

# Markets Monthly

## High oil prices add to the worries.

- High oil prices add to the factors unnerving global investors.
- Share market trends are broadly sideways.
- Low domestic growth at least ensures the next RBNZ move will be a rate cut.

Not for many years have the global financial markets been betwixt and between low growth and high inflation. Low growth prospects were gaining more attention early in the year. Inflation became the greater concern in May.

The growth shock has come from the financial market turmoil and the consequent tightening of credit. A number of other triggers in the next year or two could easily have lowered growth forecasts anyway, particularly given the low spare capacity evolving internationally. However the credit shock has brought the matter to a head sooner than had been generally expected.

The dwindling spare capacity is also at the heart of rocketing commodity prices – a key theme of May. Crude oil reached over US\$130 per barrel. Prices for corn, cattle and bulk shipping also reached new highs. Price rises to date have already pushed consumer inflation rates above targeted levels in many countries, and will push inflation even higher in the near-term.

The market response to this inflation risk has been to push down the price of bonds – i.e. push up the desired fixed yield – and to either raise expectations of monetary tightening in some countries (e.g. US, Australia) or push closer to 2009 any expectations of rate cuts elsewhere (e.g. Europe, NZ). In turn, the AUD/USD reached new highs, dragging the NZ dollar higher except against the Australian dollar itself.

But the forces are mixed. Low growth is most likely for many economies, and growth will be lower in NZ than Australia. And the high global inflation rates will limit the extent that monetary authorities can accelerate economies via easier monetary policy. In turn, the low growth will eventually reduce the inflation pressures and herald another wave of growth and faster rising share prices (the slower growth prospects have already caused price peaks for commodity such as copper, gold, zinc and rice).

For now though, a spell of general market choppiness is likely as firms and households adjust their budgets to the new order.

Date	Instrument	31-May-08	Month %	Quarter %	Year %	5-Year %	5-year %p.a.
Cash	NZ cash rate	8.25	0.00	0.00	0.50	2.75	8.25
	NZ 90-day bank bill	8.71	-0.15	-0.13	0.58	3.47	8.71
	US 90-day bank bill	2.68	-0.19	-0.39	-2.68	1.42	2.68
	NZ - US 90-day bank bill	6.03	0.04	0.26	3.26	2.05	6.03
Fixed Interest	NZ 5-year gov't stock	6.57	-0.14	-0.32	-0.35	1.56	6.57
	NZ 10-year gov't	6.49	-0.08	0.09	0.11	1.13	6.49
	NZ 10-year swap	7.57	0.04	-0.15	0.04	1.80	7.57
	AUS 10-year gov't	6.54	0.26	0.19	0.52	1.68	6.54
	US 10-year gov't	4.05	0.33	0.28	-0.85	0.68	4.05
Equities	NZ - NZX50 (NZ\$)	2628	-0.5%	-0.7%	-19.9%	25.9%	4.7%
	AUS - All Ords (A\$)	5774	2.1%	1.7%	-9.0%	93.8%	14.1%
	JAP - Nikkei (¥)	14339	3.5%	5.4%	-19.8%	70.2%	11.2%
	UK - FT100 (£)	6054	-0.6%	2.9%	-8.6%	49.5%	8.4%
	US - S&P500 (US\$)	1400	1.1%	5.2%	-8.5%	45.3%	7.8%
	WORLD - MSCI (US\$)	1526	1.1%	4.8%	-5.6%	77.9%	12.2%
	MSCI in NZD (NZ\$)	1956	0.6%	9.5%	-11.5%	31.9%	5.7%
Exchange Rates	NZD/USD	0.780	0.5%	-4.3%	6.7%	34.9%	6.2%
	NZD/AUD	0.816	-1.7%	-5.2%	-7.9%	-7.8%	-1.6%
	NZD/JPY	82.3	2.0%	-3.6%	-7.4%	20.1%	3.7%
	NZD/GBP	0.395	0.1%	-3.7%	6.7%	12.8%	2.4%
	NZD/EUR	0.503	0.9%	-6.4%	-7.6%	3.2%	0.6%
	NZ TWI	0.697	0.4%	-4.8%	-2.3%	13.9%	2.6%
	EUR/USD	1.552	-0.4%	2.3%	15.5%	30.7%	5.5%

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

- Global liquidity pressures eased further in May, the response to the determined actions of central banks in the weeks prior.
- However, global short-term bank funding costs still have around 0.25-0.5% p.a. more factored into rates for risk now than was the case twelve months ago.
- In New Zealand, the 90-day bank bill did decline around 0.2% over May but at 8.7% remains well above the 8.25% Official Cash Rate (OCR) at a time when a higher OCR is not expected.
- In fact the market is pricing the next RBNZ move to be a rate cut, with the anticipated timing of the first cut shifting backwards and forwards on new information, being pushed out during May then coming nearer after the RBNZ Statement on 5<sup>th</sup> June.

