

WESTPAC WEEKLY ECONOMIC COMMENTARY

Running to catch up.

2 May 2022



Mount Cook buttercup

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The state of the labour market has been overshadowed to some degree lately, as the surge in inflation has dominated the headlines. Nevertheless, it's giving a clear signal that the economy is overheated, and as such it's a crucial part of the story about ongoing inflation.

Indeed, we expect that the March quarter labour market surveys, released this Wednesday, will include fresh entries in the labour market record books. For the Household Labour Force Survey (HLFS), we expect the unemployment rate to drop to 3%, from 3.2% in the December quarter. That previous reading was already a record low in the history of the survey going back to 1986, and the indicators that we follow suggest that the jobs market has tightened even further from that.

Firstly, the monthly employment indicator was up by 0.2% on average over the March quarter. This measure is drawn from tax data, which means it's quite a comprehensive record of workers in New Zealand. The indicator did drop slightly in February and March, though this may have been due to disruptions during the peak of the Omicron wave. Looking at other countries that went through Omicron earlier than we did, such as Australia, there doesn't appear to have been a lasting impact on employment.

Jobseeker benefit numbers have continued to edge down this year. Over the March quarter they were almost 10% lower than the same time last year – a period that was largely free of Covid altogether. Eligibility for the benefit isn't aligned with

the official definition of unemployment in the HLFS, but the two tend to move in the same direction.

Finally, job advertisements have picked up again as the country has moved past the Delta lockdown. By March they were almost fully back to their pre-Delta level, which was itself significantly higher than pre-pandemic levels. Workers remain in hot demand, and a substantial part of the rise in job ads is likely to be due to 'churn', as workers are poached or jump to new roles.

With a jobs market as tight as this, we would expect to see upward pressure on wages and salaries as well. That is happening, although at a national level it hasn't looked particularly dramatic to date – more akin to a catch-up after a period of weak wage growth in the wake of the initial Covid shock. However, wage growth tends to lag the broader economic cycle, so this process likely has further to play out.

For the Labour Cost Index (LCI), we expect a 0.7% increase for the quarter, which would lift the annual growth rate to 2.9%, the highest since early 2009. The March quarter usually sees a relatively small increase – pay reviews are more common

in the second half of the year – so this represents more of an acceleration in the quarterly growth pace than the headline number might suggest.

Given the inevitable comparisons between wage growth and inflation, we should emphasise that the LCI is not a measure of the pay rates that workers are receiving. It is literally what it says on the label: it's an index of the cost of a given unit of labour. It strips out pay increases that are related to experience or seniority – which is a big part of where individuals' pay increases will come from.

If we want to look at 'real' wage growth, a more appropriate measure would be the unadjusted analytical series of the LCI (which was up 4.2% in the year to December) or the average hourly earnings measure in the Quarterly Employment Survey (up 3.8%). Using either measure, it's still going to be the case that pay rates haven't kept up with the cost of living – recall that consumer prices rose by 6.9% in the year to March.

Whether we should expect to see wages outstripping inflation depends on the source of the inflation. If it's the result of a cost shock, such as a jump in world oil prices, it's really a no-win situation – someone has to bear the cost, and even in an extremely tight labour market, it's likely to be shared between businesses and workers. But if inflation is being driven by strong demand in the domestic economy, it's more likely that strong competition for workers will see wage rates bid up ahead of inflation.

Of course, what we're experiencing now is both kinds of inflation. However, at least to date, cost shocks have accounted for a greater share. So it's not entirely surprising that real wages have gone backwards. That will change in time: a year from now, we expect that headline inflation will be lower than it is today, but it will also be driven largely by demand-side forces. In that environment, we expect real wage growth to turn positive again.

In its February *Monetary Policy Statement* the Reserve Bank assumed a flat outturn for unemployment in the March quarter, on the way to a gradual upturn from the second half of this year. That forecast reflects the idea that the economy is operating above 'maximum sustainable employment' and will need to ease back in order to bring inflation under control. The issue of what's sustainable is a thorny one, and ultimately it comes down to what current conditions mean for wage inflation. In that respect the RBNZ's forecasts are similar to our own, with a 0.7% rise pencilled in for the LCI.

As such, if the surveys this week come out in line with our forecasts, it would represent at best a modest upside surprise to the RBNZ's February forecasts. Indeed, this may have already been pre-empted to some degree by last month's decision to lift the Official Cash Rate by 50 basis points in one go.

