

# Markets Monthly

## Bond yields rise and shares fall.

- The US sharemarket recorded the worst February return since 1933.
- Government bond yields continue to rise as concerns mount about huge future debt issuance.
- NZD lost ground on the USD, but gained on a on a trade weighted basis due to JPY weakness.

Over the first week in February the Dow Jones industrial Average Index gain almost 3.5%, as investors gained confidence the imminent stimulus plan and a financial system overhaul would eventually help the US economy. In contrast to the early investor optimism, the economic data out of the US continued to print on the weaker side of expectations in February. In particular the slide in US employment certainly surprised markets. US non-farm payrolls fell by 598,000 - the biggest decline in 34 years. The continued weakness in the US housing sector did not show any indications of bottoming out - the level of unsold homes in the US remains daunting and vacancy rates are expected to climb sharply into the third quarter of 2009.

The eventual lack of detail by the US policy makers on the bank bailout plan contributed a change in investor sentiment, and a rout on markets as investors bailed out of equities mid-month. The sharp contraction in US economic growth (6.2% annualised) confirmed the US recession is likely to be a lot more prolonged than initially expected and ensured that US share indices closed the month on a negative note. The S&P 500 index lost 11% over the last three weeks of February, and the market posted the weakest February return since 1933. The local sharemarket lost 9.1%. Solid performance by several Australian companies lead to a sharemarket decline across the Tasman less severe than most, with the All Ords down 5.2%.

Weak economic data and falling sharemarkets would ordinarily push bond yields much lower. However, projections for government debt to rise sharply over the next few years added to market concerns about the ability to absorb large volumes of bond issuance. Credit rating concerns are another pressure. The growing level of US Government debt (forecast by the White House at the end of February to increase by \$4 trillion between 2008 and 2010) and the failure of the Federal Reserve to follow through with plans to purchase Treasuries weighed on the bond market in February. This was reinforced by some concerns that the Fed's unconventional policy measures may fuel inflation down the track.

The NZD generally weakened over February as economic data continued to show weakness. However, an 8.5% lift against the Yen helped the NZD rise 1.1% on a trade weighted basis.

Date	Instrument	28-Feb-09	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	3.50	0.00	-3.00	-4.75	-1.75
	NZ 90-day bank bill	3.19	-0.47	-2.61	-5.65	-2.40
	US 90-day bank bill	1.26	0.09	-0.94	-1.81	0.16
	NZ - US 90-day bank bill	1.93	-0.56	-1.67	-3.84	-2.56
Fixed Interest	NZ 5-year gov't stock	3.88	0.18	-0.96	-3.01	-1.85
	NZ 10-year gov't	4.52	0.17	-0.59	-1.89	-1.36
	NZ 10-year swap	4.87	0.35	-0.97	-2.85	-1.64
	AUS 10-year gov't	4.36	0.26	-0.22	-2.00	-1.19
	US 10-year gov't	2.98	0.16	0.00	-0.79	-0.99
Equities	NZ - NZX50 (NZ\$)	1768	-9.1%	-7.7%	-33.2%	-27.6%
	AUS - All Ords (A\$)	3297	-5.2%	-10.2%	-41.9%	-2.2%
	JAP - Nikkei (¥)	7568	-5.3%	-11.1%	-44.4%	-31.5%
	UK - FT100 (£)	3830	-7.7%	-10.7%	-34.9%	-14.7%
	US - S&P500 (US\$)	735	-11.0%	-18.0%	-44.8%	-35.8%
	WORLD - MSCI (US\$)	751	-10.5%	-15.9%	-48.4%	-29.7%
	MSCI in NZD (NZ\$)	1486	-10.0%	-8.3%	-16.8%	-4.4%
Exchange Rates	NZD/USD	0.505	-0.6%	-8.3%	-38.0%	-26.5%
	NZD/AUD	0.783	-0.8%	-6.8%	-9.0%	-12.0%
	NZD/JPY	49.3	8.5%	-6.1%	-42.3%	-34.5%
	NZD/GBP	0.354	-1.1%	-1.1%	-13.6%	-4.0%
	NZD/EUR	0.397	0.8%	-7.0%	-26.0%	-28.1%
	NZ TWI	0.520	1.1%	-6.7%	-29.0%	-24.0%
	EUR/USD	1.272	-1.4%	-1.4%	-16.2%	2.2%

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

**Chris Tennent-Brown** – CBA NZ Economist – 649 374 8819 – [chris.tennent-brown@asb.co.nz](mailto:chris.tennent-brown@asb.co.nz)

### General Advice Warning

As this report was prepared without taking into account your objectives, financial situation or particular needs, you should not take any action in reliance of this report without considering your particular circumstances and, if necessary, obtaining professional advice.

### Cash

- The Reserve Bank of New Zealand (RBNZ) cut the Official Cash Rate by 0.25% in July, 0.5% in September, 1% in October, and 1.5% in December 2008. The aggressive moves continued on January 29th, with the RBNZ delivering another 1.5% cut, taking the OCR to 3.5%.
- RBNZ's next interest rate announcement is on 12 March.
- 90-day bank bill yields declined in February, reflecting the expectation of further cuts from the Reserve Bank in March.
- Financial markets and our own forecasts are predicting more easing of the Official Cash Rate in coming months, although the size of any future cuts will likely be smaller.
- We expect a 1% cut on 12 March.

