

Election 2017: anything's possible

- The NZ election is on a knife edge.
- Moreover, with the result likely to be subject to coalition negotiations, the composition of government may not be known for some weeks.
- Meanwhile, we expect modest quarterly GDP growth over Q2.

The NZ election remains on a knife edge. According to the Horizon Research Poll for example (released on Saturday), National and Labour are neck-and-neck, with 38.5% and 38.2% support respectively. Translated into seats National would hold 48 seats and Labour 47.

Notably though, neither party would be able form a coalition without NZ First. Looking at the minor parties, NZ First polled 9.8% (12 seats), the Greens 7.7% (10 seats), ACT 1.4% (2 seats) and the Maori Party 0.6% (1 seat). The Opportunities Party (TOP) was best of the rest, polling 2.3%, although TOP remains below the 5% threshold for entry into parliament.

While much of the focus of recent polls has been the gap between Labour and National closing, **the poll movements for their potential coalition partners have been similarly large.** In particular, the Green Party will be pleased with this latest poll as it puts them more comfortably above the 5% threshold as other recent polls have had the Greens dangerously close. Similarly, NZ First will be pleased as its 9.8% reading is significantly higher than the 6% or so it has recorded in three other recent polls. Lastly, TOP remains an outside chance of lifting to 5% come election night.

However, **recent overseas election outcomes warn against putting too much stock on poll results.** Indeed, with recent polls also volatile, it highlights that anything may be possible on election night.

Looking at the election's impact on markets, **we expect market volatility to continue through the remainder of this week as remaining polls are released ahead Saturday's vote.** Then, if the election result require coalition negotiations, volatility is likely to continue until a government is formed. In particular, if the coalition negotiations involve NZ First and Winston Peters, then there will be nearly 3 weeks of potential uncertainty until the government's composition is known.

All up, this election is shaping up as the closest and fiercest fought since 2005. With that in mind, be sure to cast your vote!

Meanwhile, we also have a busy data week with rate announcements by the Federal Reserve and the Bank of Japan. **The local highlight is Q2 GDP on Thursday, when we expect another modest outturn of 0.6% quarterly growth.** In our view, capacity constraints and the slowing housing market have weighed on economic activity over Q2.

Foreign Exchange

- After a volatile week, the NZD opens the week higher against most major currency pairs.

Interest Rates

- Yields higher, with larger moves to longer-end yields contributing to curve steepening

Week Ahead

- GlobalDairyTrade auction, Balance of Payments, GDP, migration, and NZ election.

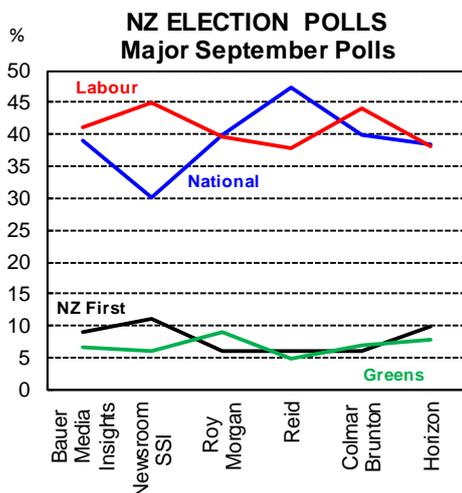
Week in Review

- September Consumer Confidence and the August Manufacturing PMI.

Global Calendars

- Federal Reserve interest rate announcement, Bank of Japan interest rate announcement.

Chart of the Week: NZ First (read Winston Peters) is likely to be this election's 'kingmaker'



The 2017 election is too close to call. As described above, Saturday's Horizon Research poll had National and Labour neck-and-neck. **Other polls during September have been similarly close.** Indeed, of the major polls released so far in September, three favour National, while three favour Labour.

However, one theme is relatively consistent. That is, based most polls, both major parties will need NZ First to form a government. So what does Winston want?

