

23 August 2017

Slow Spring

- Spring 2017 lamb number estimates reduced
- Expected milk production increase also tempered
- Recent wet weather unhelpful for many
- Export growth outlook lowered, shaving GDP forecast

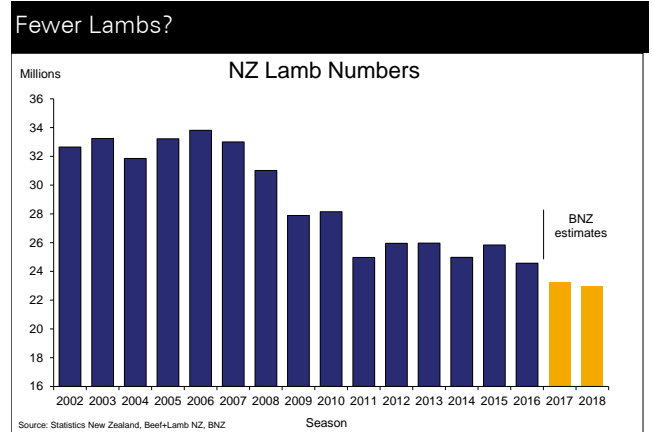
Export volumes of meat and dairy products over the coming season will, as usual, be a function of farmers' previous decisions based on such things as climatic conditions and farm economics as well as events through the season itself. That is, what is happening on farm gives a good steer to what lies in store for exports. Winter and early spring weather has been less than ideal, crimping the outlook for export volumes.

Beef+Lamb NZ recently estimated the 2017 spring lamb crop to be 23.0 million head. If this is the final tally, it would be 1.3% down on the last season. This drop is in contrast to previous indications that the lamb crop might be up around 1.1%. The drop equates to around 300,000 fewer lambs this spring compared to last year and about 500,000 fewer lambs than what was being factored in for the new season a couple of months ago.

Fewer lambs are a function of a previous drop in breeding ewe numbers. The number of breeding ewes as at the end of June 2017 is estimated to be 17.8 million, down 1.9% from 12 months earlier. This estimate has not changed.

But the weather through winter was generally awkward; being too wet in many areas. This is particularly the case across chunks of the North Island leaving the likes of the Waikato, King Country, Taranaki and Manawatu areas soaking. In addition, parts of the South Island had some severe flooding during winter.

Beef+Lamb NZ estimate the ewe lambing percentage this spring at 123.2%, marginally higher than last season's estimate of 122.8%, but a smaller gain than initially contemplated. The expected small lift in lambing percentage is not enough to offset the drop in breeding ewe numbers hence the now expected decline in lamb numbers. After accounting for retentions, it all suggests there will be around 19.3 million lambs available for export, similar to the season just ended. Meanwhile, lower sheep numbers is expected to see export mutton production in 2017/18 fall by as much as 9% from the 2016/17 season. All this sees us tab down our overall meat export volume growth forecasts for the 2017/18 season.



One consolation of fewer lambs is that it offers some support to prices, although it is hardly the best way for that to occur. Stronger demand would be much preferred! Nevertheless, after being a feature during the 2016/17 season that generated strong pricing, tight supply is expected to continue in the year ahead. We think this will see higher prices in the 2017/18 season, on average, compared to 2016/17. Reports of very little inventory held through the supply chain supports this view, although, as ever, actual pricing at the farmgate will also depend on the weather and currency levels.

Importantly, the weather has not been all bad with Eastern Hawke's Bay and up to Gisborne enjoying much better grass growing conditions. And even where it has been wet, it has not necessarily been particularly cold. Early ewe pregnancy scanning results were mixed, while subsequent anecdotes on lamb survivability have been good. So lamb numbers could yet turn out better than 23.0 million currently estimated (with flow-on consequences for exports). We will get a much better guide to actual lamb numbers when Beef+Lamb NZ's Lamb Crop report for 2017 is released in November.

In any case, the weather ahead will have a say on weight gain which has anecdotally been slow to date. This is another factor that may see lower export tonnage. The wet conditions have caused delays on farm – including getting crops in the ground. This may cause issues later in the season depending on how weather conditions unfold from here.

