

FEBRUARY 2008 NEWSLETTER

Hi John,

Back to Normal?

In the January newsletter I gave you my view as to how the financial upheavals which started in the United States residential mortgage markets might affect the property sector here in New Zealand.

As we move out of holiday mode here – nothing much happens in January in New Zealand with the weather we've had – some trends are becoming clearer.

The New Zealand (and Australian) economies remain extremely strong. For example, unemployment here reached a new low of 3.4% - the smallest since records started in 1986. The prices received by our dairy product manufacturers rose 15% in the December quarter - the largest rise for any quarter since the measure began in the June 1994 quarter.

In fact, it's the strength of our economies that is adding to the inflationary pressures that have been growing over the last year or so. The result is a continuing rise in interest rates as the Australasian central banks attempt to cool their economies. The New Zealand Reserve Bank raised the official cash rate four times last year and the Australian Reserve Bank three. Even China – where GDP grew by 11% over the last year – has been raising its interest rates.

This is in sharp contrast to the U.S. The turbulence being experienced in the global financial markets as a result of write downs of credit exposures by major financial institutions, has resulted in the Federal Reserve slashing the federal funds rate by 1.5% in the past two months. The only other major economies where interest rates have been reduced are the U.K and Canada - and then only slightly.

If the U.S. is in or heading towards recession – and views vary widely on this – for us the question remains how will this affect our economy here. The answer to this is still unclear. However if you'd like to see a really scary view click [here](#)

What is clear is that the U.S. consumer's dominance in driving global growth has waned. The Chinese economy now represents about 30% of global growth and their economy – and that of India - has become more and more driven by their own internal demand. And their trade with Asia is becoming as important as their trade with the United States. Westpac has just produced an excellent article "The rules have changed – NZ will fare better in a US slowdown than history would suggest" To see this article click [here](#)

In any event, in my view the U.S. Fed and government will do whatever is necessary to avoid a major financial upheaval in the financial markets and inflation fears will remain the over-riding factor for the global economy. In both New Zealand and Australia it is wage price inflation that's the major concern and I wouldn't be expecting any reduction in interest rates this year.

So is everything coming back to normal?

Well in my view it's been the last few years that have been abnormal where easy cheap money and under priced risk abounded.

Of course there's no doubt the credit crunch and the re-pricing of risk is affecting all parts of the economy - including property.

Higher interest rates are dampening the housing market. REINZ figures show lower sales and increased days to sell, indicating it's becoming a buyer's market. And of course the rapid rise in average residential prices over the last few years was always unsustainable. Although it's interesting to note that while average residential prices have stabilised – and may be falling – the demand and the pricing of premium houses is still strong. This will give some comfort to the New Zealand Reserve Bank and further softening of the residential market is likely as existing fixed rate mortgages re-fix at higher rates as the fixed periods fall due..

I don't really want to get into a debate about what can be done to make housing more affordable in New Zealand – I'll leave that to people like Hugh Pavletich (who can be contacted by email at hugh.pavletich@xtra.co.nz). But I will say that if the cause of unaffordability is the tax treatment of housing [here](#) – as the Herald implied in its editorial of 12 February – how come so many other countries that do not have that perceived tax advantage do have the same affordability problem?

As to commercial property, I guess that depends on how long you have been involved with that market. As I said in my last newsletter *"In my memory the rule of thumb for commercial property was 10% - with a mid city office block leased to long term prime tenants maybe 8%. Industrial property was 12% - and those with average location/leases 15%."* To me that's the norm and I'd expect yields to be more in that range than the ridiculous 4% - 5% yields that some commercial properties were selling for over the last few years.

But what's not back to normal yet is obtaining finance for commercial property and developments - although I'd say cautious optimism has returned. An increasing number of lenders are back in the market – albeit with tighter conditions and higher disclosure requirements.

There are still a number of "abnormal" happenings out there in the market.

- Developments without pre-sales or some form of exit strategy are very difficult to finance.
- There is evidence that banking credit criteria has tightened considerably for those with property and business borrowings with the same lender – particularly if the business has slowed or is underperforming from previous highs. How many times have we said it's good practice to isolate your borrowings to specific assets and amongst different lenders?
- Some financiers are no longer lending on investment properties but are prepared to lend on shorter term development projects with tangible exit strategies.

At Global Pacific we are receiving communications from financiers saying they have money to lend. It's now even more important in this "abnormal" time to match your financing requirements to the appropriate lender.

Meanwhile, very profitable joint venture and equity participation opportunities are coming available. These range from small to very large.

Email or phone me if you'd like to know more about any of the above.

Cheers

JP



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