Winston has several negotiating bottom lines including: abolishing the Maori seats; making no changes to NZ Superannuation eligibility; limiting immigration; re-entering the Pike River mine; shifting the Auckland port to Whangarei; and, adding 1,800 police.

While it's hard to anticipate what any coalition agreement would eventually include, Winston has a proven ability to keep everyone guessing. As a result, the election night result might well be just where this election begins to get interesting.

Foreign Exchange Market

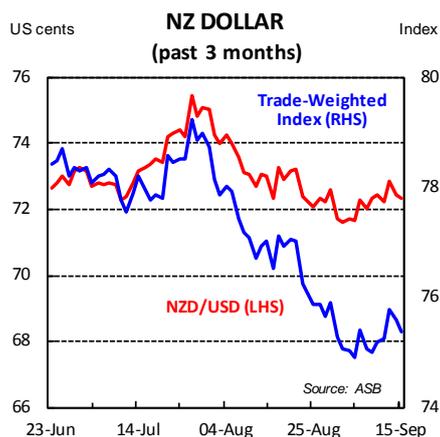
FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7281	0.7244	0.7293	0.7037	0.7308	FLAT	0.7150	0.7400
NZD/AUD	0.9104	0.8999	0.9234	0.9116	0.9719	FLAT	0.8920	0.9250
NZD/JPY	80.85	78.51	79.73	79.18	74.58	FLAT	79.70	82.10
NZD/EUR	0.6101	0.6033	0.6214	0.6540	0.6502	FLAT	0.6010	0.6200
NZD/GBP	0.5365	0.5500	0.5657	0.5682	0.5521	DOWN	0.5290	0.5450
TWI	76.1	75.2	76.9	76.3	77.9	FLAT/DOWN	74.00	77.00

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

The NZD opened higher against most of the major currencies we monitor this week, but there was also a fair degree of volatility throughout the week. For example, Hurricane Irma concerns pushed the NZD/USD above 0.7300 early in the week, before North Korea tensions saw this quickly unwound. On Wednesday the **NZD/USD and NZD/AUD each rallied by around a cent following Wednesday's Newshub poll which put National in a comfortable lead**. However, the surprise move by the **Bank of England on Thursday night to signal a possible rate hike "in coming months" caused further volatility with the GBP/USD since hitting a 15-month high**. Finally, solid US CPI data late in the week boosted US rate hike expectations (and the USD). Market pricing for a December hike has lifted back to 50% (after reaching as low as 25% early in the week).

As our attention turns to the coming week, currency volatility is likely to remain a key theme. The US Federal Reserve rate announcement, NZ Q2 GDP, the BoJ rate announcement, any further election polls and the NZ General Election itself are all event risks this week. The US Federal Reserve announcement will be the key event of the work week this week. **Market participants will be looking for a steer on future rate hikes, but are also gearing up for the possibility that the Fed outlines its plan to reduce its balance sheet.** Finally, low liquidity in currency markets this week risks exacerbating any currency movements.

Short-term outlook:



Key data

	Date	Time (NZT)	Market
NZ Current Account Q2, % GDP	20/09	10:45am	+3.1%
US FOMC Announcement	21/09	6:00am	nc
NZ GDP, Q2, %qoq	21/09	10:45am	+0.8%
BoJ Rate Announcement	21/09		nc
NZ General Election	23/09		

(Wed), Q2 GDP & Aug Net Immigration (Thu), General Election (Sat). **USD:** Aug import & export prices (Wed), Aug existing home sales (Thu), initial jobless claims/continuing claims (Fri). **AUD:** RBA Minutes (Tue). **EUR:** Aug CPI (Mon), Sep German ZEW (Thu), Sep Manufacturing/Services PMI (Fri). **GBP:** Aug Retail sales (Wed). **JP:** BoJ rate announcement (Thu).

Speakers: FOMC: Yellen (Thu). BOE: Governor Carney (Tue). BoC: Lane (Tue). BOJ: Kuroda (Thu). RBA: Ellis (Wed), Lowe (Thu). ECB: Draghi (Thu), Constancio (Fri).

