

**UBS Investment Research****European Weekly Economic Focus****■ What does \$8 trillion think?**

This week UBS hosted its *17th Annual Reserve Management Seminar for Sovereign Institutions*, the largest private gathering of central bank reserve managers, multilateral institutions, and sovereign wealth funds. More than 80 institutions with collective assets under management of over \$8 trillion attended. We took the opportunity to survey the assembly on their views on asset valuation, economic and policy outcomes, as well as issues of near- and long-term interest.

**■ Next week in Europe**

Advanced inflation data is due for Germany (Tuesday) and the Euro zone (Thursday) - we expect German inflation to remain at 2.80% YoY unchanged from May and expect the June inflation estimate for the Euro zone to rise marginally to 2.80% YoY from 2.70% previously. Final GDP numbers for France are due for release on Wednesday – it's likely that we see no change from its advanced numbers of 1.0% QoQ and 2.20% YoY. Final PMI manufacturing data is due Friday and we expect no revisions from the flash estimates for the Euro zone (52.0), Germany (54.9) and France (52.5) respectively. In the UK, final GDP data is due Tuesday; we expect no change from the advance numbers of 0.5% QoQ and 1.80% YoY. Index of services and consumer credit data is due Wednesday; we expect net consumer credit and mortgage approvals to improve marginally to GBP 0.6Bn from GBP 0.5Bn and to 46,000 from 45,200 respectively, while net lending secured on dwellings may remain unchanged at GBP 0.7Bn. We believe manufacturing PMI will be at 52.0 little changed from last month. This data is due Friday.

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## A survey of central bank reserve managers

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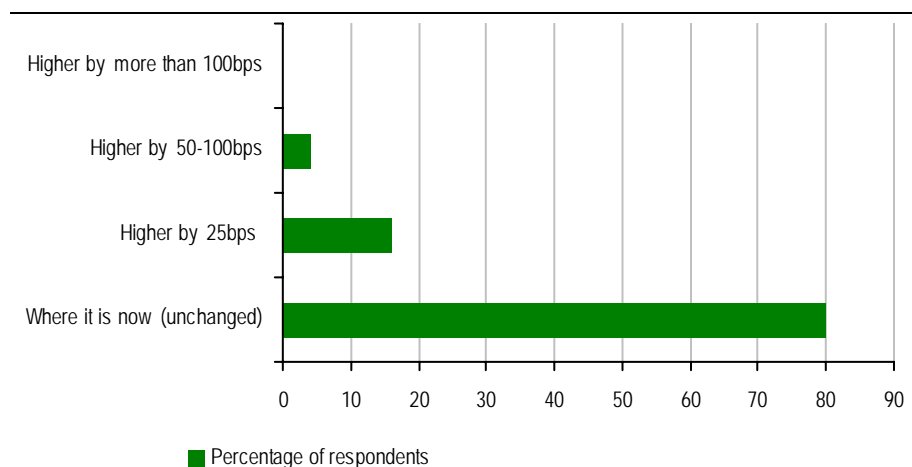
## How do they view economic policy?

Sovereign managers are cautious about the prospects for global recovery. By an overwhelming majority, they believe that the Fed will remain on hold for the remainder of 2011. They believe, however, that the ECB will raise short-term interest rates further this year. At the same time, over half of the respondents believe that sovereign default poses the single greatest risk to the world economy over the next twelve months.

We present the detailed results of the survey in the charts overleaf.

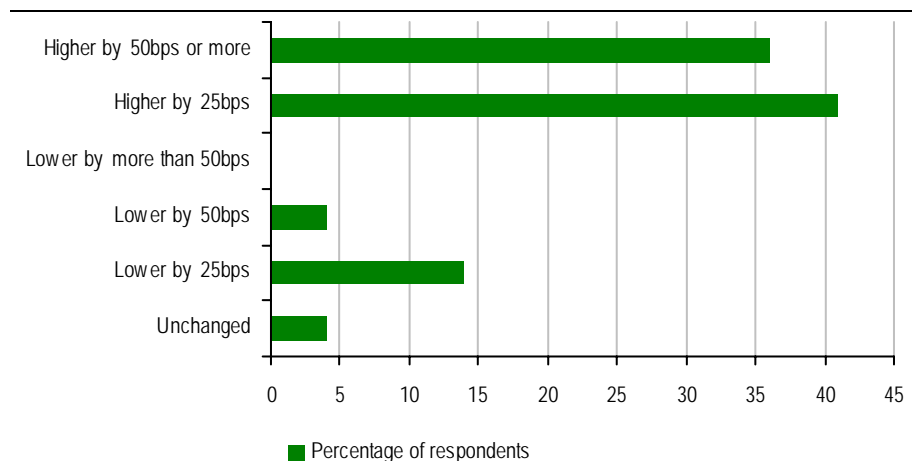
## Macroeconomics & markets

Chart 1: Where will the Fed Funds rate be at the end of 2011?



