

# Economic Weekly

30 January 2018

## US watch

**Attention this week will largely be contained to the US.** Not only is the US Federal Reserve due to meet later in the week before Non-farm Payrolls on Friday, but any further comments around America First policies will also be in the spotlight. Locally, attention will be on how NZ's net migration picture is changing given the implications of lower population growth on the wider economy (see the Chart of the Week below). **We also spend some time looking at what some of the wider influences are likely to be on the NZD over 2018.**

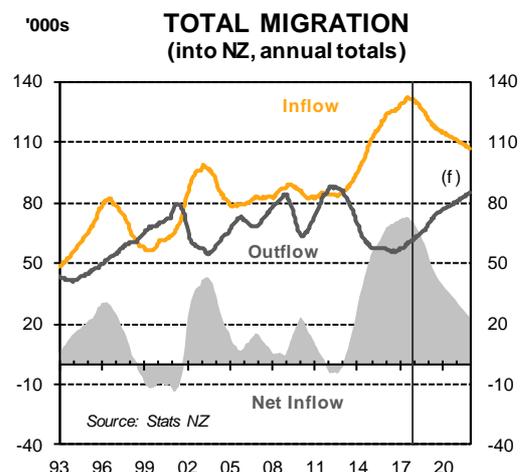
### Key events and views

<a href="#">Key Insights</a>	NZD checklist.
<a href="#">Foreign exchange</a>	The recent USD weakness was further exacerbated last week.
<a href="#">Interest rates</a>	Local rates will take direction from offshore events this week.
<a href="#">Domestic events</a>	Trade balance, net migration, building consents.
<a href="#">International events</a>	The US PCE deflator, the FOMC rate decision, Australian inflation are key this week.
<a href="#">Calendars</a>	NZ and International calendar of upcoming economic events.

### Chart of the Week: Changing History

This week, we are looking to Friday's International Travel and Migration release. Net migration into NZ has peaked and we expect to see migration continuing to slow over the coming years. Although record-high levels of net migration have been a contentious issue at times (e.g. around house prices), it has also been one of the key supports of NZ's growth story. As a result, as this tap turns off slowly, so does one support for the NZ economy.

Over the past few years, elevated net migration between NZ and Australia has been the main driver of the overall migration story. NZ's labour market was relatively stronger than Australia's, encouraging Kiwis to come home but also Australians to jump across the ditch. However, Australia's labour market is back on its feet and, as a result, we are starting to see a pick-up in outflows to Australia. We will be watching this trend closely due to its implications for NZ's overall population growth and therefore, economic growth. But luckily for us, the NZ economy is not a one-show pony. So, while one 'trick' may be losing its shine, there are plenty of others to take its place including low interest rates and improving incomes (both from the dairy recovery and record-high Terms of Trade).



## Key Insights this week: NZD checklist

**The NZD has been in the spot light**, with the NZD currently around 73.2 US cents. It briefly touched 74 US cents last week, before declining in the wake of the weaker than expected NZ CPI print. The NZD TWI at around 74.8 compares to its November 2017 trough of just over 72, consistent with our view that the late 2017 dip in the NZD was not consistent with NZD fundamentals and was likely to short-lived.

### What then are some of the wider influences impacting on the NZD over 2018?

Our FX forecasts on page 3 suggest that the NZD is expected to remain resilient over 2018. Below, we provide a checklist on some key NZD influences.

**Positive global sentiment.** Momentum in the global economy is being underpinned by widespread growth in Europe, Asia and North America. Market sentiment remains upbeat, with equity markets continuing to test record highs, market volatility remaining low, and with further signs that the global upswing has considerable momentum. Last week, the IMF released updated [forecasts](#), with the outlook for global growth in 2018 at 3.9%, the strongest since 2011. Consensus forecasts of trading partner growth also continue to be revised up. This positivity has supported currencies such as the NZD and the AUD.

