

Oops, the UK did it again

- A year after Brexit the UK springs yet another June surprise with its voting, resulting in a hung parliament.
- NZ Q1 GDP is likely to print softer than the underlying momentum we believe is still there.
- Comey and Trump aside, the main overseas event is the widely-anticipated US Federal Reserve rate hike.

Oops, the UK did it again. It's June, which means it must be time for another round of voting in the UK – and some topsy-turvy outcomes. The UK snap election was called when the Conservatives were riding high in the polls, and prevailing debate was about how many extra seats the Conservatives will pick up and whether Jeremy Corbyn will survive beyond the election.

Instead, **the Conservatives have lost their outright majority**, Theresa May is struggling for survival, and Jeremy Corbyn has won some sort of a moral victory even not at the ballot box. The Conservatives have been able to form government with the support of the Northern Irish Democratic Unionist Party, which supports Brexit.

The election was called (at least in part) to enable a strengthened Conservative majority and shore up support within the party for Teresa May's 'hard Brexit' – prioritising control over migration flows at the expense of maintaining free trade arrangements with the EU. That plan is weakened, and may need to go back to the drawing board. Newly elected Scottish Conservative MPs for, example, favour prioritising free trade over migration control.

Negotiations with the EU over Brexit are due to start on June 19. But the UK could be back to the drawing board over what its approach to Brexit is, led by a Prime Minister whose hand has been weakened and may not see negotiations through to their conclusion.

Fallout from the UK election could continue this week, meaning still **some potential volatility in the Pound**. On Friday morning NZD/GBP jumped from 0.5570 to 0.5660, though so far has remained fairly rangebound.

There are events after politics (provided you ignore your Trump twitter feed and put the ongoing Comey controversy out of your mind). NZ's Q1 GDP figure is released on Thursday morning. We expect a figure of 0.5%, slightly south of the consensus of 0.7%. The economy appears to have a lot of momentum, given the strength of migration, tourism, underlying construction demand, and Q1 retail spending. Yet, the add-up by sector hints at strength in areas that were weak in Q4 and weakness in areas of strength back then. We don't see any systematic pattern of weakness and expect solid momentum over the rest of the year, but another modest quarter of growth would reinforce that it is appropriate for interest rates to remain low for a while yet. The Q1 current account will be released on Wednesday, though will garner less attention with its benign deficit of around 2.8% of GDP.

The biggie overseas is the US Federal Reserve decision: we expect a further interest rate increase at 6am NZT on Thursday, and that outcome is about 90% priced into financial markets. Watch out to see if the Fed lowers its medium-term outlook for interest rates, as Fed may have tweaked down its inflation outlook. The remainder of the week has the Bank of England and Bank of Japan decisions, though they will have little of the potential drama of the Fed.

Foreign Exchange

- NZD/GBP hit a recent high of 0.5702; USD weakness was also a key theme last week.

Interest Rates

- NZ interest rates had a mixed week, influenced by global events, but finished largely unchanged.

Week Ahead

- Q1 GDP and Current Account Balance, Consumer Confidence for June.

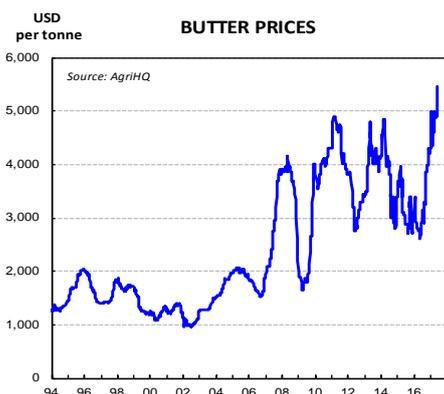
Week in Review

- Dairy prices lifted at last week's auction, while manufacturing sales volumes for Q1 contracted.

Global Calendars

- BoE and US Fed interest rate announcements, UK CPI and employment data are key this week.

Chart of the Week: Butter up



At the dairy auction last week, whole milk powder prices eased back from their recent weather-driven squeeze. The hero of the auction, though, was the rise in prices for milk fats. Butter prices hit their highest level in the 4 years butter has been on the auction platform, and in the ASB Commodity Price Index prices they are the highest in the history we have going back to 1994.

Butter is making a comeback, even featuring on the cover of Time magazine in 2014, as it is increasingly recognised that such fats may be an acceptable part of a healthy diet. The result is higher [retail prices in NZ](#). And, amazingly enough, strong butter consumption is contributing to trade tensions between the US and Canada – read [here](#) for more.

