

RBNZ's matter of fact comments hit the mark

- The RBNZ didn't react to the higher NZD or weaker Q1 GDP result as some market participants had expected.
- As NZD developments were largely due to improved economic fundamentals and the GDP outlook remains positive.
- But international political developments, including Italy's upcoming election, continue to cast a shadow over the outlook.

The NZD jumped higher on Thursday in the wake of the [RBNZ OCR Review](#). It appears that market participants had headed into the RBNZ's OCR Review on Thursday with a keen eye on how the RBNZ would respond to a higher NZ dollar and the recent weak Q1 GDP release. And indeed, the currency reaction suggests that participants were expecting the RBNZ to deliver a more dovish message, taking the opinion that these developments were negative for the inflation outlook.

However, the RBNZ instead delivered a **matter-of-fact assessment of the outlook, while maintaining a neutral tone**. And quite rightly so in our opinion. While the **NZD has indeed lifted about 3% since May, much of that strength is a result of improved economic fundamentals** such as higher export prices. The sharp recovery in dairy prices has seen dairy exports surge, one of the key supporting factors of the Terms of Trade hitting a high since 1973 in Q1. Yes, some of the strength has also come from USD weakness (reflecting ongoing US political uncertainty), but in our opinion, this was not enough to draw out fighting words from the RBNZ.

Another area that could have sparked the currency reaction was the RBNZ's similarly **straight-laced comments about the weaker than expected Q1 GDP result**. Once again the RBNZ merely stated that GDP growth was "lower than expected" before shrugging this off with an **upbeat comment about the growth outlook**. The RBNZ noted the "the growth outlook remains positive, supported by accommodative monetary policy, strong population growth, and high Terms of Trade." The RBNZ also noted that the Budget 2017 would be positive for NZ growth. **Again, we think that the RBNZ was correct to not show too much concern about the weak Q1 result**. In our opinion, the weakness is likely to be temporary, especially when you take into account the fact that those areas that were weak in Q4 2016, largely recovered in Q1 2017. Further, **we too see the high Terms of Trade as being supportive for the growth outlook** and continue to expect GDP growth of around 3-3.5% yoy over the next couple of years.

Yet areas of concern do remain and, as a result, we also see the RBNZ on hold for a considerable period of time. One key risk remains the **international political landscape**. For one, ongoing uncertainty in the US is weighing on the USD and if this continues, it does risk weighing on NZ's trailable inflation outlook. Further, many questions remain over the future of the Eurozone. The UK has officially begun divorce talks with the EU. But, **attention is quickly shifting to Italy's upcoming election**. Italy is set to go to the polls no later than May 2018 and the **Five Star Movement Party, which is anti-EU, is one of the most popular parties in Italy**. If Italy opts to also leave the EU, this would **cast serious doubt on the future of the group**.

Foreign Exchange

- The NZD lifted against all major crosses in the wake of the RBNZ's June statement.

Interest Rates

- NZ interest rate markets were relatively quiet last week.

Week Ahead

- May's trade balance, residential building consents and the ANZ Business Confidence index are due out.

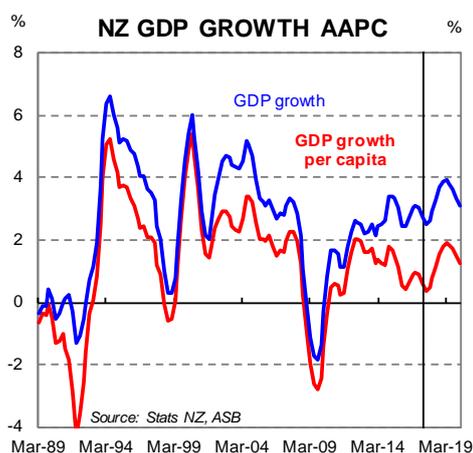
Week in Review

- Global dairy prices fell, the RBNZ left the OCR on hold, annual net migration hit a record high.

Global Calendars

- US GDP and durable goods orders, Japan and Eurozone CPI, the US PCE deflator are key this week.