NIWA forecasts to the end of the 2017 are for warmer than usual temperatures, but with normal or above normal

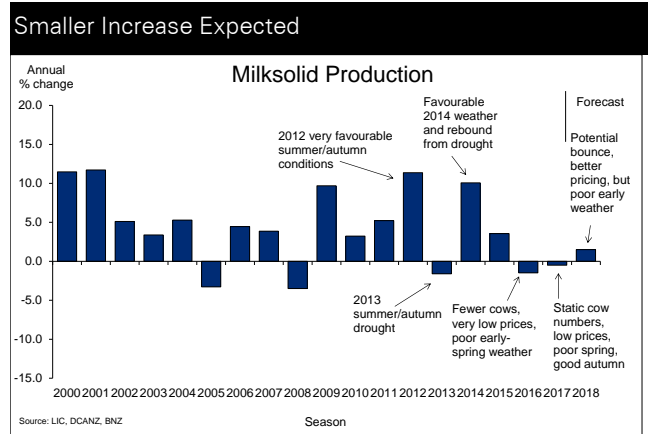
rainfall more likely for much of the country than below normal rainfall (the east of the South Island is the exception where below normal rainfall is equally likely as normal (with 40% chance each). We are also watching indicators that have moved toward La Nina conditions, although are currently not at threatening levels.

Regards the outlook for beef exports, Beef+Lamb NZ expect export production to be marginally lower in the 2017/18 season compared to 2016/17, driven by expectations of slightly lower weights combined with essentially static slaughter numbers. This follows from both breeding cow numbers as at the end of June 2017 and expected calving percentages being much the same as a year earlier. Little change is expected in the dairy cow cull that returned to more normal levels in 2016/17. Overall, a marginally lower outlook for beef export volumes is broadly in line with our previous expectations.

For dairy, early season milk production has been hampered by weather conditions being generally too wet over recent months. August NZ milk production was down 1.5% on last year (which itself was down 3.0% on the year before that). September may be no better. Milk production is ramping up in spring, but we suspect it will not be quite as strong as it usually is given recent weather conditions. This is tempering our forecast for the season as a whole. We still expect milk production this season to be higher than last season but not quite as much as we previously thought. Maybe up in a 1% to 2% range rather than a +3% to +4% range. This, in turn, sees us temper our dairy export volume forecasts in 2017/18 by a couple of percentage points, although moderate growth in real export values is still expected as more milk continues to get directed towards higher value products.

Less growth in NZ milk supply should offer some support for dairy prices amid a host of other factors. Despite question marks over how strong NZ milk supply will be during spring, dairy product prices unexpectedly fell (by 2.4%) at the early-October GDT auction. This particular result may reflect Golden Week holiday in China, along with general factors like a stronger US dollar, weaker Euro, ending of EU intervention buying and still weak international grain prices. Even though there is currently downside risk to Fonterra's \$6.75 2017/18 milk price forecast, current conditions are still well supportive of something above the previous season's \$6.12.

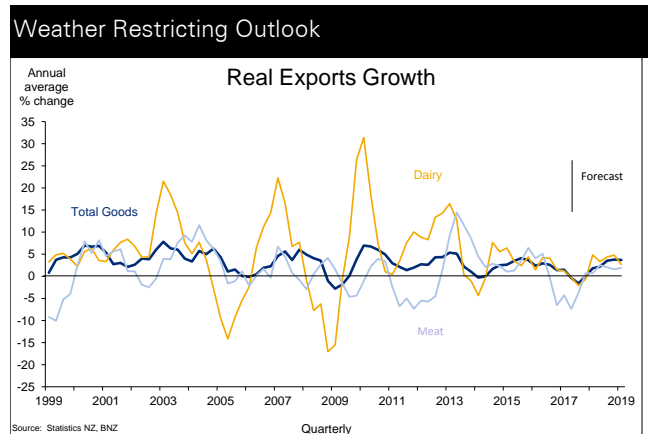
But back to the outlook for export volumes, the tempering in meat and dairy growth outlooks takes around 0.7 percentage points off our overall (goods and services) export growth forecasts on average over the coming year. This shaves our GDP growth forecasts down by around 0.2 percentage points over the same period – to 2.9% growth in 2018 rather than 3.1%. It also sees the annual current account deficit push a bit faster back towards 3% of GDP in 2018 after we see it dipping towards 2% over the next couple of quarters.



