Markets Monthly

Challenges for global markets continued in December.

- **The credit crisis continued drive markets in December.**
- **Sharemarkets were mixed over the month, with the MSCI posting a 3.1% gain in USD terms.**
- **Central banks delivered large cash rate cuts during December, as the global turmoil continued.**

The major development in December was the US Federal Reserve's rate decision and clear intention to drive long-term yields down. The FOMC's decision to slash the Fed Funds Rate to a target range of 0–0.25% somewhat surprised markets, but reflected the difficult times the US economy is facing.

The start of December saw global equity markets unable to hold onto the substantial gains of late November. In fact the Dow Jones gave up its six-day winning streak on the very first trading session for the month losing almost 700 points – coinciding with the official news that the US economy was in a recession and had been in a recession since December 2007. Other economic data filtering out of the US continued to dampen sentiment. Activity indicators such as the ISM manufacturing index fell to multi decade lows, while U.S. weekly jobless claims and unemployment figures continued to soar. Not helping markets was the continued debate on a bailout package to the struggling automakers. And with US auto sales sliding around 30% on a year ago, the negative sentiment was reflected in automakers across the globe.

But investors started to warm to the substantial interest rate cuts by central banks later in the month. Investor sentiment was also buoyed by US President-elect Barrack Obama's plan to boost infrastructure and public works. The plan aims to create nearly 3 million jobs over the next two years.

Locally, consumer confidence levels continued to improve courtesy of falling petrol prices and the continued flow of substantial interest rate cuts. The same is occurring across the Tasman, as pressure comes off household budgets. Unfortunately, the relief did not flow over into Australasian sharemarkets in December. The Australian All Ords lost 0.4% and the NZX 50 Capital Index lost 0.6% in the month. However, other markets fared better, with the US S&P 500 gaining 0.8%, and the world MSCI rising 3.1% in USD terms in December. Only three of 72 global sharemarkets monitored managed to post gains over 2008: Of the major bourses, best was the UK (down 31.3%) followed by the US Dow Jones (down 33.8%), Germany (down 40.4%), Japan (down 42.1%) and Australia (down 43.0%). It was the biggest annual decline for the Australian market. New Zealand shares fared slightly better, but still lost 36.5%.

Date	Instrument	31-Dec-08	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	5.00	-1.50	-2.50	-3.25	0.00
	NZ 90-day bank bill	5.11	-0.69	-2.89	-3.78	-0.25
	US 90-day bank bill	1.44	-0.77	-2.45	-3.29	0.32
	NZ - US 90-day bank bill	3.68	0.08	-0.44	-0.49	-0.57
Fixed Interest	NZ 5-year gov't stock	4.27	-0.56	-1.30	-2.83	-1.56
	NZ 10-year gov't	4.65	-0.46	-1.06	-1.77	-1.27
	NZ 10-year swap	4.99	-0.85	-1.81	-2.77	-1.61
	AUS 10-year gov't	3.99	-0.59	-1.48	-2.38	-1.62
	US 10-year gov't	2.07	-0.83	-1.76	-2.01	-2.18
Equities	NZ - NZX50 (NZ$)	1905	-0.6%	-13.2%	-36.5%	-22.3%
	AUS - All Ords (A$)	3659	-0.4%	-21.0%	-43.0%	10.7%
	JAP - Nikkei (¥)	8860	4.1%	-21.3%	-42.1%	-17.0%
	UK - FT100 (£)	4434	3.4%	-9.6%	-31.3%	-1.0%
	US - S&P500 (US$)	903	0.8%	-22.6%	-38.5%	-18.8%
	WORLD - MSCI (US$)	920	3.1%	-22.2%	-42.1%	-11.2%
	MSCI in NZD (NZ$)	1592	-1.7%	-9.8%	-22.3%	0.7%
Exchange Rates	NZD/USD	0.578	4.8%	-13.7%	-25.5%	-11.8%
	NZD/AUD	0.835	-0.6%	-0.3%	-5.2%	-4.6%
	NZD/JPY	52.2	-0.6%	-25.3%	-40.0%	-25.5%
	NZD/GBP	0.401	11.9%	7.7%	3.1%	8.8%
	NZD/EUR	0.411	-3.9%	-12.0%	-21.9%	-21.3%
	NZ TWI	0.563	1.0%	-11.4%	-21.8%	-13.8%
	EUR/USD	1.407	9.1%	-2.0%	-4.6%	12.1%

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

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Cash

- The Reserve Bank of New Zealand (RBNZ) cut rates by 0.25% in July, 0.5% in September and 1% in October. On December 4th, the RBNZ cut 1.5%, taking the Official Cash Rate to 5%.
- The RBNZ is expected to lower the Official Cash Rate further, assuming the outlook for inflation evolves as projected.
- 90-day bank bill yields declined in December, reflecting the expectation of further cuts from the Reserve Bank. Term deposit rates fell noticeably between late October and early December, reflecting the moves in the Official Cash rate.
- Financial markets and our own forecasts are predicting more easing of the Official Cash Rate in coming months. RBNZ's next interest rate announcement is on 29 January.

