Week beginning 1 March 2021

- RBA Board to hold the line next week.
- RBA policy decision.
- Australia: Q4 GDP and partials, current account, housing updates (prices, finance, approvals), retail, trade balance.
- NZ: terms of trade, building consents, building work put in place.
- China: Caixin PMIs, foreign reserves.
- US Federal Reserve: Beige Book and Fed Chair Powell to speak.
- US: construction spending, factory orders, payrolls, trade balance.
- Key economic & financial forecasts.

Information contained in this report current as at 26 February 2021.
RBA Board to hold the line next week

The Reserve Bank Board meets next week on March 2. While we have seen extraordinary developments in bond markets over the last week, I do not think they will impact the Bank’s key messages. We expect there will be no change in the policy settings and that the conclusion from the February Statement by the Governor will be confirmed.

“The Board will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. For this to occur, wages growth will have to be materially higher than it is currently. This will require significant gains in employment and a return to a tight labour market. The Board does not expect these conditions to be met until 2024 at the earliest”.

Markets will closely scrutinise the Governor’s Statement for any evidence that the Board may be contemplating a change in its approach to Yield Curve Control (YCC) and Quantitative Easing (QE).

In the Governor’s speech at the National Press Club on February 3 following the Board meeting on February 2 the Governor noted that the Bank’s policy of purchasing three year bonds at the cash rate of 0.1% which was aimed at supporting its expectation that the Bank expected to hold the cash rate steady at 0.1% for three years would need to be reviewed by mid-2021 to decide whether to progress its purchase program from buying April 2024 bonds to buying November 2024 bonds. Recently, markets have become convinced that the pivot to November bonds will not occur and by inference the Bank effectively declaring that the policy to hold the 0.1% cash rate steady for three years beyond April 2021 would no longer be the central outlook.

Westpac has argued consistently since the YCC policy was introduced that the time for a move away from the three year cash rate commitment would come when the Bank was not be prepared to argue convincingly that it expected the cash rate to hold for a further three years. Based on our forecasts and our assessment of the strength of commitment from central banks globally to ensure the eventual achievement of their objectives we have not expected such a change in rhetoric around YCC until the first half of 2022.

Markets are strongly disagreeing.

Whereas the April 2024 bonds are trading at 0.13%, the November 2024 bonds are trading at 0.37%.

Reports on recent trading both yesterday and today were that the RBA bought two $3 billion tranches of April 2024 bonds, and despite this the secondary market yield held at around 0.13%.

We have also been watching the swap market where the six month/three year swap rate is priced at 0.56% and the one year/three year rate is priced at 0.76%.

Certainly swap markets are somewhat distorted by banks’ hedging their fixed rate mortgage books (3 year swap rate at 0.35%) but an expectation that the RBA would still be exercising YCC in that six month to 1 year window would see a much flatter curve than implied by the current swap curve.

Last week Westpac raised its forecast for the 10 year bond rate by end 2021 from 1.55% to 1.9%. However we did not increase our near term outlook for the shorter end of the yield curve where we saw that part of the curve anchored by the outlook for RBA policy.

Curves can steepen and our forecasts implied that a rising ten year rate would not change the expected profile for monetary policy out to three years.

We expected that the inflation component of the 10 year yield would hold at around 2% and nearly all the increase would be attributable to a higher real rate (albeit still negative).

The information to a central bank from such a pivot would be that the bond market is comfortable with a more realistic growth outlook but is not expecting any overshoot on inflation.

Readers will be aware that bond rates have “taken off” since that note (no causality implied) but for both US and Australian rates the adjustment has come through the real rate (for Australia all 30 bp’s increase being attributable to a “rise” in the real rate from –0.52% to –0.11% and US rates around 15 basis points increase in the real rate to –0.6%).

What is not clear is how much of this sharp increase in near term bond and swap rates is due to a significant reassessment of the outlook for monetary policy and how much is the impact of rising long rates by lifting the shorter end of the curve.

From our perspective, to assess the likely profile for the RBA cash rate, we need to review the RBA’s current economic forecasts, particularly those for wages growth and inflation (refer back to Governor’s Statement in February which we expect to be repeated in March).

If the RBA is to signal that it expects to achieve its wage and inflation “targets” – inflation sustainably between 2-3%; and wages growth around 3.75% within the three year “window” its forecasts for wages growth and inflation will need to lift significantly from the current profiles.

In the February Statement on Monetary Policy the forecast for annual wages growth by June 2023 was 2% and for underlying inflation was 1.75%.

Both forecasts envisaged annual wages growth and inflation lifting by around 0.25% compared to the year to June 2022.

If the same pace of increase was expected from 2023 to 2024 then the RBA would currently be forecasting wages growth at 2.25% in June 2024 and inflation at 2% in June 2024.

Those conditions would not be consistent with the need for a first rate hike.

Even under the RBA’s “upside” growth scenario, which is discussed in the February Minutes (including the unemployment rate below 5% by end 2021!), the forecast for inflation by June 2023 was 2% (no associated wages forecast).

In the May Statement on Monetary Policy (SOMP) the Board will review its forecasts out to June 2023 while in the August SOMP the forecasts will be extended to December 2023.

By the SOMP in February 2022 the forecasts will be extended out to June 2024.

Clearly for the Bank to make a credible case that it expects conditions for the first-rate hike to be reached by mid-2024 and abandon its Yield Curve Control policy in mid-2021 it will have to be significantly lifting its forecasts for wages and inflation growth out to December 2023 in the August SOMP.

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Sustained 2-3% inflation and 3.75% wages growth by mid-2024 will, arguably, require wage and inflation forecasts for end 2023 of at least 3.25% for wages and 2.5% for inflation (recall that sustained 2-3% inflation will be required to trigger the first-rate hike and that word “sustained” should imply around 2.5% for at least six months).

Given the starting point from the current February SOMP forecasts it seems quite a stretch to expect that the forecasts in the August SOMP, for end 2023, will be credibly up to the 3.25% and 2.5% “targets”.

Circumstances can change over the next six months. We have recently seen upside surprises on wages growth and business investment in the December quarter.

