

Inflation spike begins to unwind

- June quarter CPI inflation is the key focus this week, we expect annual inflation to moderate to 1.9% from 2.2%.
- Food and fuel price volatility are behind the current spike in CPI inflation, which will unwind over the next 12 months.
- This week's European Central Bank announcement is the key focus for global markets this week.

Inflation is the star attraction in NZ this week, with June quarter CPI inflation figures released on Tuesday morning. **Annual inflation surged at the start of 2017**, from a measly pace of 1.3% at the end of 2016 to 2.2% in Q1 2017. This not only brought **annual inflation back into the RBNZ's 1-3% target band**, but also comfortably above the mid-point. However, the RBNZ was quick to note that this **surge in inflation will likely be temporary**, largely as a result of volatility in food and fuel prices. Indeed, **we (and the market consensus) expect annual inflation to ease back slightly to 1.9% in Q2**. This is a slightly faster moderation than the RBNZ expected at the time of the May MPS (2.1% in Q2) as petrol prices have since unwound almost half of the lift seen over the preceding two quarters.

Nonetheless, inflation will likely be close to the inflation target mid-point in Q2. **Food prices continued to surge over autumn as storms took their toll on NZ's vegetable crops**. The visitor boost, from the World Masters Games and Lions tour, is likely to put pressure on **accommodation, domestic flights and recreational services** (which include the price of rugby tickets). Meanwhile, **housing remains a key source of consumer inflation**, with rents and construction costs both likely to record continued robust growth. However, beyond the squeeze in housing and tourism, we aren't seeing evidence of sustained domestic inflation pressures. And as a result, **we expect that by early next year annual inflation could fall back as low as 1.3%**. **Global inflation pressures remain muted** and the **higher NZD** over recent months means tradable inflation is likely to remain subdued. That is in line with the RBNZ's view that the headline inflation lift is temporary and underlying core inflation pressures are still too low. Subdued inflation pressures, **coupled with the lacklustre growth** over recent quarters, reinforces why we continue to **expect the RBNZ will be leaving the OCR at current low levels for at least another year**.

The other major event this week is the **European Central Bank (ECB) policy announcement on Thursday night NZT**. Some market participations have begun to **speculate that the ECB could outline its plans at Thursday's meeting on how it will reduce its €60bn monthly quantitative easing (QE) programme**. Our view is an announcement is likely this year, but July is a bit too early. **We expect the ECB will wait until September**. Nonetheless, the Euro and European bond yields have already begun to rise in anticipation. Higher bond yields in Europe in recent weeks have led to higher longer-term borrowing costs in NZ.

Foreign Exchange

- NZD lifted against the USD last week, but fell against the AUD.

Interest Rates

- Interest rates fell last week, largely following US moves lower.

Week Ahead

- Q2 Consumer Price Index, GlobalDairyTrade auction and International Travel and Migration.

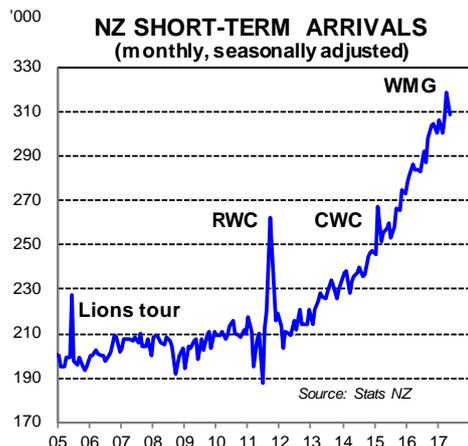
Week in Review

- June card spending growth was weak, food prices rose, while consumer sentiment stayed firm.

Global Calendars

- Bank of Japan and the European Central Bank's interest rate announcements are awaited.

Chart of the Week: How many Lions fans can NZ squeeze in?



On Friday, the June short-term visitor arrival figures are released. These will provide **insight into how much of a visitor boost the Lions tour provided**. The previous tour in **2005 attracted an additional 22,000 visitors in June** compared to May, at a seasonally low time of year. On a seasonally-adjusted basis, this implied a **14% increase in arrivals**.

However, over the past few years NZ has enjoyed a boom in tourism. **An additional 22,000 visitors this year would likely only bump visitor arrivals by 7%**. By comparison, **over the past year short-term visitor arrivals have grown 1.5% per month on a trend basis**, and the World Masters games saw arrivals lift 4% in April.