Medium-term outlook:

Last Quarterly Economic Forecasts

We updated our FX forecasts in early September. These incorporate the lower starting point for the NZD, with the TWI close to 4% lower than when our July forecasts were published. The NZD still remains the recipient of some key supports - including the near record Terms of Trade, relatively high interest rates and a solid domestic outlook – which are expected to support NZD TWI consolidation around current levels over the forecast period. **While there is a temporary and modest political risk to our NZD forecast in the short term, these fundamental factors are expected to keep the NZD elevated over the forecast horizon.**

Our forecasts also incorporate a weaker USD. Further USD falls are expected given the upward bias in non USD rates, fiscal policy inaction by the Trump Administration (delays to pending tax rate cuts), and with the strengthening synchronised global economy typically bullish for commodity currencies like the NZD and AUD. We have increased our near-term NZD/USD forecasts modestly to reflect a weaker USD. We expect the NZD/USD to end 2017 at 0.74 and 2018 at 0.77. Higher iron ore prices, the narrowing Australian current account deficit, and the strengthening domestic and trading partner should eventually pressure the NZD/AUD lower and we expect the NZD/AUD to ease from 0.93 by the end of 2017 to 0.91 by late 2018.

Supportive growth prospects, signals of pending tapering by the ECB before the end of the year and prospective ECB rate hikes next year will support the euro. **We expect the NZD/EUR to end 2017 at 0.60 and 2018 at 0.61.** With the BOE expected to keep UK rates on hold for an extended period, and with EU-UK Brexit negotiations weighing on the UK economic outlook, the NZD is expected to remain elevated against the GBP. We expect the NZD/GBP to remain in a 0.56-0.57 range till the end of 2018.

We expect the NZD/JPY to hover around the 79/80 level over the next couple of years. The large Japanese current account surplus and low US Treasury yields, and no indication of further easing by the BOJ are expected to support the JPY.

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	2.00	FLAT
90-day bank bill	1.94	1.94	1.95	1.95	2.24	FLAT
2-year swap	2.21	2.16	2.17	2.28	2.08	FLAT
5-year swap	2.70	2.58	2.63	2.95	2.25	FLAT
5-year benchmark gov't stock	2.54	2.39	2.42	2.51	2.07	UP/FLAT
NZSX 50	7763	7852	7874	7052	7251	FLAT/DOWN

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

The last week has seen the return of firmer local rates and modest curve steepening. Drivers of the moves were predominantly global. While wariness over the geopolitical situation remains, there is the feeling that, for now at least, the market rally may have run its course. Market pricing has reacted to firmer than expected readings for headline and core US CPI inflation (admittedly from low levels), and with the September BOE minutes flagging the potential for a UK rate hike in "coming months". The market is now pricing 21bps of OCR hikes in 12 months' time, with a December Fed hike a 50:50 proposition and with BOE hike odds by the end of the year currently at 73% as opposed to just 22% odds a week ago.

Local domestic data is expected to take a back seat to election (too close to call) and Thursday's FOMC decision. Our expectation of a weaker than expected Q2 local GDP print is only expected to have a fleeting market impact. In a light week for global data, the BOJ and FOMC decisions headline this week. The Fed are widely expected to signal the October start to trimming its USD4 trillion balance sheet, with the published DOT plots to show a flatter path for the Fed funds rate than in June. Whether the DOT's will fall to the extent priced in by the market remains to be seen, with the risk of a snap higher in yields and increased market volatility if the Fed fails to placate the market.