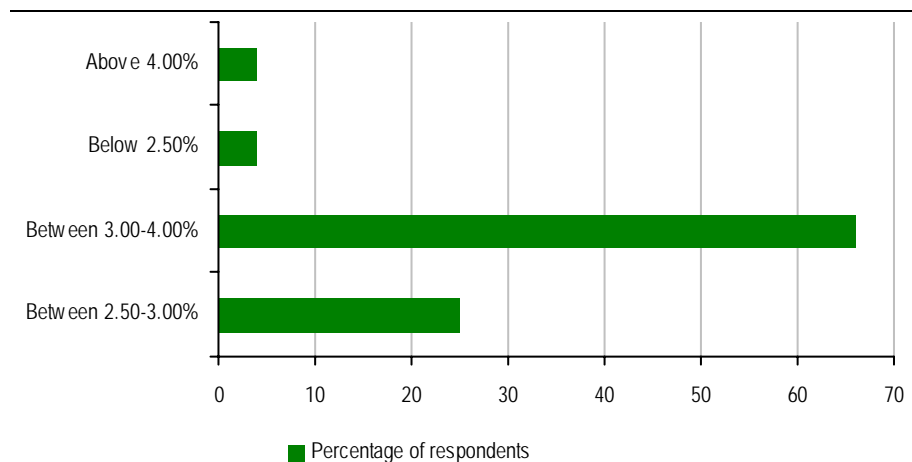
Source: UBS

Chart 2: Where will the ECB refinancing rate be at the end of 2011?



Source: UBS

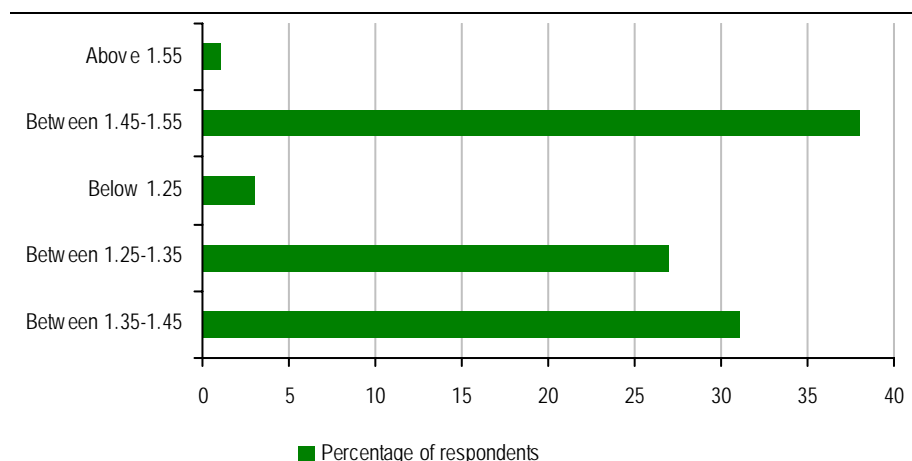
Chart 3: Where will the US Treasury 10-Year Note yield be at the end of 2011?



Source: UBS

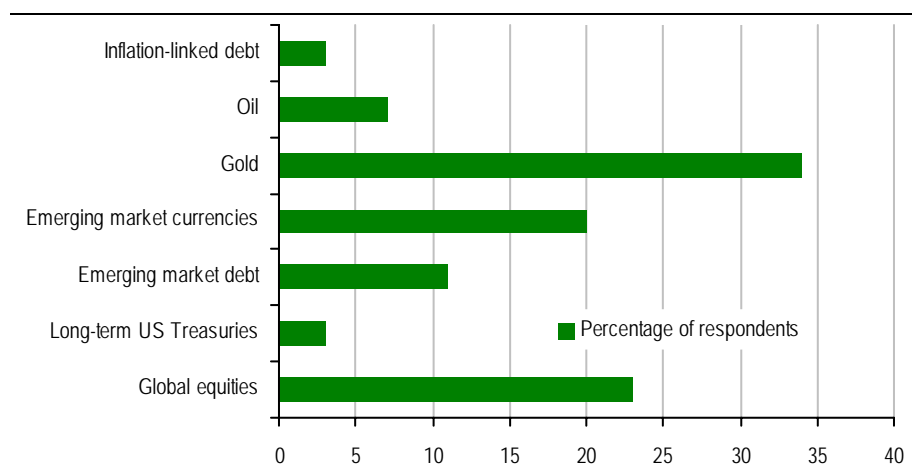
## Multi-Asset views

Chart 4: Where will the EUR/USD exchange rate be at the end of 2011?