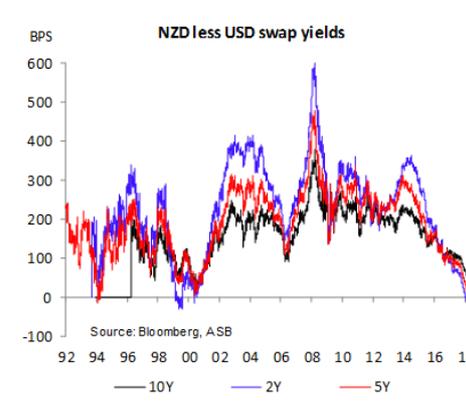
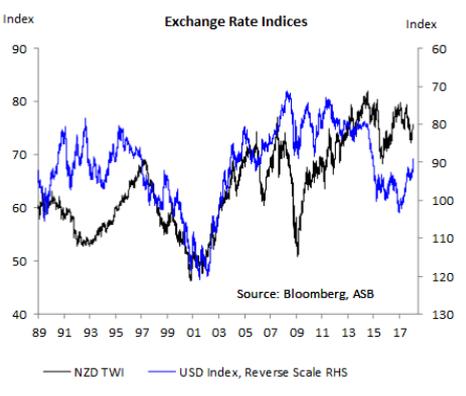
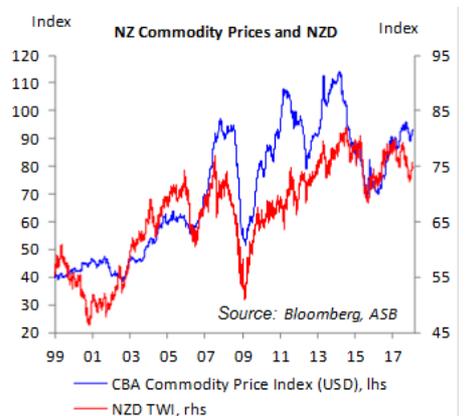
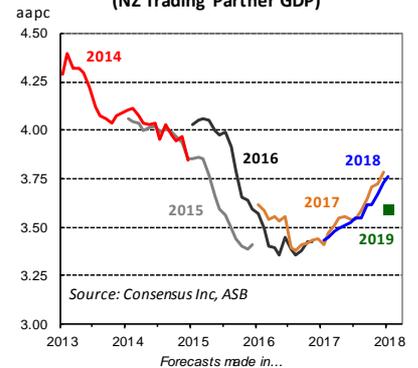
**NZ external imbalances are mild.** The resurgent global backdrop has underpinned strong demand for our export commodities, while the weaker USD has helped to push up USD-denominated export prices. High manufacturing capacity has restrained price increases for non-commodity imports, with our goods Terms of Trade at record highs. The strengthening tourism sector has helped underpin export incomes and boost GDP. Our current account deficit has remained below 3% of GDP, and is well off the radar screens of ratings agencies and overseas creditors.

**USD weakness.** Despite relatively high US interest rates and the prospect of further Fed hikes, the broader USD index continues to hover around 3-year lows as the dollar is overshadowed by the strengthening euro and yen. Last week's comments by US Treasury Secretary Mnuchin on the USD dollar - "obviously a weaker dollar is good for us as it relates to trade and opportunities" - were at odds with the standard strong dollar rhetoric from US administrations with US President Trump later re-emphasising his advocacy for a strong dollar.

**Narrowing NZ Interest rate differentials.** The NZD is high despite NZD interest rates being low, both in an absolute sense and relation to global counterparts. One of our key thematics is interest rate convergence, with rising (but lower) US interest rates converging with drifting (but higher) NZD rates. With at least two Fed hikes fully priced in for 2018, further compression for longer-term yields is likely given our view of no OCR hikes until 2019.

There are the usual risks around our forecasts. **The NZ economy is currently in a sweet spot of solid growth and low inflation, and the value of the NZD currently largely reflects that.** We remain somewhat wary, however, of the potential for an adverse shock to derail the global expansion and take the NZD down a peg or two. Asset prices could be primed for a fall as global interest rates move up. Increasing trade protectionism could also dampen the outlook despite our progress towards more trade liberalisation.

