

Markets Monthly

Caught between a rock and a hard place.

- Global financial markets, New Zealand included, remain caught between three forces.
- With no end in sight yet for credit concerns and housing declines, equity markets remain shaky.
- With no end in sight yet for inflation pressures, exchange rates remain volatile.

Credit risk is one of three influences in global financial markets at present. The general tightening of credit standards in recent months has brought an end to the easy and cheap finance of recent years. In some cases finance is simply no longer available to companies and households. More often finance is available but the premium paid for risk is higher, and was still climbing over February. This threatens to cause wider company losses and generally lower spending within economies, and meanwhile keeps share prices under threat.

The second inter-related risk is the US housing market, and what impact will occur elsewhere. And again, the situation is still worsening. US housing markets show no sign yet of having reached a low point; and slower housing markets are emerging in several other countries, including New Zealand. However, Asian and Australian growth rates remain strong, and the evidence of any slowdown has not emerged to the extent feared in the US, Europe, and Japan. The underlying fear of worsening problems is also weighing on share prices. The mixed economic news is making for volatile exchange rates and in particular a weak US dollar of late.

The third – conflicting – influence is inflation, largely the result of earlier strong global demand and now stretched capacity. Inflation rates globally are still tending higher. Oil prices topped US\$100/barrel in February. Countries such as Australia who are still riding on this wave are experiencing higher interest rates and exchange rates. Countries more exposed to the US, such as Canada, are experiencing lower interest rates. Again, this makes for volatile currencies.

New Zealand shares these influences, along with a local flavour to the credit theme. Local housing activity is falling and GDP growth is slowing. But the high dairy prices and the tight labour markets are creating pockets of strength. Meanwhile the inflation rate is still increasing. For now the Reserve Bank of New Zealand (RBNZ) have stopped tightening. But a winter will likely pass before an end to these tensions is in sight.

Date	Instrument	29-Feb-08	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	8.25	0.00	0.00	1.00	2.50
	NZ 90-day bank bill	8.84	0.11	-0.01	1.06	3.06
	US 90-day bank bill	3.07	-0.17	-2.05	-2.29	1.76
	NZ - US 90-day bank bill	5.77	0.28	2.04	3.35	1.30
Fixed Interest	NZ 5-year gov't stock	6.88	0.08	-0.21	0.50	1.56
	NZ 10-year gov't	6.40	0.13	0.07	0.54	0.66
	NZ 10-year swap	7.71	0.17	0.07	0.74	1.55
	AUS 10-year gov't	6.35	0.31	0.40	0.66	1.29
	US 10-year gov't	3.77	0.16	-0.18	-0.79	0.08
Equities	NZ - NZX50 (NZ\$)	2648	-2.7%	-12.4%	-15.3%	40.8%
	AUS - All Ords (A\$)	5675	-0.4%	-13.9%	-2.4%	104.2%
	JAP - Nikkei (¥)	13603	0.1%	-13.2%	-22.7%	62.7%
	UK - FT100 (£)	5884	0.1%	-8.5%	-4.7%	61.0%
	US - S&P500 (US\$)	1331	-3.5%	-10.2%	-5.4%	58.2%
	WORLD - MSCI (US\$)	1456	-0.7%	-9.6%	-2.3%	93.3%
	MSCI in NZD (NZ\$)	1786	-4.9%	-14.3%	-16.1%	33.2%
Exchange Rates	NZD/USD	0.815	4.3%	5.4%	16.4%	45.2%
	NZD/AUD	0.861	-1.9%	-1.2%	-3.2%	-7.2%
	NZD/JPY	85.4	2.7%	0.1%	2.9%	29.2%
	NZD/GBP	0.410	4.1%	9.3%	14.9%	15.3%
	NZD/EUR	0.537	2.0%	2.4%	1.4%	2.9%
	NZ TWI	0.732	2.2%	2.8%	6.1%	18.8%
	EUR/USD	1.518	2.2%	2.9%	14.8%	41.1%

Equity indices are the respective end of month closes. Interest rates and exchanges rates are at 5pm NZ.

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General Advice Warning

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Cash

- New Zealand short-term interest rates were high during Feb-08.
- Mostly this is due to the persistently high Official Cash Rate (OCR) set by the RBNZ to reduce inflationary pressures.
- The RBNZ reiterated on 6 March it believes the “OCR will need to remain at current levels for a significant time yet”.
- Market pricing suggests New Zealand short-term interest rates will indeed remain high but gradually decline to be around 1% lower in 18 months, still well above average.
- The second factor pushing short-term interest rates higher is the global financial market tensions. Higher risk pricing globally pushed local 90-day rates up a little in February to now put 90-day rates around 0.2% higher than usual (relative to the OCR).

