

AUGUST 2009 NEWSLETTER

Hi,

Out of intensive care - Now to the healing process!

As outlined in our June 19th addition of Global View – Economic Recovery – Consensus as to yes, but not as to shape or pace. To read this newsletter [click here](#), here in New Zealand and internationally we are experiencing a period of evolving and unfolding economic recovery from the deepest trough in the last 40 years.

However the pace and shape of this process continues to differ greatly from country to country, industry to industry, and from one day to the next, with many central government treasury officials attempting, in most cases unsuccessfully, to influence a 'balanced' recovery process.

Yet despite all the emerging optimism if you or your business or family are not experiencing some pain in one form or another during this period, you would be the exception rather than the rule.

The RBNZ and the Government clearly wants to 'rebalance' the economy with, Dr. Bollard maintaining an easing bias by threatening to further lower the O.C.R if the NZ dollar fails to fall back, believing that in doing so it will discourage international investors and will improve the international competitiveness of the traded-goods sector (ie. exporters and local firms competing against imports) and encourage consumers to save more and spend/import less.

Put simply, a balanced recovery, not one led by the property market and New Zealanders resuming a mentality of "borrow and spend".

This however is seen by a number of economists as simply wishful thinking and not a good basis for policy recommendations. Dr Bollard seems to be painting himself into a corner. If he does in fact cut, the housing market may get further away on him.

With the ongoing broad swathe of indicators suggesting daily that New Zealand is steadily emerging from the recession, making further OCR cuts looks a very long shot, with the future path of interest rates being ultimately decided by the pace of such a recovery in our domestic economy.

As regards to the currency, past history suggests that it will not stay down and the world will ignore Dr Bollard, which is what has happened in recent weeks, with a number of economists believing that contrary to Dr. Bollards reasoning any further cutting of the OCR in the current environment is more likely to result in a higher rather than lower NZD.

On balance it would appear that despite all his dovish rhetoric and jawboning, Dr Bollard is already contemplating his first OCR hike and it is far more likely to come earlier in 2010 rather than in the latter part of the year.

New Zealand

As stated the balance of the recovery process differs from country to country. In their July 2009 Economic overview – home-grown recovery on its way, Westpac economists "*believe if not for the threat of swine flu, we would say the recession has already ended.*" To read this article [click here](#).

Day after day we read new reports on the upturn in the residential property market be it sales volumes,

house price rises, rental increases and shortages of stock, the latter primarily in the main centres, spurred on by low interest rates, and surging net migration amongst other factors. This in turn is filtering through to many service industries, consumer and retail spending growth, albeit initially slower than a lot of sectors would like.

Respected forecaster Infometrics recently stated that house prices will rise by 24% over the next three years, 11% nationally in the year to June, 30% in Auckland. At the same time Mr English states that a premature housing boom would not be good for the economy and the government will consider a possible gains tax to avoid one.

To read these two articles [click here](#) and [here](#). Time will tell on all fronts.

The same trends are evolving in the latest business confidence survey's. To read the August BNZ confidence survey [click here](#), the manufacturing sector [click here](#) and – commodity prices, with the ANZ commodity price index rising for the fifth consecutive month. To see [click here](#) and [here](#). In addition the NZ share markets bench mark NZX-50 index climbed through the 3000 level for the first time in ten months in late July and has risen further since then.

On a more negative note, unemployment has surged to a 9- year high of 6% with woman and young people in the 15-19 y/o bracket the worst affected. However, such a rate is not bad for an economy in recession for more than a year and testifies to the severity of the labour shortages that preceded it. Internationally we compare well to the OECD average of 8.3%.

On the export front the 26% leap in whole milk powder prices on Fonterra's latest online global auction was a recent welcome relief from the pattern of a rising kiwi dollar and weak product prices with the jury out on the sustainability of such, with world commodity prices, particularly soft commodities, being so volatile at present. [Click here](#).

However, it is not all doom and gloom for as the world comes out of the recession with global population continuing to grow, people will always need feeding and the demand for food products will also increase.

A recent article from Cliff Brown sums the dairy situation up very well. To read this article [click here](#), where he says "*farmers the RBNZ and many commentators have bemoaned the dairy situation, worrying about the country's export revenues and the impact on the economy's recovery in these difficult times,*" with international dairy prices having simply returned to normal after a two year windfall bonus during 2006 and 2007.

The proposed recapitalization of Fonterra will be one of the biggest business stories of the months to come with it vitally important that the directors come up with a proposal that will maintain farmer control but encourages outside parties to contribute badly needed permanent capital. To read this article [click here](#).