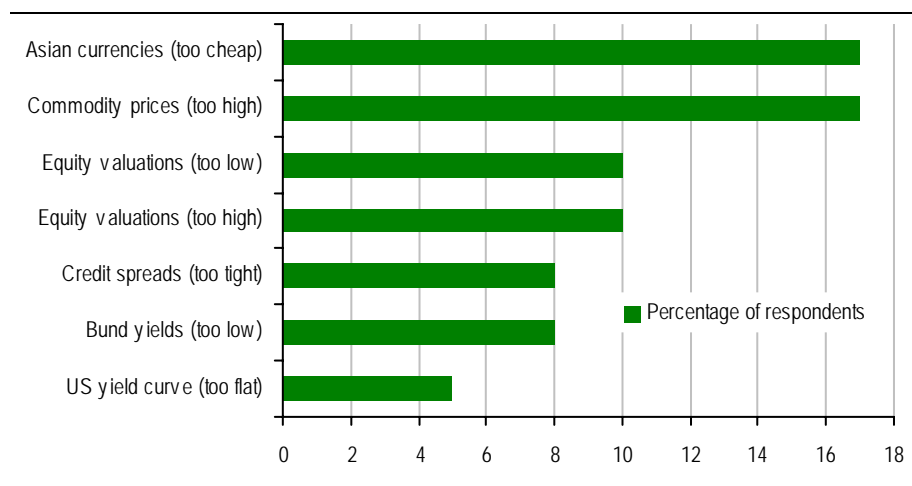
Source: UBS

Chart 5: What will be the best performing asset class between now and end of 2011?



Source: UBS

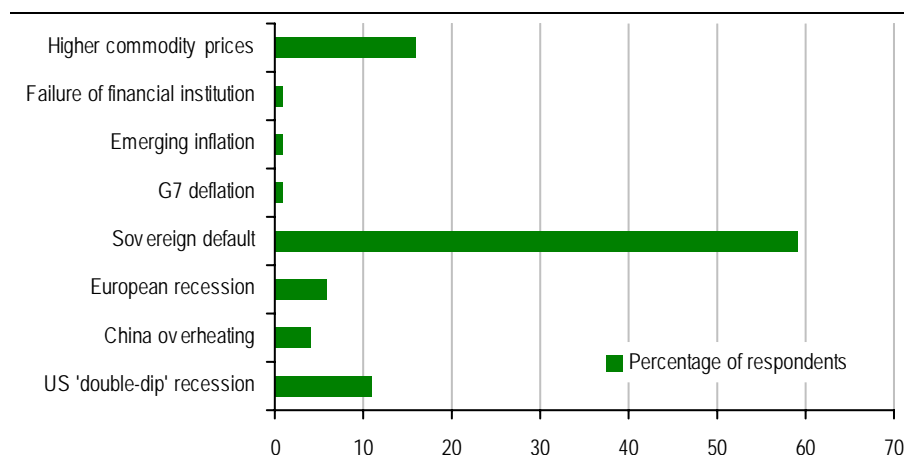
Chart 6: In your view, the biggest mispricing in global capital markets today is?



Source: UBS

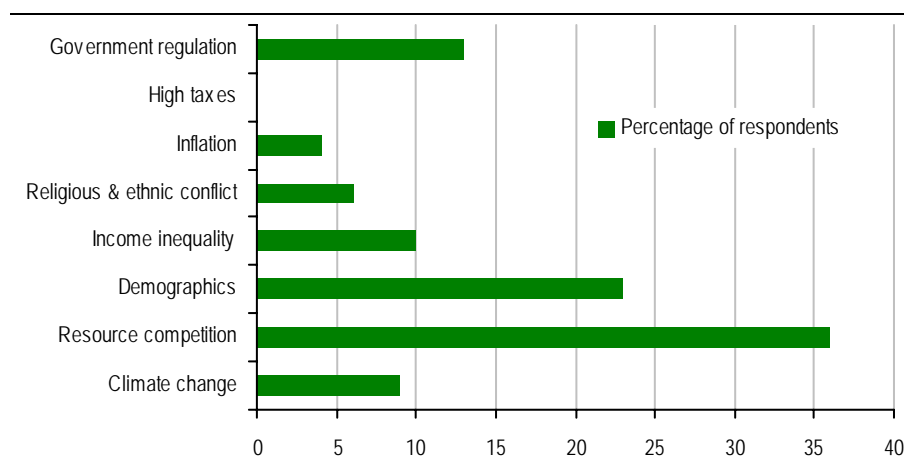
## Risk factors

Chart 7: What is the chief risk to the global economy over the next 12 months?



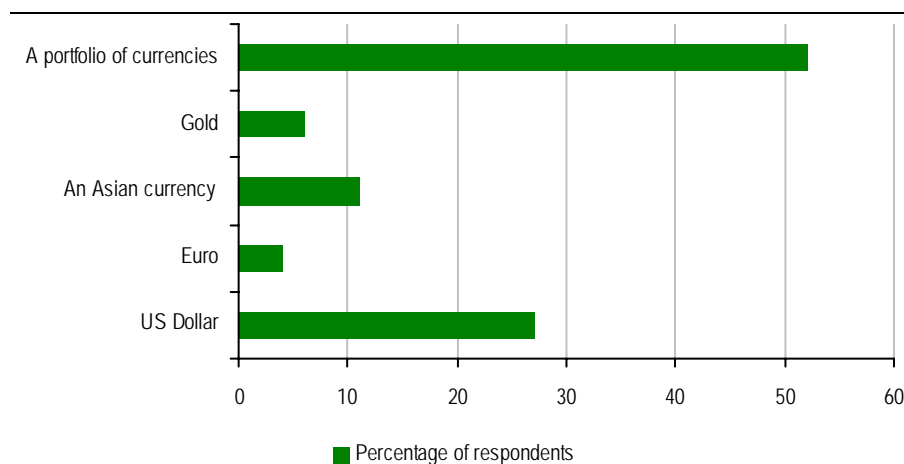
Source: UBS

Chart 8: What is the chief risk to the global economy over the next 25 years?



