



Markets Monthly

Sharemarkets shrug off uncertainties.

- Global shares posted positive returns in October, as investor confidence recovered.
- A weak US Dollar was the key FX theme for the month.
- We expect ongoing volatility in financial markets over the coming months.

Financial markets continue to deal with the fallout from the deterioration in the US sub-prime housing sector. The 50 basis point (bp) rate cut from the US Federal Reserve on September 18th was backed up with a 25bp cut on October 31st. Soft US economic data, particularly in the labour and housing markets, combined with the lower US interest rates now available kept the USD weak against all the majors, apart from the equally weak Japanese Yen. The NZ dollar has been strengthening against the USD since late August, and is trading around US 0.766 at the time of writing. On a trade-weighted basis, the NZD was down 0.4% for the month. The NZD posted gains against the USD and the Japanese Yen, but lost ground on the British Pound, Aussie Dollar, and Euro. October was positive overall for global sharemarkets. The NZ and Japanese markets declined, but the other markets posted gains.

Local bond yields rose over the month, while US rates fell. The 10-year NZ Government Bond yield rose 19bps as US 10-year yields fell 20bps. The Reserve Bank of New Zealand left the Official Cash rate on hold at 8.25% at its October meeting. Inflation pressures remain intense within the economy, but the economic outlook remains clouded somewhat by the current global financial market turbulence. Oil prices hit record highs in October, adding to the inflationary pressures both here and abroad. On balance, we continue to expect the RBNZ will remain on hold until late 2008.

Although the US economic outlook is mixed, the US sharemarket continues to advance. The economic backdrop in Asia remains very positive, and accordingly the long-term outlook remains positive for regional sharemarkets, despite the financial jitters of the last few months. The return on the Australian sharemarket has been very strong over the last month, and full year, reflecting the positive economic outlook for the lucky country. Some normality has returned to the main asset classes, though we expect pockets of volatility in prices to continue from time to time.

Date	Instrument	31-Oct-07	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	8.25	0.00	0.00	1.00	2.50
	NZ 90-day bank bill	8.65	-0.14	0.09	1.08	2.75
	US 90-day bank bill	4.91	-0.32	-0.45	-0.46	3.26
	NZ - US 90-day bank bill	3.74	0.18	0.54	1.54	-0.51
Fixed	NZ 5-year gov't stock	6.96	0.29	-0.38	0.77	0.99
	Interest					
Interest	NZ 10-year gov't	6.48	0.19	-0.18	0.73	0.17
	NZ 10-year swap	7.82	0.26	0.12	1.10	0.95
	AUS 10-year gov't	6.18	0.02	0.15	0.51	0.61
	US 10-year gov't	4.38	-0.20	-0.33	-0.23	0.38
Equities	NZ - NZX50 (NZ\$)	3145	-1.7%	-1.8%	6.2%	57.3%
	AUS - All Ords (A\$)	6779	3.0%	9.6%	26.6%	126.3%
	JAP - Nikkei (¥)	16738	-0.3%	-3.0%	2.1%	93.7%
	UK - FT100 (£)	6722	3.9%	5.7%	9.7%	66.4%
	US - S&P500 (US\$)	1549	1.5%	6.5%	12.4%	74.9%
	WORLD - MSCI (US\$)	1682	3.0%	7.4%	18.2%	112.4%
	MSCI in NZD (NZ\$)	2196	1.8%	7.8%	2.6%	33.9%
Exchange Rates	NZD/USD	0.766	1.2%	-0.4%	15.3%	58.6%
	NZD/AUD	0.830	-3.2%	-7.2%	-4.0%	-5.0%
	NZD/JPY	87.9	0.8%	-3.9%	12.5%	48.3%
	NZD/GBP	0.370	-1.1%	-2.2%	5.8%	19.7%
	NZD/EUR	0.530	-0.8%	-5.4%	1.5%	8.5%
	NZ TWI	0.709	-0.4%	-3.7%	6.7%	28.2%
	EUR/USD	1.444	2.0%	5.3%	13.6%	46.2%

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

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Cash

- The Reserve Bank of New Zealand held the Official Cash Rate at 8.25% at the 26 October review. The RBNZ looks set to hold the OCR at the current level well into 2008.
- The NZ 90-day rate briefly spiked above 9% when global credit tightness was at a peak, but continues to ease, although the yield remains high at around 8.65%. Local short-term interest rates will remain elevated in the coming months.
- Central Banks globally, including the RBNZ, have taken measures to ensure liquidity is maintained within the banking system. The Federal Reserve Bank cut their Fed Funds Rate 0.5% on September 18th, to 4.75%, and eased a further 0.25% on 31st October.

