



Summary

United States

At a crossroads

The labour market has been losing momentum. It could be additional evidence of the soft patch the US economy went through in early 2016. It could also signal further slowdown on the horizon.

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Eurozone

ECB: a race against time

Conventional monetary policy can be, and often is gradual. Unconventional policy cannot afford that luxury. Four reasons are behind the necessity of acting as fast and boldly as possible once unconventional policies have been initiated.

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Spain

The persistent labour market duality

The Spanish job market is still fragmented, split between permanent jobs on the one hand and temporary jobs on the other.

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Market overview

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Also in :



Good momentum

■ Strong start to the year for the German economy ■ Eurozone GDP up 0.5% q/q ■ Slowdown expected in the spring

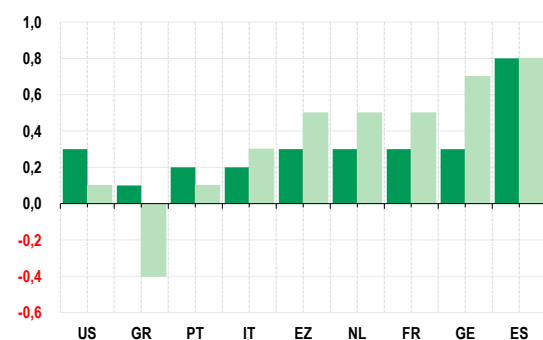
The second raft of European growth figures confirms that most Eurozone countries saw good levels of economic activity in the first quarter. After strong GDP figures from Spain (+0.8% q/q) and France (+0.5% q/q) in late April, Germany this week announced sequential growth of 0.7% in Q1 2016.

Like France's, Germany's economy was mainly supported by faster growth in domestic demand, consumer spending, investment, machinery and equipment, and construction. Growth also accelerated in the Netherlands (+0.5% q/q) and to a lesser extent Italy (+0.3% q/q). Overall, however, Eurozone GDP growth was 0.5% q/q, very slightly lower than the initial estimate.

Growth figures are expected to show a slowdown in the second quarter of 2016. That is partly because Q1 figures were boosted by several temporary factors, including the upturn in French consumer spending after a dip following the terrorist attacks, and mild weather conditions benefiting Germany's construction sector. In addition, the monthly statistics we have seen (industrial production and retail sales) show that growth has weakened in Q2. Nevertheless, this week's figures are good news overall, showing – for a change – growth that is much stronger in Europe than in the USA, where the economy did grow 0.5% in Q1, but on an annualised basis.

EUROPEAN REBOUND, US SLOWDOWN

GDP growth, % q/q ■ Q4 2015 ■ Q1 2016



Source: Eurostat

THE WEEK ON THE MARKETS

Week 9-5 16 > 12-5-16

▼ CAC 40	4 301	► 4 293	-0.2 %
↗ S&P 500	2 057	► 2 064	+0.3 %
▼ Volatility (VIX)	14.7	► 14.4	-0.3 %
▼ Euribor 3M (%)	-0.26	► -0.26	-0.2 bp
▼ Libor \$ 3M (%)	0.63	► 0.63	-0.3 bp
▼ OAT 10y (%)	0.53	► 0.51	-1.1 bp
↗ Bund 10y (%)	0.15	► 0.16	+0.7 bp
▼ US Tr. 10y (%)	1.78	► 1.77	-0.7 bp
▼ Euro vs dollar	1.14	► 1.14	-0.2 %
▼ Gold (ounce, \$)	1 290	► 1 268	-1.8 %
↗ Oil (Brent, \$)	45.9	► 47.2	+2.8 %

Source: Thomson Reuters



United States

At a crossroads

- The labour market is stabilising, with enough job creation to keep the unemployment rate unchanged.
- On a broad measure, the absorption of underemployment has come to a halt.
- Although that could be cause for concern, it is also partly due to the brief dip in activity in early 2016. In any case, this makes the Fed's cautious stance easier to understand.

