

EU crisis will delay OCR increases

- Eurozone crisis continues to suffer set backs, we have revised our interest rate outlook.
- We now expect first OCR increase in June 2012 and pace of tightening cycle will be more gradual.
- Large uncertainties remain: the longer politicians take to resolve crisis, the more damage done to global economy.

As resolution of the Eurozone sovereign crisis has suffered further setbacks, we have revised our interest rate outlook. We previously expected the first OCR increase in March. However, this was largely on the assumption that the Eurozone situation would have stabilised somewhat by the end of the year. In particular, we assumed markets would become more settled following the announcement of a comprehensive solution, preventing contagion from a 'managed' Greek default. That scenario is looking increasingly optimistic. To start, the market remains unsatisfied on the latest rescue plan due to the lack of details, particularly on the expansion of the EFSF (European Financial Stability Fund). Furthermore, the G20 meeting in Cannes over the weekend proved extremely disappointing. Hopes were raised that G20 leaders would deliver an announcement on expanding the resources available to the IMF and in turn its capacity to support European bailout efforts. Instead, leaders delayed a decision on how to boost the IMF's fire power until February, highlighting how long we can expect this crisis to drag on.

At the same time, hopes are fading that Europe can avoid a messy default scenario. Last week's developments in Greece highlight how easily rescue efforts can be set back. The action of the Greek PM (calling for a national referendum on the bail out package) is incomprehensible. As a result, European officials now also need to consider the scenario where Greece is in full default and cast out of the EU, a very costly scenario for all parties involved. Meanwhile, Italy, the country that is considered too big to bail out, appears to be on increasingly shaky ground. The ongoing uncertainty has led to a rapid rise in Italian bond yields, close to the point where borrowing costs become unmanageable and put further pressure on debt levels.

Brinkmanship behaviour from politicians and a slow decision-making process have created unnecessary volatility in markets. The uncertainty generated by the European crisis is already damaging the health of the global economy, with investment and employment decisions delayed.

Given all these developments, we have pushed the first OCR increase out to June 2012. In addition to pushing out the timing of the first OCR increase, we also expect the tightening cycle will be more gradual. After the first 3 rate hikes, the RBNZ is likely to be wary about the pace of further tightening, taking more time to assess the domestic response to higher rates and the global outlook. We have spaced out the final 3 hikes over 9 months, with the OCR reaching 4% by June 2013.

The outlook is contingent on the Europeans have a working mechanism for serving the crisis in place in the early months of 2012 – and keeping the crisis contained in the meantime. The global economy is sitting at a crossroad, and almost anything could happen. But the longer politicians fiddle, the more damage will be done to the global economy along the way.

Click here for:

[Foreign Exchange](#)

[Interest Rates](#)

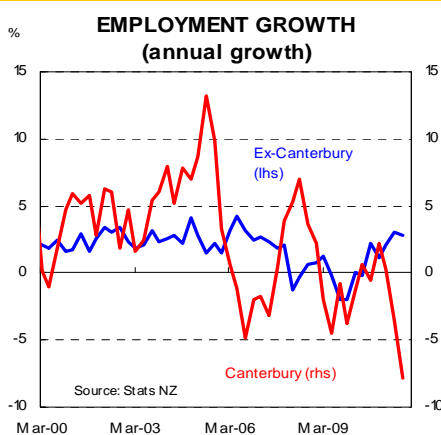
[Week Ahead](#)

[Week in Review](#)

[Global Calendars](#)

- NZD lower as comprehensive plan to resolve European debt crisis face set-backs.
- Interest rates slightly lower over the week, as domestic data continues to show softness.
- NZ retail sales the key domestic data release.
- HLFS show subdued employment growth; RBA and ECB cut their policy rates by 25bp.
- Australian employment the key data release offshore.

Chart of the Week



The domestic focus over the past week was the Q3 employment report. The headline result was disappointing, and saw the market react with a decline in the NZD and fall in interest rate expectations. Momentum from Tuesday's rate cut by the RBA and the ongoing uncertainty around the Eurozone debt crisis added to this type of reaction.

However, digging beneath the headline were some encouraging outcomes. In particular, outside of Christchurch, employment growth has been surprisingly strong, recording solid growth over the past 3 quarters. This suggests that the underlying economic recovery remains intact, despite some recent disappointing data.