Michael Gordon, Acting Chief Economist

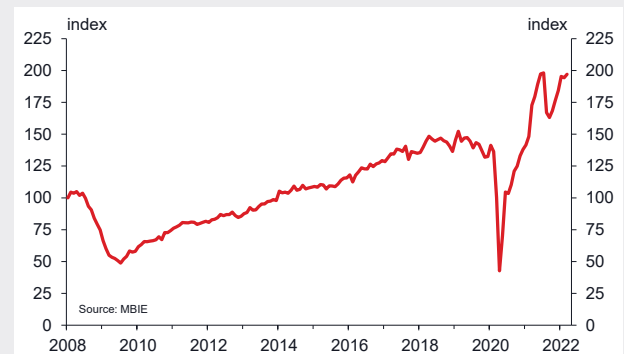
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Chart of the week

Job advertisements had recovered to around their pre-pandemic levels by early 2021, but then shot higher in the following months, and remained relatively high even during the Delta lockdown. These numbers have far outstripped the pace of the employment growth, suggesting that much of the recent increase reflects 'churn', as employers struggle to replace workers who have departed for other roles.

Online job advertisements, seasonally adjusted

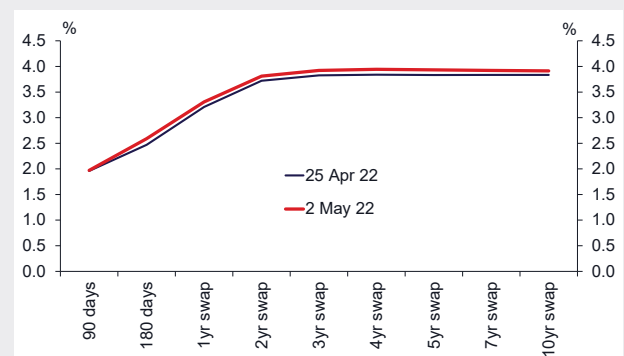


Fixed vs floating for mortgages

Wholesale interest rates have now moved substantially beyond our forecast of a 3% peak in the cash rate by the end of this year. That suggests to us that there is no advantage to fixing for longer terms.

While the one-year mortgage rate is likely to rise further in the year ahead, fixing and rolling for this term is likely to produce a lower borrowing cost on average over the next few years. Longer fixed terms would be more suited to those who want certainty in their repayments.

NZ interest rates



The week ahead

NZ Mar residential building consents

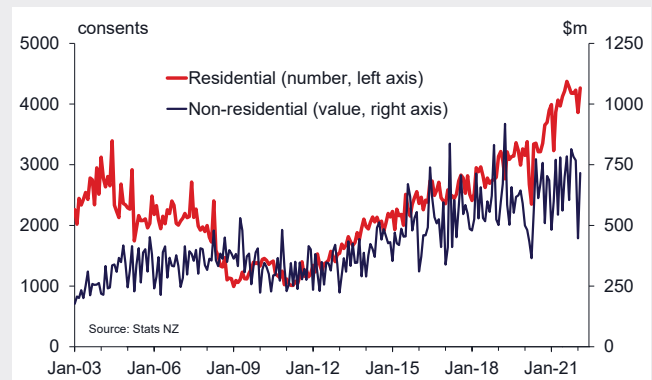
May 3, Last: +10.5%, Westpac f/c: -5.0%

Consent issuance rose 10.5% in February with just over 4,200 new dwellings approved. That increase was underpinned by a sharp rise in medium density consents.

We're forecasting a 5% fall in consents issuance in March, as some of February's sharp rise in multi-unit consents reverses. Stand-alone unit consents are expected to remain steady around firm levels. Looking through the month-to-month volatility, those developments would see annual consent issuance remaining close to their recent record highs.

We expect consent issuance and home building will remain strong over the remainder of 2022. However, the housing market has been cooling in recent months, while interest rates and build costs are pushing higher. Over time, those developments are likely to weigh on the number of new projects that come to market.

NZ building consents



NZ GlobalDairyTrade auction, whole milk powder prices

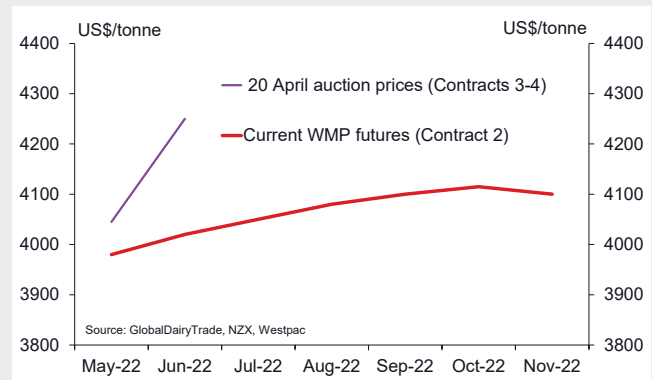
May 4, Last: -4.4%, Westpac: -2%

We expect whole milk powder prices (WMP) to fall 2% at the upcoming dairy auction. Prices have softened over the last three auctions by a combined 7.8% as global dairy markets have reacted to the Covid outbreak in China.

