

Markets Monthly

Market turmoil reaches a crescendo

- Financial market turmoil spread during the third quarter, freezing credit markets.
- Central Banks and Governments moved into crisis control during September.
- Sharemarkets plunged as fear grips the markets.

Recent developments have confirmed the finance problems have expanded out of the US financial sector, and permeated into the global economy. Central banks are now in crisis control, slashing interest rates, and providing significant funding to an extremely stressed financial system. The strain has caused the collapse of several international banks and government rescue packages have been implemented to keep others operating. In October officials have reassured savers by providing guarantees for bank deposits.

Sharemarkets around the world have plummeted, triggering comparisons to the Great Depression in the 1930s. The comparison is valid when talking about the magnitude of share price falls, but not when comparing the state of the global economy, or the response from policymakers to date. The policy responses in 2008 have on the whole been timely, positive, and appropriate. Unemployment rates are low and global growth remains positive.

The US Government's rescue package may ultimately prove to be the turning point in the current crisis, but it is still far from over. Central banks and governments need to continue to work to ease the strain. We remain positive about the long-term economic outlook, but the impact on investments has been dramatic.

The NZX 50 Capital Index of New Zealand Shares is down 5% over the last three months, and 9% in September alone. The Australian market also suffered. Resource stocks saw their share prices fall in tandem with falls in commodity prices. Bank stocks also suffered as concerns mounted about the health of the global financial system. On this point, it is worth noting that the top Australian banks are well capitalised, and have fared well in the Reserve Bank of Australia's September Financial Stability Review. High credit ratings have been maintained by the big four Australian banks and their New Zealand subsidiaries.

An easing NZD did have a positive impact on offshore investment returns, even if it was only to offset sharemarket losses, when measured in NZD terms. Over the last three months the MSCI index of world shares lost 15.7% in USD terms, but the weakening of the NZD from US \$0.76 to 0.67 reduced the loss to 4% in NZD terms.

Right now there seems to be a wall of worries for investors, but markets do not need all the storm clouds to clear before they can start to perform. The dramatic 9% US share rally on 13 October is a reminder. This was strongest one day gain on Wall Street since the Great Depression.

Date	Instrument	30-Sep-08	Month %	Quarter %	Year %	5-Year %	5-year %p.a.
Cash	NZ cash rate	7.50	-0.50	-0.75	-0.75	2.50	7.50
	NZ 90-day bank bill	8.00	-0.15	-0.66	-0.79	2.83	8.00
	US 90-day bank bill	3.88	1.07	1.09	-1.35	2.76	3.88
	NZ - US 90-day bank bill	4.12	-1.22	-1.75	0.56	0.07	4.12
Fixed	NZ 5-year gov't stock	5.57	-0.47	-0.76	-1.03	0.12	5.57
Interest	NZ 10-year gov't	5.71	-0.31	-0.68	-0.59	-0.10	5.71
	NZ 10-year swap	6.80	-0.22	-0.54	-0.77	0.34	6.80
	AUS 10-year gov't	5.47	-0.31	-0.98	-0.69	0.09	5.47
	US 10-year gov't	3.62	-0.20	-0.38	-0.96	-0.31	3.62
Equities	NZ - NZX50 (NZ\$)	2195	-9.4%	-4.9%	-31.4%	-3.8%	-0.8%
	AUS - All Ords (A\$)	4631	-11.2%	-13.2%	-29.6%	45.8%	7.8%
	JAP - Nikkei (¥)	11260	-13.9%	-16.5%	-32.9%	10.2%	2.0%
	UK - FT100 (£)	4902	-13.0%	-12.9%	-24.2%	19.8%	3.7%
	US - S&P500 (US\$)	1166	-9.1%	-8.9%	-23.6%	17.1%	3.2%
	WORLD - MSCI (US\$)	1182	-12.1%	-15.7%	-27.6%	30.0%	5.4%
	MSCI in NZD (NZ\$)	1765	-7.6%	-4.0%	-18.2%	15.2%	2.9%
Exchange	NZD/USD	0.670	-4.9%	-12.1%	-11.5%	12.8%	2.4%
Rates	NZD/AUD	0.838	2.9%	5.7%	-2.3%	-4.1%	-0.8%
	NZD/JPY	69.9	-9.0%	-13.6%	-19.9%	6.0%	1.2%
	NZD/GBP	0.372	-3.2%	-2.7%	-0.6%	4.6%	0.9%
	NZD/EUR	0.466	-2.3%	-3.4%	-12.8%	-8.6%	-1.8%
	NZ TWI	0.635	-3.3%	-6.3%	-10.8%	2.6%	0.5%
	EUR/USD	1.436	-2.6%	-9.0%	1.4%	23.5%	4.3%

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

- The Reserve Bank of New Zealand (RBNZ) decided to cut rates by 0.25% to 8.00% in July, 0.5% in September and 1% in October
- In their statement, the RBNZ stated they expected to lower the Official Cash Rate further, assuming the outlook for inflation evolves as projected.
- 90-day bank bills declined significantly over the period, reflecting the RBNZ rate cuts, 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 3 months, taking the OCR below 6% in Q1 2009.

