

# Economic Weekly

17 February 2020

## RBNZ's positive economic diagnosis despite virus

The RBNZ surprised us and markets last week with a relatively upbeat assessment of the economic outlook. Following the announcement, we changed our OCR view, ditching the 25 basis point cut that we had had pencilled in (see page 2). Markets soon returned their gaze to coronavirus developments and the virus is likely to remain the main market theme this week. Locally though, another spanner has been added to the works, with drought declared in Northland (see below). With that in mind, the balance of risks to the OCR outlook remain skewed to the downside.

### Key events and views

<a href="#">Key Insights</a>	ASB change in OCR call. On hold until 2022.
<a href="#">Foreign exchange</a>	Upbeat RBNZ assessment sees NZD jump higher.
<a href="#">Interest rates</a>	Direction will hinge on coronavirus developments.
<a href="#">Domestic events</a>	December Migration, Global Dairy Trade auction.
<a href="#">International events</a>	US Fed Meeting Minutes, January Australian labour market data.

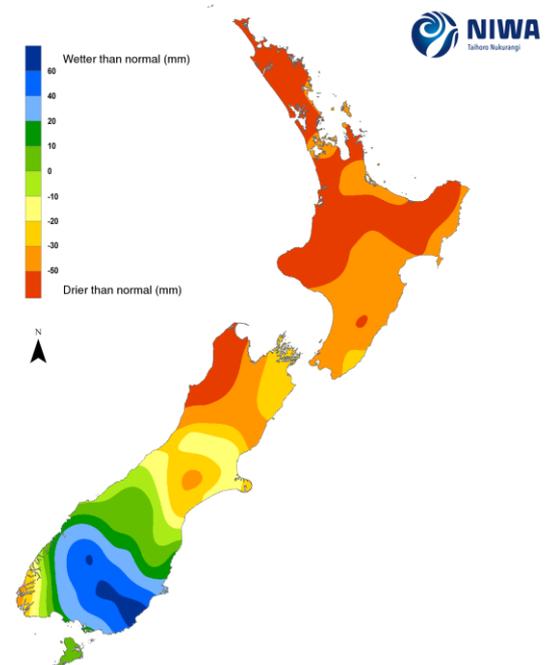
### Chart of the Week: Official drought declared

**An official drought has been declared in Northland.** The official declaration means that government assistance can be now offered to farmers in the region. **Other regions may soon see an official declaration too.** As shown on the map, the Waikato, Bay of Plenty, Taranaki and the northern part of the South Island are also very dry. Moreover, weather forecasts show little sign of short-term rain relief in these areas.

In terms of short-term economic impact, **generally droughts lower farmer confidence, if not farm incomes, which in turn leads to lower investment and household spending.** Accordingly, the emerging drought presents an additional downside risk to our OCR outlook, notably on top of the coronavirus-related risks.

**Looking at commodity price impacts, the drought will have mixed effects.** For dairy, the drought will put upward pressure on prices as dairy production and supply falls. For meat prices, the drought is having a depressing impact as farmers bring forward or increase slaughter due to a lack of feed. Already, lamb prices have fallen more than they do normally at this time of year. Meanwhile, a hot summer can boost production levels in the horticulture sector, although prices may fall as a result.

Soil moisture anomaly (mm) at 9am on 16/02/2020



## Change in our OCR call and general interest rate view

- We now expect the OCR to remain at 1.00% until 2022, followed by a series of mild OCR hikes and a 2.25% endpoint this cycle. We also have edged up our other NZ Interest rate forecasts accordingly.
- The risk profile around our interest rate forecasts remain skewed to the downside, with the impact of the coronavirus a key uncertainty to the interest rate outlook.
- We still expect NZ and global long-term interest rates to remain historically low, with more downside risk than up to our longer-term NZ interest rate forecasts over the second half of the projection period.

