

# Markets Monthly

## Euro area concerns continue to dominate

- Euro area sovereign debt concerns continued to rattle markets in early February.
- Hopes of a bailout deal for Greece helped improve market sentiment mid-February.
- Euro and GBP weaken further, USD gathers strength, NZD loses ground against AUD.

The euro area concerns dominated markets attention over February, although reports of a potential bail-out deal helped improve market sentiment over the second half of the month. Global markets (measured by the MSCI) lifted 1.2%, and adjusting for NZD movements returned 2.8% to NZ investors. Nonetheless, the equity markets remain below January peaks as residual concerns remain.

Despite various rumours of bailout deals for Greece over the month, no concrete plans for a solution to the Greek debt issues were announced. Concerns were exacerbated by several factors over the month: (1) Greek measures to reign in their fiscal deficit caused social unrest in Greece, with protests and strikes occurring through the month; (2) Major ratings agencies flagged their intentions to downgrade Greece's sovereign rating by 'one or two notches' over the coming month. In addition, four of Greece's major banks were downgraded one notch to BBB by Fitch (negative outlook); (3) Unhelpful comments from Greek officials reduced the markets' expectations for a bailout from certain European states. (4) Greece admitted to entering into swap agreements without the European Union's consent which may have served to hide some of their government debt issues. In addition to concerns for government debt levels, markets noted a slowing in the pace of the European economic recovery, as a series of economic data failed to meet the market's expectations.

Unsurprisingly, the euro remained under pressure (depreciating for the third consecutive month) as markets continued to fret over implications for sovereign ratings and the future of the European and Monetary Union. Meanwhile the USD stabilised on firmer data as well as benefiting from the euro and Pound's decline. Increasing confidence in the US economy saw the NZD and AUD lose ground against the USD (with local surprises adding to the NZD weakness). In addition, the NZD steadily lost ground against the AUD, as the differing economic outlooks became increasingly apparent.

Date	Instrument	28-Feb-10	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	2.50	0.00	0.00	-1.00	-4.00
	NZ 90-day bank bill	2.71	-0.05	-0.09	-0.48	-4.13
	US 90-day bank bill	0.25	0.00	0.00	-1.01	-2.66
	NZ - US 90-day bank bill	2.46	-0.05	-0.09	0.53	-1.47
Fixed	NZ 5-year gov't stock	5.05	-0.16	-0.26	1.15	-1.10
Interest	NZ 10-year gov't	5.80	-0.16	-0.14	1.28	-0.28
	NZ 10-year swap	5.86	-0.06	-0.19	0.99	-1.01
	AUS 10-year gov't	5.54	0.09	0.25	1.19	-0.04
	US 10-year gov't	3.65	0.03	0.42	0.67	-0.62
Equities	NZ - NZX50 (NZ\$)	2090	-0.3%	0.5%	18.2%	-34.9%
	AUS - All Ords (A\$)	4651	1.2%	-1.4%	41.1%	11.9%
	JAP - Nikkei (¥)	10126	-0.7%	8.4%	33.8%	-13.8%
	UK - FT100 (£)	5355	3.2%	3.2%	39.8%	7.8%
	US - S&P500 (US\$)	1104	2.9%	0.8%	50.3%	-8.2%
	WORLD - MSCI (US\$)	1133	1.2%	-1.4%	50.9%	-3.7%
	MSCI in NZD (NZ\$)	1634	2.8%	2.4%	10.0%	0.7%
Exchange	NZD/USD	0.694	-1.5%	-3.7%	37.3%	-4.4%
Rates	NZD/AUD	0.780	-1.2%	-0.6%	-0.5%	-15.0%
	NZD/JPY	62.0	-2.2%	-0.7%	25.7%	-18.5%
	NZD/GBP	0.454	4.1%	4.6%	28.2%	20.4%
	NZD/EUR	0.511	1.1%	6.8%	28.5%	-6.6%
	NZ TWI	64.4	-0.5%	0.8%	23.9%	-8.0%
	EUR/USD	1.36	-2.6%	-9.8%	6.8%	2.3%

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

- Markets and economists widely expect the RBNZ to keep the cash rate unchanged (2.5%) at its next announcement (11<sup>th</sup> March).
- Over February, disappointing data (including the sharp increase in the unemployment rate and signs of the housing market fading) saw markets pare back expectations of future rate hikes. The 90-day rate drifted lower over February as expectations shifted.
- We now expect the RBNZ will first hike in June (previously April), with a 25 basis point hike. However, the pace of tightening is likely to be gradual. The rise in bank funding costs (in part due to increased competition for retail term deposits) has driven a wedge between the OCR and interest rates. We estimate the neutral OCR to be around 5% (compared to 6-6.5% pre-financial crisis).