Our pick is similar to futures market pricing.

Looking beyond the next few auctions, we expect prices to remain high on strong market fundamentals. However, there is uncertainty around when China's Omicron wave passes and in turn when Chinese dairy demand recovers.

Whole milk powder prices



NZ Q1 Household Labour Force Survey

May 4, Employment last: 0.1%, WBC f/c: 0.2%, Mkt: 0.1%
Unemployment rate last: 3.2%, WBC f/c: 3.0%, Mkt: 3.1%

We expect the unemployment rate to fall to 3.0% in the March quarter. This would be another new low in the history of the survey going back to 1986. Labour market indicators point to a further tightening in the market in recent months, albeit with some disruptions from the Omicron wave. Jobseeker benefit numbers have continued to drift lower, business surveys point to a lift in employment as the country has moved beyond the Delta lockdown, and job advertisements have almost fully recovered to their pre-Delta highs.

Our forecast would represent a modest upside surprise to the Reserve Bank's view – something that was perhaps already anticipated in this month's decision to lift the OCR by 50 basis points in one go.

NZ Household Labour Force Survey



The week ahead

NZ Q1 Labour Cost Index

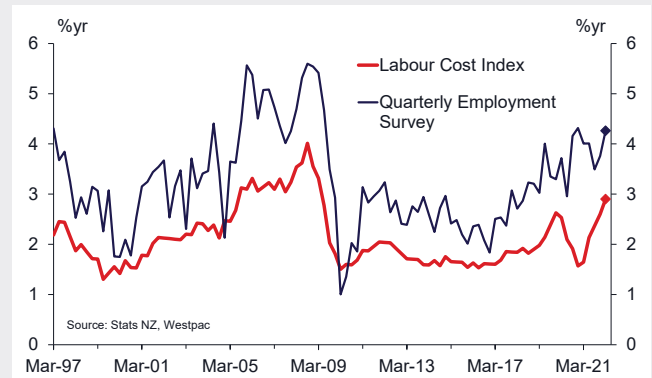
May 4, Private sector last: 0.6%, WBC f/c: 0.7%, Mkt: 0.7%

We expect a further acceleration in wage growth, albeit still falling short of the surge in consumer price inflation.

For the Labour Cost Index (LCI), we expect a 0.7% increase for the quarter, which would lift the annual growth rate to 2.9%, the highest since early 2009.

The March quarter usually sees a relatively small increase – pay reviews are more common in the second half of the year – so this represents more of an acceleration in the quarterly growth pace than the headline number might suggest.

NZ salary and wage growth, all sectors



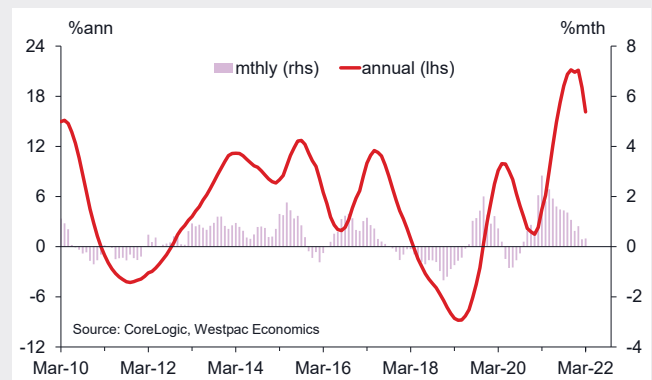
Aus Apr CoreLogic home value index

May 2, Last: 0.3%, WBC f/c: 0.3%

Dwelling prices rose 0.3% in March, matching the subdued 0.3% gain in Feb, the slowest monthly gains since Oct 2020. The annual pace of growth moderated further to 16.3%/yr, down from 21.3%/yr in Jan and is set to see a further sharp slowing in coming months as last year's strong first half burst cycles out of calculations. Q1 has seen price gains track a sub-5% pace in annualised terms. The slowdown has been particularly pronounced in Sydney and Melbourne.