Westpac has lifted its forecast for house price growth in 2021 from 4% to 10% while maintaining the call that prices will increase by 10% in 2022.

But we also require a spectacular boost to consumer spending per capita of around 5.2% in 2021 (as the 20% savings rate is wound back) to be consistent with our 4% growth forecast. (Westpac is a little more cautious with a 3.5% growth forecast for 2021).

Generally, however, Westpac’s forecasts are in line with the RBA’s February SOMP forecasts, (we both expect to see the unemployment rate down to 6% by end 2021).

But forecasts can sometimes be tilted to support a strategy.

The strategy might be to fall into line with the markets’ expectation of an earlier rise in the cash rate.

But, why would the RBA want to adopt that strategy so soon?

Why would the RBA want to be the first central bank to signal the prospect of raising rates? (I am excluding New Zealand from this “list” given reports that monetary policy in New Zealand appears to be partly now influenced by the government’s concerns around housing).

The “old” RBA approach might be consistent with such a strategy, taking guidance from market pricing. The justification would be that central banks need to be pre-emptive – to prepare for the risk of an overshoot in inflation and wages growth.

But it is our view that, globally, central banks are rejecting the “pre-emptive” approach of recent years.

Central banks perceive little evidence of the risk to overshooting.

If a central bank adopts a “pre-emptive” approach when others are playing the “waiting game” then it risks unnecessary pressure on their currency.

Recall Chair Greenspan, when asked where he saw “neutral” he would reply, “I will tell you when we get there!”

Furthermore, markets are prone to overshoot when they perceive a change in policy approach leaving private sector rates higher than necessary, (as we are observing in real time!).

Could the economy develop over the next few months in a way that would justify a substantial lift in the RBA’s forecasts for wages and inflation?

That is certainly possible (refer to the upside surprises on wages and investment in the December quarter and the booming outlook for housing). That prospect is certainly not Westpac’s current central forecast.

After many years of missing its inflation/wages forecasts (see Figure 1) and targets the RBA could be reasonably expected to adopt a conservative approach to its forecasts – better to over achieve rather than disappoint, as has been the consistent case in recent years.

**RBA wage price index forecasts**

As with our own forecasts for 2021, which are very similar to the RBA forecasts, the output gap in 2021 (having widened by around 5% of GDP in 2020) will only close by around 1.5 ppt’s in 2021 (indicating ongoing spare capacity); the unemployment rate is forecast to be well above the NAIRU (estimated at around 4-4.5%); and the structural headwinds to wages growth – technology; globalisation; low productivity growth; low inflationary expectations and falling trade union influence will continue to weigh on inflation and wages growth.

This seems unlikely to justify a significant lift in wages growth and inflation forecasts by the August SOMP.

Perhaps the view might be that, unlike the FED, the RBA has a YCC policy in addition to QE.

But the YCC policy has been effectively used to emphasise the RBA’s credibility. Dropping the policy, when not justified by the forecasts, might under-mine credibility.

**Recent Developments in the Bond Market and Prospects for QE**

Last week, when the AUD 10 year bond rate was 1.4% we raised our forecast for the rate by year’s end from 1.55% to 1.9% - with the spread between AU and USD rates estimated at 10 basis points.

That forecast extended out to end 2024 with a target of 3.2%. The inflation component of the yield had already stabilised at 2% reflecting confidence in central banks’ abilities to anchor inflation and inflationary expectations at around 2%; an equilibrium real yield of 1% and a margin of Australian bonds over US bonds of 20 basis points supported the forecast.

We expected that the progress would not be linear with a target of 2.5% by end 2022 heading to the end 2024 target of 3.2%.

Naturally, it is stunning to see the end 2021 target of 1.9% had been reached within a week, although in subsequent trading it has backed off to around 1.85%.

As discussed above the yield differential between Australian and US long bonds has increased to around 30 basis points (although volatile).
The RBA has been well pleased with its QE program pointing to a reduction in bond rates of 30 basis points and up to a 5% lower AUD.

The recent blow out in the AUD spread would have disappointed.

Back in December Westpac forecast an extension to the QE program that was scheduled to expire in April 2021 of a further $100 billion to be followed in October by a further $100 billion at half the purchase pace ($2.5 billion per week).

While we do not expect the Bank to announce any imminent increase in the current $5 billion per week program the forecast policy from October could be lifted.

One effective way to increase the program relative to our current expectations would be to extend the $5 billion per week purchase program with an open-ended approach.

When QE was first introduced, with all its associated uncertainties about a new program it made sense to provide a finite limit to its size.

Now that it is well established, has been assessed as adding value, reverting to an open-ended approach from October is worth considering.

**Conclusion**

The sharp increase in bond rates is reflecting an improving growth outlook rather than any expectation of an overshoot in inflation.

Central banks are committed to patience and do not see significant risks of overshoot – the traditional pre-emptive approach to policy has been scaled back.

Markets are convinced that the RBA cannot extend its three year guidance on a stable cash rate beyond the middle of 2021.

Justifying that market expectation will require a significant lift in inflation and wages growth forecasts.

At present Westpac does not expect to see conditions sufficiently buoyant to support the necessary lift in the official forecasts.

QE has been accepted by the Bank as a success; a more flexible approach to QE on an ongoing basis might be adopted when the current program expires in October.

**Bill Evans, Chief Economist**
The week that was

Each quarter ahead of the GDP report, two Australian data releases provide an in-depth view of investment across the economy. These are the construction work done and CAPEX surveys. This update was particularly significant as the Q4 surveys came as Australia’s recovery from the pandemic built strength, but while uncertainty over the global outlook remained front of mind. The detail of the two reports was mixed.

Construction work done surprised to the downside, falling 0.9% in Q4 to be 1.4% lower than December 2019. Weakness in private non-residential and infrastructure construction is to be expected given the depth of the recession and the lead times in construction projects. Further falls in this sector are likely in 2021, with non-residential construction approvals falling 17% in 2020 and private infrastructure commencements down 22%. The source of the headline surprise in Q4 however was public-sector work which fell 3.6%. Note though this follows two successive gains and the outlook is promising, with state governments pushing ahead with investment plans across the country.

