



WT



NEW ZEALAND CONSTRUCTION MARKET CONDITIONS REPORT

December 2023

INTRODUCTION

ESCALATION IS CERTAINLY EASING, BUT WHEN WILL CONDITIONS RESEMBLE THOSE SEEN IN PRE-COVID YEARS? AND HOW MIGHT THE OUTLOOK DIFFER BY SECTOR AND BY MARKET?

Despite the challenges posed by government changes and natural disasters in New Zealand, it's important to recognise that such events can act as catalysts for positive transformation and offer opportunity for growth and innovation.

The change in government, while posing near-term spending cuts and project cancellations, also presents an opportunity for collaboration and finding solutions that can lead to more efficient and sustainable construction practices.

In this concise update, WT remains dedicated to providing valuable insights into the construction market, specifically in the Building and Infrastructure sectors in New Zealand. Our objective is to establish a comprehensive framework that sheds light on the events, causes, and forecasts of areas of interest, enabling a clear understanding of the market situation. We are committed to assisting our clients in understanding the market and navigating through the changing landscape to ensure long-term success.

WT VIEW ON NEW ZEALAND COST ESCALATION BY KEY MARKET – BUILDING

	2020	2021	2022	2023	2024	2025	2026
AUCKLAND	2.0%	6.0%	13.0%	4.0%	2.5%	4.5%	3.5%
WELLINGTON	3.0%	4.0%	11.5%	5.0%	3.5%	3.0%	4.0%
CHRISTCHURCH	1.0%	6.5%	14.0%	5.5%	3.0%	3.5%	4.5%
QUEENSTOWN	4.0%	2.0%	17.0%	6.5%	5.0%	7.0%	3.8%

WT VIEW ON NEW ZEALAND COST ESCALATION BY KEY MARKET – INFRASTRUCTURE

	2020	2021	2022	2023	2024	2025	2026
AUCKLAND	1.0%	5.0%	15.0%	5.3%	4.0%	5.0%	5.5%
WELLINGTON	1.0%	2.5%	12.0%	6.0%	3.5%	4.5%	4.0%
CHRISTCHURCH	-1.0%	6.5%	16.0%	4.0%	3.5%	3.0%	5.0%
QUEENSTOWN	1.5%	3.5%	15.5%	6.5%	4.5%	5.0%	5.0%

NEW ZEALAND COST ESCALATION BY INPUT – BUILDING

- IMPROVES ESCALATION SIGNIFICANTLY (-)
- IMPROVES ESCALATION SOMEWHAT (-)
- HAS NO REAL IMPACT ON ESCALATION (0)
- MAKES ESCALATION SOMEWHAT WORSE (+)
- MAKES ESCALATION MUCH WORSE (+ +)

	2023	2024
LABOUR (DIRECT)	MAKES ESCALATION MUCH WORSE (+ +)	MAKES ESCALATION SOMEWHAT WORSE (+)
MATERIALS	MAKES ESCALATION MUCH WORSE (+ +)	MAKES ESCALATION SOMEWHAT WORSE (+)
PLANT & EQUIPMENT	MAKES ESCALATION MUCH WORSE (+ +)	MAKES ESCALATION SOMEWHAT WORSE (+)
ENERGY	MAKES ESCALATION MUCH WORSE (+ +)	MAKES ESCALATION SOMEWHAT WORSE (+)
FREIGHT	IMPROVES ESCALATION SOMEWHAT (-)	HAS NO REAL IMPACT ON ESCALATION (0)
EXCHANGE RATES	MAKES ESCALATION SOMEWHAT WORSE (+)	MAKES ESCALATION SOMEWHAT WORSE (+)
INDIRECT COSTS	MAKES ESCALATION MUCH WORSE (+ +)	MAKES ESCALATION SOMEWHAT WORSE (+)
TOTAL	MAKES ESCALATION MUCH WORSE (+ +)	MAKES ESCALATION SOMEWHAT WORSE (+)

NEW ZEALAND COST ESCALATION BY INPUT – INFRASTRUCTURE

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TOTAL	MAKES ESCALATION MUCH WORSE (+ +)	MAKES ESCALATION SOMEWHAT WORSE (+)

KEY POINTS TO ESCALATION OUTLOOK – BY YEAR

2023

- While the extraordinary circumstances of 2021 and 2022 have now largely passed, escalation remains at levels not seen during the 2010s and rarely in prior years.
- Building's somewhat stronger market conditions are expected to see escalation nationally finish at 6%, and between 4 and 6.5% in Auckland, Christchurch, Queenstown, and Wellington (where WT New Zealand's offices are located). For Infrastructure, escalation should come in at 5.5% nationally, and between 4 and 6.5% in those cities.