Chart of the Week: NZ population keeps rising



Last week's international migration figures showed that **annual net migration hit yet another record high in May of nearly 72,000 people**. Recently, arrivals had been looking like they were edging lower, but the last two months of data have put an end to this trend. Further, **departures remain subdued** as NZ's relatively strong labour market is encouraging many to stay in NZ.

While strong population growth has been, and is likely to continue to be, a key driver of economic growth, **GDP per capita is starting to tell another story**. In fact, on a per capita basis, **economic output actually declined in Q4 2016 and Q1 2017 according to Statistics New Zealand**.

While **net migration is likely to continue to support GDP growth**, the per capita growth story highlights the **importance of an economy firing on all cylinders to support the population's standard of living**. Ultimately, productivity growth is going to be essential in order to support the per capita growth outlook.

Foreign Exchange Market

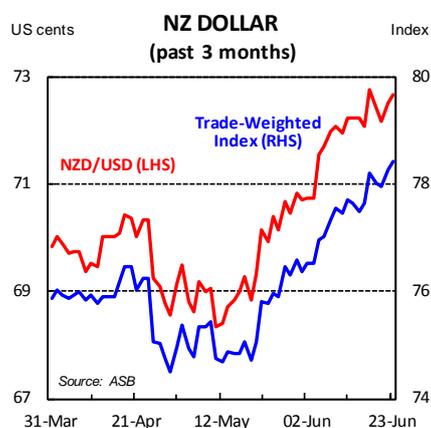
FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7281	0.7277	0.7016	0.6905	0.6984	FLAT	0.7180	0.7380
NZD/AUD	0.9622	0.9551	0.9438	0.9553	0.9524	UP	0.9520	0.9720
NZD/JPY	81.00	80.75	78.24	81.14	70.65	FLAT	80.00	82.00
NZD/EUR	0.6505	0.6500	0.6264	0.6615	0.6377	FLAT	0.6400	0.6600
NZD/GBP	0.5716	0.5697	0.5446	0.5616	0.5222	FLAT/UP	0.5650	0.5800
TWI	78.7	78.2	75.9	77.1	75.2	FLAT/UP	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 lifted against all the major crosses over the past week. The key event was the RBNZ's June OCR review. **The NZD lifted in the wake of the RBNZ's June statement**, as some market participants were expecting the RBNZ to try talk the currency down. However, the rates market, in contrast, barely moved as the RBNZ's policy stance was unchanged.

US political developments will drive currency markets this week. The USD is likely to remain under pressure due to doubts that policy makers will be able to pass the revised health-care bill before July 4th. On the US data front, the highlight is on Friday's US May core Private Consumption Expenditure (PCE) deflator (the Fed's favourite gauge of inflation). **Weak inflation pressures will also weigh on US interest rates and the USD.**

Short-term outlook:



Key data

	Date	Time (NZT)	Market
NZ Trade Balance	27/06	10.45 am	419
NZ Business Confidence	29/06	1.00 pm	-
US Q1 GDP (third estimate, sa annualised %)	30/06	12.30 am	1.2
EU CPI %yoy	30/06	9.00 pm	1.2
US core PCE Deflator, %yoy	1/07	12.30 am	1.4

Key events: NZD: May trade balance (Tue); May building consents, June business confidence (Fri). **USD:** May durable goods orders (Mon); Jun consumer confidence (Tue); May PCE deflator (Fri). **AUD:** Private sector credit (Fri). **CNY:** June PMI (Fri). **JPY:** BoJ Summary of Opinions from June meeting (Mon); May retail sales (Thu); May CPI (Fri). **EUR:** Jun German IFO business climate index (Mon); Jun CPI (Fri). **GBP:** Q1 current account (Fri).

Speakers: FOMC: non-voter William (Mon, Tue & Wed), voters Harker & Kashkari (Wed), non-voter Bullard (Fri). **RBA:** Debelle (Thu). **BoJ:** Harada (Thu). **BoE:** Carney (Tue & Wed).