**EVOLUTION OF CONSENSUS FORECASTS (NZ Trading Partner GDP)**



## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	Year ago	ST Bias	Support^	Resistance^	MT Bias
NZD/USD	0.7323	0.7322	0.7093	0.7267	FLAT/DOWN	0.7200	0.7450	UP
NZD/AUD	0.9042	0.9165	0.9098	0.9618	FLAT/DOWN	0.8920	0.9150	DOWN
NZD/JPY	79.80	81.08	80.07	83.15	FLAT	78.60	81.00	DOWN
NZD/EUR	0.5912	0.5973	0.5940	0.6771	FLAT/DOWN	0.5820	0.6000	FLAT
NZD/GBP	0.5203	0.5237	0.5276	0.5777	FLAT/DOWN	0.5120	0.5280	FLAT
TWI	74.8	75.2	74.2	79.5	FLAT/DOWN	73.50	76.00	FLAT

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

### NZD Recap

**The recent USD weakness was further exacerbated last week as the US Administration appears to have moved its focus from tax reform to its America First policy.** President Trump's new tariffs on solar panels and washing machines, combined with comments from the US Treasury Secretary that "a weaker dollar is good for us as it relates to trade and opportunities," saw the USD index hit a three-year low last week and NZD/USD hit a 5-month high. However, this was short-lived as Thursday's much weaker than expected NZ Q4 CPI read saw the NZD/USD and NZD/AUD both down by roughly 1 cent, with the NZD Trade Weighted Index falling around 1.3%. With questions raised around the timing of OCR hikes following the soft CPI result, there is a chance that the NZD/USD will remain under slight downward pressure this week. However, with key tailwinds still intact (a supportive global backdrop, synchronised global upswing, equity market strength, high export commodity prices and still-low measures of market volatility), the extent of any weakness is likely to be limited.

**After recently increasing our European currency forecasts, the euro lifted higher again last week.** The European Central Bank (ECB) left interest rates and asset purchases unchanged, but upbeat comments by Mario Draghi on the growth outlook supported the currency. Speculation is growing that the ECB will announce the end of its QE program in June, which should continue to support the euro.

### Near-term Impact

**USD developments will be the key focus this week.** In the US this week, the US Federal Reserve's policy announcement is on Thursday morning followed by Non-farm Payrolls on Friday night. The USD has started the week on the front foot after the US core Personal Consumption Expenditure (PCE) deflator came in on expectations (but still some way below the 2% target at 1.5%). No change is expected from the US Federal Reserve, but as always, any comments on the outlook and potential timing for the next rate hikes will be closely watched.

**Local and Australian events are expected to have minimal currency implications this week.** The Australian CPI could see a short-term dip in the NZD/AUD if headline inflation rises more than expected. In NZ, building consents and net migration (both Friday) are the key data releases but are unlikely to cause any currency volatility.

### Medium-term outlook

**Our medium-term bias remains a weaker USD,** reflecting narrowing USD interest rate differentials as other central banks contemplate policy tightening ahead of the Fed. **The NZD is expected to remain broadly supported** by its solid economic outlook, strong NZ commodity export prices and historically high Terms of Trade and strong demand as global central banks/other real money managers continue to increase NZD exposures.

ASB foreign exchange forecasts (end of quarter)	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Mar-20
			<< actual	forecast >>					
NZD/USD	0.73	0.72	0.71	0.72	0.73	0.74	0.75	0.76	0.79
NZD/AUD	0.95	0.92	0.91	0.90	0.90	0.90	0.90	0.90	0.90
NZD/JPY	82	81	80	79	78	78	79	79	79
NZD/EUR	0.64	0.61	0.59	0.60	0.59	0.59	0.59	0.60	0.60
NZD/GBP	0.56	0.54	0.53	0.53	0.53	0.53	0.53	0.53	0.54
NZD TWI	78.4	76.4	74.3	74.6	74.7	75.0	75.1	75.7	76.6

## Interest Rate Market

<u>Wholesale interest rates</u>	Current	Week ago	Month ago	Year ago	ST Bias	MT Bias
Cash rate	1.75	1.75	1.75	1.75	FLAT	UP
90-day bank bill	1.91	1.88	1.88	1.98	FLAT	UP
2-year swap	2.18	2.25	2.21	2.44	FLAT	UP
5-year swap	2.72	2.78	2.68	3.05	UP	UP
10-year swap	3.26	3.30	3.14	3.56	UP	UP
10-year govt bond yield	2.93	2.97	2.73	3.36	UP	UP
Curve Slope (2s10s swaps)	1.08	1.06	0.92	1.13	UP	DOWN

