

## Winston keeps us waiting

- This week's CPI release is likely to be overshadowed by a coalition announcement.
- Global growth revised up, IMF warns of asset price vulnerability on tighter financial conditions.
- RBNZ finds further evidence of increased persistence in inflation.

At the time of writing there was still no Government. NZ is still waiting in anticipation, while financial markets are showing remarkable patience, as Winston has the NZ First Board together today for the first time. It may still take days for a final announcement. **Tomorrow's CPI release will take a back seat to waiting for a governing arrangement.** [We and the market are expecting stronger inflation](#) than the RBNZ had pencilled in at the August Monetary Policy Statement. However, much of the upside surprise to the RBNZ's forecast is likely due to higher food prices. RBNZ is likely to discount the weather-related lift in vegetable prices, although the lift in dairy prices is a slightly different story as this is driven by higher export prices. **The current lift in annual inflation has been driven by food, fuel and construction costs. Beyond that, inflation pressures remain subdued.** The RBNZ expects headline inflation will fall again next year and it's the subsequent lift that the RBNZ will remain most focussed on.

**One area of optimism is the recent improvement in global growth prospects.** The International Monetary Fund's (IMF) bi-annual World Economic Outlook (WEO) lifted forecasts for global growth over the next two years. Global growth had persistently underperformed expectations since the Global Financial Crisis, so it's a pleasant change in trend for growth to now surprise on the upside. Nonetheless, there are plenty of reasons to remain nervous.

**The IMF remains wary of high asset prices** and the risks of tighter financial conditions or a 'policy mistake' triggering a substantial decline in asset valuations. Very low interest rates have resulted in a "[bull market in everything](#)" according to the Economist. In this context, the **spotlight is clearly on the Federal Reserve**, as US interest rates have a strong impact globally. The Fed is taking a **very cautious approach to lifting rates**. While another rate hike in December is now looking likely (the fifth over two years), recent meeting minutes show the Fed is becoming less confident about further hikes beyond this year. Some members of the Federal Reserve are **beginning to question if weak US inflation is indeed transient or if there are some more persistent factors**. For example, an area of surprise has been the low rate of wage inflation given the degree of tightness in the US labour market. A similar conundrum has been apparent in NZ as well. Some economists argue the usual relationship between activity and inflation does not hold any more, because of technology (examples being increased use of automation and increased prevalence of smart phones). Meanwhile **others warn against 'this time it's different' arguments** and believe that a quick lift in inflation is lurking just around the door. Interestingly, the [RBNZ released a paper last week](#) which showed that recent inflation forecasts could have been improved by placing more weight on previous outcomes. This is **further evidence of the RBNZ's belief of increased persistence in inflation dynamics**. The experience of weak inflation of recent years is likely delaying the lift we would have normally expected given the strength of the economy, suggesting the key output/inflation **relationships haven't changed, other than their timing**.

### Foreign Exchange

- Politics looks set to remain a key driver of near-term NZD direction.

### Interest Rates

- NZ longer-term rates drifted lower last week, largely reflecting offshore moves.

### Week Ahead

- CPI data, the GlobalDairyTrade auction and migration numbers are due out this week.

### Week in Review

- Retail card spending, food prices and consumer confidence dipped last week.

### Global Calendars

- Australian employment data, UK CPI and China GDP.

## Chart of the Week: Housing market not dead yet



**REINZ house sales data for September showed underlying resilience in house prices** despite the appearance of softer demand. House sales were expected to be weak given the General Election at the end of September and the uncertainty around housing policies going forward.

However, one area of surprise was the underlying resilience in house prices despite weak turnover. **In Auckland, it appears the contraction in supply**, through lower listings and a fall in overall inventory levels, has seen the market rebalance. As a result, **house prices have stabilised** on a seasonally-adjusted basis over the past two months, after recording six consecutive months of decline.

Meanwhile, **Wellington's market remains tight, with seasonally-adjusted prices continuing to rise**. The recent lift in Wellington's population growth has resulted in a short supply of housing. However, we expect this situation to be relatively short lived, with building consent demand also rising strongly in the Capital.