### Change to OCR call – on hold till 2022

**We have changed our OCR call and no longer expect a 25bp cut for 2020** (previously we had a 25bp cut pencilled in for May). This is based on the conviction that the NZ economy remains reasonably well placed and the most likely course at present is for the OCR to remain at 1.00%. In its February Monetary Policy Statement (see our take [here](#)), the RBNZ held the OCR at 1% and again showed little reluctance to move settings in the future given increased fiscal stimulus and signs that the 75bps of OCR cuts in 2019 look to have stimulated the economy. Inflation was deemed as being close to the 1-3% target mid-point (not below it), with employment as being at (or slightly above) its maximum sustainable level. The RBNZ adjudged that the coronavirus is likely to have a modest and short-lived impact on the economy, and flagged risks of stronger than forecast growth posed by higher government capital investment and increased household spending. The published OCR track was 10-15bp higher than in November, with the OCR plateauing at 1% while also signalling a 25bp hike by the end of next year and a total of 75bps of hikes by late 2022.

#### Our view of the balance of risks to the NZ interest rate outlook is still skewed to the downside.

Like the RBNZ, we have assumed that the coronavirus will have a short-lived impact on the NZ economy. If the coronavirus outbreak (see our recent [note](#)) turns to have more longer lasting impacts globally or if it reaches NZ, the economic hit to NZ would be greater and the OCR would likely move lower. Moreover, we remain sceptical that the NZ economy will accelerate to the degree that the RBNZ expects from the June quarter of this year (average quarterly growth of 0.9% is expected over the remainder of 2020).

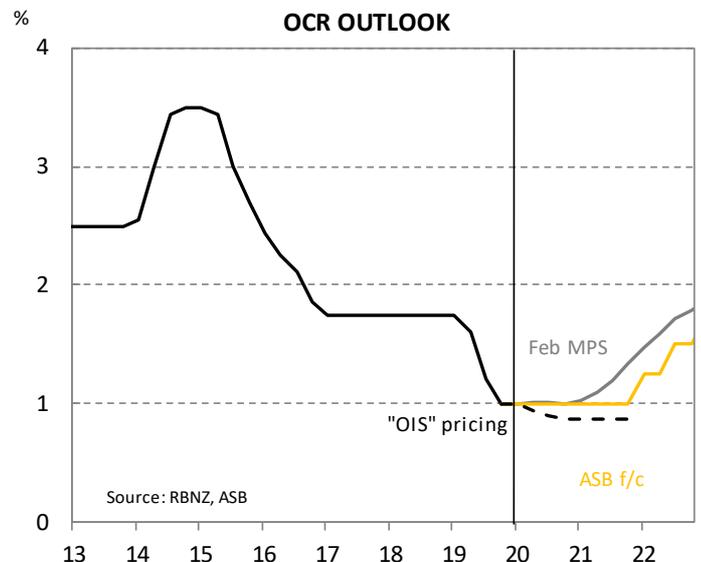
#### We expect an early 2022 start to the next RBNZ OCR

**tightening phase.** The exact timing of future OCR hikes is fluid and conditional on domestic and global developments. We expect a historically-low OCR endpoint

of just 2.25% this cycle from early 2024. This is in a similar ballpark to our estimates of the neutral OCR. Risks are skewed towards the OCR remaining on hold for longer and for a more gradual path of policy tightening.

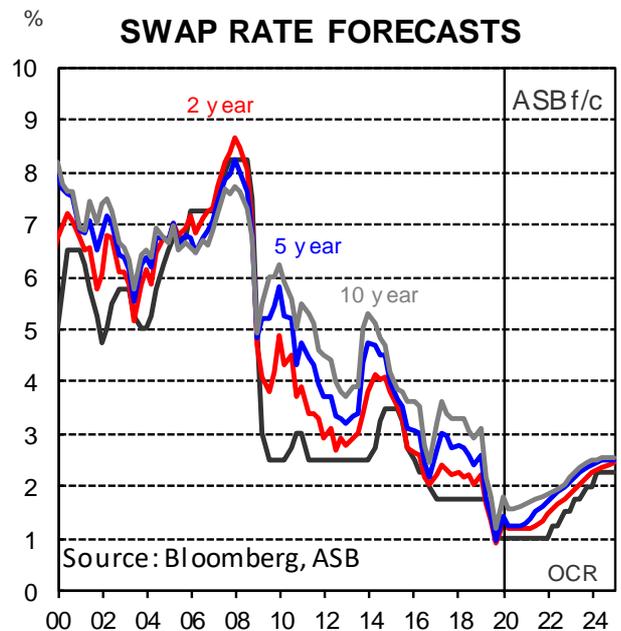
#### We also expect rate policy interest rate cuts by other central banks over 2020.