All this is relatively minor in the overall scheme of things, but a nudge to the worse nonetheless. Of course, our GDP forecasts over the coming years remain a work in progress in any case, partly as we await the formation of the next government. Whatever the final make up of government, there looks to be more fiscal stimulus on its way that will, at least initially, support growth but the extent and timing of such stimulus remains fluid.

More immediately for growth calculations, early livestock slaughter and milk production indicators for Q3 suggest agriculture and associated food processing may combine to be a drag on growth in the quarter itself – not that surprising given the run of inclement weather. Even if production managed to edge above year earlier levels, it would still represent a dip from Q2 on a seasonally adjusted basis. That is, meat and dairy production might have lifted heading into spring but not as much as it normally does. We'll look to Q3 GDP figures released just ahead of Christmas to see if this has indeed been the case (although we are wary of these quarterly estimates given their propensity to be significantly revised over time).

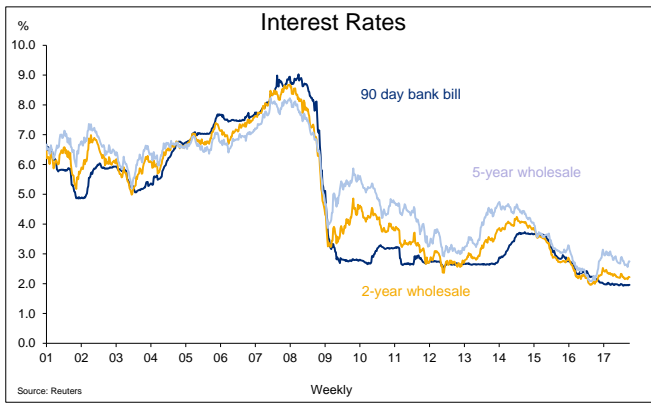
On a positive note, primary product prices as a whole are very buoyant and coupled with subdued import prices we think they will help lift New Zealand's terms of trade to an all-time high in 2017. That is a big support to real incomes.



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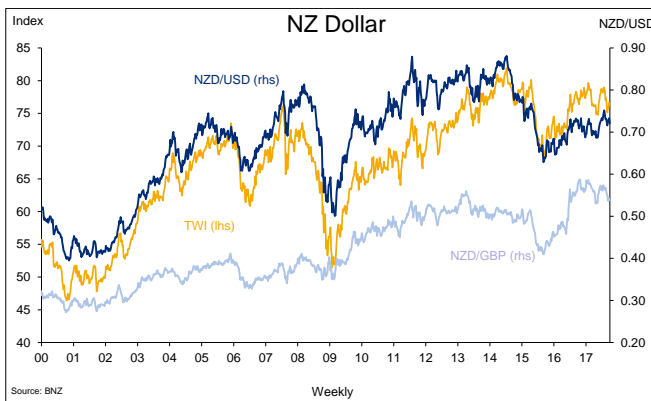
Key Macro Drivers for Commodity Producers

Interest Rates



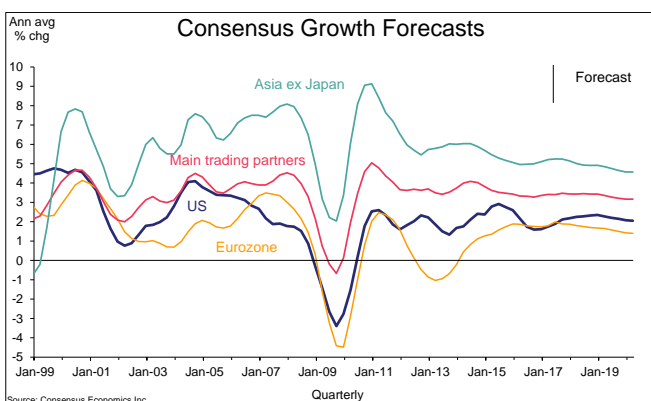
The Reserve Bank again held its cash rate at 1.75% at its late September OCR Review. Moreover, it kept its key policy guidance unchanged as well restating that 'monetary policy will remain accommodative for a considerable period'. This means floating interest rates and short term fixed rates are likely to stay relatively stable through the rest of 2017 and into early 2018, before they are expected to edge higher. There is the chance of some upward pressure coming earlier from offshore as other central banks reduce policy stimulus but this is more likely to see longer term interest rates push higher as they have already started to do. We see longer term interest rates pushing higher into the end of 2017 and through next year as policy stimulus offshore is curtailed.