## Foreign Exchange Market

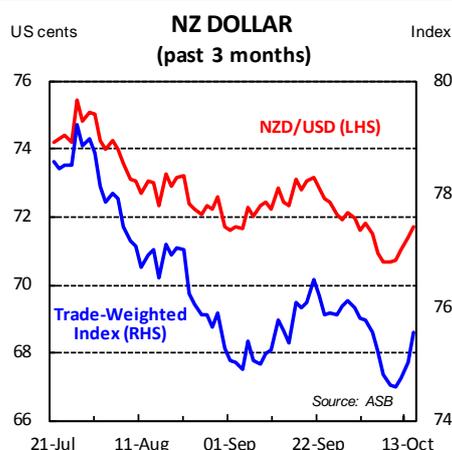
FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7172	0.7068	0.7234	0.7001	0.7104	FLAT	0.71	0.73
NZD/AUD	0.9099	0.9097	0.9050	0.9228	0.9365	FLAT	0.9000	0.9225
NZD/JPY	80.13	79.61	79.82	76.21	73.86	FLAT	78.5	81.0
NZD/EUR	0.6070	0.6022	0.6072	0.6559	0.6439	FLAT	0.5900	0.6150
NZD/GBP	0.5390	0.5396	0.5397	0.5570	0.5810	FLAT	0.5250	0.5450
TWI	75.6	74.8	75.4	75.9	76.4	FLAT	74.5	76.5

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

**Politics looks set to remain a key driver of near-term NZD direction**, as markets await the announcement of which party New Zealand First will support to form a government. **A binary impact on the NZD is possible** and previous net long NZD positions have been scaled back. NZ Q3 CPI is expected to come in above RBNZ forecasts, but contained readings for core inflation are expected to cap NZD upside and keep the RBNZ towards the back of the queue for rate hikes. A flat outcome for dairy prices at this week should be NZD neutral. **The weaker USD has been the other key NZD influence over the past week** as doubts over how quickly inflation will arise weighed on US rate hike expectations. At the weekend's IMF meetings Yellen, Draghi and Carney cautioned that improving global activity will translate into rising inflation, but last week's dovish Fed minutes and weaker than expected readings for US core CPI inflation (1.7% y/y) suggest this view is not universally shared. **Positioning is still short-USD** and while a December Fed hike has more than 70% odds, the market does not share the Fed's view of five further hikes over the next two years.

**Strengthening global demand has provided a boon to commodity currencies**, with Chinese Q3 GDP data a key bellwether this week. The strong rally in Sterling following positive comments on Brexit negotiations **highlight the potential for GBP upside** if a deal is done. Polls ahead of the October 22 Japanese election indicate the incumbent LDP Government will retain its large majority, supporting the yen. Still-strong Eurozone data are offsetting Spanish political tensions and, even if the Catalan administration declare independence this week, **downward pressure on the euro should be modest**.

### Short-term outlook:



### Key data

Key data	Date	Time (NZT)	Market
NZD CPI, Q3, %q/q	17/10	10:45am	+0.4%
NZD GDT auction	18/10	am	-
AUD Employment change, Sep	19/10	1:30pm-	+15k
CHN GDP, Q3, %y/y	19/10	3:00pm-	+6.8%

**NZD:** Q3 CPI (Tue), GDT auction (Wed), Sep migration (Fri). **USD:** Sep housing starts (Wed), Fed Beige book (Wed), Sep Industrial production/Capu (Wed), **EUR:** Sep CPI (Tue), German ZEW survey (Tue), Aug current account (Fri). **GBP:** Sep CPI (Tue), Aug labour market report (Wed). **CNH:** Sep CPI (Mon), Q3 GDP (Wed), Sep Industrial production/retail sales (Thu). **AUD:** Oct RBA Meeting minutes (Tue), Sep employment report (Wed).

