

Markets Monthly

October lives up to reputation for volatility

- Global sharemarkets rally over first half of October, but volatile end sees markets down overall.
- NZ dollar rocketed through most of October, only to sharply reverse gains in final few days.
- Interest rate markets buffeted by rapidly changing rate expectations in Australasia.

The month of October lived up to its reputation for volatility, with global equity markets making solid gains in the first half of the month, giving way to weakness and large moves in the second half. Global markets gathered momentum early in the month followed by some better-than-expected earnings results. Markets consolidated over the middle part of October, before becoming more jittery toward the end of the month. In the final three sessions of the month in the US saw exceptional volatility, rocked around by first lower-than-expected new home sales figures, then better-than-expected GDP data and finally pushed lower by end-month profit taking.

For most of October, the NZ dollar surged and outperformed on most crosses (with the AUD as obvious exception), only to lose momentum in the final days of the month. The NZ dollar lost all its gains, collapsing with the decline in global investor sentiment. While the NZD/USD wound up 0.6% lower at the end of the month, it had steadily climbed during the month to reach a peak of 0.7635 on 22nd October. Much of the increase in the NZD came on the back of USD weakness. A number of repetitive remarks by the FOMC and Fed members about their commitment to “keep interest rates low for an extended period of time” during the month of October kept downward pressure on the USD.

Interest rate markets also proved to be relatively volatile in October, underscored by large swings in cash rate expectations throughout the month. The RBA’s decision to hike the cash rate 25 basis points made it the first G20 nation to commence an exit strategy. Stronger than expected employment data followed by tougher talk by the RBA saw markets speculate on the possibility of a 50 basis point hike to follow in November. However, inflation data later in the month saw markets pull expectations back to 25 basis points.

In NZ, stronger than expected data over October, including quarterly business confidence, housing data and inflation saw markets push forward the expected timing of the first OCR hike. However, the RBNZ put a dampener on expectations at the Oct 29th review, delivering a deliberately dovish statement aimed at reining market expectations back in.

Longer-term government bond yields increased over October, although lost some of the gain in the last week.

Date	Instrument	30-Oct-09	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	2.50	0.00	0.00	-4.00	-4.00
	NZ 90-day bank bill	2.79	-0.02	0.00	-4.35	-3.92
	US 90-day bank bill	0.28	-0.01	-0.20	-2.91	-1.88
	NZ - US 90-day bank bill	2.51	-0.01	0.20	-1.44	-2.04
Fixed Interest	NZ 5-year gov’t stock	5.14	0.18	0.37	-0.72	-0.87
	NZ 10-year gov’t	5.77	0.07	0.00	-0.16	-0.27
	NZ 10-year swap	6.21	0.17	0.23	-0.34	-0.49
	AUS 10-year gov’t	5.57	0.16	-0.14	0.37	0.19
	US 10-year gov’t	3.41	0.11	-0.23	-0.53	-0.65
Equities	NZ - NZX50 (NZ\$)	2150	1.4%	4.9%	7.5%	-23.6%
	AUS - All Ords (A\$)	4647	-1.9%	9.4%	16.7%	22.7%
	JAP - Nikkei (¥)	10035	-1.0%	-3.1%	17.0%	-6.8%
	UK - FT100 (£)	5045	-1.7%	9.5%	15.2%	9.1%
	US - S&P500 (US\$)	1036	-2.0%	4.9%	7.0%	-8.3%
	WORLD - MSCI (US\$)	1106	-1.8%	5.9%	15.6%	3.1%
	MSCI in NZD (NZ\$)	1544	-1.2%	-2.9%	-5.2%	-1.8%
Exchange Rates	NZD/USD	0.717	-0.6%	9.1%	21.9%	5.1%
	NZD/AUD	0.799	-2.6%	0.8%	-8.5%	-12.7%
Rates	NZD/JPY	64.7	0.0%	3.3%	11.6%	-10.6%
	NZD/GBP	0.438	-2.7%	10.3%	21.9%	17.6%
	NZD/EUR	0.487	-1.3%	4.7%	6.3%	-9.0%
	NZ TWI	0.647	-1.3%	5.4%	9.3%	-4.2%
	EUR/USD	1.472	0.7%	4.2%	14.7%	15.4%

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

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 RBA's decision to hike the cash rate 25 basis points made it the first G20 nation to commence an exit strategy. Over the course of October, the early RBA move combined with stronger than expected NZ data saw the market increasingly price in rate hikes from the RBNZ for the first quarter of 2010.
- However, at the October 29th announcement, the RBNZ put a dampener on market expectations with a deliberately dovish statement. The RBNZ was direct, stating *"In contrast to current market pricing, we see no urgency to begin withdrawing monetary policy stimulus, and we expect to keep the OCR at the current level until the second half of 2010."*
- The RBNZ's strategy was successful, pulling market expectations back closer in line with our own view. We expect the RBNZ to keep the cash rate on hold at 2.5% until April 2010.

