November 07, 2018

Economics Group

WELLS FARGO SECURITIES

MONTHLY OUTLOOK

U.S. Overview

All Good Things in Moderation

While the recent run of good economic tidings has helped deliver the benefits of stronger economic growth to more industries, regions and individuals, it is important to remember that the key to a long life and long economic expansion is to enjoy all things in moderation. In keeping with that spirit the Federal Reserve continues to gradually remove the policy accommodation put in place in the aftermath of the Financial Crisis and is nearly at what we believe is the neutral level of the federal funds rate, which should lead to progressively more modest gains in economic growth over the forecast period.

The economy clearly has strong momentum headed into the final quarter of 2018. Real GDP grew at a 3.5% annual rate during the third quarter and the most recent employment data show nonfarm payrolls adding an average of 218,000 jobs per month for the past three months. The unemployment rate has dipped down to 3.7% and wages are now up 3.1% year-to-year.

Despite the recent string of strong economic reports, there are few signs the economy is on the verge of overheating. Inflation remains close to the Fed's target and slowing global growth appears to be weighing on commodity prices. With inflation running close to the Fed's target, the Fed should be able to stick to its plan to modestly nudge interest rates higher.

We continue to see economic growth gradually moderating back toward its long-term trend. The benefits from tax reform will continue to propel growth in 2019, but should fade over the course of the year, as interest rates rise further.

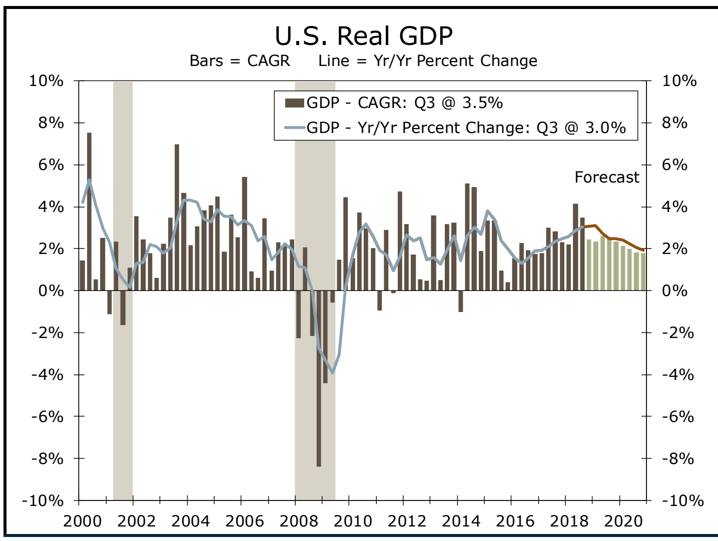
International Overview

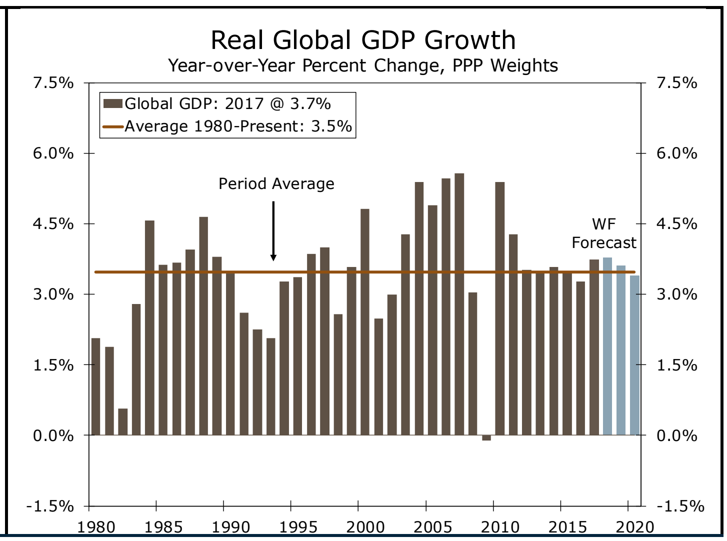
Global Growth May Be Starting to Slow

Our outlook for the global economy is little changed from our last update, although we now see a further deceleration in global GDP growth in 2019. To reflect this, we have slightly lowered our global GDP forecast for 2019 to 3.6% from 3.7%, while leaving our forecast for 2020 unchanged at 3.4%. With that said, G20 economies have continued to grow at a reasonable pace throughout 2018, while global economic activity remains resilient evidenced by solid global export volumes, increasing at 3.9% year-over-year in August, slightly below the 2017 average, but sturdy nonetheless.

One of our primary concerns is a sharper-than-expected growth slowdown in China. We believe this will result in a material slowdown to developing economies, which may also may weigh on global growth in 2019. We have also lowered our 2018, as well as 2019, growth forecasts for the Eurozone. GDP, sentiment and economic activity data have been softer than expected, leading us to revise our 2018 GDP growth forecast to under 2%, the lowest since 2016.

Risks to the outlook seem tilted to the downside, which may result in slower global economic growth than we are currently forecasting. The primary concern being a further escalation in trade tensions between the U.S. and China. There is also some possibility of faster monetary tightening, especially in the U.S. and Canada, if labor markets improve and wage pressures continue to increase. This may lead to central banks removing accommodative policy conditions at a quicker pace than currently expected.