Foreign Exchange



After falling for much of the year, the US dollar has bounced a bit as the US Federal Reserve maintains guidance that it plans to continue along its path of removing monetary stimulus (including lifting interest rates) and there is increased confidence that some sort of US tax reform package will eventually see the light of day. We expect the USD recovery to progress. Against this backdrop, the NZD has held up reasonable well. We see fundamental support for the NZD at present via very high levels of global risk appetite and NZ primary product prices performing well. If not for prospects of the USD reviving, we'd be thinking that the NZD ought to be heading a lot higher, rather than slip towards our year-end target of US0.70. We don't see the outcome of NZ's current political negotiations having much implication for the NZD.

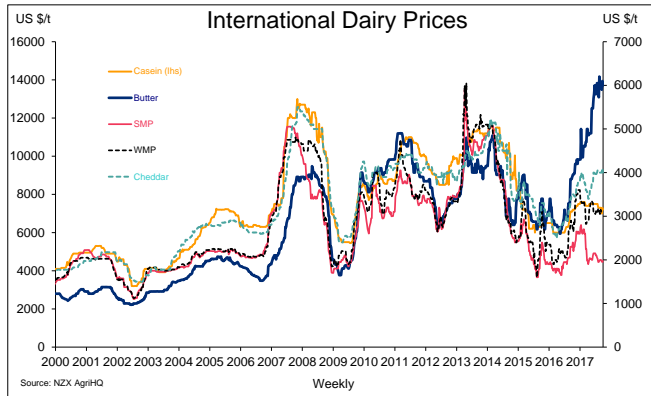
Global Growth



Economic growth in New Zealand's trading partners has lifted back to trend. More importantly, timelier indicators have strengthened further. Recent business surveys around the world show confidence levels at multi-year highs across the US, Europe, China and Japan. While we're at a point in the cycle where major central banks are guiding towards slowing or removing some stimulus, monetary policy across the world remains highly stimulatory and will remain that way for some time yet. Despite ever present risks, the current backdrop is a firm demand support to NZ primary product prices. Indeed, prices across NZ's major product categories are currently well above their respective 5 year averages.

Key Commodities

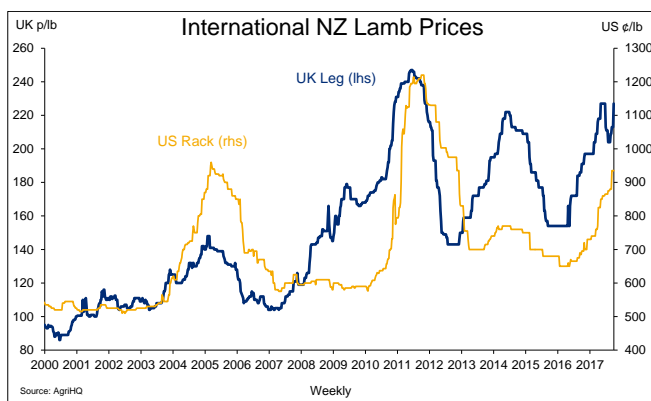
Dairy



We expect international dairy prices to drift lower over the coming year as world supply increases. But we suspect that the near term price dip in early October is a little premature for this trend to take hold given early season NZ production is being restricted by too much rain. We anticipate a small near term price bounce back. If not, then our \$6.75 forecast for 2017/18 milk price is at risk of being revised downward. Some downward pressure has also been generated by building in an effective currency level stronger than previous anticipated.