Low inflation and the downward skew of risks keep the odds skewed towards more policy support. The People’s Bank of China is likely to unveil further stimulus measures to offset the impact of the coronavirus. We expect the Reserve Bank of Australia (RBA) to deliver 50bp of cuts over 2020 (April and August), taking the RBA cash rate to a 0.25% floor. At this stage we do not expect the RBA to then undertake quantitative easing. The US Federal Open Market Committee (FOMC) is expected to continue to trim the 1.50%-1.75% Federal Funds rate by a further 50bp in 2020 (September and December), although risks are skewed towards the Fed remaining on hold for longer.



In light of the changes to our OCR view, we have also revised up our other NZ interest rate forecasts, albeit to a more modest degree. We expect long-term NZ yields to nudge higher, but we would not rule out the possibility of declines if risks of a weaker global outlook were to crystallise.

We still expect NZ and global long-term interest rates to remain historically low over the next few years, given protracted low global inflation and the global expansion remaining heavily dependent on policy support. NZ long-term yields are expected to eventually drift higher and then settle at historically-low levels (circa 2.5%). Mild RBNZ tightening, low NZ inflation, still-strong demand for NZ assets, and our historically-low outlook for global yields should cap NZ yields over the years ahead. There is more downside risk than up to our longer-term NZ interest rate forecasts over the second half of the projection period.



#### ASB INTEREST RATE FORECASTS

	OCR	90 day	1 yr swap	2 yr swap	3 yr swap	4 yr swap	5 yr swap	10 yr swap	10 yr bond	Slope	10y swaps less bonds
Dec-19 (a)	1.00	1.29	1.24	1.26	1.32	1.38	1.45	1.78	1.65	0.52	0.13
Mar-20	1.00	1.25	1.20	1.20	1.25	1.25	1.25	1.55	1.35	0.35	0.20
Jun-20	1.00	1.25	1.20	1.20	1.25	1.25	1.25	1.55	1.35	0.35	0.20
Sep-20	1.00	1.25	1.20	1.20	1.25	1.25	1.25	1.60	1.35	0.40	0.25
Dec-20	1.00	1.25	1.20	1.20	1.25	1.25	1.30	1.65	1.35	0.45	0.30
Mar-21	1.00	1.25	1.20	1.20	1.25	1.30	1.40	1.70	1.35	0.50	0.35
Jun-21	1.00	1.25	1.20	1.25	1.30	1.40	1.50	1.75	1.35	0.50	0.40
Sep-21	1.00	1.25	1.25	1.35	1.40	1.50	1.60	1.80	1.40	0.45	0.40
Dec-21	1.00	1.35	1.35	1.45	1.50	1.60	1.70	1.85	1.50	0.40	0.35
Mar-22	1.25	1.50	1.50	1.55	1.60	1.70	1.80	1.90	1.60	0.35	0.30
Jun-22	1.25	1.60	1.60	1.65	1.70	1.80	1.90	1.95	1.70	0.30	0.25
Sep-22	1.50	1.75	1.70	1.75	1.80	1.90	2.00	2.05	1.80	0.30	0.25
Dec-22	1.50	1.85	1.80	1.85	1.90	2.00	2.10	2.15	1.90	0.30	0.25
Mar-23	1.75	2.00	1.90	1.95	2.00	2.10	2.15	2.25	2.00	0.30	0.25
Jun-23	1.75	2.10	2.00	2.05	2.10	2.20	2.25	2.35	2.10	0.30	0.25
Sep-23	2.00	2.25	2.10	2.15	2.20	2.30	2.35	2.45	2.20	0.30	0.25
Dec-23	2.00	2.35	2.20	2.25	2.30	2.35	2.40	2.50	2.25	0.25	0.25
Mar-24	2.25	2.45	2.30	2.30	2.35	2.40	2.45	2.50	2.30	0.20	0.20
Jun-24	2.25	2.45	2.40	2.35	2.40	2.45	2.50	2.55	2.35	0.20	0.20
Sep-24	2.25	2.45	2.40	2.40	2.45	2.45	2.50	2.55	2.35	0.15	0.20
Dec-24	2.25	2.45	2.40	2.45	2.45	2.45	2.50	2.55	2.35	0.10	0.20