Housing construction was, and will remain, an opposing positive for Australia’s economy, with new home construction 2.6% higher in Q4 and renovation work up 3.6%. Historically-low interest rates and the experience of the pandemic, when households spent a great deal more time at home, support a long pipeline for both and the experience of the pandemic, when households spent a great deal more time at home, support a long pipeline for both new home construction and renovation work. Grants provided by the Government are also a tailwind, so too the savings accumulated by households during lockdown. These factors are also behind the 20% gain we expect to see in house prices over 2021 and 2022. For the complete view of Westpac Economics’ views on housing, see the February Housing Pulse.

The CAPEX survey subsequently surprised to the upside in Q4, with spending rising 3%. Equipment investment drove this result, rising 5.7% in the three months to December 2020; however, that still leaves this type of investment 5.2% lower than at December 2019. Changes made to the composition of the survey since the last edition as well as the abnormal circumstances of 2020 mean the margin of error around point estimates for investment intentions for both 2020/21 and 2021/22 are materially larger than through history. Still it seems appropriate to say that businesses are responding to the performance of Australia’s economy from the recession’s nadir and optimism over global recovery, investment intentions for the current financial year having improved and the first estimate for 2021/22 pointing to a robust gain for investment in that year.

The other release of significance this week for Australia was the Q4 wage price index. This also surprised to the upside, with wages gaining 0.6% in the three months to December, although that was only enough to keep the annual rate at its record low of 1.4%yr. The relaxation of wage freezes and the reversal of wage cuts seen during the pandemic look to have been the principal force behind the Q4 surprise. Supporting this view, private sector wages jumped 0.7% in Q4 after printing consecutive 0.1% gains in Q2 and Q3 2020; in Q4, the strongest gains were also seen in the cyclical sectors such as professional services and retail trade. Public sector wage rates meanwhile rose 0.3%. Over the year: private wages are up 1.4%; those in the public sector, 1.6%.

Turning to New Zealand and monetary policy, the RBNZ’s Monetary Policy Committee met this week and the RBNZ subsequently released their February Monetary policy Statement. As discussed in detail by Westpac NZ Economics, the message on policy was clear; transitory inflation will be looked through, with the RBNZ to hold off on raising their cash rate until sustained inflation is seen. Our NZ team believe this is unlikely until 2024. Over the coming year however, the RBNZ is likely to buy less government bonds than initially set out in 2020. As per Westpac NZ’s bulletin, bond purchases in New Zealand look to be calibrated to Government’s bond issuance than to keeping interest rates within a desired range.

After the RBNZ’s February meeting, the New Zealand Government announced that the RBNZ will be formally required to assess the impact of monetary policy on house prices, though this assessment will be secondary for policy to the inflation and employment goals. A full discussion of the change and the implications for RBNZ policy is provided in Westpac NZ economics’ bulletin.

Keeping to monetary policy, but switching to the US, FOMC Chair Powell and other Committee members kept to a simple, clear message when before Congress and the public this week. In short, there is good reason to be optimistic about the US and global recovery given vaccine success and substantial policy support; but the pursuit of maximum employment and sustainable at (or above) target inflation will prove difficult and protracted, requiring extraordinary monetary policy support for the foreseeable future.

Markets have certainly adopted authorities’ optimism over the outlook, but are showing concern over the eventual outlook for interest rates. While the market understands the FOMC and other central banks across the world will maintain extraordinary support for the time being, participants are highly uncertain where that will leave the economy and policy in the medium to long-term. Long-term rates have moved sharply higher this week as a result, the US 10-year up circa 20bps and the Australian 10-year more than 40bps. The US 10-year is now up 100bps from its 2020 low; while the Australian 10-year has risen over 120bps since its low. In assessing the strength and sustainability of the global recovery, the implications for sentiment and activity of higher rates will be important to continually assess.
New Zealand: week ahead & data wrap

It’s not over till it’s over
After a three-month hiatus, the RBNZ was back on deck this week delivering its February Monetary Policy Statement (MPS). And it feels like a lot has changed since the we last heard from the Bank. Back in November, the RBNZ was expecting to have to do a lot more in terms of stimulating the economy, and thought the risks were all to the downside.

But how quickly things can change. In the three months since, the Covid vaccine rollout has commenced globally. Economic data has confirmed that the New Zealand economy has bounced back strongly from the Covid lockdown. Inflation has jumped higher and somewhat surprisingly so. Meanwhile, the housing market has been on an absolute tear, with January house prices up over 19% on a year ago.

But while the risks to the outlook have receded, the economy still faces a long road ahead to full recovery. After all, the tourism sector challenges remain daunting with our borders closed. And on the health front, New Zealand is still only taking the first tentative steps of its own vaccine rollout.

With that in mind, the RBNZ is still ready and prepared to provide more stimulus, if necessary. The RBNZ was thus at pains to point out that it has completed the groundwork for the OCR to go negative, should that be required.

Financial markets, in contrast, have started to see the light at the end of the tunnel. In particular, the market suspects that recent inflation strength will endure. On this basis, the market has already priced in the possibility of OCR hikes by the middle of next year.

However, we think markets have jumped the gun – we do not have OCR hikes pencilled in until 2024. Inflation has risen, but we expect the rise to prove temporary. Much of the inflation spike has actually been due to global supply chain disruptions which will pass. Also, surging global commodity prices have pushed global inflation higher as household spending has shifted from services to goods. But this too will prove temporary. As the global vaccine rollout allows household spending to shift back to services (eg. travel, eating out and entertainment), global commodity prices will cool.

Another New Zealand factor likely to push inflation lower is the strengthening NZD. This week the NZD cracked 74 US cents, the highest level in around three years. Indeed, we expect there is more NZD strength to come, with our forecast peaking at 0.78 in mid-2022. This currency strength is more than the RBNZ has factored into its forecasts. As a result, the dampening impact of the NZD over 2021 and 2022 will surprise the Bank, reinforcing the lack of urgency for the RBNZ to start hiking the OCR.