	Current	Month ago	Year ago	Next 12 months
Whole milk powder (US \$/t)	3100	3150	2800	↓

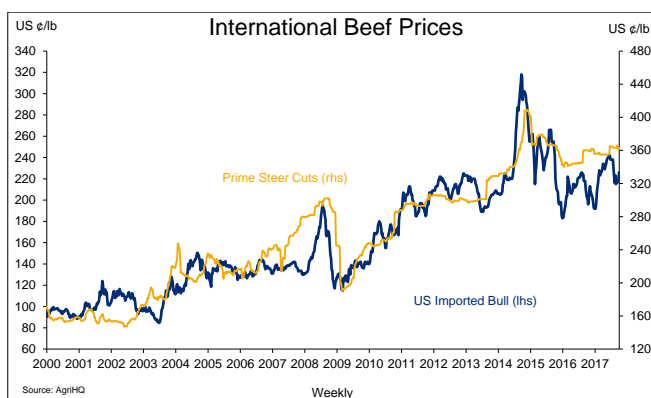
Lamb



International lamb prices have lifted over recent weeks after some previous signs of easing from recent highs. Supply remains generally tight and prices well above historical averages. NZ supply is expected to remain limited this season as lamb estimates have been revised down. This will remain a support to prices. UK politics and Brexit negotiations remain a focus offshore. A sharp weakening in the UK pound would be a negative for NZ lamb prices. For now, at least, supply tightness is holding sway sending positive signals for 2017/18 season average prices to be firmly higher than the equivalent for 2016/17.

	Current	Month ago	Year ago	Next 12 months
Lamb leg (UK p/lb)	227	209	191	→

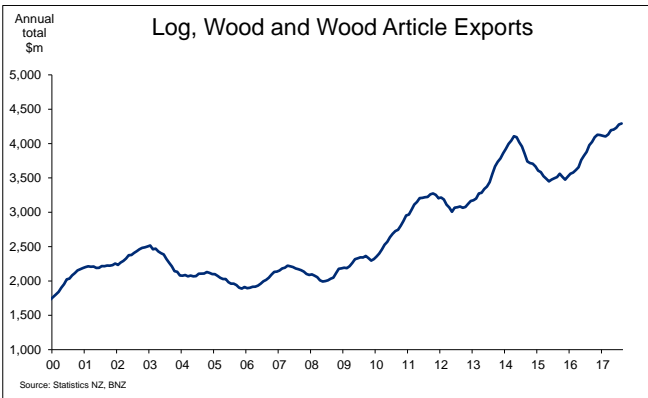
Beef



US beef prices have recouped about half of August's decline over recent weeks. Buoyant US economic conditions are supporting demand. We anticipate some downward pressure on US prices over the coming year as supply increases, supported by still low feed prices, although US domestic demand and exports will be important to watch. NZ export beef prices face a headwind from Japan's tariff increase to 50% (from 38%) on frozen NZ beef. NZ beef supply is expected to remain contained. Developments offshore have us anticipating average NZ pricing in 2017/18 slipping a touch behind 2016/17's strong levels, on average, for the season.

	Current	Month ago	Year ago	Next 12 months
Imported bull (US ¢/lb)	226	217	202	↓

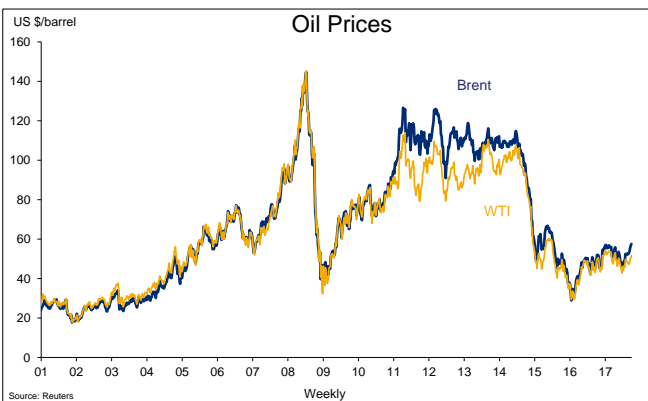
Forestry



Signals for the forestry sector remain very positive as export receipts continue to grow and the domestic market remains strong. Export values pushed to another record high in the year to August 2017 and are up 10% on a year earlier. Export volumes continue to rise as prices remain firm and well above their five year average. The domestic market remains buoyant too with encouraging indicators like building consents showing signs of acceleration, from already elevated levels, and primary sector incomes invigorated.