\* Current as at 9.30am Monday; week ago as at Monday 5pm

### Market Recap

**Local NZD swap rates started the week 3-7 bps lower across the curve compared to a week ago, with larger falls in the 2-5 year window.** The weaker-than-expected NZ CPI outturn was the major catalyst, with the bellwether NZD 2-year swap rate down 8bps immediately following the CPI print. Market pricing for the OCR was pared back, but the market is still biased towards OCR hikes, with around 15bps of tightening priced in by the end of this year, and with a full hike priced in till next March. By contrast, US rates start this week 2-5bp firmer in yield than a week ago, supported by pending Fed tightening and the positive global backdrop. Yields in Australia and Europe are also higher, with curve steepening prevalent, with signals from the ECB and BOJ that no shifts in policy direction are imminent. Concerns of the lack of action in resolving the US debt ceiling have seen Treasury yields widen relative to US swaps, with 10-year Treasury yields at 2.70%, their highest since April 2014.

### Near-term NZD interest rate outlook

**Local rates will take direction from offshore events this week. Shorter-term local yields are expected to remain anchored,** with no immediate catalysts suggesting yields need to be higher. We expect Australian CPI inflation to lift to 2.0% yoy, but for the core measures to come in at just 0.5% qoq (+1.9% yoy), which should cap Australasian yields. **Our bias is for the curve to steepen, with longer-term local yields expected to drift higher, in line with global counterparts.** The Fed is not expected to move rates this week, the last meeting before Yellen steps down as Fed chair and Powell takes over. Nevertheless, the Fed statement is expected to depict a solid activity outlook and signal pending Fed hikes. This should see NZ rates continue to outperform US rates over the short-term horizons. Our bias is for longer-term spreads between NZ and US yields to narrow further.

### Medium-term outlook

Our core macro view is that the RBNZ will start lifting the OCR in early 2019, with the risk of a later start. We expect a moderate pace of tightening by historical standards, and a low OCR endpoint of around 3.5% this cycle. Combined with our expectation of at least two Fed hikes over 2018, this should see local yields move closer to offshore equivalents. **This should help push up short-term NZD rates and help to flatten the local curve. Our expectation of a flatter NZD curve crucially depends on the assumption that local yields remain reasonably well anchored to global counterparts and that the lift in global yields is modest.** With still-considerable uncertainties over the persistence of low global inflation and a downward global risk profile, we expect long-term global yields to drift higher.

### ASB interest rate forecasts

	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Mar-20
(end of quarter)			<< actual	forecast >>					
NZ OCR	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.50
NZ 90-day bank bill	1.96	1.96	1.88	1.9	1.9	2.0	2.1	2.3	2.8
NZ 2-year swap rate	2.33	2.21	2.21	2.3	2.4	2.5	2.7	2.8	3.3
NZ 10-year Bond	2.97	2.96	2.75	3.1	3.2	3.3	3.4	3.4	3.6

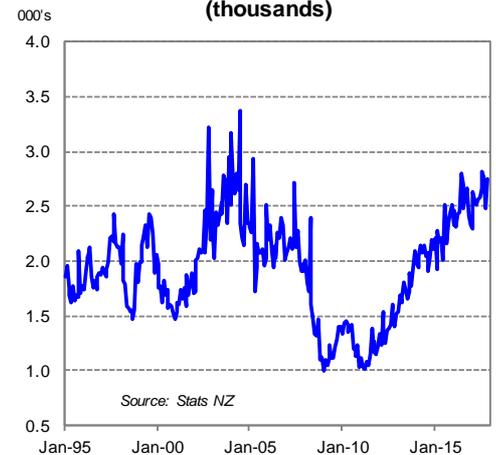
## Major Domestic Events for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Residential Building Consents, Dec, % mom	2/2	10.45 am	+10.7	-	-
Net Migration, Dec, 000's	2/2	10.45 am	5,610	-	5,500