The outlook for the US economy is uncertain, and the message provided by surveys is neither very clear nor very consistent. For example, the manufacturing ISM index rebounded in March but fell back in April. However, it remains above 50 and its employment component is improving. The labour market is continuing to send positive signals. Although the unemployment rate has risen slightly from its February low of 4.9% to 5% in March and April, it remains within the estimated range for the NAIRU (Non-Accelerating Inflation Rate of Unemployment). Although job creation was slower in April than in the previous six months, the 160,000 jobs created then are enough to stabilise the unemployment rate, assuming an unchanged level for the labour participation ratio. Although initial jobless claims have risen in the last few weeks, the 4-week moving average is at its lowest level since the first oil shock.

The message provided by economic data – both hard and soft – is rarely unequivocal. Contradictions can often be found within the same survey, which is why it can be easier to read data pulling together them into a single indicator. As regards the economic outlook, our in-house indicator is the M&N, a weighted sum of data from the two ISM surveys. The message from that indicator is that the US economy has slowed in early 2016, with activity falling back to the previous post-recession low points, but also rapidly bottomed out to strengthen in March and April.

As for the labour market, we came up with two different indicators. The first, the SLACK Index, measures underemployment or as Janet L. Yellen once called it the “shadow unemployment”. The second is actually double, the Ben Index and the Janet Index, and includes a leading component. As a result, the SLACK index shows progress made, while the Ben and Janet indexes are also partly forward-looking¹. All three indexes are sending the same message: the labour market has shown no further improvement since late 2015.

The fact that the labour market has stopped improving could simply be because economic activity was weak in early 2016. On that assumption, and if the upturn in our M&N Index is confirmed, the labour market could regain momentum. However, it is also

¹ For more details on these indicators, see “The truth is out there, or why the falling unemployment rate is late accelerating wages”, Alexandra Estiot, Conjoncture BNP Paribas, October-November 2014.

After the major recession

— M&N index (3-month moving average)

Since April 2010: — Average; --- Min / Max

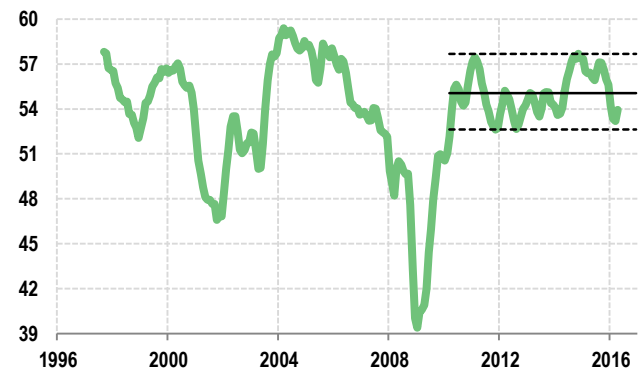


Figure 1

Source: BNP Paribas Economic Research

Stable employment

— SLACK index ; — Ben index; --- Janet index

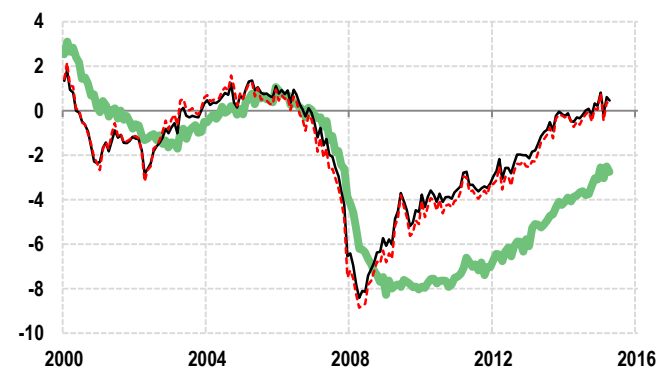


Figure 2

Source: BNP Paribas Economic Research

reasonable to be concerned about the lack of improvement in the job market. Consumer spending and residential investment not only make up most of US demand. They have also propped up growth in the last few quarters. If they were to stall, there is almost nothing else capable of supporting US growth, which would therefore decelerate. The situation makes the cautious approach adopted by the Fed, which knows that it has limited scope for action, easier to understand. Note, however, that there is no need for excessive pessimism, since the absorption of underemployment has paused several times recently without pushing down consumer spending.



Eurozone

ECB: a race against time

- Conventional monetary policy can be, and often is gradual.
- Unconventional policy cannot afford that luxury.
- Four reasons are behind the necessity of acting as fast and boldly as possible once unconventional policies have been initiated.

