

Markets Monthly

Global turmoil hits Australian shores.

- Sharemarkets continued to struggle, with the exception of the gain posted in the local market.
- The global financial turmoil hit Australian shores in July.
- The RBNZ cut the Official Cash Rate. The RBA looks likely to follow suit later this year.

Sharemarkets continued to struggle in July, with all the offshore markets we monitor posting declines. In contrast, the local sharemarket lifted 4.4% during the month. The gain is pleasing, but cold comfort for long-term investors who have endured its 25% decline over the last year. The global financial turmoil hit Australian shores in July, as two of the four 'banking pillars' provided disappointing earnings guidance due to greater than expected bad debt provisioning. Australian financial stocks fell sharply as a result, and the Australian sharemarket was down 5.3% for the month. The Australian dollar depreciated in July, despite reaching a 25-year high mid-month against the US dollar. The Australian economy is facing some of the same headwinds the New Zealand economy is grappling with, and market participants are now speculating the next move from the Reserve Bank of Australia will be a cut in the cash rate. On our side of the Tasman, the Reserve Bank of New Zealand (RBNZ) decided to cut rates by 0.25% to 8.00% in July. In their statement, the RBNZ stated they expected to lower the Official Cash Rate further, provided the outlook for inflation improves and the New Zealand Dollar (NZD) remains steady. The NZD sold off on the announcement, and suffered a broadly-based depreciation over July. By month end, the NZD was trading around US \$0.73 - its lowest rate since September 2007, and had touched a 7-year low against the AUD. The local currency has fallen a long way from its 2007 highs. Ongoing depreciation will benefit unhedged offshore investments and provide a long-awaited boost to the export sector. The New Zealand economy is going through a challenging period of low growth but high inflation. In the short term, the rebalancing within the economy will mean a period of modest growth, and volatility in investment returns. The lead into the next growth phase typically comes from easing monetary conditions, from lower interest rates and exchange rates. This process is firmly underway. Interest rates should continue to ease over the next 18 months, and we expect the orderly depreciation of the New Zealand Dollar to continue.

Date	Instrument	31-Jul-08	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	8.00	-0.25	-0.25	-0.25	3.00
	NZ 90-day bank bill	8.32	-0.34	-0.54	-0.24	3.27
	US 90-day bank bill	2.80	0.01	-0.07	-2.56	1.71
	NZ - US 90-day bank bill	5.52	-0.35	-0.47	2.32	1.56
Fixed Interest	NZ 5-year gov't stock	6.12	-0.20	-0.58	-1.22	0.91
	NZ 10-year gov't	6.15	-0.23	-0.42	-0.51	0.42
	NZ 10-year swap	7.11	-0.23	-0.42	-0.60	0.79
	AUS 10-year gov't	6.20	-0.24	-0.08	0.17	0.78
	US 10-year gov't	4.04	0.04	0.31	-0.67	-0.35
Equities	NZ - NZX50 (NZ\$)	2410	4.4%	-8.8%	-24.8%	12.3%
	AUS - All Ords (A\$)	5053	-5.3%	-10.7%	-18.3%	62.6%
	JAP - Nikkei (¥)	13377	-0.8%	-3.4%	-22.4%	39.9%
	UK - FT100 (£)	5412	-3.8%	-11.1%	-14.9%	30.2%
	US - S&P500 (US\$)	1267	-1.0%	-8.5%	-12.9%	28.0%
	WORLD - MSCI (US\$)	1367	-2.5%	-9.4%	-12.7%	53.9%
	MSCI in NZD (NZ\$)	1868	1.5%	-4.0%	-8.3%	22.4%
Exchange Rates	NZD/USD	0.732	-4.0%	-5.7%	-4.8%	25.8%
	NZD/AUD	0.775	-2.1%	-6.7%	-13.2%	-12.9%
	NZD/JPY	79.0	-2.3%	-2.0%	-13.6%	13.1%
	NZD/GBP	0.370	-3.3%	-6.3%	-2.4%	2.6%
	NZD/EUR	0.470	-2.7%	-5.7%	-16.2%	-8.5%
	NZ TWI	0.657	-3.0%	-5.4%	-10.8%	5.2%
	EUR/USD	1.558	-1.3%	0.0%	13.6%	37.4%

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

As this advice has been prepared without considering your objectives, financial situation or needs, and before acting on the advice, you should consider its appropriateness to your circumstances. The Bank as a provider of investment, borrowing and other financial services undertakes financial transactions with many local corporate entities. This may include any corporate issuer referred to in this report.

Cash

- The Reserve Bank of New Zealand (RBNZ) decided to cut rates by 0.25% to 8.00% in July.
- In their statement, the RBNZ stated they expected to lower the Official Cash Rate further, provided the outlook for inflation improves and the New Zealand Dollar (NZD) remains steady.
- 90-day bank bills declined around 0.34% over July, reflecting the RBNZ rate cut, and the expectation of further cuts over the coming months.
- Financial markets and our own forecasts are predicting a series of cuts over the next 12 months, taking the OCR below 7% in Q1 2009.