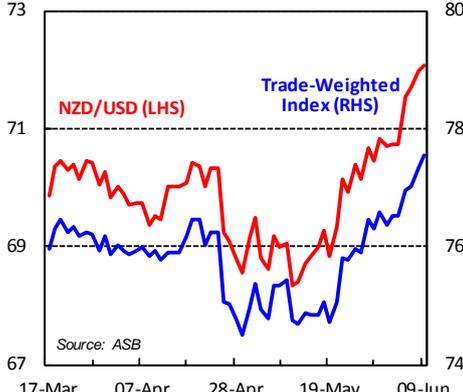
Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7208	0.7075	0.6841	0.7139	0.7084	FLAT	0.7100	0.7300
NZD/AUD	0.9570	0.9572	0.9267	0.9583	0.9557	DOWN	0.9500	0.9700
NZD/JPY	79.52	78.94	77.76	82.28	75.81	DOWN	78.00	81.00
NZD/EUR	0.6429	0.6306	0.6293	0.6758	0.6271	FLAT	0.6350	0.6500
NZD/GBP	0.5667	0.5494	0.5306	0.5672	0.4902	UP	0.5550	0.5750
TWI	77.8	76.5	74.7	78.6	75.5	FLAT	76.00	78.00

^Weekly support and resistance levels * Current is as at 9.30 am Monday; week ago as at Monday 5pm.

The GBP was the big mover last week, as the General Election resulted in the hung Parliament. This was in contrast to the Conservatives victory polls had suggested prior to the election. The GBP dropped over 2% against the USD and the NZD/GBP hit a high of 0.5702, the highest level since March. The Conservatives are now trying to form a Government with the Democratic Unionist Party (DUP) which, if successful, would result in a razor-thin majority. As a result, **political uncertainty could remain elevated for some time, creating GBP volatility.**

USD weakness was also a key theme last week, with the NZD/USD hitting a three-month high over the week. Given that market pricing for a US Federal Reserve this week is almost 100% priced in, a rate hike is unlikely to cause too much volatility on the day. However, any tweaks to forecast rate hikes could cause some volatility. **Locally, Q1 GDP is the key release. If Q1 GDP has grown by less than market expectations (+0.7% qoq), we could see some weakness in the NZD.**

Short-term outlook:	Key data	Date	Time (NZT)	Market
NZ DOLLAR (past 3 months) 	UK CPI, May, %yoy	13/06	8:30pm	2.7
	US Federal Reserve rate announcement	15/06	6:00am	1.25
	NZ GDP, Q1, %qoq	15/06	10:45am	0.7
	AU Unemployment, May, %	15/06	1:30pm	4.6
	BoE rate announcement	15/06	11:00pm	0.25
	Key events: NZD: Q1 current account (Wed); Q1 GDP (Thu). AUD: May business confidence (Tue); May employment (Thu). CNY: May retail sales, industrial production & fixed asset investment (Wed). JPY: BoJ meeting (Fri). GBP: May CPI (Tue); Apr unemployment & wage report (Wed); May retail sales & BoE meeting (Thu). Speakers: RBA: Debelle (Mon & Thu). FED: Kaplan (Fri).			

Medium-term outlook:

Last Quarterly Economic Forecasts

Our FX forecasts were updated in early May to reflect the weaker near-term outlook for the USD. Expected fiscal stimulus from US President Trump was the main driver of near-term USD strength in our previous FX forecasts. However, difficulties in getting other reforms through Congress have highlighted uncertainties around the timing of the fiscal stimulus. **As a result, we expect the NZD/USD to now appreciate to around 0.7300 by the end of 2017. Further out, the NZD is now expected to further appreciate vs. the USD over the next 18 months.** Firstly, the risk of the RBNZ starting a tightening cycle is rising, but the first hike is still not expected until the end of 2018. Further, the ongoing recovery in dairy prices and continued increase in tourism earnings will help the current account deficit narrow even further, supporting the NZD. While we are expecting ongoing NZD/USD strength, further policy rate hikes by the Federal Reserve (which we expect in June and September) will limit NZD strength over 2017. **We expect the USD to stabilise (NZD/USD weaken) once the fiscal policies are signed into effect, however, this may now not occur until 2019.**

The NZD remains supported by relatively high Terms of Trade, relatively high interest rates, increased offshore investor demand and a structural improvement in the current account deficit. **Given these factors are NZD-supportive, combined with the fact the RBNZ signalled it had finished its easing cycle at the November MPS, we see little sustained downward pressure on the NZD.** Over 2017, we expect the NZD/AUD to remain in a relatively high range of 0.93-0.96.

