Week beginning 15 March 2021

- Consumer Sentiment at 10 year high, a key positive for 2021 growth prospects.
- RBA minutes, RBA Governor Lowe and RBA Assistant Governor Financial Markets speaking.
- NZ: current account, GDP.
- China: industrial production, fixed asset investment, retail sales.
- UK: BoE policy decision.
- US: FOMC policy decision, retail sales, industrial production, housing starts and permits.
- Key economic & financial forecasts.

Information contained in this report current as at 12 March 2021.
Consumer Sentiment at 10 year high, a key positive for 2021 growth prospects

The Westpac-Melbourne Institute Index of Consumer Sentiment increased by 2.6% to 111.8 in March from 109.1 in February.

The Index is now just 0.2 points below the December level which was a ten-year high. The main factors driving the Index are improving economic conditions and prospects, both domestically and abroad, particularly as they relate to our labour market.

Australia’s success in containing COVID-19, the promise of vaccine rollouts bringing an end to the pandemic, and support from stimulatory government policies have all contributed to the sustained lift.

However, the survey shows evidence of tensions emerging in the housing market.

Every quarter, the survey includes additional questions around news recall that give a clearer indication of the topics influencing sentiment. Responses this quarter indicate that positive news around the economy, jobs and budget/tax policy have been most influential.

Some 57% of respondents assessed news on ‘economic conditions’ as favourable (up from 47% in December); while 51% assessed news on ‘employment conditions’ as favourable (up from 33% in December). There was a marginal deterioration in assessments of news around ‘budget/tax policy’ – 48% seeing this as favourable down from 57% in December, although the previous read was an eleven-year high.

Overall, these proportions of favourable assessments are very strong by historical standards with the assessment of economic conditions near a ten-year high.

All components of the Index were higher in March. Confidence around the economic outlook led the gains with the ‘economy, next 12 months’ sub-index up 3.7% and the ‘economy, next 5 years’ sub-index up 2.3%.

Assessments of family finances also improved. The ‘finances compared to a year ago’ sub-index lifted by 2.8% and the ‘finances, next 12 months’ sub-index was up by 0.2%.

The ‘time to buy a major household item’ sub-index rose by 3.7%.

Confidence in the labour market improved. The Westpac-MI Index of Unemployment Expectations fell by 2.2% (recall that lower readings on the Index mean fewer consumers expect unemployment to rise in the year ahead). The Index is also seeing the best readings in nearly a decade, emphasising the level of confidence around the outlook for jobs.

Prospects for growth and the consumer in 2021

A confident consumer is critically important to growth prospects for 2021.

The recently released December quarter National Accounts revealed that the key components of growth – household consumption, business investment and dwelling construction – all surprised on the upside. Our forecasts anticipate solid ongoing momentum in those components in 2021.

We now anticipate that the Australian economy will expand by 4.5% in 2021, upgraded from 4.0% previously. This includes expectations for consumer spending to increase by a brisk 5.8% over the year, directly contributing a sizeable 3.1ppts to overall activity.

Household consumption lifted by 4.3% in the December quarter 2020, significantly boosted by the reopening of Victoria where spending jumped 10.4% (but is still 7.2% below pre-pandemic levels). Spending in the rest of Australia rose by 2.3%, reflecting households’ high confidence levels; the emerging boom in housing; and the accumulated savings that are now allowing households to slow their growth in new savings.

Over the quarter the household savings rate – the share of disposable income unspent – fell from 18.5% to 12%, a slowing worth $22bn that allowed spending to lift by $12bn despite an $11bn decline in disposable income (as fiscal supports were wound back).

The extent to which the household sector continues to reduce new saving and draw on accumulated reserves to fund gains in spending will be the key driver of the household spending outlook in 2021.

The ‘new’ savings rate is expected to average a relatively low 4.6% in 2021 as households take comfort in and draw on the high level of savings that have been accumulated in 2020; respond to the further relaxation of social distancing rules; and as the housing market booms. One negative, this forecast is adversely affected by the collapse in population growth as the national border remains closed. However, the dominant dynamic near term will be around savings.

