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Yovich & Co. Market Update

29th May 2022

As at 27th May	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	11267.39	7391.04	3146.57	7389.98	31261.90	11354.62	0.9095	0.6391	1.50%
Week Close	11065.15	7413.13	3130.24	7585.46	33212.96	12131.13	0.9129	0.6530	2.00%
Change	-1.79%	0.30%	-0.52%	2.65%	6.24%	6.84%	0.37%	2.17%	0.50%

International sharemarkets made strong recoveries last week, with the S&P 500 in the US up 6.58%, its best weekly performance since November 2020, and the FTSE in the UK up 2.65%. The NZ market however was down 1.79% after having posted a modest gain in the previous week. The NZ market is now down 14.7% over the year, and 18.5% down from its high in January 2021.

The Reserve Bank of NZ raised the OCR from 1.5% to 2.0%, pushing the 1-month bank bill rate up 24bps from 1.77% to 2.01%. The 1-year swap rate increased 30bps to 3.46%, while the 5-year swap rate increased by 12bps to 3.73%. US interest rates were down over the week, with the 10-year Treasury yield down 12bps to 2.75%.

The NZD rallied strongly over the week, up 2.17% against the USD, to 0.6530, with improving risk sentiment and stronger commodity prices, plus the hawkish forecast for NZ rates by the RBNZ. The price of oil is back up at its previous high point, closing at US$119 per barrel.

The biggest movers of the week ending 27th May 2022			
Up		**Down**	
Pushpay Holdings	20.00%	Serko	-9.38%
Synlait Milk	6.92%	Fisher & Paykel Healthcare	-6.47%
Ryman Healthcare	2.54%	EROAD	-6.32%

Economic News – Reserve Bank Increases OCR to 2.0%

The Reserve Bank Monetary Policy Committee made the decision on Wednesday last week to raise the Official Cash Rate (OCR) by 50bps to 2.0%, as widely expected by the market. Included in the statement by the RBNZ was their updated forecasts for the future path of the OCR, which was more aggressive than the market predicted, forecasting a peak of 3.9% in 2023, compared with their previous forecast in February of a peak of 3.4% in 2024. In balancing risks, the RBNZ sees the higher risk being moving too slowly and not far enough, as compared with too much too soon, and indeed the bank stated that it is 'resolute' in its commitment to ensure inflation returns to the 1%-3% target range.

Forecast for Inflation

In February, RBNZ was forecasting for inflation to peak in the March 2022 quarter at 6.6%, before falling to below 3% by June 2023. The actual inflation rate for the March quarter was 6.9%, and the RBNZ has revised its forecast for inflation to peak in the June 2022 quarter at 7.0% before falling gradually back to 3.0% by the September 2023 quarter.

What is causing inflation? In simple terms, inflation of consumer prices occurs when aggregate demand for goods and services in an economy outstrips the aggregate supply of goods and services in an economy. The RBNZ have stated that "monetary conditions need to act as a constraint on demand until there is a better match with NZ's productive capacity." In other words, the RBNZ needs to dampen people's propensity to spend so that it better aligns with our capacity to produce. Employment is one measure of capacity constraint within an economy, and with unemployment at record lows, employment is above its maximum sustainable level, and labour shortages are the major constraint on production.

The three main contributors to inflation have been food, energy, and housing-related costs (which includes house construction costs). The global causes include the ongoing supply chain disruptions, especially due to the ongoing Covid-19 restrictions in China, and the Russian invasion of Ukraine, which is pushing up prices for food and energy. However, while global price pressures are impacting NZ, equally influential are domestic price pressures, and that includes government spending, which RBNZ notes is contributing to a modest increase in demand. We discussed the Budget in last week's update, where although it is contractionary, that is compared to massive fiscal stimulus in the previous year.

Forecast for OCR

RBNZ has signalled aggressive increases to the OCR this year, so we can expect further raises during the year unless inflation does not meet expectations. With the tight labour market, rising wage pressures are expected, and lifting the OCR higher and sooner is necessary to avoid future costs to employment and the economy in general.

The RBNZ recognises the risk of the steep path of increases, that it will put pressure on some households' spending decisions, especially those that are highly indebted. Based on the forecast OCR path, mortgage interest rates would reach into the late 6% to early 7% range, which will have an impact on discretionary spending. However, on average, household balance sheets are healthy, and banks have been testing mortgage lending at higher interest rates.

For this reason, stabilising inflation remains the RBNZ's priority, and it will lift the OCR until convinced that monetary conditions are sufficient to balance aggregate demand with aggregate supply and stabilise inflation expectations.

Will the Forecast Be Reality?

Whether the forecast turns into reality will depend in part on how the forecasts impact on market expectations. While the 50bp increase was expected, the hawkish stance by the RBNZ (i.e. its forecast of higher rates) was not expected. It is likely the RBNZ is sending a strong message in order to curb people's inflation expectations before they become more entrenched, especially as wage pressure grows, which can spark an ongoing continuous loop of price and wage increases.

