

## RBNZ still on track for November OCR cut

- The RBNZ reaffirms its strong easing bias at the September OCR review.
- We continue to expect a cut in November, focus is now on if further cuts will be required early next year.
- Weak inflation measures, a higher TWI and increased funding costs are the main factors that could prompt a second cut.

**RBNZ left the OCR unchanged at 2% at the September OCR review**, as widely expected. However, the RBNZ did deliver a clear message that it anticipates cutting at least once more – helping correct market pricing for rate cuts (which had drifted higher in recent weeks) and helping nudge the TWI lower. The statement was as we expected and largely similar to August's. **A key focus was the RBNZ's language on the NZD** – which is that it still needs to be lower despite the RBNZ conceding that some of the recent lift is warranted by higher dairy prices.

The RBNZ appears fairly wary of **recent data upsides**. This likely reflects the fact that inflation risks remain so heavily skewed to the downside and as a result the RBNZ does not want to place too much weight on stronger growth when inflation pressures are still surprisingly weak. Recent **GDP growth figures were deemed 'consistent'** with expectations, so the RBNZ is not banking too much upside from the positive revision. Likewise, the **RBNZ took a conservative approach to the dairy price outlook** as it remains early days in the season (in contrast we remain very confident that recent price gains will be sustained).

From our perspective, a **November OCR cut is largely a done deal**. The RBNZ **maintained a strong easing basis** (further policy easing *will* be required). Furthermore, inflation risks remain skewed to the downside so it seems fairly unlikely for data to outperform to such an extent the RBNZ refrains from cutting further. Also, the RBNZ learned the hard way that by opting to delay a cut (as it did in June) risks losing credibility with the market and seeing the NZD higher (all else equal).

How future economic data evolve will influence the **probability of further cuts early next year**. The RBNZ was 50/50 on this risk back at the August MPS, and the tone of the September statement suggests this balance of probabilities has not altered significantly. **The key events** ahead of the RBNZ's November MPS include **CPI** (18<sup>th</sup> October), **inflation expectations** (Consensus Economics mid-October, RBNZ Survey 2<sup>nd</sup> November) and **Q3 labour market data** (2<sup>nd</sup> November). In addition to these releases, the **path of the TWI** will also be a key driver of policy as well as any further stretch in **funding costs** (see chart of the week).

The **NZ economic calendar is fairly quiet over the next few weeks**. On Friday we get another monthly read on building consents and **business confidence**. Business and consumer confidence are both now gradually improving – and encouraging sign that RBNZ stimulus is gaining traction. Next week's **Quarterly Survey of Business Opinion** will provide more additional insights into business conditions over the September quarter. Key metrics such as difficulty of finding labour and reported price/cost increases will be closely scrutinised by the RBNZ before the next full review of its own economic forecasts.

### Foreign Exchange

### Interest Rates

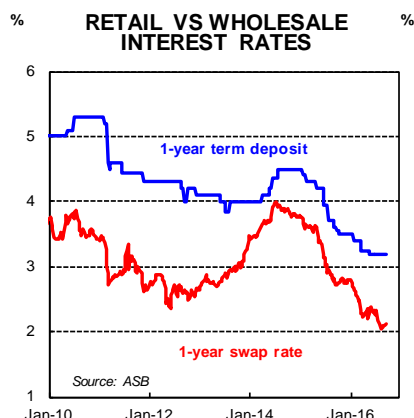
### Week Ahead

### Week in Review

### Global Calendars

- The NZD was a touch weaker last week.
- NZ interest rates moved lower last week on the RBNZ's firm easing bias.
- Building consents and RBNZ credit growth for August; ANZ Business Outlook for September.
- GDT lifts; net migration stays strong; RBNZ signals easing bias, Fonterra announces record profit.
- Eurozone and Japan CPI; Australia private sector credit; Japan industrial production; China PMI.

### Chart of the Week: Funding costs re-enter the equation



**NZ lending demand has increased with lower interest rates**, but at the same time banks' domestic funding growth has slowed. Meanwhile, **offshore long-term funding also remains relatively expensive**, as investors are demanding higher risk premiums globally for investing in the banking sector.

The good news for NZ savers is that **higher funding costs are resulting in higher term-deposit rates** than would otherwise be the case for the current level of the OCR (as indicated by the 1-year swap rate in the opposite chart). In turn, this increased funding cost is starting to be passed on to borrowers.

