

# Markets Monthly

## Tremors continue in financial markets.

- Risk aversion continued to drive markets in August.
- Sharemarkets and bond yields fell as some investors switched to less risky investments.
- The NZD fell sharply in late July, and the slide continued through August.

Financial markets became increasingly worried about the fallout from the deterioration in the US sub-prime housing sector during August. The resulting market turmoil involved equity market falls, broader credit concerns, hedge fund losses, unwinding of carry trades and severe illiquidity in money markets.

That illiquidity and risk aversion resulted in reduced demand for all but the lowest risk investments. This lack of demand caused bank-bill yields to rise sharply in August, and credit spreads to widen. The US Federal Reserve decision to cut the discount rate by 50bp revealed the depth of the market turmoil and the Fed's associated concern. The market turmoil has caused investors to flee to the relative safety of government bonds. Consequently, bond yields fell sharply across all maturities, in all the main markets in August.

The month was negative overall for global sharemarkets, but most made strong recoveries in the second half of the month. Sharemarkets regained some confidence when the US Fed cut their discount rate, and made it clear they would act as needed to mitigate the adverse effects on the economy from the disruptions in financial markets. And a sharp fall in the NZD boosted returns when measured in NZD terms.

The NZD dollar fell heavily against all major currencies during August, having rallied through May, June and July, and setting a post float high of US \$0.8112 on July 24<sup>th</sup>. The NZ dollar lost 5 cents US in the last week of July, and the slide continued through August, with the NZD dipping to a low of US 0.66 cents briefly mid-month. The NZD has now consolidated around US 0.70, and volatility has reduced towards the end of the month, after several days of very choppy trade at the peak of the financial market turmoil.

Date	Instrument	31-Aug-07	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	8.25	0.00	0.50	1.00	2.50
	NZ 90-day bank bill	8.62	0.06	0.49	1.13	2.75
	US 90-day bank bill	5.58	0.22	0.22	0.18	3.78
	NZ - US 90-day bank bill	3.04	-0.16	0.27	0.95	-1.03
Fixed	NZ 5-year gov't stock	6.64	-0.70	-0.27	0.50	0.60
Interest	NZ 10-year gov't	6.18	-0.48	-0.20	0.43	-0.12
	NZ 10-year swap	7.44	-0.27	-0.09	0.75	0.53
	AUS 10-year gov't	5.92	-0.11	-0.10	0.26	0.16
	US 10-year gov't	4.56	-0.15	-0.34	-0.18	0.42
Equities	NZ - NZX50 (NZ\$)	3112	-2.9%	-5.2%	12.0%	56.1%
	AUS - All Ords (A\$)	6248	1.0%	-1.5%	23.0%	103.3%
	JAP - Nikkei (¥)	16569	-3.9%	-7.3%	2.7%	72.2%
	UK - FT100 (£)	6303	-0.9%	-4.8%	6.7%	49.1%
	US - S&P500 (US\$)	1474	1.3%	-3.7%	13.1%	60.9%
	WORLD - MSCI (US\$)	1562	-0.3%	-3.4%	14.9%	88.0%
	MSCI in NZD (NZ\$)	2222	9.1%	0.5%	6.5%	25.7%
Exchange	NZD/USD	0.703	-8.6%	-3.9%	7.9%	49.6%
Rates	NZD/AUD	0.857	-4.1%	-3.3%	0.2%	0.8%
	NZD/JPY	81.6	-10.7%	-8.1%	6.7%	47.3%
	NZD/GBP	0.349	-7.8%	-5.7%	2.0%	15.0%
	NZD/EUR	0.514	-8.3%	-5.5%	1.2%	7.9%
	NZ TWI	0.678	-8.0%	-5.0%	4.1%	26.7%
	EUR/USD	1.366	-0.4%	1.7%	6.6%	38.6%

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

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### Cash

- RBNZ raised the official cash rate (OCR) 0.25% on July 26<sup>th</sup>.
- The OCR has been hiked 4 times this year, and stands at 8.25%
- The NZ 90-day rate spiked to over 9% when global credit tightness was at a peak, but has subsequently eased.
- Central Banks globally, including the RBNZ have taken measures to ensure liquidity is maintained within the banking system.
- The Federal Reserve Bank is expected to cut their Fed Funds Rate on September 18<sup>th</sup>, having cut the discount rate in August.
- Other Central Banks are largely expected to remain on hold when they meet in September.

