

# Economic Weekly

24 February 2020

## Double trouble

Financial markets took up defensive positions amid growing concerns around the spread of the coronavirus beyond China last week. Indeed, safe haven assets like gold rallied over the week. On that front on Page 2, we discuss what to look for in terms of data releases and financial market reaction over coming months as the outbreak develops and then runs its course. The added complication for NZ is that drought is hitting agricultural production and markets at the same time as the outbreak (see below). As a result, we expect the economy to contract slightly over Q1.

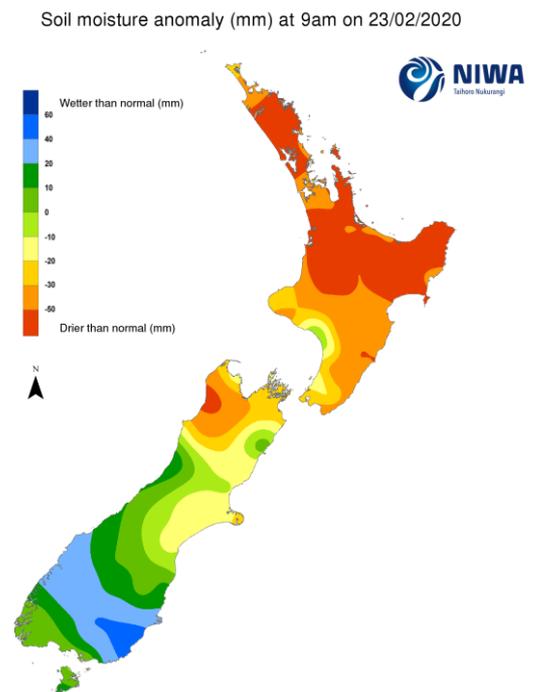
### Key events and views

<a href="#">Key Insights</a>	Coronavirus and watching the data/events over 2020
<a href="#">Foreign exchange</a>	Falling commodity prices sees "fair-value" collapse 4 cents
<a href="#">Interest rates</a>	Yields likely to remain volatile amid virus concerns
<a href="#">Domestic events</a>	Retail sales volumes, ANZ Business Outlook & Consumer Confidence
<a href="#">International events</a>	US Q4 GDP and GDP deflator; Chinese PMIs

### Chart of the Week: Rain hits and misses; coronavirus an added complication

**Some parched regions welcomed rain over the weekend.** Notably, the Taranaki, Manawatu, Whanganui, and Canterbury received good rain. **But, some of the driest areas, including Northland and the Waikato, received disappointingly modest amounts.** As a result, we expect many dairy farmers to continue to bring forward plans to dry off herds (or milk less frequently). Sheep and beef farmers will also continue to slaughter early, if they find space at meatworks.

**Complicating matters are the disruptions to supply chains from the coronavirus outbreak – in effect, a double whammy for some export sectors.** The dual impact is most pronounced in meat markets. For example, lamb prices have dropped over \$2/kg since November when the normal seasonal drop is around \$1.25/kg. The impact is less severe for the dairy sector, as evidenced by our relatively modest 10-cent cut to our 19/20 milk price forecast last week. The horticulture sector has been spared the worst impacts, as peak harvest (kiwifruit) and picking (apples) has occurred or is set to occur outside the peak impact of the virus and hot weather can help yields. For the forestry sector drought is largely irrelevant, but prices have slid by around 14% in the space of a few weeks purely on virus-related disruptions.



## COVID-19 watch: What to look out for over 2020

- The (uncertain) impact of the COVID-19 coronavirus represents a risk to the NZ and global outlook.
- It will take time for the impacts of the coronavirus to show in the published activity data.
- Financial markets could be susceptible to additional volatility over 2020, particularly if activity prints reveal surprises.

## COVID-19 clouds the 2020 economic outlook

**At the start of the year the NZ economy appeared to be well placed** with inflation close to the midpoint of the 1-3% inflation target and with employment at (or slightly above) its maximum sustainable level. There remain a number of key supports, but the COVID-19 coronavirus outbreak represents a dark cloud on the domestic and global outlook.

