

Markets Monthly

Staring into the abyss

- The credit crisis continued to hound markets in October.
- Sharemarkets plunged to multi-year lows, as global growth prospects slashed.
- The Reserve Banks of New Zealand and Australia deliver large cash rate cuts.

The escalation of the global credit crisis over September and October has seen global credit markets remain frozen. Central banks and governments continue to introduce a range of measures to boost liquidity and return confidence to credit markets. Although there are tentative signs of recovery for short-term funding, global term funding premiums remain extremely elevated.

Poor New Zealand economic data played a part over the month. Weak housing data, a weaker Pre-election Economic and Fiscal Update and increased expectations that the Reserve Bank of New Zealand would cut rates aggressively. The poor sentiment weighed on the NZD and the local sharemarket.

What concerned us the most in the recent plethora of weak economic news is the developments in China, and the flow on impact on Australia and NZ. For example, China's industrial production report for October came in well below expectations, with output in the "world's factory" falling to 8.2% pa - a severe slowdown from 18%pa growth just a few months ago. With weakening demand in our key trading partners, NZ's export led recovery looks increasingly fragile, and lower interest rates are appropriate. On 23 October, the RBNZ slashed the Cash Rate by 1.0% to 6.50%. We expect more cuts from the RBNZ, with 1% forecast on December 4th.

The NZD depreciated over the month of October as the USD surged, and investors pulled away from "riskier" currencies such as the NZD which presided over large current account deficits. The NZD lost 12% against the USD, touching a 5-year low of US\$0.535, and depreciated 17% against the JPY to touch a 6-year low of 49.3. The NZD lost ground against the USD in the early days of October as equity markets sold off as the US rescue package failed in its first attempt to be passed by Congress. The AUD has been faring worse than the NZD in the last few months. The RBA cut their cash rate by 1% on 8 October, and the NZD-AUD cross spiked to a 3-year high on 10 October.

NZ and US Government Bond yields actually rose over the month, but remain low by historical standards. All the sharemarkets monitored suffered significant losses during the October, with only the falling NZD providing some relief for unhedged offshore investments.

Date	Instrument	31-Oct-08	Month %	Quarter %	Year %	5-Year %	5-year %p.a.
Cash	NZ cash rate	6.50	-1.00	-1.50	-1.75	1.50	6.50
	NZ 90-day bank bill	7.14	-0.86	-1.18	-1.51	1.91	7.14
	US 90-day bank bill	3.19	-0.69	0.39	-1.72	2.04	3.19
	NZ - US 90-day bank bill	3.95	-0.17	-1.57	0.21	-0.13	3.95
Fixed Interest	NZ 5-year gov't stock	5.86	0.29	-0.27	-0.98	0.01	5.86
	NZ 10-year gov't	6.07	0.36	-0.09	-0.42	-0.11	6.07
	NZ 10-year swap	6.54	-0.26	-0.57	-1.28	-0.26	6.54
	AUS 10-year gov't	5.21	-0.26	-1.00	-0.98	-0.55	5.21
	US 10-year gov't	3.94	0.11	-0.02	-0.55	-0.35	3.94
Equities	NZ - NZX50 (NZ\$)	2000	-8.9%	-17.0%	-36.4%	-13.3%	-2.8%
	AUS - All Ords (A\$)	3983	-14.0%	-21.2%	-41.3%	21.3%	3.9%
	JAP - Nikkei (¥)	8577	-23.8%	-35.9%	-48.8%	-18.8%	-4.1%
	UK - FT100 (£)	4377	-10.7%	-19.1%	-34.9%	2.1%	0.4%
	US - S&P500 (US\$)	969	-16.9%	-23.6%	-37.5%	-7.8%	-1.6%
	WORLD - MSCI (US\$)	957	-19.0%	-30.0%	-43.1%	-0.6%	-0.1%
	MSCI in NZD (NZ\$)	1628	-7.8%	-12.8%	-25.9%	3.2%	0.6%
Exchange Rates	NZD/USD	0.588	-12.2%	-19.7%	-23.3%	-3.7%	-0.7%
	NZD/AUD	0.873	4.2%	12.6%	5.2%	0.7%	0.1%
	NZD/JPY	58.0	-17.0%	-26.6%	-34.0%	-12.7%	-2.7%
	NZD/GBP	0.359	-3.5%	-2.8%	-3.0%	-0.2%	0.0%
	NZD/EUR	0.458	-1.8%	-2.5%	-13.7%	-12.8%	-2.7%
	NZ TWI	0.592	-6.7%	-9.9%	-16.5%	-5.9%	-1.2%
	EUR/USD	1.284	-10.6%	-17.6%	-11.1%	10.5%	2.0%