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

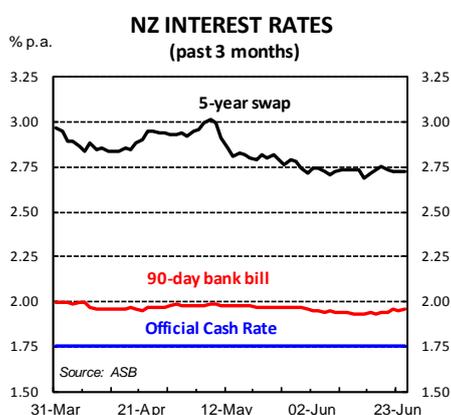
Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	1.75	1.75	1.75	1.75	2.25	FLAT
90-day bank bill	1.96	1.93	1.97	2.01	2.33	FLAT
2-year swap	2.25	2.25	2.26	2.57	2.23	FLAT
5-year swap	2.72	2.73	2.76	3.18	2.36	FLAT
5-year benchmark gov't stock	2.45	2.46	2.48	2.78	2.03	FLAT
NZSX 50	7554	7591	7437	6880	6668	FLAT

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

NZ interest rate markets were relatively quiet this past week. There was a **small lift in NZ interest rates on Monday and Tuesday**, as they followed Australian rates higher. Positive global market sentiment and upbeat comments from both the RBA Governor and the RBA meeting minutes provided a supportive backdrop for Australasian interest rates. However, **rates eased lower as global market sentiment faded over the second half of the week.**

The **RBNZ June OCR announcement was a key focus.** With the RBNZ remaining neutral, NZ interest rates were unchanged. **Interest rate markets currently have an OCR hike fully priced in for August 2018**, which is slightly ahead of our view the RBNZ will begin lifting rates in November 2018.

Short-term outlook:



Key data

	Date	Time (NZT)	Market
NZ Business Confidence	29/06	1.00 pm	-
US Q1 GDP (third estimate, sa annualised %)	30/06	12.30 am	1.2
NZ Building Consents	30/06	10.45 am	-
EU CPI %yoy	30/06	9.00 pm	1.2
US core PCE Deflator, %yoy	1/07	12.30 am	1.4

Comment: It is likely to be a **quiet start to the week** with the Australasian economic calendar notably quieter than the last few weeks. The action picks up over the second half of the week with **NZ building consents** and monthly **business confidence** released. The latter can be occasionally market moving. In particular, the market would be sensitive to **any indication that own-activity expectations are faltering** given weak GDP outcomes and that the **RBNZ is heavily relying on a pickup in growth.**

Key offshore events include Eurozone CPI, US GDP (third estimate) and **US core PCE deflator.** The Fed's preferred inflation measure is likely to be under close scrutiny given soft wage inflation and weaker economic data of late.

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
US Durable Goods Orders, May, %mom	27/06	12:30 am	-0.8	-0.6	-0.9
RBA Deputy Governor Debelle to speak in Singapore	29/06	-	-	-	-
UK Mortgage Approvals, '000s	29/06	8:30 pm	64.6	64.0	64
US GDP, Q1, %qoq	30/06	12:30 am	1.2	1.2	1.2
Australia Private Sector Credit, May, %mom	30/06	1:30 pm	0.4	0.4	0.4
Japan CPI, May, %	30/06	11:30 am	0.4	0.5	-
Eurozone CPI, %	30/06	9:00 pm	1.4	1.2	1.2
US Core PCE deflator, May, %yoy	01/07	12:30 am	1.7	1.5	1.5

The **Reserve Bank of Australia's Deputy Governor Debelle is due to speak** in Singapore on the global FX Code of Conduct launch and re-regulation of the FX markets.

Australian private sector credit growth has slowed due to a decline in business and personal lending. Credit growth for housing is still expanding at a solid rate but will likely moderate as APRA's latest tighter lending policies kick in and due to an increase in mortgage interest rates by the major lenders.

We **expect Japan's core CPI deflationary pressures to persist in May**. Low Japanese business and consumer inflation expectations are a major headwind to a pick-up in inflation outcomes.

We **expect another small fall in US durable goods orders**. This volatile series includes aircraft sales.