2024 and 2025

- New Zealand is expected to enter recession in 2024. This will impact construction activity – Building more so than Infrastructure – although elevated population growth and a healthy lead (in some sectors and regions) from consents suggests this impact may be softened.
- Escalation is forecast to fall back to around 3% across the larger cities (Building) and 3.5-4.5% (Infrastructure).

2025 and 2026

- While recession is expected to continue, at least for the first half of 2025, the likelihood of recovery (timing and magnitude) will be crucial to escalation.
- In some sectors, more so in larger markets such as Auckland, tangible signs of recovery may see a flurry of projects come to market – and a surprise escalation jump. But elsewhere, persistent weakness may see escalation fall further, although the negative supply response will put a floor under falls.
- Conversely, likely improved conditions in 2026 could see a positive capability response, keeping a lid on escalation despite higher activity.
- In all, 2025 should see escalation largely at 3-4.5% (Building) and 3 to 5% (Infrastructure). For 2026, escalation of 3.5 to 4.5% (Building) and 4 to 5.5% (Infrastructure) is forecast across our cities. For Queenstown, escalation (Building) is set to remain strong (7% in 2025) before falling below 4% in 2026.

Late 2020s

- Escalation could oscillate around elevated levels for a prolonged period later this decade.
- Key factors here may include strong (overseas-led) population growth, elevated levels of construction activity (in order to prioritise resilience of infrastructure and to rebuild after natural disasters), and persistent stretched capability of the construction labour force.
- New Zealand's existing advantage in renewable energy (vs. a country such as Australia) will mean less resources will need to be committed to construction of new green power during this time (to satisfy Net Zero mandates). Hence, the escalation impact of this into the medium-term is less likely to be as significant as in other countries.

ECONOMIC OUTLOOK, IMPLICATIONS FOR CONSTRUCTION AND COST ESCALATION

THIS SECTION EXPLORES THE GENERALLY CLOSE LINKS BETWEEN THE ECONOMIC AND CONSTRUCTION OUTLOOKS. THIS MAY BE ESPECIALLY USEFUL, GIVEN EXPECTED ECONOMIC TURBULENCE AHEAD.

The New Zealand economy has shown increasing signs of weakness through 2023. While not yet at the widely expected stage of recession, developments suggest this outcome is at best delayed. With that said, some surprisingly buoyant sectors are likely to mean any recession is softened.

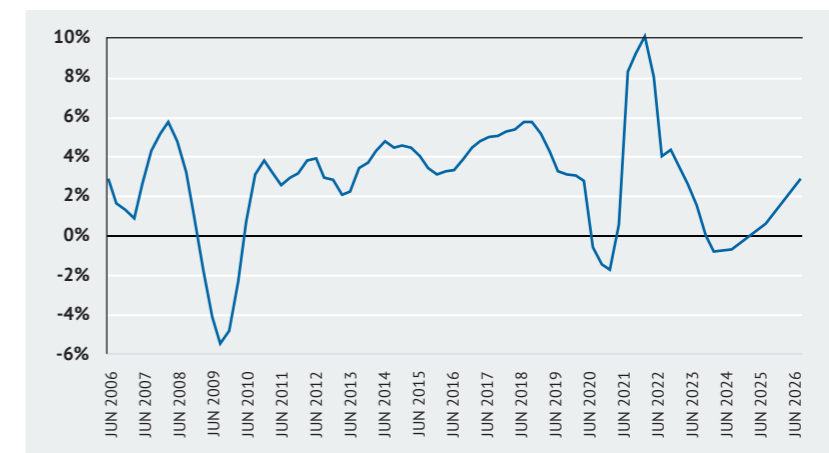
New Zealand shares many aspects to a number of developed economies, which saw the need for sharp increases in borrowing costs aimed at reining in inflation (currently just below 7%, a 33-year high) to try to maintain sustainable economic momentum. This task was more urgent in New Zealand due to the persistent strength of some soft commodities prices (e.g., food, dairy etc.), which boosted national income. These borrowing cost increases have weighed on household consumption growth, although it remains in low-positive territory despite record-low consumer confidence.

At the same time, the contribution to economic growth from other sectors has slowed. This has been seen from the winding back of extraordinary pandemic-related public spending, as well as investment activity (i.e., undertaking upgrades or new spend on productive capacity) reaching a plateau across private and Government sectors.

In all, gross national expenditure (GNE) (i.e., Gross Domestic Product (GDP) less overseas trade – so economic activity most closely focused on domestic conditions, including construction) is set to turn negative in annual change terms by the end of 2023. It is expected to remain negative through 2024 with recovery only gaining traction from the back half of 2025.

GROSS NATIONAL EXPENDITURE (GNE)

Annual % Change¹



ECONOMIC OUTLOOK, IMPLICATIONS FOR CONSTRUCTION AND COST ESCALATION CONT.