Source: UBS

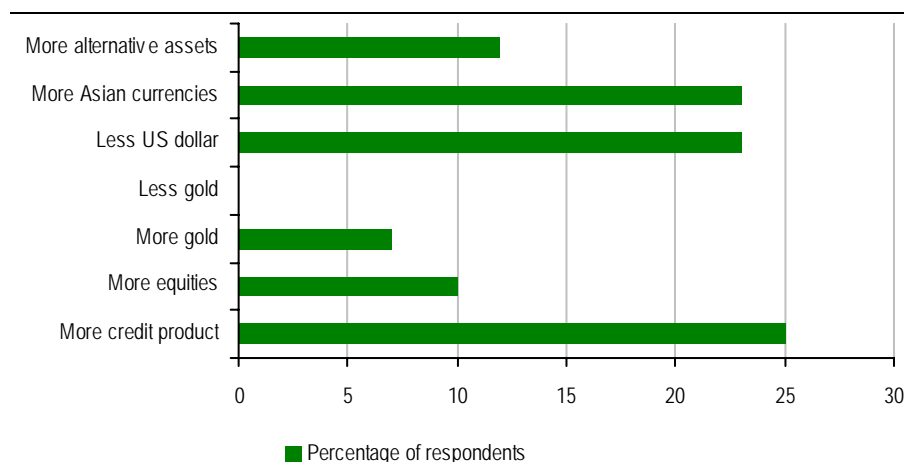
Chart 9: What will be the most important reserve currency in the world in 25 years?



Source: UBS

## Sovereign management

Chart 10: In your opinion, what will be the biggest change in your institution's asset allocation over the next 10 years?

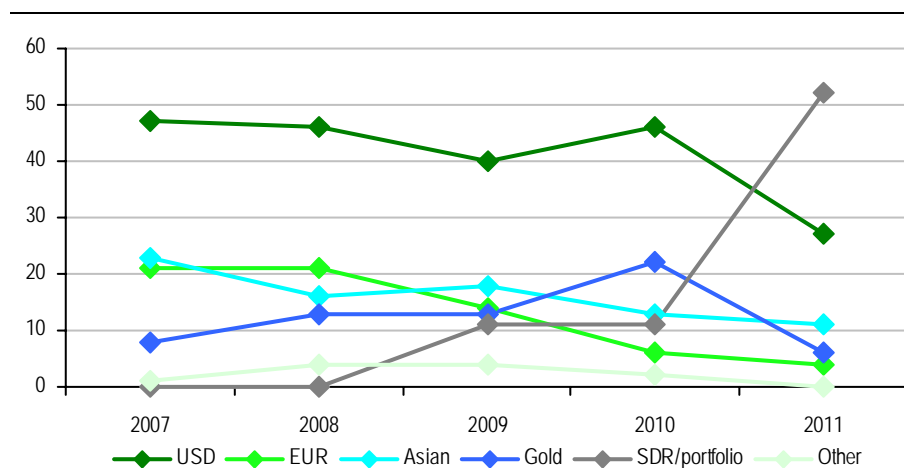


Source: UBS

## Dollar under siege?

In a notable departure from past surveys, reserve managers anticipate that the dollar will fall from its pedestal as the sole reserve currency within the next 25 years (see Chart 9 above). In past surveys the dollar typically was tipped to remain the chief reserve currency by a plurality—if not a majority—of those polled. This time, over half of respondents believe that within 25 years a portfolio of currencies will supplant the dollar in that role (see chart 11).

Chart 11: What will be the most important reserve currency in the world in 25 years? Question results in the past 5 years



Source: UBS

A third party specialist company conducted an electronic poll as an informal exercise among the audience during the conference this week. Audience members were polled on various issues surrounding key themes, the results of which have been compiled and presented in this document. The results of these polls represent the views of the voters and not necessarily those of UBS.