Furthermore, there is some risk that the **Lions supporters simply crowded out tourists who would have been here otherwise**. With **accommodation capacity tight and at a premium**, there are some early indications that higher accommodation costs **reduced the amount of money the Lions fans had to spend elsewhere**. These figures could contain lessons for the 2021 America's Cup challenge. Without additional capacity, NZ will struggle to make the most from hosting these one-off events.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7347	0.7275	0.7207	0.7091	0.7153	UP	0.7220	0.7450
NZD/AUD	0.9383	0.9559	0.9499	0.9485	0.9366	FLAT	0.9300	0.9500
NZD/JPY	82.66	83.01	80.14	80.93	75.66	FLAT	81.40	83.90
NZD/EUR	0.6406	0.6378	0.6466	0.6683	0.6429	DOWN	0.6310	0.6500
NZD/GBP	0.5976	0.5641	0.5643	0.5895	0.5327	FLAT/UP	0.5520	0.5690
TWI	78.3	78.2	77.7	78.1	76.1	FLAT	77.00	80.00

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

The NZD was mixed last week. The NZD/USD hit a five-month high on Thursday, largely as a result of USD weakens. The weakness followed less hawkish than expected comments from Fed Chair, Janet Yellen, as part of her Testimony to Congress. The NZD also lifted against the EUR and GBP last week, but these moves were relatively modest. In contrast, the NZD fell against the AUD last week. Softer than expected NZ card spending data (despite the Lion's rugby tour) and an increase in iron ore prices saw the NZD/AUD hit a four-month low last week.

We expect the USD to remain under pressure this week, following Friday night's soft CPI result. Ongoing US CPI softness is making it harder for officials to call this a temporary blip and, as a result, expectations for further US rate hikes are tempering. Closer to home, NZ Q2 CPI released on Tuesday will be key for the NZD. We are expecting inflation to dip to 0.1% qoq (1.9% yoy) after reaching as high as 1.0% qoq in Q1. However, the RBNZ itself has warned that inflation is likely to be volatile over the next few readings and as a result, is unlikely to be too concerned with the soft result. The result could see market expectations for RBNZ rate hikes dip, however, weighing on the NZD.

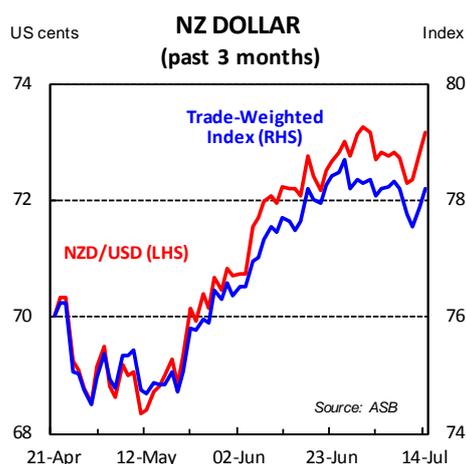
Short-term outlook:

Key data

Date

Time (NZT)

Market



NZ CPI, Q2, %qoq

18/07

10.45 am

+0.2

GlobalDairyTrade Auction

18/07

overnight

-

AU Unemployment, June, %

20/07

1:30 pm

+5.6

BoJ Rate Announcement

20/07

-

-0.1

ECB Rate Announcement

20/07

11:45pm

0.0

Key events: **NZD:** Q2 CPI (Tue), Global Dairy Trade auction (Tue). **AUD:** July meeting minutes (Tue); Jun employment (Thu). **USD:** Jun housing starts & building permits (Wed); Jul Philly Fed business index (Thu). **CNY:** Jun retail sales, industrial output & fixed asset investment (today); Q2 GDP (today). **GBP:** Jun CPI (Tue); Jun retail sales (Thu).

Speakers: **RBA:** Heath (Wed), Debelle & Bullock (Fri), Lowe (26 Jul).