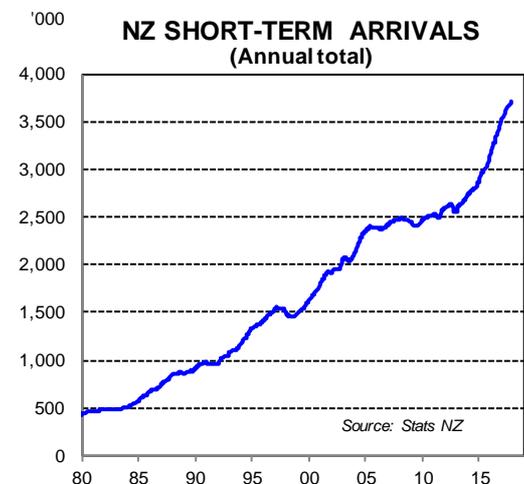
**Residential consent issuance** bounced back strongly in November, with house building demand apparently less concerned by the change in Government than we expected. Over the second half of 2017, election uncertainty, capacity constraints, credit conditions and a slowing housing market have constrained house building demand. **Looking ahead over the next few months, additional uncertainty (as developers await further details of the proposed KiwiBuild plan) may weigh on construction demand. But this should be a short-lived dip.** We expect further growth in Wellington housing construction over the coming year, and for Auckland activity to hold up at very high levels.

**We expect a net permanent and long-term (PLT) inflow of around 5,500 persons in December.** This would see the annual net PLT inflows fall below 70,000 persons for the first time since September 2016. Arrivals are still outnumbering departures by more than two-to-one, but we expect this gap to close as the strengthening Australian labour market facilitates a further lift in PLT departures, whilst migration policy tightening in NZ and the strengthening global economy should see PLT arrivals ease. We expect net PLT inflows to slow to around 50,000 persons by the end of 2019, and to just over 20,000 persons by the end of 2021. A small pullback in seasonally-adjusted tourism arrivals is possible given evidence of further peak-spreading on net inflows in earlier months. Nevertheless, **we expect annual visitor numbers to remain close to (and potentially set) a record high, confirming that the strong tourism market remains a major support to the New Zealand economy.**

**RESIDENTIAL BUILDING CONSENTS (thousands)**



**NZ SHORT-TERM ARRIVALS (Annual total)**



## Major International Events for the week ahead

Data	Date	Time (NZT)	Market	ASB
Australia Business Conditions, December	30/01	1:30pm	-	-
US Core PCE Deflator, December, %yoy	30/01	2:30 am	1.5	1.6
Australia Inflation, Q4, %qoq	31/01	1:30 pm	0.7	0.7
Bank of Japan Summary of Opinions	31/01	12:50 pm	-	-
Japan Industrial Production, December, %mom	31/01	15:50 pm	1.5	0.5
US Federal Reserve Interest Rate Announcement, %	31/01	3:00 am	1.25-1.50	1.25-1.50
Australia CBA Manufacturing PMI, January	01/02	11:00 am	-	-
Australia CoreLogic Dwelling Prices, January	01/02	12:00 pm	-	-0.3
Australia Building Approvals, December	01/02	1:30 pm	-7.6	-12.5
US ISM Manufacturing, January, Index	02/02	4:00 am	58.6	58.1

**Australian business conditions** remain well above their long-run average and are at solid levels across most industries. The construction sector is looking particularly good. However, the retail sector is lagging behind.

We are forecasting a modest 0.5% result for **underlying Q4 Australian inflation**. The annual rate is expected to stay steady around 1.9%. We expect headline inflation to come in at a stronger 0.7% on the back of a solid increase in petrol prices over the period.

The **Bank of Japan's "summary of opinions"** for the 23 January meeting may shed some light on the central bank's bond buying program that has garnered some market interest.