The likely impact on the economic outlook from Government may be a key contributor. The recently released Pre-Election Economic and Fiscal Update² highlighted the deteriorating state of public finances. This lays the platform for the newly Elected Government to make spending cuts or other generally unpopular measures (so as to undertake necessary 'fiscal repair' early on in the electoral cycle; a traditional political approach) in addition to the project cancellations already announced.

While this would play a key role in the magnitude and extent of economic weakness, the strength of population growth (and how long this is sustained for) is also important. New Zealand's closed borders policy being maintained for longer meant population growth remained flat until well into 2022 but has since made up for lost time: should the pace of growth have continued into the September quarter (as initial data suggests), then annual growth will hit a long-term high (2.3%).

Historically, elevated population growth – especially, but not only, growth sourced from migration – can wane during periods of economic weakness. But if New Zealand's growth can be maintained or strengthened, this will support near-term economic growth, while boosting growth further out, due largely to additional construction required.

Implications

This phenomenon – elevated population growth supporting construction activity – is already being played out. Annual population growth leading into 2020 rose to 2.3%, which has helped drive growth in non-residential construction activity to exceed 17% by mid-2023. This is the fastest pace of growth since the mid-1990s and has been important in supporting the economic outlook.

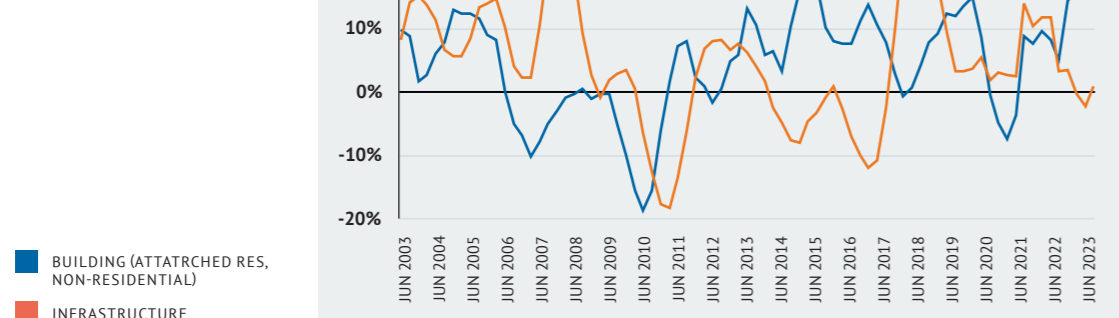
In addition, Building, as defined in this report, includes attached residential construction (typically, but not exclusively, apartments). Sustained growth in construction activity in this sector since the early 2010s has seen it become almost as large as non-residential. For context, it was ~15% of non-residential activity in 2010.

This has seen Building activity double in size over the last 9 years. Part of this has come at the expense of detached residential (i.e., housing) construction, but otherwise Building's capability (to deliver output without significant escalation) has become increasingly stretched. This has been an underrated factor in strengthening escalation in recent years.

For Infrastructure construction, however, while it continues to trend higher, it has largely stabilised over the last year, following notable growth episodes through 2018 and 2021.

CONSTRUCTION BY BROAD SECTOR

Annual % Change²



The recent trends by broad sector may switch around in coming years. Non-Residential's elevated standing suggests a peak in activity may be close in any event. However, with a recession set to unfold over the next 2 years, this points to non-residential being impacted more than most.

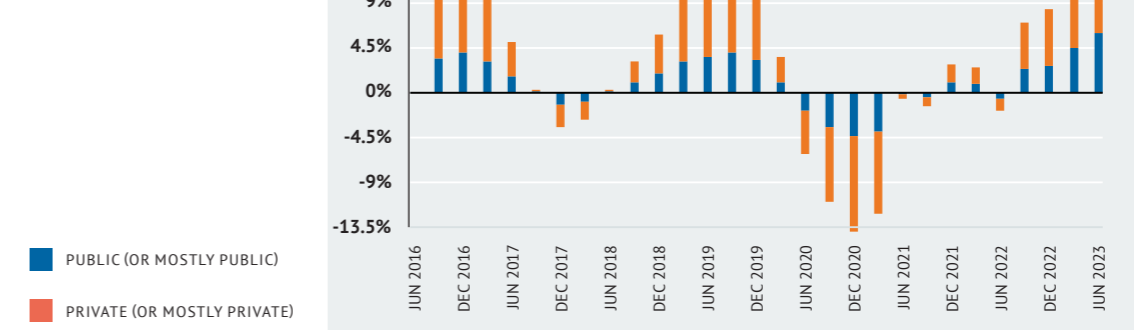
Should population growth also lose some impetus (as is often the case, if economic weakness is felt across much of the world), this adds to the case for weaker non-residential activity but also for attached residential. This may even be the case if attached residential's share of total residential continues to climb.

From an escalation perspective, this suggests risks are to the downside (i.e., the risk is greater for escalation to come in below our forecast than above our forecast). The key factor to consider will be the 'supply response' of the sector to any notable weakness in activity. If this is largely the same as is currently the case, it increases the chance of much weaker escalation.