Conventional monetary policy, to smooth cyclical fluctuations of either inflation or inflation and economic growth, depending on the mandate of the central bank, tends to be a gradual process. During a tightening cycle, too aggressive an approach could cause overkill and push the economy in recession. During an easing cycle, gradualism reflects the willingness of avoiding a panic reaction of the public or a boom/bust cycle, if the easing were to turn out to be excessive. Gradual easing can also be based on the idea that if it fails in achieving the objective(s) of the central bank, unconventional policy still can be used as a last resort. This is exactly what has happened in several countries in recent years with quantitative easing being adopted by the Fed, the BoE, the BoJ and the ECB.

Non-conventional monetary policy is by design of a different nature than traditional policy. The central bank boosts the size of its balance sheet and financial asset prices play a bigger role as a transmission channel (the credit channel dominates with traditional interest rate cuts). These differences, however, imply that once a central bank adopts a non-conventional policy, it starts a race against time.

First, there are limits to quantitative easing. One argument is that by boosting the size of its balance sheet, the sensitivity to interest rate shocks increases. On a mark to market basis, the central bank is bound to face unrealised losses. Indeed, the objective of quantitative easing is to boost growth (intermediate objective) and by extension inflation (final objective). To the extent that the policy is successful, bond yields will ultimately rise. In case of the BoJ, which has been buying ETFs as well, the sensitivity of its balance sheet to equity market shocks is another element to be taken into account. Still, that argument is not key, as it is generally accepted that a central bank can function properly with low or even negative equity.

A more important argument is the scarcity of the bonds which are bought in the context of a QE programme. This makes the implementation of QE increasingly difficult the longer it lasts and the bigger it is. It also reduces the leeway in terms of increasing the volume and /or extending the programme in time. In the eurozone, it is estimated that the net issuance of government paper, taking into account the buying of the ECB, will be a negative EUR 303 bn in the second half of this year. Quite understandably the ECB has recently announced it would also buy investment grade corporate bonds, although there again the available supply is limited. This is probably one of the reasons why the deposit rate has been lowered further in negative territory, in order to exert additional pressure on interest rates across the yield curve.

Another reason to consider is the limit of negative rates. The rationale of negative rates is that it removes the constraint of the zero lower bound. The refinancing rate may very well be non-negative, the negative rate applied to excess reserves deposited at the ECB implies that the entire yield curve can shift down further than would be the case if only QE were applied. In addition to the incentive for banks to expand credit, it can trigger a portfolio rebalancing away from government paper and into riskier assets. There also is a signalling role: when the deposit rate is lowered further, one can assume it will take even more time until the refinancing rate is increased. Yet, the negative deposit rate as a policy tool meets with a lot of criticism. When the BoJ introduced it recently, a surprise move, it caused a decline in the equity market and in particular banking stocks as well as a strengthening of the yen. The latter was exactly the opposite of what the BoJ was aiming at, since it will weigh on inflation, and it reflected mounting doubts about the ability of the BoJ to boost inflation. One can suppose that these points have played a role in the recent decision of the ECB to limit the additional cut in the deposit rate. Moreover, looking at recent statements, it seems that the bar to lower it further is quite high now.

A third factor is that too little progress on the inflation front could weigh on the credibility of the central bank or more strictly, on the market belief that it will be able to boost inflation. Such doubts can lead to increased uncertainty and could even lead to an appreciation of the currency with negative consequences for growth and inflation.

Finally, the sensitivity of the eurozone to developments in the rest of the world makes it also necessary to realise progress on the inflation front. Indeed, a deterioration of the external environment would make it more difficult to reach the inflation goal. More concretely, we have to hope that inflation converges sufficiently close to the ECB's target before the US enters a recession. Admittedly, a recession in the US is not our base scenario for this year or next, but it is clear that it would trigger a deflationary shock in the eurozone via worsening export prospects and a stronger euro.