Currently these **moves are fairly small by historical experience**, particularly compared to the Global Financial Crisis. Nonetheless, the RBNZ uses the OCR to influence broader interest rates in the economy. Should funding costs continue to increase, and interest rates further decouple from the OCR, **the moves could be enough to convince the RBNZ that another OCR cut is needed next year**.

## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7236	0.7296	0.7312	0.6698	0.6336	FLAT	0.7120	0.7380
NZD/AUD	0.9493	0.9685	0.9578	0.8925	0.9037	FLAT	0.9380	0.9700
NZD/JPY	73.12	74.43	73.49	75.47	76.17	FLAT/DOWN	72.10	74.30
NZD/EUR	0.6446	0.6533	0.6476	0.5992	0.5672	FLAT/DOWN	0.6360	0.6550
NZD/GBP	0.5584	0.5596	0.5535	0.4750	0.4160	FLAT/DOWN	0.5500	0.5670
TWI	77.0	77.9	77.4	71.6	69.2	FLAT/DOWN	76.00	79.75

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

The NZD saw a touch of weakness last week, partly aided by the RBNZ's decision to hold the OCR rate steady, but also by the clear underlining that more easing is in the pipeline. For the NZD, the slight miss in the GDT dairy auction was more-or-less offset by the surprise lift in the season's milk price estimate from Fonterra. However, general USD strength was a key determinant, with commodity currencies such as the NZD relatively underperforming. Talk of a parity-party with the Australian Dollar was put on ice, with the latter finding some support after the RBA's minutes. This generated a downward revision in market pricing for further rate cuts this year, while the RBNZ still looks set to cut in November.

After last week's plethora of central bank meetings, the week ahead is somewhat quieter. This could mean further consolidation for the USD, but it would be a surprise to see recent ranges face any great tests, at least in the early part of the week. Friday brings US PCE inflation and inflation data from Japan and Europe but the main opportunity for volatility may well lie in political development as the US election campaigns rumble on. The Presidential candidates will have their first head-to-head debate this week.

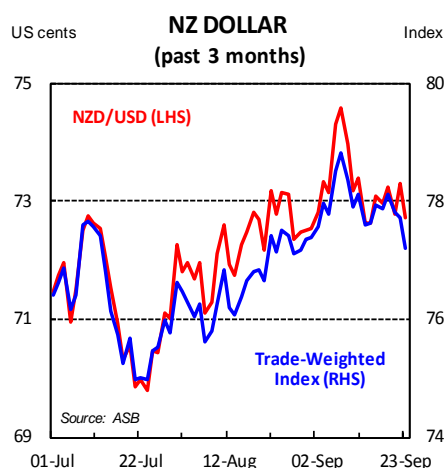
### Short-term outlook:

### Key data

### Date

### Time (NZT)

### Market



US New home sales, August

27/9

3.00 am

600k

US Consumer confidence, September

28/9

3.00 am

98.8

US Durable goods orders, August, mom

29/9

1.30 am

-1.5%

NZ Building consents, August, mom

30/9

10.45 am

-

Japan, unemployment, August

30/9

12.30 pm

3.0%

Japan, CPI ex food/energy, September, yoy

30/9

12.30 pm

0.2%

**Key events:** NZD: Aug building permits (Fri); Sep business confidence (Fri). USD: Jul house prices (Tue); Aug durable goods orders (Wed); Q2 GDP 3rd estimate (Thu); Aug personal income & PCE deflator (Fri). AUD: Aug private sector credit (Fri). JPY: Aug CPI (Fri). EUR: Sep CPI (Fri). UK: Q2 GDP 3rd estimate (Fri); Q2 balance of payments (Fri).

**Speakers:** FOMC: Tarullo (Tue), Kaplan (Tue), Vice Chair Fischer (Wed), Chair Yellen (Wed & Fri), Bullard (Wed), Evans, Mester, George, Harker, Lockhart & Powell (Thu), Kashkari (Fri). RBA: Edey (Wed). BoJ: Kuroda (Thu). ECB: Draghi (Tue & Wed), Nowotny (Tue), Hansson (Wed); Praet (Thu); Constancio (Fri). BoE: Shafik (Wed).