For Infrastructure, an asset class which tends to benefit from counter-cyclical investment by Governments (as a means of providing support to a weakened economy), the looming recession and recent weakness in activity suggests increased investment may be likely. This could see a higher floor for escalation, although the exact nature of increased spending will be important here.

NON-RESIDENTIAL BUILDING

Growth by Source⁴



Lastly, we have considered a breakdown of non-residential activity to help understand what proportion of activity may be vulnerable to cuts to Government spending.

While the share of building due to Government-led sectors has risen steadily, it is the private sector that continues to account for the majority of spending. Of course, the private sector-led activity is also vulnerable to a recession, but it suggests an examination of each sector's outlook and drivers may be more important.

Of the largest non-residential sectors, those related to industrial and logistics (i.e., those linked to soft commodities and to disruptions to demand for consumer goods) should be insulated. However, those related to the commercial sectors (i.e., retail and offices) may be elevated risk, although uncertainty around the permanence of remote working may see office activity remain robust.

Our detailed analysis of contributors to escalation by construction component follows.

ESCALATION COMPONENT ANALYSIS

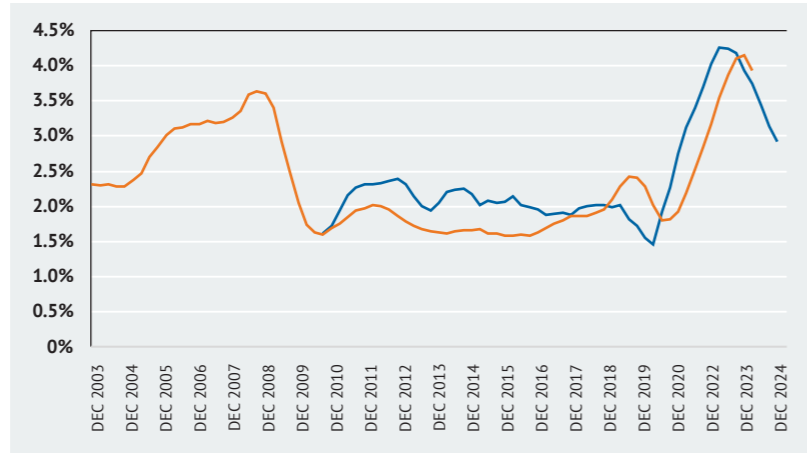
LABOUR



NZ – CONSTRUCTION WAGES

Annual % Change⁵
(calendar years:
2023 – estimate,
2024 – forecast)

■ CONSTRUCTION
■ ALL INDUSTRIES



Recent Trends: The prolonged period of steady construction wages growth for most of the 2010s masked a consistent march forward of construction activity (i.e., demand). When the growth in activity continued after the onset of the pandemic, this saw sector capability approach its limits and wages growth shoot up to 4.25%. While data only goes back to 2011, the close relationship with total wages growth suggests 4.25% is a long-term high.

Looking Forward: While signs point to a looming recession and to an increased supply of construction labour (via increased immigration), wages growth may still rise a little higher on the back of momentum from existing projects. However, the impact from weaker economic activity, a likely cut in Government spending and increased construction labour should see wages growth moderate through 2024.

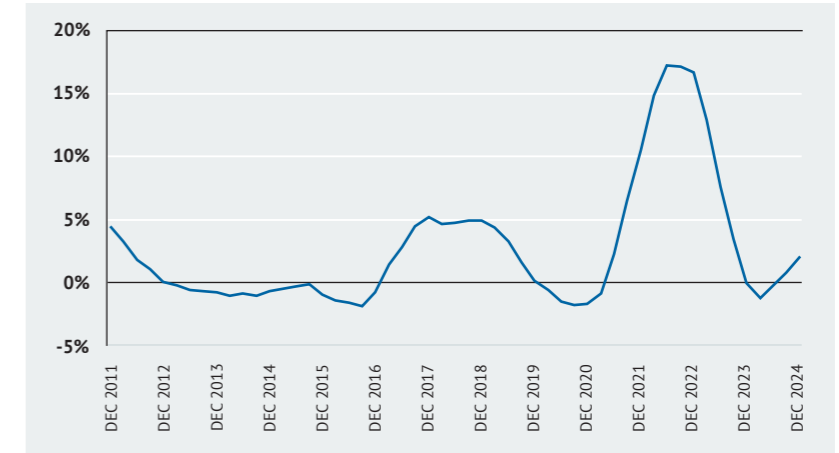
With that said, we expect it to remain above that seen during the 2010s, at least through 2024. This may not persist through 2025, should the recession persist, but a medium-term projection, given population growth is likely to remain elevated, suggests a strong outlook for construction activity and an environment of above-average wages growth and ongoing skills shortages.