April is set to be another repeat, daily measures pointing to a 0.3% gain nationally with slight declines in Sydney and Melbourne but continued gains in Brisbane, Adelaide and Perth. Turnover will also be of some interest given revised figures showing a sharp pull-back in the first quarter and buyer sentiment turning down quickly.

Australian dwelling prices



Aus RBA policy decision

May 3, Last: 0.1%, WBC f/c: 0.25%

Mkt f/c: 0.25%, Range: 0.10% to 0.50%

We expect the RBA Board to announce the start of an interest rate tightening cycle at the May meeting - the first increase in rates since November 2010. The likely size of any move is a matter of conjecture. We anticipate an increase of 15bps, to 0.25%, up from a record low of 0.10%. There will be the adoption of a strong tightening bias justifying the decision, as well as the signalling of a follow-up move in June.

The RBA's policy objectives have broadly been met and the need for emergency settings has passed. The unemployment rate is at an equal 48 year low, and set to move lower. Core inflation has rapidly moved from below the 2-3% target band, at 1.6% for June 2021, to be well above, at 3.7% in March 2022 - including a strikingly large 1.4% rise in the March quarter.

Westpac expects a series of moves in 2022 (including 25bps hikes in June, July and August), lifting the cash rate by year end to 1.5%, then rising to a peak of 2.0% in mid-2023.

RBA cash rate and 3 year bonds



The week ahead

Aus Mar retail trade

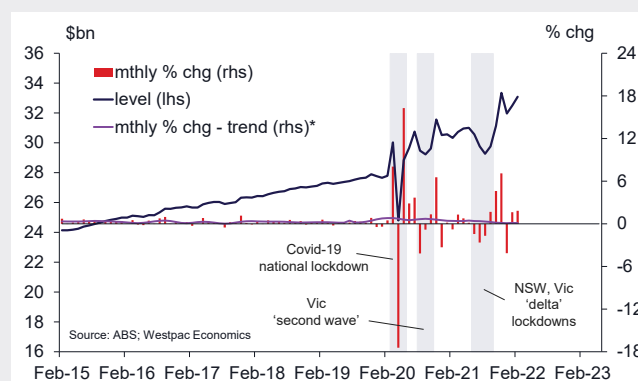
May 4, Last: 1.8%, WBC f/c: -1.0%

Mkt f/c: 0.5%, Range: -1.0% to 1.0%

Retail sales posted a robust 1.8% gain in Feb following a better than expected 1.6% rise in Jan. Momentum has built steadily despite setbacks from both COVID (the omicron outbreak in early Jan), weather events (flooding in parts of Qld and NSW in the latter part of Feb) and higher fuel prices (fuel is outside the scope of the survey but higher fuel costs can siphon demand away from retail). That said, the Q1 CPI shows much of the lift is coming from higher prices rather than volumes.

Our Westpac Card Tracker suggests weather and fuel price effects became a little more pronounced in March with retail components notably softer in the second half of the month. With spending also rotating towards non-retail components this is likely to see sales retrace in the month. We expect retail sales to dip back 1% but still be up 2.5% vs Dec. Note that this is preliminary release only includes top level monthly aggregates. The detailed release including Q1 volume estimates is due out the following week on May 10.

Monthly retail sales



Aus Mar housing finance approvals

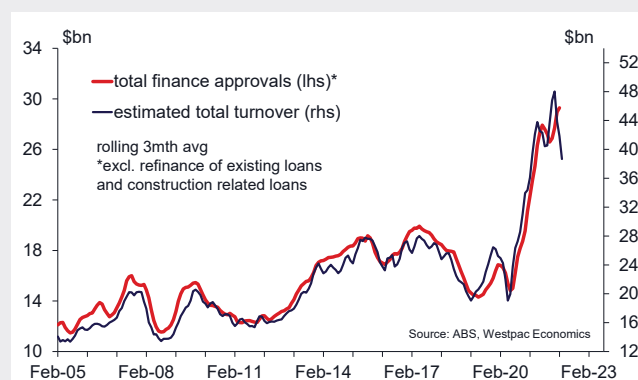
May 4, Last: -3.7%, WBC f/c: -3.5%

Mkt f/c: -1.6%, Range: -3.5% to 1.50%

Housing finance approvals declined 3.7% in Feb, with the start of the year now looking like the peak of the cycle – revised turnover data from CoreLogic now showing a significant 20% decline in the nominal value of housing sales during the first quarter. Housing finance is likely to follow that turn with a slight delay.

We expect the value of finance approvals to show another 3.5% decline in March with owner occupiers again leading the way.

