GLOBAL PACIFIC

GLOBAL VIEW

19th January 2010

Hi John,

Global recovery, bubbles appearing, food's the future

Some speak of the future,
My love she speaks softly,
She knows there's no success like failure
And that failure's no success at all.

To see the Bob Dylan "Love Minus Zero/ No Limit" video click here

In my last GLOBAL VIEW I talked about how confidence was increasing, where interest rates were heading, the fact that money was still hard to get, and whether housing was still the favoured investment for New Zealanders. To see that issue click here

The GLOBAL UPDATE that followed listed some of the investment opportunities I've seen in joint ventures or equity or loan/equity participation in projects. I'll update that in a new GLOBAL UPDATE in the next few days.

One of the great things about the Christmas/New Year break is we all get a chance to reflect on the past year – no it hasn't been very good for some – and catch up on some reading in a relaxed atmosphere.

I chose buy some books I've been meaning to read including The Ascent of Money by Niall Ferguson, Warren Buffet's The Business of Life, and the second Freakonomics book (Super Freakonomics) by Steven Levitt and Stephen Dubner.

I can recommend them all as they give a great global view on what's happening out there. For the lighter read which really makes you think, the last one is a must (especially the chapter about global warming – but we won't go there).

Anyway it made me think about how we in New Zealand were faring since the worst global recession in 80 in years. And so far it's looking pretty good – especially compared with other countries.

So let's start at home - literally.

Housing still strong – but for how long?

According to November 2009 building consent totals just released by Statistics New Zealand, the pace of residential home-building continues to pick up, although few new apartments are being built and non-residential construction is down across most sectors. To read the Sharechat report click here

The number of house sales has held up well at about 6,000 per month and house prices ended the year only just under 5% of their late 2007 peak. In fact for the whole of 2009, New Zealand house values rose 2.8% to an average sale price of $404,671. To see the Herald article click here

But house prices and sales are extremely sensitive to interest rates and as Rodney Dickens reports in his latest Housing Prospects publication *"A remaining uncertainty is how much more sensitive than normal house sales are to interest rates because house prices are too high relative to income and rents. And because many people who geared up during the housing boom are still burdened with too much debt."*

He says the inevitable increase in interest rates as the Reserve Bank increases the Official Cash Rate over the next 12 – 18 months, and other leading indicators *"suggest the temporary rise in the national median house price has little left in it."* To subscribe to Rodney's excellent publications click here

Mixed messages from offshore

According to a Bloomberg survey of users on six continents, confidence in the world economy rose as an acceleration in manufacturing and service industries signaled a sustained recovery from last year's recession.

The survey of 5,437 Bloomberg users was conducted between the 4th of January and the 8th. Since the previous survey, revised figures show the U.S. added jobs in November for the first time in almost two years, while manufacturing in the world's largest economy expanded last month at the fastest pace in more than three years. To see the article click here

In an article in Times Online, long time commentator Anatole Kaletsky says he believes *"a roaring US recovery is already under way. Unlike most other analysts, who believe that the strong fourth quarter will prove just a temporary aberration to be followed by a long period of sub-trend growth, I expect US growth to remain around 4 per cent throughout 2010, making this the strongest year for the US economy since the 1990s."*

He says *"The reason for this growth surge will be quite simple. The Federal Reserve Board is determined to maximise growth and employment in an environment where consumers, financial institutions and government all need to improve their finances. To facilitate this process, the Fed will keep interest rates near zero until late this year at least and when it does start to tighten, it will do so only very slowly, raising interest rates by no more than a quarter-point or half a point before the end of the year."*

But he has a different view for Europe where he feels the world's weakest currency is likely to be the euro, as US exporters increase their global market share mainly at the expense of European rivals, while Chinese and Japanese manufacturers divert to Europe many of the goods that they can no longer sell in the U.S.

He says *"German government labour subsidies will soon expire and the financial pressures on Greece, Ireland, Portugal, Spain and Central Europe can only intensify. I therefore repeat a point I made last year: before this crisis is completely over, the cohesion of the eurozone will be tested to near-destruction".*

To read the article click here

Bubble, bubble, toil and trouble

We're now starting to see concerns about a negative side to the massive economic stimulus program introduced by governments to shield their economies from the fallout of the global financial crisis.

A recent article in the Economist entitled "Bubble warning" sums it up pretty well. They point out that for all the panic last year, following the stimulus packages introduced, the American housing market, where the crisis started, homes are priced at around fair value on the basis of rental yields, but they are overvalued by almost 30% in Britain and by 50% in Australia, Hong Kong and Spain.

And while the American stockmarket is around 25% below the level it reached in 2007, it is still nearly 50% overvalued on the best long-term measure, which adjusts profits to allow for the economic cycle, and is on a par with two of the four great valuation peaks in the 20th century, in 1901 and 1966.