# Central bank watch

## European central banks' monetary policy decision announcement schedule

ECB	Bank of England	Swedish Riksbank	Norwegian Norges Bank	Swiss National Bank	Bank of Israel
<b>2010</b>					
5 Aug (Unchanged)	5 Aug (Unchanged)		11 Aug (Unchanged)		23 Aug (Unchanged)
2 Sep (Unchanged)	9 Sep (Unchanged)	2 Sep (25bp hike)	22 Sep (Unchanged)	16 Sep (Unchanged)	27 Sep (25bp hike)
7 Oct (Unchanged)	7 Oct (Unchanged)	26 Oct (25bp hike)	27 Oct (Unchanged)		25 Oct (Unchanged)
4 Nov (Unchanged)	4 Nov (Unchanged)				22 Nov (Unchanged)
2 Dec (Unchanged)	9 Dec (Unchanged)	15 Dec (25bp hike)	15 Dec (Unchanged)	16 Dec (Unchanged)	27 Dec (Unchanged)
<b>2011</b>					
13 Jan (Unchanged)	13 Jan (Unchanged)		26 Jan (Unchanged)		24 Jan (25bp hike)
3 Feb (Unchanged)	10 Feb (Unchanged)	14 Feb (25bp hike)			21 Feb (25bp hike)
3 Mar (Unchanged)	10 Mar (Unchanged)		16 Mar (Unchanged)	17 Mar (Unchanged)	28 Mar (50bp hike)
7 Apr (25bp hike)	7 Apr (Unchanged)	20 Apr (25bp hike)			24 Apr (Unchanged)
5 May (Unchanged)	5 May (Unchanged)		12 May (25bp hike)		23 May (25bp hike)
9 Jun (Unchanged)	9 Jun (Unchanged)		22 Jun (Unchanged)	16 Jun (Unchanged)	27 Jun (Fcst: No Change)
7 Jul (Fcst: 25bp hike)	7 Jul (Fcst: No Change)	5 Jul (Fcst: 25bp hike)			25 Jul (Fcst: No Change)

Source: ECB, BoE, Riksbank, Norges Bank. Note: The brackets show the outcome for that meeting

## UBS European and US rate forecasts

		Current	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
<b>Euro Area</b>	ECB refi rate	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.75
<b>UK</b>	MPC repo rate	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50
<b>Sweden</b>	Riksbank repo rate	1.75	1.75	2.25	2.75	3.00	3.25	3.50	3.75
<b>Norway</b>	Norges Bank deposit rate	2.25	2.25	2.50	2.75	3.00	3.25	3.50	3.75
<b>Switzerland</b>	3M Libor target rate	0.25	0.25	0.50	0.75	1.00	1.25	1.50	1.75
<b>US</b>	Fed funds rate	0.13	0-0.25	0-0.25	0-0.25	0.50	0.75	1.25	1.75
<b>Israel</b>	Discount rate	3.25	3.25	3.50	3.75	4.25	4.50	4.50	4.50
<b>Euro Area</b>	10 years	2.92	3.25	3.40	3.50	3.60	3.70	3.75	3.80
<b>UK</b>	10 years	3.19	3.80	3.90	4.00	4.10	4.20	4.30	4.40
<b>Sweden</b>	10 years	2.87	3.37	3.45	3.85	4.00	4.15	4.30	4.45
<b>Norway</b>	10 years	3.31	3.95	3.95	4.00	4.05	4.15	4.20	4.30
<b>Switzerland</b>	10 years	1.66	2.00	2.10	2.20	2.30	2.40	2.50	2.50
<b>US</b>	10 years	2.91	3.20	3.50	3.80	3.80	3.85	3.88	4.00

Source: Bloomberg, UBS estimates

## UBS FX forecasts

	Current	End-2011	End-2012
<b>EUR/USD</b>	1.43	1.30	1.30
<b>EUR/JPY</b>	114.86	117.00	130.00
<b>EUR/GBP</b>	0.89	0.80	0.80
<b>EUR/SEK</b>	9.16	8.60	8.20
<b>EUR/NOK</b>	7.81	7.50	7.10
<b>EUR/CHF</b>	1.20	1.35	1.33
<b>USD/ILS</b>	3.46	3.45	3.40

Source: Bloomberg, UBS estimates

# UBS Euro economic forecasts: What and why?

## Main views

- **The sovereign crisis:** The degree to which support is made available to other countries is key; a global mechanism is needed to stop the domino effect. In the longer term, we expect more fiscal discipline and enforcement mechanisms. Risky assets, euro and sovereign spreads could benefit if successful.
- **The fiscal consolidation process:** Deficit problems concentrated in a limited number of countries: Greece, Ireland, Portugal, Spain and France. Consolidation will take many years. If decent fiscal plans are delivered, sovereign spreads could start to converge. Sectors reliant on government spending could suffer, as spending cuts rather than tax increases are implemented.
- **The behaviour of inflation:** Pockets of inflation have started to appear amid mounting price pressures as the recovery continues and commodity and oil prices continue to rise.
- **Investment:** Risk of positive surprise on investment; we think the consensus view is too low.

## UBS versus consensus

Our economic forecasts are now very close to consensus. We are looking for 1.8% growth in the euro area this year while consensus is 1.7%. There is a wide convergence of view towards a slow but sustainable recovery.

## Risks

- **External shock:** This could be a double dip in the US or recession in China (not our forecast), a sharp appreciation of the euro (not our forecast), or a sustained surge in commodity prices.
- **Policy mix mistake:** If the ECB hikes too aggressively or fiscal consolidation is too aggressive.
- **Financial crisis:** If a major financial institution defaults or fiscal measures trigger a panic in sovereign markets.

