ECONOMICS

6 Jul. 09

Markets Monthly

The sharemarket rally continues in June.

- **Sharemarkets around the rallied in early June, but softened in the closing weeks of the month.**
- **Financial markets remained optimistic, and focused on signs of recovery in June.**
- **NZD posted gains on most currencies during June, lifting 2.5% on a trade-weighted basis.**

The rally in global equity markets continued through the first two weeks of June, with underlying strength in commodity prices buoying resource stocks. Early in June better manufacturing activity out of both China and the US boosted investor sentiment. The US ISM manufacturing survey rose to an eight-month high while in China the equivalent manufacturing gauge hit a 10-month high.

The US housing sector and labour market figures added to the flow of positive economic indicators over the month. Over the first two weeks of June the Dow Jones rallied 3.5% to a six-month high while the Australian All Ords closed in on an eight-month high, up 6.3% over the two-week period. The third week of June was a bit more subdued, with investors taking stock after the solid rally in equity markets.

A surprising profit increase from US home retailer Bed Bath & Beyond and improved new sales by home builder Lennar spurred a rally in US markets into the close of the month. For the full month, equity markets were mixed across the globe with the US S&P 500 remaining largely flat. Reflecting the stronger domestic economy the Australian All Ords index rallied by 3.5% over the month. At the other end of the scale, the UK's FTSE 100 index shed 3.8%. The NZ sharemarket lifted a more subdued 0.7% in June.

Concerns over rising US Treasury yields weighed on markets after an auction of long-dated US Treasuries was not well supported, resulting in 10-year yields rising above 4% for the first time in eight months. The impact on borrowing costs was the major concern with investors worried the rise in yields could crimp economic activity. In contrast, a record US$104 billion in an auction of US treasuries in late June was well supported, allowing markets to focus on the upcoming US earnings season. US bond yields dropped from the 4% high, yielding a modest 3.51% at month end.

The USD weakened over the month, and the NZD posted gains on the cross rates we monitor. Foreign central bank comments regarding the USD's position as the major reserve currency caused volatility in the USD over the month. The NZD reached a 9-month high of US$0.6594 against the USD early in June. The local currency lifted 2.5% on a trade-weighted basis despite a deepening in the New Zealand recession. GDP data released in June showed the economy contracted 1% in the first quarter.

Date	Instrument	30-Jun-09	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	2.50	0.00	-0.50	-5.75	-3.25
	NZ 90-day bank bill	2.82	0.07	-0.51	-5.84	-3.33
	US 90-day bank bill	0.60	-0.07	-0.61	-2.19	-0.95
	NZ - US 90-day bank bill	2.22	0.14	0.10	-3.65	-2.38
Fixed Interest	NZ 5-year gov't stock	4.77	0.22	0.31	-1.55	-1.44
	NZ 10-year gov't	5.96	0.19	0.69	-0.42	-0.38
	NZ 10-year swap	6.04	0.09	0.26	-1.30	-0.92
	AUS 10-year gov't	5.64	0.15	0.98	-0.80	-0.24
	US 10-year gov't	3.51	-0.10	0.77	-0.44	-1.18
Equities	NZ - NZX50 (NZ$)	1902	0.7%	6.8%	-17.6%	-29.5%
	AUS - All Ords (A$)	3948	3.5%	11.8%	-26.0%	11.8%
	JAP - Nikkei (¥)	9958	4.6%	22.8%	-26.1%	-16.0%
	UK - FT100 (£)	4249	-3.8%	8.2%	-24.5%	-4.8%
	US - S&P500 (US$)	919	0.0%	15.2%	-28.2%	-19.4%
	WORLD - MSCI (US$)	964	-0.6%	19.7%	-31.2%	-9.3%
	MSCI in NZD (NZ$)	1480	-4.2%	4.4%	-19.5%	-12.6%
Exchange Rates	NZD/USD	0.651	3.8%	14.6%	-14.6%	3.8%
	NZD/AUD	0.805	1.1%	-2.5%	1.6%	-11.7%
	NZD/JPY	62.3	2.9%	11.6%	-22.9%	-8.5%
	NZD/GBP	0.392	-0.4%	-1.4%	2.4%	12.9%
	NZD/EUR	0.462	2.9%	7.7%	-4.4%	-11.0%
	NZ TWI	0.613	2.5%	7.4%	-9.6%	-4.5%
	EUR/USD	1.411	0.9%	6.4%	-10.7%	16.7%

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

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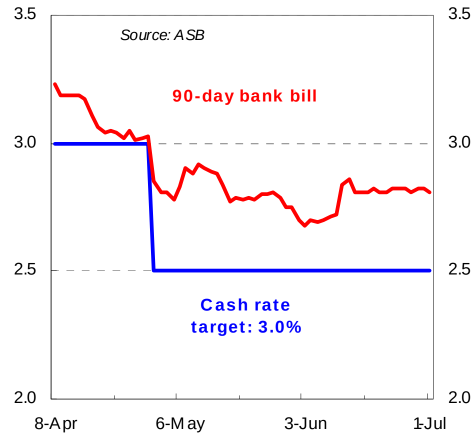
Cash