We revised our GBP forecast higher in May on the basis the UK economy has held up better than expected following the UK's vote to leave the EU. We had, however, expected the UK election to reaffirm a Conservative majority, supporting the Pound. But, the surprise hung Parliament has dented the Pound. We expect the NZD/GBP to largely remain with a range of 0.55-0.57 until the end of 2019, though there is increased risk the cross rate drifts higher if UK political uncertainty remains rife.

In the near term we continue to see NZD/JPY hold above 75. Further out, the prospect for more BOJ easing should weaken the JPY, pushing NZD/JPY towards 77 over 2017.

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	1.75	1.75	1.75	1.75	2.25	FLAT
90-day bank bill	1.94	1.95	1.98	2.04	2.41	FLAT
2-year swap	2.24	2.25	2.27	2.36	2.35	FLAT/UP
5-year swap	2.73	2.74	2.85	2.95	2.52	FLAT/UP
5-year benchmark gov't stock	2.45	2.46	2.34	2.57	2.15	FLAT/UP
NZSX 50	7436	7500	7452	6876	6968	FLAT/UP

^Weekly support and resistance levels * Current is as at 9.30am Monday; week ago as at Monday 5pm.

Interest rates fell at the start of last week as local markets reacted to the weaker US employment report the previous weekend. However, **interest rates recovered over the week, in large part due to offshore influences.**

US yields lifted over the second half of the week in the wake of Former FBI Director Comey's testimony to the Senate. Markets had been jittery ahead of the testimony. However, **markets reacted to the Testimony relatively calmly** due to the perceived lack of overwhelming evidence to impeach President Trump. Both Comey and Trump have accused each other of lying, setting the stage for this political saga to continue.

While the UK election result shook FX markets, NZ interest rates markets remain relatively unscathed.

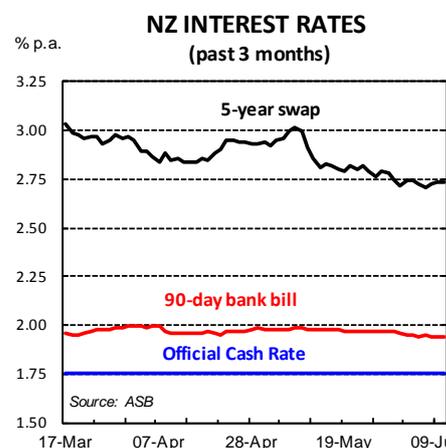
Short-term outlook:

Key data

Date

Time (NZT)

Market



UK CPI, May, %yoy

13/06

8:30pm

2.7

US Federal Reserve rate announcement

15/06

6:00am

1.25

NZ GDP, Q1, %qoq

15/06

10:45am

0.7

AU Unemployment, May, %

15/06

1:30pm

4.6

BoE rate announcement

15/06

11:00pm

0.25

Comment: Looking ahead, we see **offshore drivers (particularly the US) as being the key influence on NZ rates rather than Australasian events.** The FOMC rate announcement is the key event for markets. We see some risk that the Fed sounds more upbeat than the market is expecting, triggering a lift in both US and NZ rates.

While we have a GDP forecast that is below market, we believe the market reaction will be relatively limited if GDP prints weaker than the market expects. The RBNZ is expected to be on hold for a prolonged period and near-term economic volatility is unlikely to change the NZ OCR outlook materially.

Medium-term outlook:

Last Quarterly Economic Forecasts

The RBNZ continued to hold the OCR at its record-low of 1.75% at its May OCR Review and Monetary Policy Statement (MPS). The RBNZ surprised markets by **retaining its neutral policy stance, despite the stronger than expected Q1 CPI result and Q2 RBNZ inflation expectations data.** Overall, the RBNZ viewed developments since the February MPS as having a neutral impact on its OCR outlook and its OCR forecast track still implies no OCR increase until late 2019. **The RBNZ continues to view the global environment as a key downside risk, but noted that the global outlook had improved marginally in recent months.**

Interestingly, the RBNZ noted that the softer than expected GDP growth over the second half of 2016 meant that domestic capacity pressures were less than initially thought. However, **the RBNZ was pleased with the recent depreciation in the TWI,** although noted that the fall needs to be sustained in order to boost the inflation outlook. **The RBNZ remains cautious on the dairy price outlook.**