## To watch closely

- **Credit availability:** Our research shows that credit availability is improving. Credit to corporates is picking up, albeit slowly, suggesting that one of the key arguments of the bears is faltering.
- **Labour market:** All the leading indicators point to an improvement in the labour market. This is starting to materialise in hard data, albeit slowly at the moment.
- **Country divergence:** This has been one of our ongoing themes. Unusually, high country divergence looks set to persist for an extended period.

## ECB rate call

After the 25bp rate hike in April, we envisage a gradual hiking cycle to 1.75% at end-2011 and 2.75% at end-2012.

## Other key views

- **Credit is improving:** We monitor M3 data closely; they show that credit to corporates is on the verge of turning (credit to households turned more than a year ago).
- **No deflation; no inflation:** We think inflation will peak in the next quarter and trend down slowly until the end of the year, as non-core inflation recedes.
- **Sovereign spreads too high:** Our research shows that the risk premium on sovereigns is higher than the risk premium was in the credit market at the peak of the financial turmoil. We think this is excessive, and that sovereign spreads will have to contract in the medium term.



# Data and events calendar

Date	Time	Country	Indicator	Units	Forecast	Prior	Consensus	Importance
24-Jun-11	07:30	Switzerland	Release of SNB Quarterly Report					
26-Jun-11	23:01	UK	Lloyds Business Barometer (Jun)			14		
27-Jun-11	07:30	Sweden	Trade Balance (May)	SEK Bn	5.5	5.8		
	14:30	Israel	Base Rate Announcement (Jun)	%		3.25%	3.25%	***
	01-Jul	Germany	Retail sales (May)	m-o-m	0.30%	0.60%	0.70%	**
	01-Jul	Germany	Retail sales (May)	y-o-y		3.60%		**
	05-Jul	Germany	Import Price Index (May)	m-o-m	0.30%	0.30%	-0.50%	
		UK	Nat'wide House prices sa (Data Due: 27-30 Jun)	m-o-m	0.10%	0.30%		
		UK	Nat'wide House prices nsa (Data Due: 27-30 Jun)	y-o-y	-1.10%	-1.20%		
28-Jun-11	06:00	Germany	GfK Consumer Confidence Survey (Jul)		5.5	5.5	5.3	
	07:30	Sweden	Retail sales sa (May)	m-o-m	0.90%	1.60%		
	07:30	Sweden	Retail sales nsa (May)	y-o-y		5.20%		
	08:30	UK	Total Business Investment (Final) (Q1)	q-o-q		-7.10%		
	08:30	UK	Total Business Investment (Final) (Q1)	y-o-y		-3.20%		
	08:30	UK	Current Account (Q1)	GBP Bn		-10.5		
	08:30	UK	GDP (Final) (Q1)	q-o-q	0.50%	-0.50%	0.50%	***
	08:30	UK	GDP (Final) (Q1)	y-o-y	1.80%	1.50%	1.80%	***
	09:00	Italy	Business Confidence (Jun)		102.3	101.3		
	16:00	France	Jobseekers- Net Change (May)		-20	-10.9		
	16:00	France	Total Jobseekers (May)		2649	2669.1		
		Germany	Consumer Price Index (Provisional) (Jun)	m-o-m	0.10%	0.00%	0.10%	**
		Germany	Consumer Price Index (Provisional) (Jun)	y-o-y	2.30%	2.30%	2.30%	**
29-Jun-11	05:30	France	Gross Domestic Product (Final) (Q1)	q-o-q	1.00%	0.30%		**
	05:30	France	Gross Domestic Product (Final) (Q1)	y-o-y	2.20%	1.40%		**
	07:00	Spain	Adjusted Real Retail sales (May)	y-o-y	-2.00%	-2.00%		
	08:00	Norway	Credit Indicator Growth (May)	y-o-y	6.40%	6.40%	6.50%	
	08:30	UK	Index of Services (3mth/3mth) (Apr)	%		0.90%		**
	08:30	UK	Index of Services (Apr)	m-o-m		0.60%		**
	08:30	UK	M4 Ex OFCs 3M Annualised (May)	%		-2.00%		
	08:30	UK	Net Consumer Credit (May)	GBP Bn	0.6	0.5		**
	08:30	UK	M4 Money Supply (May)	m-o-m		0.10%		
	08:30	UK	M4 Money Supply (May)	y-o-y		-0.90%		
	08:30	UK	Net Lending Sec. on Dwellings (May)	GBP Bn	0.7	0.7		**
	08:30	UK	Mortgage Approvals (May)	Thousand	46	45.2		**
	09:00	Euro Zone	Business Climate Indicator (Jun)			0.99		
	09:00	Euro Zone	Consumer Confidence (Final) (Jun)					
	09:00	Euro Zone	Economic Confidence (Jun)			105.5	105.1	
	09:00	Euro Zone	Industrial Confidence (Jun)			3.9	3.5	
	09:00	Euro Zone	Services Confidence (Jun)			9.2		
	09:30	Switzerland	KOF Leading Indicator (Jun)		2.07	2.30		**
	09:30	Switzerland	KOF Business Climate Industry (Jun)		11.5	10.4		*
	09:30	Switzerland	KOF Business Climate Retail Sector (Jun)		8.8	8.5		*
	23:01	UK	GfK Consumer Confidence Survey (Jun)			-21		
30-Jun-11	06:45	France	Producer Prices (May)	m-o-m		0.80%		
	06:45	France	Producer Prices (May)	y-o-y		6.40%		
	07:00	Spain	CPI (EU Harmonised) (Provisional) (Jun)	y-o-y	3.20%	3.40%		
	07:00	Spain	Consumer Price Index (Provisional) (Jun)	y-o-y	3.40%	3.50%		
	07:00	Switzerland	Balance of Payments (Q1)					

