In this second of a series of articles on "why so many international investors invest in New Zealand" I aim to provide an overview of what drives the New Zealand economy. An understanding of the economy will give a much clearer picture of why New Zealand is an attractive investment destination.

Food, Food and more food

Until the United Kingdom joined the EU in the early 1970's New Zealand was known as the food basket of the UK. Virtually all the food products and many of its other primary resources were exported and sold to the UK. A market so large compared to New Zealand, that it could take all New Zealand produced. This resulted in a wealthy growing country but the UK joining the EU stopped all that. Suddenly, New Zealand was left to fend for itself as the UK engaged in open boarder trade with the European Union.

As the world went through the oil shocks of the 1970's, financial shocks of the 80's and the Asian crisis of the 90's it looked as though an agricultural based economy like New Zealand was doomed to struggle at the commodity end of the production chain. However, these issues force change in New Zealand. The removal of all tariffs and trading barriers along with the removal of all agricultural subsidies meant the agricultural sector needed to grow stronger to survive. New Zealand maintained the highest of first world food health practises whilst investing much in agricultural research and reforms.

What Happened Next?

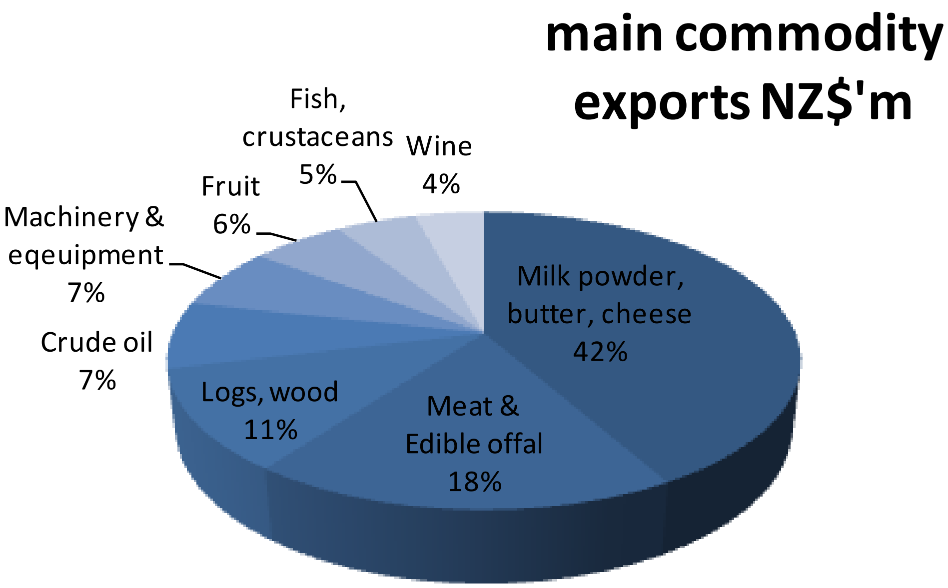
Asia began to grow at a pace greater than the Western world. Lead by China but also India, Indonesia and others the middle classes of these fast growing economies began to expand at an unprecedented pace.

What did those people want most? ; Coal and minerals from Australia? ; Internet products from the US? Financial Services from the UK?; or engineering from Europe? No all these things grew largely as Asia's infrastructure grew but want the people wanted was better food, protein based food and most importantly food safety and food they could trust.

So as we hit the 2,000's New Zealand was becoming the world's largest exporter of dairy as well as a major exporter of other meat (protein) products. New Zealand's products were now gaining a higher premium due to New Zealand's: freedom from BSE (Mad Cow disease), foot and mouth, no nuclear policy and no genetic modification policy; as well as being free from other issues that many of the rest of the world's food exporters had. Sometimes it pays to be an isolated island!

In 2012, 70% of all goods exported were primary products and 25% were manufactured goods. Milk powder, butter, and cheese continue to be New Zealand's highest-value export, accounting for 25% of goods exported[1]

[1] Statistics New Zealand www.statistics.govt.nz



Who's buying?

New Zealand has moved from a time where nearly all of its primary produce exports were taken by the United Kingdom to a position in 2007 where its four largest trading partners where Australia followed by the USA, Japan and China.

In 2008 New Zealand signed the first and to date only free trade agreement of any country with China. In the March quarter 2013 China has moved to become New Zealand's largest trading partner followed by Australia, USA and Japan. The United Kingdom is now only 7th.

In contrast, with Australia has not feared so well. Although China was previously the power behind Australia's mineral boom and strength through the global recession, this has significantly reduced whilst China's demand for high quality food and protein has continued to drive New Zealand's exports and therefore GDP growth.

GDP Growth Drivers

Exports drive around 30% of New Zealand's GDP. Overall GDP is forecast to continue to grow at 2.4%-2.5% through 2014 and 2015[2]. Although a large amount of this growth is due to continued commodity export demand there is also the significant impact of the Christchurch Earthquake rebuild.

The New Zealand Treasury's assumption is that the rebuild of Christchurch will cost the equivalent of around 10% of GDP, as a comparison, the March 2011 earthquake and tsunami in Japan is estimated to have caused damage equivalent to around 3% to 4% of Japan's annual GDP.

[2] The Treasury, Budget and Economic Fiscal update 2013

This means the economic impact of the rebuild is significantly more important to New Zealand's economic growth. New Zealand was particularly fortunate that it was so well insured. It is reported that the Christchurch earthquake is the world's 3rd costliest insured disaster of all time meaning that millions upon millions of international insurance and re-insurance money is flowing back into New Zealand. The rebuild will not be quick and this economic stimulus is expected to continue for several years to come.

Positive Population Growth

We have seen that New Zealand is a large exporter, especially of food, it is also gaining economically from the rebuild of Christchurch but New Zealand also benefits from positive population growth. New Zealand's population (4.4 million in 2012) is projected to increase to 5.4 million in 2036 and 6.0 million in 2061[3].

New Zealand's population growth is a mix of births exceeding deaths as well as positive migration. These factors have assisted a particularly strong property market, especially in Auckland the largest city. In recent years, post GFC, the amount of new residential property built has slowed. This has lead to a demand exceeding supply scenario in many major cities. New housing growth is also contributing to New Zealand's GDP growth with a notable increase in perceived foreign or international investment into New Zealand residential property.

As an example, at Bancorp we have found our clients have been receiving net cash yields on residential property of between 4% and 5% per annum whilst those same properties are maintaining the 20 year average compounded capital growth rate of around 7% (in some cases much high in the last 3 years) and there is no capital gains tax in New Zealand. With global bank deposits remaining at record lows and in many countries zero New Zealand property yields at 4% and above look very attractive as an investment.

The Reserve Bank is very aware of the need to avoid any property bubble but at this stage much of the growth in property prices is demand lead. In addition, the Reserve Bank is weary of pushing interest rates to a level that result in the New Zealand dollar becoming too strong and affecting the export sector.

By now you, as a reader, will no doubt have decided that you should come to New Zealand, buy a residential property, drink lots of milk and invest in a construction company based in Christchurch.

My next article will look at how the New Zealand dollar could influence your decision and how interest rate management within New Zealand impacts on the currency.

[3] Statistics New Zealand