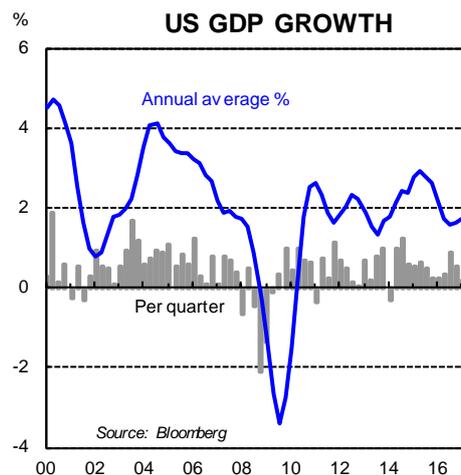
Steady US GDP growth combined with an unemployment rate of 4.3% indicates that the US Fed is still likely to lift rates in September.

We anticipate **May UK mortgage approvals** will print at levels around 64k. This is consistent with a modest slowdown in the UK housing market.

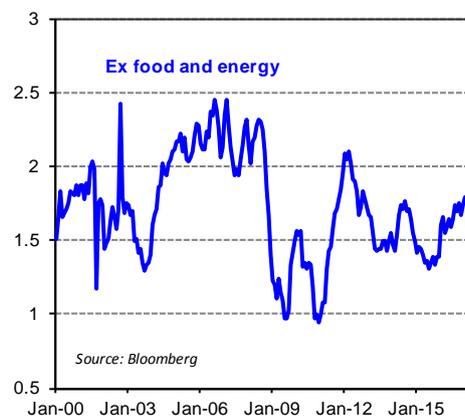
We anticipate **June Eurozone headline CPI** will print around 1.2% yoy. Core CPI will print around 0.9% yoy. The decline in headline CPI reflects base effects, notably oil price dynamics.

The **US core Private Consumption Expenditure (PCE) deflator** (the Fed's favourite gauge of inflation) eased in April to 1.5%pa, the slowest pace since December 2015. The US core PCE deflator has been below the Fed's 2% objective since May 2012. Slower wage growth suggests the core PCE deflator will remain muted in May and below the FOMC's 2017 projection of 1.7%.

US GDP GROWTH



US PCE INFLATION Core Private Consumption deflator



NZ Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Trade balance, May, \$m	27/06	10:45 am	+578	+419	+350
Residential building consents, May, %mom	30/06	10:45 am	-7.6	-	-
ANZ Business Confidence, headline general outlook, June	30/06	1.00 pm	14.9	-	-

We expect a modest **trade surplus of \$350m in May**. Looking over the month, we expect dairy export values to maintain their new higher level, and for this to translate into a third successive monthly surplus. At the same time, import values remain firm in line with healthy domestic demand. Looking at the annual balance, **we expect the annual trade deficit to narrow to \$3.48 billion**.

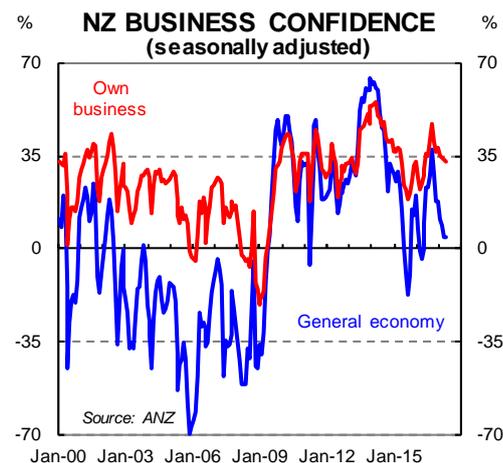
We expect residential building consents to bounce back in May, following a 7.6% decline in April. The fall in April was disappointing, but StatsNZ suspects building consents may have been impacted by the timing of Easter. Over the rest of 2017, we expect to see a clear recovery in residential building construction demand, particularly in Auckland, after a slowing down over the second half of 2016. Meanwhile, we expect non-residential construction to remain at elevated levels.

Headline business confidence fell over the first half of 2017, likely impacted by increased economic and political uncertainty offshore and domestically (with the General Election taking place in September). However, **businesses remain comparatively upbeat on the prospects for their own activity**. Own activity tends to be a better indicator of trend growth, and robust expectations point to above-trend growth. Meanwhile, **the survey should also confirm a continued uptick in inflation pressures** from currently low levels.