The weakness in employment over the past year has all been in Canterbury, as a result of the earthquakes, rather than the underlying economic fundamentals. Nonetheless, to still see such large declines in Canterbury employment is sobering and highlights the ongoing challenges the region faces.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7967	0.8088	0.7729	0.7934	0.7924	FLAT	0.7850	0.8050
NZD/AUD	0.7655	0.7680	0.7899	0.7361	0.7808	FLAT	0.7600	0.7750
NZD/JPY	62.26	64.03	59.23	63.88	64.02	FLAT	71.50	73.50
NZD/EUR	0.5764	0.5773	0.5756	0.5512	0.5579	FLAT	0.5700	0.5850
NZD/GBP	0.4962	0.5064	0.4999	0.4840	0.4873	FLAT	0.4925	0.5025
TWI	69.6	70.4	68.9	68.2	69.3	FLAT	69.00	70.00

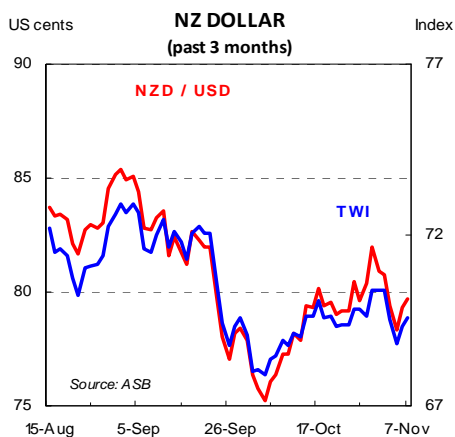
^Weekly support and resistance levels * Current is as at 11.30am Monday; week ago as at Monday 5pm.

The NZD fell across the board last week, reflecting the decline in risk appetite given ongoing setbacks to finding a resolution to the European debt crisis. The weaker than expected NZ employment data also added downward pressure to the currency. Global financial market developments will likely remain the key influence on movements in the NZ dollar over the coming week.

The RBA's 25 basis point cut to its cash rate, soft Australian data and the increase in risk aversion in markets placed downward pressure on the Australian dollar last week.

With few important economic data released this week, Italy is likely to be in focus. Significant further increases in Italian yields towards 7% would likely call into question the sustainability of Italian government debt and drag the EUR/USD down. In this scenario, the USD would like move higher against most currencies, except CHF and JPY.

Short-term outlook: Key data Date Time (NZT) Market



Key data	Date	Time (NZT)	Market
Australian Employment – October, change	10/11	1.30pm	+10.0
Retail Trade Survey – Q3, total retail volumes	14/11	10.45 am	-

Potential local currency movers this week: EU retail sales (7th); UK industrial production (8th); AU housing finance (9th); AU employment, European Commission economic forecasts, BoE rate announcement, US jobless claims (10th); US consumer confidence (11th).

Speakers: Fed: Kocherlakota, Plosser (8th), Bernanke, Turullo (9th), Bernanke, Evans (10th), Yellen (11th).

EU – Schaeuble, Weidmann (7th), Merkel (8th).

Medium-term outlook: [Last Quarterly Economic Forecasts](#)

The global demand for USD funding escalated as the Eurozone sovereign crisis dragged on and the threat of a US recession increased. The USD tends to rise whenever the US enters recession, or the threat of a US recession significantly rises. The combination of a downward revision to US and Eurozone GDP forecasts is generating a period of softer global growth. We have recently adjusted our FX forecasts to account for these developments.

In addition to rising USD demand, our revised currency forecasts reflect a host of local and global factors: (1) the lower EUR and GBP forecasts are a function of weaker euro zone and UK economic growth as well as an easing in the European Central Bank (ECB) and Bank of England's (BoE) monetary policy stance; (2) a weaker CHF is a result of the interventionist policy measures undertaken by the Swiss National Bank (SNB); (3) the downward revision to the AUD and NZD forecasts reflect a period of softer global economic growth in the world economy; and (4) lower CAD forecasts reflect the softer global economy, the softer US economy, and a shift by the Bank of Canada to a neutral stance following an unexpected Q2 contraction in the Canadian economy

An extended period of "temporary" USD strength and softer global growth are the two main factors behind the trimming of our AUD and NZD forecasts. However, the bulk of downward revisions to GDP growth are coming from outside non-Japan Asia, meaning the net impact on the AUD and NZD is somewhat insulated. The net modest downward revision to global economic growth suggests to us that the commodity currencies of the NZD, AUD (and CAD) therefore only need to be revised modestly lower. We expect the NZD to peak around 0.84 and the AUD to peak around 1.08 against the USD over 2012, lower than our previous forecasts of 0.88 and 1.10.