**Viral outbreaks have typically resulted in a sharp, but relatively brief, shock to both the NZ and global economies, and the RBNZ has assumed as much for COVID-19.** In the February Monetary Policy Statement, the [RBNZ](#) assumed that the COVID-19 coronavirus will deliver a short-term hit to NZ GDP, with most of the impacts occurring in the first half of 2020. The RBNZ's projections assumed a 0.3 percentage point hit to Q1 GDP (+0.4% qoq growth), but for growth to subsequently rebound, with quarterly growth to accelerate to 0.9% for the remainder of 2020 (i.e. Q2, Q3, Q4). At present ASB expects a virus-induced dip in Q1 NZ GDP (see our [note](#) here), but for the NZ economy to regain momentum in Q2, with the solid growth outlook a key facet underpinning our on-hold OCR view for 2020 and 2021.

## Data lags will prolong the uncertainty for markets and policymakers

Evidence is building that the COVID-19 coronavirus is imposing significant disruption on both the NZ economy and that of our key trading partners. Already we have seen a number of global confidence gauges and other forward-looking activity indicators soften. **It is generally acknowledged that NZ and global GDP will stumble in Q1, but less clear is the extent to which the NZ and global economy will bounce back over the remainder of the year.** If the COVID-19 coronavirus looks to have a more sizeable and drawn-out impact on NZ and global growth, we expect policy settings (mostly monetary) to try and offset the impacts. Central banks (where possible) will likely trim interest rates.

**Given the uncertainty over the coronavirus impacts, policymakers and markets will likely place considerable weight on forward-looking indicators and activity gauges.** Confidence readings and global manufacturing/services PMIs can provide timely signals on where the economy is heading. PMIs are typically published at the end of the month to which they apply for many of our key trading partners. Readings over the next few months are likely to show signs of virus-related disruptions and could prove useful in signalling how long-lasting the impact is likely to be.

## We can see a volatile period ahead for published data that could potentially add to financial market volatility.

Forward-looking indicators, however, have been known to provide false signals. GDP measures are still widely acknowledged as being the most appropriate measure for economy-wide activity, but they are typically published with a lag of 2-3 months. We could well face a situation where published GDP figures are publicising a Q1 hit, whereas forward-looking indicators published at around the same time could be pointing to a pending rebound in economic activity (as is generally expected) or a more prolonged hit. Also adding to volatility could be different publication lags, with the release of GDP for China considerably timelier than for NZ.

Table 1 summarises key decision dates for the RBNZ and a calendar of key NZ and global data prints. It shows:

- Q1 GDP figures will not be released until mid-April through to mid-June. China is one of the earliest economies to report provisional GDP figures (17 April for Q1 GDP), NZ is one of the laggards (16 June). April global PMIs will be published well ahead of NZ GDP.
- Q2 GDP figures are not available from about mid-July (China) till mid-September (NZ). It will not be until the NZ Q2 GDP release in mid-September that the RBNZ will have confirmation over how persistent the COVID-19 impact was. The NZ General Election (September 19) would likely be an added complication for September OCR deliberations.
- Q3 GDP will not be published until October 19 in China and mid-December in NZ. The next OCR window that the RBNZ could respond to after that NZ GDP print would be the February MPS on 24 February 2021.

Efforts by authorities and central bankers to support confidence have helped to calm financial markets, notwithstanding some virus-related volatility from softer company announcements. **However, the upshot is that published data are unlikely to be smooth over the coming months and this could be a cause for additional financial market volatility.**

**This will not make the lives of central bankers any easier, either, including the RBNZ.** The table below shows the OCR decision dates and the list of the latest data available to the RBNZ at that time. By the August 2020 MPS, for example, the RBNZ would have NZ Q2 CPI, Q2 QSBO, Q2 labour market data and the Q3 RBNZ Survey of Expectations, but not Q2 GDP (which could prove to be a pivotal number, given potential coronavirus impacts). The RBNZ would have Q2 Chinese and Q2 US GDP and global manufacturing/services PMI data out to July as well as recent RBA and Fed decisions to ponder.