RESIDENTIAL BUILDING CONSENTS (thousands)



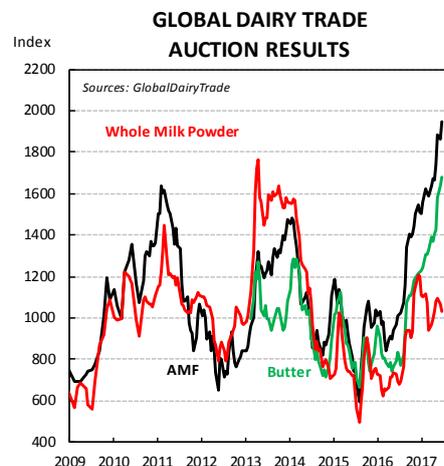
NZ BUSINESS CONFIDENCE (seasonally adjusted)



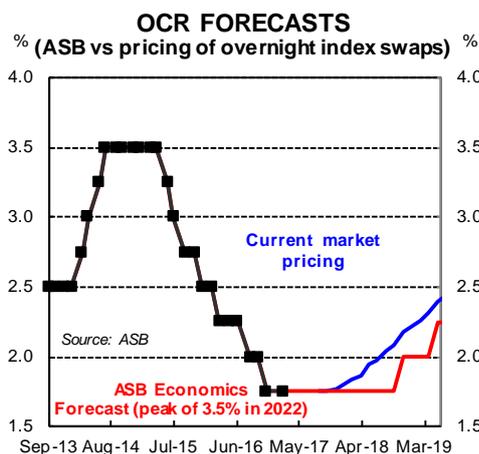
Data Recap: weekly recap

Data	Date	Actual	Market forecast	ASB Forecast
GlobalDairyTrade auction, whole milk powder, % change	21/03	Overnight	-2.9	-
RBNZ rate announcement	22/06	9:00 am	No change	No change
International Travel & Migration, May, Net Migration, 000s	22/06	10:45 am	5,780	-

Dairy prices fell by 0.8% at last week's Global Dairy Trade auction. Key product, **Whole Milk Powder (WMP), led the fall, dipping 3.3%.** The WMP fall contrasted with futures prices prior to the auction; futures prices had pointed to a 1% to 3% lift. Meanwhile, **milk fat prices continued their charge higher.** In fact, both Anhydrous Milk Fat (AMF) and butter set fresh auction record highs of US\$6,886/MT and US\$5,768/MT, respectively. Moreover, butter prices have now more than doubled over the past year.



The RBNZ left the OCR on hold at 1.75% as widely expected. The focus was on the tone of the statement, which was still **neutral and reiterated that policy was to remain accommodative** for a considerable period. We continue to expect the **RBNZ to remain on hold until late 2018.**



The RBNZ remains **upbeat on the growth outlook** despite the weaker Q1 GDP outcome. While the RBNZ's **language around the higher NZD remained factual and similar in tone to previous statements**, some market participants may have been looking for a stronger attempt to talk the currency down.

Net migration inflows remain close to record highs on a monthly basis, with 5,910 net arrivals in May (seasonally-adjusted). Annual net migration lifted to another new record high of 71,964. Arrivals ticked higher for the second consecutive month, putting an end to the trend of small declines, that were beginning to develop. **NZ's relatively strong economy and robust labour market appears to be the key driver 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.



Short-term visitor arrivals fell in May as expected, down 3% and partially unwinding the previous month's Masters Games-induced 3.8% spike. Nonetheless, **short-term visitor arrivals remain 10% above year-ago levels.** We expect arrivals to spike higher again in June (on a seasonally-adjusted basis) due to the Lions tour.

Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 26 Jun	17:00	JN	Leading index CI	Apr F	Index	104.5	~	~
	17:00	JN	Coincident index	Apr F	Index	117.7	~	~
Tue 27 Jun	10:45	NZ	Trade balance	May	NZD mn	578.0	419	350
	10:45	NZ	Exports	May	NZD bn	4.8	~	~
	10:45	NZ	Imports	May	NZD bn	4.2	~	~
	13:30	CH	Industrial profits	May	y%ch	14.0	~	~
Wed 28 Jun	17:00	JN	Small business confidence	Jun	Index	48.9	~	~
Thu 29 Jun	~	CH	BoP current account balance	Q1 F	CNY bn	19.0	~	~
	10:50	JN	Retail sales	May	m%ch	1.4	~	~
	13:00	NZ	ANZ business confidence	Jun	~	14.9	~	~
	13:00	AU	HIA new home sales	May	m%ch	0.8	~	~
	13:30	AU	Job vacancies	May	%	1.8	~	~
	18:30	JN	BOJ Harada speaks in Tokyo					
	20:30	AU	RBA's Debelle gives Speech on Global FX Code					
Fri 30 Jun	10:45	NZ	Building permits	May	m%ch	-7.6	~	~
	11:30	JN	Jobless rate	May	%	2.8	~	~
	11:30	JN	Overall household spending	May	y%ch	-1.4	~	~
	11:30	JN	National CPI	May	y%ch	0.4	~	~
	11:30	JN	National CPI ex fresh food, energy	May	y%ch	0.0	~	~
	11:50	JN	Industrial production	May P	m%ch	4.0	~	~
	13:00	CH	Manufacturing PMI	Jun	Index	51.2	~	~
	13:00	CH	Non-manufacturing PMI	Jun	Index	54.5	~	~
	13:30	AU	Private sector credit	May	m%ch	0.4	0.4	0.4
	17:00	JN	Housing starts	May	y%ch	1.9	~	~
17:00	JN	Construction orders	May	y%ch	-0.2	~	~	

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 26 Jun	13:30	US	Durable goods orders	May P	%	-0.8	-0.9	~
	13:30	US	Chicago Fed Nat Activity Index	May	Index	0.5	~	~
	15:30	US	Dallas Fed manufacturing activity	Jun	~	17.2	~	~
Tue 27 Jun	14:00	US	S&P CoreLogic CS US HPI	Apr	y%ch	5.8	~	~
	15:00	US	Conf. Board consumer confidence	Jun	Index	117.9	115.4	~
	15:00	US	Richmond Fed Manufacturing Index	Jun	~	1	~	~
	16:00	US	Fed's Harker speaks on Economy in London					
Wed 28 Jun	22:30	US	Fed's Kashkari speaks at Townhall Event in Houghton, Michigan					
	07:03	UK	Nationwide house PX	Jun	m%ch	-0.2	~	~
	08:30	US	Fed's Williams speaks in Canberra					
	13:30	US	Advance goods trade balance	May	\$bn	-67.1	-65.5	~
	13:30	US	Wholesale inventories	May P	m%ch	-0.5	~	~
Thu 29 Jun	15:00	US	Pending home sales	May	m%ch	-1.3	0.6	~
	09:30	UK	Mortgage approvals	May	000	64.6	~	~
	10:00	EC	Economic confidence	Jun	~	109.2	~	~
	10:00	EC	Business climate indicator	Jun	~	0.9	~	~
	13:30	US	GDP annualized	Q1 T	q%ch	1.2	1.2	~
	13:30	US	Initial jobless and continuing claims	Jun	~	~	~	~
Fri 30 Jun	18:00	US	Fed's Bullard speaks on Monetary Policy in London					
	00:01	UK	GfK consumer confidence	Jun	~	-5.0	~	~
	09:30	UK	Current account balance	1Q	£bn	-12.1	~	~
	09:30	UK	GDP	Q1 F	q%ch	0.2	~	~
	10:00	EC	CPI estimate	Jun	y%ch	1.4	~	~
	13:30	US	Personal income	May	%	0.4	0.3	~
	13:30	US	PCE deflator	May	m%ch	0.2	-0.1	~
	14:45	US	Chicago Purchasing Manager	Jun	Index	59.4	58.0	~
15:00	US	Uni. of Michigan sentiment	Jun F	Index	94.5	94.4	~	

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