It’s on the house
The RBNZ was in the news again the day after the MPS. Finance Minister Grant Robertson announced changes that will require the RBNZ to assess the impact of monetary policy on house prices, and to take the Government’s broader housing policy into account when setting financial stability policy. The RBNZ’s Monetary Policy Remit now includes a new sub-clause: “In pursuing the operational objectives, the Monetary Policy Committee shall… assess the effect of its monetary policy decisions on the Government’s policy [to support more sustainable house prices].”

We don’t think this Remit change will have a material impact on OCR settings. Indeed, the change effectively it doesn’t require the RBNZ to act any differently – just to report on the housing market effects of its actions. It’s also important to note that housing is a secondary consideration – the RBNZ’s dual mandates of price stability and supporting maximum sustainable employment still take precedence.

That said, adding the housing market to the mix might, at the margin, lead the RBNZ to take a more gradual path towards reaching its main goals. We had already factored this prospect into our forecasts last year, one of several factors that led us away from forecasting further OCR cuts at the time.

All up, we’re broadly supportive of this change. We have long felt that the RBNZ has underplayed the link between interest rates and house prices. Requiring the RBNZ to assess this link more deeply might actually lead to better forecasts of activity and inflation, and hopefully better monetary policy outcomes over time.

The changes around financial stability policy are more significant. Under the RBNZ Act, the Minister has directed the RBNZ to: “have regard to the impact of its actions on the Government’s policy of supporting more sustainable house prices, including by dampening investor demand for existing housing stock, which would improve affordability for first-home buyers.”

Financial stability policy, unlike monetary policy, has more scope for trade-offs – for instance, the RBNZ may be willing to accept more risk around the build-up of debt by first-home buyers, if it serves the Government’s wider housing affordability goals. Arguably the RBNZ’s prudential polices have been heading in this direction in recent years anyway, but the Minister’s directive formalises this arrangement. The potential implication is that future RBNZ financial stability policies are likely to be squarely aimed at property investors, rather than first-home buyers.

We believe that markets have overdone their reaction to the Minister’s announcement. Interest rates rose sharply, but we would have thought the opposite reaction was more appropriate. Previously, there was a risk that the Minister would require the RBNZ to react to house prices when setting monetary policy. But in reality, that outcome has been avoided. The fact that the Minister was focussed more on the RBNZ’s financial stability policies should have assured the market that the RBNZ will remain dovish for the foreseeable future.

Round-up of local data released over the last week

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<tr>
<th>Date</th>
<th>Release</th>
<th>Previous</th>
<th>Actual</th>
<th>Mkt f/c</th>
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<td>Q4 real retail sales</td>
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<td>-2.7%</td>
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<td>RBNZ policy decision</td>
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<td>Feb ANZ business confidence</td>
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<td>Fri 26</td>
<td>Feb ANZ consumer confidence</td>
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<td></td>
<td>Jan trade balance $m</td>
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Data previews

Aus Feb CoreLogic home value index

Mar 1, Last: 0.7%, WBC f/c: 2.0%

- Australian housing markets are showing a strong pick up in to what is shaping as a sustained boom. The CoreLogic home value index, covering the eight major capital cities, posted a robust 0.7% gain in Jan, following rises of 0.9% in Dec, 0.7% in Nov and 0.2% rise in Oct. Prior to this, prices had recorded five consecutive monthly declines. Prices at the end of Jan were now just 0.4% below their pre-COVID peak and 1.4% below the peak in late 2017.

- CoreLogic measures are set to clear both benchmarks in Feb with the daily index showing prices skipping ahead in the month. We expect a very strong 2.0% gain for the month, with momentum showing a clear tilt back towards Sydney (up 2.2%mth) and Melbourne (now seeing moves in line with the pace nationally).

Aus Jan housing finance approvals

Mar 1, Last: 8.6%, WBC f/c: -2.0%

Mkt f/c: 2.0%, Range: -2.0% to 5.0%

- Housing finance approvals jumped 8.6% in Dec to be up 31.2%yr, putting paid to any lingering doubts about the housing upturn. Some of the strength related to a surge in construction-related loans as the Federal government’s HomeBuilder grant reduced from $25k to $15k at the turn of the year. That said, the upturn has become more evenly balanced with non construction loans and investor loans also rising.

- While we still see housing heading into a strong multi-year upturn, finance approvals are likely to show a partial retracement in Jan. HIA figures on new home sales, which have been a good guide to HomeBuilder effects, plunged in Jan to be 40% below their Nov level (having spiked 90% in Dec). While the financing associated with these purchases will likely follow a gentler path, a sharp pull-back in construction related loans (20% of total) is likely to outweigh gains elsewhere, producing a 2% dip in the month.

Aus Q4 company profits

Mar 1, Last: 3.2%, WBC f/c: -4%

Mkt f/c: 1.5%, Range: -11.0% to 12.0%

- In 2020, government policy support in response to the covid crisis was well in excess of past episodes.

- Assistance programs, including the centre piece JobKeeper, provided transfers to households and businesses - such that incomes, in aggregate rose. The tapering of these programs will act to moderate private incomes, off a high base.

- Company profits surged by 15.8% in Q2, on the income transfers. Profits rose by a further 3.2% in Q3, as assistance continued and the economy rebounded.

- In the December quarter, the economic rebound continued, with output up around 2½% and nominal GDP growth likely in excess of 4%, boosted by the rising terms of trade. Typically, such results would point to a solid rise in profits.

- However, we expect profits to fall in Q4 - with policy tapering, the “fiscal cliff”, the key dynamic. Our forecast is a -4%, but there is considerable uncertainty around this point estimate.

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Data previews

Aus Q4 inventories

Mar 1, Last: -0.5%, WBC f/c: 0.2% (+0.2ppt cont’n)
Mkt f/c: 0.2%, Range: -1.5% to 1.0%

- During the COVID recession output collapsed and this was associated with a sharp reduction in business inventories - a typical dynamic during economic downturns.
- Inventories contracted by 1.4% in Q1 and then fell by a further and dramatic 2.9% in Q2.
- Over the second half of 2020, with activity rebounding as the economy reopens, inventories are beginning to stabilise. Aiding this trend is a sharp rebound in goods imports after an even sharper drop over the initial part of the year.
- During Q3, inventories fell by “only” 0.5% and we anticipate a small increase in Q4, up a forecast 0.2%.
- Such a result, subject to revisions, would see inventories add 0.2ppt to activity in Q4.

