and non-residential construction work across the broader Wellington Region. Some types of infrastructure work such as roading can span multiple Territorial Authorities. Therefore, we only forecast infrastructure work across Regional Council areas.

Wellington Council's planned infrastructure and non-residential construction projects are expected to make up between 13% (in 2024) and 6% (in 2033) of total infrastructure and non-residential construction work across the Wellington Region. Infrastructure and non-residential construction work across Wellington Region is expected to have peaked at just over $3.1bn in the year to June 2023, before softening out to 2026, which should create capacity for Wellington City Council's planned construction work (see Chart 11).

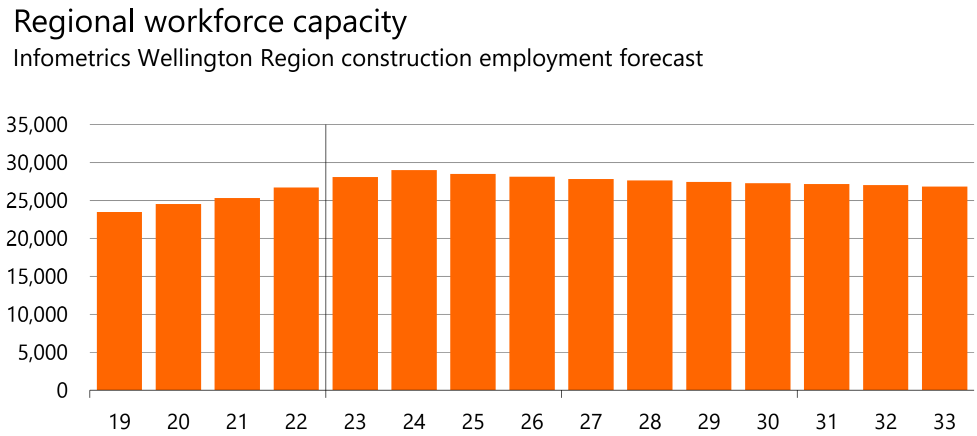
Chart 11



Residential construction work in Wellington Region is expected to fall away even more steeply than non-residential and infrastructure work. Having peaked at over $2.1bn in 2023, high interest rates in the short-term and a weak economic outlook in the medium term are expected to see residential work fall 42% to just over $1.2bn in 2033.

Responding to the peak in workload in 2023, the Wellington Region construction workforce is expected to decline in size from 2025 onwards (see Chart 12). However, ongoing demand for building maintenance and renovations mean this decline is expected to be gradual.

Chart 12



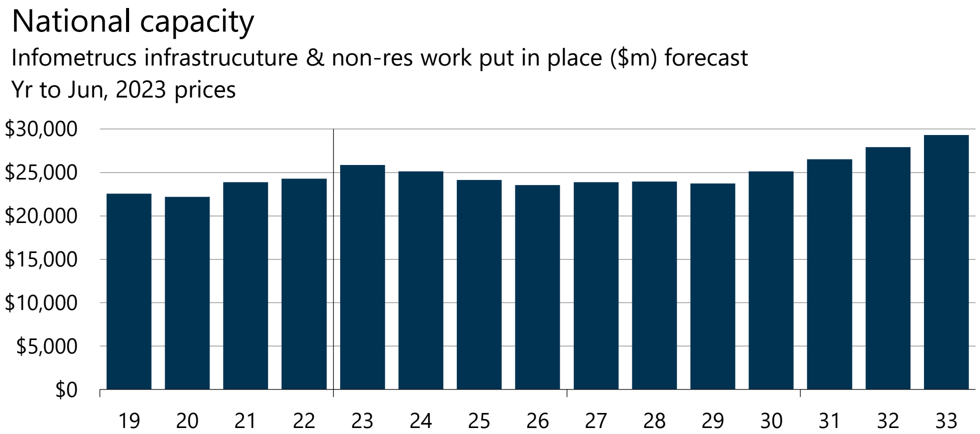
The decline in the size of the region's construction workforce could prove to be steeper than we expect, which could lead to capacity constraints. However, continued growth in the broader Wellington Region workforce, and the construction sector's ability to draw in workers from other sectors when needed mean any constraints are likely to be short lived.