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	2.50	2.50	2.50	2.50	3.00	FLAT
90-day bank bill	2.70	2.72	2.79	2.66	3.17	FLAT
2-year swap	3.14	3.19	3.13	3.40	4.11	DOWN
5-year swap	3.92	4.01	3.82	4.51	4.69	FLAT/DOWN
5-year benchmark gov't stock	3.96	4.09	4.00	4.19	4.64	FLAT/DOWN
NZSX 50	3332	3333	3384	3519	3319	FLAT

* Current is as at 11.30am Monday; week ago is as at Monday at 5pm. Please note there are currently no NZ gov't bonds on issue that are close to a 5-year maturity. As a result, we are currently using the Dec 2017 maturity, which is technically a 6-year maturity. Please be very careful with comparisons of gov't bond yields and swap rates.

Domestic interest rates edged slightly lower over the week, in line with offshore developments. While employment data were on the soft side of market expectations, this largely reflected weakness in the Christchurch region. Nonetheless, the result adds to the recent slew of domestic data which indicates there is no urgency for the RBNZ to raise the OCR.

The setbacks to coming up with a resolution to the European debt crisis continued to weigh on interest rates over the past week. In contrast, Italian long-term bond yields reached all time highs despite buying by the ECB, reflecting the lack of demand for its bonds given the increasing instability in the country.

Australian interest rates were lower over the week. While the 25bp cash rate cut was largely expected by markets, there was still some degree of uncertainty going into the announcement. Markets are expecting further cuts to the cash rate over the coming year.

Short-term outlook:

Key data

Date

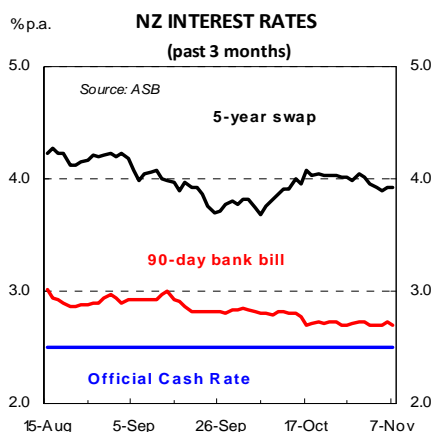
Time (NZT)

Market

Australian Employment – October, change	10/11	1.30pm	+10.0
Retail Trade Survey – Q3, total retail volumes	14/11	10.45 am	-

Comment: Global developments are likely to remain the key influence on interest rates over the coming week. Progress in resolving the European debt crisis have been curtailed time and again, leading to volatility in financial markets.

Australian employment growth has shown signs of slowing recently. We expect further modest employment growth in October as economic activity expands. Meanwhile, we expect another increase in Q3 Retail Trade Survey, reflecting the boost from the Rugby World Cup.



Medium-term outlook:

[Last Quarterly Economic Forecasts](#)

The RBNZ left the OCR on hold at 2.5% at the October OCR Review, as widely expected. As in the September MPS the statement reiterated the “real risk” of the European debt crisis sparking weakness in the global economy. Back in September a weaker global growth outlook prompted the RBNZ to revise down its medium-term growth forecasts.

Again the RBNZ has highlighted its concern at the potential flow-on effects of the recent tightening in funding markets on NZ bank funding costs, noting the crisis could put pressure on bank funding costs “over the coming year”. Back in September the potential impact contributed to the RBNZ lowering its medium-term outlook for the 90-day bank bill to 4.3%. This outlook implies the RBNZ expects the OCR will level off at 4% - in line with our own expectations.

Although the domestic economy has been slightly softer than the RBNZ’s September forecasts, the RBNZ continued to note that earthquake reconstruction will give domestic demand a significant boost.