### Medium-term outlook:

### Last Quarterly Economic Forecasts

We amended the GBP, EUR and JPY outlook in late June after the Brexit vote. The UK's decision to exit the EU at the June 23 referendum saw us cut our near-term GBP/USD estimate in response to likely recession and uncertainty. The exit vote provoked the buying of safe-haven currencies, strengthening the Yen in particular.

Meanwhile, the NZD remains supported by relatively high Terms of Trade, relatively high interest rates, increased offshore investor demand and a structural improvement in the current account deficit. The NZD/USD risks remaining above our forecast range of 0.67-0.68. However, we expect the RBNZ to cut interest rates once more in 2016, in November. While this will potentially weigh on the NZD/USD, a lowered chance of Fed interest rate hikes will limit NZD/USD downside. Over 2017, we see the NZD/USD remaining elevated in a range of 0.70-0.73.

We still expect the RBNZ to cut the OCR to 1.75%, but the RBA is likely to move its cash rate to 1.25%. The RBA's May/August rate cuts and prospect for more means we have firmed our NZD/AUD medium-term forecast to 0.95. Although our forecasts had NZD/AUD remaining around 0.93 over the near term, that pair is likely to trade around 0.94-0.97 until the RBNZ cuts the OCR further.

There is a firm chance the NZD now remains more elevated against the EUR than had previously thought. Following the UK's June 23 vote to leave the EU, there is now a higher chance that the ECB provides more stimulus to the European economy. However, the Eurozone's current account surplus will continue to help support the EUR, limiting downside. In the near term we continue to see NZD/JPY hold above 70. Further out, the prospect for more BOJ easing should weaken the JPY, pushing NZD/JPY above 85 in 2017.

The GBP fell sharply in response to the UK's decision to leave the EU. Consequently, the GBP is now likely to remain lower than its pre-Brexit level and the NZD/GBP higher as a result.

## Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	2.00	2.00	2.00	2.25	2.75	FLAT
90-day bank bill	2.23	2.23	2.23	2.33	2.84	FLAT
2-year swap	2.06	2.13	2.01	2.30	2.78	DOWN
5-year swap	2.21	2.30	2.12	2.62	3.13	DOWN
5-year benchmark gov't stock	1.98	2.10	1.82	2.39	2.72	DOWN
NZSX 50	7297	7278	7391	6663	5688	FLAT

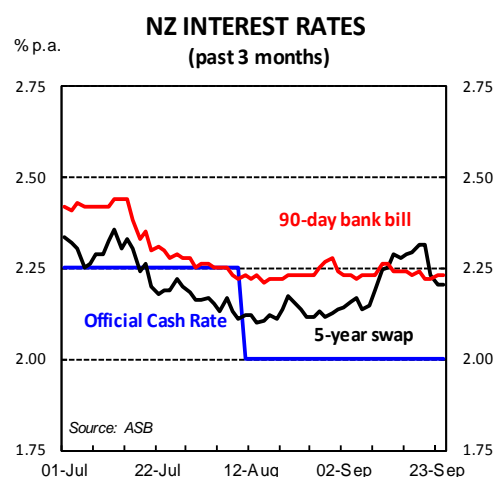
^Weekly support and resistance levels \* Current is as at 9.30am Monday; week ago as at Monday 5pm.

**NZ interest rates moved lower last week as the RBNZ left the OCR unchanged on Thursday while maintaining a firm easing bias.**

The 2-year swap rate fell 7 basis points over the week, while the 5-year swap fell 9 basis points. In its OCR statement, the RBNZ reiterated that "further easing will be required". These strong words were enough to reignite expectations of further OCR cuts which had begun dwindling leading into Thursday's statement. The market is now pricing in a 75% chance of a rate cut in November, in contrast to the roughly 50% chance priced in ahead of Thursday.

However, it wasn't only the RBNZ in action last week. The US Federal Reserve's rate announcement preceded the RBNZ on Thursday morning. While holding off from lifting interest rates, the Fed continued to signal one rate hike this year. However, in contrast to this, the Fed's infamous 'dot plot' signalled that expectations for future interest rates had been pared back. Combined, the impact on interest rates was relatively muted before the RBNZ's announcement.