### Fixed interest

- The trend for local fixed interest rates appears unchanged after the events of May.
- Looser NZ fiscal policy – and hence more Government borrowing off the private sector – prompted yields to jump sharply mid month.
- Around the time the renewed focus on inflation was also pushing global bonds yields higher, another pressure on local rates.
- But by the end of the month yields generally were drifting lower. The net effect was lower yields in the month in NZ but higher elsewhere.
- This see-saw pattern could persist for several months yet.

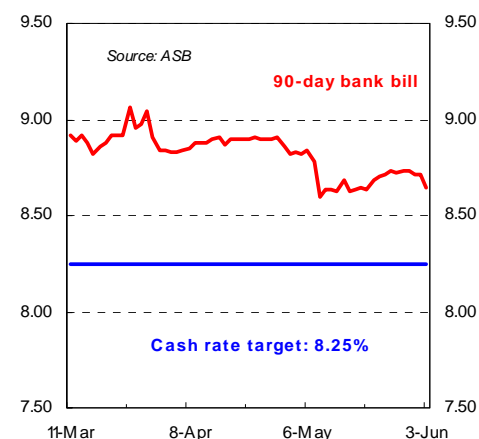
### Equities

- The topsy-turvy trend was even more evident in the global equity markets.
- Early in the May share prices tended to rally as bargain prices (at least relative to what they were only a few weeks earlier) attracted a fresh wave of buyers, relieved that global banking concerns were easing.
- Towards the end of the month, the sellers had regained dominance as the prospect of a long period of slow growth became more likely with each rise in oil prices.
- The net effect is that New Zealand share prices, on average, are off their March lows but remain much the same now as two years ago, and appear to be largely trading sideways at present.

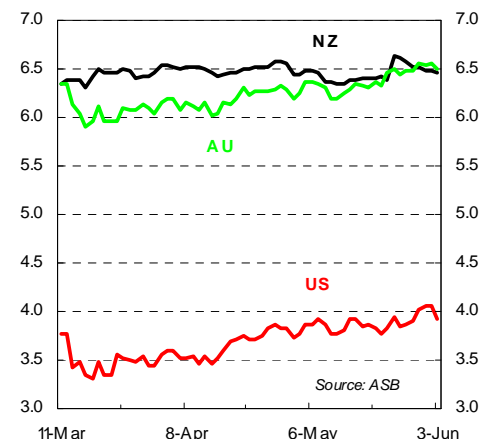
### Exchange rates

- Both the link and the difference between New Zealand and Australia were evident in the currency markets in May.
- The combination in Australia of strong commodity demand/investment, higher domestic inflation and ongoing, albeit slowing, GDP growth prompted Australian dollar buying over the month.
- This Australian dollar strength, in turn, tended to drag the NZ dollar higher against a range of third currencies, including the important US dollar.
- However the NZ dollar – held back by the prospect of lower local interest rates and low growth – was unable initially to stay with the AUD, the NZD/AUD cross rate falling to near 80.5c at times during the month.

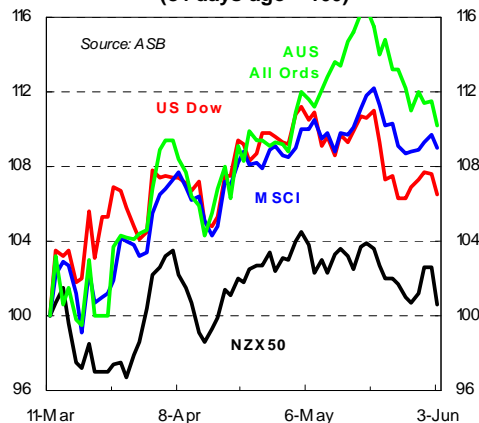
% p.a. **NZ SHORT-TERM RATES**



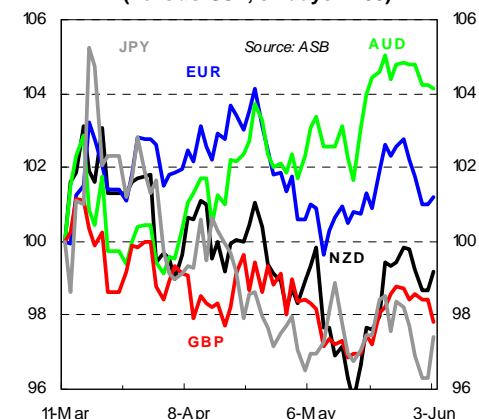
% p.a. **10-YEAR BOND YIELDS**



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



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



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