Housing market developments

The tensions in the housing market are likely to be evidence of an emerging squeeze on affordability from rising prices.

The Westpac-MI Consumer Sentiment survey provides some useful insights on these issues.

While optimism around house prices is surging, respondents are becoming more hesitant around the attractiveness of buying and remain wary about real estate as an investment option.

The ‘time to buy a dwelling’ index slipped a further 3.6% – a fourth consecutive fall to be down 11.9% from the peak in November.

We have found this Index to be closely linked to affordability in the past. The decline suggests resurgent prices are already starting to dampen buyer interest and that we may see some easing in the recent surge in demand from owner occupiers, particularly from first home buyers who are the most sensitive to affordability.

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On the other hand, the Westpac-Melbourne Institute House Price Expectations Index increased a further 3.1% in March to a new seven-year high. The Index is 12.5% above its pre-pandemic level. The Index is a better lead indicator of the confidence of investors, whose presence in the early stages of the current housing boom has been overshadowed by owner occupiers.

House price expectations are particularly buoyant in NSW (up 6.4% to 161.6); Queensland (up 5.7% to 162.4) and WA (up 4.6% to 161.8). Surprisingly, expectations eased in Victoria, the state index easing back 2.1% to 154.2 – still 4% below its pre-pandemic level.

In contrast, expectations across all the other major states are comfortably above their pre-pandemic levels (NSW 4.5%; QLD 12.3%; and WA 19.3%). That said, price expectations in Victoria may still be playing catch-up as the state economy continues to reopen.

To date, the optimism around house prices contrasts to reported attitudes towards ‘real estate’ as an investment option.

Every quarter we ask additional questions about where consumers see the ‘wisest place for savings’. In March, just 9.3% of consumers nominated ‘real estate’, the third lowest result in the 47 years we have been running the question. More consumers (10.5%) favour shares than real estate.

‘Safe’ options continue to dominate with 30% of consumers nominating ‘bank deposits’ and 18% nominating ‘pay down debt’ – compared to the post GFC averages of 30.3% and 20.3% respectively.

The fall in the ‘pay down debt’ category shows some increased comfort with leverage particularly compared to recent years – the range in 2016-2019 was 20–25%.

**Policy implications**

The Reserve Bank Board next meets on April 6. The Board will continue to be well pleased with Australia’s economic progress.

It is unlikely to make any changes to its current policy settings or signal any likelihood of changes in the near future.

Our survey signals sustained high confidence levels in the community. Enthusiasm for spending and comfort with job prospects and security will be reassuring to the Board.

But markets and some commentators have been warning against damaging housing bubbles.

The survey points to rising house prices although investors still appear cautious.

Owner occupiers, including first home buyers, may already be becoming deterred by the associated deterioration in affordability.

Indeed it seems very likely that investors will soon become a much bigger factor in the market.

However, as the RBA Governor has noted in his Statement following the March Board meeting, “Investor and business credit growth remain weak”.

Market overheating, which is usually associated with investor activity, still appears to be some way off but it will be useful to monitor this survey for any signs of excessive exuberance around real estate.

We can be confident that if the RBA does become concerned about over-heating the likely policy response will be to impose regulations on bank lending rather than to increase interest rates.

**Bill Evans, Chief Economist**
This week's key data highlighted that the momentum apparent in GDP in Australia in Q4 has been sustained in early 2021, bolstering our prospects for recovery.

In February, the NAB business survey reported business conditions at their strongest level since mid-2018, when the last home-building boom peaked. Confidence also improved in the month, printing at an 11-year high. Importantly, the uptrend in confidence and conditions is broad-based across the nation and by industry; and the conditions detail points to businesses becoming increasingly more disposed to expanding their workforce.

Combined with the global vaccine rollout and the growing expectation of a swift, full recovery, Australia’s domestic strength has left the consumer in a very optimistic mood. The headline measure from our Westpac-MI consumer sentiment survey remaining near its 10-year high in March as each of the core components (the 1 and 5-year economic outlook and family finance expectations) printed above their respective long-run averages. Our gauge of labour market sentiment also showed strength in the month, reporting one of its best readings in nearly a decade.

