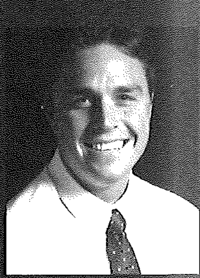
TURMOIL IN ASIA:

What can New Zealand expect?

Some are calling it a crisis, others the 'Asian flu'. Whatever the title there is no doubt that East Asia, formally the fastest growing region in the world, has experienced an economic shock.



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WHAT HAS HAPPENED IN ASIA?

Asian countries have experienced extremely volatile currency, interest rate and equity market movements after a dramatic descent in their value in October 1997. The reasons vary, however the combined influence of acrimonious regulations and high levels of debt, especially in the real estate sector, appear to be the main contributors.

"A huge debt build-up led to a currency crisis which in turn led to a debt run and as the debt crisis got worse it compounded the currency crisis" *Michael Rosenberg, Merrill Lynch*

As a result the Indonesian, Malaysian, Thai and Philippine currencies have fallen to record lows. Interest rates in Hong Kong and Thailand are currently at six year highs. South Korea, Indonesia and Thailand have been given regulatory and restructuring advice from the International Monetary Fund (IMF) and will require substantial financial bail out packages.

In contrast, the Chinese and Taiwan economies have remained relatively unscathed. This is predominantly because they have large foreign reserves and large trade surpluses. Singapore's equity market, previously insulated from the crisis, is now showing signs of pressure and has fallen about 35% however its long term outlook remains positive.

WHAT NEXT?

Many investment analysts, the United States government and the European Commission believe the foundations of troubled Asian economies are solid.

"Asia's economic fundamentals are healthy and the region can emerge with confidence from its present crisis if the right steps are taken" *European Commission President Jacques Santer*

Latest reports show signs of economic recovery: stock market indices are rising and interest rates are falling. However, commentators suggest this is only a 'bounceback' and Asia's long term economic future remains uncertain.

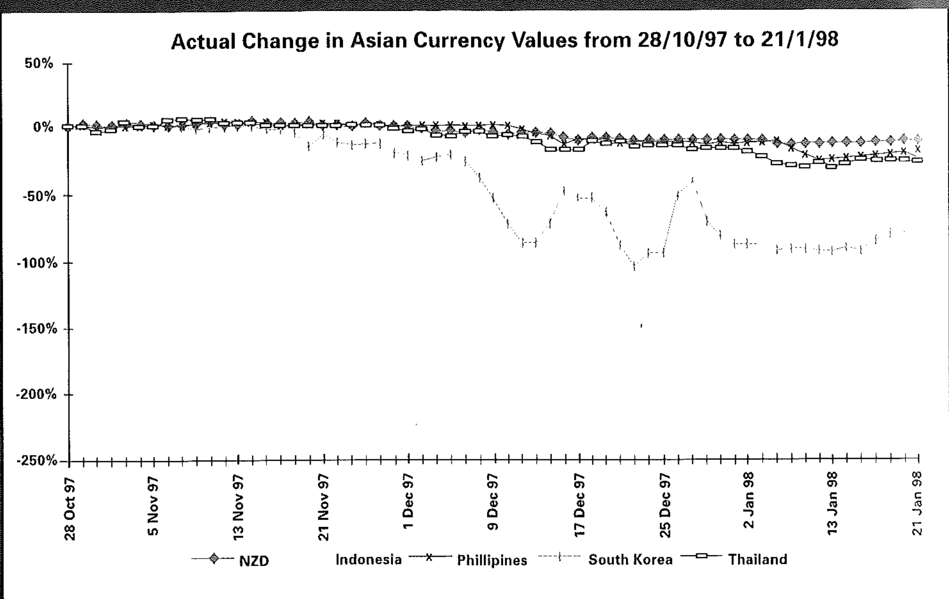
Major restructuring is required, especially in Korea, Malaysia and Indonesia. Hong Kong, followed by Malaysia, is expected to be the first to recover, possibly by early 1999.

THE IMPACT ON NEW ZEALAND'S ECONOMY

At present, the New Zealand dollar is struggling to differentiate itself from the Asian crisis. The dollar has fallen to 0.57 against the USD and may fall even further before showing signs of recovery. Consequently, interest rates have risen with 90 day bank bills currently around 9%, up from 7.5% in December.