The RBNZ addressed **likely volatility in upcoming headline inflation figures.** Higher petrol and food prices are boosting inflation in the near term and have pushed headline annual inflation back above to 2%. However, given these price-lifts are one-off moves, their impact on inflation is not likely to be sustained. As a result, inflation is likely to dip back below 2% over 2017. **The RBNZ reminded that a sustainable move to the 2% mid-point of the target band is not likely until the medium term.**

The RBNZ's May Monetary Policy Statement OCR projections show the OCR remaining at 1.8% well into 2019. The RBNZ's outlook has a 25bp hike built in by late 2019. **We continue to view OCR increases as a long way off, towards the end of 2018.** In contrast, market pricing implies an early/mid 2018 start.

Key international data for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
UK CPI, May, %yoy	13/06	8:30 pm	2.7	2.7	2.8
Australia Westpac Consumer Confidence, June, Index	14/06	12:30 pm	98.0	-	-
UK Unemployment, April, %	14/06	8:30 pm	4.6	4.6	4.6
Australia Unemployment Rate, May, %	15/06	1:30 pm	5.7	5.7	5.7
US Fed interest rate announcement, upper bound, %	15/06	6:00 am	1.00	1.25	1.25
UK Bank of England interest rate announcement, %	15/06	11:00 pm	0.25	0.25	0.25

Australian consumer sentiment has been below its long-run average for the past five months. Weak wages growth and high household debt are weighing on confidence.

Australia's employment level has risen strongly in the past two months, with almost 100k new jobs added. However there are some anomalies with the data as they show hours worked have fallen despite the strong lift in jobs. We are forecasting a flat outcome for employment in May following two consecutive strong outcomes. A small fall in the participation rate should keep the unemployment rate steady.

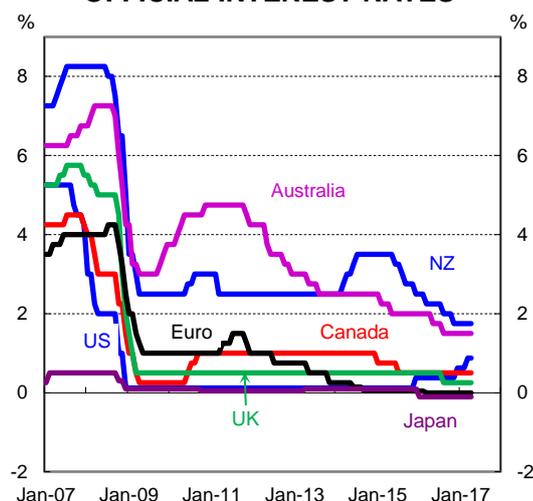
We anticipate the **UK's May CPI number** will print at 2.8% yoy. The increase in the CPI reflects a base effect, the Pound's 12% trade-weighted depreciation since the June 2016 Brexit referendum and oil price increases.

We anticipate the **UK's April unemployment rate** will print at 4.6%, unchanged from the March print.

The **US Federal Reserve is widely expected to raise the target range** for the federal funds rate 25bps to 1.00-1.25%. However, we anticipate the FOMC to lower its US core PCE inflation projections because wage growth remains muted and the core PCE deflator slowed to 1.5% in April. The Fed could also lower its long-term median Fed funds rate estimate in our view. The Fed is unlikely to make material changes to its US GDP growth outlook.

We anticipate the **Bank of England** will keep rates and asset purchases unchanged at 0.25% and £435bn respectively. We expect the Monetary Policy Committee to vote 7-1 to keep rates on hold at 0.25%.