The RBNZ views underlying inflation as settling around 2% once government-related impacts are accounted for. While recent inflation indicators also suggest there is breathing space for the RBNZ on the inflation front at the moment, the fact medium-term inflation expectations remain close to the top of the RBNZ’s target band is of some concern.

Efforts to resolve the European debt crisis have been repeatedly curtailed. Meanwhile, activity indicators globally suggest subdued activity in the Western economies. The RBNZ has indicated global developments remain the dominant factor for the RBNZ in determining its interest rate outlook. This suggests there is little urgency for the RBNZ to raise the OCR. We now expect the RBNZ will keep the OCR on hold until June 2012. We also now expect some pauses in the tightening cycle, such that the OCR is not expected to reach its peak of 4% until June 2013.

Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
Electronic Card Transactions – October, total mom	9/11	10.45 am	+0.4%	+0.7%	+1.4%
Business NZ PMI - October	10/11	10.00 am	50.8	-	-
Food Price Index – October, mom	11/11	10.45 am	-1.0%	-	-
Australian Employment – October, change 000s	10/11	1.30pm	+20.4	+10.0	+10.0
Retail Trade Survey – Q3, total retail volumes qoq	14/11	10.45 am	+0.9%	-	+0.9%

New Zealand Data Previews

Wednesday 9 November

Electronic Card Transactions - October

Monday 14 November

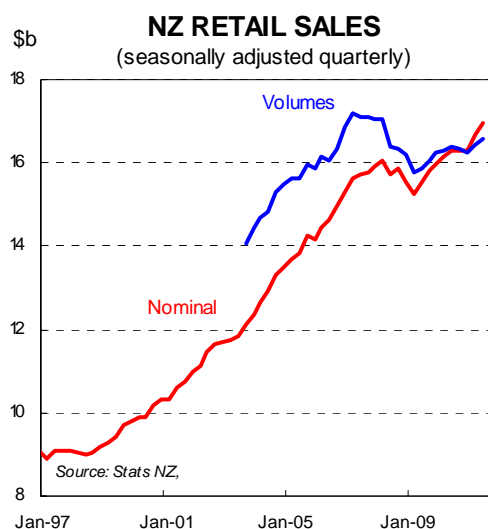
Retail Trade Survey – Q3

Total volumes – previous: +0.9% qoq, f/c: +0.9% qoq

Ex-auto volumes – previous: +1.0% mom, f/c: +0.9% qoq

The recovery in retail spending has been very gradual to date, with the boost to spending from the Rugby World Cup not as great as expected. We expect a robust increase in spending in the hospitality sector will underpin a solid increase in card spending this month, as locals and visitors revelled in the knock-out stages of the RWC.

In regards to spending in other areas, we generally expect a return to trend. Beyond the boost from the RWC, the continued improvement in underlying employment demand is likely to underpin a recovery in consumer confidence. This in turn will likely encourage households to increase spending in discretionary areas such as durables and hospitality.



International Data Previews

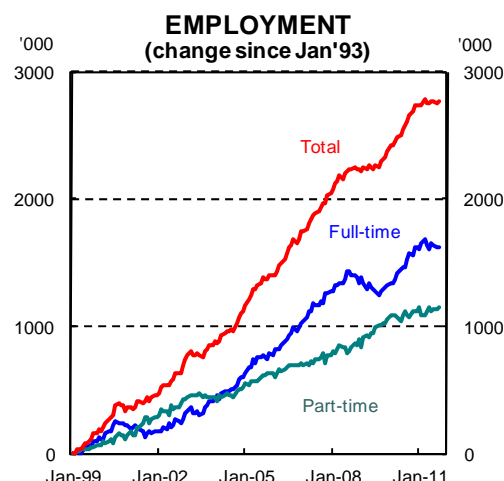
Thursday 10 November

Australian Employment – October, change 000s

Previous: +20.4, f/c: +10.0

The September employment outcome was strong, with jobs rising by 20.4K. However, the overall pace in the last few months has been weak. As at September, a total of just 5.4K jobs had been created over the three months. Whilst underlying economic momentum remains intact, financial market uncertainty has dented business and consumer confidence.

Firms appear reluctant to take on new staff, and have been increasing average weekly hours worked. With economic activity continuing to expand, at some point additional labour will be needed. We are forecasting a further modest increase in October employment. However jobs growth is likely to be just enough to keep the unemployment rate stable.