The share market has also been adversely affected - in one week in October the NZSE 40 fell 18% and remains unusually volatile.

A recent report prepared by the IMF warns that New Zealand faces serious challenges in the future, the economy is vulnerable to external shocks and it urges authorities to be cautious. The IMF's concerns centre on the widening current account deficit and projections that New Zealand's economic growth will slow to 1.9% for 1997 from 2.8% in 1996.



The outlook for New Zealand currency, interest rates and equities is for more volatility in 1998.

THE IMPACT ON NEW ZEALAND TRADE

The crisis is beginning to show itself in Australia and New Zealand, dragging down trade and company profits. It is debatable how much of the Asian turmoil is already factored into current New Zealand stock prices: Qantas has already issued a profit warning and it is expected that increasing numbers of company profit down-grades will occur in the near future.

Logging, dairy and manufactured goods will be the hardest hit. The Timber Industry Federation estimates log exports to South Korea will fall to less than half their June 1997 numbers. The Dairy Board estimates losses up to $70 million in product sales to Malaysia, Philippines, Thailand and Indonesia.

In the manufacturing sector, New Zealand can expect intense price-based competition as Asian countries attempt to rebuild their foreign exchange earnings and 'export' themselves out of debt. This may result in a deluge of cheap products, making New Zealand made goods less competitive.

Contrary to this pessimism, trade opportunities in fields such as energy and consulting could arise as a result of the injection of funds by the IMF and World Bank.

THE IMPACT ON REAL ESTATE INVESTMENT

Lending on real estate has been one of the contributing factors in the Asian crisis. Lenders allowed huge property debts to accumulate as developers and property companies rode the development and expansion wave. Even before the crisis, the economic viability of many construction and business projects was questionable.

Now, more and more Asian companies are choosing to sell real estate and Asian development companies are cutting prices to generate revenue and repay bank debt.

Those Asian developers who remain strong enough to take advantage of falling land values are facing a credit squeeze due to bank's reluctance to lend for new property purchases. This has caused Hong Kong property prices to fall over 30% since October 1997 and they could fall much further this year.

Thailand, Indonesia, Malaysia and the Philippines real estate markets have been crippled, the function of overbuilding, high interest rates and expectations for the slowest economic growth since the 1960s. Real estate companies with significant property holdings in these areas will experience large asset write-downs. Vacancy rates are expected to rise, not only with new supply coming onto the market and reductions in ongoing demand but instantly through the exodus of insolvent companies. In Thailand alone, 56 finance companies, occupying 218,000 square metres of CBD office space have become insolvent. Government sponsored infrastructure projects have also been cancelled.

In an attempt to salvage the situation, countries like South Korea and Thailand have dramatically relaxed their foreign property ownership laws.

Although not yet directly affected by the crisis, China's office market is experiencing a worsening oversupply problem. Rents in Shanghai are down 50% and Beijing is expecting 3.5 million square metres of new space over the next three years in an already oversupplied market.

ASIAN INVESTMENT IN NEW ZEALAND REAL ESTATE

Asian investors are significant players in the New Zealand property market. The New Zealand Overseas Investment Commission says that investors, predominantly from Hong Kong but also Malaysia, Taiwan and Singapore, have been active participants in some of New Zealand's largest commercial property sales and construction.

Asian investors may be forced to sell offshore property to realise profits produced by their local currency de-valuations and to salvage their financial position at home. Many will go through a period of consolidation and may not participate in foreign bidding until their domestic financial positions are strengthened. In addition, tourism related property values may suffer as Asian visitor numbers decline and expected cashflows are revised down.

If this does occur, two pertinent questions exist, can local demand absorb Asian divestment? and will the removal of some Asian participants cause a decrease in market liquidity?

There may be some Asian investors, weary of the volatility at home, who will be looking for safe real estate with good fundamental demand and supply dynamics, as currently exist in New Zealand. Some investors, especially those from Singapore and Taiwan, may take advantage of Asian sales to purchase property at a discount.

New Zealand construction companies expecting Asian work will be affected, one such company has lost two significant projects because of the crisis.

No longer purring, the Asian Tiger has experienced an extreme market collapse. The test will be how New Zealand's property market withstands our trade partners' volatility.

Andrew Crosby, Real Estate Group consultant has conducted an in depth analysis of the impact of the Asian crisis on New Zealand. Contact him on (09) 377-4790.