MATERIALS



NZ MATERIALS COST INDEX

Annual % Change⁶
(calendar years:
2023 – estimate,
2024 – forecast)



Recent Trends: While the annual change remains above 7%, quarterly falls since the final quarter of 2022 will likely translate to an annual decline in our materials cost index over 2023. This is despite local construction activity marching higher during this time, which emphasises the importance of supply chain disruption and temporary construction stimulus in larger external markets of driving materials costs.

Looking Forward: Despite the expected recession and associated weakness in some areas of construction, materials costs are likely to move higher in 2024. This could be due to a range of factors, including a weaker NZD and higher energy costs, but the importance of a (negative) supply response to a weaker economic/construction outlook (and this putting a floor under weaker escalation) cannot be understated.

Towards 2030 and beyond, the shift towards 'greener' materials and methods will see upward pressure on materials escalation. However, the magnitude of this contribution will be ultimately determined by how fast this shift takes place (in New Zealand but also in key external markets, such as Australia and China).



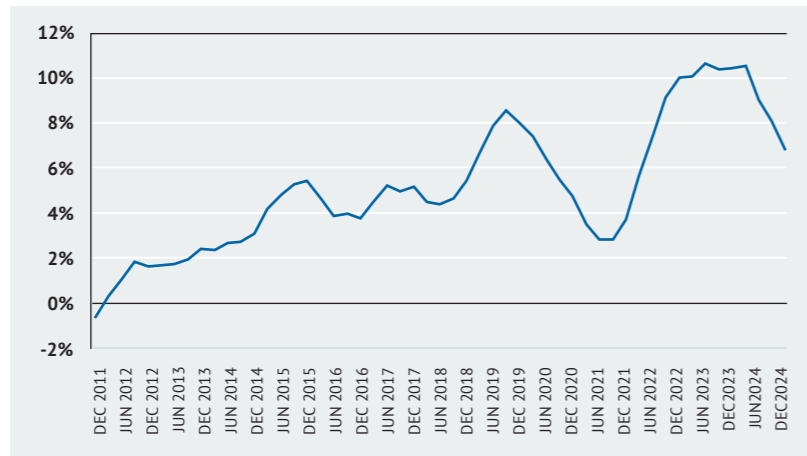
ESCALATION COMPONENT ANALYSIS CONT.

PLANT & EQUIPMENT



NZ – RENT OF PLANT, MACHINERY & EQUIPMENT

Annual % Change⁷
(calendar years:
2023 – estimate,
2024 – forecast)



Recent Trends: Plant and equipment costs have seen pressures persist for longer than many other cost categories. This has been due to the presence of ongoing supply chain issues for some types of equipment but also industry concerns in major plant and equipment producing regions: shutdowns (due to soaring energy costs) in Europe and falling price (via excess supply) issues in China.

Looking Forward: The persistence of these drivers may see escalation rise further or remain at very high levels for some time yet. Our most likely outlook suggests these drivers will begin to weaken but for escalation to remain fairly high in 2024, with further moderation thereafter as these sector issues move closer to resolution.

WT New Zealand Quantity Surveying Project: Park Hyatt, Auckland

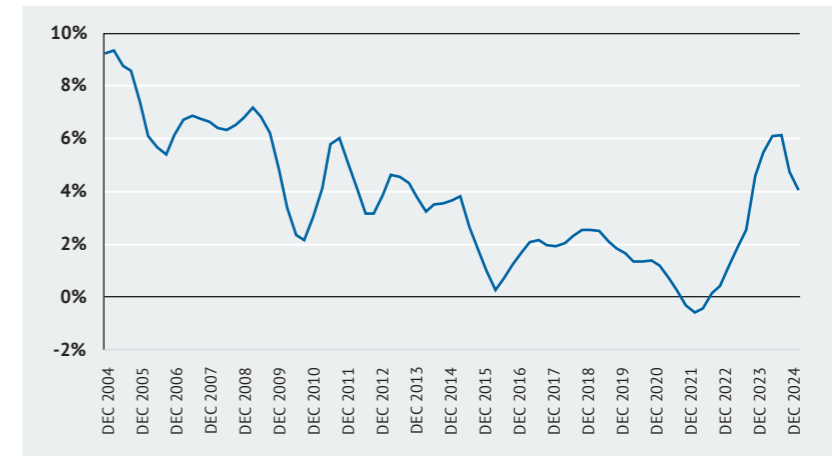


ENERGY



NZ ENERGY (ELECTRICITY) CPI

Annual % Change⁸
(calendar years:
2023 – estimate,
2024 – forecast)



Recent Trends: With wholesale prices having spiked at various times (not just due to the beginning of the Russo-Ukraine War in early 2022) in recent years, this has now translated into strengthening energy prices more generally (as seen in Consumer Price Index (CPI) data). Annual energy price growth (CPI) hit a ten-year high in the June quarter, with more likely before the peak is reached.

