

**SEPTEMBER 2008 NEWSLETTER**

Hi John,

**What is Happening Mister Jones?**

*You walk in so politely  
And you ask, "Is this where it is?"  
And somebody points to you and says  
"It's his"  
And you says, "What's mine?"  
And somebody else says,  
"Where what is?"  
And you say, "Oh my God  
Am I here all alone?"  
But something is happening here  
But you don't know what it is  
Do you, Mister Jones*

To see Bob Dylan's Ballad of a Thin Man [click here](#)

So what is happening?

Well first, thing's in the global financial markets have been so outrageous I'm about three weeks overdue in the September GLOBAL VIEW.

And second, nobody seems to know what is happening - other than the global financial markets are in complete turmoil with no end in sight.

Words like "Eye of the storm" and "Heading into the storm rather than out of it" have a ring of truth. To see a summary of how it got to where it is now, you can follow my newsletters from February 2007 when I first expressed concern about a world awash with cheap money and slack credit, and the April 2007 issue of GLOBAL VIEW when we got the first warnings about the sub-prime crisis in the U.S. The list is shown in the P.S. to this newsletter and can be accessed in our archives files [here](#)

Or to read a recent Time Magazine article about the mayhem [click here](#)

Here are some thoughts on the international crisis.

- As former U.S. Federal Reserve Chairman Alan Greenspan said, this "is probably a once in a century event".
- There is lot more to come in the Credit Crunch in offshore markets. In August the bank write-offs were some US\$500 billion. Expected write offs vary between US\$1 trillion (IMF) and US\$2 trillion (Dr Nouriel Roubini). See John Mauldin's Thoughts from the Frontline [here](#)
- First it was the sub-prime residential mortgages, then it was other residential mortgages, then it was bundles of mortgages in the CDOs (collateral debt obligations), and then the counter parties insuring those sophisticated financial instruments (credit default swaps). To see John Maudlin's article on Residential Mortgage Backed Securities in the U.S. [click here](#)

- There's no question that the most vital rescue by the U.S. Fed was AIG insurance as the virus spread out of housing into the insurance industry. A collapse like that would have been catastrophic.
- The next area of concern in the financial markets will be the consumer backed securities like cars and credit cards. To see Bloomberg article [click here](#)

But in the end what interests you and me, is how it's going to affect us?

There's an excellent article at [interest.co.nz](http://interest.co.nz) which gives some history and concludes the Credit Crunch here will "reduce our household wealth by cutting house prices and will squeeze our disposable income by stopping our debt servicing cost from falling much. It will probably also extend our recession into 2009, but is unlikely to morph into a 1930s style depression." To read the article [click here](#)

Well here's my view, on the basis the financial markets do not collapse like 1929 (in which case we may as well all go fishing)

- New Zealand is partly insulated from the U.S. and European turmoil in that it does not have direct exposure to the U.S. financial system. But as we all know now, consumers led the markets up with cheap money, easy credit and new found wealth in their houses – and they will eventually lead it down. It will be a slow road out. See Neville Bennett's article [here](#)
- The New Zealand (Australian) banks look safe. See the New Zealand Reserve Bank release [here](#)
- The initial finance company collapses here had nothing to do with the events in the U.S. They were the result of easy money and slack credit here. Once confidence went, all financiers that relied on publicly funded debenture stock found it difficult to raise money. To see the list of finance company failures [click here](#)
- Interest rates will remain (relatively) high as credit spreads offshore re-price risk. Any drop in the Official Cash Rate here (next review 23 October) may mean a drop in floating interest rates but is unlikely to affect fixed rates which are funded from offshore. However, in my view, the banks will try and keep residential mortgages lower at the expense of business and commercial property loans, due to competition amongst banks and the more favourable capital ratio requirements they enjoy for residential loans.
- If business and commercial property interest rates remain high I would expect cap rates -which determine the price of commercial property - to rise and values to drop. In any event (as I've said on numerous occasions before) some of the rates at which commercial property has sold over the last few years is quite ridiculous. (Unless of course you are a dairy farmer with tons of money with nowhere to go other than own a nice commercial property in your home town and you're happy with the same sort of return on capital value as your farm.)
- In the property sector loans are far more difficult to get and many for other than vanilla transactions have dried up. Mezzanine development finance and second mortgages have become as rare as the Moa. Forget attempting to get a loan without proof of debt servicing or a clear repayment strategy (although at Global Pacific we do have access to "security" loans where strong asset backing can be shown). If you've got a loan offer now take it – whatever the cost.
- Housing in New Zealand is overpriced, but I'm not sure that it will drop the 30% some predict – partly for the reason given above (residential interest rates will remain low) and partly because New Zealand looks more and more like a great place to live. See page 7 of Tony Alexander's Overview [here](#)
- There is anecdotal evidence that people offshore are looking at New Zealand as a place to invest. Not so much for the actual return – they intend to leave the income and capital here and avoid exchange risk – but as a safe haven. If the NZ dollar drops much more expect to see far more of this.
- Confidence surveys by the National Bank and BNZ show business confidence is improving. See

Tony Alexander's Overview above.

- And hey, it's election year. To see an excellent commentary on what we should expect from the next government [click here](#)

All in all, Rodney Dickens sums it up pretty well in his last Rodney's Ravings entitled Banking Lunacy of Unimaginable Proportions. As part of his argument for no further interest rate cuts he says "hopefully you can appreciate my skepticism in the need for the RBNZ to become super aggressive in cutting the OCR, especially when the leading indicators of local growth are already on the improve, and when there is plenty of stimulus in the growth pipeline from the fall in mortgage interest rates to date, the lower exchange rate, tax cuts that are about to hit consumers' pockets and petrol prices that have nudged lower." To see his article [click here](#)

But change does bring opportunities. For those of you who do not already get my new GLOBAL OPPORTUNITIES newsletter, and would like to do so, simply reply to this email and ask for a copy of the last one to be forwarded to you.

Cheers

JP



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**P.S. GLOBAL VIEW** newsletters tracing the credit crunch, these can be seen in our archives files here <http://www.globalpacific.co.nz/newsletterarchives/tabid/3589/Default.aspx>

February 2007	World continues to be awash with cheap money
March 2007	U.K. Independent article on risk being underpriced, especially with housing
April 2007	Lemming loans in the U.S. foreshadow people with jobs losing their homes.
August 2007	U.S. hedge fund Basis Capital succumbs to the U.S. sub-prime problems.
September 2007	Central banks start responding by holding interest rate rises and injecting liquidity into the markets.
October 2007	International Monetary Fund reports on the collapse of the credit markets.
November 2007	Signs that the mortgage backed securities are only the start of the problems.
December 2007	Large international banks in the U.S. and U.K. start writing off debts linked to the sub-prime market.
January 2008	Links in P.S. to articles explaining the causes and effects of the Credit Crunch.
February 2008	U.S. heads towards recession with Fed cutting interest rates by 1.5% over 2 months.
March 2008	Credit crunch now ingrained here, money hard to get and expensive.
April 2008	First major investment bank rescue in the U.S. - Bear Stearns.
August 2008	U.S. Fed rescue Freddie Mac and Fannie Mae.

**Global View:** is an email newsletter reporting on the New Zealand Economy with a bias towards how it affects the property and

business finance markets. It is a regular commentary delivered to you by email every month.

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