Their view is global markets are too dependent on unsustainable government stimulus and something's got to give. It's an article well worth reading. To do so click here

China takes a breath?

Of all the economies to bounce back from the global economic crisis, China would have to be streets ahead of everyone.

But now there's real concern that China's economy is overheating as asset bubbles and inflation pressures build. Residential and commercial real-estate prices in 70 Chinese cities climbed 7.8% from a year earlier, beating a 5.7% gain in November. Large cities like Shanghai and Beijing saw houses price increase more than 60% in 2009.

According to a report issued by the World Economic Forum before this year's 27 - 31 January annual meeting in Davos, Switzerland, a drop in momentum in the world's fastest-growing major economy "*could adversely affect global capital and commodity markets.*" To read the Bloomberg article click here

So last week China's central bank caused a stir when it tightened credit by ordering banks to set aside more cash for the first time in a year and a half, while raising a key market rate in an accelerating bid to fight inflation. They also raised the yield on its one-year bills for the first time in five months, the second such liquidity-draining step in four sessions.

The two tightening moves provide *"a clear sign that policymakers are following through on their pledge to guide credit in order to pre-empt rising inflation and avoid asset price bubbles",* said Jing Ulrich, JPMorgan's managing director for China equities. To read the article click here

But as Daily Reckoning's Joel Bowman reported during a trip to Hong Kong last week, *"Few doubt that property markets both here and on the mainland are getting a bit "frothy." But that's only part of the story. There is also the very real, tangible demand of the world's largest population to contend with. One point three billion people demand basics like water, food, fertilizer, energy and the infrastructure to produce and harness it all. They've worked long and hard to produce junk for the rest of the world. Now they want some return on their labour."* To read the article click here

The opportunity for New Zealand - protein

It's not so much that there are so many people in China to feed; it's their shifting diet habits that people seek as they move from the equivalent of "serfdom" to "lower middle class" workers. Going to another post from Daily Reckoning, Chris Mayer speaks about "Food – The Trade of the Decade". This is something you must read – to do so click here

He points out *"The world's population has more than doubled since 1950 – from about 2.5 billion to 6.7 billion. By 2050, there will be more than 9 billion people on the planet. Almost all of this growth will occur in the emerging markets like China and India. And their populations will all be doing one thing, for sure – eating."*

"After population growth, the second layer is the mix of food eaten, which is important. These undeveloped economies are becoming wealthier. Predictably, as people everywhere have done and continue to do when they have a little more money in their pockets, they change their diets. They spend more on food. The average Chinese person spends 40 cents of every additional dollar earned on food. In India, it's about 70 cents of every additional dollar. What do they buy?"

"They buy more meat, more fruits and more vegetables. Their calorie intake rises. That's why the UN says we'll need to boost food production by 70% by 2050 – a big task, given increasing restraints on water and quality arable land."

The article gives the example of Brazil with excess water and arable land and doesn't actually mention New Zealand, but the principles are the same.

He points out there is a lot of support for higher prices for agricultural commodities. Inventory levels remain low worldwide. Grain prices are all well off their highs. After adjusting for inflation, many of them are as cheap as they have been for decades.

And to remind us all opportunities exist at the worst of time he says *"In the Great Depression, purchases for jewellery and clothing and the like fell by 50%. But purchases for food – even for meat – held steady. We've seen similar patterns in recent busts. In the Asian Crisis of 1998 –2001, the demand for food held steady, even while other markets collapsed."*

Interestingly enough in late 2008 there was an opportunity I presented in GLOBAL UPDATE to participate in a grain growing business leasing land from sheep farmers. The timing was bad as it was around the time Lehman Bros went under and everyone was running for cover. It's now being examined by a fund out of Japan. What a shame people here didn't see it.

Meanwhile the Aussies are enjoying a bonanza with their exports to Japan. Rio Tinto has just reported its fourth-quarter iron ore output rose 49% after Chinese steel mills bought record volumes. To see Herald report click here

And a recent article in the Australian shows how the economic interest is not just one way. Last week they pointed out Australia's largest trading partner is extending its investment activities into sectors other than mining and resources as the Shanghai based food and beverage conglomerate Bright Group, signalled its interest in paying $1.5 billion cash for the sugar and renewable energy division of CSR, and is now looking at winemakers. Australia is the behind only France as an exporter of wine to China and sold $93 million worth there last year. Wine is Australia's 3rd biggest agricultural export with sales of $2.7 billion in 2007-08.

The article notes Chinese corporations are flush with cheap loans from state owned banks and are looking at a range of food processors and agribusinesses for so called food security and access to technology and expertise. To see the article click here

I'm unfamiliar with the negotiations the New Zealand government has with China in matters like the free trade agreement, but let's hope they're doing a good job.

Here's looking forward to a great summer and a successful 2010.

Cheers

JP

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