

RBNZ to remain on hold while risks are balanced

- Q4 GDP was weaker than expected, but underlying demand remains firm.
- Coupled with an improved near-term inflation outlook, the RBNZ likely to be less concerned about GDP result than otherwise.
- Still-balanced risks to the inflation outlook will see the RBNZ leave rates on hold this week.

Last week, [Q4 GDP growth](#) surprised many by coming in 0.3ppts lower than market expectations. Further, Q4's 0.4% qoq result was 0.6ppts below the RBNZ's forecast for growth of 1.0% qoq. On top of this, Q3 growth was revised 0.3ppts lower to 0.8% (from 1.1% qoq). Overall, **the weaker than expected result, combined with Q3's downward revision, means 2016's growth profile was more moderate than previously thought.**

However, **there were a couple of redeeming features within Q4's GDP result.** Firstly, **the weaker components in Q4 are generally the more volatile components.** For example, the transport industry was a key source of weakness in Q4. The transport sector was significantly disrupted by the Kaikoura earthquake, given the road, rail and port damage that occurred. How this affected measurement of transport sector is unclear, for example road miles likely lifted as trucks had to take a longer route through the top half of the South Island, but ferry sailings were outright cancelled. Further, manufacturing, mining and the information, media and telecommunications industry were also weaker than expected. But, as mentioned above, weakness in these sectors appeared to be due to volatility rather than stemming from underlying weakness. Indeed, **the fact that underlying demand appears to remain firm (particularly supported by strong tourism demand, construction activity and household demand) suggests GDP growth should remain respectable over 2017.**

Normally the RBNZ would be concerned to see Q4 growth come in 0.6ppts lower than its own forecast. However, **the second redeeming feature of last week's GDP result, from the RBNZ's perspective, is that the weak result is offset by the better near-term inflation outlook.** Coupled with the recent lifts in inflation, the RBNZ is less likely to be concerned about the Q4 GDP result than it would be otherwise. However, from our perspective, **Q4's GDP result does highlight the fragility of the inflation outlook. Q4's GDP result reinforces that there aren't any widespread capacity pressures building in the economy just yet.**

As a result, we think the RBNZ will **remain cautious on the inflation outlook at Thursday's OCR Review.** But overall, we expect the message delivered will be in line with February's MPS and Graeme Wheeler's recent speech, **suggesting the risks are largely balanced.** Current **upside risks** to the inflation outlook include the **recent fall in the NZ dollar** on a trade-weighted index (which has fallen below the RBNZ's forecasts). And on the back of stronger than expected food prices over Q1 so far and the lift in petrol prices, inflation looks set to hit the middle of the RBNZ's 1 – 3% target range in Q1. However, these impacts are largely being **offset by the weaker-than-expected Q4 GDP result** (and accompanying lack of widespread capacity pressures), the **recent dip in dairy prices and the ongoing global uncertainty.** As a result, we **expect the RBNZ to leave the OCR unchanged at 1.75% at the March OCR Review and to maintain its neutral bias in the accompanying statement.**

Foreign Exchange

- NZD/USD lifts as Fed tone more 'dovish' than expected, NZD/AUD down on weak NZ GDP.

Interest Rates

- Long and short-term yields moved lower following the Fed's "dovish" rate hike & NZ Q4 GDP.

Week Ahead

- International travel and migration, GDT auction, RBNZ interest rate announcement, Trade balance.

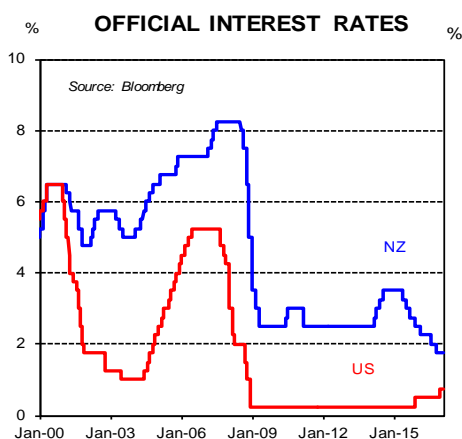
Week in Review

- Current account deficit narrows, GDP growth weaker than expected, consumer confidence robust.

Global Calendars

- RBA and BoJ meeting minutes, ECB Economic bulletin, UK retail sales, US current account balance.