Fixed interest

- The NZ Government bond market has rallied over the third quarter, sending yields lower, influenced by ongoing flows to risk-free assets.
- The 5-year bond yield fell to 5.57% at the end of September, while the 10-year yield dropped to 5.71%. Yields have fallen 0.76% and 0.68% on 5 and 10 year bonds.
- The Australian bond market has rallied even harder, and the 10-year Government bond yield dropped to 1% to 5.47% over the third quarter
- In the US, rates were already significantly below long-run averages, but Government bonds still rallied. The 10-year yield fell 0.38% to 3.62%.

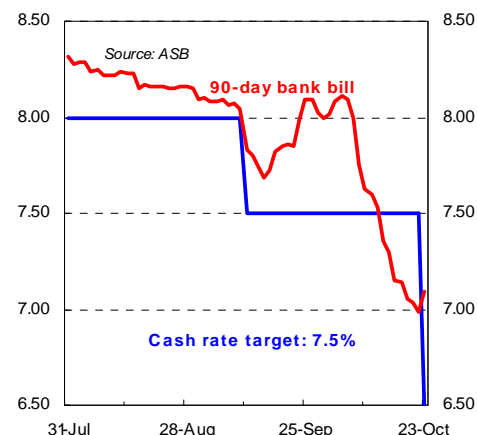
Equities

- The month of September 2008 was one of the most volatile months in financial market history, with a history-making number of bank failures and the need for the US government to design a 'bailout' package to rescue the situation.
- The economic data very much took a backseat over the quarter, but the news offshore continued to show signs of further weakness in key statistics such for industrial production growth, GDP, labour markets and confidence.
- Sharemarket plunges during September drove all the indices we monitor into negative territory for the full quarter. The worst performer over three months was the Japanese market, with the Nikkei index losing 16%. The UK FTSE 100 was down 12.9%, and the US S&P 500 was down 8.9%.

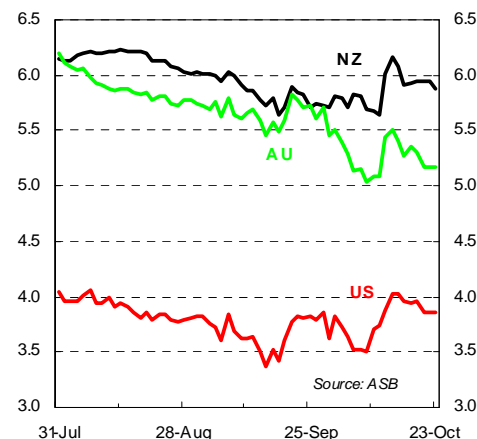
Exchange rates

- The NZD has already softened against the major currencies in recent months. We continue to expect the NZD to gradually weaken further against the USD over time. In October, the NZD has moved down further, trading around US\$ 0.60 at the time of writing.
- The Japanese Yen has been the standout performer, posting quarterly gains on all the crosses we monitor.
- The NZ Trade Weighted Index is down 8% from July 24, when the RBNZ began cutting the OCR. Given the circumstances, the TWI depreciation has been reasonably orderly.
- We have adjusted our NZD forecasts down and currently expect the NZD to trade as low as US\$0.55 in early 2009, before recovering back towards current levels later in 2009.

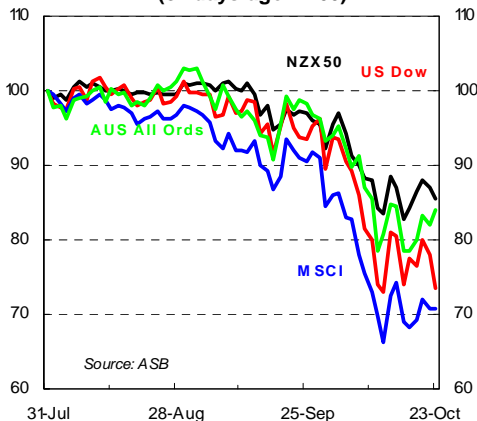
NZ SHORT-TERM RATES



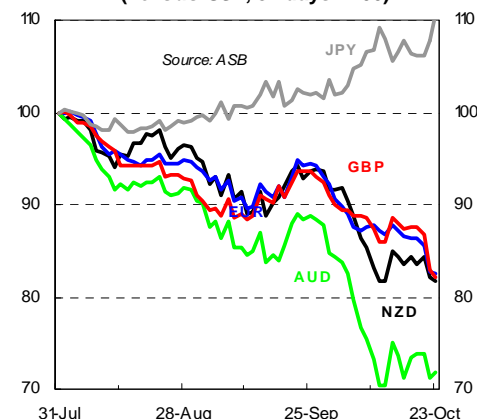
10-YEAR BOND YIELDS



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



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



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