Fixed interest

- Fixed interest rates were choppy during February, but ended the month higher.
- Yields drifted higher for most of the month as some calm was restored to equity markets.
- But then dropped towards the end of the month as general anxiety again pervaded the financial markets.
- Adding to local upward rate pressure were greater expectations early February of tighter monetary policy in Australia, since delivered in the form of another cash rate hike Tuesday 4 March.
- And, third, there remains a general drift higher in credit risk premiums.

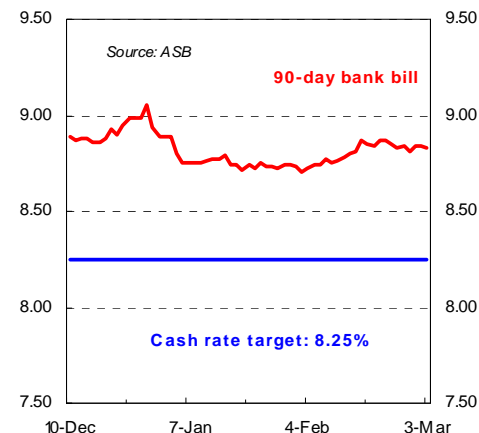
Equities

- For a while it appeared that global equity markets might stabilise after the sharp falls of January.
- But the US S&P500 Index was again trending downward by the end of the month, albeit the Index remained above the mid January low.
- Global equity markets are still largely taking their lead from the US share market.
- Although the NZ market did fall more sharply mid February, making new lows in the process.
- Generally company price-to-earnings measures appear reasonable but there remains a lingering doubt about whether forecast earnings will be realised, and whether short-term price falls might emerge in the meantime for other reasons.

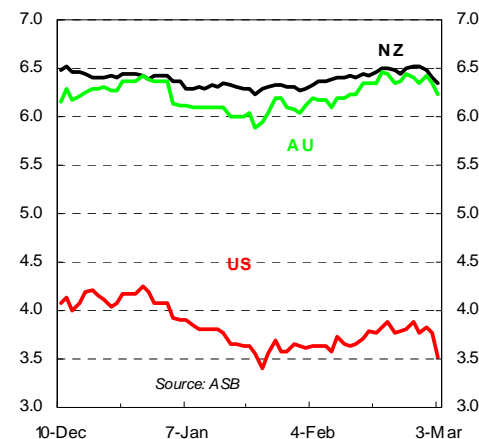
Exchange rates

- The dominant currency theme of February was a weak US dollar, the result of continued weak US economic activity and confidence measures and statistics that were generally not as bad as feared in other major economies.
- One exception was the British pound. It also was weak as news of UK housing problems emerged.
- The New Zealand dollar trend was largely upwards over the month, benefitting from a greater appetite for risky investments earlier in February and from a generally strong Australian dollar amidst Reserve Bank of Australia tightenings.
- In the process setting a new post-float peak of 82.1 US cents.
- And to remind of the current volatile environment, the NZ dollar fell sharply late in the month when equity prices again declined.

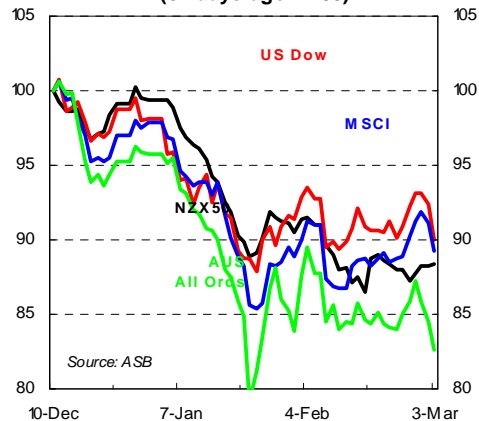
NZ SHORT-TERM RATES



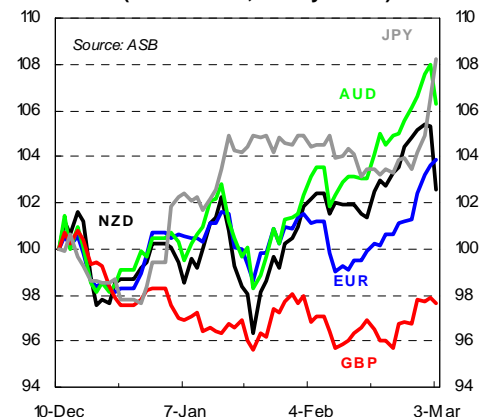
10-YEAR BOND YIELDS



**SHARE INDICES
(84 days ago = 100)**



**EXCHANGE RATE INDICES
(versus USD, 84 days =100)**



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