OFFICIAL INTEREST RATES



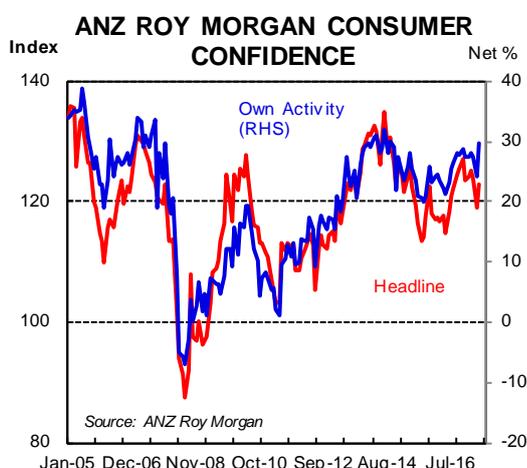
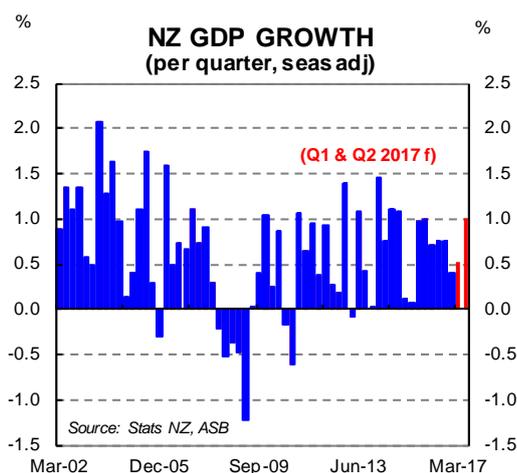
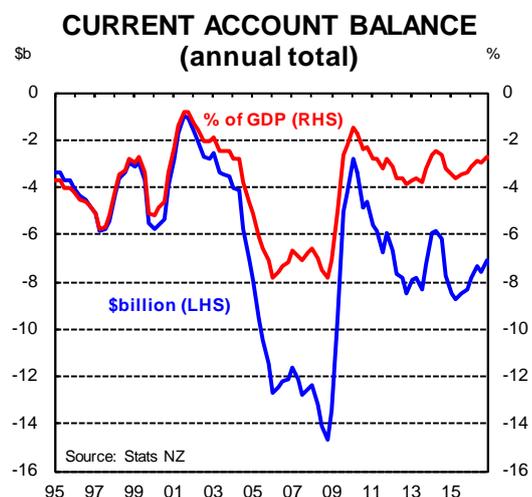
NZ Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Current account, Q1, % of GDP	14/05	10:45 am	-2.7	-2.7	-2.8
GDP, Q1, % qoq	15/05	10:45 am	0.4	0.7	0.5
Consumer confidence, June	16/05	1:00 pm	123.9	-	-

We expect NZ's current account deficit to widen a touch over Q1. The Q4 deficit came in at 2.7% of GDP, narrowing from 3.0% in Q3. We expect that some of the narrowing was due to temporary factors. In terms of drivers, we expect the annual goods balance to fall on the back of strength in import values. All up, **we expect the Q1 annual current account deficit to widen marginally to 2.8% of GDP.** However, over the remainder of 2017 we expect the deficit to narrow, particularly as both dairy export volumes and prices improve.

We expect Q1 GDP growth of just 0.5%. However, sub-trend Q1 growth follows Q4's paltry 0.4% growth (which itself was meant to be a temporary blip). Two quarters of sub-trend growth would be very surprising – growth of less than 1% over six months does not fit in with robust business confidence surveys. The NZ economy is supposed to be humming on the back of strong population growth, improving export incomes and low interest rates. On the other hand, sub-trend growth could be an early warning that the economy is not firing on all cylinders. Excluding tourism and construction sectors, growth momentum may be comparatively modest. **Either way, there is no urgency for rate hikes.** The RBNZ has plenty of time to figure out how strong the economy is. **The RBNZ can continue to hold rates for as long as necessary to jump-start broader consumer demand and investment spending.**

The ANZ/Roy Morgan consumer confidence measure picked up over May. This lift took confidence back above long-run averages. Overall, confidence remains supported by generally low interest rates, a robust labour market, and the recovery in dairy sector incomes. **With this in mind, we expect a similar firm result over June.**