Aus Jan dwelling approvals

Mar 2, Last: 10.9%, WBC f/c: -8%
Mkt f/c: -2.0%, Range: -8.0% to 6.8%

- Dwelling approvals surged 10.9% in Dec, also reflecting the rush to beat HomeBuilder scheme deadlines. Remarkably, total approvals are up 57% from their COVID low, 21% above their pre-COVID level in Feb and up 22.8%yr. The HomeBuilder boost is most apparent in detached houses – typically a stable segment, approvals surged 15.8% in Dec to an all-time record high.
- A big retracement clearly looms in Jan with a further step down likely once the HomeBuilder scheme expires altogether at the end of March. We expect total dwelling approvals to record a sharp 8% decline in the month.

Aus Q4 net exports, ppts cont’n

Mar 2, Last: -1.9, WBC f/c: -0.4
Mkt f/c: -0.3%, Range: -1.1% to 0.5%

- International trade flows have swung dramatically during 2020, impacted by large shifts in domestic demand and hit by disruptions (including lock-downs / global supply chains) .
- Net exports added to growth in Q1 and Q2 (+0.5ppt and +0.8ppt respectively), as imports collapsed.
- The reverse is the case over Q3 and Q4, with net exports subtracting -1.9ppt and a forecast -0.4ppt, respectively.
- Goods imports have roared back as the domestic economy reopens, while exports have been somewhat disappointing, in part due to weak global demand for energy (LNG and coal).
- For Q4, we estimate that import volumes rose by 5%qtr, -9.4%yr and exports by +2.4%qtr, -12.3%yr.

Sales and inventories: hit by covid

Net exports: f/c -0.4ppt, imports rebound

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Data previews

Aus Q4 current account, AUDbn
Mar 2, Last: 10, WBC f/c: 13.5
Mkt f/c: 13.1, Range: 10.0 to 14.8

- Australia is running current account surpluses, and has been since June 2019.
- The December quarter 2020 will be the 7th consecutive surplus - matching the run from June 1972 to December 1973, together the longest run of quarterly surpluses in the history of the series (dating back to 1959).
- We are forecasting a current account surplus of $13.5bn for Q4, following a $10.0bn for Q3 and a $16.3bn for Q2.
- The trade position improved on a higher terms of trade, up an estimated 5.7%, led by higher commodity prices. The preliminary trade balance for Q4 was $17.4bn, an improvement on the $13.6bn for Q3.
- The net income deficit has shrunk to a low level, at $3.6bn for Q3, well down from $10bn plus a year earlier. We expect a consolidation in Q4.

Current account: Q4 f/c +$13.5bn

Sources: ABS, Westpac Economics

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Aus RBA policy decision
Mar 2, Last: 0.1%, WBC f/c: 0.1%
Mkt f/c: 0.1%, Range: 0.1% to 0.1%

- We expect no change in the policy settings and confirmation of the conclusion of the February Statement.
- In February the Board noted it “will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range. For this to occur, wages growth will have to be materially higher than it is currently. This will require significant gains in employment and a return to a tight labour market. The Board does not expect these conditions to be met until 2024 at the earliest.”
- Recently, markets became convinced that the pivot to November bonds will not occur and so are expecting a change to the policy of a steady cash rate beyond April 2024.
- Based on our forecasts and assessment of the commitment of central banks globally to their objectives, we don’t expect such a change in rhetoric until the first half of 2022.

Australian economy: activity rebounds

Aus Q4 GDP
Mar 3, Last: 3.3%qtr, -3.8%yr, WBC f/c: 2.5%qtr, -1.8%yr
Mkt f/c: 2.4%qtr, Range: 1.6%qtr to 3.4%qtr

- Over the second half of 2020, activity rebounded briskly as the economy reopened with the rolling back of many (but not all) COVID restrictions. Confident consumers are spending up, boosted by earlier government support, and home building is rebounding, up in response to cheap credit and incentives.
- The quarterly output profile for 2020 was: -0.3%, -7.0%, +3.3% for Q3 and a forecast +2.5% for Q4.
- Hours worked have mirrored the movements in output, with the labour force survey reporting a Q4 rise of 3.2%.
- The arithmetic of our Q4 GDP forecast is: domestic demand +3%; total inventories +0.1ppt; and net exports -0.4ppts, as well as statistical discrepancy of -0.1ppt.
- Consumer spending is a forecast +4.5% (to be -2.6%yr); home building +3%; business investment +0.9% (the first rise since 2019 Q1); and public demand +0.7%.
Data previews

Aus Jan retail trade

Mar 4, Last: -4.1%, WBC f/c: 0.6%
Mkt f/c: 0.6%, Range: 0.2% to 1.0%

- The ABS released preliminary estimates showing retail sales up 0.6% in Jan, a partial rebound on a 4.1% fall in Dec. Tightened COVID restrictions, including a full lockdown for Sydney’s Northern Beaches, put a damper on Christmas-New Year festivities – many of which were cancelled – and on Boxing Day sales. Some of the weakness also reflects activity cycling a reopen ‘catch-up’ in Vic and strong ‘Black Friday’ sales. Overall, sales are still strong, up 10.7% yr
- The final estimates will provide more colour on sales across store-types and states. Revisions are also possible, particularly given the large seasonal adjustments at this time of year – the ABS flagged in its preliminary release that there would be reviewed with the final release of Jan sales figures. Note that our Westpac Card Tracker had suggested sales would be somewhat stronger through Jan.