Source: ASB

## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6444	0.6406	0.6641	0.6824	FLAT	0.6300	0.6580	UP
NZD/AUD	0.9586	0.9560	0.9633	0.9622	FLAT	0.9400	0.9750	FLAT
NZD/JPY	70.80	70.31	73.18	75.27	FLAT	69.30	72.10	FLAT
NZD/EUR	0.5943	0.5849	0.5966	0.6045	FLAT/UP	0.5820	0.6060	UP
NZD/GBP	0.4942	0.4967	0.5079	0.5332	FLAT/UP	0.4840	0.5030	UP
TWI	71.8	71.2	72.7	74.21	FLAT/UP	N/A	N/A	FLAT/UP

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

### NZD Recap

Covid-19 (coronavirus) headlines over the week and the Reserve Bank of New Zealand (RBNZ) announcement on Wednesday drove currency market direction over the past week. **The upbeat assessment from the RBNZ on Wednesday saw the NZD jump higher last week**, with both the NZD/USD and NZD/AUD both leaping around 60 points following the Statement. Meanwhile, a spike in number of new reported Covid-19 cases on Thursday sent jitters through financial markets, although it was subsequently reported that a change in testing procedures in China may have been behind the spike. Looking through this spike, it appears that the number of new cases reported each day may be starting to fall and, along with news of fiscal stimulus from Chinese officials, may see financial market confidence stabilise this week.

### Near-term outlook

**FX markets will continue to take direction from Covid-19 headlines.** We expect the USD to continue to trend higher this week; the Federal Reserve meeting minutes should reinforce that the US economy remains in a good place, supported by the strong labour market.

After the RBNZ boost to the NZD last week, **we anticipate that the NZD will trade within the ranges seen since the RBNZ announcement.** NZD/USD will struggle to materially appreciate above its 100-day moving average of 0.6480 this week. Although the RBNZ moved from an easing bias to a neutral bias last week, **the firm USD will contain NZD upside.**

It's a relatively quiet week ahead on the NZ data front, with the only key event being this week's dairy auction overnight Tuesday. The market remains concerned about the impact of the coronavirus on short-term dairy demand. **We expect whole milk powder (WMP) prices to fall between 1% and 2% at the auction.** A fortnight ago WMP prices slid 6.2% on the back of coronavirus concerns.

Following the RBNZ's shift to a neutral bias last week, the **NZD/AUD can re-test recent highs from earlier in February** (with the NZD/AUD previously failing to break through 0.9700).

### Medium-term outlook

We expect the NZD to remain on a gradual uptrend through the first half of 2020, although our view of a still-strong USD is expected to cap the extent of NZD/USD strength. We also expect the NZD/AUD to continue rising over 2020, as the NZ economy continues to outperform that of Australia. In NZ we now expect the RBNZ to leave the OCR on hold, while in Australia we expect two more RBA cuts. [jane.turner@asb.co.nz](mailto:jane.turner@asb.co.nz)

ASB foreign exchange forecasts (end of quarter)	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
		<< actual	forecast >>				
NZD/USD	0.63	0.67	0.67	0.66	0.64	0.66	0.68
NZD/AUD	0.93	0.96	0.99	0.99	0.96	0.96	0.96
NZD/JPY	68	73	69	69	67	67	71
NZD/EUR	0.57	0.60	0.61	0.59	0.57	0.58	0.58
NZD/GBP	0.51	0.51	0.50	0.49	0.49	0.50	0.52
NZD TWI	70.2	73.8	72.7	71.8	69.4	70.2	71.9

## Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.00	1.00	1.00	1.75	UNCH	UP
90-day bank bill	1.21	1.25	1.29	1.90	UNCH	UP
2-year swap	1.13	1.11	1.22	1.91	UNCH	UP
5-year swap	1.22	1.15	1.35	2.08	UNCH	UP
10-year swap	1.51	1.43	1.69	2.49	UNCH	UP
10-year govt bond yield	1.36	1.28	1.54	2.20	UNCH	UP
Curve Slope (2s10s swaps)	0.38	0.32	0.47	0.58	UNCH	DOWN

\* Current as at 9.30am today; week ago as at Monday 5pm. Key UNCH = Broadly unchanged