Medium-term outlook:

Last Quarterly Economic Forecasts

Our FX forecasts were fine-tuned last week following a period of low volatility in currency markets. Despite the fine-tuning, we have left our USD forecasts unchanged. Uncertainties around the timing of US fiscal stimulus remain, especially given the ongoing difficulties in getting other reforms through Congress, and will continue to weigh on the USD. **As a result, we continue to expect the NZD/USD to now appreciate to around 0.7200 by the end of 2017. Further out, however, the NZD is expected to further appreciate vs. the USD over the next 18 months.** Firstly, NZ's persistently high Terms of Trade (ToT) will continue to provide the NZD with significant support. The high ToT have lifted real GDP and will keep the RBNZ on track to raise interest rates by the end of 2018. **We expect the USD to stabilise once the fiscal policies are signed into effect, however, this may now not occur until 2019.**

On top of the persistently high ToT, the NZD remains supported by relatively high interest rates, increased offshore investor demand and a structural improvement in the current account deficit. As a result, we expect the NZD/AUD to remain firm. Further, the **risk that the RBNZ raises interest rates before the Reserve Bank of Australia will further support the NZD/AUD.** Over 2017, we expect the NZD/AUD to remain above 0.9400 before lifting above 0.9600 towards the end of 2018.

We have revised our GBP forecast higher again, following our upward revision in May. Higher than anticipated UK CPI is likely to see the BoE raise interest rates in November. Further, the fact that the European Court of Justice will now have a role in UK law making post-Brexit means the UK economy is likely to hold up better than expected over the forecast horizon. We expect the NZD/GBP to largely remain with a range of 0.54-0.57 until the end of 2019.

In the near term we expect to see NZD/JPY hold above 80. The recent narrowing of the Japanese current account surplus has removed some of the JPY strength. Further out, the prospect for more BOJ easing and RBNZ tightening should further strengthen the NZD against the JPY, holding the NZD/JPY above 84 over 2018.

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	1.97	1.97	1.94	2.00	2.44	DOWN
2-year swap	2.31	2.37	2.23	2.44	2.24	DOWN
5-year swap	2.89	2.95	2.72	2.98	2.33	FLAT
5-year benchmark gov't stock	2.62	2.70	2.45	2.54	2.05	FLAT
NZSX 50	7650	7584	7553	7069	7078	FLAT

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

Interest rates fell last week, largely driven by offshore (US) moves. Less hawkish than expected comments by Fed Chair, Janet Yellen, on Wednesday and Thursday night saw US interest rates dip. Yellen noted the recent soft inflation reads and while she didn't entirely rule out the chance of a rate hike in September, noted that the Fed remain undecided over timing of both the next rate hike and the start of balance sheet normalisation (also expected later this year). Friday night's soft US CPI result further weighed on US interest rates. Currently, market pricing for a September rate hike is sitting at around 10%.

This downward momentum flowed into NZ interest rates last week and saw NZ rates unwind some more of their recent gains. These falls have seen market pricing for RBNZ rate hikes in 2018 to ease, although market expectations remain higher than our forecasts. There is currently around 48bp "priced in" between now and the end of 2018. This contrasts to our forecast of one 25bp rate hike by November 2018.

Short-term outlook:	Key data	Date	Time (NZT)	Market
<p>NZ INTEREST RATES (past 3 months)</p> <p>Source: ASB</p>	NZ CPI, Q2, %qoq	18/07	10.45 am	+0.2
	GlobalDairyTrade Auction	18/07	overnight	-
	AU Unemployment, June, %	20/07	1:30 pm	+5.6
	BoJ Rate Announcement	20/07	-	-0.1
	ECB Rate Announcement	20/07	11:45pm	0.0
	Comment: This week, market expectations for US Federal Reserve rate hikes will continue to be a key theme in interest rate markets. However, this week, NZ interest rates will also be influenced by Tuesday's Q2 CPI result. With a soft 0.1% qoq expected, the risk is that market pricing for additional rate hikes falls further. However, we do not expect the RBNZ to be concerned about the soft reading, as it noted that inflation is likely to be volatile over coming quarters.			
Attention will also be on the ECB's rate announcement on Thursday as the risk is that the ECB announces it will begin balance sheet normalisation in early 2018.				

Medium-term outlook:

Last Quarterly Economic Forecasts

The RBNZ continued to hold the OCR at its record-low of 1.75% at its June OCR Review. In May, the RBNZ surprised markets by retaining its neutral policy stance, despite the stronger than expected Q1 CPI result and Q2 RBNZ inflation expectations data.

At the June OCR review, the RBNZ acknowledged the major developments since the May Monetary Policy Statement. **GDP growth proved weaker than expected, the TWI has appreciated and energy prices have declined.** However, providing some offset, the **higher Terms of Trade and Budget 2017** are all positive for medium-term growth prospects. While the **RBNZ's assessment of events was broadly in line with our expectations, some market participants were surprised that the RBNZ did not use firmer language on the NZD.** The RBNZ 'merely' noted the higher NZD was partly due to export prices.