	Current	Month ago	Year ago	Next 12 months
\$1/\$2 log price (NZ \$/t)	127	127	115	➔

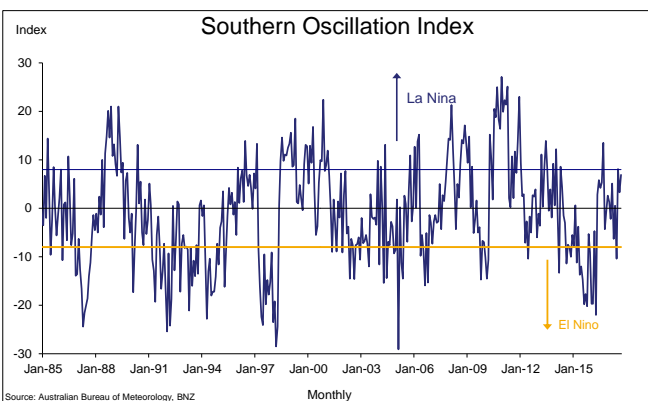
Oil



Crude oil prices have been in the ascendency recently with Brent pushing up toward US\$60/bbl, testing the top end of a range that has held for more than two years. The price has reacted to US-hurricane-linked supply shocks, indications that OPEC and Russia are keen to extend the current production cuts agreement to the end of 2018 (from March 2018 currently), and recent inventory data showing US stocks have resumed their fall from recent record highs. With the NZD holding in the low 70s of late, crude price gains have flowed through to NZ domestic pricing.

	Current	Month ago	Year ago	Next 12 months
West Texas Intermediate (US \$/b)	52	47	48	⬆

Weather



Weather over recent months has been generally awkward; being too wet in many areas. This is particularly the case across chunks of the North Island leaving the likes of the Waikato, King Country, Taranaki and Manawatu areas soaking. In addition, parts of the South Island had some severe flooding during winter. Importantly, the weather has not been all bad with Eastern Hawke's Bay and up to Gisborne enjoying much better grass growing conditions. And even where it has been wet, it has not necessarily been particularly cold. NIWA forecasts to the end of the 2017 are for warmer than usual temperatures, but with normal or above normal rainfall more likely for much of the country than below normal rainfall (the east of the South Island is the exception where below normal rainfall is equally likely as normal (with 40% chance each). We are also watching indicators that have moved toward La Nina conditions, although are currently not at threatening levels.

Quarterly Forecasts

Quarterly Forecasts

Forecasts as at 9 October 2017

Key Economic Forecasts

Quarterly % change unless otherwise specified

Forecasts

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
GDP (production s.a.)	0.7	0.8	0.7	0.4	0.6	0.8	0.7	0.5	0.5	1.0
Retail trade (real s.a.)	0.8	2.0	0.8	0.9	1.6	2.0	-0.6	0.8	0.7	1.6
Current account (ytd, % GDP)	-2.9	-2.7	-2.8	-2.5	-2.9	-2.8	-2.6	-2.4	-2.3	-2.6
CPI (q/q)	0.2	0.4	0.3	0.4	1.0	0.0	0.3	0.5	0.7	0.4
Employment	1.2	2.4	1.4	0.7	1.1	-0.1	0.8	0.7	0.7	0.6
Unemployment rate %	5.2	5.1	4.9	5.2	4.9	4.8	4.7	4.7	4.7	4.7
Avg hourly earnings (ann %)	2.5	2.1	1.6	1.1	1.1	1.2	2.0	2.7	2.8	2.6
Trading partner GDP (ann %)	3.1	3.4	3.2	3.5	3.5	3.5	3.6	3.4	3.6	3.5
CPI (y/y)	0.4	0.4	0.4	1.3	2.2	1.7	1.7	1.8	1.5	2.0
GDP (production s.a., y/y)	2.8	3.5	3.3	2.6	2.5	2.5	2.5	2.6	2.5	2.7