### Fixed interest

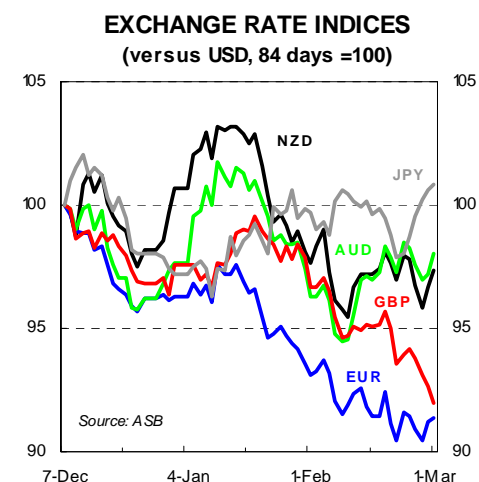
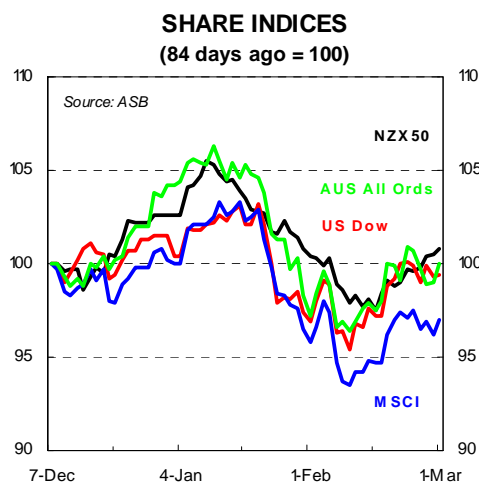
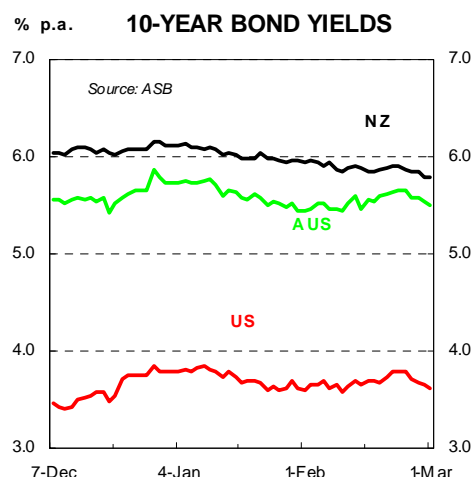
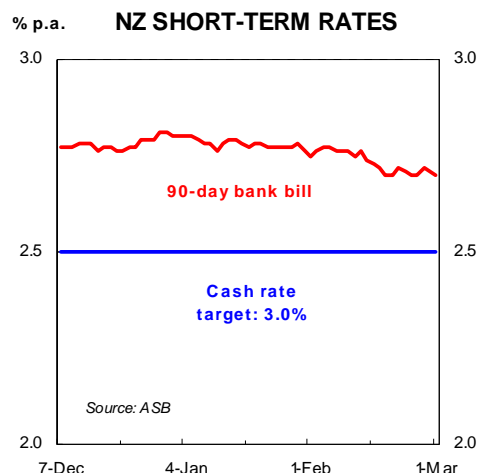
- US Treasury bond yields finished the month relatively unchanged, although traded within a wide range throughout February. Much of the fluctuation appears to be driven by the US Treasury's monthly issuance program and the market's ability to absorb such on-going heavy new issuance.
- The Federal Reserve's earlier than expected increase in the discount rate (regarded as a sign of increased confidence in the US economic recovery) initially saw Treasury yields spike higher, but had little lasting impact.
- Sovereign risk indicators rose sharply in early February as concerns over Greece's budget position and default risk escalated. This dented risk appetite and caused some flight to higher quality markets.

### Equities

- Global markets remained under pressure during the first week of February as markets remained fixated on the eurozone sovereign debt concerns.
- However, news that European leaders had struck a deal to provide financial aid to Greece and gave assurances that Greece will stick to its austerity plan, were cheered by markets. A strong rally was recorded in banking shares while the sharp gains in commodity prices flowed through to resources stocks.
- Markets continued to steadily improve from around the 9<sup>th</sup> of February and held onto these gains over the last week of February. Nonetheless, markets remain below the January peak.
- The local sharemarket finishing relatively unchanged over the month. The NZX50 did not weaken as much during January, so did not need to recover as much lost ground over February.

### Exchange rates

- The euro remained under pressure (depreciating for the third consecutive month) as markets continued to fret over European government debt levels.
- The GBP weakened when the Bank of England left the door open to further quantitative easing and deficit concerns emerged.
- The USD stabilised at higher levels during February after the FOMC revised up US GDP growth and raised the discount rate (indicating increased confidence in the US economy). The USD was also favoured as the EUR continued to lose popularity.
- The AUD and NZD suffered weakness at the start of the month, but recovered over the second half as market sentiment shrugged off some of the Eurozone related concerns. The NZD steadily underperformed the AUD as the differing economic outlooks became increasingly apparent.



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