Aus Jan trade balance, $bn

Mar 4, Last: 6.8, WBC f/c: 8.3
Mkt f/c: 6.3, Range: 6.0 to 10.5

- Australia’s trade account has been in surplus for 36 consecutive months - each month through 2018, 2019 and 2020. The 2021 year is set to start with another surplus.
- For January, we expect the surplus to climb, rising to a forecast $8.3bn, up from $6.8bn in December.
- Export earnings rose by a forecast 4%, boosted by higher commodity prices - which rose by 7.6% in US$ terms or 4.8% in AUD terms. A stand out has been the spike in the iron ore price, up on strong demand from China and constrained supply.
- Imports are expected to be broadly flat - a consolidation after goods imports rebounded over the second half of 2020, up from the May low.

NZ Jan employment indicators

Mar 2, Last: +0.9%, Westpac f/c: -0.3%

- The monthly employment indicator is a relatively new release, based on data from income tax filings. It provides a less detailed but more timely snapshot of employment trends compared to the quarterly surveys.
- The number of filled jobs was fairly steady over the second half of 2020, though with a surprisingly strong lift in December. However, the weekly snapshots from Stats NZ suggest some pullback in January.
- We expect that the absence of international tourists will have a more noticeable impact on economic activity over the summer months.

Australia’s trade balance

NZ Monthly Employment Indicator filled jobs

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.
Data previews

NZ Global Dairy Trade auction, whole milk powder prices

Mar 3, Last: +4.3%, Westpac: +3.0%

- We expect whole milk powder prices to continue their strong momentum at the upcoming dairy auction. Another price lift would make it eight consecutive auction price gains.
- Our pick is slightly below current futures market pricing, which is pointing to a lift of circa 4%.
- Recent auctions have been a little stronger than even we expected. Accordingly, if this auction is as strong as expected, upside risks to our 2020/21 farmgate milk price forecast of $7.50/kg will increase further.

NZ Jan residential building consents

Mar 3, Last: +4.9%, Westpac f/c: -2.0%

- December was another strong month for consent issuance, capping off what turned out to be a massive year. Following the easing in lockdown conditions last year, strong house price growth has underpinned a significant and widespread increase in home building activity. That follows an extended period where home building did not keep pace with population growth.
- We expect that consent numbers will ease by 2% in January. That's due to an expected easing in apartment consents, which rose strongly in December in regions outside of Auckland. Apartment consents can be lumpy on a month-to-month basis, especially in regional centres where they make up a smaller share of building.
- Our forecasts would still leave annual issuance at a multi-decade high, signalling a strong construction pipeline of work.

NZ Q4 building work put in place

Mar 5, Last: +34.6%, Westpac f/c: +3.0%

- Construction rebounded in the September quarter. That followed a large lockdown related drop earlier in the year. The September quarter rise in activity was spread across both the residential and non-residential segments, and took building activity back to its pre-Covid levels.
- We’re forecasting a further 3% rise in the December quarter. That’s underpinned by an expected 4% rise in residential building work. Raising house prices are encouraging new building. New Zealanders are also undertaking more renovations. Non-residential building activity is expected to post only a limited rise.
- The risks around our forecasts mainly relate to timing. Construction activity is on the rise. However, disruptions around the planning process and uncertainty around economic conditions last year may mean that work will take longer to get underway.

NZ real building work put in place

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Data previews

US Feb employment report
Mar 5, nonfarm payrolls, last: 49k, WBC: 200k
Mar 5, unemployment rate, last: 6.3%, WBC: 6.4%

- 49k jobs were created in the US in January according to the nonfarm payrolls release. However, the starting level from which this gain was achieved was 159k lower than previously estimated. As such, at the turn of the year, the US labour market was in a very weak state.
- Come February, momentum should begin to return. We look for a 200k gain, although part of this rise could come as a positive revision to the prior two months.
- Moderate to strong monthly gains should be seen throughout 2021 as stimulus takes effect and the COVID-19 new case count continues to decline rapidly. This robust trend is expected to see the unemployment rate tend towards 5% even as the 2ppt deficiency in participation to pre-pandemic levels is made up. Of course, in any given month, a jolt to participation could temporarily lift the unemployment rate.

US maximum employment a long way off

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### Mon 1

<table>
<thead>
<tr>
<th>Country</th>
<th>Indicator</th>
<th>Last</th>
<th>Median</th>
<th>Westpac Forecast</th>
<th>Risk/Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aus</td>
<td>Feb CoreLogic home value index</td>
<td>0.7%</td>
<td>-</td>
<td>2.0%</td>
<td>Market has taken off in early 2021.</td>
</tr>
<tr>
<td>Aus</td>
<td>Jan housing finance</td>
<td>8.6%</td>
<td>2.0%</td>
<td>-2.0%</td>
<td>Still strong but to retrace slightly as HomeBuilder unwinds.</td>
</tr>
<tr>
<td>Aus</td>
<td>Q4 company profits</td>
<td>3.2%</td>
<td>1.5%</td>
<td>-4%</td>
<td>&quot;Profits&quot; distorted by tapering of government assistance.</td>
</tr>
<tr>
<td>Aus</td>
<td>Q4 business inventories</td>
<td>-0.5%</td>
<td>0.2%</td>
<td>0.2%</td>
<td>Stabilising after sharp run-down. Adds 0.2pts to activity.</td>
</tr>
<tr>
<td>Aus</td>
<td>Feb AiG PMI</td>
<td>55.3</td>
<td>-</td>
<td>-</td>
<td>Manufg expanding – reopening &amp; housing upswing.</td>
</tr>
<tr>
<td>Aus</td>
<td>Feb MI inflation gauge</td>
<td>1.5%</td>
<td>-</td>
<td>-</td>
<td>Unsure as to why it understated the COVID impact.</td>
</tr>
<tr>
<td>Aus</td>
<td>Feb ANZ job ads</td>
<td>2.3%</td>
<td>-</td>
<td>-</td>
<td>Improving in line with broader labour market recovery.</td>
</tr>
<tr>
<td>Aus</td>
<td>Chn</td>
<td>Feb Caixin Mfg China PMI</td>
<td>51.5</td>
<td>51.3</td>
<td>Stay-at-home Golden Week may support mfg in Feb.</td>
</tr>
<tr>
<td>Aus</td>
<td>Asia</td>
<td>Feb Nikkei manufacturing PMIs</td>
<td>-</td>
<td>-</td>
<td>Last: Jpn 50.6, Idr 52.2, Inr 57.7. On Tues: Kor 53.2; Twn 60.2.</td>
</tr>
<tr>
<td>Aus</td>
<td>Eur/US</td>
<td>Feb Markit manufacturing PMIs</td>
<td>-</td>
<td>-</td>
<td>Last: Eur 57.7; Ger 60.6; UK 54.9; US 58.5.</td>
</tr>
<tr>
<td>Aus</td>
<td>UK</td>
<td>Jan net mortgage lending Ebn</td>
<td>5.6</td>
<td>5.1</td>
<td>- Well above pre-COVID levels.</td>
</tr>
<tr>
<td>Aus</td>
<td>US</td>
<td>Jan construction spending</td>
<td>1.0%</td>
<td>0.7%</td>
<td>- Private residential construction the clear outperformer.</td>
</tr>
<tr>
<td>Aus</td>
<td>US</td>
<td>Feb ISM manufacturing</td>
<td>58.7</td>
<td>58.8</td>
<td>- At elevated levels, where it is likely to remain.</td>
</tr>
<tr>
<td>Aus</td>
<td>Fedspeak</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>- FOMC’s Williams (01:00 AEDT) and others (06:00 AEDT).</td>
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### Tue 2