### Fixed interest

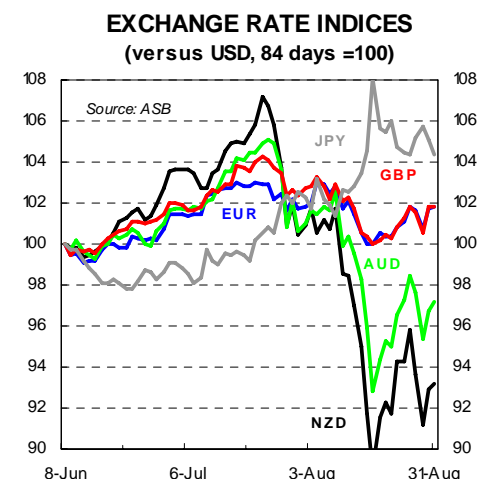
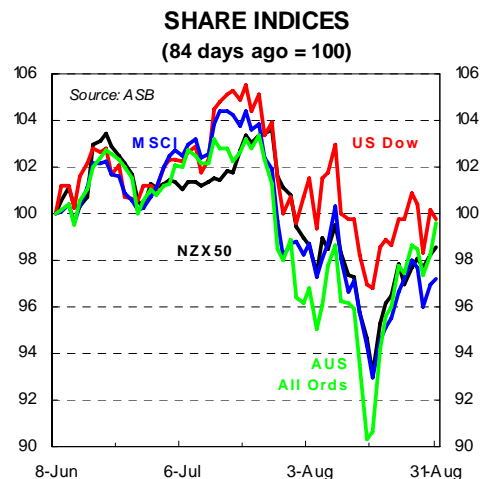
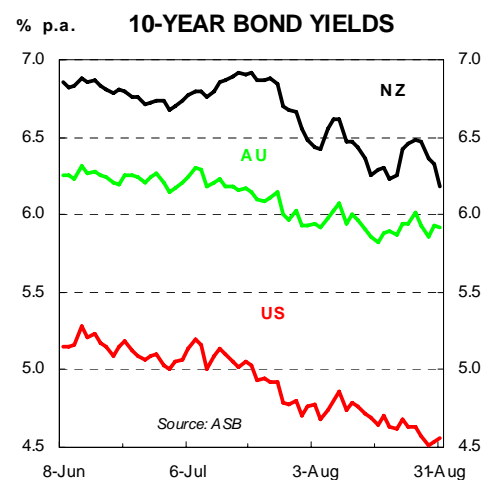
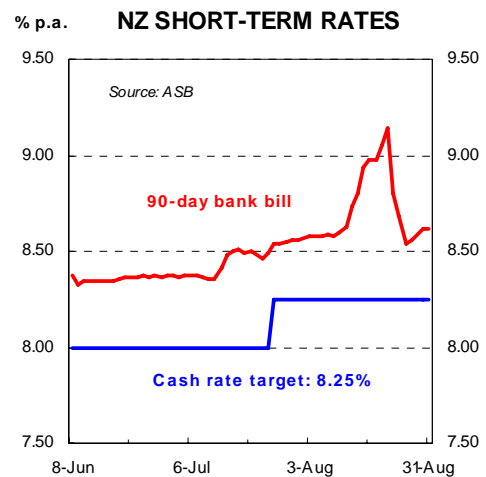
- Government bond rates fell due to a flight to safety from shares and riskier credit investments to bonds.
- Long-term fixed interest rates fell over August, with the 10-year NZ Government Bond yield dropping a large 48 basis points. US 10-year yields fell 15 points after easing 24 points in July.
- A low level of mortgage fixing activity from banks contributed to a drop in wholesale swap rates drop over the month. The one year rate eased 16 points, and the five year rate fell 29 points.
- US 10-year Government stock is now trading around 4.52% in early September. The NZ 10-year rate is now trading around 6.17%.
- We expect a period of volatile sideways action in interest rate markets, including NZ rates. Longer-term, rates should rise from today's levels, once the current risk aversion subsides.

### Equities

- August was negative overall for global sharemarkets, but most made strong recoveries in the second half of the month.
- Concerns about the US housing market, sub prime mortgages, and indeed the health of the overall US economy all weighed heavily on US shares in July and early August.
- The market regained some confidence when the US Fed cut their discount rate, and made it clear they would act as needed to mitigate the adverse effects on the economy from the disruptions in financial markets.
- The NZD had a major impact on offshore investment returns over the full month, as it ended August down 8% in value.
- The MSCI index of world shares posted a 0.3% decline in US dollars and a 9.1% gain in New Zealand dollar terms for the month.

### Exchange rates

- The NZ dollar rallied through May, June and July, and set a post float high of US \$0.8112 on July 24<sup>th</sup>.
- The NZ dollar lost 5 cents US in the last week of July, ending the month at US\$ 0.769.
- The slide continued through August, with the NZD dipping to a low of US 0.66 cents briefly mid-month.
- The NZD has consolidated around US 0.70, and volatility has reduced.
- The NZD has declined on other cross rates, and lost ground against the Japanese Yen, AUD and GBP. On a trade weighted basis, the NZD is down 500 points for the month, to 67.80.



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