New finance approvals*



Aus Mar dwelling approvals

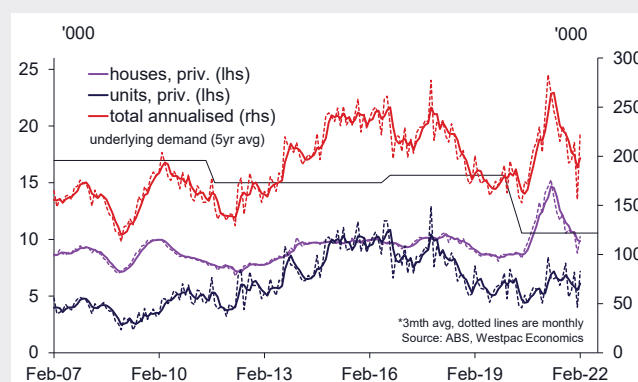
May 5, Last: 43.5%, WBC f/c: -4%

Mkt f/c: -15%, Range: -20% to +5%

Virus disruptions have generated enormous volatility in dwelling approvals in early 2022, a -27% plunge in Jan followed by a spectacular +43.5% surge in Feb that takes approvals back to slightly above their Dec level. Taking the two months together, average approvals are down 5% compared to the average in Q4 last year, suggesting some underlying softening.

March ought to be a bit more settled. That said, there may be some unwind in high rise unit approvals which were at a relatively high level in Feb (perhaps some catch-up for processing delays?). That plus some softening in detached houses in line with the wider market turn would give a 4% decline in the month.

Dwelling approvals



The week ahead

Aus Mar trade balance, \$bn

May 5, Last: 7.5, WBC f/c: 10.7
Mkt f/c: 9.5, Range: 6.5 to 10.7

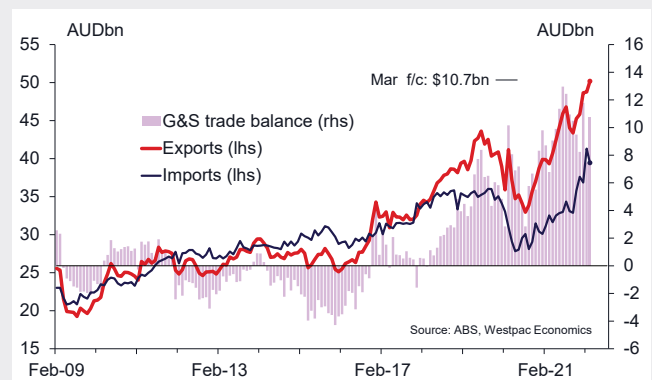
Australia's trade surplus narrowed from a high of \$11.8bn in January to \$7.5bn in February centred on a clustering of imports, which surged by 12% in the month, up \$4.4bn.

For March, we expect the surplus to snap back, up \$3.2bn to \$10.7bn.

Imports are expected to pull-back after the February surge - within the context of an underlying upward trend associated with rising domestic demand. We've factored in a decline of -4.5%, -\$1.8bn. Other factors at play in the month - mixed price dynamics (higher energy prices but downward pressure from a higher AUD).

Export earnings are forecast to rise by 2.9%, +\$1.4bn. Coal will lead the way on higher prices, partially offset by lower volumes (with some flood impacts). Commodity prices more generally moved higher, across fuels, metals, gold and rural goods.

Australia's trade balance



US May FOMC meeting

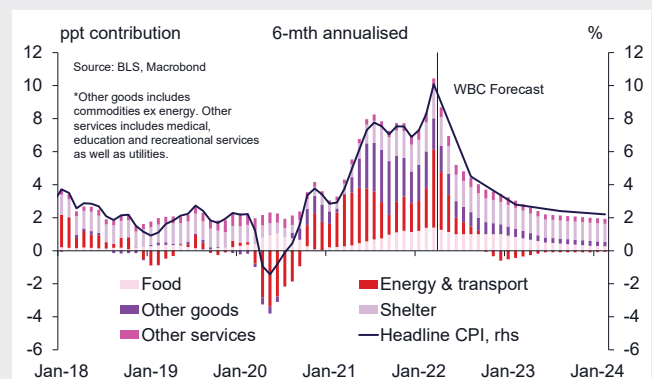
May 3-4, Fed Funds rate, Last: 0.375%, WBC f/c: 0.875%,
Mkt f/c: 0.875%

Heading into the May meeting, members of the FOMC are singularly focused on the historic pace of inflation and associated risks.

A 50bp hike in the fed funds rate at this meeting is therefore anticipated along with a clear signal that the rapid tightening of rates will continue in June and be paired with a quick ramping up of quantitative tightening through mid year.

