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Yovich & Co. Market Update

6th February 2023

As at 3rd February	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	12036.05	7709.54	3264.81	7765.15	33978.08	11621.71	0.9134	0.6538	4.25%
Week Close	12197.15	7771.81	3263.41	7901.80	33926.01	12006.96	0.9140	0.6359	4.25%
Change	1.34%	0.81%	-0.04%	1.76%	-0.15%	3.31%	0.07%	-2.74%	0.00%

Last week was another positive week for global sharemarkets, continuing the recent trend. In the US, the S&P 500 Index was up 1.62%, led by the NASDAQ, which increased by 3.31%. The driver of the moves in the US was the statement by US Federal Reserve Chair Jerome Powell regarding the outlook for inflation. While the Fed increased the benchmark rate by 25bps last week, in line with expectations, and retained their forecasts for ongoing increases in rates, Powell said that the "disinflationary process has started", noting supply chain improvements helping in the goods sector. This statement prompted the market to rally, and interest rates to drop, despite the Fed also saying that inflation remains elevated.

The NZ market followed the US market, up 1.34%, with the stand out performer being Serko, up another 7.84% following their positive revenue guidance upgrade in the previous week. The Australian market was also up 0.81%, and the UK market increased by 1.76%.

The Bank of England and the European Central Bank also increased rates last week by 0.50% each, as expected. The BOE's cash rate has increased from 3.50% to 4.00%, while the ECB rate has increased from 2.00% to 2.50%. The Fed's rate rise sees the upper bound of the Fed Funds Rate move to 4.75%.

Market interest rates in the US moved downwards, with the 2-year US Treasury rate down 10bps to 4.10%, and the 10-year Treasury rate down 15bps to 3.38%. NZ rates also moved downwards, with the 2-year swap rate down 21bps to 4.70%, and the 5-year swap rate down 17bps to 4.08%.

The USD rallied over the week following a stronger than expected jobs report, with the US Dollar Index increasing by 1.09%. The NZD was down against the USD as a result, dropping 2.74% to 0.6359. The Dow Jones Commodity Index was down 4.06%, while the price of Brent Crude oil was down 7.70% to finish the week below US$80 per barrel.

Due to the recent flooding in Auckland, construction projects may be delayed for several months as the short-term repair and remediation pipeline surges. Westpac is highlighting that construction costs will stay high as a result of increased demand triggered by the storm, with the latest construction sector inflation at 17% in Auckland. Estimates for flood claims are now reaching as high as $1bn. Westpac economists are predicting that residential construction will slow in the second half of 2023, and that the market will end up with fewer, larger building firms focussed on the installation of pre-fabricated units.

Unemployment in NZ has risen to 3.4% from 3.3%, while private sector average hourly wage growth slowed to 8.1% year-on-year from 8.6%. The RBNZ had expected unemployment to drop to 3.2% and private sector hourly growth to increase to 9.1%.

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Yovich &Co WEALTH MANAGEMENT

The biggest movers of the week ending 3rd February 2023				
Up			**Down**	
Serko	7.84%		Freightways	-4.76%
Mercury NZ	7.24%		Ebos Group	-4.05%
Stride Property	7.14%		Fonterra Shareholders' Fund	-3.60%
Sky Network Television	5.44%		Scales Corporation	-3.17%
Pacific Edge	5.26%		Skellerup Holdings	-2.85%

Market Spotlight – Official Cash Rate

The Reserve Bank of NZ is responsible for keeping consumer price inflation low and stable, aiming for 1%-3% pa, and its main tool for achieving this goal is to use the Official Cash Rate (OCR) to influence short-term interest rates in the economy. Inflation occurs when aggregate demand for goods and services exceeds aggregate supply, which has occurred due to supply chain constraints leading to a shortage of supply of goods. This excess demand is due to too much money in the economy chasing too few goods, pushing up prices. So how is money created?

Money is created via bank lending. Banks act as intermediaries between savers and borrowers, taking deposits from savers, and lending money to borrowers. However, banks can create new loans without requiring the equivalent amount of capital or deposits, which increases the amount of money in the economy. This system allows the money supply to increase in line with the growth of the economy, as the amount of money created through bank lending is ultimately determined by the supply of and demand for bank loans.

Supply for bank loans is constrained however by the banks' ability to attract sufficient capital, as the RBNZ requires banks to hold sufficient capital to comply with minimum capital ratios. These laws came into effect following the Global Financial Crisis, recognising the need for banks to be able to withstand large economic shocks with strong capital buffers to absorb potential losses. These capital requirements therefore limit the rate of money creation, because as banks grow their lending and deposits, they need to raise more capital to ensure they have enough capital relative to their lending.

Demand for bank loans depends on many factors, including the availability of investment opportunities, the prices of assets (for example houses, plant & machinery), and the cost of borrowing, being interest rates. It is the last point where the OCR has influence, being the wholesale rate for borrowing money. Over time, central banks have found that setting interest rates, being the price of money, rather than targeting the quantity of money, is the most effective way of affecting economic activity and inflation.

Banks hold settlement cash balances in settlement accounts with the RBNZ, allowing banks to settle transactions between each other each day. The RBNZ pays interest on settlement account balances held overnight, and charges interest on overnight borrowing, at rates linked to the OCR. This then influences the retail interest rates that banks then set for consumers and businesses, meaning that short-term market interest rates generally track changes in the OCR.

By increasing or decreasing the OCR, the RBNZ affects the demand for bank loans: As interest rates move up, demand for bank loans diminishes, which constrains the money supply and reduces investment, leading to weakened demand in the economy, and a drop in inflation. Conversely, if inflation is too low, it risks restraining economic growth where capacity is available. By lowering the OCR, the RBNZ can incentivise more bank loans, increasing the money supply and spurring investment and demand in the economy.

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Investment News

Arvida Group (ARV.NZ) - Parklane Residents Evacuated Due to Flooding

Arvida's Parklane retirement village in Auckland experienced serious flooding on Friday 27th January, and affected Parklane residents were evacuated from their homes and successfully relocated to temporary accommodation. The flood damage to affected villas, apartments, and the clubhouse is currently being assessed. None of Arvida's other Auckland retirement communities were impacted to any significant extent. Arvida confirms that comprehensive insurance cover is in place.

Current Share Price: $1.17, **Consensus Target Price**: $1.80