**Speakers:** **FOMC:** Dudley (Wed), Kaplan (Wed), Yellen (Sat). **RBA:** Ellis (Tue). **ECB:** Draghi (Wed), Praet (Wed). **BOJ:** Sakurai (Wed), Kuroda (Fri). **BOE:** Carney (Tue),

### Medium-term outlook:

### Last Quarterly Economic Forecasts

**We updated our FX forecasts in early September.** 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. **The narrowing Australian current account deficit, and the strengthening trading partner growth 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 NZD/EUR to end 2017 at 0.60 and 2018 at 0.61.** 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	1.93	1.93	1.94	1.96	2.14	FLAT
2-year swap	2.20	2.21	2.21	2.27	2.07	FLAT
5-year swap	2.72	2.75	2.68	2.80	2.25	UP
5-year benchmark gov't stock	2.52	2.57	2.51	2.33	2.01	UP
NZSX 50	8089	8008	7757	7240	7126	UP

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

**NZ short-term interest rates were largely flat last week. However, longer-term rates drifted lower with the curve flattening slightly as a result.** A combination of (mostly offshore) events weighed on long-term rates over the past week. Firstly, **Trump's tax reforms are looking more unlikely to be in place this side of Christmas** after reports that Trump was likely to "overhaul" a key part of the reform. Secondly, although the **US FOMC meeting minutes** (on Thursday) largely confirmed a Dec rate hike was live, it **showed that many officials were becoming "concerned that low inflation is not only transitory."** These concerns weighed on interest rate expectations further out in the curve. Further, **Friday's softer than expected US core CPI reading slightly tempered expectations for a December rate hike**, with market pricing dipping to 73% from 80% last week. Fed Chair Janet Yellen's positive inflation comments on Sunday have done little to change market pricing for a December rate hike as of yet.

On top of this, **NZ First failed to meet its self-imposed Thursday deadline of announcing which Party it would form a coalition with.** With limited details on when an announcement is likely, outside of sometime this week, uncertainty is likely to continue to weigh on NZ interest rates until we get an answer.

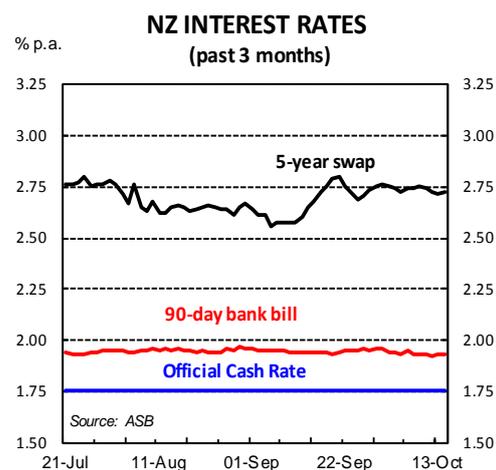
### Short-term outlook:

### Key data

### Date

### Time (NZT)

### Market



NZ CPI, Q3, %qoq

17/10

10:45 am

+0.4

RBNZ Core Inflation, Q3, %yoy

17/10

3:00 pm

-

GDT Auction

18/10

Overnight

-

AU Employment, September, 000s

19/10

1:30 pm

+20

CH GDP, Q3, %yoy

19/10

3:00 pm

+6.8

NZ Net Migration, September, 000s

20/10

10:45 am

-

**Comment:** Locally, the key data focus this week will be Tuesday's Q3 CPI release. With market expectations firmly ahead of the RBNZ's forecasts, a result in line or stronger than market expectations will support NZ interest rates. However, headline inflation has been particularly volatile recently. The RBNZ's measure of core inflation, released on Tuesday afternoon, will be an important steer on where the RBNZ sees core inflation. We expect this will remain subdued.

**Offshore, Australian employment will be key.** Ongoing employment growth should begin to translate into wage pressures, which in turn, will support expectations for a RBA rate hike late in 2018. Outside of economic data, NZ political developments will continue to be closely watched.