While unlikely at the May meeting, from June/July the FOMC's view on risks will again broaden to include activity. Assuming inflation pressures are by then showing signs of easing, the July meeting is likely to see a return to 25bp increases in the fed funds rate, taking the policy rate to a peak of 2.375% at year end.

US supply side inflation to recede



US Apr employment report

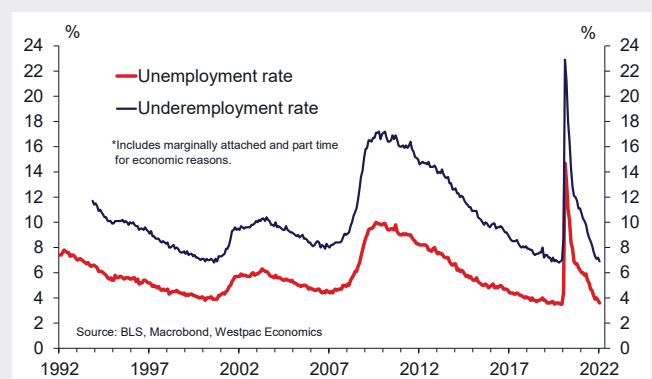
May 6, nonfarm payrolls, Last: 431k, WBC f/c: 425k, Mkt f/c: 390k
May 6, annualised, Last: 3.6%, WBC f/c: 3.6%, Mkt f/c: 3.6%

For the US labour market, the supply of workers remains the prime concern. Highlighting this point, at March the unemployment rate was just 0.1ppt off its pre-pandemic low while participation was a percentage point below its prior peak.

This situation is likely to persist in coming months, slowing job creation back to levels more consistent with a stable unemployment rate.

Into 2023, limited supply is expected to be joined by another headwind, real activity growth slowing below trend. Through that year, a degree of slack will grow, balancing out the labour market and dampening wages growth back to average levels.

US 'maximum employment' achieved

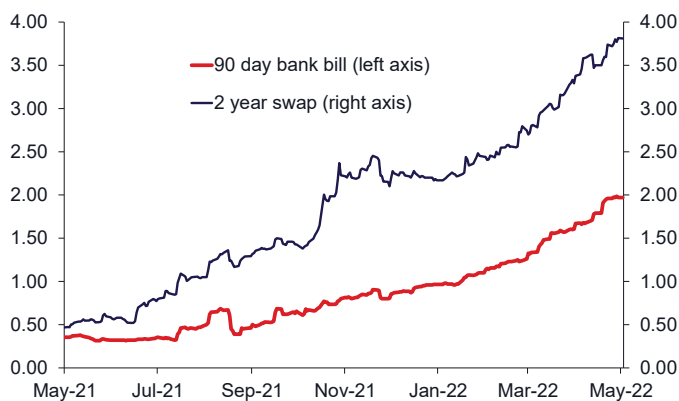


New Zealand forecasts

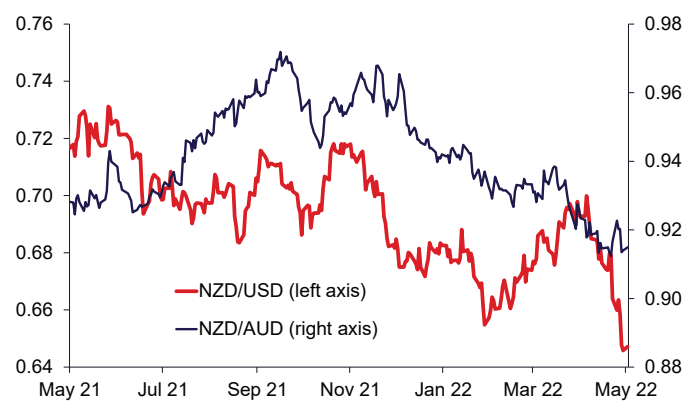
Economic forecasts	Quarterly				Annual			
	2021	2022						
% change	Dec (a)	Mar	Jun	Sep	2020	2021	2022f	2023f
GDP (Production)	3.0	0.3	0.7	2.3	-2.1	5.6	3.4	4.8
Employment	0.1	0.2	0.4	0.1	0.6	3.7	0.9	0.8
Unemployment Rate % s.a.	3.2	3.0	3.0	3.0	4.9	3.2	3.0	3.3
CPI	1.4	1.8	0.8	1.1	1.4	5.9	4.3	2.7
Current Account Balance % of GDP	-5.6	-5.8	-6.5	-6.5	-0.8	-5.6	-6.1	-5.5