Date	Time	Country	Indicator	Units	Forecast	Prior	Consensus	Importance
	07:30	Sweden	Household Lending (May)	y-o-y	7.00%	7.20%		
	07:30	Sweden	Wages - Non-Manual Workers (Apr)	y-o-y	1.90%	1.70%		
	07:55	Germany	Unemployment Change (Jun)	Thousand	-10	-8	-13	
	07:55	Germany	Unemployment Rate (sa) (Jun)	%	7.00%	7.00%	7.00%	
	08:00	Euro Zone	M3 sa 3 mth ave. (May)	%	2.10%	2.10%		***
	08:00	Euro Zone	Euro Zone M3 sa (May)	y-o-y	2.10%	2.00%	2.10%	***
	08:00	Norway	Retail sales - vol sa (May)	m-o-m	0.20%	0.00%	0.50%	
	08:00	Norway	Retail sales Vol. nsa. (May)	y-o-y		11.40%		
	09:00	Euro Zone	CPI Estimate (Jun)	y-o-y	2.80%	2.70%	2.70%	***
	09:00	Italy	CPI (NIC including tobacco) (Provisional) (Jun)	m-o-m	0.20%	0.10%		*
	09:00	Italy	CPI (NIC including tobacco) (Provisional) (Jun)	y-o-y	2.80%	2.60%		*
	09:00	Italy	CPI - EU Harmonized (Provisional) (Jun)	m-o-m	0.20%	0.20%		*
	09:00	Italy	CPI - EU Harmonized (Provisional) (Jun)	y-o-y	3.00%	3.00%		*
	10:00	Euro Zone	European Commission Issues Qty Report on Euro Area					**
1-Jul-11	06:30	Sweden	Swedbank PMI Survey (Jun)		56	56.1		
	07:00	Norway	PMI sa (Jun)		56.2	56.9	56	
	07:00	Norway	Unemployment Rate (Jun)	%	2.50%	2.50%		
	07:15	Spain	Manufacturing PMI (Jun)		46.0			*
	07:30	Switzerland	Purchasing manager index (June)		60.3	59.2		**
	07:45	Italy	PMI Manufacturing (Jun)		50.7	52.8		*
	07:50	France	PMI Manufacturing (Final) (Jun)		52.5			*
	07:55	Germany	PMI Manufacturing (Final) (Jun)		54.9			*
	08:00	Euro Zone	PMI Manufacturing (Final) (Jun)		52.0			*
	08:00	Italy	Unemployment Rate (sa) (Q1)	%	8.40%	8.50%		
	08:00	Italy	Unemployment Rate (sa) (Provisional) (May)	%	8.10%	8.10%		*
	08:30	UK	PMI Manufacturing (Jun)		52.0	52.1	53.0	**
	09:00	Euro Zone	Unemployment Rate (May)	%	9.90%	9.90%	9.90%	***
	09:00	Italy	Deficit to GDP (year to date) (Q1)	ytd	8%	4.50%		
	17:00	Italy	Budget Balance (Jun)	EUR Bn	3.8	-5		
	17:00	Italy	Budget Balance (Year to date) (Jun)	EUR Bn	-41	-44.8		

Source: Bloomberg, UBS estimates. Note: Three asterisks in the importance column represent the most important and potentially market-moving data. Time zone used for events and releases is GMT.

## Next week in Europe

Advanced inflation data is due for Germany (Tuesday) and the Euro zone (Thursday) - we expect German inflation to remain at 2.80% YoY unchanged from May and expect the June inflation estimate for the Euro zone to rise marginally to 2.80% YoY from 2.70% previously. Final GDP numbers for France is due for release on Wednesday – it's likely that we see no change from its advanced numbers of 1.0% QoQ and 2.20% YoY. Final PMI manufacturing data is due Friday and we expect no revisions from the flash estimates for the Euro zone (52.0), Germany (54.9) and France (52.5) respectively. In the UK, final GDP data is due Tuesday; we expect no change from the advance numbers of 0.5% QoQ and 1.80% YoY. Index of services and consumer credit data is due Wednesday; we expect net consumer credit and mortgage approvals to improve marginally to GBP 0.6Bn from GBP 0.5Bn and to 46,000 from 45,200 respectively, while net lending secured on dwellings may remain unchanged at GBP 0.7Bn. We believe manufacturing PMI will be at 52.0 little changed from last month. This data is due Friday.