Looking Forward: Escalation here should start to moderate during 2024, with the lead from wholesale prices having softened over the last year or so. With that said, we don't necessarily expect this moderation to be swift, with annual escalation remaining above 4% through 2024. Of course, this has escalation ramifications for direct as well as indirect (i.e., energy-intensive building materials manufacture) energy use.

WT New Zealand Project Management Project: Auckland International Airport Limited



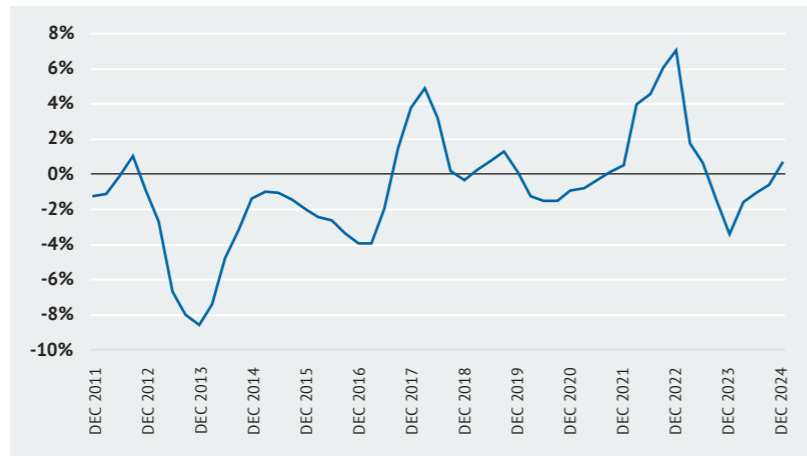
ESCALATION COMPONENT ANALYSIS CONT.

FREIGHT



NZ – WATER
TRANSPORT OF
FREIGHT COST INDEX

Annual % Change⁹
(calendar years:
2023 – estimate,
2024 – forecast)



Recent Trends: While spot rates on global shipping markets have received much attention over recent years, market-wide data on freight rates (encompassing spot as well as contract rates, for domestic and overseas freight) are somewhat less spectacular. The COVID-led, supply chain disruption-induced spike is still there, as is the decline into negative territory seen during 2023, but all at much more measured levels of change.

Looking Forward: Although demand (from New Zealand construction) is set to stabilise and perhaps decline during 2024, the supply response from the freight sector – not just to conditions in construction, but likely weaker conditions more generally – should see a floor during 2024, with escalation back around zero.

There is the potential for another leg down during 2025, perhaps due to prolonged recessionary conditions but more likely due to new global shipping capacity (from orders made during the boom shipping conditions of 2021 and 2022) putting downward pressure on shipping costs.

WT New Zealand Advisory Project: Heke Rua Archives Building, Wellington

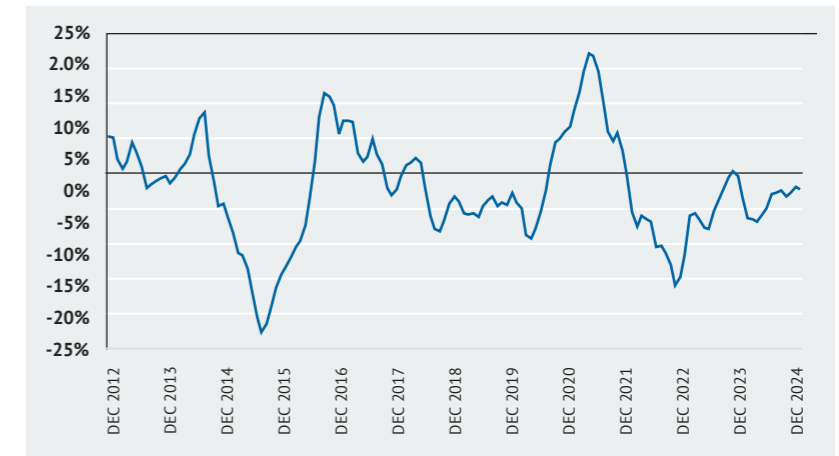


EXCHANGE RATES



NZD / USD
EXCHANGE RATE

Annual % Change¹⁰
(calendar years:
2023 – estimate,
2024 – forecast)