### Medium-term outlook:

### Last Quarterly Economic Forecasts

**The RBNZ continued to hold the OCR at its record-low of 1.75% at September OCR Review.** The RBNZ retained its neutral bias and continued to note the numerous uncertainties. However, the key surprise was the **RBNZ downgraded its growth outlook**, commenting it expected growth to "maintain its current pace" whereas at the August Monetary Policy Statement (MPS), the RBNZ's forecasts assumed growth would accelerate. However, the RBNZ will be mindful that **election promises will likely boost growth further once the RBNZ has revised fiscal projections from Treasury.** Furthermore, we have for some time seen upside risks to the RBNZ's growth forecasts due to the RBNZ's relatively modest dairy price assumption.

**The NZD had eased since August**, when the RBNZ had been very frustrated. Nonetheless, the RBNZ continues to note that a lower NZD would be helpful in delivering more inflation and a more "balanced" growth outlook.

**The RBNZ remains confident in the medium-term inflation outlook**, despite anticipated volatility in headline inflation this year. The RBNZ's August MPS forecasts show 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 Trade Balance, August, €bn	16/11	10.00 pm	18.6	20.2	23
Reserve Bank of Australia Meeting Minutes	17/11	-	-	-	-
UK CPI, September, %yoy	17/11	9.30 pm	2.9	3.0	2.9
UK Average Weekly Earnings, August, %yoy	18/11	9.30 pm	2.1	2.1	2.3
Australia Unemployment Rate, September, %	19/11	1.30 pm	5.6	5.6	5.5
China GDP, Q3, %yoy	19/11	3.00 pm	6.9	6.8	6.8

The **Reserve Bank of Australia's** October Monetary Policy Statement was neutral in tone and consistent with policy remaining on hold for an extended period of time. We are not expecting anything in the **October Minutes** to suggest that the RBA may be contemplating tightening policy in the near future.

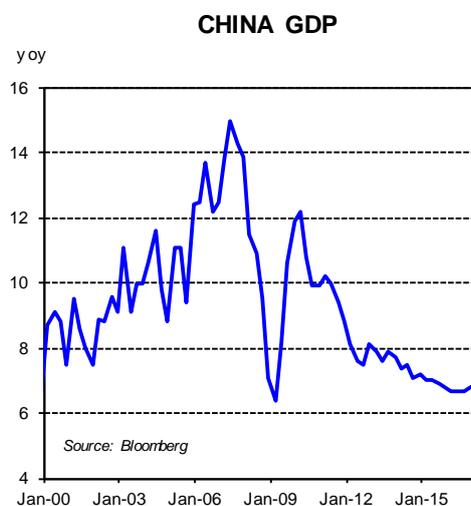
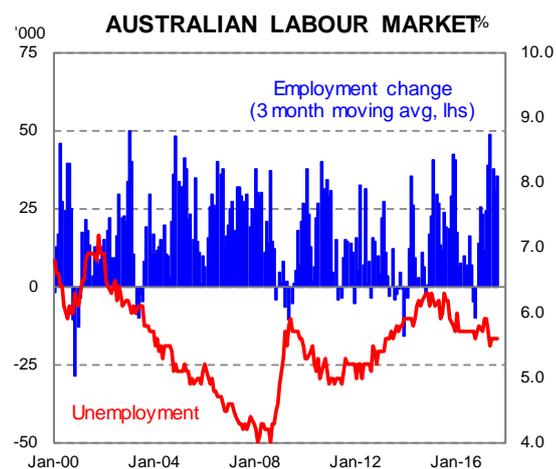
The **Australian labour market** has improved markedly over 2017. There have been six strong monthly employment reports in a row. The improvement is evident in a range of labour market indicators and it has been broad-based across all states. We expect to see another decent report in September, consistent with other forward-looking indicators.

**China's economy is likely to grow by 6.8% yoy** driven by steady consumption and investment. The PMIs are also consistent with encouraging economic activity. There are upside risks as Research and Development will be included in GDP for the first time.

We anticipate the **August Eurozone trade balance** will print at a seasonally adjusted €23bn. Increasingly synchronised global economic growth leads to robust demand for Eurozone exports, which will be reflected in a lift in the trade balance from the July print.