The Wellington Region construction sector has also experienced growth in its migrant workforce in recent years with visa holders and recent residents making up 8.8% of the construction workforce in 2023 compared with 4.5% in 2012. This openness to migrants allows for further workforce flexibility.[11]

Nationally, we expect non-residential and infrastructure construction work to follow a similar trend to that of Wellington Region with a peak in activity in 2023 giving way to a gradual decline in the near term (see Chart 13). Weaker activity nationally should mean that other regions will not need to draw on Wellington Region's construction workforce which should help avoid capacity constrains in Wellington Region. However, there is some uncertainty in these forecasts. The extent of infrastructure damage from Cyclone Gabrielle, particularly in Hawke's Bay, has been difficult to quantify so far. We are currently awaiting announcements from the Government about the extent of recovery spending which will give us a much better idea of the volume of additional construction work needed across weather affected regions.

[11] Source: Migrant Employment Dataset, MBIE

Chart 13


National capacity
Infometrucs infrastrucuture & non-res work put in place ($m) forecast
Yr to Jun, 2023 prices
$30,000
$25,000
$20,000
$15,000
$10,000
$5,000
$0
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33

Appendix 1. Forecasting methodology

We first forecast the overall macroeconomic conditions of the New Zealand economy. Then, we model this down to industries at a national level. We then break down our national industry forecasts to industries at a city and district level, using an array of forecasting models over the short and long term.

Macro-economic forecast

Macro-economic model

Infometrics maintains a macroeconomic forecasting model that underpins our five-year forecasts of activity across the national economy. Our model accounts for the relationships between different sectors of the economy and their responsiveness to one another. These include the labour market, households, businesses, government, the international trade sector, and financial markets.

In times of economic upheaval, we refine the output from the model based on expert input from our forecasting team, their knowledge of rapidly changing trends in the economy, and the insights we gain from our interactions with central government, Councils, Economic Development Agencies, and private sector clients.

Overseeing the forecasting process and model is Gareth Kiernan, who has been forecasting the New Zealand economy for more than 20 years. The framework provides quarterly forecasts of GDP, employment, unemployment, and a range of other macroeconomic indicators up to 2027.

General equilibrium

Infometrics general equilibrium (GE) model enables us to produce long term national forecasts of employment by 55 industries. To obtain projections for a 30-year horizon requires an approach that is based on structural issues such as technological change, industry productivity, demographics, evolving demand for different consumer goods and services, and New Zealand's international competitiveness. The model presents a picture or scenario of the economy for the target years (in our case 2030 and 2050) based on plausible assumptions of economic factors including international commodity prices, population growth, carbon price, automation, changes in energy efficiency, and substitution between four energy types (coal, oil, gas and electricity). Some of the key macro-economic assumptions used in the ESSAM model are shown in Table 1.

Long term forecasts should ideally be presented as scenarios given the uncertainty of the future. In this project we will present a central scenario which is based on a central view of a range of factors that can influence employment outcomes over the long term.

Infometrics GE model is maintained by one of New Zealand's foremost econometricians, Dr Adolf Stroombergen.

Table 1. ESSAM macro-economic assumptions and outputs

Indicator	2025-2030	2030-2050
Growth rates		
Population	1.0%pa	1.0% pa
Labour force	0.7%pa	0.46%pa
GDP	2.9%pa	1.7%pa*
World trade	2.7%pa	2.5%pa
Public investment	3.0%pa	2.5%pa
Government consumption	2.1%pa	1.7%pa
Investment in dwellings	2.0%pa	1.0%pa
Real prices		
Oil price	US$110/bbl in 2030	US$110/bbl in 2050
Carbon price	NZ$100/tonne CO_2 in 2030	NZ$200/tonne CO_2 in 2050

* These are model results, not input assumptions.

Regional Forecasting Model

The Regional Forecasting Model (RFM) is an econometric model which breaks national employment forecasts to detailed industry and regional level. It draws on Infometrics 20-year quarterly time series of employment by detailed industry by territorial authority. The model uses a mix of top-down and bottom-up approaches. It simultaneously provides forecasts for all industries in all territorial authorities that are constrained to be consistent with Infometrics macroeconomic forecasts for the national economy in the medium term and the outputs of the GE model in the long term.