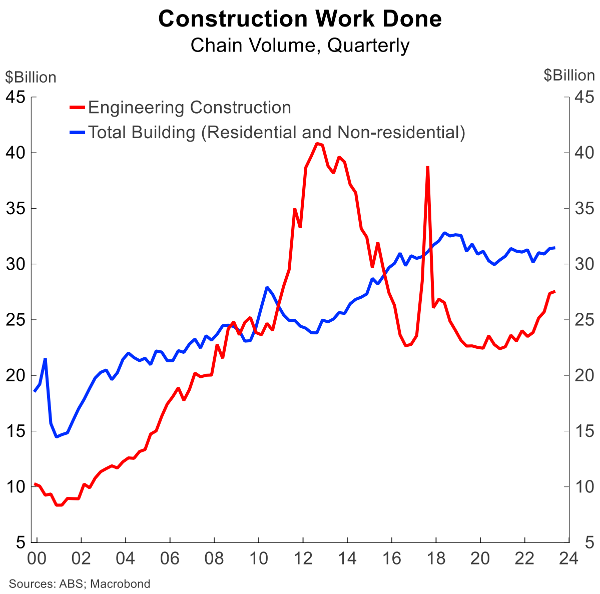
Data snapshot

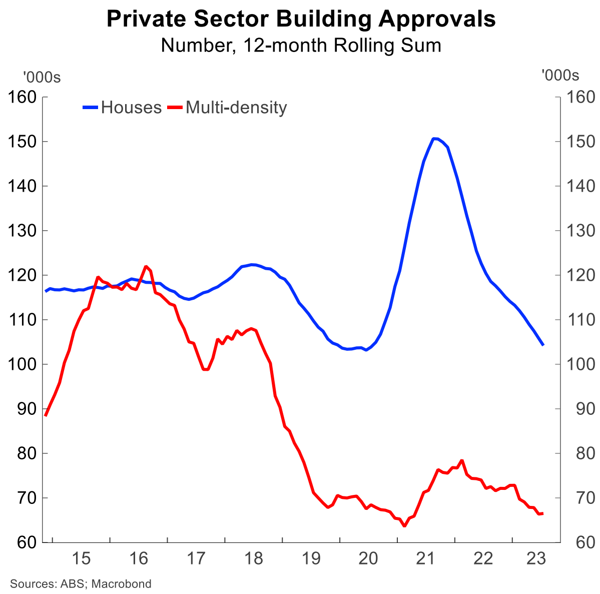
Bank of Melbourne

Wednesday, 30 August 2023

Construction Activity Update
Resi Construction Proving Achilles Heel

- **Construction activity rose a modest 0.4% over the June quarter. However, the strength of the result was masked by a large upward revision to activity in the March quarter. In level terms, construction activity was at its highest level since the June quarter of 2018.**
- **Engineering (infrastructure) and non-residential (commercial/office/industrial) construction underpinned the pickup in construction activity. Non-residential construction rose to its highest on record while public sector engineering construction also reached a record high.**
- **Residential housing construction is yet to hit its stride. Disruptions in the residential construction sector are the likely catalyst. Residential builders continue to face supply issues and are struggling to compete for labour with large public infrastructure projects draining a large share of the talent.**
- **Building approvals continued to trend downwards in a volatile fashion in July, a trend well-entrenched since early 2021. Governments at all levels have taken notice of the prolonged downswing in new approvals and are pulling some levers to try and lift approvals.**
- **However, the challenge for housing supply lies with disruptions in the sector and subdued construction activity. Until this is addressed, we are unlikely to see the supply response necessary to ease the housing market imbalance.**





Construction work done

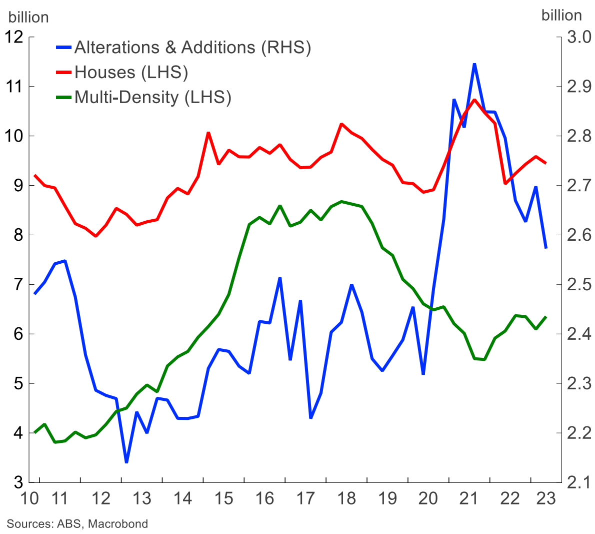
Construction activity rose a modest 0.4% over the June quarter. However, the strength of the result was masked by a large upward revision to activity in the March quarter, from 1.8% to 3.8%. This means that in level terms, construction activity was solid. In fact, the value of construction work completed in the June quarter was its strongest since the June quarter of 2018, notwithstanding the underwhelming quarterly growth.