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

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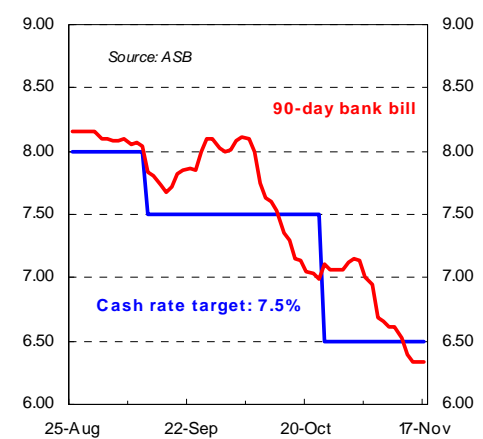
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Cash

- The Reserve Bank of New Zealand (RBNZ) 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 bill yields continue to decline in October and early November, reflecting 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, with another cut of 1% expected on December 4th.

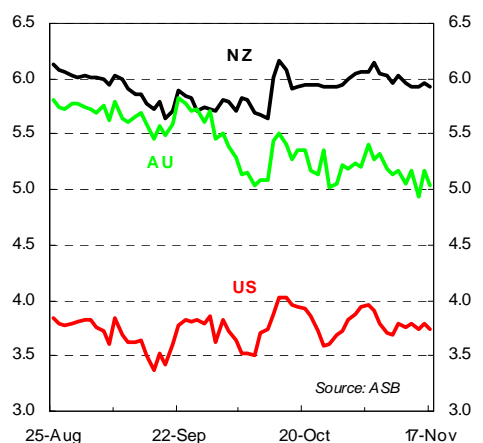
NZ SHORT-TERM RATES



Fixed interest

- The NZ Government bond market rallied over the third quarter, sending yields lower, influenced by ongoing flows to risk-free assets.
- In October, this flow was partially reversed, and yields rose on NZ Government bonds. In New Zealand, the Government, Reserve Bank and Treasury released details of the retail deposit guarantee scheme in October. This helped restore confidence in the banking system, and encourages investors out of safe haven Government bonds, and back into other fixed interest investments covered by the scheme. A wholesale scheme was announced in early November.
- The Australian Government also played their part in restoring confidence by guaranteeing bank deposits and announcing an A\$10.4 Billion fiscal stimulus package.

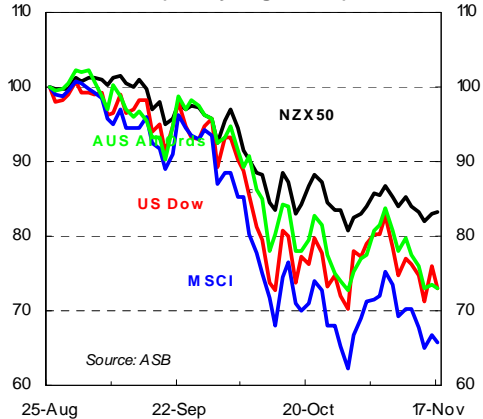
10-YEAR BOND YIELDS



Equities

- Sharemarket plunges during October were dramatic, with all the offshore markets we monitor falling over 10%, with the Japanese market losing 23.8% in the month, to be down a staggering 48.8% on year-ago levels.
- The 8.9% plunge in the New Zealand market is less dramatic, but the relatively good performance is of no comfort to investors, and the NZX-50 was down 36.4% on year-ago levels at month end.
- The direction for the New Zealand market continues to be set by offshore developments. However, the magnitudes of the daily moves are usually smaller. Volumes are also very light in the New Zealand market at present.

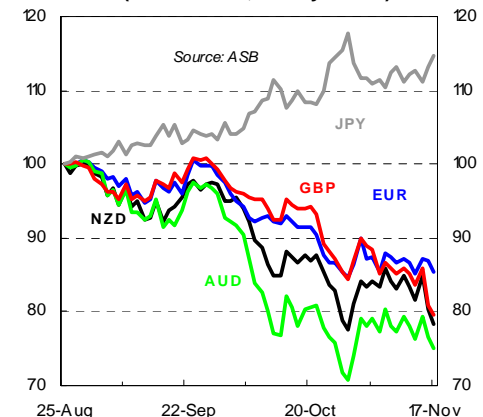
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(84 days ago = 100)**



Exchange rates

- The NZD has weakened significantly against the major currencies in recent months.
- The NZD depreciated over the month of October as the USD surged, and investors pulled away from "riskier" currencies, which presided over large current account deficits.
- The NZD lost 12% against the USD and 17% against the JPY to touch a 6-year low of 49.32. The Japanese Yen continues as the standout performer, posting large gains on all the crosses we monitor.
- The AUD lost ground against a firm USD over the month of October. The troubled international economic outlook and the fall in commodity prices were negatives for the AUD.

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



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