### Short-term outlook:



### Key data

	Date	Time (NZT)	Market
Eurozone CPI	29/30	8.00 pm	+0.2%
JP CPI	30/9	12.30 pm	-0.5%
ANZ Business Confidence	30/9	1.00 pm	-
NZ Credit Growth	30/9	3.00 pm	-
US PCE Deflator	01/10	1.30 am	0.1%

**Comment:** After a busy week last week, the market looks set to be substantially quieter this week, with little major data on the horizon. However, Friday's ANZ Business Confidence report could garner some interest, especially in relation to the pricing intentions and inflation expectations components. The RBNZ remains very concerned about inflation expectations falling, given the sustained period of time headline inflation has now been low. US data will continue to be closely scrutinised for any evidence of the economy (in particular inflation and employment), lifting back to target. Strong data should see US interest rate hike expectations continue to build.

### Medium-term outlook:

#### Last Quarterly Economic Forecasts

**The RBNZ left the OCR on hold at 2%, as widely expected, on September 22.** In addition, **the RBNZ maintained a firm easing bias** of "our current projections and assumptions indicate that further policy easing will be required." The market was expecting a strong easing bias and, combined with "a lower exchange rate is needed", financial markets were not disappointed.

**The RBNZ's concerns were very much in line with those raised in the August MPS. Although the RBNZ is still concerned about housing risks, it is also now more concerned about the downside inflation risks, particularly if inflation expectations were to fall further.** The NZD Trade Weighted Index assumes the NZD will gently depreciate from around 76 beyond year-end, and there is a risk that the RBNZ will have to ease to a greater extent if the NZD doesn't follow that path. The NZD was again called out as making it difficult for the RBNZ to meet its inflation objective and in need of depreciation. However, at the same time, the RBNZ did acknowledge that some of the recent strength of the NZD was due to the gains in dairy prices.

**We continue to expect the RBNZ to cut once further, in November,** when the RBNZ has received the next set of key economic data, including key long-term inflation expectations, and has comprehensively redone its forecasts. **In addition, the risks remain skewed to a lower OCR than 1.75%, particularly if the NZD persists above the RBNZ's assumed level, inflation expectations weaken or funding pressures limit the extent to which banks pass on November's OCR cut.**

## Key international data for the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Eurozone CPI, September (provisional), yoy%	29/09	8.00 pm	-0.1	+0.2	-
Australia Private Sector Credit, August, mom%	30/09	2.30 pm	+0.4	+0.5	+0.5
Japan CPI, August, yoy%	30/09	12.30 pm	-0.4	-0.5	-0.3
Japan Industrial Production, August, mom%	30/09	12.50 pm	-0.4	+0.5	+0.5
China Manufacturing PMI, September, Index	01/10	2.00 pm	50.4	50.5	50.2

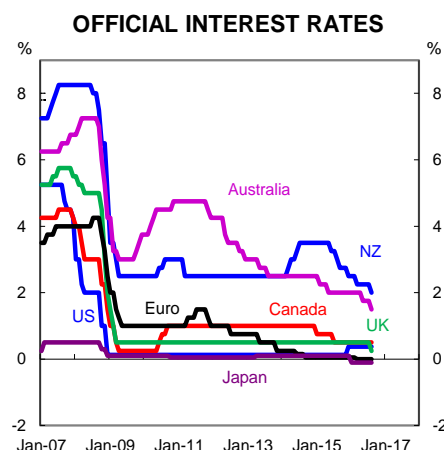
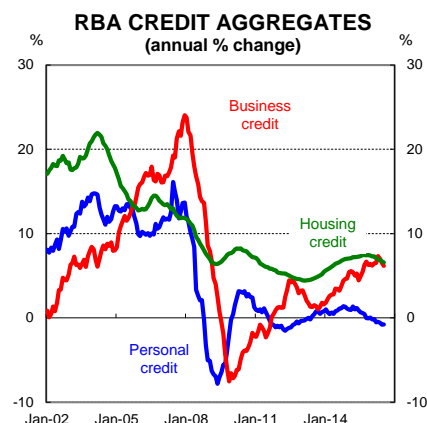
We expect a 0.5% increase in **Australian private sector credit**, which would see the annual rate tick down to 5.9%. Private sector credit growth has slowed, as a slowing in investor lending has outweighed higher business credit growth. This month's data pick up the early impacts of the RBA's August rate cut.

**Japanese inflation pressures are easing rapidly.** The BoJ's favourite core measure – excluding fresh food and energy – has collapsed from 1.3%pa in December 2015 to 0.5%pa in July 2016. We expect another step down to 0.4%pa or even lower. The upshot is that more policy support is required in Japan. But we do not think the BoJ's recent change to its policy framework to target the interest rate yield curve is enough to push Japanese inflation higher.