Data Recap: weekly recap

Q3 Labour Cost Index Q3 Quarterly Employment Survey

The 0.5% increase in the LCI private ordinary time wage and salary rates for Q3 is in line with our expectations. The result brings annual wage growth to 2%, indicating a continued recovery in wage growth, albeit from very subdued levels. This is in line with recent business surveys, which point to emerging signs of a skills shortage as underlying employment demand recovers.

StatsNZ noted that wages in the construction industry in Christchurch continue to rise faster than the rest of the country. This is likely to reflect the tight supply of construction labour resource in Christchurch as post-earthquake rebuilding activity gets underway.

Average hourly earnings (private sector) increased 1.3% over Q3, building on the strong increase also recorded in Q2 and bringing earnings up 3.4% on year-ago levels. The QES measure of earnings is not adjusted for composition changes within the work force, and can be more volatile than the LCI measure. The LCI measure provides better guidance of the underlying trends in salary and wages through the economy.

RBA Rate Announcement

The RBA cut its cash rate by 25bp in the latest meeting. The RBA's updated growth and inflation forecasts suggest rates are on hold in the November Statement on Monetary Policy, with near-term risks on the downside. This suggests the RBA considers the path ahead for the economy to be one that requires no further policy adjustment. Economic growth is expected to be around trend, and inflation contained in the middle of the target band (excluding the impacts of pricing carbon).

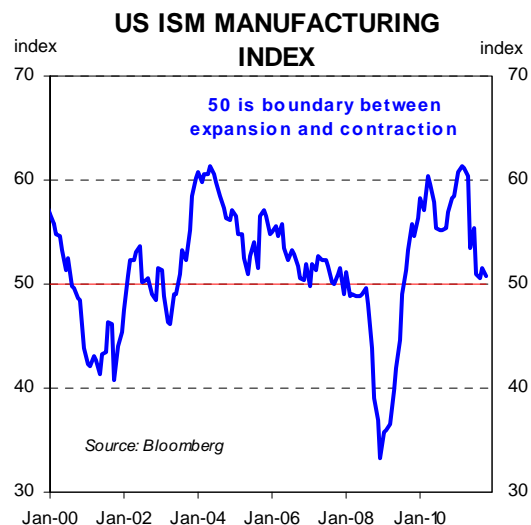
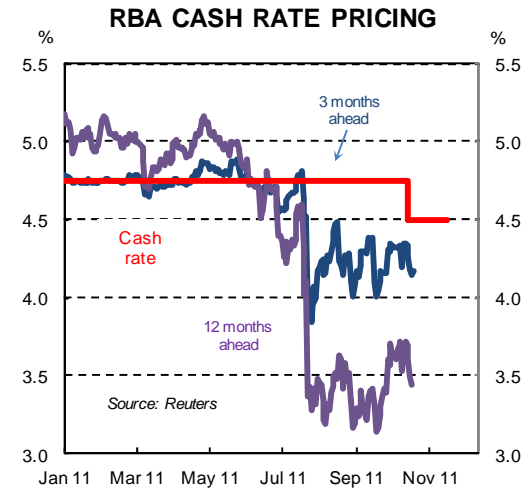
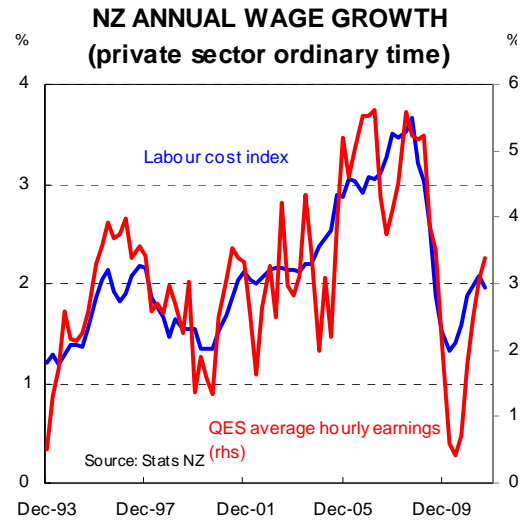
We think that continued heightened volatility and concerns about the global growth outlook – largely stemming from Europe – will continue to erode sentiment and sap economic activity. Whilst the policy easing on Tuesday will assist in stemming the impacts, we think the RBA's hand will be forced and that further policy easing is required. We now expect the RBA to deliver one further 0.25% cut, taking the cash rate to 4.25%. With the cash rate then firmly in the neutral zone we expect the RBA to hold policy steady through the course of 2012.