We anticipate **September UK CPI** will print at 2.9% yoy for the headline measure and 2.7% for the core measure. There is an upside risk for the headline CPI print, reflecting increasing energy prices.

We anticipate **August UK average weekly earnings** will print around 2.3%. UK unemployment is at a forty-year low and the Bank of England believes wage and price pressures are firming in the UK economy.



# NZ Data Preview: a look at the week ahead

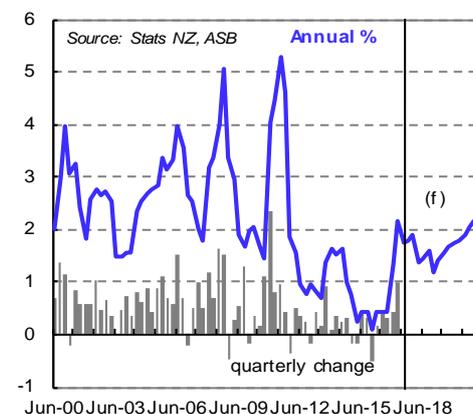
Data	Date	Time (NZT)	Previous	Market expects	ASB expects
CPI, Q3, %qoq	17/10	10:45 am	0.0	0.5	0.4
GlobalDairyTrade Auction, whole milk powder, % change	17/10	overnight	-2.7	-	+1 to +3
International Travel & Migration, Sep, Net Migration (sa), 000s	20/10	10.45 am	5,490	-	5,500

**We expect the CPI to print at 0.4% qoq in Q3, with annual CPI inflation firming to 1.8%.** Rising petrol prices and a stronger near-term outlook for food prices likely explain much of the difference with the RBNZ's +0.2% qoq pick. We expect the CPI to confirm that domestic inflation pressures remain subdued outside of one or two pockets. While the outlook for economic activity remains constructive and the beneficiary of a number of key supports, evidence of a firming in inflationary pressure is mixed at best. In such an environment, and given a number of downside risks still lurking in the background, there is plenty of sense in the RBNZ holding the pause button for a while longer.

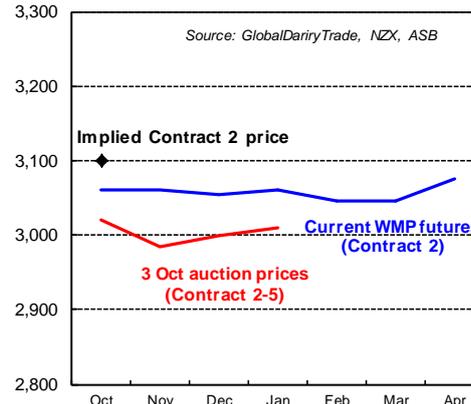
We expect prices to lift a touch at the **GlobalDairyTrade auction** overnight Tuesday. A fortnight ago whole milk powder (WMP) prices decreased by 2.7%. **At the current juncture, futures pricing suggests WMP will rise by between 1% and 3%.** Over the past few months, global dairy prices have largely treaded water around current levels. However, we expect that recent poor weather will have constrained production and, in turn, this is likely to lead to rising prices over coming auctions. Moreover, when combined with the global butter shortage, dairy prices could end 2017 on a high.

**Migration data should confirm that NZ is past the peak for annual net inflows (a shade over 72,000 persons).** August monthly net inflows fell to a 19-month low and while modest strengthening is possible in the short term, arrival numbers seem to have peaked, with departures expected to continue to drift up from low levels. We expect this softening trend to continue given the likelihood of a less favourable policy backdrop for non-resident arrivals. This, combined with the improved Australian labour market, will likely prompt more departures across the Tasman. There is also the possibility of a small lift in seasonally-adjusted tourism arrivals in September and a possible new annual record high. Increasing flight connectivity and New Zealand's reputation as a safe tourist destination have proved to be important drawcards. However, with popular tourist destinations bulging at the seams over peak periods and with constraints over accommodation capacity and tourism infrastructure, **we are cautious over the ability of the sector to continue to generate record tourism numbers.**

