GLOBAL PACIFIC

GLOBAL VIEW

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NOVEMBER 2009 NEWSLETTER

Confidence up, housing stable, credit down.

"There must be some way out of here," said the joker to the thief,
"There's too much confusion, I can't get no relief."

To see the Bob Dylan video click here

Investor confidence up – but where to invest?

In the September GLOBAL VIEW I reported the BNZ confidence survey revealed 56% of respondents felt the economy would improve over the coming year – compared with 42% in August and only 15% in July.

Well now the ASB bank's latest quarterly investment survey supports this, as investor confidence reaches a 2 year high. *"In the September quarter a net 14% of people surveyed expected a better return on their investment in the coming 12 months,"* says Nick Tuffley, ASB Chief Economist.

"This is a turnaround of a net 25 points in the space of only three months, the largest change in quarterly confidence in the survey's 11-year history. There has been a huge reversal in confidence since March 2009 with a dramatic net 39% improvement being recorded. This rise in confidence has been greater than the level by which it fell following the world economic collapse in late 2008 - a 28 % fall in six months."

But there are mixed views about the best investment opportunity in the coming 12 months.

In the ASB April 07 investment survey – well before the credit crunch hit - residential rental property remained the highest ranked asset class, up slightly to a net 21% from the previous survey, but still some way short of its record high of 25% back in 2000. They said there was "*continued growth in confidence in residential rental returns."*

But now, while investors believe that things will get better, there is no consensus as to where the best future returns will be achieved.

Tuffley says the traditional safe havens in uncertain times - rental property, bank savings and term deposits - still head the list of where investors thought returns will be best, although all had ebbed in popularity in the last three months.

Rental property remained marginally ahead of bank savings as the most popular form of investment – a net 16% - but its appeal has tracked down in the last three months. Of those who do have rentals as their main form of investment, 57% believe it will offer the best return in the coming 12 months.

Bank savings, at 15%, is the second most popular investment, but of those people who held bank savings as their main investment, only 32% felt it would offer the best returns over the next year. Underline is mine.

To read the Share Chat article on the ASB survey and see the graph, click here

So is housing still the preferred investment?

There's no question the housing market has recovered from the doldrums. For example:

- The latest ASB housing market survey shows 48% of the respondents see now is a good time to buy a house and 40% feel prices will rise in the next 12 months. To read the Herald article click here

- REINZ report their average house sale price measure was up 1.9% in September following a 1.2% rise in August and 1% in July. Average house prices hit a 10 year high of $335,000 in October and have now recovered 8% since January and are only 4.5% down from their peak in late 2007.

- Barfoot & Thompson reports Auckland dwelling sales in September were 73% ahead of a year earlier.

- Westpac reports *"New Zealand housing is displaying all the symptoms of a bull market. House sales have risen sharply, and now stand around their long-term average. The time taken to sell has shortened. The number of houses listed on the market has fallen. All indicators are typical of a market upturn, and point to a significant price increase."* They say the two key factors in driving prices higher are strong population growth combined with lack of building activity creating a shortage of new houses, and low mortgage rates. To read the article click here

Meanwhile the New Zealand Reserve Bank continues to highlight the risks of another residential property boom. In its six monthly Financial Stability report released last week, Governor Alan Bollard warned of the need to avoid a return to a "*debt-fuelled*" housing cycle. To read the 57 page report click here
or to read a summary from the NBR click here

In my view the housing market has stabilised and the chance of another boom like the last one is slim. The demand pushing prices is now from home owners who see a shortage of stock, rather than investors seeking minimal rental returns and relying on capital gain as the real return on their investment.

For a realistic comment about house prices I like BNZ economist Tony Alexander's comments. In his BNZ Weekly Overview of 5 November, he says *"The implications for house prices of what is happening in the housing market are as clear now as they have been for a year and a half. Specifically*

1*. The Reserve Bank have said they are determined to keep floating interest rates low until the second half of 2010. That means ongoing strong support for the housing market as borrowers are attracted by currently low financing costs.*
2. There is no massive surge in house construction underway though a recovery is occurring. Construction remains near the lowest levels in four decades at a time when housing is already in shortening supply.
3. The net migration numbers continue to increase and are now in above average territory.
4. The ability of housing supply to recover strongly is going to be constrained first by a lack of finance for subdivisions, then by builders going across to Australia to take advantage of a strong building recovery there to handle a massive housing shortage." Underline is mine.

He goes on to say *"House prices are likely to keep rising but one should not be thinking in terms of a boom. In fact it pays to keep an ear open to the comments from the likes of the Finance Minister regarding the potential for some reform in the ability of property investors to offset losses against other income. No capital gains tax is coming, but given that it is looking more likely some other change will occur, property buyers should make sure they are purchasing for positive cash flow and not doing what so many did in the past and plan ongoing cash losses in the hope of long term strong capital gain."*

Well said Tony. To read the article click here and go to page 11.

As to the search for investments that give better returns than bank deposits, I'm starting to see some excellent opportunities in business and property as owners see joint ventures and equity participation as an alternative to obtaining debt finance in the midst of this lingering credit crunch.

