

## Is the New Zealand and the World Economy Deflating?

The world has spent about 80 years with inflation. Everyday we have seen prices rise and almost every day we need more dollars to purchase the basics.

The price of land has almost always needed more dollars to make a purchase reality. A barrel of oil has always needed more dollars for its acquisition as well.

About four months ago we started needing less dollars. You only need half the dollars to purchase a barrel of oil now. You can buy real estate and shares for less than you paid before. Could it be that the dollar you have now is actually worth more, not less, than it did before! It does purchase more doesn't it?

You need fewer dollars to acquire what you are purchasing.

We used to have a gold standard, all currencies related to gold. That is gone now, and given the role of oil in the world economy, should our dollar relate to an 'oil standard'? Oil has halved in price. Has the value of the dollar increased by double, because we need fewer dollars to buy a barrel of oil?

Then put on top of all this is the effect of the multiplier. Effectively the multiplier is how often the dollar changes hands. In buoyant times the dollar will go from person to person quickly, with many people partaking in the spending of that dollar. When times get tough we all stop spending. The dollar sits in our pocket and no one else can partake in the dollars activity, until we decide to spend that dollar and pass it onto someone else.

So if you need fewer dollars (because they are worth more) to purchase that piece of real estate then the real prices have fallen / deflated.

However the debt remains the same, it does not deflate. If the real estate is deflating but your debt remains constant the margin between your equity, or hurt money falls.

An example:

	Before	Now
The value of property	\$2,000,000	\$1,500,000
Debt	\$1,000,000	\$1,000,000

Your equity has gone from \$1,000,000 to \$ 500,000

The banks are secured first. This means that if a sale takes place then they get first dibs on the proceeds. You and I get what is left. The banks are not silly you know. If you are faced with falling real estate values and are unable to make the interest payments to the bank, then an orderly sale is strongly advised. If you hold onto your assets too long, and you can not pay the interest bill then your margin or equity will rapidly reduce.

Some other indicators of deflation (your dollar being worth more) is that many commodities have fallen in price recently. (less dollars needed for the purchase) copper is back 33%, wheat is back 28%, platinum 26% and lumber 24%.

Dairy commodities have also taken a tumble, and we see the price of fertilizer falling as well. Commodities have seen the biggest fall in 50 years.

Many commentators look at the USA and compare what is happening there now with what did happen in Japan when their economy deflated ten years ago. Both have their root and lax monetary policies, no financial controls or regulation and boom times then bust. The Japanese keep their cash in the bank and under the pillow and do nothing. This results in a nothing economy.

And yes it is going to get 'grumpy'. We all need to learn to spend within our means. We need to realise we are probably in a deflation period. As farmers we are a very resilient bunch, but will we be able to cut our cost fast enough to get a margin over and above the sale of our product.

The world is down to 19 days of dried stored food. About 3 years ago I talked about 60 days stored food, and many people were shocked, and laughed at me. This factor will see New Zealand better placed than most countries in the world to survive the financial turmoil that is gripping the globe. It is little wonder that China, Korea and now USA want to snuggle up to us. WHY, because we are major exporters of food, we have enough food in this country to feed 35 million people. Thank goodness for that!

#### IN SUMMARY:

It looks like the world is deflating and the dollar that you own can purchase more not less. The price of various commodities and resources, have fallen dramatically.

The world is facing some serious structural issues. We in New Zealand and at the bottom of the world are well placed to weather the storm. We need to however, be judicious in the decisions we make.

If we need to make decisions around the ownership of property, and its sale then those should be made quickly and the process handled correctly.

Remember the dollar in your hand will probably buy more anyway.

**These are the opinions of Don Fraser of Fraser Farm Finance. Any decisions made should not be based on this article alone and appropriate professional assistance should be sought.**

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