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</thead>
<tbody>
<tr>
<td>Aus</td>
<td>Jan dwelling approvals</td>
<td>10.9%</td>
<td>-2.0%</td>
<td>-8.0%</td>
<td>Unwinding HomeBuilder pull-forward in houses to impact.</td>
</tr>
<tr>
<td>Aus</td>
<td>Q4 net exports, ppts cont’n</td>
<td>-1.9</td>
<td>-0.3</td>
<td>-0.4</td>
<td>Import rebound continues, exports off low.</td>
</tr>
<tr>
<td>Aus</td>
<td>Q4 current account, AUDbn</td>
<td>10.0</td>
<td>13.1</td>
<td>13.5</td>
<td>Current a/c surplus lifts on improved trade position.</td>
</tr>
<tr>
<td>Aus</td>
<td>Q4 public demand</td>
<td>1.8%</td>
<td>-</td>
<td>0.7%</td>
<td>2020: brisk growth, incl. covid response. Q4: investment dip.</td>
</tr>
<tr>
<td>Aus</td>
<td>RBA policy decision</td>
<td>0.10%</td>
<td>0.10%</td>
<td>0.10%</td>
<td>On hold – having already delivered considerable stimulus.</td>
</tr>
<tr>
<td>Aus</td>
<td>NZ</td>
<td>Jan employment indicators</td>
<td>0.9%</td>
<td>-</td>
<td>-0.3%</td>
</tr>
<tr>
<td>Aus</td>
<td>NZ</td>
<td>Q4 terms of trade</td>
<td>-4.7%</td>
<td>1.0%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Aus</td>
<td>Eur</td>
<td>Feb CPI %y/y</td>
<td>0.9%</td>
<td>1.1%</td>
<td>- Near-term increase expected due to base effects.</td>
</tr>
<tr>
<td>Aus</td>
<td>US</td>
<td>Fedspeak</td>
<td>-</td>
<td>-</td>
<td>- FOMC’s Brainard (05:00 AEDT) and Daly (06:00 AEDT).</td>
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### Wed 3

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<th>Westpac Forecast</th>
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<tbody>
<tr>
<td>Aus</td>
<td>Q4 GDP</td>
<td>3.3%</td>
<td>2.4%</td>
<td>2.5%</td>
<td>Rapid rebound as economy reopens. consumers spend up.</td>
</tr>
<tr>
<td>Aus</td>
<td>Feb AiG PCI</td>
<td>57.6</td>
<td>-</td>
<td>-</td>
<td>- Construction index lifts – rising new orders, notably housing.</td>
</tr>
<tr>
<td>Aus</td>
<td>Weekly Payroll Jobs and Wages</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>- Week ending 13 February.</td>
</tr>
<tr>
<td>Aus</td>
<td>NZ</td>
<td>Global/DairyTrade auction, WMP</td>
<td>4.3%</td>
<td>-</td>
<td>-3.0%</td>
</tr>
<tr>
<td>Aus</td>
<td>NZ</td>
<td>Jan building consents</td>
<td>4.9%</td>
<td>-</td>
<td>-2.0%</td>
</tr>
<tr>
<td>Aus</td>
<td>NZ</td>
<td>Feb ANZ commodity prices</td>
<td>3.6%</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Aus</td>
<td>Asia</td>
<td>Feb Nikkei services PMIs</td>
<td>-</td>
<td>-</td>
<td>- Jan: Jpn 45.8; Inr 52.8</td>
</tr>
<tr>
<td>Aus</td>
<td>Chn</td>
<td>Feb Caixin China PMI services</td>
<td>52</td>
<td>51.8</td>
<td>- Will serve as a gauge of Golden Week spending.</td>
</tr>
<tr>
<td>Aus</td>
<td>Eur/US</td>
<td>Feb Markit services PMIs</td>
<td>-</td>
<td>-</td>
<td>- Jan: Eur 44.7; Ger 45.9; UK 49.7; US 58.9.</td>
</tr>
<tr>
<td>Aus</td>
<td>US</td>
<td>Feb ADP employment change</td>
<td>174k</td>
<td>165k</td>
<td>250k</td>
</tr>
<tr>
<td>Aus</td>
<td>US</td>
<td>Feb ISM non-manufacturing</td>
<td>58.7</td>
<td>58.1</td>
<td>- Services to be supported by robust retail into year end.</td>
</tr>
<tr>
<td>Aus</td>
<td>Fedspeak</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>- FOMC’s Harker (02:00 AEDT) and Evans (05:00 AEDT).</td>
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### Thu 4