China/Australia/Japan

Clearly China with their surging economy is leading the world recovery from the recession largely as a result of government investment and state – directed/controlled lending, to an extent that in July, state – controlled banks were instructed to rein in on excessive lending. To read more on this subject [click here](#).

In Australia the property market is surging ahead as investors return to the market. Business confidence in July was higher than any time in almost two years, and based on the RBA latest forecasts the first official interest rate rise is expected in late 2009, early 2010, with the treasury secretary, Ken Henry quoted recently "*its fair to say that nobody fully understands the reason for that (Australia's) better economic performance.*"

Japan, the worlds second largest economy, and the hardest hit because of its reliance on exports, has recently announced that for the first time in 15 months the economy has begun to grow on an annualized basis, on the back of Chinese demands for basic materials such as chemicals and steel.

USA/UK/Europe

After almost six months of gains, and having recently been treating the recession like a blip, Wall St markets have slowed recently with investors having stopped rewarding "less bad" news and are now looking for clearer signs of an economic recovery following last weeks first optimistic outlook from the

Federal Reserve. Having watched the US economy move out of crisis mode, primarily due to the passage of time and to extraordinary monetary and fiscal stimulus the markets are now looking to the recovery of the consumer, improvement in retail sales and unemployment as determining the strength and pace of the US recovery.

In the UK where the Bank of England have admitted that the recession "*has been deeper than previously thought*" the bank announced late last week a further intention to pump another \$84B into the UK economy in another effort to steer the country out of recession, stating "*the pace of contraction has moderated and business surveys suggest that the trough is close at hand.*"

This was closely followed by an announcement in Europe this week from the 16- member Eurozone of an unexpected rebound in French and German GDP growth after having shrunk for the past year.

Bank bashing

As predicted in our last newsletter the emerging "pop phrase" of "bank bashing" has continued unabated in recent weeks. To read two recent articles [click here](#) and [here](#). However, to put the subject into perspective only eleven banks in the world are rated AA and four of them are the big Australian Banks that operate in New Zealand.

In summary despite the RBNZ efforts to pressure the banks into lowering their floating rates, only state owned Kiwibank has been the only major lender to drop their rates on all products, whilst at the same time they have raised deposit rates, lifting them beyond rates offered by the Australian owned banks.

Medium to long term fixed rates have been increasing across the board in recent weeks. The local success of Kiwibank has resulted in an open letter from six of Australia's most influential economists urging the government to create a "Aussie bank" in response to the increasing power of the big four banks that dominate the financial sectors of both countries. Here the BNZ initially led the P.R stakes by cutting unpopular but lucrative penalty fees with the remainder reluctantly following. The big four banks are also facing tax avoidance cases with the IRD to the tune of \$2.32B, with the BNZ having already lost in the High Court a \$661m decision and the Westpac hearing currently being heard.

Whilst the banks are now happier to lend 80% or more, albeit under tighter criteria, for "missionary" residential lending, it is their continued intransigent attitude to lending for business and commercial purposes that is continuing to obstruct the stimulation of the economy through monetary policy. They will need to remember that there will be a price for them to pay if their business customers continue to feel cheated.

Furthermore the availability of "traditional" commercial funding is further complicated as the finance industry holds its breath waiting for the government to decide what to do with the Crown Retail Deposit Guarantee Scheme. To read a recent article [click here](#).

Whilst the current finance market dynamics remain difficult alternative and new lenders continue to emerge into the market as the property market in general improves. With bank term deposit rates generally on the rise they still remain 3-4% less than that offered to investors by some first tier non bank lenders many of whom remain flush with funds available to prospective borrowers on good terms and conditions.

From a developers perspective, the size constraints put on by lenders in the market mean that development projects are having to be broken down into a number of smaller stages. The days of the large aggressively geared mezzanine facility are well and truly gone. Another option for a developer in this market is to enter a joint venture arrangement with either a high net-worth individual or construction company, taking the stance that it is better to have 50% of something rather than 100% of nothing.

As always to obtain funding it's a case of knowing where to go, the criteria each funder is looking for, and a proper presentation being the key essentials to success.

In today's market if we at Global cannot source funding for a particular deal, whatever the risk profile, then nobody can.

Consequently, should you or any of your clients or colleagues require finance of any kind, please call me anytime on 021 333011, contact me via email, or visit our website, to see examples of the finance we can have arranged.

Cheers



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