**Japanese industrial production** will likely have expanded 0.5% over December, largely due to solid global growth.

**Australia's manufacturing PMI** picked up in December and is now close to a record high.

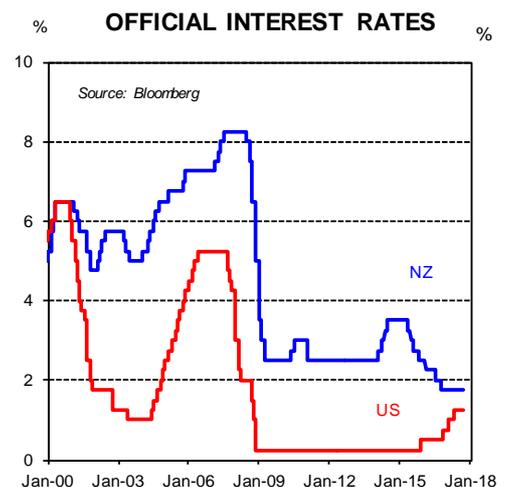
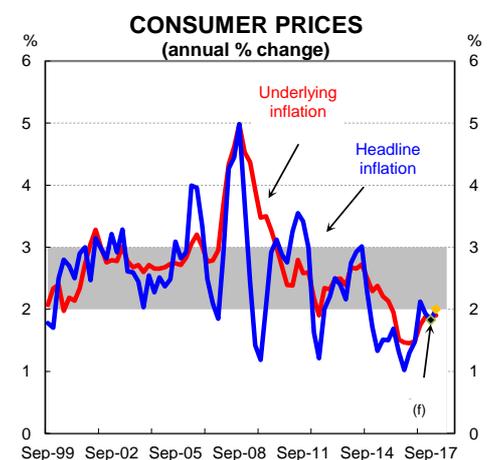
**Australian dwelling prices** have fallen over the past two months, weighed down by falls in Sydney property prices. The daily data are pointing to another 0.3% fall over the month of January.

**Australian building approvals** surged over December due to a large development project in Victoria. However, for the month of January, we are forecasting a 12.5% fall as approvals backtrack again.

Already-released **US CPI** data suggest the **core PCE deflator** accelerated to 1.6%pa over December. This is a reasonable lift from the August low of 1.3%pa. However, the weakness in average earnings suggests Q4 employment costs remained soft, rising only 0.4% (2.4%pa).

We expect no new policy announcements from the **US Federal Reserve**. The Funds rate is slated to remain steady at 1.25-1.50% while the Fed's balance sheet will continue to shrink by \$20 billion per month.

Already-released **US regional manufacturing surveys** suggest that the national ISM manufacturing index dropped from 59.8pts in December to 58.1pts in January, still a very strong level.



## Global Data Calendars

### Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Tues 30	12:50	JN	Retail sales	Dec	m%ch	1.8	~	~
	13:30	AU	NAB business conditions	Dec	~	12.0	~	~
Wed 31	12:50	JN	Industrial production	Dec P	m%ch	0.5	~	0.5
	13:30	AU	CPI	Q4	q%ch	0.6	~	0.7
	14:00	CH	Manufacturing PMI	Jan	Index	51.6	51.5	~
	18:00	JN	Consumer confidence index	Jan	Index	44.7	~	~
Thu 1	10:00	NZ	ANZ job advertisements	Jan	m%ch	-0.3	~	~
	11:00	AU	CBA Australia PMI manufacturing	Jan	Index	57.1	~	~
	12:00	AU	CoreLogic house px	Jan	m%ch	-0.4	~	~
	13:30	AU	Import price index	Q4	q%ch	-1.6	~	~
	13:30	AU	Building approvals	Dec	m%ch	11.7	~	-12.5
	14:45	CH	Caixin China PMI manufacturing	Jan	Index	51.5	51.5	~
Fri 2 Feb	10:00	NZ	ANZ consumer confidence index	Jan	Index	121.8	~	~
	10:45	NZ	Building permits	Dec	m%ch	10.8	~	~
	10:45	NZ	Net migration	Dec	~	5,610	~	5,500
	13:30	AU	PPI	Q4	q%ch	0.2	~	~