Short-term outlook:	Key data	Date	Time (NZT)	Market
<p>NZ INTEREST RATES (past 3 months)</p> <p>Source: ASB</p>	NZ Current Account Q2, % GDP	20/09	10:45am	+3.0%
	FOMC Announcement	21/09	6:00am	nc
	NZ GDP Q2, %qoq	21/09	10:45am	+0.8%
	NZ General Election	23.09	-	-
	Comment: Short-term local rates are expected to continue to trade in reasonably tight ranges leading up to the election, with only a fleeting impact expected from local data. Long-term local rates will take direction from global yields. Barring an adverse global event, the bias is for the curve to steepen, but for market volatility to increase if the Fed's signalled withdrawal of policy stimulus unsettles markets. It's been tough week for NZ bonds, with spreads widening in relation to US yields and spreads narrowing relative to swaps. Thursday's tender of NZD200m in 2025 bonds (Thu) three days prior to the election could struggle.			

Medium-term outlook:

Last Quarterly Economic Forecasts

The RBNZ continued to hold the OCR at its record-low of 1.75% at its August Monetary Policy Statement (MPS) and Official Cash Rate (OCR) Review. The RBNZ retained its neutral bias and continued to note the numerous uncertainties. However, **the key surprise was the RBNZ left the OCR outlook unchanged** (with two hikes by mid-2020) in contrast to widely-held expectations of a flatter OCR forecast.

The RBNZ's frustration with the elevated NZD increased in August. The RBNZ made an effort to undermine support for the NZD by emphasising the external currency drivers (i.e. weaker USD) while downplaying the domestic drivers (i.e. higher NZ export prices) and stated that a lower NZD was "needed". **The RBNZ dismissed the recent weaker GDP growth outcomes** and focussed on the robust economic outlook. Going forward, growth will be supported by low interest rates, strong population growth, high Terms of Trade and fiscal stimulus. Furthermore, we see **upside risk to the RBNZ conservative medium-term milk-price assumption**, which will provide further support to NZ growth.

The RBNZ remains confident in the medium-term inflation outlook, despite anticipated volatility in headline inflation this year. The RBNZ expects inflation will dip below 1% (due to volatility in fuel and food) before swiftly recovering to reach 2% by 2018. **The RBNZ appears to be relying on a very swift pick-up in non-tradable inflation.** This is a fairly bold assumption given the RBNZ is wary that **price-setting behaviours have become more backward looking.** Nonetheless, **we expect the RBNZ will start lifting the OCR in Q1 2019**, which is slightly earlier than the RBNZ's expectations for a hike in Q3 2019.

Key international data for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Eurozone CPI, August, Headline, %yoy	18/09	9:00 am	1.3	1.5	1.3
Australia House Prices, Q2, %qoq	19/09	1:30 pm	2.2	1.3	0.8
Reserve Bank of Australia Meeting Minutes, September	19/09	-	-	-	-
Reserve Bank of Australia Asst. Governor Ellis speech	20/09	-	-	-	-
UK Retail Sales ex-auto, fuel, August, %mom	20/09	8:30 pm	0.5	0.0	0.1
US Federal Reserve Interest Rate Announcement, %	21/09	6:00 am	1.00-1.25	1.00-1.25	1.00-1.25
Reserve Bank of Australia Governor Lowe speech	21/09	-	-	-	-
Bank of Japan, Interest Rate Announcement, %	21/09	-	-0.1	-0.1	-0.1

Australian house price growth has slowed over Q2 as APRA's measures to limit interest-only lending have started to bite.

There was nothing surprising in the Statement that accompanied the **Reserve Bank of Australia's September meeting**. In a recent speech, Governor Lowe mentioned that the meeting's special discussion issue was on China. We can likely expect to hear more on the RBA's thinking on this topic in this Tuesday's minutes.

Assistant Governor (Economic) at the Reserve Bank of Australia, Dr Ellis, is due to speak at an Australian Business Economists function on the current global expansion.