These include opportunities to invest in a number of properties and industries. In addition to those mentioned in my October GLOBAL UPATE – click here to read - they include businesses as diverse as marketing via mobile phones and aged care.

The details of many of these are subject to signing a confidentiality agreement and some are only available to those who qualify as an "eligible person".

If you're interested in discussing this type of investment opportunity give me a call.

Interest rates

On page 9 of the BNZ Weekly Overview mentioned above, Tony discusses why monetary policy is actually tighter at the moment than implied by the level of the cash rate.

He says "*The relationship between the cash rate set by the RB and the cost to us banks of borrowing money has structurally altered. We used to almost always have retail deposit rates below the cash rate or at least bank bill yields. Now the opposite is true. The cash rate is 2.5%, 90-day bank bill yields 2.8%, and term deposit rates are around 4.5% for the popular 150 or so day period.*

"NZ banks are striving to boost domestic funding of domestic lending and that means higher rates being offered to savers. This has implications for finance companies which from the early 1990s were able to easily secure funds from generally older savers because those savers wanted improved returns. Now with the lesson of lending to finance companies learnt to the cost of many of those poor people, and banks offering higher rates over the cycle, the pool of funds for a second tier group of financiers in NZ is going to be much smaller."

He goes on to say "*One of the reasons is credit criteria are tighter than they used to be. This means that at any given level of the cash rate the availability of funds from banks to NZ borrowers is reduced – courtesy of the biggest global financial crisis since the 1930s."* Underlines are mine.

Late last month the Reserve Bank of New Zealand kept the Official Cash Rate at 2.5%. In his statement Governor Alan Bollard said "*In contrast to current market pricing, we see no urgency to begin withdrawing monetary policy stimulus, and we expect to keep the OCR at the current level until the second half of 2010."*

Well the Aussies don't seem to share that view. They've raised their Cash Rate twice in October and November to 3.5% from the low of 3.00% in April. Their statement said "*With the risk of serious economic contraction in Australia now having passed, the Board's view is that it is prudent to lessen gradually the degree of monetary stimulus that was put in place when the outlook appeared to be much weaker."*

So why the difference in views between the two reserve banks?

Alan Bollard issued a statement a couple of weeks ago that "*the financial markets and businesses need to appreciate the different futures New Zealand and Australia are charting out of the global financial crisis."*

He puts the difference down to Australia's strong terms of trade, vast mineral deposits, the Chinese market, and rapid population growth.

He said *"New Zealand and Australia have very different resource endowments, financial markets treat us like Australia, but actually we are quite different. We talk about catching up with Australian incomes, but we have better chances of taking advantage of their growth."*

But Rodney Dickens has the view the Aussies are on the right track. In his November Rodney's Ravings he says *"Unfortunately, in my considered opinion, Governor Bollard's current attempt to try a new approach to monetary policy is just a repeat of his misplaced "go for growth" approach first adopted in 2003 that merely resulted in the economy being subjected to a damaging boom-bust cycle. This is one case in which following the lead of the Australians, who have a much better track record at running monetary policy than the RBNZ, is a good idea." To read the article click here*

Credit is still a problem

In the RBNZ’s Financial Stability Report mentioned above, Governor Alan Bollard says “*The banks nevertheless remain very cautious in their credit and funding decisions. While generally supporting this approach, we have continued to emphasise that the banks should not overly restrict lending to the business sector.”*

Unfortunately this hasn’t been happening. As I’ve been saying for the last few GLOBAL VIEW’s the stimulus of low interest rates has not helped the availability of credit - and in particular to commercial property and businesses. To see the July, August and September issues see the newsletter archives here

It’s still hard to borrow money.

As Rodney Dickens says in his latest Interesting Times, “*Some major banks still appear to be retrenching, but there will be other lenders, especially some smaller institutions, that will be taking advantage of the current situation to grow market share. Most importantly, looking ahead, the flexibility of the financial system should never be under-estimated. If there is a dollar to be made funding good projects then funding will be forthcoming, one way or another. Equally, faced with credit rationing firms will have found more efficient ways of using credit. What should also not be overlooked is that in a deregulated financial system growth in bank lending lags economic growth.”*

To subscribe to Rodney’s excellent pay-to-view newsletter and see how economic growth rebounded well ahead of bank lending growth in 1994, click here

The remaining major finance companies have withdrawn from the property market while they sort out their own problems and we’re still seeing reluctance from the banks to lend – especially to new customers.

But the emergence of new lenders is starting appear. Some of these non-bank lenders are only interested in short term bridging loans and are expensive, but there are others that charge near bank rates for residential and commercial property provided good debt servicing can be shown. The shortage of credit for small businesses is still a problem though.

The cost of money reflects the wide risk profile between low ratio loans with proven debt servicing, and loans given at a time of uncertainty about asset values and the ability to realise them in the event of default.

If you’re interested in knowing how to get the best finance for your circumstances give me a call.

Cheers

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