### Market Recap

**NZ yields rose sharply after the RBNZ delivered a more upbeat assessment of the economy than the market (including us) had generally been expecting.** The RBNZ adjudged that the coronavirus was likely to have a modest and short-lived impact on the NZ economy, and flagged upside risks to the NZ growth outlook. Even with an estimate of the coronavirus impact factored in, the published OCR track was 10-15bp higher than in November, with the OCR plateauing at 1% and signalling a 25bp hike by the end of 2021 and a total of 75bps of hikes by late 2022. **Given the reluctance of the RBNZ to consider rate cuts, we have dropped our May OCR cut view and now expect the OCR to be held at 1% for this year and next. However, we remain of the view that OCR cuts are more likely than hikes over 2020.** Coronavirus headlines contributed to impact global yields. Optimism that the outbreak was under control at the start of last week has given way to increasing concern and risk aversion by the end of the week, with NZ yields slightly lower after the reported number of new coronavirus cases jumped and signs pointed to a more marked economic hit. In response, China has continued to roll out policy stimulus, with more to come.

### Near-term NZD interest rate outlook

The near-term direction of NZ and global yields will largely depend on developments relating to the (highly uncertain) impact of the coronavirus. **The market is currently pricing in 14bps of OCR cuts over 2020 and we view this to be a fair reflection of the risk profile. We believe the RBNZ have underestimated the disruption caused by the coronavirus and are too upbeat on the 2020 NZ economic outlook. However, it will likely take time for enough downside risks to emerge before the RBNZ seriously entertains the idea of further OCR cuts.** Various speeches this week by central bank officials from the US, Australia, Eurozone, and UK will be of greater market relevance than minutes from the Reserve Bank of Australia and Federal Open Market Committee. Both the Fed and RBA are likely to view the economic outlook as being well placed and monetary settings as appropriate, but will be wary of coronavirus risks. Odds of near-term RBA rate cuts (only 10bps of cuts are priced in by May) will likely firm if Thursday's Australian labour market data is weak, and if the unemployment rate drifts up from 5.1%. Long-term global yields are sensitive to falls if manufacturing PMI data at the end of the week signals an impending virus-related hit to global growth.

### Medium-term outlook

We expect the OCR to remain on hold at 1.00% until early 2022 followed by a series of gradual OCR hikes, culminating in an OCR endpoint of around 2.25% from 2024. The RBA is expected to cut the 0.75% cash rate by 50bps in 2020 (April, Aug), with risks of later moves. The 1.50%-1.75% Federal Funds rate is expected to be cut by 50bps in 2020 (Sep, Dec) given the weaker outlook for labour demand. Low inflation, moderate global growth and negative risks should cap NZ and global long-term interest rates at low levels. [mark.smith4@asb.co.nz](mailto:mark.smith4@asb.co.nz)

### ASB interest rate forecasts

	Sep-19	Dec-19	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
(end of quarter)		<< actual	forecast >>				
NZ OCR	1.00	1.00	1.00	1.00	1.00	1.25	1.75
NZ 90-day bank bill	1.2	1.3	1.3	1.3	1.3	1.5	2.0
NZ 2-year swap rate	0.9	1.3	1.2	1.2	1.2	1.6	2.0
NZ 5-year swap rate	0.9	1.4	1.3	1.3	1.4	1.8	2.2
NZ 10-year swap rate	1.2	1.8	1.6	1.6	1.7	1.9	2.3
NZ 10-year Bond	1.1	1.7	1.4	1.4	1.4	1.6	2.0

