

# Markets Monthly

## Markets finish the year in an upbeat mood

- USD starts to strengthen on stronger economic data, particularly US labour market data.
- Global sharemarkets post further gains while US government bond yields rise sharply.
- NZD outperforms major crosses as RBNZ adopts more hawkish tone.

Global markets managed to shake off November's Dubai debt concerns early in December, buoyed by stronger than expected economic data. Global sharemarkets made strong gains, with the MSCI benchmark increasing 1.7% over December, and 1.4% adjusting for NZD movements over the month.

The turning point was brought about by the surprisingly good US labour market data, including the first decline in the US unemployment rate in this cycle. Global sharemarkets rallied and the USD started to strengthen as markets looked for an earlier withdrawal of monetary stimulus by the Federal Reserve. Importantly, the strengthening of the USD following the better than expected US economic data illustrated a shift in the psychology of market pricing toward the USD, post the release of good US economic data.

USD strength added to weakening support for the Yen, triggered by further Bank of Japan policy action described as "effectively quantitative easing". The lower Yen was welcomed by Japanese sharemarkets.

The NZ dollar lifted against all major crosses, with the Trade-Weighted exchange rate up 3.4%. Despite USD strength, the NZD ended the month slightly higher against the USD over the month. The kiwi steadily declined against the USD through the most of the month (troughing on the 23<sup>rd</sup> of December after briefly breaking below 70 cents) only to swiftly recover lost ground over the final few days.

The NZD outperformed the AUD as markets factored in stronger rate expectations in NZ. The RBNZ kept the OCR unchanged at 2.5% at the December 10 meeting. However, the tone of the accompanying statement was significantly more hawkish than expected. The RBNZ now expects it will begin to lift the OCR in the middle of 2010, compared to the 'second half' it previously implied. The NZD/AUD gained 2 cents immediately following the more hawkish comments from the RBNZ, and maintained this gain for the remainder of the month. Fixed interest markets now have close to 50 basis points of OCR hikes priced in by April.

Global longer-term bond yields increased strongly over the month, in part buoyed by better-than-expected data and improved risk sentiment. However, an auction of US\$118bn bonds in the final days of December, typically an illiquid time of the year, possibly exacerbated the rise in US bond yields.

Date	Instrument	31-Dec-09	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	2.50	0.00	0.00	-2.50	-4.00
	NZ 90-day bank bill	2.80	0.00	-0.01	-2.31	-3.95
	US 90-day bank bill	0.25	-0.01	-0.04	-1.18	-2.31
	NZ - US 90-day bank bill	2.55	0.00	0.03	-1.13	-1.64
Fixed Interest	NZ 5-year gov't stock	5.53	0.22	0.54	1.23	-0.49
	NZ 10-year gov't	6.11	0.18	0.47	1.46	0.14
	NZ 10-year swap	6.16	0.11	0.12	1.17	-0.56
	AUS 10-year gov't	5.73	0.44	0.32	1.75	0.38
	US 10-year gov't	3.79	0.57	0.49	1.73	-0.47
Equities	NZ - NZX50 (NZ\$)	2134	2.7%	0.7%	12.1%	-30.4%
	AUS - All Ords (A\$)	4883	3.5%	3.0%	33.4%	20.5%
	JAP - Nikkei (¥)	10546	12.8%	4.1%	19.0%	-8.2%
	UK - FT100 (£)	5413	4.3%	5.4%	22.1%	12.4%
	US - S&P500 (US\$)	1115	1.8%	5.5%	23.5%	-8.0%
	WORLD - MSCI (US\$)	1168	1.7%	3.7%	27.0%	-0.1%
	MSCI in NZD (NZ\$)	1617	1.4%	3.5%	1.6%	-0.6%
Exchange Rates	NZD/USD	0.723	0.3%	0.2%	25.0%	0.5%
	NZD/AUD	0.808	3.0%	-1.5%	-3.3%	-12.5%
	NZD/JPY	66.8	7.0%	3.1%	27.9%	-9.5%
	NZD/GBP	0.449	3.5%	-0.1%	12.2%	20.4%
	NZD/EUR	0.504	5.4%	2.1%	22.6%	-4.6%
	NZ TWI	66.1	3.4%	0.8%	17.4%	-4.0%
	EUR/USD	1.43	-4.8%	-1.9%	1.9%	5.4%

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 RBNZ kept the OCR unchanged at 2.5% at the December 10 meeting. However, the tone of the accompanying statement was significantly more hawkish than expected. The RBNZ now expects it will begin to lift the OCR in the middle of 2010, compared to the 'second half' and 'latter part' previously.
- RBNZ now recognises the stronger economic outlook and sees the risks to inflation moving toward the upside. Markets reacted strongly to the change in stance, with 25 basis point hike now fully priced in by March and 50 basis points priced in by April.
- The RBNZ acknowledged the recent rise in deposit rates, noting that the widening gap between the OCR and bank funding costs was doing some of the tightening in financial conditions for them "reduces the need for more immediate action".