Unsurprisingly, house price expectations rose again in March to a new 7-year high, with the readings for NSW, QLD and WA particularly upbeat. However, as actual and expected prices jolt higher, perceived affordability is deteriorating, the ‘time to buy a dwelling’ indicator from our survey falling 12% over the four months to March to be below its long-run average. As the recovery matures, it will be critical to assess how actual and perceived affordability constraints affect housing and consumption.

This week also saw the release of our latest Market Outlook and Market Outlook in Conversation podcast. As detailed by Chief Economist Bill Evans in the podcast, the momentum of the early recovery in the second half of 2020 combined with strong support for the consumer in 2021 from elevated savings, an improving labour market and rising wealth have led us to revise up our growth expectations for 2021 from 4.0% to 4.5% with a still-above-trend 3.0% gain to follow in 2022.

While we have also lifted our expectations for term interest rates this month on the back of the global recovery, we remain of the view that the RBA and other key central banks will persist with asset purchases to at least late-2022, and hold their policy rates at the lower-bound for years.

As detailed by RBA Governor Lowe this week, the timing of lift-off for the cash rate will depend critically on “sustainably higher rates of wages growth” which will require “a tight labour market for an extended period”. With the full employment level of the unemployment rate for Australia conceivably “in the 4s”, Westpac’s forecast for a strong recovery through 2021 and 2022 still does not result in the pre-conditions for robust wages growth being in place given we see the unemployment rate ending the period above 5.0%. Hence, we expect the cash rate to remain unchanged till well after the end of our forecast window in 2022.

As alluded to above, central banks across the world face the same situation. In the US, even though President Biden's stimulus will stoke growth to almost three times potential in 2021 and more than twice potential in 2022, the output gap created by the pandemic will only just close by end-2022. The US economy is also therefore unlikely to see strength in wages growth, let alone the sustained period of inflation above target necessary to begin making up for a decade of underperformance. Europe and the ECB are further behind still, with the ECB’s latest inflation projection for 2023 only 1.4%, nowhere near their target of 2.0%.

The additional concern for the US, and arguably for Europe as well, is that the investment outlook remains challenged. Domestically-focused businesses certainly have good justification to be positive on the near-term outlook; but as much of the above-trend momentum stems from stimulus, they are likely to remain circumspect on the medium-term, making them wary to expand capacity. Globally-focused businesses can expect sustained robust growth in demand owing to the economic development that is continuing in Asia and elsewhere in the world; but for many of these businesses it will make more sense to locate their expansion in Asia and other emerging markets, where growth is focused and the cost of production lower.

As we look out beyond the end of 2022, this is why China's outlook is so promising. Like the West, they have benefitted from a strong recovery in consumption and will see further gains in 2021. But Chinese authorities’ focus is instead on maximising investment to ready the economy to expand its markets abroad, and to provide a much larger share of the goods and services consumed locally by their own consumers. Last week’s 2021 NPC made clear that high-return investment will remain the focus for China over the coming 5 years, with the dividends to flow well beyond.
New Zealand: week ahead & data wrap

Economy quiet as housing market roars

The New Zealand economy has been in a soft patch. Indeed, economic data has been hinting that the economy has been cooling since around October or November last year.

Recent data have cemented this trend. Business confidence fell in the preliminary March estimate, and the reading of businesses’ own activity also dipped. Importantly, retail spending has also slowed for five consecutive months, with the February electronic card transactions showing a 2.5% decline.

The recent Covid lockdowns are certainly part of the weaker economic mix. Recall that Auckland has been at Covid Alert Level 3 twice over the past month, while the rest of the country has been at Level 2 at times. While Level 2 presents little-to-no disruption to aggregate business activity, Level 3 in Auckland does matter – even if the total impact is smaller than initially feared because much activity is delayed rather than cancelled.