Fixed interest

- Local bond yields rose over the month, while US rates fell. The 10-year NZ Government Bond yield rose 19 basis points. In contrast, US 10-year yields fell 20 basis points.
- A low level of mortgage fixing activity from banks continued in October. Wholesale swap rates rose significantly over the month, reflecting low interest from investors. The one year rate rose 14 points, and the five year rate rose 30 points, and now stands at the highest level for 2007.
- US 10-year Gov't stock is now trading around 4.35% in early November. The NZ 10-year rate is now trading around 6.50%.
- We expect a period of volatile sideways action in interest rate markets, including NZ rates. Long-term rates eventually should continue to rise from today's levels, once the current risk aversion subsides.

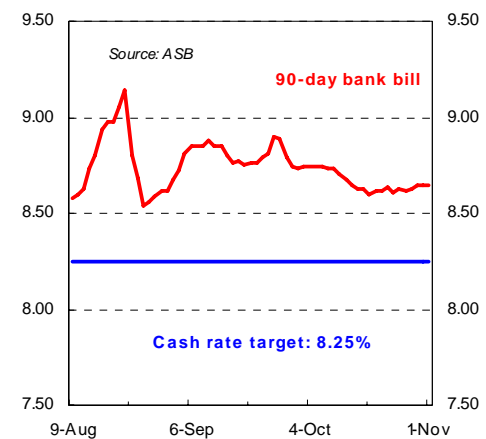
Equities

- October was positive overall for global sharemarkets.
- The NZ and Japanese markets declined, but the other markets posted gains.
- Concerns about the US housing market, sub prime mortgages, and indeed the health of the overall US economy continue to remain the main concern for market watchers and investors.
- US companies that generate earnings offshore are benefiting from a lower US dollar, and oil producer stocks are performing well due to soaring oil prices. Shares have responded positively to the Fed rate cuts discussed above.
- Once again, the NZD strength had an impact on offshore investment returns, eroding gains in NZD terms.
- The MSCI index of world shares posted a 3% gain in US dollars and a 1.8% gain in New Zealand dollar terms for the month.

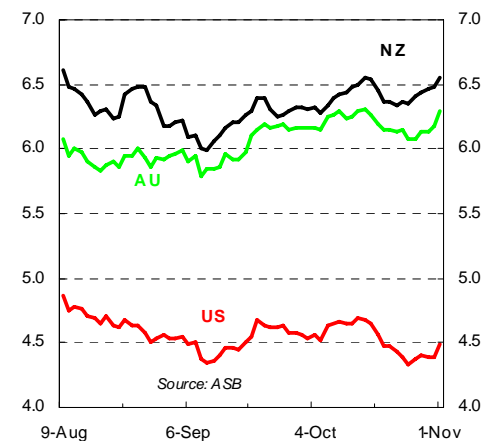
Exchange rates

- The main FX theme at the moment is a weak USD. The chart opposite shows the NZD has underperformed the currencies monitored over the last 84 days, but has strengthened against a weak USD.
- On a trade weighted basis, the NZD was down 0.4% for the month. The NZD posted gains against the USD and the Japanese Yen (which is also weak at present), but lost ground on the British Pound, Aussie Dollar, and Euro.
- We expect the USD and the Yen to remain weak in the coming months, and the NZD could well revisit fresh highs on these cross rates.

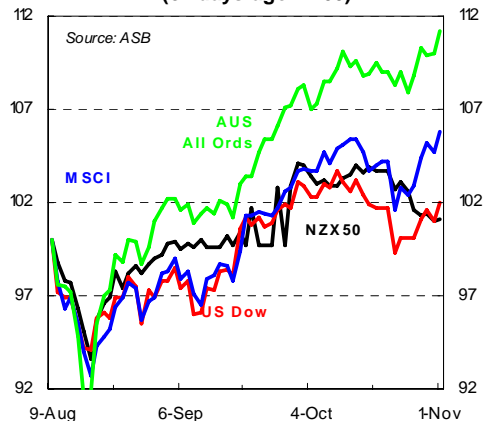
% p.a. **NZ SHORT-TERM RATES**



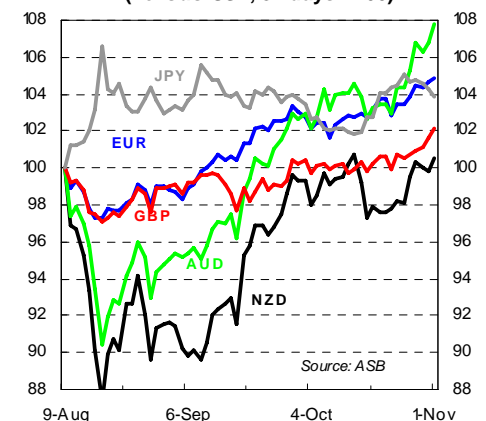
% p.a. **10-YEAR BOND YIELDS**



SHARE INDICES
(84 days ago = 100)



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



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