Chart of the Week: US interest rates catching up



The RBNZ choosing to sit tight this Thursday comes after the **US Fed lifted interest rates by 0.25% on the 16th of March.** Markets had been anticipating that the Fed would raise rates (market pricing was sitting near 100%) following a number of hawkish comments by a range of Fed officials, including Fed Chair, Janet Yellen. **The sudden lift in expectations for a rate hike put significant downward pressure on the NZD leading into the announcement on the 16th of March.**

However, with no changes to the Fed's underlying interest rate forecasts, markets were initially disappointed. Yellen also warned in the following press conference that the **"economic outlook is highly uncertain"** suggesting that the **Fed remains committed to raising rates gradually.** Despite the gradual focus on rate hikes, **the Fed is forecasting 5 interest rate hikes between now and the end of 2018, compared to our forecast of one hike by the RBNZ in late 2018.** If respective interest rates lift as expected, **one of the structural factors supporting the NZD of late – relatively high interest rates – will lessen.**

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7021	0.6936	0.7207	0.7296	0.6838	FLAT	0.6920	0.7120
NZD/AUD	0.9126	0.9160	0.9360	0.9685	0.8933	FLAT/DOWN	0.9000	0.9200
NZD/JPY	79.10	79.63	81.65	74.43	76.07	FLAT	78.00	80.00
NZD/EUR	0.6540	0.6483	0.6751	0.6533	0.6041	FLAT	0.6480	0.6620
NZD/GBP	0.5666	0.5695	0.5764	0.5596	0.4729	FLAT	0.5600	0.5750
TWI	76.5	75.9	78.4	77.9	72.3	FLAT/DOWN	75.80	80.00

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

The **NZD lifted against the USD last week**, as the USD declined. The Federal Reserve hiked interest rates as expected, but remained slightly more cautious on the outlook relative to market expectations. Meanwhile, the **NZD fell against the AUD** due to the weaker NZ GDP result.

We expect the **NZD/AUD to continue to trend lower** this week, as iron ore prices support the AUD while we expect further falls in NZ dairy prices at this week's Global Dairy Trade auction to weigh on the NZD.

The **RBNZ is widely expected to keep the OCR unchanged at 1.75% this Thursday**, and we expect a statement with a similar tone as the February MPS noting that inflation risks remain roughly balanced.

We expect the **USD may continue to trend lower this week** in the absence of any major US data and Trump announcements, although there are a number of Fed speeches scheduled this week.

The **GBP remains vulnerable** to strident Brexit-related rhetoric. Meanwhile, **we believe the EUR may improve** as risks have shifted around the ECB outlook (to less stimulus rather than more) and French political uncertainty is overblown.

Short-term outlook:	Key data	Date	Time (NZT)	Market	
US cents NZ DOLLAR (past 3 months)	Index	NZ Net migration, February, 000	21/03	10:45 am	-
		UK February CPI, % mom	21/03	10:30 am	0.5%
		GDT Dairy auction	21/03	Overnight	-
		RBNZ OCR Review	23/03	09:00 am	1.75%
		NZ Trade balance, February, \$mn	24/03	10:45 am	160m
		Key events: NZD: Global Dairy Trade auction (Wed); RBNZ OCR announcement (Thurs); Trade Balance (Fri). USD: Balance of Payments (Tue); Building permits and durable goods orders (Fri). AUD: Home Price Index, RBA March meeting minutes (Tue). EUR: Balance of Payments (Wed); PMI's (Fri). GBP: CPI (Tue); Retail Sales (Thurs).			
	Speakers: RBA: Ellis (Monday); Debelle (Wed). Fed: Evans (Tue, Fri); Dudley (Tue); Yellen (Thurs); Kaplan (Fri). BoE: Deputy Governor Woods (Mon), Haldane, Governor Carney (Tue).				

Medium-term outlook:

Last Quarterly Economic Forecasts

Our FX forecasts were updated in mid-December with the short- and medium-term outlook tweaked. Further out, the NZD is now expected to depreciate vs. the USD over the next 18 months. The driver is USD strength due to the expected fiscal stimulus US President-elect Trump is forecast to deliver. This spending should be inflationary, pushing the US Federal Reserve into lifting the Fed Funds rate faster than previously expected. Capital inflows to the US are also expected to support the USD. We expect the UUSD to strengthen (NZD/USD weaken) once the fiscal policies are signed into effect. Meanwhile, also supporting the USD, the Federal Reserve hiked policy rates in March and signalled two more rate hikes were likely in 2017 (which we expect in June and December).