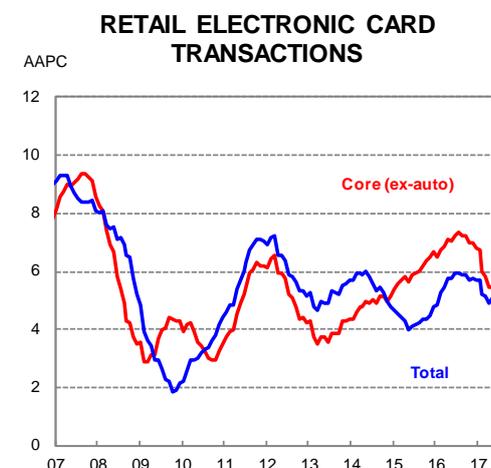
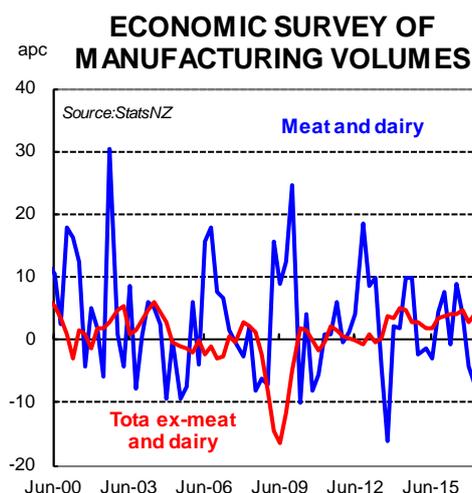
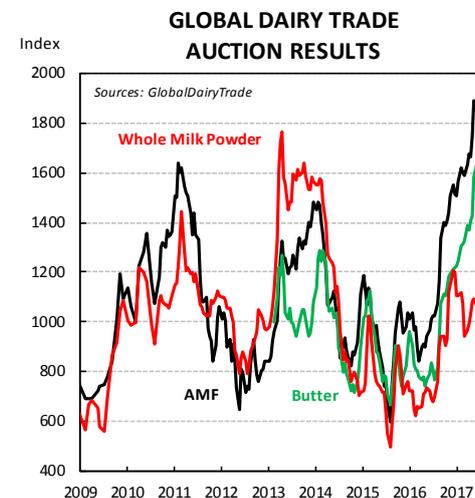
Data Recap: weekly recap

Data	Date	Actual	Market forecast	ASB Forecast
GlobalDairyTrade auction, whole milk powder, % change	06/06	-2.9	-	-3 to -1
Manufacturing Survey, sales volumes ex-meat & dairy, Q1, %qoq	07/06	1.7	-	-
Electronic Card Transactions, May, %mom	12/05	-0.4	0.2	-0.3

Dairy prices lifted by 0.6% at last week's auction. However as expected, key product Wholesale Milk Powder (WMP) fell 2.9%. Anhydrous Milk Fat prices also retreated from previous auction record highs, falling 1.2%. **These two pace-setters aside, the auction was firm.** In particular, butter has set a fresh auction record high of US\$5,631/MT. In addition, cheddar spiked 14.5%, while Skim Milk Powder jumped 7.9%. Five out of the seven main products we monitor, rose. **The WMP fall can be put down to better-than-expected NZ production.** NZ production has held up; for example, April NZ production was 6.8% higher than in April 2016. We expect prices to remain firm at or near current levels. **In terms of the new season milk price forecast, we continue to expect \$6.75/kg.**

Manufacturing sales volumes contracted 0.3% over Q1, dragged lower by a 7.8% drop in meat and dairy volumes. **Meat and dairy sales volumes contracted sharply for the second consecutive quarter,** with sales now 7.1% below year-ago levels. Low rates of livestock slaughter and some inventory accumulation are likely to be driving the weak sales result this quarter. **Meanwhile, sales volumes excluding meat and dairy lifted a robust 1.7%,** bouncing back from a small contraction in Q4 2016. Non-primary manufacturing production has performed well over recent years, displaying **broad-based strength across a range of manufacturing industries.**

Spending growth dipped over May, as expected. The 0.4% fall in both total and core spending was in line with our forecasts, although higher than the market expected. **We anticipated the fall based on the fact both consumables and durables spending was very buoyant over April.** As a result, some payback was due, with consumables spending dipping 0.7%, while durables spending was essentially flat over the month. Looking through the monthly volatility, spending growth remains moderate, albeit back from 2016 highs. **From here, we expect spending to continue at similar levels over the remainder of 2017.**