**Table 1: Data and events calendar for 2020**

2020	New NZ data published prior to OCR decision	Key overseas data/events	RBA/US Fed timetable
OCR – 25 Mar	Q4 2019 GDP (Mar 19) Feb ANZ Business Outlook (27-Feb) Feb PMI (13-Mar), Feb PSI (16-Mar)	Q4 Australia GDP (4 Mar) Feb 2020 Global manufacturing and services PMIs (Feb 21/22)	RBA – Mar 3 US Fed – Mar 19
MPS – 13 May	NZ Budget (14 May) Q1 2020 CPI (20 Apr) Q1 2020 labour market (May 6) Q1 QSBO (early Apr), ANZBO (30 Apr) Q2 RBNZ Survey (7 May) Mar PMI (17 Apr), Mar PSI (21 Apr)	Q1 China GDP (17 April) Q1 US GDP (Apr 30) Apr 2020 Global manufacturing and services PMIs (Apr 23/24)	RBA – May 5 US Fed – Apr 30
OCR – 24 Jun	FSR – 27 May Q1 2020 GDP (16 Jun) May ANZBO (28 May) May PMI (12 Jun), May PSI (15 Jun)	Q1 Australia GDP (June 3) Jun 2020 Global manufacturing and services PMIs (Jun 23/24)	RBA – June 2 US Fed – June 11
MPS – 12 Aug	Q2 2020 CPI (16 Jul) Q2 2020 labour market (early Aug) Jul ANZBO (30 Jul), Q2 QSBO (early Aug) Q3 RBNZ Survey Expectations (early Aug) June PMI (17 Jul), June PSI (20 Jul)	Q2 China GDP (July 16) Q2 US GDP (July 31) Jul 2020 Global manufacturing and services PMIs (Jul 24/25)	RBA – Aug 4 US Fed – July 30
OCR – 23 Sep	NZ General Election (Sep 19) Q2 2020 GDP (mid Sep) Aug ANZBO (31 Aug) Aug PMI (11 Sep), Aug PSI (14 Sep)	Q2 Australia GDP (Sep 2) Aug 2020 Global manufacturing and services PMIs (Aug 21/22)	RBA – Sep 1 US Fed – Sep 17
MPS – 11 Nov	Q3 2020 CPI (16 Oct) Q3 2020 labour market (6 Nov) ANZBO (29 Oct), Q3 QSBO – early Oct Q4 RBNZ Survey (early Nov) Sep PMI (16 Oct), Sep PSI (19 Oct)	US Presidential Election (Nov 3 US time) Q3 China GDP (Oct 19) Q3 US GDP (Oct 30) Oct 2020 Global manufacturing and services PMIs (Oct 23/24)	RBA – Nov 3 US Fed – Nov 6

- Source: ASB, Statistics NZ, FOMC, RBA, RBNZ, Bloomberg. For some non-Statistics New Zealand data and policy releases – e.g. NZ Budget, QSBO/ANZ Business Outlook – the RBNZ sometimes gets advance data/information prior to the official publication.
- This note was earlier published by ASB Economic Research on 20 February 2020.

## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.6321	0.6431	0.6617	0.6775	DOWN	0.6300	0.6580	UP
NZD/AUD	0.9581	0.9564	0.9661	0.9548	FLAT	0.9400	0.9750	FLAT
NZD/JPY	70.36	70.61	72.44	75.01	FLAT	69.30	72.10	FLAT
NZD/EUR	0.5839	0.5933	0.5988	0.5974	DOWN	0.5800	0.6060	UP
NZD/GBP	0.4882	0.4929	0.5042	0.5197	DOWN	0.4840	0.5030	UP
TWI	71.1	71.4	72.7	73.44	DOWN	N/A	N/A	UP

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

### NZD Recap

Currency performance is fast becoming a game of picking which country is going to suffer more from coronavirus impacts.

The JPY was the weakest performing currency last week, as coronavirus impacts compound an already weak Japanese economy and investors start to price recession. The AUD and NZD were tied for 2<sup>nd</sup> weakest as investors punished the antipodeans for their relatively tight links with China. The AUD/USD slumped to 11-year lows and the NZD/USD is languishing at 4-month lows around 0.6320.