Financial forecasts	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Cash	2.00	2.50	3.00	3.00	3.00	3.00	3.00
90 Day bill	2.40	2.90	3.10	3.10	3.10	3.10	3.10
2 Year Swap	3.70	3.80	3.80	3.70	3.50	3.30	3.10
5 Year Swap	3.80	3.80	3.80	3.65	3.50	3.35	3.20
10 Year Bond	3.60	3.60	3.40	3.30	3.20	3.10	3.00
NZD/USD	0.67	0.69	0.70	0.71	0.72	0.73	0.73
NZD/AUD	0.91	0.92	0.92	0.92	0.92	0.92	0.91
NZD/JPY	87.1	88.3	88.2	88.0	87.8	87.0	86.9
NZD/EUR	0.63	0.63	0.63	0.63	0.63	0.63	0.63
NZD/GBP	0.52	0.53	0.53	0.53	0.53	0.53	0.54
TWI	73.1	74.3	74.5	74.8	75.2	75.1	75.5

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 2 May 2022

Interest rates	Current	Two weeks ago	One month ago
Cash	1.50%	1.50%	1.00%
30 Days	1.60%	1.57%	1.34%
60 Days	1.79%	1.68%	1.51%
90 Days	1.97%	1.79%	1.68%
2 Year Swap	3.81%	3.50%	3.39%
5 Year Swap	3.93%	3.64%	3.51%

NZ foreign currency mid-rates as at 2 May 2022

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6472	0.6741	0.6928
NZD/EUR	0.6130	0.6241	0.6297
NZD/GBP	0.5140	0.5174	0.5291
NZD/JPY	83.90	85.35	85.08
NZD/AUD	0.9149	0.9148	0.9229
TWI	71.97	73.05	74.58

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 02					
Aus	Apr CoreLogic home value index	0.3%	-	0.3%	Prices moderating nationally, dipping in Sydney, Melbourne.
	Apr MI inflation gauge %/yr	4.0%	-	-	Material inflation pressures have increased in 2022.
	Apr ANZ job ads	0.4%	-	-	Job ads up strongly; evidence of a tight labour market.
Eur	Apr S&P Global manufacturing PMI	55.3	55.3	-	Final estimate for the month.
US	Apr S&P Global manufacturing PMI	59.7	59.7	-	Final estimate for the month.
	Mar construction spending	0.5%	0.8%	-	Activity supported by home building strength.
	Apr ISM manufacturing	57.1	57.7	-	Robust momentum still evident in manufacturing.
Tue 03					
NZ	Mar building consents	10.5%	-	-5.0%	Small pull-back after last month's bounce, annual still high.
Aus	RBA policy decision	0.10%	0.25%	0.25%	Tightening cycle to begin, the first rate hike since Nov 2010.
Eur	Mar unemployment rate	6.8%	6.7%	-	Tight labour market laying foundation for wages growth.
UK	Apr S&P Global manufacturing PMI	55.3	-	-	Final estimate for the month.
US	Mar factory orders	-0.5%	1.1%	-	Capital investment should gain over 2022...
	Mar durable goods orders	0.8%	-	-	... as inventories return to pre-pandemic levels.
	Mar JOLTS job openings	11266k	-	-	Pointing to extraordinary demand for workers.
Wed 04					
NZ	GlobalDairyTrade auction prices (WMP)	-4.4%	-	-2.0%	China's Omicron outbreak continues to weigh on prices.
	RBNZ Financial Stability Report	-	-	-	Six-monthly review of the financial system's health.
	Q1 unemployment rate	3.2%	3.1%	3.0%	Indicators point to a tightening labour market...
	Q1 employment	0.1%	0.1%	0.2%	... albeit with some headwinds for growth.
	Q1 LCI wage inflation (pvt, ord time)	0.7%	0.7%	0.7%	Wage growth picking up but lagging behind inflation.
	Apr ANZ commodity prices	3.9%	-	-	Dairy prices fell over April on Chinese Omicron outbreak.
Aus	Mar retail sales	1.8%	0.5%	-1.0%	Weather, fuel price effects look to have dragged in March.
	Mar housing finance	-3.7%	-1.6%	-3.5%	Market now clearly looks to have peaked at start of 2022...
	Mar owner occupier finance	-4.7%	-	-4.0%	... total value of sales down 20% in Q1 and housing finance...
	Mar investor finance	-1.8%	-	-2.5%	... likely to follow suit in coming months.
Eur	Apr S&P Global services PMI	57.7	57.7	-	Final estimate for the month.
	Mar retail sales	0.3%	-	-	Spending outlook is dampened by inflation risks.
UK	Mar net mortgage lending £bn	4.7	-	-	Softer lending to be seen as rate rises take effect.
US	Apr ADP employment change	455k	385k	-	Jobs growth holding at robust levels.
	Mar trade balance US\$bn	-89.2	-87.0	-	Deficit to remain wide on demand and inventory rebuild.
	Apr S&P Global services PMI	54.7	-	-	Final estimate for the month.
	Apr ISM non-manufacturing	58.3	58.7	-	Services sector remains in robust health.
	FOMC policy decision, midpoint	0.375%	0.875%	0.875%	First of two consecutive 50bp hikes; QT detail confirmed.
Thu 05					
Aus	Mar dwelling approvals	43.5%	-15%	-4%	Softening looks likely after wild swings through Jan-Feb.
	Mar trade balance \$bn	7.5	9.5	10.7	A likely partial unwind of February's 12% import surge.
Chn	Apr Caixin China PMI services	42.0	41.0	-	Covid-19 lockdowns weighing on service sector.
UK	Apr S&P Global services PMI	58.3	-	-	Final estimate for the month.
	BoE policy decision	0.75%	1.00%	1.00%	25bp rate hike in May; a pause to assess is nearing.
US	Q1 productivity	6.6%	-2.3%	-	Likely to remain volatile throughout 2022.
	Initial jobless claims	180k	-	-	To remain near record lows.
Fri 06					
Aus	RBA Statement on Monetary Policy	-	-	-	Updated forecasts key focus.
US	Apr non-farm payrolls	431k	390k	425k	Employment gains sustaining a healthy pace...
	Apr unemployment rate	3.6%	3.6%	3.6%	... keeping the unemployment rate near its lows...
	Apr average hourly earnings %mth	0.4%	0.4%	0.4%	... and supporting robust wages growth.
	Fedspeak	-	-	-	Williams to speak.