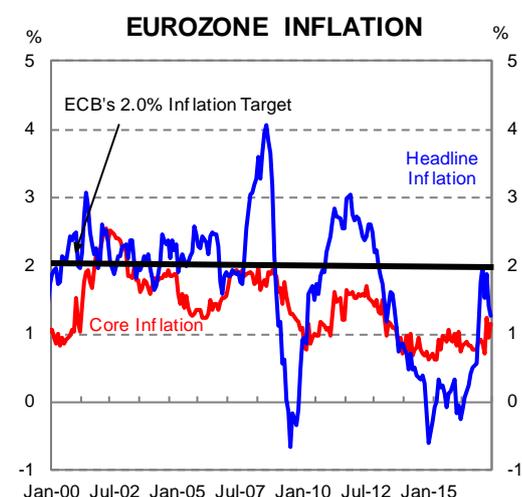
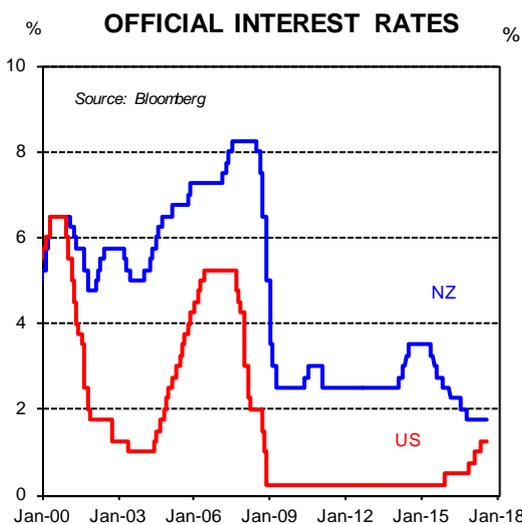
The **Reserve Bank of Australia's Governor Lowe** is due to speak at a business briefing later this week. The title of the speech is "The Next Chapter". Lowe will likely touch on the current and future drivers of economic growth.

We expect **no policy changes from the Bank of Japan**. Inflation is well below the BoJ's target despite a tight labour market and strong economic growth. There is a small risk the BoJ dumps or lowers its target of JGB purchases since it is redundant. Moreover, the BoJ's recent purchases are well below the target ¥80 trillion.

We anticipate the **final reading of August Eurozone CPI** will be unchanged at 1.3% for the headline reading and 1.2% for the core reading.

We anticipate **August UK retail sales** will print around 0.1% mom, showing a very slight increase over July data. This is consistent with the latest consumer survey data.

Recent speeches by US Federal Reserve participants suggest that the **Fed Funds rate will be kept on hold at 1.00-1.25%**. However, the Fed is likely to announce its long-awaited balance sheet run-down, with an initial cap of \$10 billion per month. We also expect some tweaking of its forecasts. In particular, the Fed may cut its 2017 core Private Consumption Expenditure deflator and its longer-run Funds rate estimate by one or two tenths.