October US ISM Manufacturing

The US ISM manufacturing index edged lower to 50.8 in October, from 51.6 in the previous month. The result indicates the US economy is still growing at a subdued pace, consistent with annual GDP growth of around 2%.

The detail within the survey was more encouraging, with the new orders index rising to a six-month high of 52.4. Meanwhile, the employment index nudged lower to 53.5, suggesting a modest fall in manufacturing payroll employment.

The sharp decline in the prices paid index to a two-and-a-half-year low of 41.0 indicates producers are starting to benefit from lower raw material costs.



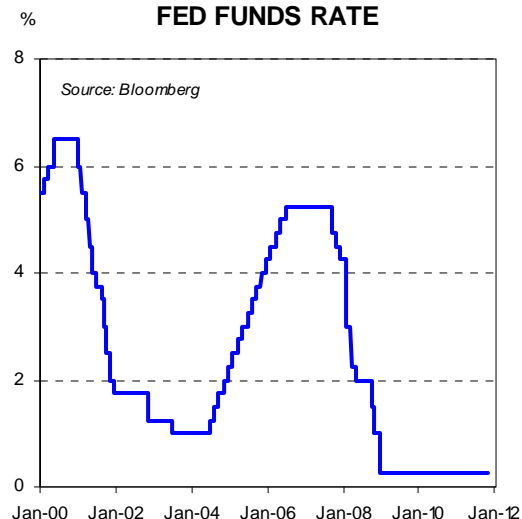
FOMC Rate Announcement

The FOMC kept its target rate between 0-0.25%, and there were few surprises in the statement. The Federal Reserve noted that while the US economy had picked up, significant downside remains. Growth forecasts were also revised lower, with the unemployment rate now expected to decline at a slower pace.

The Fed retained its pledge to keep the benchmark interest rate near zero through at least mid-2013, and only one member on the board voted in favour of additional policy easing. Overall, the statement left the door open to additional monetary policy easing.

Given the loss of momentum in the US economy, we expect the Fed to initiate more policy easing in 2012. Policy easing is first likely to take the form of enhanced guidance.

FED FUNDS RATE



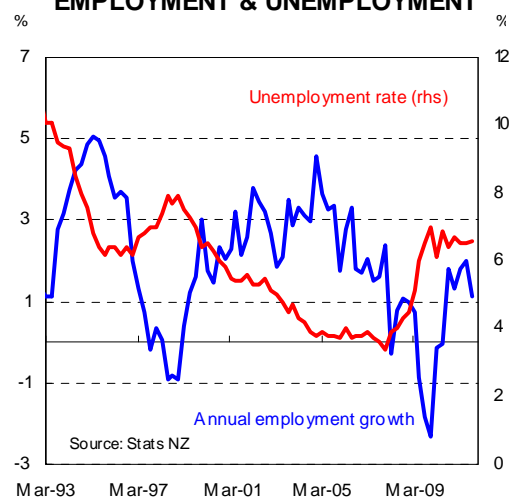
Q3 Household Labour Force Survey

The nationwide employment growth of 0.2% over Q3 was fractionally weaker than ours and market's expectations (0.3% and 0.4% respectively). The subdued result was driven by weakness in Christchurch, with employment excluding Christchurch actually rising 0.9% by our seasonally-adjusted estimates. This result indicates underlying employment demand remains strong. The robust 1.0% increase in hours worked is also very encouraging, pointing to strong underlying labour demand and suggests further growth in employment over the coming year.

The weakness in employment in Christchurch (-3.8% qoq by our seasonally-adjusted estimate) was concentrated in the retail and hospitality sectors, which is consistent with the ongoing closure of the Canterbury CBD and extensive damage sustained by some of the major hotels.

Meanwhile, the unemployment rate ticked up slightly to 6.6% in Q3, from 6.5% in the previous quarter. The participation rate ticked up slightly to 68.4% in Q3 from the downwardly revised 68.3% in the previous quarter.