However, the bigger driver of the economic slowdown has been the summer of no tourists. We have estimated that the impact of the absence of international tourists on economic activity will vary from as low as around 2% in the September quarter to as high as around 6% in the March quarter. Hence, the absence of international tourists has left a sizeable economic hole over the December and March quarters.

More subtly, the absence of international tourism has disrupted the seasonal patterns in the GDP data. GDP rose by 14% in the September quarter, more than reversing the 11% drop during the lockdown and taking it to slightly above its pre-Covid level. That whopper result was partly because of catch-up spending as Covid restrictions were lifted, but also because the loss of international tourism was less of an issue during the winter months. Over the summer quarters this tourism impact reverses, before flipping back the other way come the June quarter.

We expect that this tourism hole will culminate in falling GDP over the summer quarters. Specifically, we expect next week’s data to show that December quarter GDP fell 0.3%.

A 0.3% December quarter GDP decline would leave GDP about the same level as a year ago. More significantly, the economy will remain about 3% shy of what we would have expected if Covid-19 had not happened.

Our forecast is at the low end of the market range. Many are picking a positive result, while the Reserve Bank assumed a zero result. 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. 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 results ultimately achieved may differ substantially from these forecasts.

In contrast to the recent cooling in the economy, the housing market continues to roar. House prices have leapt 8% over the last three months, with this three-month price increase the fastest on record.

The February housing data also showed a strong lift in house sales, although not enough to fully recover from the sharp drop in sales in January. That said, house sales remain high, the number of days it takes to sell is extremely low, and other data shows a lack of inventory available for sale. These are all classic indicators of ongoing rapid price increases in the near future.

The driver of rising house prices at present is ultra-low mortgage rates. And movements in mortgage rates will largely determine where to from here for the housing market.

On the mortgage front, we expect longer-term fixed rates will rise this year, even though we do not expect OCR hikes until 2024. The catalyst for rising mortgage rates will be multi-pronged. Firstly, we anticipate that the Funding for Lending Programme (FLP) will not be renewed. Secondly, we expect RBNZ will gradually scale back its quantitative easing programme (or LSAP). Thirdly, the RBNZ is going to require banks to hold more capital over coming years. And lastly, market expectations of future OCR hikes are enough for longer-term interest rates to begin rising.

Short-term fixed rates will probably rise later. We expect that the two-year fixed rate will start rising late this year, to about 4% at the end of 2022, and 4.5% at the end of 2023.

With mortgages as large as they are these days, mortgage rate increases in the order of what we expect will be enough to slow the housing market, and eventually send it into reverse.

At the current juncture, we forecast 17% house price inflation over 2021 as a whole, after a 12% increase in 2020. But we expect that the monthly pace of price increases will start gradually easing due to rising mortgage rates.

So we remain comfortable with our forecast for a 17% rise in house prices over 2021 (which is the highest in the market). And we forecast a 7.5% house price increase in 2022 - slower than today, but nonetheless still a hot housing market.

Round-up of local data released over the last week

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Data previews

Aus Q1 AusChamber–Westpac business survey

Mar 16, Last: 48.4

• The Australian Chamber–Westpac Survey of Industrial Trends, Australia’s longest running business survey dating from 1966, provides a timely update on manufacturing and insights into economy-wide trends. The Q1 survey was conducted from 8 February to 1 March.

• In Q4, the Actual Composite improved to 48.4 in the December quarter after rising to 42.8 in the September quarter. This recovery followed the dramatic fall to 24.0 in the June quarter associated with the initial lockdown and the response to Covid.

• With the activity index nearing 50, the Q4 survey suggested conditions were stabilising. Output expanded for the first time in the calendar year, and new orders only contracted marginally.

• In the second half of the year, activity recovered briskly, with GDP advancing 3.4% and 3.1% in Q3 and Q4 respectively. This momentum in the real economy has carried into the first quarter of 2021.

Aus Feb Westpac–MI Leading Index

Mar 17, Last: 4.48%

• The Leading Index growth rate rose to 4.48% in Jan from 4.24% in Dec – consistent with growth running well above trend through 2021.