At the May MPS, a key point of difference between our view and the **RBNZ's was our medium-term milk price assumption.** We see scope for the RBNZ to revise this up in light of **Fonterra's confident opening season milk price forecast.** However, we will have to wait for the August MPS to confirm if this is the case.

The **RBNZ's view of the inflation outlook remained unchanged from the May MPS and OCR Review.** The RBNZ reiterated that the Q1 strength was largely due to temporary rises in petrol and food prices and that inflation was likely to be volatile over the next few quarters. This is in line with our view and we are expecting inflation to dip back below 2% in Q2 as the recent falls in oil prices weigh on tradable inflation. Looking forward, we expect tightening domestic capacity pressures and improving global growth to lift inflation back towards the 2% mid-point of the target band by late 2019.

We continue to expect the RBNZ to leave the OCR on hold at 1.75% until late 2018.

Key international data for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
China GDP, Q2, %yoy	17/07	2:00 pm	6.9	6.8	6.8
China Retail Sales, June, %yoy	17/07	2:00 pm	10.7	10.6	10.8
China Industrial Production, June, %yoy	17/07	2:00 pm	6.7	6.7	7.0
Reserve Bank of Australia Board Meeting Minutes, July	18/07	1:30 pm	-	-	-
UK CPI, June, %yoy	18/07	8:30 pm	2.9	2.9	3.0
Bank of Japan Interest Rate Announcement, %	20/07	-	-0.1	-0.1	-0.1
Australia Unemployment Rate, June, %	20/07	1:30 pm	5.5	5.6	5.5
European Central Bank Interest Rate Announcement, %	20/07	11:45 pm	0.0	0.0	-

Net exports remain a key growth driver in China. Housing investment is holding up better than expected while manufacturing investment is bottoming out gradually.

Stable labour markets in **China** are supporting resilient **retail sales growth**.

Industrial production growth in **China** is likely to remain range bound over the coming months.

The **Reserve Bank of Australia is due to put out its July board meeting minutes this week.** The Statement accompanying the July “no change” outcome remained neutral. The housing market is showing some tentative signs of cooling. However non-mining business investment remains weak and indicators of the labour market remain mixed with plenty of spare capacity. This will need to be digested before wage (inflation) pressures start to lift. We don’t anticipate anything in the July minutes which would suggest that the RBA is contemplating a move to a tightening bias. Our policy view remains that the central bank will not move the official cash rate until Q4 2018, when it will likely lift the cash rate by 0.25% to 1.75%.

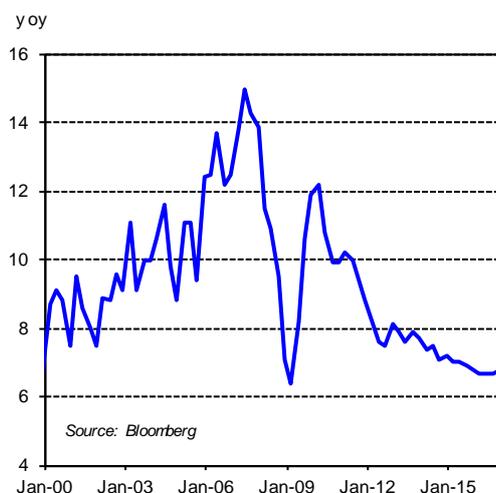
Australian employment data have risen strongly over the past three months, with almost 150k new jobs added. We are forecasting a 15k growth in jobs in June, making it four months of solid jobs growth on the trot. An unchanged participation rate should keep the unemployment rate at 5.5%.

We do not expect the Bank of Japan to make any change to its monetary policy. The BoJ Governor has made it clear he does not want to make further changes to the Bank’s policy framework. But very low inflation means a change is likely following Kuroda’s departure in early 2018.

We anticipate **June UK CPI** will print at 3% yoy. The increase is due to the lagged effects of the Pound’s depreciation following the Brexit referendum. UK headline CPI is likely to stay around 3.0% for the remainder of 2017.