EMPLOYMENT & UNEMPLOYMENT



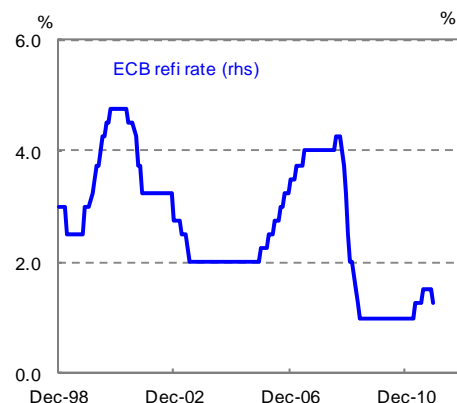
ECB Rate Announcement

The ECB Governing Council decided to cut the refinance rate by 0.25% to 1.25%, the first cut to its policy rate since early 2009. The move came just 4 months after the last move, a rate hike from 1.25% to 1.5% back in July. Mr. Draghi confirmed that the decision was unanimous.

Justification for the move was driven primarily by the deteriorating growth outlook. While the ECB Governing Council has for a while now referred to the "intensified downside risks" to growth, Mr. Draghi suggested that "some" of these downside risks have now materialised. In particular Mr. Draghi referred to worsening survey data, "especially manufacturing, new orders growth."

Generally speaking, the ECB decision came as a surprise to markets and ourselves alike, largely because of the timing. To the extent that there had been expectations of an easing of ECB monetary policy, most commentators had been anticipating a December move.

EZ REFI RATE

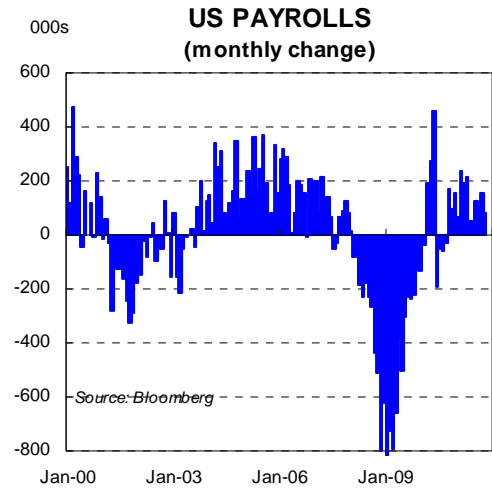


October US Non-farm Payrolls

Employment increased 80,000 in October, down from a revised increase of 158,000 in the previous month. While there are signs that US employment growth is slowing, the upward revisions to the August and September, which totalled 108,000, were encouraging.

An alternative household survey measure showed the unemployment rate edged down to a six-month low of 9.0% in October, from 9.1% in the previous month. However, a large part of the employment gains seen in this survey may reflect a rebound after some big declines in the spring.

Fed officials have become increasingly vocal about the continued high level of the unemployment rate. The latest set of employment result adds to the case for further quantitative easing down the track.



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 7 Nov	11:30	AU	Ai Group PCI	Oct	Index	30.0	~	~
	13:30	AU	ANZ job advertisements	Oct	m%ch	-2.1	~	~
Tue 8 Nov	12:50	JN	Official reserve assets	Oct	¥bn	1200.6	~	~
	13:30	AU	Trade balance	Sep	A\$bn	3.1	3.0	3.8
	13:30	AU	NAB business confidence	Oct	Index	-2.0	~	~
	13:30	AU	NAB business conditions	Oct	Index	2.0	~	~
Wed 9 Nov	~	CH	Industrial production	Oct	ytd	14.2	14.0	~
	~	CH	Fixed assets inv excl. rural	Oct	ytd	24.9	24.8	~
	~	CH	Retail sales	Oct	ytd	17.0	17.0	~
	10:45	NZ	NZ card spending - total	Oct	m%ch	0.2	~	~
	12:00	NZ	QV house prices	Oct	y%ch	0.7	~	~
	12:30	AU	MI/ WBC consumer confidence	Nov	m%ch	0.4	~	~
	12:50	JN	Current account total	Sep	¥bn	407.5	1,330.5	~
	13:30	AU	Home loans	Sep	m%ch	1.2	1.8	3.0
	13:30	AU	Investment lending	Sep	m%ch	1.8	~	~
	13:30	AU	Owner-occupied home loan value	Sep	m%ch	0.6	~	2.0
	15:00	CH	CPI	Oct	y%ch	6.1	5.4	~
15:00	CH	Producer price index	Oct	y%ch	6.5	5.8	~	
Thu 10 Nov	~	CH	Trade balance	Oct	US\$bn	14.5	26.7	~
	~	CH	Exports	Oct	y%ch	17.1	17.0	~
	~	CH	Imports	Oct	y%ch	20.9	22.2	~
	10:30	NZ	Business NZ PMI	Oct	Index	50.8	~	~
	11:30	AU	RBA's Lowe speaks in Melbourne at Australia Farm					
	13:00	NZ	ANZ consumer confidence index	Nov	Index	112.2	~	~
	13:00	NZ	ANZ consumer confidence	Nov	m%ch	-0.4	~	~
	13:30	AU	Employment change	Oct	'000	20.4	10.0	10.0
	13:30	AU	Unemployment rate	Oct	%	5.2	5.3	5.2
	13:30	AU	Participation rate	Oct	%	65.6	65.6	65.6
19:00	JN	Machine tool orders	Oct	y%ch	20.1	~	~	
Fri 11 Nov	10:45	NZ	Food prices	Oct	m%ch	-1.0	~	~
	12:50	JN	Loans & discounts corp	Sep	y%ch	-1.6	~	~