• The index growth rate, which is a six month annualised measure, is likely to see a sharp loss in altitude in coming months as last year’s COVID disruptions start to drop out of the picture. Where the growth rate settles will be an important gauge of how the economy will perform once the direct disruptions from the virus are over.

• For the Feb month, component updates are mixed with small gains for the ASX200 and consumer sentiment-based measures, solid months for US industrial production and commodity prices, and a notable steepening in the yield curve (usually a positive signal for growth) but dwelling approvals and hours worked both falling very sharply.

Aus Feb labour force survey, employment change

Mar 18, Last 29.1k; WBC f/c: 30k, Mkt f/c 30.0k, range: 14.2k to 55.0k.

• Total employment has recovered 813.6k, or 6.7%, from the May low to be just 58.5k, or 0.5%, below the pre-COVID level.

• The labour market has had a sharp V-shaped recovery, much stronger than anticipated. However, the state data reveals the impact of further lockdowns, and re-openings, with employment surging in Victoria while it stalled in NSW. In addition, the recovery has been dominated by male part-time employment.

• Victoria is still running behind the recovery seen in other states while NSW should bounce back from the temporary lockdowns in January. However, these positives are tempered by the payrolls data which suggests overall employment growth slowed in February.

• Our forecast gain will see February employment down just 28.5k, or -0.2%, on the March 2020 level.

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Data previews

Aus Feb labour force survey, unemployment %
Mar 18, Last 6.4%; WBC f/c: 6.3%,
Mkt f/c 6.3%, range: 6.4% to 6.2%.

- In January the sound 29.1k gain in employment drove an outsized 0.2ppt fall in the unemployment rate to 6.4% due to a surprising 0.1ppt fall in the participation rate. It is unusual for participation to fall with a sound print on employment.
- So far the improvement in unemployment has not been as solid as the improvement in employment – the 6.4% print still 1.1ppt higher than it was in March 2020. This is due to solid participation which at 66.1% is just 0.5ppt below where it was in March and thus it has not fully offset the gap in employment.
- Our forecast for +30k on employment (based on a NSW bounce and a softer Victoria) with a 0.1ppt rise in participation results in a 0.1ppt fall in unemployment to 6.3%.

Aus Feb retail trade
Mar 19, Last: 0.5%, WBC f/c: 1.0%
Mkt f/c 0.6%, Range: -0.5% to 2.5%

- Final estimates showed Jan retail sales up a modest 0.5% in the month and still well above pre-COVID levels (up an impressive 10.6%yr). Sales have been choppy through Nov-Dec-Jan due to both COVID disruptions (‘mini-lockdowns’ in several states) and shifts relating to ‘Black Friday’ sales and catch-up spend in Vic following the state’s reopening.
- Feb saw yet more COVID disruptions, this time with Qld and Vic both instituting week-long lockdowns. Our Westpac Card Tracker suggests these had limited impact for the month as a whole. On balance we expect Feb to show a decent 1% gain.
- It should be noted that retail is likely to see some softening in sales as the economy fully reopens and consumers shift more of their spending back towards areas previously affected by restrictions – many of which are services that are outside the scope of the retail survey (e.g. tourism, travel and entertainment).

NZ GlobalDairyTrade auction, whole milk powder prices
Mar 16, Last: 21.0%, Westpac: -2.0%

- We expect whole milk powder prices to recede following last auction’s massive lift. Prices spiked 21% a fortnight ago, with the price rise the largest since 2010.
- Our pick is in line with current futures market pricing. However, given the magnitude of the lift at the last auction a wide range of results are possible.
- Following the last auction, we lifted our 2020/21 farmgate milk price forecast by 40 cents to $7.90/kg. This put our forecast at the top of Fonterra’s forecast range of $7.30/kg to $7.90/kg.
Data previews

NZ Current Account Balance, % of GDP

Mar 17, Last: -0.8%, Westpac: -1.0%

- We expect the annual current account deficit to widen to 1.0% of GDP in the December quarter, after having narrowed to a 19-year low of 0.8% in September.
- The main factor this quarter is the lack of the usual lift in overseas visitor spending at this time of year. This will see the deficit widen further over 2021, with overseas travel not expected to begin in earnest until early next year.
- The balance of trade in goods remains – unusually – in surplus, although the gap is narrowing. Imports remain well below pre-Covid levels, while goods exports continue to hold up well.