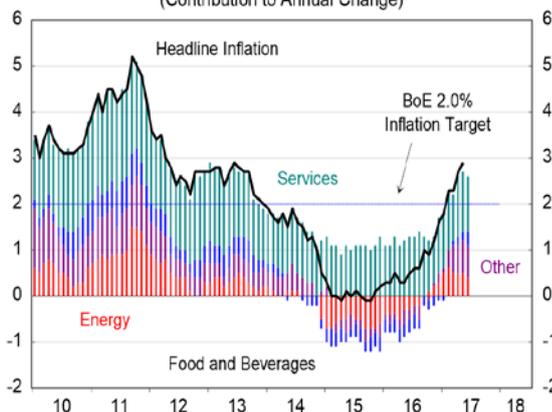
We anticipate the **European Central Bank will leave all interest rates and asset purchases unchanged.** We believe the ECB will wait until the September meeting to outline its Quantitative Easing tapering proposals.

CHINA GDP



U.K. INFLATION

(Contribution to Annual Change)



NZ Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
CPI, Q2, %qoq	18/07	10:45 am	1.0	0.2	0.1
GlobalDairyTrade auction, whole milk powder, % change	18/07	Overnight	2.6	-	1 to 3
International Travel & Migration, May, Net Migration, 000s	21/07	10.45 am	5,910	-	6,000

We expect the CPI to print at 0.1% qoq in Q2 (1.9% yoy), weaker than the RBNZ's 0.3% qoq forecast in May's Monetary Policy Statement (MPS). This is a sharp slowdown from Q1's 1.0% quarterly lift in inflation. However, **Q1's jump was the result of a number of one-off lifts, many of which have reversed again in Q2.**

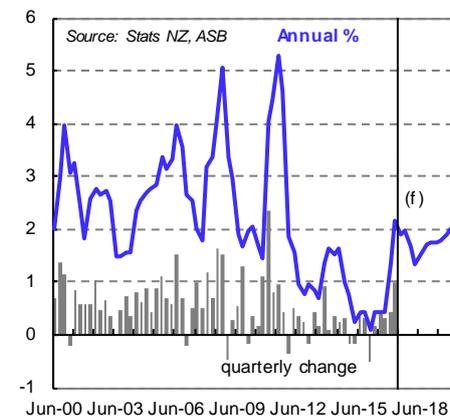
While inflation is currently being buffeted by temporary factors, **the RBNZ is more focussed on the underlying inflation trend.** Domestically, **we expect inflation to remain soft in Q2 outside of a few key sectors (notably accommodation, construction and, increasingly, rents).** GDP growth has been subdued recently and wage growth also remains soft. Although global economic conditions are improving, it appears that the inflation impetus of this improvement is some way off. As a result, **we expect the RBNZ to remain comfortable leaving the OCR on hold for some time yet.**

We expect prices to lift a touch at the **GlobalDairyTrade auction** overnight Tuesday. A fortnight ago whole milk powder (WMP) prices also lifted 2.6%, although overall prices drifted 0.4% lower. With NZ production currently in between seasons, dairy prices are largely trading water. Indeed, we don't expect material movement either way until the NZ spring. **At the current juncture, futures pricing suggests WMP will rise by between 1% and 3%.** Beyond the auction and looking over the rest of the year, we expect prices to fluctuate around current levels, with global supply and demand largely in balance.

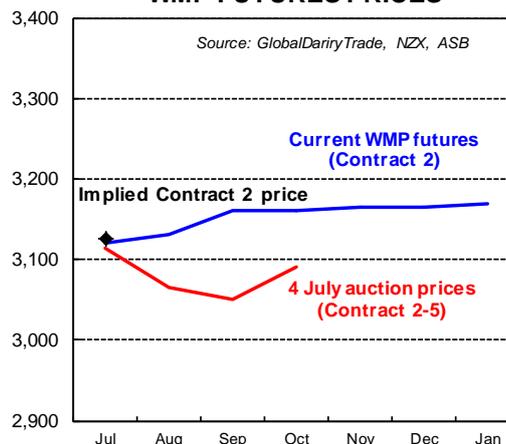
Net migration inflows remain close to record highs on a monthly basis, and continue to post new records on an annual basis (just 36 people shy of 72,000 in May). NZ's relatively strong economy and labour market appear to be the key drivers of elevated net migration. The number of arrivals on work visas continues to climb, and now make up 34% of all arrivals compared to 31% a year ago. Meanwhile, departures remain at very low levels as fewer NZers head across the Tasman and previous student arrivals do not appear to be leaving quite yet.