Fixed interest

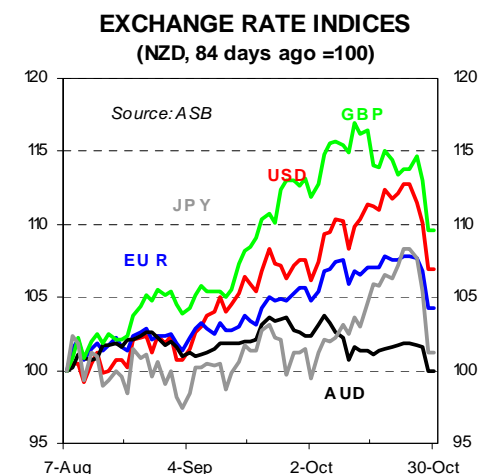
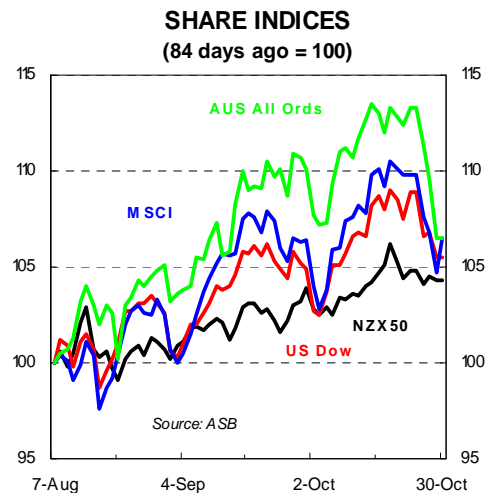
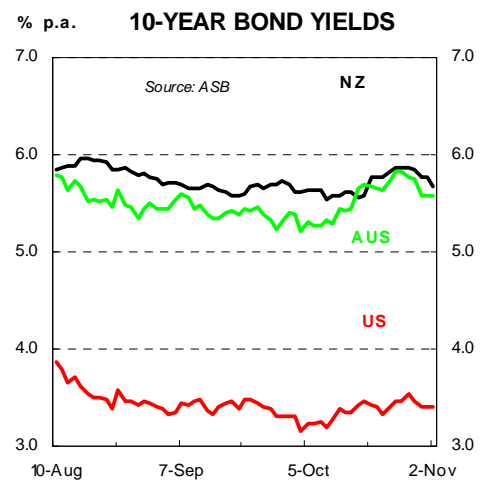
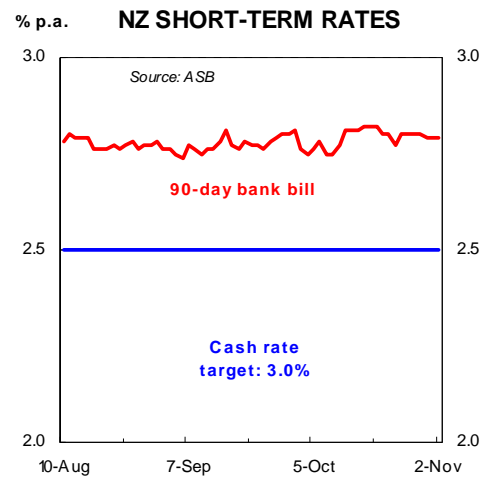
- Longer-end government yields trended up over most of October, a trend that was shared globally. Underpinning much of the rise was a more positive outlook for global economic prospects.
- The buoyant mood saw appetites for risk improve, which generally favoured asset allocation into equities, at the expense of safer assets such as government bonds. However, this sentiment reversed over the last few days of October, driving a decline in yields.
- In line with rising government bond yields, NZ swap rates also trended up for much of October. The shorter end of the swap curve (1-2 year) saw large lifts in interest rates, on the back of views for earlier rate hikes, causing the yield curve to flatten. However, the yield curve remains steep by historical comparison.

Equities

- The month of October lived up to its reputation for volatility, with solid gains in equity markets over the first half of the month, giving way to weakness and large moves in the second half.
- Overall, the US Dow Jones ended October largely unchanged (up less than a point). But the broader S&P 500 lost 2.0 per cent while the Nasdaq surrendered 3.6 per cent.
- Global equity markets, as summarised by the MSCI Index, lost 1.8%, but for NZ investors in offshore markets the 0.6% decline in the NZ dollar helped mitigate this loss to 1.2%.
- The NZX50 appeared to buck the trend of global markets, as at October 30 managing to hold its gain of 1.4% while other markets lost between 1% and 2%. Alas, amidst the large volatility during the final days of October, the start of the new month saw the weakness in global markets catch up with NZ markets.

Exchange rates

- For most of October, the NZ dollar surged, outperforming on most crosses. However, in the last few days a renewed bout of risk aversion reversed most of the Kiwi's gains.
- The NZD climbed steadily through the month against the USD, to reach a peak of 0.7635 on the 22nd of October. Much of the strength in the NZ dollar came on the back of USD weakness and upbeat views on global economic growth prospects.
- The NZ dollar also made strong gains against the Pound, as the market became extremely unsettled on the UK economy's fragile outlook. Movements in the Yen tended to mimic those against the USD. In contrast, the NZD remained weak against the AUD as the rosier outlook across the Tasman remained in focus.



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