NZ Data Preview: a look at the week ahead

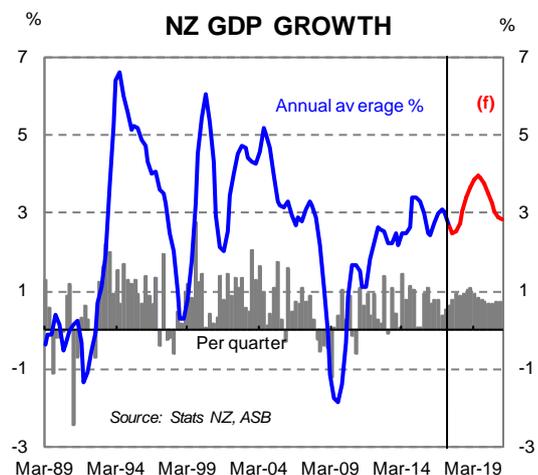
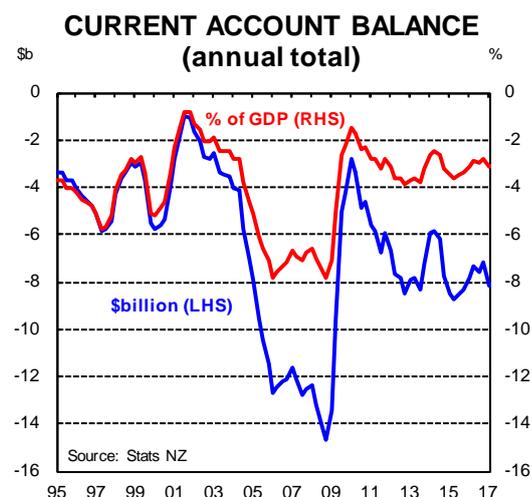
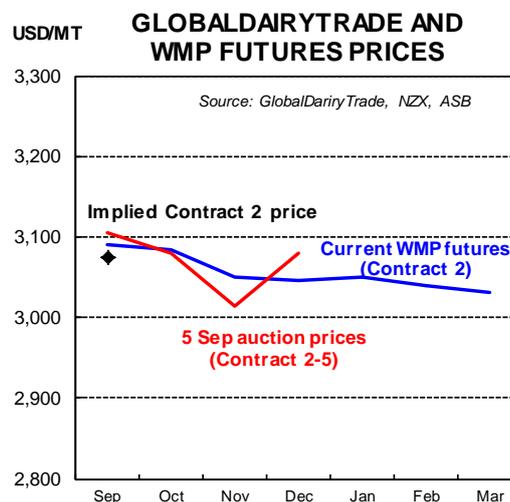
Data	Date	Time (NZT)	Previous	Market expects	ASB expects
GlobalDairyTrade Auction, whole milk powder, % change	19/09	overnight	-1.6	-	-2 to 0
Current account, Q2, % of GDP	20/09	10:45 am	-3.1	-3.0	-3.0
GDP, Q2, % qoq	21/09	10:45 am	0.5	0.8	0.6
International Travel & Migration, Aug, Net Migration, 000s	21/09	10.45 am	5,810	-	6,000

We expect prices to be flat or fall a touch at the **GlobalDairyTrade** auction overnight Tuesday. A fortnight ago whole milk powder (WMP) prices decreased by 1.6%. **At the current juncture, futures pricing suggests WMP will be flat or fall by up to 2%.** Essentially, global dairy prices are likely to continue their recent sideways trend. However, we expect that, if poor current weather continues, prices are likely to rise over coming months. Moreover, when combined with the global butter shortage, dairy prices could end 2017 on a high.

We expect NZ's current account deficit to narrow in Q2. The Q1 deficit came in at 3.1% of GDP, widening from 2.8% in Q4. However, we expect surging goods export values to help narrow the deficit over Q2. In seasonally-adjusted terms, we expect the annual goods balance to increase on the back of a bumper quarter for dairy exports. Meanwhile, the Lions Tour is also likely to lift the services balance further. All up, **we expect the Q2 annual current account deficit to narrow to 3.0% of GDP.** Over the remainder of 2017 we expect the deficit to narrow further, particularly as the Terms of Trade remain near or above record highs.

We expect Q2 GDP growth of just 0.6% qoq, weaker than the +0.8% qoq market consensus and the 0.9% qoq RBNZ pick. Despite the Lions and Masters Games boost to retail spending and accommodation, along with a strengthening primary sector value added, capacity constraints and the impact of the slowing housing market will ensure mixed readings across the various production components. In particular, we expect sluggish readings for manufacturing and construction activity. The outlook is for a gradual strengthening in the annual growth momentum over the next 12-18 months. However, with the potential for election-related volatility to impact on forthcoming data readings, the RBNZ will feel no urgency to move the OCR.

Net migration data of late has continued to post record highs on an annual basis but shown signs of plateauing. PLT arrivals are outpacing PLT departures by roughly two-to-one, and we expect monthly net inflows to remain around current levels in the near term given NZ's comparatively strong labour market, geo-political and economic stability. **Net migration inflows will start to abate** as the Australian labour market recovery gains further traction. Meanwhile, short-term visitor arrivals fell 5.3% sa in July following the commencement of the Lion's Tour. Despite this, visitor numbers for both, the July month and July year, hit new record highs, testament to the strong allure of NZ as a tourist destination. We expect the good news story for the tourism sector to continue, **but caution that constraints over accommodation capacity could constrain growth**, particularly once we head back into the high season over the NZ summer.