Short-term visitor arrivals fell in May, as expected, unwinding the spike in April due to the Masters Games. We expect **short-term visitor arrivals to have surged again in June** as a result of the Lions Rugby tour. It will be interesting to see how much visitor arrivals spiked in June due to the Lions tour, or if Rugby fans simply crowded out other visitors during that month.

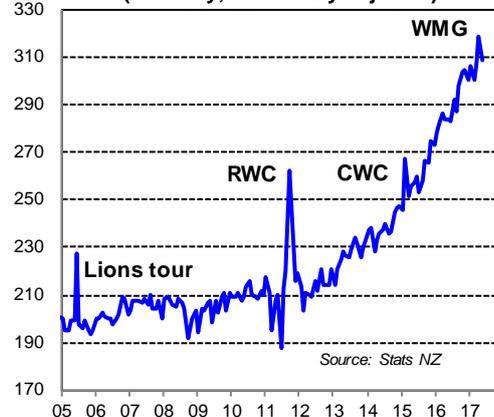
NZ CPI INFLATION



GLOBALDAIRYTRADE AND WMP FUTURES PRICES



NZ SHORT-TERM ARRIVALS (monthly, seasonally adjusted)



Data Recap: weekly recap

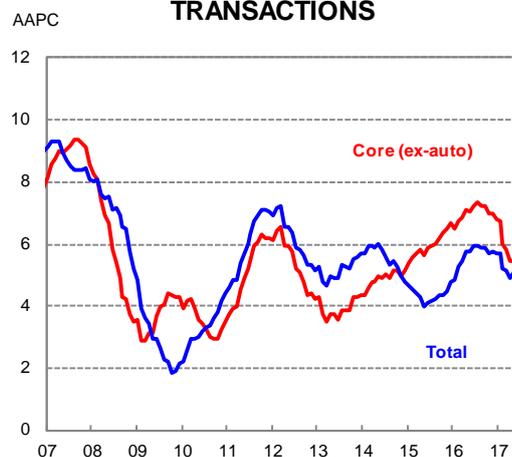
Data	Date	Actual	Market forecast	ASB Forecast
Electronic Card Transactions, June, %mom	11/07	0.0	-	0.8
Food Price Index, June, %mom	13/07	0.3	-	0.8
Consumer confidence, July, Index	13/07	125.4	-	-

June card spending growth was weaker than expected. In particular, the flat total spend for the month disappointed versus our expectations of a 0.8% rise. However, the 0.8% lift in core spending was more in line with our forecast 1.2% lift. **The anticipated boost from the Lions tour only boosted hospitality spending, while other categories were weaker than expected.** Petrol prices fell 4.4% for the month, dragging down the overall spend. **From here, we expect spending to continue at its recent trend pace over the remainder of 2017.** High population growth, improving dairy incomes, lower petrol prices along with improved consumer confidence are to a degree being offset by a more subdued housing market along with the late-2016 lift in interest rates.

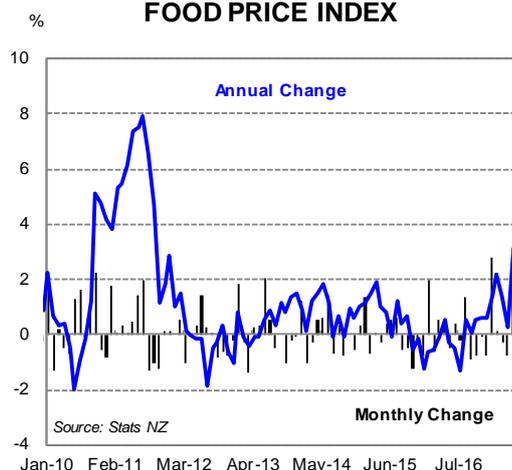
Seasonally-adjusted food prices dipped 0.3% mom in June, largely driven by a 6.5% fall in fruit and vegetable prices (reversing May's 6.8% lift). Despite the fall in fruit and vegetable prices, they remain 9.4% higher on an annual basis (after hitting a near six-year high in May). This confirms our view that food prices did not lift as strongly in Q2 as they did in Q1, and are forecast to have contributed 0.14ppts to Q2's CPI release. We are forecasting the CPI to have risen 0.1% qoq (however, this is sitting just below the rounding error and as a result is very close to being rounded higher to 0.2%) and 1.9% yoy.