### Near-term outlook

The NZD has started the week on the back foot, as markets begin to panic about the fact COVID-19 appears to be spreading more rapidly outside of China. Market pricing is starting to reflect a serious and potentially prolonged hit to global growth. Equities have backed off recent highs, implied volatility has spiked, and two full rate cuts are now expected from the US Federal Reserve this year. NZD/USD momentum is negative and another test of 0.6300 looks likely. The daily RSI is not yet in oversold territory.

Notably, the 'fair-value' range implied by our short-term NZD/USD valuation model has fallen appreciably. While risk aversion and lower NZ interest rates have been a factor here (a full 25bps RBNZ rate cut is now priced by November), it's actually commodity prices that have done the damage. A near 10% fall in NZ's commodity export prices have shaved a full 4 cents off the fair value range, which now sits at 0.6350-0.6750. Moreover, given pressure is likely to remain on commodity prices in the near term, we'd suggest further falls in fair value are likely.

Currency market sentiment is being set by day-to-day news on coronavirus. Economic data remain largely irrelevant but there will be some passing interest in how NZ business confidence fares in the February addition of the ANZ index released Thursday.

### 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.

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### 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	1.14	1.19	1.28	1.89	UNCH	UP
2-year swap	1.02	1.12	1.23	1.88	UNCH/DOWN	UP
5-year swap	1.08	1.21	1.33	2.05	UNCH/DOWN	UP
10-year swap	1.37	1.50	1.61	2.47	UNCH/DOWN	UP
10-year govt bond yield	1.25	1.35	1.45	2.18	UNCH/DOWN	UP
Curve Slope (2s10s swaps)	0.35	0.38	0.38	0.59	UNCH/DOWN	DOWN

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

## Market Recap

**Concerns over the COVID-2019 coronavirus outbreak have continued to weigh on NZ and global yields and flatten yield curves.** Market pricing for OCR interest rate cuts have firmed, with a full OCR cut priced by the end of 2020 (from about 15bp of cuts a week ago). US, Australia and NZ government 10-year bond yields are down 40-45bps since the start of the year and are around 2020 lows, with US30-year Treasury yields at a record low 1.92%. The climb in new confirmed COVID-19 cases in China looks to have slowed, but yields were weighed by signs that the outbreak was intensifying in other countries (including South Korea, Italy and Iran), signalling potentially greater economic disruption. Policymakers at the G20 meeting avowed to provide additional policy support if needed. An increase in the Australian unemployment rate to 5.3% pushed up odds of pending RBA interest rate cuts. The speech on Friday by RBNZ Governor Orr was of limited market relevance, emphasising the sound inflation and labour market starting points for the economy, and briefly mentioned COVID-19 risks.

## Near-term NZD interest rate outlook

**We expect interest rate markets to remain volatile over the next few months.** The near-term direction of NZ and global yields will continue to depend on developments relating to the (highly uncertain) impact of the COVID-19 coronavirus. **The degree of OCR cuts currently priced in looks to be a fair reflection of the risk profile, and we believe the RBNZ has underestimated the disruption caused by COVID-19 and is too upbeat on the 2020 NZ economic outlook. Our focus on the next few months will be the impact of COVID-19 on global and NZ growth.** Chinese manufacturing and services PMIs for February and local consumer and business confidence reports this week are the key data to watch. February PMIs to date have shown mixed signals, with US and Australian gauges pointed to contraction, whilst those for the Eurozone actually improved. Other published data this week are mostly backward looking and should have a limited impact on NZ yields.