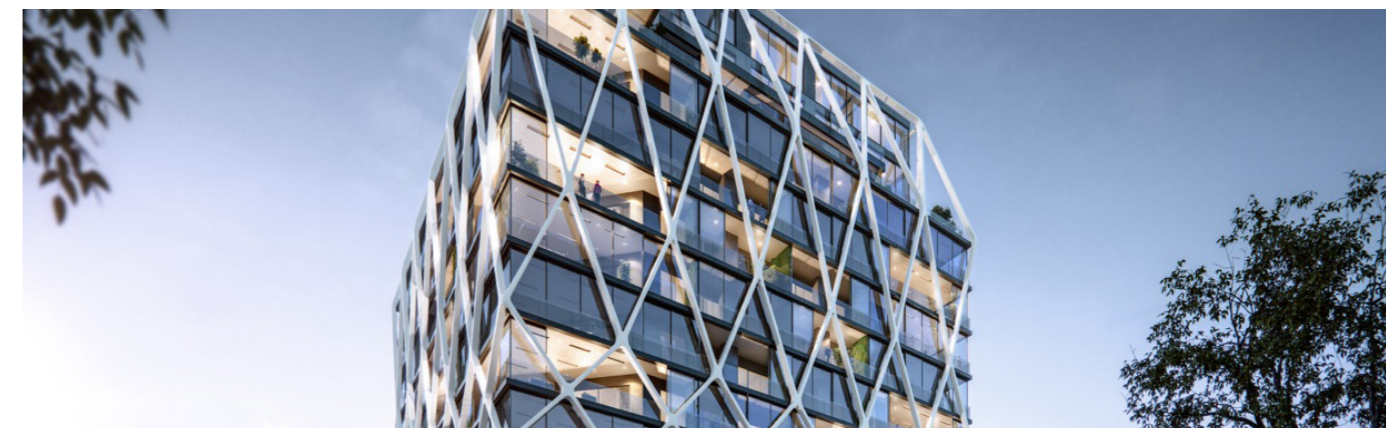


Recent Trends: While the NZD / USD exchange rate is not the only exchange rate used for the importation of construction resources, it is the most dominant one and is generally the best barometer of the strength of a given currency. Coming off the weak performance during 2022, the NZD is set to see an improved performance vs. the USD over 2023, although still likely to record a fall in buying power. A falling NZD vs. the USD in annual terms (which puts upward pressure on escalation (all else being equal)) is the typical state of affairs, although there can be periods where the NZD turns the tables. These typically include when soft commodities (e.g., food, dairy, wool) are seeing elevated prices, as was the case during 2022.

Looking Forward: Despite prospects of a recession across many global markets during 2024 or 2025, there is the prospect of rising food and other soft commodity prices for a range of factors. These include the ongoing Russo-Ukraine War and the onset of El Nino conditions in the western Pacific (including Australia and New Zealand, an important source of food supply globally).

However, this does not guarantee a stronger NZD. In uncertain or recessionary conditions, a flight to safety (i.e., elevated demand for USD) and/or commodity countries collectively seeing weaker exchange rates (be they soft or hard commodity countries) can still arise. Our view is the NZD / USD to weaken further during 2024, but with conditions for improvement to increase (and hence some downward pressure on escalation (all else equal)) from 2025.

WT New Zealand Quantity Surveying Project: The International, Auckland



ESCALATION COMPONENT ANALYSIS CONT.

INDIRECT COSTS (INCLUDING PRELIMINARIES, DESIGN, OVERHEADS) \$

PROFESSIONAL SERVICES WAGES

Annual % Change¹¹
(calendar years:
2023 – estimate,
2024 – forecast)



Recent Trends: Indirect construction costs (often known as ‘Indirects’) typically include wage costs for white-collar labour and other costs generally linked to the CPI. Like many other cost categories, Indirects have been at long-term highs, with white-collar construction wages having hit a long-term high in mid-2022 and the CPI just off 33-year highs and still above 6%.

Looking Forward: In contrast to construction labour, available evidence suggests demand for white-collar labour is not as robust as its construction cousin. It is also more likely to be impacted by increased supply from immigration. This points to a faster decline in white-collar labour wages growth through 2024 – however, this is still likely to see escalation remain above levels seen for most of the 2010s.

CPI inflation is slated to fall back within the Reserve Bank of New Zealand’s medium-term target range (1-3%) during the 2025 financial year. Developments and data releases, both locally (e.g., quarterly inflation updates) and externally (e.g., decisions by central banks in markets such as the US and Australia) will play an important role in how fast and how hard CPI inflation reverts.

WT New Zealand Quantity Surveying Project: The Pacifica, Auckland



IMPLICATIONS AND RISKS

Implications

Labour – Capability:

- Ongoing growth in construction, augmented by COVID stimulus and population growth-elevated underlying demand, has seen construction’s share of the labour force hit 10.8% in early 2023.
- Australia, a leader in construction workforce proportion, peaked at 9.7% in 2020. This suggests ongoing tightness in construction labour, even allowing for the looming recession.