Despite the revision, 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 0.94-0.96.

We revised our GBP forecast lower in late October and have pushed the Pound a touch lower again in December's update. We believe the fundamental down-trend in the GBP will remain intact, and expect the NZD/GBP to continue to gradually lift toward the mid-0.60's by 2018.

In the near term we continue to see NZD/JPY hold above 70. Further out, the prospect for more BOJ easing should weaken the JPY, pushing NZD/JPY above 84 in 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	2.00	2.25	FLAT
90-day bank bill	1.96	1.96	2.03	2.23	2.35	FLAT
2-year swap	2.30	2.38	2.41	2.13	2.28	FLAT/UP
5-year swap	2.99	3.10	3.08	2.30	2.57	FLAT/UP
5-year benchmark gov't stock	2.12	2.62	2.63	2.10	2.35	FLAT/UP
NZSX 50	7158	7202	7090	7278	6605	FLAT

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

With a packed agenda, it was no surprise to see plenty of movement in rates last week. **The US Federal Reserve lifted the Fed Funds rate by 25bp** on Thursday morning (NZT). The move was very much expected and there was little change to the forward guidance as well. However, the statement was not as hawkish as some were expecting, with some even **referring to the event as a "dovish hike"**. This pushed yields a touch lower across the curve, while **NZ rates also moved lower**.

Shortly after the Fed's move, **NZ Q4 GDP was released and missed expectations on the downside**, while Q3 was also revised lower. This pushed yields back even further, with the **curve moving lower and flatter**. The cherry on top was Australia's soft employment data. At this stage **a rate hike from either the RBNZ or RBA does not look to be on the short-term agenda**. Indeed, the chances of a rate hike this year from the RBNZ are down to 40% vs 50% prior to the Federal Reserve's decision.

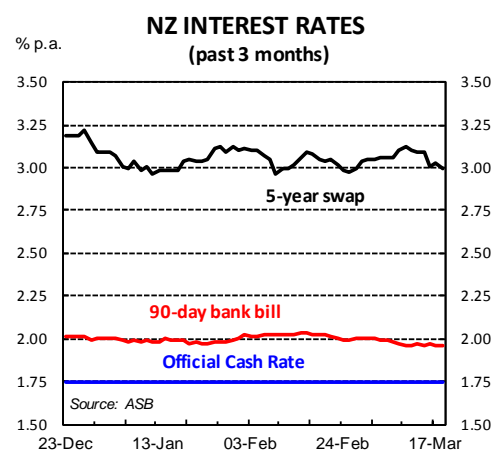
Short-term outlook:

Key data

Date

Time (NZT)

Market



NZ Net migration, February, 000

21/03

10:45 am

-

UK February CPI, % mom

21/03

10:30 am

0.5%

GDT Dairy auction

21/03

Overnight

-

RBNZ OCR Review

23/03

09:00 am

1.75%

NZ Trade balance, February, \$mn

24/03

10:45 am

160m

Comment: Looking ahead and after so much activity last week, there is a bit of a lull in potentially market-moving news. **The main event is the RBNZ's OCR Review**, on Thursday. **No change is expected** at this meeting, or for the rest of this year. There is a small chance the RBNZ will choose to edit the language in the statement, with the inflation outlook slightly firmer compared to the February MPS. **However, as this is just an OCR Review, and not a full MPS, there is a good chance the statement will be identical to February's MPS**, with the focus shifting towards May's MPS and forecast updates. NZ rates could also be impacted by Tuesday's night's GDT dairy auction, with another small drop expected as the dairy price-correction continues.

Offshore the only major release is UK CPI, but with the Bank of England unlikely to alter interest rates this year, the data will have limited impact.

Medium-term outlook:

Last Quarterly Economic Forecasts

The RBNZ held the OCR at its record-low of 1.75% as widely expected, on February 9. The policy bias was the same as in November, with a neutral stance but a cautious eye on global developments: *"numerous uncertainties remain, particularly in respect of the international outlook, and policy may need to adjust accordingly."* **The RBNZ sees the global environment as a key downside risk.**

The RBNZ revised its growth outlook higher for 2017 and 2018, although continues to project a sharper slow-down in growth compared to ASB in 2019 and 2020. Growth is lifting due to accommodative monetary policy and high population growth. The RBNZ sees the key upside risk to the growth outlook as stronger net demand from net migration than we are currently seeing. **The RBNZ assumed that some of the recent dairy price gain is temporary** and, as in the November MPS, has whole milk powder prices settling at USD 3,000 per tonne.

