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2023 New Zealand equity outlook

Labour availability, inflation in focus

By the New Zealand Equity Team
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2022 saw rampant inflation and central banks battle to gain control through material increases in interest rates. The result has been an increase in discount rates applied when valuing equities and also the death of TINA, the expression being that "There Is No Alternative to equity"/real asset investments given low rates on offer in cash and fixed interest investments. As of 9 November 2022, the S&P/NZX 50 index is down 13.8% year to date and the New Zealand 10-year government bond has increased from 2.39% to 4.60%.

While earnings for listed companies have held up relatively well so far, one of the biggest issues for businesses has been the availability of labour. Companies are struggling to fill vacancies, wage inflation is high and staff turnover is also high as employees jump from job to job for higher wages. The outlook for 2023, at least the early part of the year, sees no relief as New Zealand is likely to continue to have low net immigration. New Zealand is fighting a global battle for workers with countries that have higher wages and arguably better working conditions with obvious examples being nurses, doctors and teachers.

Consumers will continue to face cost of living pressures as inflation will take some time to tame and even if it does drop, prices of goods and services are set at much higher levels than a year or two ago. The full effect of mortgage rate increases is still to be felt as fixed rate mortgages roll off on to materially higher rates. What might have started with a 2% or 3% mortgage will now be +6%. This ultimately means lower disposable income.

2023 could see a material economic slowdown, potentially a recession which should provide some flex in the labour market—but unfortunately through demand for goods and services falling and businesses downsizing or failing.

Companies face uncertain revenue outcomes as they increase prices but potentially lower demand/sales while cost pressures will continue through labour costs, raw materials and higher interest costs. The interest cost increase may take some time to fully flow through depending on the level of interest rate hedging, much like the fixed rate mortgage situation for homeowners. Ultimately it means falling margins for companies.

With 2023 being an election year for New Zealand there will be the usual lolly scramble from the government and promises from opposition parties. It will be important for us to follow policies and polling to see what may impact companies we invest in or could invest in.

While it might sound like a negative outlook, New Zealand's listed market is more defensive than the broader economy with large weights in defensive sectors such as utilities and telecommunications where consumers are likely to continue to pay their bills and are less labour intensive.

2022 has shown that equity markets are eager to go better with negative economic news greeted by markets rallying on the basis that central banks won't need to raise rates as high as markets are expecting. Any adjustment down of the peak in the Official Cash Rate should be greeted by the equity market moving higher. When equity markets move, they can move materially in a short period of time, so the old adage of time in the market rather than timing the market is important to remember.

Left field events such as an escalation of the war in Ukraine and the potential for either expansion across borders or through use of nuclear weapons or conflict between China and Taiwan need to be considered. These events can't be priced by the market but we need to be mindful of them.

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