The July ANZ-Roy Morgan Consumer Confidence Survey shows household sentiment remains firm. While headline confidence dipped over the month, seasonally-adjusted confidence lifted to its highest level since September 2014. **Recent developments have been positive for households' economic outlook.** For example, the Budget contained tax cuts and other income support, the Fonterra milk price has lifted, petrol prices have fallen, while the Lions tour may have brought in a "feel good" factor as well. At this juncture, indicators are also consistent with household spending growth accelerating over the second half of 2017. However, with the NZ election scheduled for 23 September and the possibility of a tight election, **there is a risk that confidence wanes over coming months and spending growth disappoints.**

RETAIL ELECTRONIC CARD TRANSACTIONS



FOOD PRICE INDEX



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 17 Jul	14:00	CH	Retail sales	Jun	y%ch	10.7	10.6	10.8
	14:00	CH	Industrial production	Jun	y%ch	6.5	6.5	7.0
	14:00	CH	GDP	Q2	q%ch	1.3	1.7	1.7
Tue 18 Jul	10:45	NZ	CPI	Q2	q%ch	1.0	0.2	0.1
	11:30	AU	ANZ Roy Morgan Consumer Confidence	Jul	Index	113.0	~	~
	13:30	AU	New motor vehicle sales	Jun	m%ch	2.9	~	~
Wed 19 Jul	13:30	AU	RBA July Rate Meeting Minutes					
	12:30	AU	WBC leading index	Jun	m%ch	-0.0	~	~
	17:30	AU	RBA's Heath speech in Sydney					
Thu 20 Jul	18:00	JN	Machine tool orders	Jun F	y%ch	31.1	~	~
	~	JN	BOJ Monetary Policy Statement					
	11:50	JN	Trade balance adjusted	Jun	¥bn	133.8	~	~
Fri 21 Jul	13:30	AU	NAB business confidence	Q2	~	6.0	~	~
	13:30	AU	Employment change	Jun	000	42.0	15.0	15.0
	18:30	JN	BOJ Kuroda speaks at press conference after MPM					
	19:00	JN	Convenience store sales	Jun	y%ch	1.0	~	~
	10:45	NZ	Net migration	Jun	~	5,900	~	~
	11:50	JN	Japan buying foreign bonds	Jul	¥bn	839.5	~	~
	14:40	AU	RBA's Debelle speech in Adelaide					
15:00	NZ	Credit card spending	Jun	m%ch	0.9	~	~	
15:30	AU	RBA's Bullock speech in Melbourne						
17:30	JN	Nationwide department sales	Jun	y%ch	0.0	~	~	

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 17 Jul	00:01	UK	Rightmove house prices	Jul	m%ch	-0.4	~	~
	13:30	US	Empire manufacturing	Jul	~	19.8	15	~
Tue 18 Jul	09:30	UK	CPI	Jun	m%ch	0.3	~	~
	09:30	UK	House price index	May	y%ch	5.6	~	~
	10:00	EC	CPI	Jun	m%ch	-0.1	~	~
	10:00	EC	ZEW survey expectations	Jul	~	37.7	~	~
	10:00	EC	CPI core	Jun F	y%ch	1.1	~	~
	13:30	US	Import price index	Jun	m%ch	-0.3	-0.1	~
Wed 19 Jul	13:30	US	Export price index	Jun	m%ch	-0.7	0.1	~
	10:00	EC	Construction output	May	m%ch	0.3	~	~
	12:00	US	MBA mortgage applications	Jul	%	-7.4	~	~
	13:30	US	Housing starts	Jun	000	1,092	1,160	~
Thu 20 Jul	13:30	US	Building permits	Jun	000	1,168	1,210	~
	09:00	EC	Current Account	May	€bn	21.5	~	~
	09:30	UK	Retail sales ex auto fuel	Jun	m%ch	-1.6.6	~	~
	12:45	EC	ECB main refinancing rate	Jul	%	0.0	~	~
	13:30	US	Initial jobless and continuing claims	Jul	~	~	~	~
	13:30	US	Philadelphia Fed Business Outlook	Jul	~	27.6	20.0	~
	15:00	EC	Consumer confidence	Jul A	~	-1.3	~	~
15:00	US	Leading index	Jun	%	0.3	0.4	~	

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