The RBNZ's own OCR projections show the OCR remaining at 1.8% well into 2019, effectively a neutral stance. The RBNZ's outlook has a 25bp hike built in by early 2020. The flagging of a distant tightening is more realistic than its previous OCR forecast which held the OCR unchanged. But it should not be taken as a sign of an imminent tightening, given the RBNZ remains concerned about the high NZ dollar and sees the lift in long-term interest rates as an effective tightening.

We continue to view OCR increases as a long way off, towards the end of 2018. The RBNZ also noted premature tightening could undermine growth and stall the expected increase in inflation. In contrast, market pricing implies an early 2018 start, though has taken some heed of the RBNZ's caution.

Key international data for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Reserve Bank of Australia Meeting Minutes, March	21/03	1:30 pm	-	-	-
Australia House Price Index, Q4	21/03	1:30 pm	1.5	2.5	2.0
UK CPI, February, %yoy	21/03	10:30 pm	1.8	2.1	-
UK Retail Sales ex auto fuel, February, %mom	23/03	10:30 pm	-0.2	0.3	-
Eurozone Manufacturing PMI, March, index	24/03	10:00 pm	55.4	55.3	-

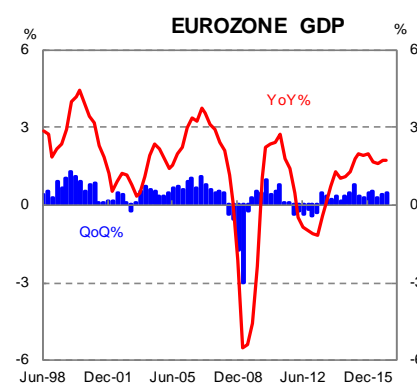
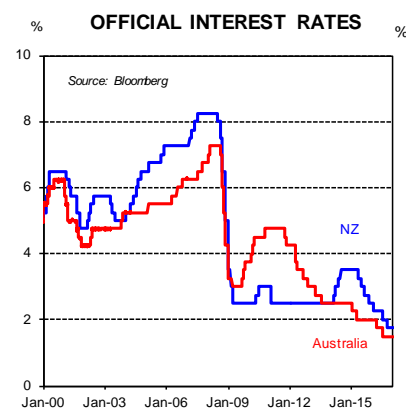
The **Reserve Bank of Australia** left the cash rate on hold and reaffirmed its neutral bias. We will be reading the **Minutes** for more information on the RBA's outlook for business investment. The Statement accompanying the meeting stated that there has been a further pickup in business investment. It will also be interesting to see what the RBA's most up-to-date thinking is on the labour market and wage outlook.

The **Australian CoreLogic data** point to a 2% lift in dwelling prices over the December quarter, driven chiefly by robust price rises in Sydney and Melbourne.

UK headline CPI inflation (1.8%pa in January) should continue to accelerate in February because of the weak Pound and diminishing UK labour market slack. The Bank of England projects inflation to quicken to 2% in Q1.

Leading indicators like the BRC sales point to a weak **UK February retail sales** report.

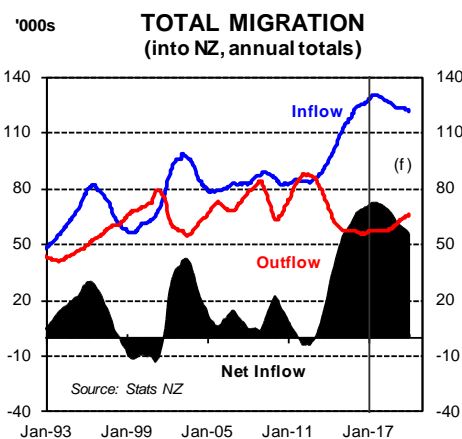
The **manufacturing and services PMIs in the Eurozone** are expected to remain firm in March, consistent with further modest expansion in economic activity.