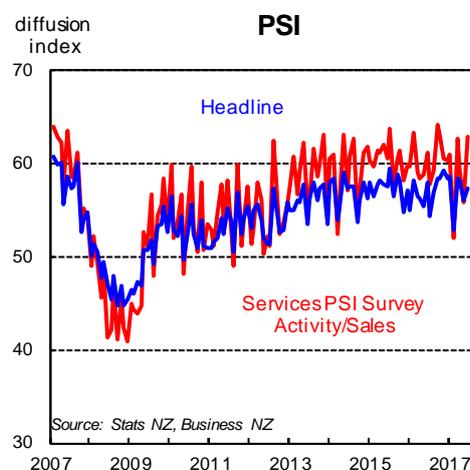
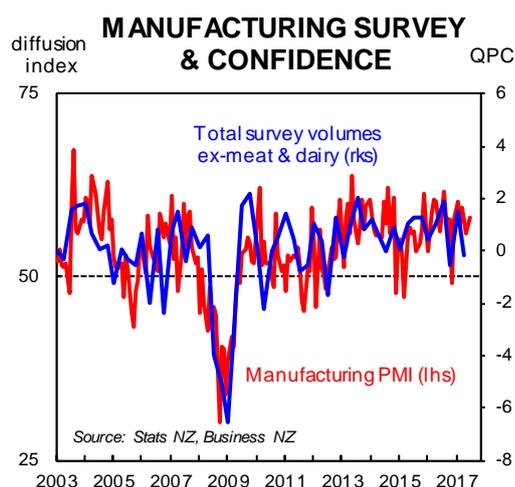
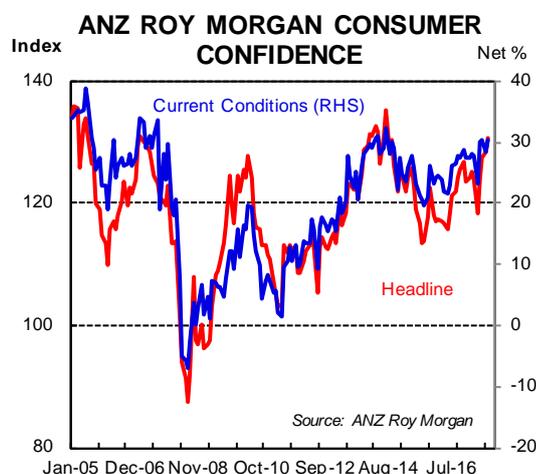
Data Recap: weekly recap

Data	Date	Actual	Market forecast	ASB Forecast
Consumer confidence, Sep	14/09	129.9	-	-
Manufacturing PMI, Aug	15/09	57.9	-	-
BusinessNZ Services PSI, Aug	18/09	57.3	-	-

The headline September ANZ-Morgan Consumer Confidence rose 3.7 points to 129.9, a three-year high, and well above historical averages (119). Once we adjust for seasonality, the index rose by 2 points to also be at its highest level since July 2014. The closing election race and slowing housing market are not making a dent on the consumer mood as yet. Solid household income growth in relation to low consumer price inflation, low unemployment and higher rural incomes look to provide considerable support. Net optimism towards the economy one year out lifted from +25 to +30, and optimism over the five-year economic outlook rose to +29, with both at around two-year highs. Inflation expectations edged up to 3.1% from 3% while national house price expectations continued to drop. At 2.5% over the next 2 years, they are the lowest since 2012 and have halved compared to five months ago. The upshot is that robust levels of sentiment point to solid economic momentum going forward.

The Manufacturing PMI lifted 2.4 points to 57.9 in August, the highest reading since May. Three of the five sub-sectors increased, with the lift in the PMI supported by high levels of new orders and production activity. The orders-to-stocks ratio also remains elevated, another indicator of continued production growth. Elevated levels of manufacturing sentiment point to strong momentum in non-primary manufacturing activity. The domestic construction sector and improving global outlook are key drivers of manufacturing demand in NZ. However, question marks remain on whether elevated levels of sentiment can translate into economic activity given the capacity constraints afflicting the NZ economy.

