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Yovich & Co. Market Update

2nd April 2023

As at 31st March	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	11580.81	7137.60	3265.65	7405.45	32237.53	11823.96	0.9333	0.6202	4.75%
Week Close	11884.50	7373.34	3272.86	7631.74	33274.15	12221.91	0.9359	0.6261	4.75%
Change	2.62%	3.30%	0.22%	3.06%	3.22%	3.37%	0.28%	0.95%	0.00%

Share markets saw a recovery last week, led by the US, with the S&P500 Index up 3.48%, as risk aversion eased following the fears of a banking crisis. The NZ market was up 2.62% over the week, to finish the month of March down 1.08%, while the Australian market was up 3.30% over the week, to finish the month down 1.11%.

There was market-friendly news coming from the US last week regarding inflation, with the personal consumption expenditures (PCE) index for February being weaker than expected, indicating moderating inflation pressure. The Reserve Bank of NZ will release its next Monetary Policy Statement this Wednesday, with the market seeing another 0.25% increase as a near certainty, which would take the OCR to 5.00%. The Reserve Bank of Australia will also release its next interest rate decision this week, with markets anticipating a pause in rate hikes at a policy rate of 3.60%.

US Treasury yields bounced back upwards last week, as the receding risk aversion in the market meant less buying pressure in safe assets. The 2-year Treasury rate rose by 36bps back up to 4.13%, while the 10-year Treasury rate rose by 19bps to 3.57%. In NZ, the 2-year swap rate was up 16bps to 5.03%, while the 5-year swap rate was up 10bps to 4.42%.

China's PMI (Purchasing Managers' Index) data was stronger than expected, causing downward pressure on the USD and a boost to commodity currencies. This saw the NZD appreciate against the USD by 0.95%, moving up to 0.6261. The Dow Jones Commodity Index moved strongly upwards during the week, up 2.76%, and the price of Brent Crude oil was up 6.35% to finish just below US$80 per barrel.

In NZ housing, CoreLogic data highlights that around 60% of households will need to refinance mortgages over the next year or so, moving onto much higher interest rates, which will have an obvious impact on discretionary spending. The number of dwellings consented in February was down 29% compared to February last year. As the housing demand slows down, Westpac's CEO says that mortgage competition is the most intense he has ever seen.

Regarding employment however, a survey by the Employers and Manufacturers Association highlights that businesses are still struggling to find staff despite signs of a recession. IRD's PAYE tax records back that up, showing growing employment.

The biggest movers of the week ending 31st March 2023					
Up			Down		
Scales Corporation	12.89%		Synlait Milk	-11.25%
Vital Healthcare Property Trust	8.08%		The Warehouse Group	-7.96%
Kiwi Property Group	7.69%		Arvida Group	-2.11%
Contact Energy	7.20%		Auckland International Airport	-1.81%
Goodman Property Trust	7.00%		The a2 Milk Company	-1.11%

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Economic News – RBNZ Chief Economist Speech on Inflation

Reserve Bank of NZ Chief Economist Paul Conway has given a speech on inflation at a conference in Wellington, where he has outlined the path back to low inflation. In the speech he discussed why inflation is high, the factors affecting the outlook, and what is being done to bring inflation back to the target range of 1%-3%.

Why is Inflation High?

As we have covered here before, the Covid-19 pandemic and associated global lockdowns reduced the world's ability to produce goods and services. Supply chains were disrupted, and we saw shortages of labour. The war in Ukraine exacerbated the issue, driving up energy and food prices.

Fiscal and monetary responses to the pandemic were aimed at supporting demand in the economy, keeping employment high and spending strong, while cash and savings continued to build. Resilient demand plus restricted supply translates into inflation, as people's money chases fewer goods and services.

Pandemic, War, and Floods Have Made Us Worse Off

In addressing the RBNZ's role in taming inflation, Mr Conway emphasised that while monetary policy can respond to inflationary pressures caused by excess demand, it cannot do much to improve the ability of our economy to produce output. These events have reduced our living standards through a loss of real income as costs increase faster than income. The example used was that monetary policy can do nothing to make up for a shortage of kumara or onions or apples caused by flooding.

The message being that people need to accept that we are poorer as a result, and if businesses and workers continue to try to push up profits and wages to make up for inflation, monetary policy will need to be more contractionary for longer, resulting in a deeper recession.

The Path Back to Low Inflation

Lifting supply-side issues comes from higher productivity in the economy, and more competitive markets. However, RBNZ is still mandated to bring inflation back to the 1%-3% range, whereas it is currently sitting above 7%. To do this, it has raised the Official Cash Rate (OCR) by 450 basis points over the last 18 months to 4.75%, being the most rapid increase in its history. Mr Conway admits that in hindsight, the RBNZ should have started tightening earlier in 2021.

Higher interest rates will encourage saving and less spending, and restrict business investment, lowering aggregate demand in the economy. The point being to lower demand for goods and services to match the lower output, and moving employment back towards its maximum sustainable level, reducing inflation in prices and wages. The RBNZ expects this monetary policy tightening to cause NZ's economy to enter a mild recession later this year as demand slows.

The path back to the target range will depend in large part on setting clear expectations. If businesses and households make decisions based on the expectation of rising prices in the future, then inflationary pressures will persist. This illustrates the importance of the RBNZ's messaging to set the expectation that inflation will return to the target band, as the more realistic we all are in adjusting to new economic realities, the easier the RBNZ's job will be.

The latest Monetary Policy Statement (MPS) in February included the RBNZ's projection for the OCR to peak at 5.5% during 2024. With the recent bank collapses around the world, credit conditions will likely tighten, which will assist in dampening demand. The next MPS is on 5th April, where we will see the RBNZ's updated forecasts, but some economic commentators are predicting a potentially lower peak OCR of 5.00-5.25%, meaning one or two more raises.

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Investment News

Synlait Milk (SML.NZ) – First-Half Adjusted Net Profit Down 43%

Synlait Milk announced its first-half results for FY23, with revenue down 3% to $769.8m, and adjusted NPAT down 43% from 1H22, to $8.9m (actual NPAT $4.8m). Operating cash flow is down to -$124.7m, while net debt has increased 32% to $518.6m. The company reports that while underlying momentum is lifting, their full financial recovery will take longer than planned, from two years to three years. Delays, one-off costs, and cost pressures significantly impacted performance. Guidance is for FY23 NPAT is $15m-$25m. No interim dividend will be paid.
Current Share Price: $2.13, **Consensus Target Price**: $3.15

Sky TV (SKT.NZ) Finalises Organisational Changes

Sky has concluded a consultation process, resulting in organisational changes being announced, which include a 40% boost to customer care to improve customer experience, more capacity in technology, a $6m permanent annual savings in operational costs, and savings in future capex. The changes will be achieved with a one-off cost of approximately $6m.
Current Share Price: $2.52, **Consensus Target Price**: $2.94

Freightways (FRW.NZ) Provides Update on One-Off Costs and Trading

Freightways has provided an update on several one-off costs to fall in FY23. The floods have had an impact on the Express Package business of around $2m. The company has incurred a number of one-off costs associated with mergers and acquisitions activities and the preparation for a potential dual listing on the ASX. Changes to the leased aircraft fleet, aimed at improving reliability, more capacity, and reduced emissions, will have an annualised impact of $3.5m pa. These costs will be mostly mitigated with general rate increases from 1st July. Express Package volumes have remained steady, but the company remains mindful of the risk of slower business in the short term.
Current Share Price: $9.45, **Consensus Target Price**: $10.30