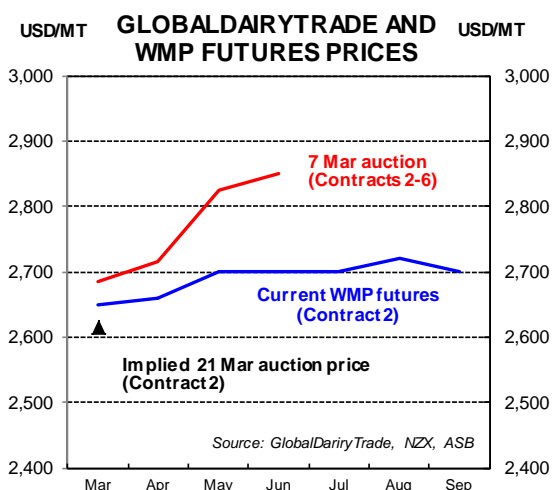
NZ Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
International Travel & Migration, February, Net Migration, 000s	21/03	10:45 am	6,460	-	6,200
GlobalDairyTrade auction, whole milk powder, % change	21/03	Overnight	-12.4	-	-4 to -2
RBNZ Official Cash Rate announcement, %	23/03	9:00 am	1.75	1.75	1.75
Trade balance, February, \$bn	24/03	10:45 am	-285mn	+160mn	+127mn

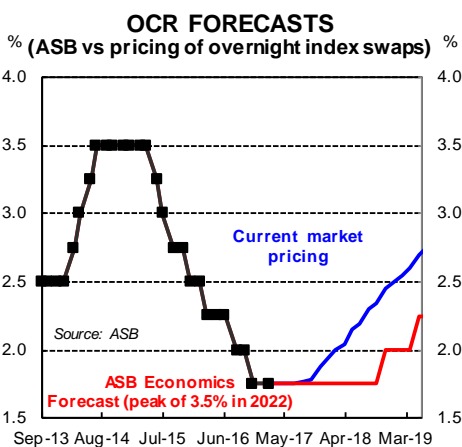
As each month goes by, NZ net migration records another record high. In January, the new record was 71,305 new migrants over the past 12 months. Recent data show this is not just an arrivals story, with departures continuing to hold around recent lows. We continue to look for net migration to hold above 70,000 through 2017 and there is a good chance we will see 72,000 before we see 70,000. Further out though, we continue to look for a gentle decline in net migration, as students return home when studies are completed. In addition, as the Australian economy improves, it will tempt some Kiwis away. It will also be more attractive for Australians and Kiwis currently in Australia to stay put, rather than cross the Tasman.



We expect another weak result at the **GlobalDairyTrade auction** overnight Tuesday. This is a continued function of better-than-expected production, with the NZ summer delivering positive growing conditions. The increased supply is weighing on prices and as a result, we reduced our milk price forecast for this season to \$6.00/kg from \$6.50/kg after the last auction. **Current futures pricing suggests whole milk powder prices will fall by between 2% and 4% at the auction.**



We expect the RBNZ to hold the OCR steady at 1.75% at the March OCR Review and maintain its neutral bias in the accompanying statement. The overall outlook has not materially shifted since the February MPS, although there have been developments in the domestic inflation outlook and the NZD's Trade Weighted Index (TWI). We continue to expect the RBNZ will hold the OCR at 1.75% through to late 2018. Inflation risks are roughly balanced. The NZD has continued to depreciate since the February MPS and remains below the Bank's TWI assumed levels, while petrol and food prices have climbed. However, GDP growth was weaker than expected with downward revisions, dairy prices have stepped back from the peak, and there is little sign of broader capacity pressures creeping into the economy outside of housing and construction. **In addition to expecting the RBNZ to hold the OCR at 1.75%, we look for the RBNZ's policy assessment to again be fairly neutral.** In particular, comments on the uncertain international outlook should be reiterated, stressing that "policy may need to adjust accordingly".