From a financial market perspective, the introduction of non-conventional monetary policy implies that a race against time has started: investors will be impatient to see progress on the inflation front. In reality, however, we don't know in advance by when inflation will have risen sufficiently. In such a situation, one understands the emphasis of the ECB on its ability and determination to do more if needed. We should also welcome that in recent communication the reference to achieving a pick-up in inflation as soon as possible has been dropped. The combination of patience and a willingness and ability to act if needed is the right way to run a race against time of an unknown distance.



Spain

The persistent labour market duality

- Temporary jobs were widely used by companies when the crisis broke out.
- Spain aimed at reducing the job market's duality notably by increasing the compensation paid when temporary contracts were terminated.
- So far, however, the reforms seem to have had little impact on the hiring behaviour of companies.

The job market reforms, implemented for the most part as of 2012, aimed in particular at giving companies greater internal flexibility and reducing the duality of the job market. These reforms helped get the country back on track to growth and job creations as of 2014 (+938,000 since Q4 2013). Coupled with a shrinking active population - the combined effect of emigration and an aging population - these reforms helped to bring down the unemployment rate as of summer 2013. However, despite this improvement, the job market is still fragmented, split between permanent jobs on the one hand and temporary jobs on the other.

Promotion of permanent job contracts

Temporary jobs were a form of employment widely used by companies when the crisis broke out. Temporary employment as a share of total payroll employment was 31.5% in 2007, compared to a eurozone average of 16.4% for the same period. Temporary employment thus became the main adjustment variable when the economy collapsed. Nearly 60% of the 3.7 million jobs destroyed between late 2007 and late 2013 were temporary jobs.

Dismissal procedures were eased and the notion of layoffs on economic grounds was also revised. Companies reporting losses or experiencing three consecutive quarters of year-on-year declines in sales or revenues are now allowed to terminate job contracts on economic grounds. In cases of unjustified dismissals, the amount of compensation was capped at 33 days per year of service and 24 months' pay (as opposed to 45 days per year of service and 42 months' pay, previously). Administrative authorisation is no longer required for collective layoffs.

Alongside efforts to ease dismissal procedures for permanent jobs, labour reforms also sought to curb the use of short-term contracts by increasing the compensation paid when contracts were terminated (12 days of pay per year of service as of 1 January 2015). Companies also benefit from a reduction in employers' charges when training and apprenticeship contracts are transformed into permanent contracts. A new type of permanent contract was also created for companies with fewer than 50 employees. Known as a "company support contract", it provides a 1-year trial period and reduced fiscal and social contributions.

Praising temporary jobs

Temporary employees as a share of sector employees (4 quarter moving average) (%)

— Total; — Manufacturing; - - - Construction; - - - Services

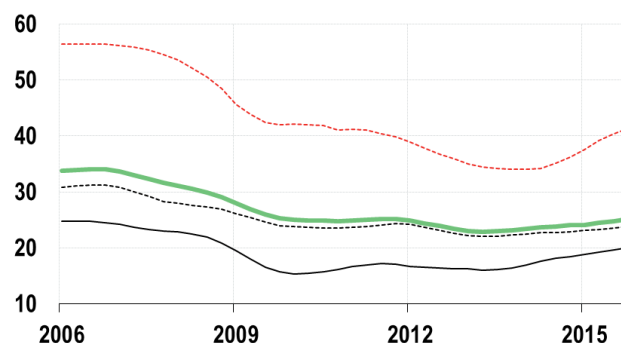


Chart 1

Source : Eurostat

Temporary contracts are still in demand

As a share of total employees, temporary contracts will apparently remain below pre-crisis levels due to structural changes in the Spanish economy. The construction sector is particularly inclined towards short-term contracts (nearly 40% of jobs in the construction sector in 2015), but its weighting has declined to 6% of total employment in 2015 from 13.3% in 2007. It will apparently hold below the 2007 level for some time. Indeed, economic policies aim specifically at favouring sectors offering higher value added.

So far, however, the reforms seem to have had little impact on the hiring behaviour of companies. The increase in employees as of Q3 2013 went hand in hand with an increase in temporary employment. Of the payrolls created since then, nearly 60% have been temporary contracts (see chart 1). As a share of total employees, temporary employment has increased by nearly 3 points since spring 2013, to 25.7% in Q4 2015. Moreover, the transition rate from a temporary contract to permanent employment is low, at only 12% in 2014 (vs. 29.7% in 2006 according to Eurostat).