- On 30 April, the RBNZ delivered a 50bp cut to the Official Cash Rate (OCR).
- The RBNZ kept the OCR on hold at 2.5% as we were expecting on June 11. In addition the tone of the RBNZ's statement delivered few surprises.
- The RBNZ said "*The OCR could still move modestly lower over the coming quarters. As we said at the time of the April OCR decision, we expect to keep the OCR at or below the current level through until the latter part of 2010".*
- The 90-day bank bill yield lifted modestly during June, but the market pricing at present is consistent with the RBNZ most likely being on hold over the coming months.
- Term deposit rates for longer time frames remained high in June.

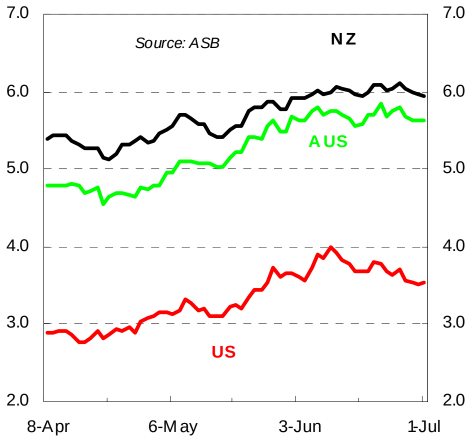
% p.a. **NZ SHORT-TERM RATES**



Fixed interest

- The upward drift in local government bond yields continued in May. There has been upward pressure on bond yields globally as markets anticipate a large increase in the supply of bond issuance from both corporates and governments.
- NZ 10-year Gov't Bond yields lifted 19 basis points during the month, and are currently trading over 170 basis points above the lows touched in early 2009.
- The US 10-year Treasury yield rocketed up over 50bps in early June, breaking through 4% on 11th June, before rallying back to close the month with yields back around 3.5%. Concerns over supply drove the move to 4%, but auctions of Treasuries were well supported late in the month and doubts re-emerged over the vigour of the economic recovery. A record US$104 billion in an auction of US Treasuries in late June was well supported.

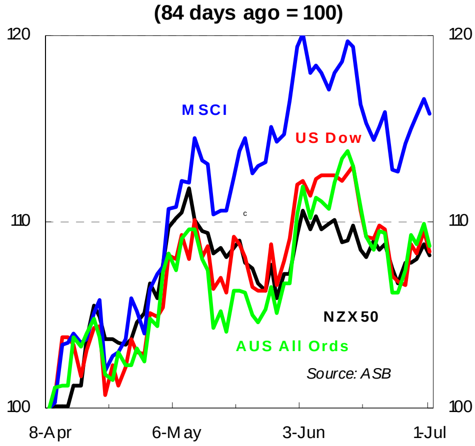
% p.a. **10-YEAR BOND YIELDS**



Equities

- Early in June better manufacturing activity out of both China and the US boosted investor sentiment, and equity markets rallied globally.
- Over the first two weeks of June the Dow Jones rallied 3.5% to a six-month high. For the full month, equity markets were mixed across the globe with the US S&P 500 remaining largely flat. Reflecting the stronger domestic economy the Australian All Ords index rallied by 3.5% over the month. At the other end of the scale, the UK's FTSE 100 index shed 3.8%. The NZ sharemarket lifted a more subdued 0.7% in June.
- Over the quarter the S&P 500 posted its best quarter in a decade up 25.1 per cent, while the NZ sharemarket was up 8% over the quarter.

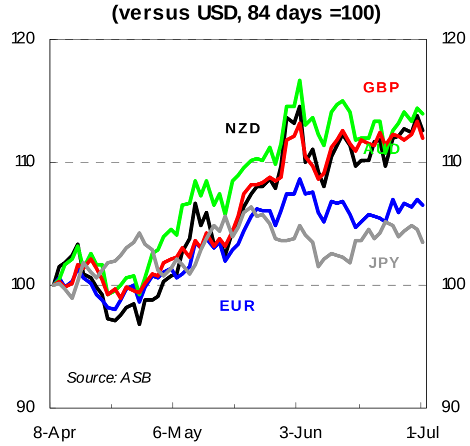
SHARE INDICES
(84 days ago = 100)



Exchange rates

- The USD gained ground over the month, rising 1.0% in trade weighted terms.
- The New Zealand dollar (NZD) posted a 3.8% appreciation against the USD over the month, reaching a high of 0.6594 in early June. In trade-weighted terms, the NZD appreciated 2.5%.
- The NZD outperformed all major currencies over the month, with the exception of the GBP.
- As with the AUD, the NZD received support from rising investor appetite for risk.
- The Government and the RBNZ both attempted to jawbone the currency lower over the month. But markets resisted their calls the NZD remained buoyant. Despite being in recession for five quarters, the NZ economy overall is performing better than many, and the currency reflects this sentiment.

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



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