We expect a **trade surplus of \$127m in February**, breaking the run of seven consecutive deficits. In particular, we expect the earlier improvement in dairy prices to translate into higher dairy export prices and values over the month. At the same time, import values remain constrained by low global inflation for now. Looking at the broader trend, the **annual goods trade deficit is likely to widen to \$3.7 billion.**

Data Recap: weekly recap

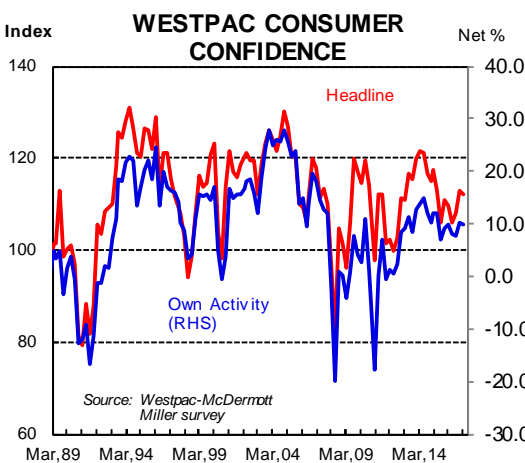
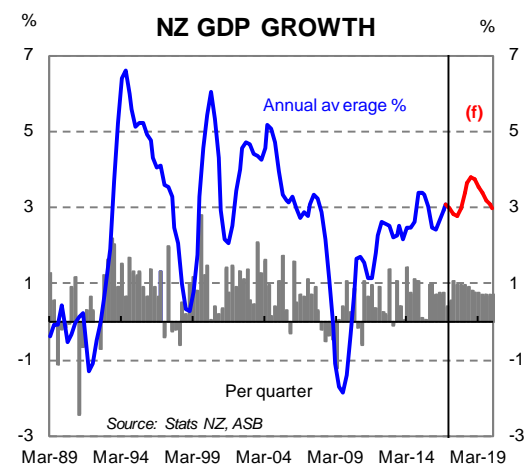
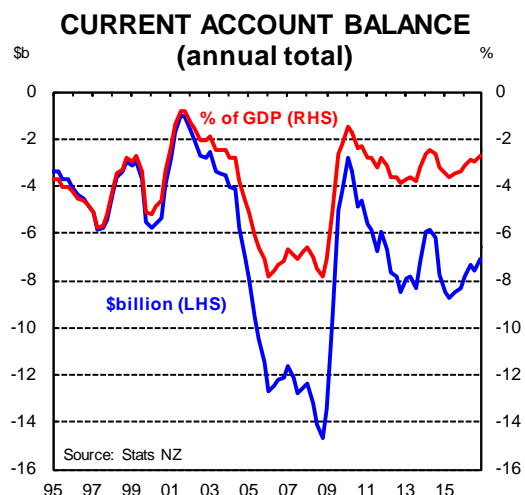
Data	Date	Actual	Market forecast	ASB Forecast
Current account, Q4, % of GDP	15/03	-2.7	-2.7	-2.9
GDP, Q4, % qoq	16/03	0.4	0.7	0.9
ANZ Roy Morgan Consumer Confidence Index, March	17/03	125.2	-	-
Westpac McDermott Miller Consumer Confidence Index, Q1	20/03	111.9	-	-

The annual current account deficit narrowed to 2.7% of GDP in Q4 from a revised 3.0% in Q3, largely in line with market expectations. Meanwhile, the seasonally-adjusted current account deficit narrowed to the smallest deficit since Q1 2014. Over the quarter, a smaller income deficit drove much of the narrower current account deficit and explained the surprise versus our expectations. All up, **the Q4 balance of payments data paint a stable external position for NZ.** The current account deficit is narrowing and NZ's net liabilities relative to its income are falling. Looking at the current account, we expect the annual deficit to narrow further over the year.

GDP growth was weaker than expected, rising just 0.4% in Q4 and well below our own and the RBNZ's expectations (0.9% and 1.0%, respectively). Furthermore, Q3 growth was revised lower by 0.3 percentage points, from 1.1% to 0.8%. The result is a more moderate growth profile over the past year than previously believed. **A key source of weakness in Q4 was the transport industry** which was a major source of uncertainty for us ahead of the release. The transport sector was significantly disrupted by the Kaikoura earthquake, given the road, rail and port damage that occurred. Manufacturing activity was also weaker than expected, due to widespread weakness throughout the food and beverage category. Overall, the main areas of weakness in Q4 appear to be a result of volatility and not reflective of any underlying weakening in trend growth. The economy remains supported by strong tourism demand, construction activity, robust business confidence and healthy household demand.

The ANZ Roy Morgan consumer confidence index had another robust month in March, sitting in the middle of the range over the last 6 months. Headline consumer confidence only ticked down to 125.2 from 127.4. Household views on whether they are better or worse off compared to a year ago also only ticked down a touch, coming down to a net of 13% of respondents from 15% in February. Looking at the next 12 months, a net 32% expect things to improve, up from 31% in January and marking a 7th consecutive month above 30, the longest run for over 2 years.