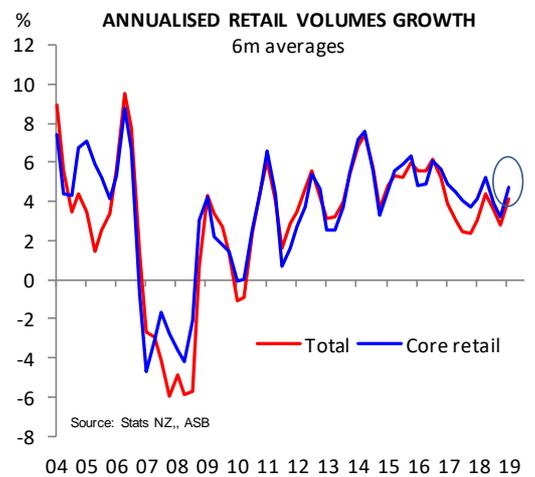
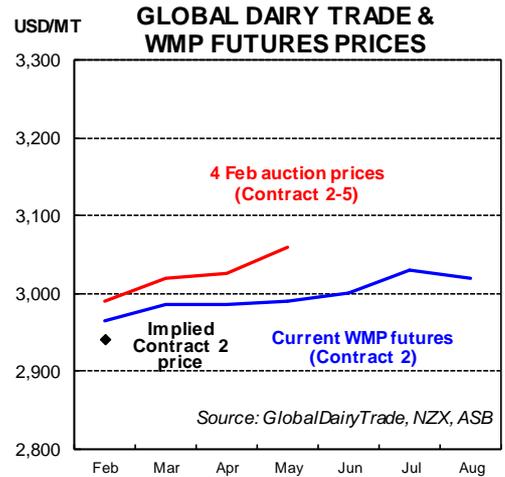
## Domestic events

Data	Date	Time (NZT)	Market	ASB
GlobalDairyTrade auction, whole milk powder, % change	18/02	overnight	-	-1.5
Retail Sales volumes, Q4, % qoq	24/02	10:45am	-	+0.8

**We expect whole milk powder (WMP) prices to fall around 1.5% at the GlobalDairyTrade auction overnight Tuesday.** The market remains concerned about the impact of the coronavirus on short-term dairy demand. A fortnight ago WMP prices slid 6.2% on the back of coronavirus concerns.

After a soft start to 2019, retail trade volumes rebounded 1.6% qoq in Q3, underpinned by a broad-based rebound in most of the 15 retail sub-groups. **Signs generally point to a solid Q4 for retail activity.**

Underpinned by a Black Friday surge in durable retail, quarterly nominal card spending growth accelerated to just under 2% qoq in Q4. However, a tailing off in vehicle registrations, and likely pullback from Q3 strength suggest that Q4 retail sector volumes growth is likely to fall short of its very strong Q3 showing. **Disruptions from the coronavirus are likely to weigh on overall retail at the start of 2020, but the underlying picture for the retail sector appears sound.** The 75bps of OCR cuts delivered over 2019 look to be encouraging consumers to bring forward consumption plans. The housing market has a more solid look to it, wage growth is moving along at a decent clip, and consumer confidence has recovered from its mid-2019 lull. The OCR looks set to stay at 1% for a while yet.



## Major International Events for the week ahead\*

Data	Date	Time (NZT)	Market	ASB
Japan GDP, Q4, %qoq	17/02	12:50 pm	-1.0	-1.5
RBA Board Minutes, February	18/02	1:30 pm	-	-
UK Labour Market, December	18/02	10:30 pm	3.8	-
UK CPI, January, %yoy	19/02	10:30 pm	1.6	-
Australia Labour Market, Unemployment Rate, %	20/02	1:30 pm	5.2	5.1
UK Retail Sales, January, %yoy	20/02	10:30 pm	0.8	-
US FOMC Meeting Minutes, January	20/02	8:00 am	-	-
Australia CBA PMI, February	21/02	11:00 am	-	-
Japan CPI, January, Headline, %yoy	21/02	12:30 pm	0.7	0.8

\*Originally published by CBA Global Markets Research on Friday 14<sup>th</sup> February at 1:58 pm

We expect **Japan's GDP** contracted in Q4, with consumption and industrial production key drags on economic growth over the quarter. The fall in GDP follows Japan's government hiking the Value Added Tax (VAT) on 1 October from 8% to 10%. Japan's GDP contracted 1.9%qoq the last time the government increased the VAT in 2014.

In its February Statement on Monetary Policy (SMP) the **Reserve Bank of Australia (RBA)** said "if the unemployment rate were to be moving materially higher and there was no further progress being made towards the inflation target, the balance of arguments would tilt towards a further easing of monetary policy". The RBA also downwardly revised its forecasts of the unemployment rate to 5% by December 2020. The **February Board Minutes** are unlikely to contain any new market moving information and we expect the central bank to reiterate its easing bias.