### Calendar - North America & Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 29	13:30	US	PCE deflator	Dec	m%ch	0.2	0.1	~
	15:30	US	Dallas Fed Manufacturing Activity	Jan	~	29.7	25.3	~
Tue 30 Jan	09:30	UK	Net consumer credit	Dec	£bn	1.4	~	~
	10:00	EC	Economic confidence	Jan	~	116.0	~	~
	10:00	EC	GDP	Q4 A	q%ch	0.6	~	~
	15:00	US	Conf. Board consumer confidence	Jan	Index	122.1	123.1	~
Wed 31	00:01	UK	GfK consumer confidence	Jan	~	-13.0	~	~
	10:00	EC	Unemployment rate	Dec	%	8.7	~	~
	13:15	US	ADP employment change	Jan	000	250.0	185.0	~
	19:00	US	FOMC rate decision (upper bound)	Jan	%	1.50	1.50	~
Thu 1 Feb	09:00	EC	Markit Eurozone manufacturing PMI	Jan F	Index	~	~	~
	09:30	UK	Markit UK PMI manufacturing	Jan	Index	56.3	~	~
	13:30	US	Nonfarm productivity	Q4P	%	3.0	1.2	~
	13:30	US	Unit labor costs	Q4 P	%	-0.2	1.0	~
	15:00	US	ISM manufacturing	Jan		59.7	58.9	~
Fri 2 Feb	09:30	UK	Markit/CIPS UK construction PMI	Jan	~	52.2	~	~
	10:00	EC	PPI	Dec	m%ch	0.6	~	~
	13:30	US	Change in nonfarm payrolls	Jan	000	148.0	180.0	~
	15:00	US	Uni. of Michigan sentiment	Jan F	Index	94.4	95	~
	20:30	US	Fed's Williams speaks in San Francisco					

## Key Forecasts

### ASB NZ economic forecasts

	Jun-17 « actual	Sep-17 forecast >>	Dec-17 forecast >>	Mar-18 forecast >>	Jun-18 forecast >>	Sep-18 forecast >>	Dec-18 forecast >>	Mar-19 forecast >>	Mar-20 forecast >>
GDP real - Q%	1.0	0.6	0.6	0.5	0.9	1.0	1.0		
GDP real - A%	2.8	2.7	2.9	2.6	2.6	3.0	3.4	3.9	3.3
GDP real - AA%	3.3	3.0	2.9	2.8	2.7	2.8	2.9	3.2	3.6
CPI - Q%	0.0	0.5	0.1	0.4	0.5	0.5	-0.1		
CPI - A%	1.7	1.9	1.6	1.0	1.5	1.5	1.3	1.6	1.7
HLFS employment growth - Q%	-0.1	2.2	-0.6	1.0	0.6	0.7	0.6		
HLFS employment growth - A%	3.1	4.1	2.7	2.6	3.3	1.8	3.0	2.5	1.8
Unemployment rate - %sa	4.8	4.6	4.7	4.5	4.4	4.1	3.9	3.8	3.5
Annual current account balance as % of GDP	-2.7	-2.6	-2.7	-2.4	-2.7	-3.0	-3.1	-3.0	-2.9

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

	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Mar-20
(end of quarter)			« actual	forecast >>					
NZ OCR	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.50
NZ 90-day bank bill	1.96	1.96	1.88	1.9	1.9	2.0	2.1	2.3	2.8
NZ 2-year swap rate	2.33	2.21	2.21	2.3	2.4	2.5	2.7	2.8	3.3
NZ 10-year Bond	2.97	2.96	2.75	3.1	3.2	3.3	3.4	3.4	3.6

### ASB foreign exchange forecasts

	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Mar-20
(end of quarter)			« actual	forecast >>					
NZD/USD	0.73	0.72	0.71	0.72	0.73	0.74	0.75	0.76	0.79
NZD/AUD	0.95	0.92	0.91	0.90	0.90	0.90	0.90	0.90	0.90
NZD/JPY	82	81	80	79	78	78	79	79	79
NZD/EUR	0.64	0.61	0.59	0.60	0.59	0.59	0.59	0.60	0.60
NZD/GBP	0.56	0.54	0.53	0.53	0.53	0.53	0.53	0.53	0.54
NZD TWI	78.4	76.4	74.3	74.6	74.7	75.0	75.1	75.7	76.6

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