Pace of Adherence to Global Climate Targets:

- The landscape for materials cost escalation is set to undergo transformation as the market fully incorporates Net Zero mandates. This transformation will not be instant but will be driven by the pace at which the market can absorb the generally increased costs linked to ‘greener’ construction materials and/or methods of production.
- New Zealand is better placed than most, given it has a greater share of energy production from renewable methods than many others, but there is still significant adjustment ahead especially for energy-intensive materials largely or solely produced locally.
- From an escalation perspective, the main impact will be in the ‘fast growth’ segment of the S-curve (the well-established theory of how new technology or ideas spread through a community), i.e., when the pace of adoption of the new material or method of production is at its fastest. This is not likely to be until the 2030s, but this may come forward into late 2020s.

Sector slack vs. Resilience / Natural Disasters:

- The recent strength or tightness of various construction indicators implies little room (without a sharp or even sustained escalation hit) for additional construction activity at short notice. This could be to prioritise work to improve resilience of infrastructure or to give urgent attention in the event of natural disasters.

- New Zealand’s recent experience after Cyclone Gabrielle and the Auckland Anniversary Weekend Floods in early 2023 – not to mention the prolonged impact on the construction sector from the Christchurch Earthquake rebuild during the 2010s – shows this is not a new concern. However, it is one which is likely to become increasingly important.

Risks

Population Growth:

- New Zealand’s population growth is likely to have hit a long-term high in recent months. However, this is not an issue exclusively of concern to New Zealanders. Canada, Australia, and the UK have also seen population growth rebound sharply since borders have reopened.
- While there is likely a period of global economic weakness ahead, which typically reduces demand to migrate, these trends and New Zealand’s desirability as a destination for migrants suggests sustained strength in population could become the norm.
- In addition to those areas of risk of higher escalation already noted, sustained above-average population growth could unleash prolonged periods of high escalation. Population, or demand for construction in general, moves much faster than sector capability, and if population growth persists, sector capability may not be able to ‘catch up’.

China:

- Increasing doubts as to the strength of the economic engine – or, at best, an increasing need to recalibrate away from investments to private sector consumption as its key driver – point to ongoing economic weakness for China.
- This is likely to impact a wide variety of countries for whom China is a (or the) key trading partner. For New Zealand however, given its abundance of soft commodities (e.g., food, dairy, wool, forestry), these are perhaps best placed to benefit from the necessary economic transition.
- From an escalation perspective, China’s ongoing weakness before this transition takes place will put downward pressure on costs (perhaps significantly so, if China looks to aggressively win market share in the materials and/or plant/equipment sectors). When the transition is ultimately complete, this will see upward pressure on escalation (all else equal).

METHODOLOGY

While our view is based on a variety of sources (not the least of which is WT market insight), the general approach in this pack is based on escalation from the input cost perspective. This aligns with the traditional QS approach to escalation but also allows rationalisation of bottom-up (i.e., input-level) and top-down (i.e., sector or economy level) escalation perspectives.

The market-level data used in this report draws heavily from statistics provided by Statistics New Zealand. From a national perspective, the main data series used include national accounts, wages/employment, producer/consumer price index and building activity by sector.

While Statistics NZ data is broad and useful, it does not cover cost escalation by city. To overcome this shortfall, we have utilised Stats NZ data which can help to explain construction and construction costs where this data is available at national and city/regional levels: building consents, construction employment and ready-mixed concrete production.

Points to note:

- All escalation shown is on a calendar year basis and is the % change between the full-year average vs. the previous year's full-year average of the index or metric in question.
- Building escalation (referred to in this pack) is a weighted average of attached residential (largely apartments) and non-residential escalation.
- Escalation contribution by input is on a general (sector-agnostic), New Zealand-wide basis. Our city-level estimates are general across sectors, project types and project costs.

For more information on escalation relative to your project or sector, please contact your local WT office.

CONSTRUCTION ECONOMIST DAMON ROAST



Damon Roast
Construction Economist

Damon joined WT (Australia) in June 2022 as Construction Economist to support the team and our clients in understanding economic conditions and their influence upon our projects. Damon joined us with a wealth of experience both in the local construction market and various global markets.

Damon provides research and analysis to help inform both our Market Reports and frequent reporting to our internal team and board. He is also available to assist our clients on research required for specific project opportunities.

Footnote references

- | | | | |
|---|---|----|---|
| 1 | Statistics NZ (national accounts), The New Zealand Treasury (Pre-Election Economic and Fiscal Update) | 6 | Statistics NZ (producer price index), WT |
| 2 | The New Zealand Treasury | 7 | Statistics NZ (producer price index), WT |
| 3 | Statistics NZ (national accounts) | 8 | Statistics NZ (consumer price index), WT |
| 4 | Statistics NZ (building activity) | 9 | Statistics NZ (producer price index), WT |
| 5 | Statistics NZ (wages, employment), WT | 10 | Reserve Bank of Australia, WT |
| | | 11 | Statistics NZ (wages, employment, and consumer price index), WT |

WT New Zealand Quantity Surveying Project: Eden Park, Auckland



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WORLD OF THE COST CONSULTANT
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PRACTICE.**

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