Interest Rates

Historical data - qtr average

Forecast data - end quarter

	Cash	Government Stock			Swaps			US Rates		Spread
		90 Day	5 Year	10 Year	2 Year	5 Year	10 Year	Libor 3 month	US 10 yr	NZ-US Ten year
2016 Sep	2.10	2.30	1.95	2.25	2.05	2.15	2.50	0.80	1.55	0.70
Dec	1.85	2.10	2.45	2.95	2.25	2.65	3.10	0.90	2.10	0.80
2017 Mar	1.75	2.00	2.70	3.25	2.35	3.00	3.50	1.15	2.50	0.80
Jun	1.75	1.95	2.45	2.95	2.25	2.80	3.25	1.25	2.20	0.75
Sep	1.75	1.95	2.45	2.95	2.20	2.70	3.20	1.30	2.20	0.75
Forecasts										
Dec	1.75	1.95	2.75	3.20	2.20	3.00	3.50	1.45	2.60	0.60
Mar	1.75	1.95	2.80	3.25	2.30	3.05	3.55	1.55	2.75	0.50
2018 Jun	1.75	2.05	2.80	3.25	2.40	3.05	3.55	1.70	2.75	0.50
Sep	2.00	2.30	3.15	3.60	2.60	3.40	3.90	1.95	3.00	0.60
Dec	2.25	2.55	3.25	3.70	2.85	3.50	4.00	2.20	3.00	0.70
Mar	2.50	2.80	3.25	3.70	3.10	3.50	4.00	2.30	3.00	0.70
2019 Jun	2.75	3.05	3.30	3.75	3.20	3.50	4.00	2.30	3.00	0.75
Sep	3.00	3.20	3.35	3.80	3.30	3.50	4.00	2.30	3.00	0.80
Dec	3.00	3.20	3.40	3.85	3.30	3.55	4.05	2.30	3.00	0.85

Exchange Rates (End Period)

USD Forecasts

	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY
Current	0.71	0.78	1.17	1.31	113
Dec-17	0.70	0.75	1.17	1.33	116
Mar-18	0.69	0.74	1.18	1.30	118
Jun-18	0.69	0.73	1.20	1.31	118
Sep-18	0.70	0.73	1.22	1.28	118
Dec-18	0.70	0.73	1.20	1.26	120
Mar-19	0.71	0.74	1.20	1.25	120
Jun-19	0.72	0.75	1.18	1.24	120
Sep-19	0.73	0.76	1.18	1.25	118
Dec-19	0.73	0.76	1.17	1.24	117
Mar-20	0.73	0.76	1.19	1.26	116

NZD Forecasts

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.71	0.91	0.60	0.54	79.5	75.1
Dec-17	0.70	0.93	0.60	0.53	81.2	75.3
Mar-18	0.69	0.93	0.59	0.53	81.4	74.5
Jun-18	0.69	0.95	0.58	0.53	81.4	74.5
Sep-18	0.70	0.95	0.57	0.54	82.0	74.9
Dec-18	0.70	0.96	0.58	0.56	84.0	75.7
Mar-19	0.71	0.96	0.59	0.57	85.2	76.5
Jun-19	0.72	0.96	0.61	0.58	86.4	77.5
Sep-19	0.73	0.95	0.61	0.58	85.6	77.4
Dec-19	0.73	0.95	0.62	0.59	84.8	77.4
Mar-20	0.73	0.96	0.61	0.58	84.7	77.5