Fixed interest

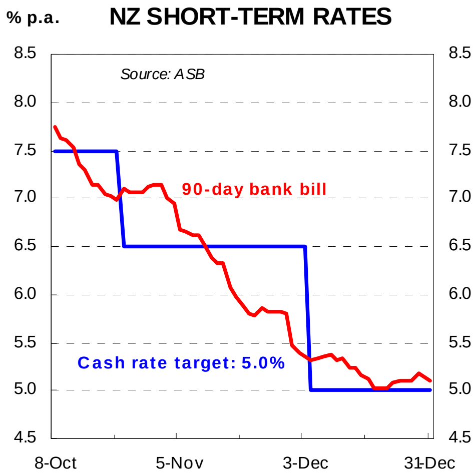
- The ongoing fall in Government Bond yields reflects an ongoing flight to safety. The 10-year bond fell 0.46% to 4.65%.
- The US 10-year bond fell by more – down 0.83%. The yield there is getting close to 2%. The yield on this note had never gone below 3% in its 46-year history until November 2008.
- The spread between NZ and US 10-year bonds widened to around 2.6 – 2.8%. It was as wide as 3% earlier in 2008, but remains wider than the average of 1.5% over the last 10 years. New Zealand maintains a significant interest rate advantage over offshore rates, despite falling local rates.
- In both the US and New Zealand, 10-year bond yields are below the rate of inflation, reflecting both extreme risk aversion, and an expectation of rapidly diminishing inflation.

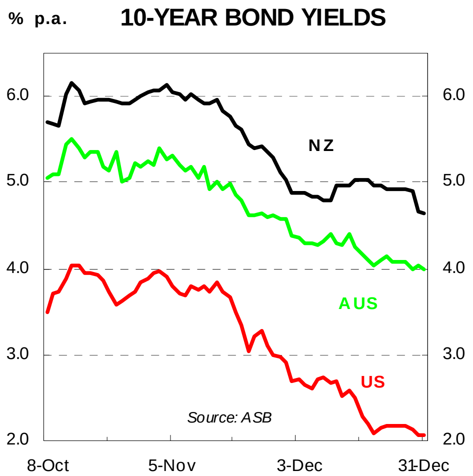
Equities

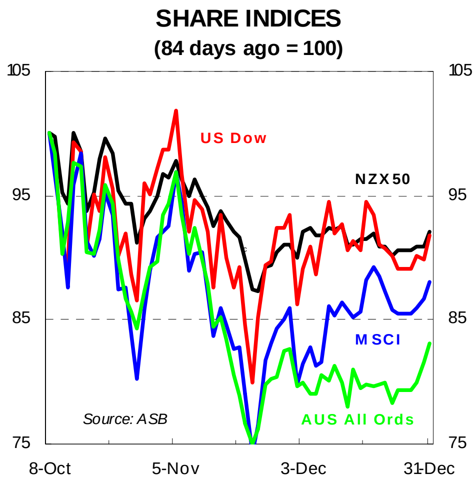
- The start of December saw global equity markets unable to hold onto the substantial gains of late November.
- The Dow Jones gave up its six-day winning streak on the very first trading session for the month, losing almost 700 points.
- Not helping markets was the continued debate on a bailout package to the struggling automakers. The negative sentiment was reflected in automakers across the globe.
- But investors started to warm to the substantial interest rate cuts by central banks late in the month. Investor sentiment was also buoyed by US President-elect Barrack Obama's plan to boost infrastructure and public works.
- The Australian All Ords lost 0.4% and the NZX 50 Capital Index lost 0.6% in the month. However, other markets fared better, with the world MSCI rising 3.1% in USD terms in December.

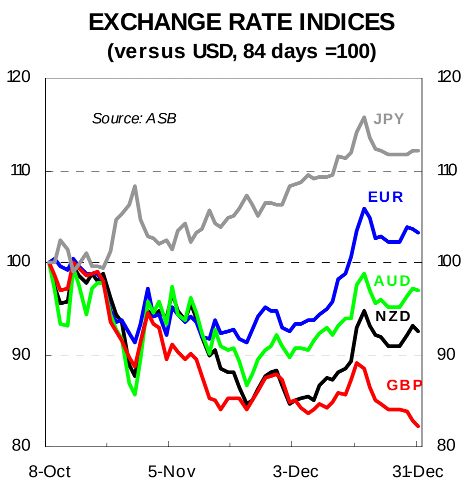
Exchange rates

- The NZD has weakened significantly against the major currencies in recent months.
- However, the NZD appreciated 4.8% against the USD over the month of December. The USD strength over recent months ended, and the greenback languished after the larger than expected cut in the Fed Funds rate on 16 December. The USD lost 9% against the Euro and 5% against the JPY.
- The NZD lost 0.6% against the JPY and continues to trade around low levels last seen in 2001.
- On a trade weighted basis the NZD lifted 1% over the month, with gains against the USD and GBP outweighing losses against the JPY, AUD and Euro.









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