NZ Q4 GDP

Mar 18, Last: 14.0%, Westpac f/c: -0.3%, Mkt f/c: -0.1%

- We expect a 0.3% drop in GDP for the December quarter, following a 14% rebound in September as Covid-19 restrictions were lifted.
- Domestic activity has already returned to around pre-Covid levels, making further gains hard to come by while the international border remains closed.
- The absence of international tourism has disrupted the seasonal patterns in the data. We expect to see weaker outturns in the spring and summer months, and higher than normal growth in winter.

US Mar FOMC policy meeting

Mar 16-17, fed funds rate, last: 0.125%, WBC: 0.125%

- The FOMC will most certainly look to revise up their growth and labour market views for the forecast period at the March meeting following the safe passage of President Biden’s stimulus package through Congress.
- However, given the substantial degree of labour market slack still to work through, and the decade-long inflation underperformance of the US, participants are unlikely to materially revise up their views on inflation.
- As a result, we expect that, while some members of the Committee will look to bring forward their anticipated timing for the first fed funds rate hike(s), the median will remain at or very close to zero to the end of the forecast period.
- While not included in the forecast table, any guidance on triggers for the tapering of asset purchases will also be closely scrutinised.

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Key data & event risk for the week ahead

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Economic & financial forecasts

Interest rate forecasts

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<td>0.30</td>
<td>0.25</td>
<td>0.30</td>
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<td>10 Year Bond</td>
<td>1.70</td>
<td>1.85</td>
<td>1.85</td>
<td>1.90</td>
<td>2.05</td>
<td>2.20</td>
<td>2.35</td>
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<tr>
<td>10 Year spread to US (bps)</td>
<td>16</td>
<td>20</td>
<td>15</td>
<td>10</td>
<td>10</td>
<td>10</td>
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US

| Fed Funds | 0.125          | 0.125  | 0.125  | 0.125  | 0.125  | 0.125  | 0.125  | 0.125  |
| US 10 Year Bond | 1.54          | 1.65   | 1.70   | 1.80   | 1.95   | 2.10   | 2.25   | 2.40   |

New Zealand

| Cash      | 0.25           | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   |
| 90 day bill | 0.32           | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   |
| 2 year swap | 0.52           | 0.40   | 0.40   | 0.40   | 0.45   | 0.50   | 0.55   | 0.60   |
| 10 Year Bond | 1.71           | 1.90   | 1.90   | 1.95   | 2.00   | 2.10   | 2.20   | 2.30   |
| 10 Year spread to US | 17 | 25 | 20 | 15 | 5 | 0 | -5 | -10 |

Exchange rate forecasts

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<td>EUR/USD</td>
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Australian economic growth forecasts

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<th>2020</th>
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<th>Calendar years</th>
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<tr>
<td></td>
<td>Q2</td>
<td>Q3</td>
<td>Q4</td>
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<tr>
<td>GDP % qtr</td>
<td>-7.0</td>
<td>3.4</td>
<td>3.1</td>
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<tr>
<td>%yr end</td>
<td>-6.3</td>
<td>-3.7</td>
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<tr>
<td>Unemployment rate %</td>
<td>7.0</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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<tr>
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New Zealand economic growth forecasts

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<tr>
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<td>Q2</td>
<td>Q3</td>
<td>Q4f</td>
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<tr>
<td>GDP % qtr</td>
<td>-11.0</td>
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<tr>
<td>Annual avg change</td>
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<td>Unemployment rate %</td>
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<td>CPI % qtr</td>
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<td>0.5</td>
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<tr>
<td>Annual change</td>
<td>1.5</td>
<td>1.4</td>
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