Fixed interest

- The NZ Government bond market rallied over July sending yields lower, influenced by ongoing flows to risk-free assets.
- The 5-year bond yield fell to 6.12% from 6.32% at the end of June, while the 10-year yield dropped to 6.15% from 6.38%.
- The Australian bond market surged in the later stages of July, influenced by weakening domestic data and growing credit concerns, which hit equity markets hard and prompted strong flows to risk-free assets. The 10-year yield dropped to 6.22% from 6.45%
- The above movement has ended (for now anyway) a rare period where Australian yields were higher than NZ yields. Since 2000, NZ has averaged a 50 basis point yield advantage over Australia.

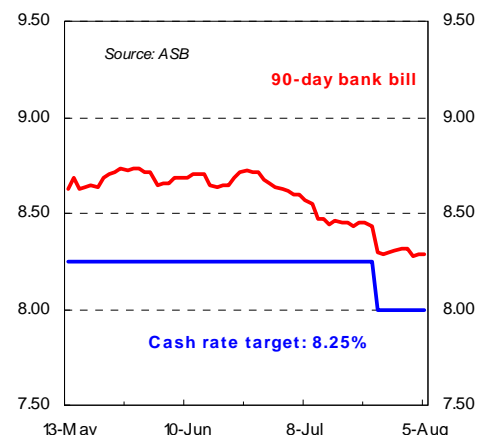
Equities

- Sharemarkets continued to struggle in July, with all the offshore markets we monitor in this report posting declines.
- In contrast, the local sharemarket lifted 4.4% during the month. The global financial turmoil hit Australian shores in July, as two of the four 'banking pillars' provided disappointing earnings guidance due to greater than expected bad debt provisioning. Australian financial stocks fell sharply as a result.
- The news was mixed for US financial stocks in June. Banking giants Wells Fargo and JPMorgan easily exceeded (downbeat) profit expectations. But optimism faded again after the failure of IndyMac Bancorp and two smaller US regional banks. This led to another leg down in financials and contributed to an overall decline of 1% in the S&P 500 index of US shares.

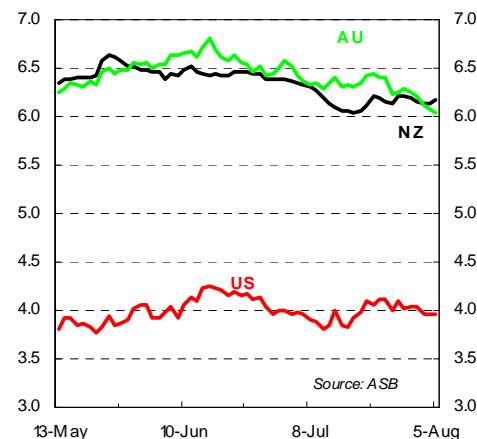
Exchange rates

- The NZD mostly range traded in early in the month, with little New Zealand economy data to entertain traders.
- But by month end, the NZD was trading around US \$0.73 - its lowest rate since September 2007, and had touched a 7-year low against the AUD.
- The NZD fell 3.7% against the USD, 2.1% against the JPY, 2.7% against the EUR and 3.3% against the GBP. The NZD fell 3.3% against the CAD and 2.0% against the AUD over the month.
- The Australian domestic economy has begun to slow more rapidly than anticipated. We believe the AUD peaked at US\$0.985 on 15 July 2008.

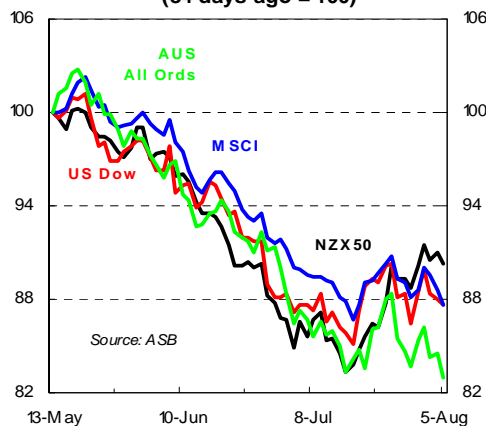
% p.a. **NZ SHORT-TERM RATES**



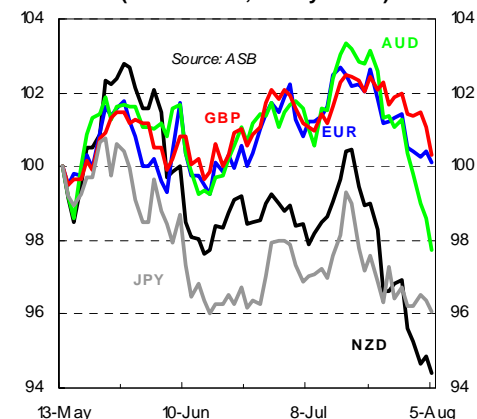
% p.a. **10-YEAR BOND YIELDS**



SHARE INDICES
(84 days ago = 100)



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



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