The underlying improvement in activity reflects the continued easing of supply disruptions, less delays from adverse weather and some, albeit minimal, relief in labour shortages. However, there is considerable divergence in construction activity across sub-sectors.

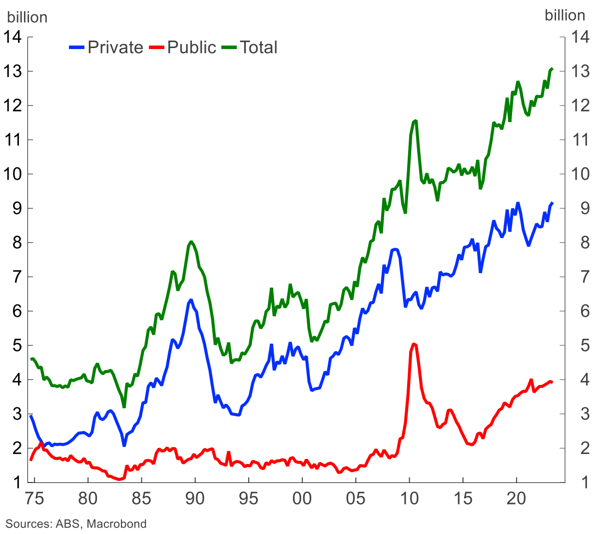
Residential housing construction is yet to hit its stride and has so far been slow in making headway into the large pipeline of construction work yet to be completed. Disruptions in the residential construction sector are the likely catalyst, with further contagion a big risk to residential construction activity moving ahead. Residential builders are also still facing supply issues and are struggling to compete for labour with large public infrastructure projects draining a large share of the talent.

Residential construction activity was flat in the June quarter and at around $18.4 billion, the value of work completed was about 2.9% below the 10-year average. There are some interesting dynamics unfolding within the residential construction industry. Renovation activity is continuing to cool from it's meteoric high's underpinned by pandemic policies. Alteration and addition activity tumbled 4.7% in the June quarter but remains 4.3% above the 10-year average level. Meanwhile, housing construction activity looks to be stabilising undergoing a similar fall from elevated levels and multi-density construction is entering a tentative upswing but is far from the glory days of 2016 to 2018.

Residential Construction Work Done
Value, Chain Volume



Non-Residential Construction Work Done
Value, Chain Volume



Most of the strength in construction activity is owed to engineering (infrastructure) and non-residential (commercial/office/industrial) construction. Non-residential construction activity lifted 0.6% in the June quarter to $13.1 billion, the highest on record. Strength in non-residential construction has been broad based across both the public and private sector with activity running at 25.6% and 12.3% above the 10-year average, respectively.

Engineering construction, which rose 0.7% in the June quarter, was running around 2.1% above the 10-year average at $27.6 billion. However, the public sector was doing the heavy lifting here.

Public sector engineering construction rose 0.2% in the June quarter to a record high $12.4 billion – more than 35% above the 10-year average.

Building Approvals

Building approvals continued to trend downwards in a volatile fashion in July, a trend well-entrenched since early 2021.

Total approvals fell 8.1% in the month and are now running at around 27% below their 10-year average. This was driven by a 3.1% fall in private sector house approvals and amplified by a characteristically volatile 19.9% fall in multi-density approvals. Private sector house and multi-density approvals are currently sitting 17.3% and 39.8% below their 10-year averages, respectively. In other words, a deep and prolonged downswing in new approvals is underway which means the pipeline of construction work is not being replenished.

This is happening on the backdrop of a record increase in the population. Governments at all levels have taken notice and are trying to pull some levers to get approvals up and running to fill this potential void. However, the challenge for new supply lies with weak residential construction activity. Additionally, these disruptions are feeding back into investment decisions and impacting the rate of new approvals. Until this is addressed, we are unlikely to see the supply response necessary to ease the pressure valve in the residential property market.

Outlook

In aggregate construction activity is relatively robust but is failing to accelerate meaningfully. This is being largely driven by the divergence in activity between the residential and non-residential/engineering construction sectors. Without action to address the disruptions in the residential construction segment, supply disruptions and delays and acute labour shortages, we are unlikely to see a meaningful lift in construction work.

Additionally, while steps have been taken by governments to prompt a rise in new residential developments, we are unlikely to see a sustained turn in approvals until some of the pressures in the construction process are addressed. Or at the very least, a recovery in new approvals will be slow to translate into new supply due to the ructions in the construction industry.

Jameson Coombs, Economist

Ph: +61 401 102 789

Contact Listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
+61 404 844 817

Senior Economist
Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
+61 481 476 436

Senior Economist
Pat Bustamante
pat.bustamante@bankofmelbourne.com.au
+61 468 573 786

Economist
Jameson Coombs
jameson.coombs@bankofmelbourne.com.au
+61 401 102 789