Already-released **Japanese export volumes for August** suggest Japanese industrial production increased solidly by around 0.5% in August. But the sharp strengthening of the yen could see industrial production weakening over the coming months.

Suspension of production in **China** during the G20 meeting and Mid-Autumn Festival is expected to slow **September's PMI figure**.

The positive base-effects related to the unwinding of previous oil price declines should support **annual headline Eurozone inflation in September**, and over the remainder of the year. That said, the excess capacity that remains in the Eurozone economy is a headwind for core inflation which continues to track at a very low rate despite the ECB's actions.



## NZ Data Preview: a look at the week ahead

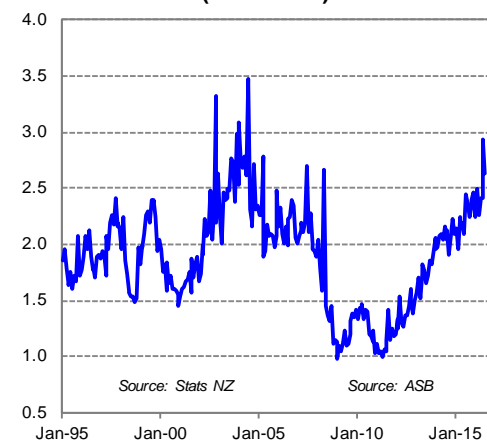
Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Building Consents, August, %mom	30/09	10.45 am	-10.5	-	-
ANZ Business Outlook, General Outlook, September, net %	30/09	1.00 pm	15.5	-	-
RBNZ Credit Growth, August, household credit, %mom	30/09	3:00 pm	+0.86	-	-

**Building consents fell 10.5% in July**, partially reversing the previous month's 22% gain and living up to its own reputation as a volatile series. Nonetheless, the **trend in building consents remains encouraging**, with steady broad-based growth across the country (with the exception of Canterbury, which continues to gradually ease from its post-earthquake rebuild peak). **We expect continued growth in building demand over the coming year, particularly Auckland.**

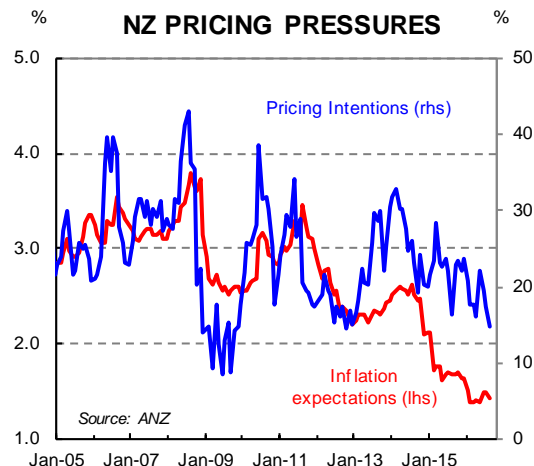
**Business confidence has improved on a seasonally-adjusted basis** and suggests the recent momentum in growth can continue. However, the real concern for the RBNZ is the ongoing weakness in inflation pressures. Market focus will be on **the 1-year-ahead measure of inflation expectations, which fell to 1.44% in August.**

**Household credit growth has remained strong** over the last few months, with annual lending growth now at its highest level since 2008. While the new LVR restrictions should see housing credit slow by the end of the year, we expect the recent momentum in lending to continue into August as low interest rates continue to support demand. Agricultural credit growth has been slowing since late 2015 and we expect that to continue. However, cashflows are expected to remain weak for some time, which will continue to drive a degree of growth, despite the recent dairy price lifts. Furthermore, many non-dairy agricultural sectors are faring well. Business credit growth is expected to remain steady, supported by the reasonable levels of economic growth we are expecting.