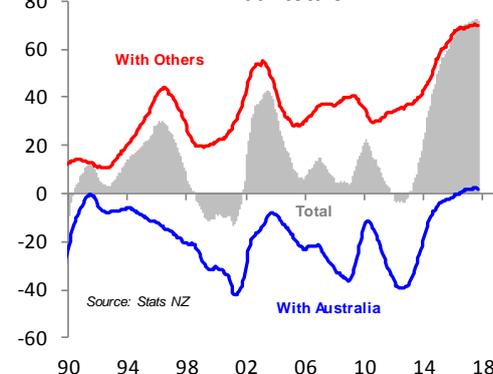
**NZ CPI INFLATION**



**GLOBALDAIRYTRADE AND WMP FUTURES PRICES**



**NET PLT INFLOWS**  
Annual totals



## Data Recap: weekly recap

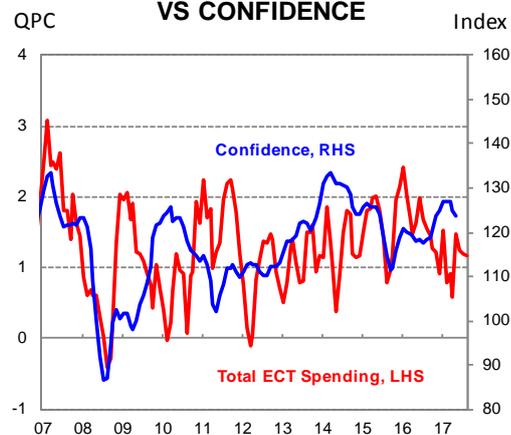
Data	Date	Actual	Market forecast	ASB Forecast
Electronic Card Transactions, September, Total, %mom	10/10	0.1	0.7	0.8
Food Price Index, September, Total, %mom	12/10	-0.2	-	-1.0
Consumer confidence, October	12/10	126.3	-	-

**Retail card spending rose just 0.1% in September, weaker than the +0.7% mom consensus expectation.** Core spending (which excludes spending on fuel and vehicles) fell 0.2% in September, the third consecutive sub-par month. Retail spending declined 0.1% over Q3, the weakest in close to a decade. Core spending managed a more respectable 0.9% qoq increase, although this is at two-year lows. Consumers have been on the sidelines over Q3 and, with election-related uncertainties expected to persist into Q4, **the likelihood is that consumer spending will play less of a role in the domestic expansion in the second half of this year than it did in the first.**

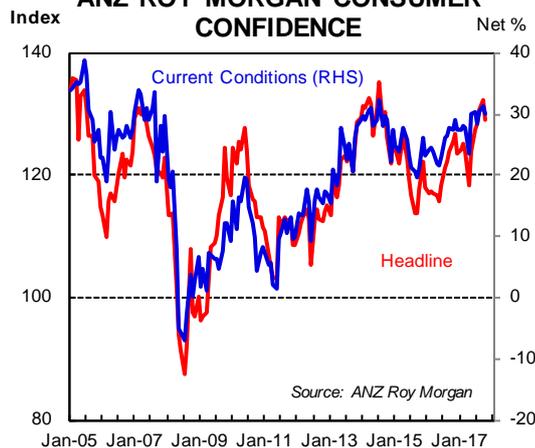
Unadjusted **food prices dipped 0.2% mom in September**, driven by a 4.9% fall in fruit and vegetable prices. However, offsetting the produce price drop to a degree, was a 0.9% lift in grocery prices over the month. This lift was largely driven by higher dairy (butter) prices. Overall, food prices have increased by 1.12% over Q3, contributing 0.21ppts to our Q3 CPI forecast (which accounts for roughly half of the inflation over the quarter).

