

**MAY 2008 NEWSLETTER**

Hi John,

**Credit Crunch and Countercyclical Opportunities**

Looking at the continuing turmoil in the global financial markets, I'm reminded - in a recent article by U.S. investment writer and analyst Dr Woody Brock - of Stein's Law.

This says "If something cannot go on forever, it will stop," by which Stein meant that if a trend (balance of payments deficits in his example) cannot go on forever, there is no need for action or a program to make it stop, much less to make it stop immediately; it will stop of its own accord. It is often rephrased as: "Trends that can't continue, won't."

To read Dr Brock's thought provoking article about the U.S. economy [click here](#)

So how does this apply to the current situation in New Zealand?

Well it was obvious the housing market here couldn't continue the way it was going. Price increases were being driven by low interest rates, easy credit and – especially in the section and new apartment market - speculation. I wouldn't be surprised if half the pre-sales for sub-divisions and developments were people hoping to on-sell for a profit when they were completed. Houses became unaffordable for first time buyers. The trend couldn't continue – and didn't.

It was clear that the fall out would eventually hit consumers as;

- the ability to spend from the increased equity in their houses disappeared, and
- inflation reared its ugly head and the Reserve Bank's policies increased floating interest rates, and
- fixed interest rates rose as the sub-prime crisis re-priced risk offshore.

The pressure on the New Zealand consumer has been exacerbated by higher oil and food prices. As I pointed out in the last newsletter growth in the western world in recent years has been consumer driven. Now – at least in the U.S. - the downturn is consumer driven. The trend couldn't continue – and didn't.

Low interest rates offered by traditional providers of fixed interest investment like banks, led to a proliferation of new offerings to mum and dad investors like finance company debentures. Slack credit policies for finance for cars, property and other assets by a number of these led to defaults and the demise of several companies. Investors fled and even those companies with sound assets felt the pinch as re-investment ratios fell. All of a sudden the choice of financier was no longer there and borrowers are scrambling to find alternatives. Easy credit has gone. The trend couldn't continue – and didn't.

I'm sure you can think of numerous examples – how about the new luxury car market? But all that's history now and the question is what's the next cycle in the business and property markets and how can one profit from it?

While I pointed out in my last newsletter that those waiting for bargains to come out of the property sector are likely to be disappointed – many should never have got off the ground in the first place – there will be opportunities for those investors that have patience and can think outside the square.

As the remaining lenders become credit conscious to the extreme – which in many case worsens their

position - there are a lot of good business and property investments out there that are screaming for funds.

Which I suppose leads to the last trend I'll mention in this newsletter. And that's lending policies.

When times are good - or shall we say as times get better because this is not a quick process – everybody wants to lend you money.

- Why not increase your house mortgage to take the family on overseas holiday (or actually do anything if it's your house that's the security)?
- Great leasing opportunity on new luxury car.
- Use the equity in your house to join the thousand who are making a fortune out of residential property investment.
- Expand your business – new plant and equipment offer.
- Special offer on credit cards.

But when times look not so good – and this is a quick process – nobody wants to lend you money. And if they have they want it back! The trend couldn't continue – and didn't.

Those of us who are old enough will have seen it all before.

But here are ways of getting the funds needed for good business and property deals. Memories of front end loaded loans, vendor finance, land banking income earning properties, joint ventures, quasi equity participation, collateral guarantees, re-financing to isolate or free security, location specific investing, and so on - if not fresh in the memory - do come flooding back.

It's just a matter of riding the next trend – and getting out before it ends.

Cheers

JP



John Paine  
Global Pacific Corporation Limited  
112 Gladstone Road, Parnell,  
P O Box 3229, Auckland, New Zealand  
Phone +64 9 303 3700, Fax +64 9 303 3031  
Mobile +64 21 902 004  
Email [john.paine@globalpacific.co.nz](mailto:john.paine@globalpacific.co.nz)  
Web site [www.globalpacific.co.nz](http://www.globalpacific.co.nz)

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