This means that the job market's duality will probably continue to hurt the Spanish economy. Employees with temporary contracts are not paid as well. They are more highly exposed to part-time work and benefit from less training than full-time employees. This lack of training in turn undermines their employability and increases the risk of job market exclusion.



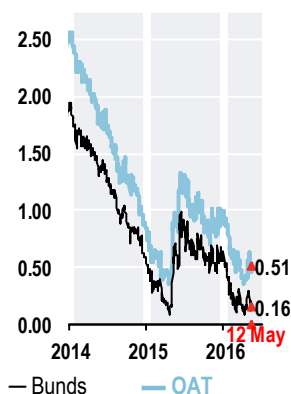
Markets overview

The essentials

Week 9-5 16 > 12-5-16

➤ CAC 40	4 301	➤ 4 293	-0.2 %
➤ S&P 500	2 057	➤ 2 064	+0.3 %
➤ Volatility (VIX)	14.7	➤ 14.4	-0.3 %
➤ Euribor 3M (%)	-0.26	➤ -0.26	-0.2 bp
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➤ OAT 10y (%)	0.53	➤ 0.51	-1.1 bp
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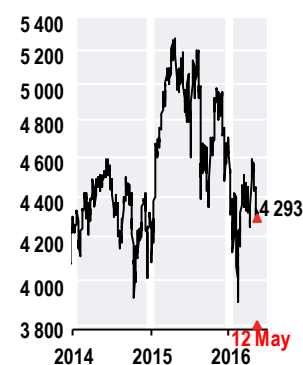
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



Money & Bond Markets

Interest Rates		highest' 16		lowest' 16	
€ ECB	0.00	0.05	at 01/01	0.00	at 16/03
Eonia	-0.34	-0.13	at 01/01	-0.35	at 24/03
Euribor 3M	-0.26	-0.13	at 01/01	-0.26	at 10/05
Euribor 12M	-0.01	0.06	at 01/01	-0.03	at 04/03
\$ FED	0.50	0.50	at 01/01	0.50	at 01/01
Libor 3M	0.63	0.64	at 15/03	0.61	at 04/01
Libor 12M	1.23	1.24	at 16/03	1.12	at 12/02
£ BoE	0.50	0.50	at 01/01	0.50	at 01/01
Libor 3M	0.59	0.59	at 15/02	0.58	at 08/03
Libor 12M	0.98	1.07	at 01/01	0.98	at 12/02

At 12-5-16

Yield (%)		highest' 16		lowest' 16	
€ AVG 5-7y	0.19	0.49	at 12/01	0.16	at 01/03
Bund 2y	-0.51	-0.34	at 01/01	-0.56	at 03/03
Bund 10y	0.16	0.63	at 01/01	0.09	at 07/04
OAT 10y	0.51	0.98	at 01/01	0.36	at 05/04
Corp. BBB	1.75	2.50	at 20/01	1.69	at 06/05
\$ Treas. 2y	0.76	1.06	at 01/01	0.64	at 11/02
Treas. 10y	1.77	2.27	at 01/01	1.64	at 11/02
Corp. BBB	3.65	4.50	at 12/02	3.61	at 11/05
£ Treas. 2y	0.39	0.65	at 01/01	0.28	at 08/02
Treas. 10y	1.41	1.96	at 01/01	1.28	at 11/02

At 12-5-16

10y bond yield & spreads

7.40%	Greece	724 pb
3.24%	Portugal	308 pb
1.63%	Spain	146 pb
1.59%	Italy	143 pb
0.61%	Ireland	45 pb
0.55%	Belgium	39 pb
0.51%	France	35 pb
0.44%	Finland	28 pb
0.38%	Netherlands	21 pb
0.37%	Austria	21 pb
0.16%	Germany	

