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Yovich & Co. Market Update

16th October 2022

As at 16th October	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	11103.79	6976.11	3024.39	6991.09	29296.79	10652.40	0.8803	0.5610	3.50%
Week Close	10868.09	6948.59	3071.99	6858.79	29634.83	10321.39	0.8974	0.5561	3.50%
Change	-2.12%	-0.39%	1.57%	-1.89%	1.15%	-3.11%	1.94%	-0.86%	0.00%

Markets faced another week of falls, with a higher-than-expected US inflation report sparking higher rate hike expectations, and rising risk aversion. The US CPI report showed US inflation increased 0.4% in September, versus expectations of 0.3%, taking annual inflation to 8.2%. Markets now expect the Federal Reserve in the US to raise the Fed Funds rate by consecutive 0.75 percentage point rate hikes in November and December. US equities fell as a result, with the S&P500 index down 1.55% over the week, and the NASDAQ down 3.11%.

The NZ market was down 2.12%, while the Australian market fell 0.39%. Higher rate expectations in the US, coupled with risk-off sentiment, saw the US dollar strengthen yet again. The US Dollar Index increased again by 0.49%, and is up 18.3% so far this year. As a result, the NZD is at multi-year lows, now down to 0.5561 against the USD.

Commodity prices fell during the week, including aluminium and copper, with the Dow Jones Commodity Index down 3.15%. The price of Brent Crude oil fell 6.78% down to US$91 per barrel.

Interest rates continued to rise in the US, with the 2-year Treasury rate up 14bps to 4.42%, and the 10-year Treasury rate up 5bps to 3.90%. NZ interest rates were also up heavily over the week, with the 2-year swap rate up 21bps to 4.94% and the 5-year swap rate up 25bps to 4.71%.

Electronic card spending in NZ was stronger than economists expected in September, up 1.4%, potentially driven by increased spending from international tourists. The government is reopening the skilled migrant category, and the parent visa category will also be reopened.

REINZ's national HPI Index fell 0.7% in August, and is now down 8.1% over the last 12 months (-12.6% from November peak), while Auckland is down 11.2% (-17.3% from November peak).

The biggest movers of the week ending 16th October 2022				
Up			Down	
Tourism Holdings	10.51%		EROAD	-9.27%
Westpac Bank	5.85%		Scales	-7.14%
Air NZ	4.17%		Kiwi Property Group	-6.01%

Market Theme – Are we getting on top of inflation?

The dominant theme for 2022 has been rampant inflation, causing interest rates to rise, and in turn causing asset prices to fall, including house prices and shares. It is a global theme, and has taken central banks by surprise. The Covid outbreak threatened the economy in early 2020, and the Reserve Bank of NZ responded by lowering the OCR from 1.00% (already low) to 0.25%, where it stayed until October 2021. During this time, the RBNZ also ran a Large Scale Asset Purchase (LSAP) programme, buying government bonds to increase the supply of money in the economy, and to further reduce interest rates in the market. By October 2021, we saw inflation start to rise above the target 1%-3% band, caused by rising oil prices, and supply shortages caused by global Covid lockdowns, especially in China. The RBNZ raised the OCR up to 0.50%, marking the beginning of the current tightening cycle. The question at the time was: Is this inflation transitory, or long-term?

In February 2022, Russia invaded Ukraine, adding more fuel to the inflation fire. Oil prices increased further, as Russia is a major producer of commodities, including oil, and supplies a large proportion of Europe's energy supply. The longer inflation sticks, the more pressure there is to raise wages, which then leads to a wage-price spiral effect. Inflation has now hit 7.3% in the June quarter in NZ, the highest rate since 1990.

The main driver for NZ inflation has been house construction: prices for the construction of new dwellings increased 18% to June 2022. Supply chain issues, labour costs, and higher demand have continued to push up the cost of building a new house. The RBNZ raised the OCR to 3.5% in October, stating that core consumer price inflation is too high, and labour resources are scarce. Our productive capacity is still being constrained by labour shortages, and wage pressures are heightened. Meanwhile, our spending continues to outstrip the capacity to supply goods and services. At the same time, the NZ dollar has fallen, making imported goods more expensive, and contributing further to inflation.

It is still too early to tell whether we have reached peak inflation, although some economic commentators believe we have. The RBNZ notes that a recent decline in oil prices, and an easing in some supply chain constraints have seen inflation fall in some countries. This may result in a lower inflation rate in the next quarter for NZ, which would be welcome, but the RBNZ needs to continue to curb core inflation and bring the rate back down to the 1%-3% band. Key indicators will be the unemployment rate increasing, and construction costs falling. Their forecast is for the OCR to reach 4.0%-4.25 during 2023, before being reduced slowly during 2024, and for inflation to decline from the current 7.3% going forward, to reach the target band again in mid-2024. Wholesale interest rate markets seem more sceptical however, and are pricing in an OCR of 4.75%-5.00% by May next year.

Investment News

Sky TV (SKT.NZ) Secures World Ruby Rights and Confirms RugbyPass Sale

Sky TV has agreed a deal with World Rugby that secures exclusive rights to premium competitions, including Rugby Word Cups, for seven years. Under the deal, World Rugby will acquire RugbyPass, the digital platform with rugby news, analysis, shows, podcasts, live match statistics, and results.
Current Share Price: $2.16, **Consensus Target Price**: $2.90

Kiwi Property Group (KPG.NZ) – Portfolio Valuation Update – 5.8% Decrease

Kiwi Property has released the draft valuations for its property portfolio as at 30th September, showing a 5.8% decrease in fair value compared to 31st March 2022. CEO Clive MacKenzie said the high inflation, high interest rate environment has led to capitalisation rate softening across the property sector. Increases in occupancy rates and rents over the past 6 months have not been enough to offset the cap rate softening.
Current Share Price: $0.86, **Consensus Target Price**: $1.10

Tourism Holdings Ltd (THL.NZ) Lifts FY23 Profit Guidance

THL's current expectation is that net profit after tax in FY23 will be above $30m. Earlier guidance in August was for NPAT of between $17.0m and $30.2m. The improved outlook is primarily a result of performance in the first quarter of FY23 exceeding earlier expectations, and greater certainty on forward rental revenue for the upcoming high season in Australia and NZ.
Current Share Price: $3.05, **Consensus Target Price**: $4.37