International forecasts

Economic Forecasts (Calendar Years)	2018	2019	2020	2021f	2022f	2023f
Australia						
Real GDP %yr	2.8	2.0	-2.2	4.7	4.4	3.4
CPI inflation %yr	1.8	1.8	0.9	3.5	5.6	2.6
Unemployment rate %	5.0	5.2	6.8	4.7	3.2	3.4
Current account % of GDP	-2.1	0.7	2.6	3.5	3.7	-0.4
United States						
Real GDP %yr	3.0	2.2	-3.5	5.7	3.1	1.8
CPI inflation %yr	2.4	1.9	1.3	7.1	3.7	2.3
Unemployment rate %	3.9	3.7	8.1	5.4	3.7	4.1
Current account % of GDP	-2.3	-2.6	-2.5	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	0.6	0.3	-4.8	1.8	2.2	1.4
Euro zone						
Real GDP %yr	1.9	1.3	-6.6	4.9	3.0	2.3
United Kingdom						
Real GDP %yr	1.3	1.4	-9.9	7.2	3.7	2.0
China						
Real GDP %yr	6.7	5.8	2.3	8.1	5.7	5.6
East Asia ex China						
Real GDP %yr	4.4	3.7	-2.4	4.2	4.7	4.6
World						
Real GDP %yr	3.6	2.8	-3.3	5.5	3.7	3.5

Forecasts finalised 29 April 2022

Interest rate forecasts	Latest	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Australia								
Cash	0.10	0.50	1.00	1.50	1.75	2.00	2.00	2.00
90 Day BBSW	0.71	0.70	1.20	1.70	1.95	2.20	2.20	2.20
10 Year Bond	3.15	3.20	3.10	2.80	2.65	2.50	2.35	2.20
International								
Fed Funds	0.375	1.375	1.875	2.375	2.375	2.375	2.375	2.375
US 10 Year Bond	2.82	2.90	2.80	2.50	2.40	2.30	2.20	2.10

Exchange rate forecasts	Latest	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
AUD/USD	0.7102	0.74	0.75	0.76	0.77	0.78	0.79	0.80
USD/JPY	130.87	130	128	126	124	122	120	119
EUR/USD	1.0497	1.07	1.10	1.12	1.13	1.14	1.15	1.15
GBP/USD	1.2459	1.28	1.30	1.32	1.34	1.36	1.37	1.36
USD/CNY	6.6266	6.55	6.45	6.35	6.25	6.20	6.15	6.15
AUD/NZD	1.0945	1.07	1.07	1.07	1.08	1.08	1.09	1.10

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