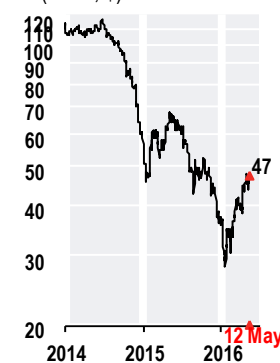
Commodities

Spot price in dollars		lowest' 16		2016(€)	
Oil, Brent	47	28	at 20/01	+25.9%	
Gold (ounce)	1 268	1 062	at 01/01	+13.7%	
Metals, LMEX	2 274	2 049	at 12/01	-1.7%	
Copper (ton)	4 627	4 328	at 15/01	-6.3%	
CRB Foods	364	329	at 11/01	+3.6%	
wheat (ton)	168	146	at 04/01	+3.6%	
Corn (ton)	146	134	at 31/03	+1.1%	

At 12-5-16

Variations

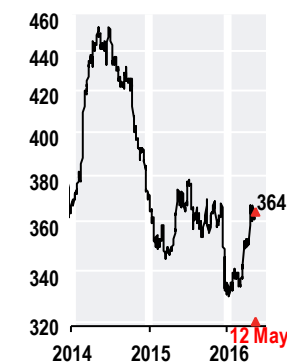
Oil (Brent, \$)



Gold (Ounce, \$)



CRB Foods



Exchange Rates

€ =		highest' 16		lowest' 16		2016	
USD	1.14	1.15	at 03/05	1.07	at 05/01	+5.0%	
GBP	0.79	0.81	at 08/04	0.73	at 05/01	+6.7%	
CHF	1.10	1.11	at 04/02	1.08	at 29/02	+1.4%	
JPY	123.98	131.84	at 01/02	121.84	at 06/05	-5.1%	
AUD	1.55	1.60	at 11/02	1.45	at 20/04	+4.0%	
CNY	7.43	7.47	at 04/05	6.99	at 05/01	+5.3%	
BRL	3.98	4.53	at 16/02	3.94	at 14/04	-7.4%	
RUB	74.31	91.22	at 11/02	73.05	at 28/04	-6.3%	
INR	76.00	77.50	at 11/02	71.42	at 05/01	+5.8%	

At 12-5-16

Variations

Equity indices

Index		highest' 16		lowest' 16		2016	2016(€)
CAC 40	4 293	4 637	at 01/01	3 897	at 11/02	-7.4%	-7.4%
S&P500	2 064	2 102	at 20/04	1 829	at 11/02	+1.0%	-3.8%
DAX	9 862	10 743	at 01/01	8 753	at 11/02	-8.2%	-8.2%
Nikkei	16 646	19 034	at 01/01	14 953	at 12/02	-12.5%	-7.8%
China*	53	59	at 01/01	48	at 12/02	-9.9%	-14.3%
India*	451	460	at 01/01	393	at 11/02	-1.1%	-6.5%
Brazil*	1 419	1 454	at 29/04	860	at 21/01	+20.8%	+30.4%
Russia*	487	509	at 28/04	331	at 20/01	+9.8%	+14.6%

At 12-5-16

Variations

* Indices MCSI



Economic forecasts

En %	GDP Growth			Inflation			Curr. account / GDP			Fiscal balances / GDP		
	2015	2016 e	2017 e	2015	2016 e	2017 e	2015	2016 e	2017 e	2015	2016 e	2017 e
Advanced	1.9	1.6	1.4	0.3	0.6	1.7						
United States	2.4	1.6	1.5	0.1	1.2	2.1	-2.7	-2.8	-2.9	-2.5	-3.2	-3.2
Japan	0.5	0.1	0.2	0.5	0.0	0.7	3.3	3.6	3.3	-4.6	-3.7	-3.2
United Kingdom	2.3	1.7	2.0	0.1	0.6	1.8	-4.5	-4.8	-3.8	-4.1	-3.0	-2.2
Euro Area	1.5	1.3	1.4	0.0	-0.0	1.1	3.0	2.6	2.5	-2.2	-2.0	-1.7
Germany	1.4	1.4	1.5	0.1	0.1	1.6	8.1	7.7	7.6	0.7	0.3	0.3
France	1.2	1.2	1.3	0.1	0.3	1.2	-0.1	-0.1	-0.8	-3.5	-3.4	-3.2
Italy	0.6	1.0	0.9	0.1	-0.2	0.9	2.1	2.0	2.0	-2.7	-2.8	-2.3
Spain	3.2	2.6	2.1	-0.6	-0.9	1.0	0.9	0.6	0.5	-5.2	-3.8	-2.7
Netherlands	2.0	1.8	1.6	0.2	0.3	1.1	9.6	8.7	8.5	-1.8	-2.0	-1.8
Belgium	1.4	1.3	1.6	0.6	0.5	1.6	0.8	1.4	1.7	-2.7	-2.7	-2.5
Portugal	1.5	1.0	1.3	0.5	0.5	1.5	1.0	1.2	1.4	-4.1	-3.0	-2.5
Emerging	4.1	4.1	4.6	6.0	6.4	5.4						
China	6.9	6.4	6.1	1.4	1.5	1.7	2.8	3.1	2.2	-2.4	-3.0	-3.3
India	7.3	7.9	8.1	4.9	5.8	5.2	-1.3	-0.6	-0.6	-4.1	-3.9	-3.5
Brazil	-3.8	-4.0	0.0	9.0	9.1	7.3	-3.3	-1.0	-1.1	-10.3	-8.4	-8.2
Russia	-3.7	-1.8	0.6	15.6	7.9	6.8	5.4	2.8	7.4	-3.7	-5.3	-4.7
World	3.1	3.0	3.2	3.6	3.9	3.8						