Over the past two months **Australia's employment growth** has accelerated, driving the unemployment rate down to 5.1% in December from 5.3% in October. We have the unemployment rate holding at 5.1% on a slight fall in the participation rate.

The **Commonwealth Bank of Australia's Composite PMI** has oscillated around the critical 50 level that separates expansion from contraction. In January the CBA Composite PMI fell to 48.6 although the fall was concentrated in the services sector. Both manufacturing (49.1) and services (48.9) PMIs in January were at their lowest level since the survey began in 2016. The PMI surveys cover manufacturing and services or 75% of GDP.

Already-released Tokyo inflation suggest that **Japan's headline inflation** remained steady at 0.8%yoy in January. We expect core (excluding fresh food and energy) eased slightly to 0.8%yoy.

**UK labour market** conditions remain tight. The Bank of England projects the UK unemployment rate to remain under its estimated equilibrium rate of unemployment of 4.25% over the next few years. However, slower UK pay growth, a decline in the number of job vacancies and weaker surveys of hiring intentions suggest the labour market is no longer tightening.

**UK inflation pressures** have eased in the past few months driven by falls in energy prices. Headline CPI inflation is expected to remain subdued around 1.3%yoy in January because of ample spare capacity in the UK economy.

**UK retail sales volumes** are expected to recover in January underpinned by positive real wage growth, favourable employment conditions and a pick-up in consumer confidence.

The **US Federal Reserve's January Meeting Minutes** are unlikely to contain any new information given the Federal Open Market Committee (FOMC) chair Jay Powell's testimony to Congress last week. The Minutes should reinforce that the US economy remains in a good place, supported by the strong labour market. But, the FOMC is likely to characterise inflation as below target, with measures of inflation expectations remaining low.

## Key Forecasts

### ASB NZ economic forecasts

	Sep-19 << actual	Dec-19 forecast >>	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
GDP real - Q%	0.7	0.6	-0.1	0.7			
GDP real - A%	2.3	1.8	1.3	2.0	3.3	2.8	2.6
GDP real - AA%	2.7	2.3	1.9	1.8	2.4	2.9	2.7
CPI - Q%	0.7	0.5	0.6	0.4			
CPI - A%	1.5	1.9	2.4	2.2	1.8	2.0	2.1
HLFS employment growth - Q%	0.2	0.0	0.2	0.3			
HLFS employment growth - A%	1.0	1.0	1.2	0.8	1.6	1.6	1.3
Unemployment rate - %sa	4.1	4.0	4.2	4.3	4.2	3.9	4.0
Annual current account balance as % of GDP	-3.3	-2.9	-2.7	-2.7	-2.9	-3.3	-3.1

Q% = percentage change on previous quarter

A% = percentage change since same quarter the previous year

AA% = percentage change for year ending quarter since the previous year

### ASB interest rate forecasts

	Sep-19 (end of quarter)	Dec-19 << actual	Mar-20 forecast >>	Jun-20	Mar-21	Mar-22	Mar-23
NZ OCR	1.00	1.00	1.00	1.00	1.00	1.25	1.75
NZ 90-day bank bill	1.2	1.3	1.3	1.3	1.3	1.5	2.0
NZ 2-year swap rate	0.9	1.3	1.2	1.2	1.2	1.6	2.0
NZ 5-year swap rate	0.9	1.4	1.3	1.3	1.4	1.8	2.2
NZ 10-year swap rate	1.2	1.8	1.6	1.6	1.7	1.9	2.3
NZ 10-year Bond	1.1	1.7	1.4	1.4	1.4	1.6	2.0

### ASB foreign exchange forecasts

	Sep-19 (end of quarter)	Dec-19 << actual	Mar-20 forecast >>	Jun-20	Mar-21	Mar-22	Mar-23
NZD/USD	0.63	0.67	0.67	0.66	0.64	0.66	0.68
NZD/AUD	0.93	0.96	0.99	0.99	0.96	0.96	0.96
NZD/JPY	68	73	69	69	67	67	71
NZD/EUR	0.57	0.60	0.61	0.59	0.57	0.58	0.58
NZD/GBP	0.51	0.51	0.50	0.49	0.49	0.50	0.52
NZD TWI	70.2	73.8	72.7	71.8	69.4	70.2	71.9

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