### Fixed interest

- Government yields are still well below long-term averages, despite lifting off their lows over 2009.
- NZ 10-year Government Bonds are yielding around 4.5%, compared with the average of 6.6% over the past 15 years. US 10-year Government Bonds are yielding around 3%, compared with the average yield of 5.2% over the past 15 years.
- Economic data was very weak in February and share markets fell sharply, which would ordinarily push bond yields much lower. But the growing level of Government debt (e.g. US Debt is forecast by the White House to increase by \$4 trillion between 2008 and 2010) weighed on the market in February.
- Credit rating concerns are also putting upward pressure on yields, as investors demand more return for the risks they are taking in holding bonds.

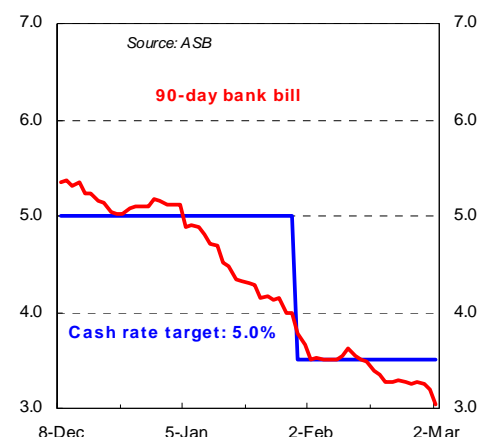
### Equities

- Over the first week of February, the Dow Jones Industrial Average gain almost 3.5%, as investors gained confidence the US stimulus plan and financial system overhaul would likely help the US economy.
- In contrast to the early investor optimism, the economic data out of the US continued to print on the weaker side of expectations, and investors bailed out of equities mid-month. The S&P 500 index lost 11% over the last three weeks of February, and posted its worst February result since 1933.
- The local sharemarket lost 9.1%, reflecting disappointing earnings reports and difficult trading conditions. In contrast, solid performance by several Australian companies lead to a sharemarket decline across the Tasman less severe than most, with the All Ords down 5.2%.

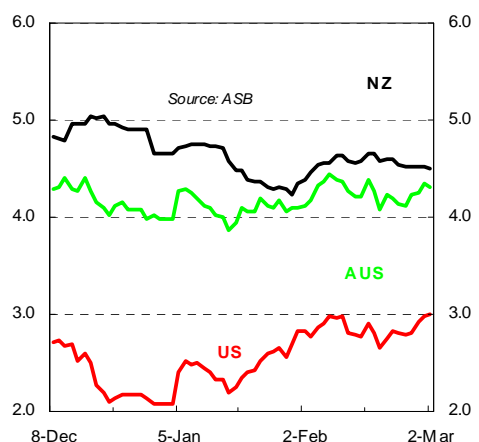
### Exchange rates

- The NZD generally weakened over February as local economic data continued to show considerable weakness in February.
- However, an 8.5% lift against the Yen helped the NZD rise 1.1% on a trade weighted basis.
- The December Crown Accounts reasserted fears for a long-term currency rating downgrade post the 28 May New Zealand budget.
- These fears were played out in selling NZD over late February. NZD/AUD, in particular sold at the end of the month as relative interest rate differentials maintained AUD support.
- The USD strengthened 2.3% over the month on a trade weighted basis.

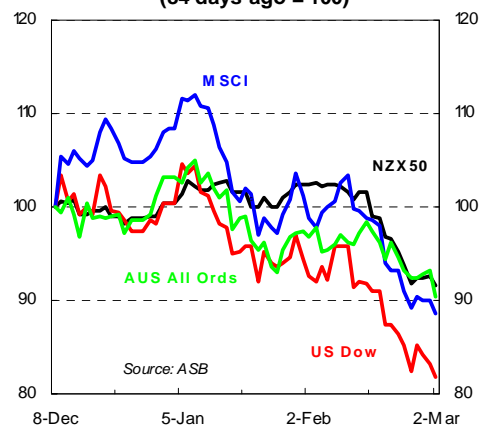
% p.a. **NZ SHORT-TERM RATES**



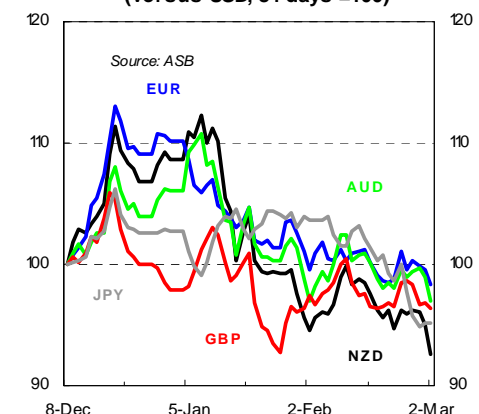
% p.a. **10-YEAR BOND YIELDS**



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



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



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ASB ECONOMICS  
Level 9, 135 Albert Street, Auckland

ASB GROUP ECONOMICS			PHONE	FAX
Chief Economist	Nick Tuffley	<a href="mailto:nick.tuffley@asb.co.nz">nick.tuffley@asb.co.nz</a>	(649)374 8604	
Economist	Jane Turner	<a href="mailto:jane.turner@asb.co.nz">jane.turner@asb.co.nz</a>	(649) 374 8185	(649) 302 0992
CBA NZ Economist	Chris Tennent-Brown	<a href="mailto:chris.tennent-brown@asb.co.nz">chris.tennent-brown@asb.co.nz</a>	(649) 374 8819	

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