Calendar - North America & Europe

Please note all days and times are UK time. Add 12 hours for NZ times.

Date	Time (UK)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 7 Nov	06:45	SZ	Unemployment rate (s.a.)	Oct	%	3.0	3.0	~
	08:15	SZ	CPI	Oct	y%ch	0.5	~	~
	08:15	SZ	CPI - EU harmonised	Oct	y%ch	0.2	~	~
	10:00	EC	Euro-Zone retail sales	Sep	m%ch	0.1	0.1	~
	11:00	GE	Industrial production	Sep	m%ch	-1.0	0.1	~
	17:45	SZ	SNB's Jordan speaks in Lucerne					
	20:00	US	Consumer credit	Sep	US\$bn	-9.5	5.0	~
	23:00	EC	SNB's Hildebrand, ECB's Weidmann, Stark speak in					
Tue 8 Nov	00:01	UK	BRC sales like-for-like	Oct	y%ch	0.30%	~	~
	07:00	GE	Trade balance	Sep	€bn	11.8	14.0	~
	09:30	UK	Industrial production	Sep	m%ch	0.2	0.1	~
	09:30	UK	Manufacturing production	Sep	m%ch	-0.3	0.1	~
	09:40	SZ	SNB's Jordan speaks in Lucerne					
	13:15	CA	Housing starts	Oct	'000	207.6	200.0	~
	13:20	CA	Bank of Canada Governor Carney speaks in London					
	13:30	SZ	Bundesbank's Weidmann, SNB's Hildebrand speak					
Wed 9 Nov	15:00	UK	NIESR GDP estimate	Oct	q%ch	0.5	~	~
	09:30	UK	Visible trade balance			Sep	£mn	-7,768
	09:30	UK	Total trade balance	Sep	£mn	-1,877	~	~
	14:30	US	Bernanke speaks at Fed conference on small					
	15:00	US	Wholesale inventories	Sep	%	0.4	0.6	~
Thu 10 Nov	19:00	EC	ECB's Stark speaks in Frankfurt					
	07:00	GE	CPI - EU harmonised	Oct	y%ch	2.8	2.8	~
	10:00	EC	European Commission releases economic growth					
	12:00	UK	Bank of England Monetary Policy Committee					
	12:00	UK	BOE asset purchase target	Nov	€bn	275.0	275.0	~
	12:00	UK	BOE announces rates	Nov	%	0.5	0.5	~
	13:30	CA	International merchandise trade	Sep	C\$bn	-0.62	-0.45	~
	13:30	US	Trade balance	Sep	US\$bn	-45.6	-46.0	~
Fri 11 Nov	13:30	US	Initial jobless and continuing claims	Nov	'000	~	~	~
	09:30	UK	PPI output	Oct	y%ch	6.3	6.0	~
	09:30	UK	PPI output core	Oct	y%ch	3.8	~	~
	14:55	US	University of Michigan confidence	Nov	Index	60.9	61.0	~

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