It is more likely however that the RBNZ will not require to follow through with the extent of future increases as forecast. While we still expect to see prices of food and energy at high levels, we should see stabilisation unless the war in Ukraine materially escalates, and the restrictions in China become worse. With the RBNZ sending a strong signal to the market, this should assist in dampening demand enough to revise the trajectory of the OCR to a peak of under 3.5%.

Investment News

Kiwi Property Group (KPG.NZ) – Full Year Profit Up 14.1%

KPG announced its full year results, with revenue from continuing operations up 5.5% on pcp, and net profit of $224.3m, up 14.1%. Net rental income increased 7.8% to $187.1m, bolstered by a full period of trading at Sylvia Park's Level 1 expansion. A final dividend of 2.85cps was announced, taking the full year dividend to 5.60cps, an increase of 8.7% on pcp. The target for FY2023 is a cash dividend of no less than 5.70cps.
Current Share Price: $1.005, **Consensus Target Price**: $1.16

Tourism Holdings (THL.NZ) Updates Guidance for a Loss of $2m-$4m

THL has provided an updated guidance for FY22 to end of June 2022, expecting a statutory net loss of $2m-$4m, with the underlying net loss being $4.7m-$6.7m. The statutory result includes a number of one-off items, including the gains made from the sale of shares in Roadpass Digital.

As global travel restrictions ease, THL is seeing a recovery of international demand for RV travel.
Current Share Price: $2.78, **Consensus Target Price**: $3.83

Pushpay Holdings (PPH.NZ) Receives Expressions of Interest

PPH received expressions of interest from third parties in April, and appointed Goldman Sachs to assist as financial adviser. Since then, the company has had further interest from multiple parties. Pushpay is continuing with a process that is already underway and is in an early stage with multiple parties.
Current Share Price: $1.44, **Consensus Target Price**: $1.57

Fisher & Paykel Healthcare (FPH.NZ) – Full Year Profit Down 28%

FPH announced its full year results, with revenue of $1.682b down 15% on pcp, and net profit of $376.9m, down 28%. While results were negative compared with the 2021 financial year, revenue was still 33% above the pre-Covid 2020 financial year. 2021 was unprecedented, with Covid-19 driving huge demand for the company's products. A final dividend of 22.5cps was announced, taking the full year dividend to 39.5cps, up 4% from last year.
Current Share Price: $19.50, **Consensus Target Price**: $23.58

Mainfreight (MFT.NZ) – Full Year Profit Up 89%

Mainfreight has announced its full year results, with revenue of $5.22b, up 47.2% on pcp, and net profit of $355.40m, up 89%. Mainfreight announced that they are pleased with the result, particularly in light of ongoing supply chain disruptions and pandemic-enforced lockdowns. A final dividend of 87.0cps was announced, bringing the full year dividend to 142.0cps, an increase of 89.3% over the previous year.
Current Share Price: $75.51, **Consensus Target Price**: $95.59

Infratil (IFT.NZ) Issues New Infrastructure Bond

Infratil are issuing a new bond with an 8-year term, with a rate reset date after 4 years. The offer is for up to $50m, with the ability to accept a further $15m. The indicative issue margin is 2.05%-2.25%, with a minimum interest rate of 5.75% per annum.
Current Share Price: $7.94, **Consensus Target Price**: $8.63

Genesis Energy (GNE.NZ) Issues New Green Capital Bond

Genesis is offering up to $225m of new bonds, with the ability to accept a further $60m. The bonds are 30-year unsecured, subordinated, green capital bonds, with a rating of BB+. The indicative margin is 1.75%-1.90%, with a minimum interest rate of 5.35% per annum to the first interest reset date in June 2027. If successful, Genesis will exercise its option to redeem its existing green capital GNE040 bonds.
Current Share Price: $2.68, **Consensus Target Price**: $2.79

Arvida Group (ARV.NZ) – Full Year Profit Up 52%

Arvida has announced its full year results, with revenue of $201.7m, up 16% on pcp, and net profit of $198.9m, up 52%. Underlying profit was $73.5m, up 42% on pcp, with the overall result being impacted by unrealised movements in the fair value of investment property. The company made 580 sale of occupation rights, up 44% on pcp, and delivered 221 new units, against a target of 200+. Gearing is at 25% against a target range of 25%-35%. The company announced a final dividend of 3.0cps, bring the full year dividend to 5.5cps, up from 5.4cps last year.
Current Share Price: $1.59, **Consensus Target Price**: $2.10

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Pacific Edge (PEB.NZ) Announces Full Year Loss of $19.8m

Cancer diagnostics company Pacific Edge has announced its full year results, with revenue of $13.9m, up 33% on pcp, and a net loss of $19.8m, reflecting a 37% increase in operating expenses ($3.7m). Total laboratory throughput increased 46% to 23,086 tests, while commercial test volumes increased 48% to 19,196.

Current Share Price: $0.77, **Consensus Target Price**: $1.02