TWI Weights

14.0% 20.7% 11.3% 4.6% 6.4%

Source for all tables: Statistics NZ, Bloomberg, Reuters, RBNZ, BNZ

Forecasts

Forecasts as at 9 October 2017	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2016	2017	2018	2019	2020	2015	2016	2017	2018	2019
GDP - annual average % change										
Private Consumption	2.8	4.8	3.5	3.5	2.2	2.9	4.3	4.0	3.4	2.6
Government Consumption	2.6	2.4	3.2	1.6	1.3	2.6	2.2	3.5	1.8	1.2
Total Investment	2.5	5.6	2.0	3.9	2.9	2.1	5.5	2.7	3.4	3.3
Stocks - ppts cont'n to growth	-0.2	-0.3	0.0	0.2	0.0	-0.3	0.0	0.0	0.1	0.0
GNE	2.5	4.3	3.1	3.4	2.2	2.3	4.1	3.6	3.2	2.5
Exports	5.6	0.7	2.4	2.7	4.3	6.9	1.6	1.0	2.6	4.2
Imports	2.0	5.1	4.4	3.8	3.4	3.7	3.4	5.1	3.8	3.6
Real Expenditure GDP	3.5	3.0	2.6	3.1	2.4	3.2	3.5	2.5	2.9	2.7
GDP (production)	2.4	2.9	2.5	3.1	2.4	2.5	3.0	2.5	2.9	2.7
<i>GDP - annual % change (q/q)</i>	2.8	2.5	2.5	3.3	2.1	2.2	2.6	2.6	3.3	2.2
Output Gap (ann avg, % dev)	0.8	0.9	0.8	1.3	1.1	0.8	0.9	0.8	1.1	1.2
Household Savings (gross, % disp. income)	1.2	0.1	-0.5	-0.3	0.4					
Nominal Expenditure GDP - \$bn	250.7	264.7	277.2	288.8	300.6	247.6	260.7	274.7	285.7	297.6
Prices and Employment - annual % change										
CPI	0.4	2.2	1.5	1.9	1.8	0.1	1.3	1.8	1.7	1.8
Employment	2.0	5.7	2.0	2.4	1.7	1.4	5.8	2.5	2.5	2.0
Unemployment Rate %	5.2	4.9	4.7	4.7	4.8	4.9	5.2	4.7	4.7	4.8
Wages - ahote	2.5	1.1	2.8	2.8	2.7	2.5	1.1	2.7	2.6	2.8
Productivity (ann av %)	0.3	-2.6	-0.3	0.6	0.3	0.1	-1.7	-1.1	0.3	0.4
Unit Labour Costs (ann av %)	2.4	4.7	3.0	2.5	2.7	2.6	3.6	3.6	2.8	2.6
External Balance										
Current Account - \$bn	-7.3	-7.7	-6.3	-8.7	-9.5	-8.0	-6.6	-6.7	-8.6	-9.3
Current Account - % of GDP	-2.9	-2.9	-2.3	-3.0	-3.2	-3.2	-2.5	-2.4	-3.0	-3.1
Government Accounts - June Yr, % of GDP										
OBEGAL (core operating balance)	0.7	1.5	1.0	1.2	1.9					
Net Core Crown Debt (excl NZS Fund Assets)	24.5	22.4	21.9	21.4	19.9					
Bond Programme - \$bn	7.0	8.0	7.0	7.0	7.0					
Bond Programme - % of GDP	2.8	3.0	2.5	2.4	2.3					
Financial Variables ⁽¹⁾										
NZD/USD	0.67	0.70	0.69	0.71	0.73	0.68	0.70	0.70	0.70	0.73
USD/JPY	113	113	118	120	116	122	116	116	120	117
EUR/USD	1.11	1.07	1.18	1.20	1.19	1.09	1.05	1.17	1.20	1.17
NZD/AUD	0.90	0.92	0.93	0.96	0.96	0.93	0.96	0.93	0.96	0.95
NZD/GBP	0.47	0.57	0.53	0.57	0.58	0.45	0.56	0.53	0.56	0.59
NZD/EUR	0.61	0.66	0.59	0.59	0.61	0.62	0.67	0.60	0.58	0.62
NZD/YEN	76.2	79.1	81.4	85.2	84.7	82.1	81.6	81.2	84.0	84.8
TWI	72.2	76.5	74.5	76.5	77.5	73.4	78.1	75.3	75.7	77.4
Overnight Cash Rate (end qtr)	2.25	1.75	1.75	2.50	3.00	2.50	1.75	1.75	2.25	3.00
90-day Bank Bill Rate	2.41	1.98	1.95	2.78	3.12	2.78	2.02	1.95	2.53	3.20
5-year Govt Bond	2.40	2.70	2.80	3.25	3.45	2.95	2.75	2.75	3.25	3.40
10-year Govt Bond	2.90	3.25	3.25	3.70	3.90	3.45	3.30	3.20	3.70	3.85
2-year Swap	2.30	2.30	2.30	3.10	3.20	2.80	2.40	2.20	2.85	3.30
5-year Swap	2.60	3.00	3.05	3.50	3.70	3.15	3.00	3.00	3.50	3.65
US 10-year Bonds	1.90	2.50	2.75	3.00	3.00	2.25	2.50	2.60	3.00	3.00
NZ-US 10-year Spread	1.00	0.75	0.50	0.70	0.90	1.20	0.80	0.60	0.70	0.85

⁽¹⁾ Average for the last month in the quarter

Source for all tables: Statistics NZ, EcoWin, Bloomberg, Reuters, RBNZ, NZ Treasury, BNZ

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