

New Zealand Equity Monthly May 2023

Bright signs emerging despite labour market and living cost challenges

By Michael Sherrock, Portfolio Manager
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Employment environment and wage costs remain challenging for companies

In May, persistently low unemployment and growing wage costs continued to create a challenging corporate environment in New Zealand. Official data released on 3 May showed that unemployment was unchanged at 3.4% in the March 2023 quarter. The figure has remained low since dropping from 4% in the June 2021 quarter to 3.3% in the September 2021 quarter and highlights a continuing shortage of workers in the economy. In our view, relief in the labour market will only be provided by a significant uptick in unemployment. Compounding the challenges, official data also released on 3 May revealed that annual wage cost inflation as measured by New Zealand's labour cost index climbed to 4.3% in the year to the March 2023 quarter. The figure was up from 4.1% in the year to the December 2022 quarter and stood at its highest level since the series began in 1992. We feel that the increase shows the effect of company employees successfully negotiating for higher wages to compensate for higher living costs amid soaring inflation. New Zealand's consumers price index (CPI) remained high in the year to the March 2023 quarter at 6.7%. A hike in the country's hourly adult minimum wage from New Zealand dollar (NZD) 21.20 to NZD 22.70 as of 1 April is also likely to have boosted the wage inflation figure.

Soaring cost of living continuing to buffet consumers

As mentioned above, the high cost of living continues to be a significant issue in New Zealand. Given that the Official Cash Rate (OCR) currently stands at 5.5% after multiple hikes, mortgage payments form an increasingly significant portion of the costs faced by households. On 1 May the household living-costs price index (HLPI) for all households, which treats housing differently to the CPI by covering mortgage interest payments instead of the cost of building a new home, showed annual inflation in the year to the March 2023 quarter at 7.7%, making it significantly higher than the CPI figure of 6.7%. We feel that cost-of-living pressures will persist as mortgage holders continue to switch to higher rates than those they fixed previously. However, as the Reserve Bank of New Zealand (RBNZ) signalled in its Monetary Policy Statement on 24 May that the OCR has peaked at 5.5%, our view is that cost indices are likely to decline to a certain degree going forward.

Peak in OCR and strong corporate earnings providing sources of optimism

The RBNZ's decision to have the OCR peak at 5.5% surprised the market, which had started to price in a peak of 5.75% or 6.0%. The lower-than-expected peak in the OCR is positive for equities as higher interest rates dampen spending by consumers and businesses. In another encouraging sign for the market, corporate earnings in the reporting season for March 2023 have been generally strong versus expectations. These developments are providing a source of optimism for the market amid the continuing challenges faced by companies.

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