**RESIDENTIAL BUILDING CONSENTS**  
(thousands)



**NZ PRICING PRESSURES**





## Data Recap: weekly recap

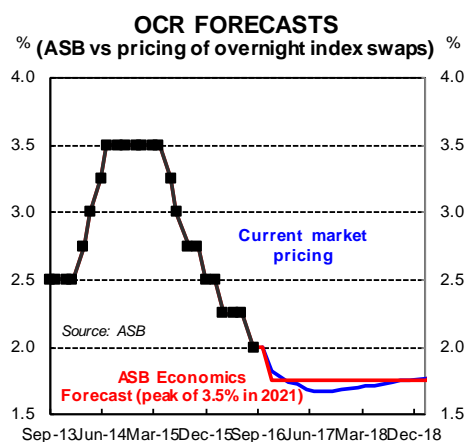
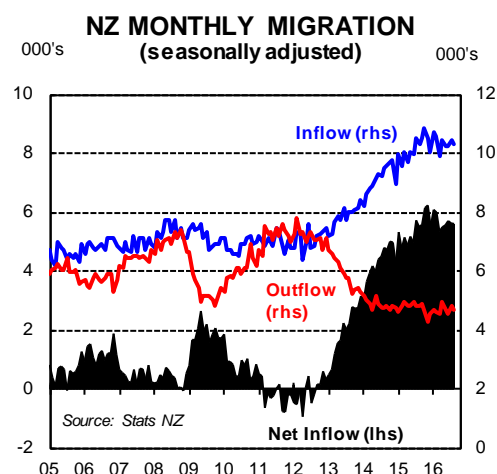
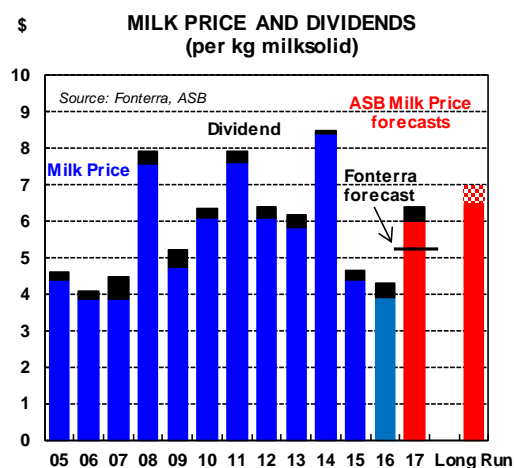
Data	Date	Actual	Market forecast	ASB Forecast
GlobalDairyTrade auction, whole milk powder, % change	20/09	-0.2	-	+8 to +10
Net migration, August	21/09	5,600	-	5,450
RBNZ OCR decision	22/09	2.00%	2.00%	2.00%
Fonterra annual results, earnings per share	22/09	\$0.51	-	-

**Dairy prices consolidated recent gains at last week's GDT auction.** Overall prices rose 1.7%, while WMP prices were largely unchanged (down 0.2%) after big moves in the three previous auctions. In view of the recent price surge, it is not surprising that dairy markets wanted to catch their breath. WMP prices, for example, have spiked 35.1% over August and September. From here, we expect prices to consolidate over the coming auctions as markets will need to take stock. In our view, **we expect continued production weakness to lift prices again later in the season.** On that basis, we look to NZ spring data that support or challenge our view that there is further global production weakness to come over 2016.

**Net migration is continuing to run at record annual highs,** but appears to be plateauing on a monthly basis. August seasonally-adjusted net migration was effectively stable, while annual net migration equalled June's record high. Monthly gross arrivals remain comfortably above 10,000, although they remain shy of the record level set back in October 2015. Monthly departures were also in line with their recent trend. Australia was the main source of non-resident arrivals, with Chinese arrivals falling back after a strong July. UK arrivals also lifted above 1,000 for the month in line with their normal seasonal pattern. People leaving NZ are chiefly returning to (or moving to) Australia, with Europe the next most popular destination.

The RBNZ **kept the OCR on hold at 2% as widely expected.** The clear easing bias of "further policy easing will be required" was retained. The key parts of the statement were very similar to the August Monetary Policy Statement assessment and the statement as a whole was very much in line with what we were expecting to see. We continue to expect the RBNZ to cut the OCR to 1.75% in November, with a high risk of a further cut to 1.5% in early 2017. **Key factors for determining a second cut include inflation expectations, the NZD and developments in bank funding costs.**

**Fonterra has announced improved financial results over the 2015/16 financial year.** Earnings per share settled at 51 cents, compared to 29 cents in 2014/15. Similarly, Fonterra's balance sheet ended the year in a stronger position. Debt reduced by \$1.6 billion to \$5.5 billion, while Fonterra's gearing ratio fell to 44.3% from 49.7%. The cash dividend was also confirmed at the previously-indicated 40 cents. However, the cash payout for farmers fell from 2014/15. All up and with the milk price confirmed at \$3.90/kg, the cash payout settled at \$4.30/kg. This was 35 cents lower than the \$4.65/kg for 2014/15.