**The headline October ANZ-Morgan Consumer Confidence fell 3.6 points to 126.3.** However, the reading was still well above historical averages (119). Our seasonally-adjusted estimates also showed a 3pt fall in confidence (to 129). Households' assessments of current conditions (which are more closely correlated to retail spending) eased 2.7 points to 124 and are fractionally below July/August levels. **Consistent with signs of stabilisation in the nationwide housing market**, nationwide house price expectations rose modestly to 3% over the next 2 years versus 2.5% prior. The upshot is that **resilient levels of consumer sentiment still point to solid economic momentum going forward.** Solid household income growth in relation to low consumer price inflation, low unemployment and higher rural incomes look to provide considerable support.

**CORE RETAIL CARD SPENDING VS CONFIDENCE**



**ANZ ROY MORGAN CONSUMER CONFIDENCE**



## Global Data Calendars

## Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 16 Oct	14:30	CH	CPI	Sep	y%ch	1.8	1.6	~
	17:30	JN	Industrial production	Aug F	m%ch	2.1	~	~
Tue 17 Oct	10:45	NZ	CPI	Q3	q%ch	0.0	0.5	0.4
	11:30	AU	ANZ Roy Morgan Consumer Confidence Index	Oct	Index	113.8	~	~
	13:30	AU	RBA October Rate Meeting Minutes					
	13:30	AU	New motor vehicle sales	Sep	m%ch	0.0	~	~
	13:30	AU	RBA's Ellis Participates in a Panel					
Wed 18 Oct	12:30	AU	WBC leading index	Sep	m%ch	-0.1	~	~
	14:30	JN	BOJ Sakurai makes a speech					
Thu 19 Oct	~	AU	RBA's Bullock gives Speech in Sydney					
	12:50	JN	Trade balance	Sep	¥bn	367.3	312.8	~
	13:30	AU	NAB business confidence	Q3	~	7.0	~	~
	13:30	AU	Unemployment rate	Sep	%	5.6	5.6	~
	15:00	CH	GDP	Q3	q%ch	1.7	1.7	~
	19:00	JN	Machine tool orders	Sep F	y%ch	45.3	~	~
Fri 20 Oct	10:45	NZ	Net migration	Sep	~	5,490	~	5,500
	15:00	NZ	Credit card spending	Sep	m%ch	-0.7	~	~
	19:35	JN	BOJ Kuroda speaks in Tokyo					

## Calendar - North America &amp; Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 16 Oct	00:01	UK	Rightmove house prices	Oct	m%ch	-1.2	~	~
	10:00	EC	Trade balance	Aug	€bn	18.6	~	~
	13:30	US	Empire manufacturing	Oct	~	24.4	20.4	~
Tue 17 Oct	09:15	UK	BOE's Carney, Ramsden and Tenreyro Testify to Lawmakers					
	09:30	UK	CPI	Sep	m%ch	0.6	~	~
	10:00	EC	CPI	Sep	m%ch	0.3	~	~
	14:15	US	Industrial production	Sep	m%ch	-0.9	0.3	~
Wed 18 Oct	09:30	UK	ILO unemployment rate 3 months	Aug	%	4.3	~	~
	10:00	EC	Construction output	Aug	m%ch	0.2	~	~
	13:00	US	Fed's Dudley and Kaplan discuss Economic					
	13:30	US	Housing starts	Sep	000	1,180	1,180	~
	13:30	US	Building permits	Sep	000	1,272	1,230	~
	19:00	US	U.S. Federal Reserve releases Beige Book					
Thu 19 Oct	09:30	UK	Retail sales ex auto fuel	Sep	m%ch	1.0	~	~
	13:30	US	Initial jobless and continuing claims	Oct	~	~	~	~
	13:30	US	Philadelphia Fed Business Outlook	Oct	Index	23.8	20.3	~
	14:45	US	Bloomberg economic expectations	Oct	Index	51.5	~	~
	15:00	US	Leading index	Sep	%	0.4	0.1	~
Fri 20 Oct	09:00	EC	ECB current account	Aug	€bn	25.1	~	~
	15:00	US	Existing home sales	Sep	\$mn	5.4	5.3	~
	19:00	US	Fed's Mester speaks on Global Regulatory Structure					
Sat 21 Oct	00:15	US	Yellen speaks to National Economists Club in Washington					

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