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<tr>
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<th>Risk/Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aus</td>
<td>Jan retail sales</td>
<td>-4.1%</td>
<td>0.6%</td>
<td>0.6%</td>
<td>Jan mixed, buffeted by ‘mini-lockdowns’ in several states.</td>
</tr>
<tr>
<td>Aus</td>
<td>Jan trade balance, AUDbn</td>
<td>6.9</td>
<td>6.3</td>
<td>8.3</td>
<td>Another large surplus, led higher by exports.</td>
</tr>
<tr>
<td>Aus</td>
<td>RBA’s Kearsn, Head of Fin. Stability</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>- Participation at Moody’s Credit Trends.</td>
</tr>
<tr>
<td>Aus</td>
<td>Eur</td>
<td>Jan unemployment rate</td>
<td>8.3%</td>
<td>8.3%</td>
<td>- Compositional effects may be driving falling u/e rate.</td>
</tr>
<tr>
<td>Aus</td>
<td>US</td>
<td>Q4 productivity</td>
<td>-4.8%</td>
<td>-4.6%</td>
<td>- Will not have space to fully recover until lockdowns end.</td>
</tr>
<tr>
<td>Aus</td>
<td>US</td>
<td>Initial jobless claims</td>
<td>730k</td>
<td>-</td>
<td>- Final - no changes expected.</td>
</tr>
<tr>
<td>Aus</td>
<td>US</td>
<td>Jan factory orders</td>
<td>1.1%</td>
<td>1.0%</td>
<td>- Markets hoping a new downtrend will be established.</td>
</tr>
<tr>
<td>Aus</td>
<td>US</td>
<td>Fed Chair Powell</td>
<td>-</td>
<td>-</td>
<td>- Business investment finished 2020 on a strong note.</td>
</tr>
<tr>
<td>Aus</td>
<td>US</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>- Discuss the US Economy (04:05 AEDT).</td>
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### Fri 5

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<th>Country</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Aus</td>
<td>Feb AiG PSI</td>
<td>54.3</td>
<td>-</td>
<td>-</td>
<td>- Services expanding – reopening, consumer spending.</td>
</tr>
<tr>
<td>NZ</td>
<td>Q4 building work put in place</td>
<td>34.6%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>Residential construction on the rise.</td>
</tr>
<tr>
<td>NZ</td>
<td>NZ</td>
<td>Feb non-farm payrolls</td>
<td>49k</td>
<td>100k</td>
<td>200k</td>
</tr>
<tr>
<td>NZ</td>
<td>NZ</td>
<td>Feb unemployment rate</td>
<td>6.3%</td>
<td>6.4%</td>
<td>6.4%</td>
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<tr>
<td>NZ</td>
<td>NZ</td>
<td>Feb average hourly earnings %mth</td>
<td>0.2%</td>
<td>0.2%</td>
<td>0.3%</td>
</tr>
<tr>
<td>NZ</td>
<td>NZ</td>
<td>Jan trade balance US$bn</td>
<td>-66.6</td>
<td>-67.5</td>
<td>-</td>
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<tr>
<td>NZ</td>
<td>NZ</td>
<td>Jan consumer credit</td>
<td>9.734</td>
<td>13.500</td>
<td>-</td>
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### Sun 7

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<th>Country</th>
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<tbody>
<tr>
<td>Chn</td>
<td>Feb foreign reserves $bn</td>
<td>3210.67</td>
<td>-</td>
<td>-</td>
<td>Authorities have seen no need to intervene.</td>
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</tbody>
</table>
### Economic & financial forecasts

#### Interest rate forecasts

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<tr>
<td>Cash</td>
<td>0.10</td>
<td>0.10</td>
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<td>90 Day BBSW</td>
<td>0.03</td>
<td>0.02</td>
<td>0.02</td>
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<td>0.02</td>
<td>0.04</td>
<td>0.06</td>
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<td>3 Year Bond</td>
<td>0.12</td>
<td>0.10</td>
<td>0.10</td>
<td>0.10</td>
<td>0.10</td>
<td>0.15</td>
<td>0.20</td>
<td>0.30</td>
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<td>3 Year Swap</td>
<td>0.36</td>
<td>0.30</td>
<td>0.25</td>
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<td>0.35</td>
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<td>10 Year Bond</td>
<td>1.92</td>
<td>1.65</td>
<td>1.70</td>
<td>1.80</td>
<td>1.90</td>
<td>2.05</td>
<td>2.20</td>
<td>2.50</td>
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<tr>
<td>10 Year Spread to US (bps)</td>
<td>45</td>
<td>25</td>
<td>20</td>
<td>15</td>
<td>10</td>
<td>10</td>
<td>10</td>
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<tr>
<td><strong>US</strong></td>
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<td>US 10 Year Bond</td>
<td>1.47</td>
<td>1.40</td>
<td>1.50</td>
<td>1.65</td>
<td>1.80</td>
<td>1.95</td>
<td>2.10</td>
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<td>90 day bill</td>
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<td>2 year swap</td>
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<td>0.35</td>
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<td>0.45</td>
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<td>10 Year Bond</td>
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<td>1.75</td>
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<td>10 Year spread to US</td>
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<td>20</td>
<td>15</td>
<td>10</td>
<td>5</td>
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<td>-5</td>
<td>-10</td>
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#### Exchange rate forecasts

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<td>AUD/USD</td>
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<td>NZD/USD</td>
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#### Australian economic growth forecasts

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<td>GDP % qtr</td>
<td>Q2</td>
<td>Q3</td>
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<tr>
<td>Q2f</td>
<td>Q3f</td>
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<td>% yr end</td>
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<td>Unemployment rate %</td>
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<td>CPI % qtr</td>
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<td>Annual change</td>
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<td>CPI trimmed mean: %qtr</td>
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<td>% yr end</td>
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#### New Zealand economic growth forecasts

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<td>GDP % qtr</td>
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<td>Q3</td>
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<tr>
<td>Q2f</td>
<td>Q3f</td>
<td>Q4f</td>
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<tr>
<td>% yr end</td>
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<td>Annual avg change</td>
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<td>Unemployment rate %</td>
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<tr>
<td>CPI % qtr</td>
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<tr>
<td>Annual change</td>
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<td>1.4</td>
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