The Westpac McDermott Miller Consumer Confidence Index followed the trend seen in the ANZ series, dipping in Q1 2017, albeit only marginally so. Headline consumer confidence ticked down to 111.9 from 113.1 in the December quarter. However, the 1.2% point move was well within the range of normal seasonal moves and **could be partly a consequence of the relatively wet summer.** The headline index remained well clear of 10-year average level of 109.7, but dipped below the 5-year average of 112.3. The main change was in the 1-year-ahead economic outlook, declining to 11.8 from 18.0, although that was still the second highest read of the last 2 years. The 5-year-ahead outlook went the other way, rising to 17.8 from 17.2.



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 20 Mar	12:30	AU	RBA's Ellis speech in Canberra					
Tue 21 Mar	08:45	NZ	Net migration	Feb	~	6,460	~	~
	09:30	AU	ANZ Roy Morgan Weekly Consumer Confidence	Mar	Index	113.1	~	~
	11:30	AU	House price index	Q4	q%ch	1.5	~	~
	11:30	AU	RBA March Rate Meeting Minutes					
	13:00	NZ	Credit card spending	Feb	m%ch	0.2	~	~
Wed 22 Mar	00:00	CH	Conference Board China Leading Economic					
	10:30	AU	WBC leading index	Feb	m%ch	0.0	~	~
	10:50	JN	BOJ Minutes of January 30-31 meeting					
	10:50	JN	Trade balance	Feb	¥bn	155.5	551.9	~
	11:00	AU	Skilled vacancies	Feb	m%ch	1.0	~	~
	12:30	JN	BOJ Funo speaks in Shizuoka					
	12:40	AU	RBA's Debelle speech in Singapore					
	15:30	JN	All industry activity index	Jan	m%ch	-0.3	~	~
Thu 23 Mar	07:00	NZ	RBNZ official cash rate	Mar	%	1.75	1.75	~
Fri 24 Mar	08:45	NZ	Trade balance	Feb	NZD mn	-285.0	~	~
	11:30	JN	Nikkei Japan PMI manufacturing	Mar P	Index	53.3	~	~
	16:00	JN	Leading index CI	Jan F	Index	105.5	~	~

*P = Preliminary

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 20 Mar	00:01	UK	Rightmove house prices	Mar	m%ch	2.0	~	~
	10:00	EC	Labour costs	Q4	y%ch	1.5	~	~
	12:30	US	Chicago Fed National Activity Index	Feb	Index	-0.1	~	~
	17:10	US	Fed's Evans speaks on Economy and Policy in New York					
Tue 21 Mar	09:30	UK	CPI	Feb	m%ch	-0.5	~	~
	09:30	UK	House price index	Jan	y%ch	7.2	~	~
	12:30	US	Current account balance	Q4	\$bn	-113.0	-128.6	~
	16:00	US	Fed's George speaks in Washington on U.S. Economy and the Fed					
	22:00	US	Fed's Mester speaks at University of Richmond					
Wed 22 Mar	09:00	EC	Current account	Jan	€bn	47.0	~	~
	14:00	US	Existing home sales	Feb	\$mn	5.7	5.6	~
Thu 23 Mar	09:00	EC	ECB Publishes Economic Bulletin					
	09:30	UK	Retail sales ex auto fuel	Feb	m%ch	-0.2	~	~
	12:00	US	Fed's Yellen speaks at Community Development Conference					
	12:30	US	Initial jobless claims	Mar	~	~	~	~
	14:00	US	New home sales	Feb	000	555.0	560.0	~
	14:45	EC	ECB's Lautenschlaeger speaks at Vienna Conference					
	15:00	EC	Consumer confidence	Mar A	~	-6.2	~	~
	16:30	US	Fed's Kashkari speaks on U.S. education outcomes in D.C.					
	23:00	US	Dallas Fed's Kaplan speaks on Economy in Chicago					

Fri 24 Mar	09:00	EC	Markit Eurozone manufacturing PMI	Mar P	Index	55.4	~	~
	12:00	US	Fed's Evans speaks at Community Development Event					
	12:30	US	Durable goods orders	Feb P	%	2.0	1.0	~
	13:05	US	Fed's Bullard to speak to Economic Club of Memphis					

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