The services sector firmed in August, with the PSI up 1.3 points to 57.5, but sentiment is still below levels reached earlier in the year. Three of the five sub-sectors increased, with four of the five sub-components above historical averages. Readings for activity/sales reached a 2017 high. New orders and inventories also firmed, with the new order to inventory ratio (1.2), moving above historical averages (1.1). Elevated levels of services and manufacturing sentiment point to strong momentum in economic activity. This reflects a number of key supports, including the sizeable pipeline of construction sector work, the booming tourism market and improving global outlook. To date, slowing housing activity does not look to be weighing on sentiment.



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 18 Sep	13:30	AU	New motor vehicle sales	Aug	m%ch	-2.0	~	~
Tue 19 Sep	10:00	NZ	WBC consumer confidence	Q3	Index	113.4	~	~
	13:30	AU	House price index	Q2	q%ch	2.2	~	0.8
	13:30	AU	RBA September rate meeting minutes					
			GlobalDairyTrade Auction, whole milk powder			-1.6%		-2 to 0
Wed 20 Sep	10:45	NZ	Current account, % of GDP	Q2	NZD bn	-3.1	-3.0	-3.0
	11:50	JN	Trade balance adjusted	Aug	¥bn	337.4	~	~
	15:05	AU	RBA's Ellis gives speech in Sydney					
Thu 21 Sep	~	AU	RBA Governor Lowe gives speech in Perth					
	~	JN	BOJ policy balance rate	Sep	%	-0.1	~	-0.1
	10:45	NZ	GDP	Q2	q%ch	0.5	0.8	0.6
	10:45	NZ	Net migration	Aug	~	5,800	~	6,000
	15:00	NZ	Credit card spending	Aug	m%ch	0.9	~	~
	18:30	JN	BOJ Kuroda speaks at press conference after MPM					

Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 18 Sep	10:00	EC	CPI	Aug	m%ch	-0.5	~	~
Tue 19 Sep	09:00	EC	ECB current account	Jul	€bn	21.2	~	~
	10:00	EC	Construction output	Jul	m%ch	-0.5	~	~
	10:00	EC	ZEW survey expectations	Sep	~	29.3	~	~
	13:30	US	Housing starts	Aug	000	1,155	1,180	~
	13:30	US	Current account balance	Q2	\$bn	-116.8	-112.4	~
Wed 20 Sep	09:30	UK	Retail sales ex auto fuel	Aug	m%ch	0.5	0.1	0.1
	19:00	US	FOMC rate decision (upper bound)	Sep	%	1.25	1.25	1.25
	19:00	US	FOMC rate decision (lower bound)	Sep	%	1.0	1.0	1.0
Thu 21 Sep	09:00	EC	ECB publishes Economic Bulletin					
	13:30	US	Philadelphia Fed Business Outlook	Sep	~	18.9	17.1	~
	15:00	EC	Consumer confidence	Sep A	~	-1.5	~	~
	15:00	US	Leading index	Aug	%	0.3	0.2	~
Fri 22 Sep	09:00	EC	Markit Eurozone manufacturing PMI	Sep P	Index	57.4	~	~
	09:00	EC	Markit Eurozone services PMI	Sep P	Index	54.7	~	~
	09:00	EC	Markit Eurozone composite PMI	Sep P	Index	55.7	~	~
	11:00	US	Fed's Williams speaks to Media at Swiss					
	14:30	US	Fed's George speaks at Conference on Outlook for Oil					
	14:45	US	Markit US manufacturing PMI	Sep P	Index	52.8	~	~
	14:45	US	Markit US services PMI	Sep P	Index	56.0	~	~
	14:45	US	Markit US composite PMI	Sep P	Index	55.3	~	~
	18:30	US	Fed's Kaplan speaks at Dallas/Kansas City Fed Oil Conference					

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