### Fixed interest

- US and Australian 10-year government bond yields lifted strongly over the month (up 57 and 44 basis points respectively), although the lift in NZ government bonds was slightly more muted (up 18 basis points).
- The Treasury released its Half Year Fiscal and Economic Update, showing a much improved set of fiscal accounts and (overall) a smaller bond issuance programme. However, local bond markets were unmoved by the announcement.
- The yield on Government bonds in the US, Europe and Asia were all driven higher by some year-end asset reallocation, diminished concerns of Dubai credit default, and generally stronger economic data. Compounding upon the sell-off was the US\$118bn worth of 2, 5 and 7-year Treasury notes auctioned between 29<sup>th</sup> and 31<sup>st</sup> December (an illiquid period in the market).

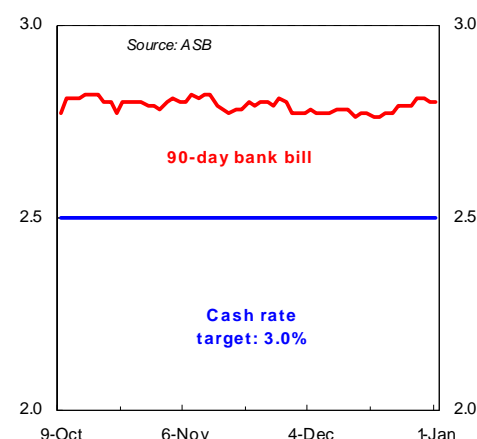
### Equities

- NZ equity market movements over the month mirrored Australian fortunes, with respective market benchmarks gaining 2.7% and 3.5% respectively.
- The big issue over November – the Dubai debt situation – largely retreated from view in December, although replaced to some extent by rating agency actions on a number of European nations. Global market sentiment entered the month with caution, as Dubai-related concerns lingered. However, risk appetites quickly recovered following a string of stronger than expected economic data (particularly US non-farm payrolls on December 4<sup>th</sup>). The US S&P gained 1.8% over the month.
- The Nikkei was the star performer for the month, recovering 12.8%, benefiting from the lower Yen against the USD (improving Japanese export prospects).

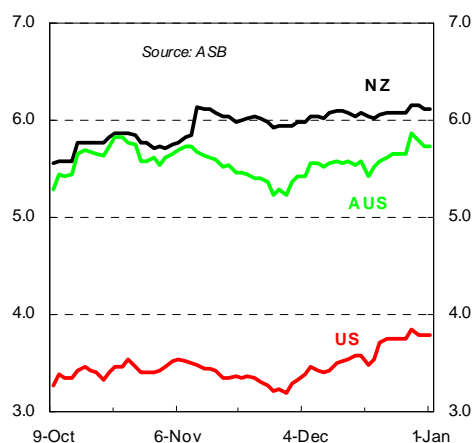
### Exchange rates

- The NZ Trade-Weighted exchange rate was up 3.4%, with solid gains against all the major crosses. A more hawkish tone from the RBNZ underpinned the out performance of the NZD/AUD. The NZD also made strong gains against the Yen, Euro and Pound following Christmas.
- The USD firmed during the month following stronger than expected data, spurred a larger than expected improvement in the US labour market and the first decline in the US unemployment rate this cycle.
- The Euro was undermined by sovereign ratings concerns (with the Greek sovereign credit outlook lowered). Meanwhile, the Yen was weighed down by the Bank of Japan's December 1st meeting which resulted in a new lending facility classed as 'effectively quantitative easing' by the BOJ Governor.

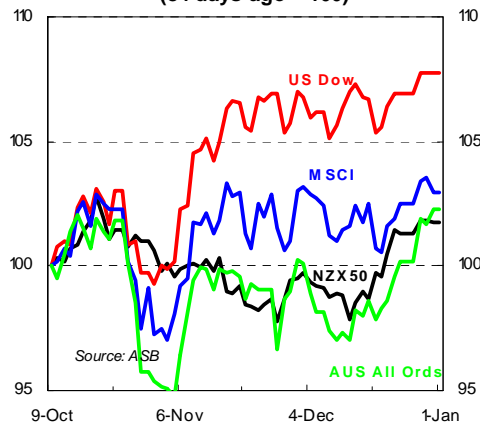
% p.a. **NZ SHORT-TERM RATES**



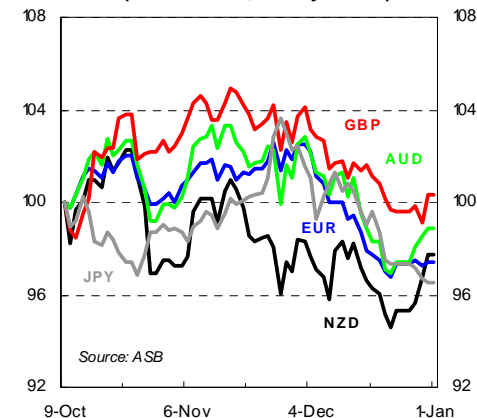
% p.a. **10-YEAR BOND YIELDS**



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



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



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