## Global Data Calendars

## Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 26 Sep	17:30	JN	BOJ Kuroda makes a speech in Osaka					
Tues 27 Sep	11:50	JN	PPI services	Aug	y%ch	0.4	~	~
	11:50	JN	BOJ Minutes of July 28-29 meeting					
Wed 28 Sep	13:30	CH	Industrial profits	Aug	y%ch	11.0	~	~
	12:20	AU	RBA's Edey speech in Melbourne					
Thu 29 Sep	13:45	CH	WBC MNI consumer sentiment	Sep	Index	111.5	~	~
	11:50	JN	Retail sales	Aug	m%ch	1.5	-0.5	~
	13:30	AU	Job vacancies	Aug	%	-1.9	~	~
Fri 30 Sep	18:35	JN	Kuroda speaks at Security Association Conference					
	~	CH	BoP current account balance	Q2 F	RMB bn	59.4	~	~
	09:45	NZ	Building permits	Aug	m%ch	-10.5	~	~
	11:30	JN	Jobless rate	Aug	%	3.0	3.0	~
	11:30	JN	National CPI	Aug	y%ch	-0.4	-0.5	-0.3
	11:30	JN	BOJ summary of opinions at September 20-21 meeting					
	11:30	JN	Industrial production	Aug P	m%ch	-0.4	1.3	0.5
	12:00	NZ	ANZ business confidence	Sep	~	15.5	~	~
	13:00	AU	HIA new home sales	Aug	m%ch	-9.7	~	~
	13:30	AU	Private sector credit	Aug	m%ch	0.4	0.5	0.5
	13:45	CH	Caixin China PMI manufacturing	Sep	Index	50.0	50.1	~
	15:00	NZ	RBNZ Credit Growth (household)	Aug	m%ch	+0.86	~	~
	17:00	JN	Housing starts	Aug	y%ch	8.9	7.6	~
	17:00	JN	Construction orders	Aug	y%ch	-10.9	~	~
	Sat 1 Oct	CH	Manufacturing PMI	Sep	Index	50.4	50.5	50.2
		CH	Non-manufacturing PMI	Sep	Index	53.5	~	~

\*P = Preliminary

## Calendar - North America &amp; Europe

Date	Time (UKT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 26 Sep	15:00	EC	ECB's Draghi speaks at European Parliament in Brussels					
	15:00	US	New home sales	Aug	000	654.0	594.0	~
	18:30	US	Fed's Kaplan speaks in San Antonio Moderated Q&A					
Tue 27 Sep	14:00	US	S&P CoreLogic CS US HPI MoM SA	Jul	m%ch	0.2	~	~
	14:45	US	Markit US services PMI	Sep P	Index	51	~	~
	15:00	US	Consumer confidence index	Sep	Index	101.1	98.5	~
Wed 28 Sep	10:03	UK	Nationwide house PX	Sep	m%ch	0.6	~	~
	13:30	US	Durable goods orders	Aug P	%	4.4	-1.0	~
	21:35	US	Fed's Mester speaks on Economic Outlook and Policy					
Thu 29 Sep	09:30	UK	Net consumer credit	Aug	£bn	1.2	~	~
	10:00	EC	Economic confidence	Sep	Index	103.5	~	~
	13:00	GE	CPI	Sep P	m%ch	0.0	~	~
	13:30	US	GDP annualized	Q2 T	q%ch	1.1	1.4	~
	13:30	US	Initial jobless and continuing claims	Sep	~	~	~	~

Fri 30 Sep	15:00	US	Pending home sales	Aug	m%ch	1.3	-0.3	~
	21:00	US	Yellen addresses minority banking conference via video link					
	00:01	UK	GfK consumer confidence	Sep	~	-7.0	~	~
	09:30	UK	GDP	Q2 F	q%ch	0.6	~	~
	09:30	UK	Current account balance	Q2	£bn	-32.6	~	~
	10:00	EC	Unemployment rate	Aug	%	10.1	~	~
	10:00	EC	CPI core	Sep A	y%ch	0.8	~	~
	13:30	US	Personal income	Aug	%	0.4	0.2	~
	14:45	US	Chicago Purchasing Manager	Sep	Index	51.5	52.5	~
	15:00	US	Uni. of Michigan Sentiment	Sep F	~	89.8	90	~

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