Source : BNP Paribas Group Economic Research / GlobalMarkets (e: Estimates & forecasts)

Financial forecasts

Interest rates		2015				2016				2015	2016e	2017e
End period		Q1	Q2	Q3	Q4	Q1	Q2e	Q3e	Q4e			
US	Fed Funds	0.25	0.25	0.25	0.5	0.5	0.25-0.50	0.25-0.50	0.25-0.50	0.01	0.25-0.50	0.25-0.50
	3-month Libor \$	0.27	0.28	0.33	0.61	0.63	0.70	0.70	0.70	0.61	0.70	1.05
	10-year T-notes	1.93	2.35	2.03	2.27	1.79	1.75	1.65	1.50	2.27	1.50	1.75
EMU	Refinancing rate	0.05	0.05	0.05	0.05	0.00	0.00	0.00	0.00	0.05	0.00	0.00
	3-month Euribor	0.02	-0.01	-0.04	-0.13	-0.24	-0.30	-0.30	-0.30	-0.13	-0.30	-0.30
	10-year Bund	0.18	0.77	0.59	0.63	0.16	0.20	0.00	-0.20	0.63	-0.20	-0.20
	10-year OAT	0.42	1.20	0.90	0.98	0.41	0.50	0.30	0.10	0.98	0.10	0.10
	10-year BTP	1.29	2.31	1.73	1.60	1.23	1.45	1.25	0.95	1.60	0.95	0.80
UK	Base rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.00
	3-month Libor £	0.57	0.58	0.58	0.59	0.59	0.75	0.75	0.75	0.59	0.75	1.25
	10-year Gilt	1.58	2.03	1.77	1.96	1.42	1.40	1.47	1.50	1.96	1.50	1.80
Japan	Overnight call rate	0.02	0.01	0.01	0.04	-0.00	-0.30	-0.30	-0.30	0.04	-0.30	-0.50
	3-month JPY Libor	0.17	0.17	0.17	0.17	0.10	-0.30	-0.30	-0.30	0.17	-0.30	-0.50
	10-year JGB	0.40	0.44	0.35	0.25	-0.04	-0.35	-0.35	-0.35	0.25	-0.35	-0.50

Exchange rates		2015				2016				2015	2016e	2017e
End period		Q1	Q2	Q3	Q4	Q1	Q2e	Q3e	Q4e			
USD	EUR / USD	1.07	1.11	1.12	1.09	1.14	1.16	1.15	1.14	1.09	1.14	1.05
	USD / JPY	120	122	120	120	112	108	110	115	120	115	124
EUR	EUR / GBP	0.72	0.71	0.74	0.74	0.79	0.77	0.74	0.72	0.74	0.72	0.68
	EUR / CHF	1.04	1.04	1.09	1.09	1.09	1.14	1.14	1.16	1.09	1.16	0.01
	EUR/JPY	129	136	134	131	128	125	127	131	131	131	130

Source : BNP Paribas Group Economic Research / GlobalMarkets (e: Estimates & forecasts)



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