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 12 May	~	AU	Queen's Birthday Publication Holiday (NSW, VIC, NT, ACT, SA, TAS)					
	08:16	NZ	REINZ house sales	May	y%ch	-31.0	~	~
	10:45	NZ	Card spending retail	May	m%ch	1.1	~	-0.3
	11:50	JN	Machine orders	Apr	m%ch	1.4	~	~
	18:00	JN	Machine tool orders	May P	y%ch	34.7	~	~
	20:30	AU	RBA's Debelle speech in Hong Kong					
Tue 13 May	11:50	JN	BSI large all industry	Q2	q%ch	1.3	~	~
	13:30	AU	NAB business conditions	May	~	14.0	~	~
Wed 14 May	~	AU	Queensland's State Budget					
	10:45	NZ	Food prices	May	m%ch	-0.8	~	~
	10:45	NZ	BoP current account balance	Q1	NZD bn	-2.3	-2.7	-2.8
	11:30	AU	ANZ Roy Morgan Weekly Consumer	Jun	Index	112.9	~	~
	12:30	AU	WBC consumer confidence index	Jun	Index	98.0	~	~
	14:00	CH	Retail sales	May	y%ch	10.7	10.7	~
	14:00	CH	Industrial production	May	y%ch	6.5	6.4	~
	16:30	JN	Industrial production	Apr F	m%ch	4.0	~	~
Thu 15 May	10:45	NZ	GDP	Q1	q%ch	0.4	0.7	0.5
	13:00	AU	Consumer inflation expectation	Jun	%	4.0	~	~
	13:30	AU	Unemployment rate	May	%	5.7	~	5.7
	16:00	JN	Tokyo condominium sales	May	%	38.6	~	~
	19:40	AU	RBA's Debelle speech in Sydney					
Fri 16 May	~	CH	FX net settlement - clients	May	CNY bn	-88.1	~	~
	~	JN	BOJ policy balance rate	Jun	%	-0.1	~	~
	08:20	JN	Nationwide department sales	May	y%ch	0.7	~	~
	10:30	NZ	BusinessNZ manufacturing PMI	May	Index	56.8	~	~
	15:00	NZ	Non-resident bond holdings	May	%	61.5	~	~

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 12 Jun	19:00	US	Monthly Budget Statement	May	\$bn	182.4	-91.5	~
Tue 13 Jun	09:30	UK	CPI	May	m%ch	0.5	~	~
	09:30	UK	Retail price index	May	Index	270.6	~	~
	10:00	EC	ZEW survey expectations	Jun	~	35.1	~	~
	11:00	US	NFIB small business optimism	May	~	104.5	105.0	~
	13:30	US	PPI final demand	May	m%ch	0.5	0.0	~
Wed 14 Jun	09:30	UK	Jobless claims change	May	000	19.4	~	~
	09:30	UK	ILO unemployment rate 3 months	Apr	%	4.6	4.6	~
	10:00	EC	Industrial production	Apr	m%ch	-0.1	~	~
	10:00	EC	Employment	Q1	q%ch	0.3	~	~
	13:30	US	CPI	May	m%ch	0.2	0.0	~
	13:30	US	Real average weekly earnings	May	y%ch	0.3	~	~
	13:30	US	Retail sales advance	May	m%ch	0.4	0.1	~
	15:00	US	Business inventories	Apr	%	0.20	-0.1	~
	19:00	US	FOMC rate decision (upper bound)	Jun	%	1.00	1.25	~
19:00	US	FOMC rate decision (lower bound)	Jun	%	0.75	1.00	~	

Thu 15 Jun	09:30	UK	Retail sales ex auto fuel	May	m%ch	2.0	~	~	
	10:00	EC	Trade balance	Apr	€bn	23.1	~	~	
	12:00	UK	Bank of England Bank rate	Jun	%	0.25	0.25	~	
	12:00	UK	BOE asset purchase target	Jun	£bn	435.0	435.0	~	
	13:30	US	Import price index	May	m%ch	0.5	-0.1	~	
	13:30	US	Empire manufacturing	Jun	~	-1.0	5.0	~	
	13:30	US	Initial jobless claims	Jun	~	~	~	~	
	13:30	US	Philadelphia Fed Business Outlook	Jun	~	38.8	23.5	~	
	14:15	US	Industrial production	May	m%ch	1.0	0.0	~	
	15:00	US	NAHB housing market index	Jun	Index	70.0	70.0	~	
	21:00	US	Total net TIC flows	Apr	\$bn	-0.7	~	~	
	Fri 16 Jun	07:00	EC	EU27 new car registrations	May	%	-6.6	~	~
		10:00	EC	Labour costs	Q1	y%ch	1.6	~	~
		10:00	EC	CPI	May	m%ch	0.4	~	~
13:30		US	Housing starts	May	000	1,172	1,225	~	
13:30		US	Building permits	May	000	1,228	1,250	~	
15:00		US	Labor market conditions index change	May	~	3.5	3.0	~	
15:00		US	Uni. of Michigan sentiment	Jun P	~	97.1	97.1	~	
17:45		US	Fed's Kaplan speaks in Dallas						

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