## 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. Additional policy support could be unveiled over the coming months as Chinese authorities seek to offset the impacts of COVID-19. Low inflation, moderate global growth and negative risks should cap NZ and global long-term interest rates at low levels. Risks to the local NZ interest rate outlook remain skewed to the downside. [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

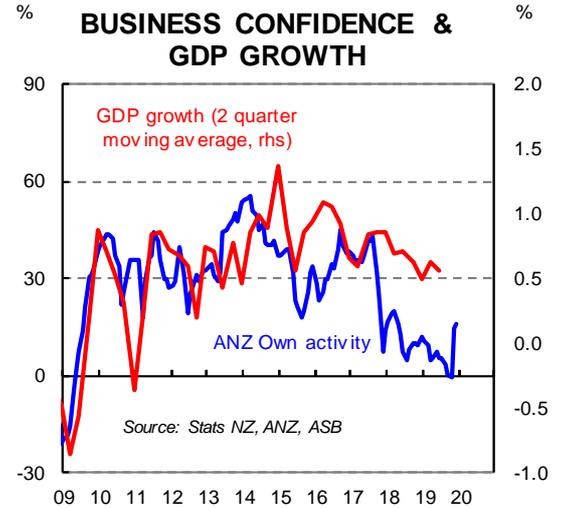
## Domestic events

Data	Date	Time (NZT)	Market	ASB
Merchandise trade balance, Jan, \$m	27/02	10:45am	-533	-250
ANZ Business Outlook, Own Activity next 12 mths, February	27/02	1:00pm	-	-

**We expect a trade deficit of circa \$250m in January.** Note NZ normally posts a trade deficit over January as dairy exports move past their seasonal peak. Looking at the underlying trends, earlier lifts in dairy prices are likely to boost dairy export values. Meanwhile, meat export values are likely to fall as meat prices recede from record highs. On the imports side, we expect import values growth to rebound from temporary weakness in December. All up, the annual trade deficit is likely to continue to narrow towards \$3.6 billion.

**ANZ monthly business confidence improved over November and December,** indicating the RBNZ's OCR cuts over 2019 were finally resulting in an improvement in the economic outlook – a positive and reassuring development for the RBNZ. However, other business surveys have subsequently failed to replicate the strength of the pick-up in confidence seen in the ANZ survey, which does cast some doubt over the extent of the improvement. **Furthermore, the outbreak of**

**Covid-19 has resulted in fairly dramatic economic disruption** over the first quarter of the year as authorities attempt to limit and control the spread of the virus. **Most of the ANZ survey results are received very early in the month when the coronavirus situation was still developing,** so it is unclear how much of business confidence will be dampened as a result of the Covid-19 economic impacts on the NZ export sector.



## Major International Events for the week ahead\*

Data	Date	Time (NZT)	Market	ASB
Australia Construction Work Done, Q4, %qoq	26/02	1:30 pm	-1.0	-1.0
Australia Private Sector Capex, Q4, %qoq	27/02	1:30 pm	0.5	1.5
Australia Private Sector Credit, January, %mom	28/02	1:30 pm	-	0.2
US PCE Deflator, January, %yoy	29/02	2:30 am	1.8	1.6

\*Originally published by CBA Global Markets Research on Friday 21<sup>st</sup> February at 4:27 pm

We expect the value of **construction work done in Australia** to fall 1.0% in Q4 2019, driven by similar trends which played out in Q3 2019. This includes a weak private sector tempered by solid public sector growth. We anticipate residential construction to continue to ease with a partial offset by non-residential work. The largest proportion of construction work done, engineering work, tracked sideways last quarter and we expect this to continue into Q4 2019.

Our forecast is for the actual volume of **Australian Q4 2019 capex** to increase by 1.5% after a 0.2% contraction in Q3 2019. Business demand for credit is soft and CBA's PMIs are pointing to non-mining investment staying subdued in the near term.

Total **credit to the private sector in Australia** rose by 0.2% in December with annual growth sitting at 2.4%. There has been a broad-based softening in both housing and business credit growth. While the *flow* of lending has been growing strongly, the stock has not increased proportionally due to households paying down their mortgages faster in the low rate environment. We expect credit to grow by 0.2% in January and annually at 2.4%.

Already-released CPI data suggest the headline **US PCE deflator** will stabilise at 1.6-1.7%yoy in January.

## 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	0.5	0.4			
CPI - A%	1.5	1.9	2.3	2.1	1.9	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	Dec-19 << actual	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
(end of quarter)			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

### ASB foreign exchange forecasts

	Sep-19	Dec-19 << actual	Mar-20	Jun-20	Mar-21	Mar-22	Mar-23
(end of quarter)			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

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