# UBS forecasts

% yoy	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E
<b>Demand &amp; Output</b>									
Consumers' expenditure	1.5	1.8	2.1	1.7	0.4	-1.1	0.8	1.2	1.3
Government consumption	1.6	1.6	2.2	2.2	2.3	2.5	0.7	0.5	0.5
Fixed investment	1.9	3.4	5.7	4.6	-1.0	-11.2	-1.0	3.0	5.1
Stocks <sup>1</sup>	0.2	-0.1	0.1	0.2	-0.2	-0.8	0.5	0.1	-0.3
Domestic demand	1.7	2.0	3.0	2.6	0.3	-3.4	0.9	1.5	1.6
Exports	6.9	5.3	8.8	6.3	0.7	-13.1	10.9	7.2	6.4
Imports	6.6	6.0	8.7	5.8	0.6	-11.7	9.0	6.5	5.8
Net exports <sup>1</sup>	0.2	-0.2	0.1	0.3	0.0	-0.8	0.8	0.4	0.4
GDP	1.9	1.8	3.2	2.8	0.3	-4.1	1.8	1.8	2.0
Industrial production	1.8	1.9	4.1	3.4	-2.4	-13.7	4.2	3.4	2.3
<b>Labour Market</b>									
Unemployment rate (%)	9.1	9.0	8.4	7.6	7.6	9.5	10.1	9.8	9.5
Workforce in employment	0.8	1.0	1.7	1.8	0.8	-1.8	-0.4	0.6	1.0
Nominal wage growth	2.2	2.0	2.3	2.5	3.2	1.5	1.7	2.1	2.2
Unit wage costs	1.1	1.1	0.8	1.5	3.7	3.8	-0.5	1.0	1.3
<b>Inflation</b>									
Producer prices	2.3	4.1	5.1	2.7	6.0	-5.1	3.0	4.4	2.7
HICP	2.1	2.2	2.2	2.1	3.3	0.3	1.6	2.8	2.2
GDP Deflator	1.9	2.0	1.9	2.4	2.1	1.0	0.8	1.4	1.2
<b>Finance</b>									
Current account (% of GDP)	0.8	0.1	-0.1	0.1	-1.5	-0.3	-0.4	0.4	1.0
Budget balance (% of GDP)	-3.0	-2.5	-1.4	-0.7	-2.0	-6.3	-6.0	-4.2	-3.5
General government debt (% of GDP)	69.5	70.0	68.4	66.2	69.9	79.3	85.1	86.7	87.6
Broad Money	5.9	7.5	8.8	11.4	9.0	2.6	0.7	1.0	-0.3
<b>Interest and exchange rates (end period)</b>									
3 month interest rate	2.14	2.47	3.71	4.65	2.90	0.64	0.97	1.85	2.85
10-year bund yield	3.60	3.40	3.80	4.30	3.20	3.20	2.90	3.50	3.80
EUR/USD	1.36	1.18	1.32	1.47	1.39	1.44	1.34	1.30	1.30
EUR/JPY	139.86	139.06	156.75	164.45	126.35	134.09	108.38	117.00	130.00

	2011				2012			
% yoy	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
<b>Demand &amp; Output</b>								
Consumers' expenditure	1.0	1.1	1.2	1.3	1.3	1.4	1.3	1.1
Government consumption	0.8	0.6	0.3	0.2	0.3	0.4	0.6	0.8
Fixed investment	2.6	1.5	2.9	4.9	4.8	5.0	5.3	5.2
Stocks <sup>1</sup>	0.4	0.0	0.0	0.1	-0.3	-0.3	-0.4	-0.4
Domestic demand	1.7	1.1	1.4	1.9	1.5	1.6	1.6	1.5
Exports	9.9	6.8	6.2	6.1	6.2	6.3	6.5	6.6
Imports	8.3	5.6	5.7	6.3	6.2	5.9	5.6	5.4
Net exports <sup>1</sup>	0.8	0.6	0.3	0.0	0.1	0.3	0.5	0.7
Real GDP (% qoq)	0.6	0.2	0.4	0.5	0.5	0.5	0.6	0.6
Real GDP	2.2	1.5	1.5	1.8	1.6	1.9	2.1	2.1
Industrial production	4.7	2.8	3.4	2.9	2.4	2.6	2.4	2.0
<b>Labour Market &amp; Inflation</b>								
Unemployment rate (%)	10.0	9.9	9.8	9.7	9.6	9.5	9.4	9.4
Money GDP	3.6	2.8	3.0	3.2	2.8	3.1	3.3	3.4
HICP	2.5	2.9	2.9	2.8	2.3	2.1	2.1	2.2
<b>Interest and exchange rates (end period)</b>								
ECB Refi rate	1.00	1.25	1.50	1.75	2.00	2.25	2.50	2.75
10-yr bund yield	3.20	3.25	3.40	3.50	3.60	3.70	3.75	3.80
EUR/USD	1.42	1.41	1.40	1.30	1.30	1.30	1.30	1.30

Source: Eurostat, ECB, Bloomberg, Haver, UBS estimates

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