Source: U.S. Department of Commerce, International Monetary Fund and Wells Fargo Securities

Together we'll go far

This report is available on wellsfargo.com/economics and on Bloomberg WFRE.

Growth Appears Set to Moderate

Real GDP growth appears set to slow following the strongest back-to-back quarterly growth in three years. Third quarter growth came in close to expectations, with real GDP rising at a 3.5% annual rate. Growth was bolstered by solid growth in consumer spending, which rose at a 4% annual rate, and another strong gain in government spending, which grew at a 3.3% pace and was helped along by the bi-partisan budget agreement and some improvement in state and local government finances. Inventory building also rebounded, surging by $76.3 billion and adding 2.1 percentage points to third quarter growth.

We are looking for growth to moderate during the current quarter, as consumer spending settles back down to a 2.8% pace and inventory building maintains its recent pace. Business fixed investment is expected to rebound, however, as the prior quarter's growth appears to have underperformed the recent trend in orders and shipments. The public sector looks set for another large gain, with increased defense outlays and stronger state and local government spending paving the way.

The moderation in economic growth is expected to extend into 2019. We now expect real GDP to rise 2.7% for the year as a whole, but fourth-quarter to- fourth-quarter growth will be closer to 2.4%. Fiscal stimulus will provide less of a boost during the coming year, while rising interest rates weigh progressively more on growth. Housing, the most interest-rate-sensitive part of the economy, is already flashing warning signs, with residential investment declining in five of the past six quarters.

Consumer Spending Should Remain Solid

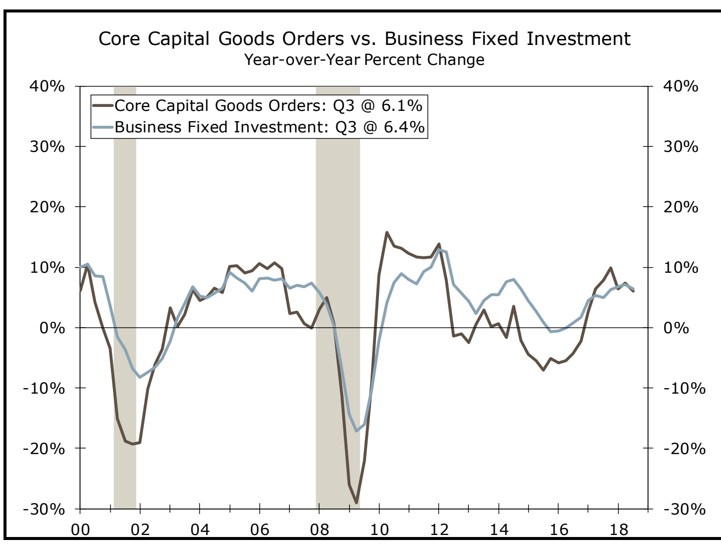
While we expect consumer spending to moderate in coming quarters, we are still looking for fairly solid gains. Stronger job and income growth continues to buoy consumer confidence and provide ample support for spending over the next few quarters. Our forecast for Q4 consumer spending assumes spending rises at just a 0.2% pace per month during the quarter, which seems reasonable given the recent strong growth in nonfarm employment and uptick in average hourly earnings. Consumer spending is largely expected to trace after-tax income growth through the remainder of the forecast period.

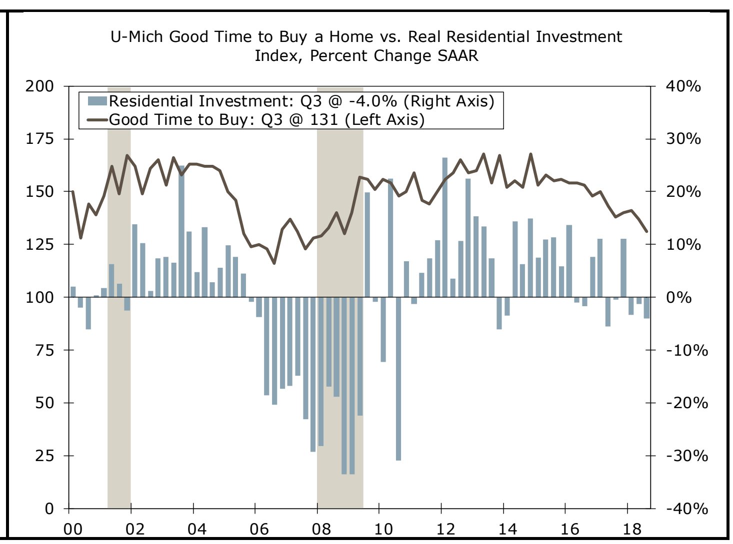
Housing has been a notable weak spot for the economy, with real residential investment declining in five of the past six quarters. The weakness is evident across all aspects of the housing market. Existing home sales have declined in seven of the past nine months and are running 2.1% below their year-ago pace through the first nine months of 2018. The slower pace of existing home sales impacts real GDP through less commission income for realtors and also less spending on alterations and repairs. New home sales have fared slightly better with sales climbing 3.6% through September and starts of single-family homes are up 6.0% through this period. Prices have moderated across the board, which means spending will get less of a tailwind from rising household wealth.

Business fixed investment came in below expectations during the third quarter, largely due to a decline in outlays related to oil and gas exploration. Energy exploration had surged earlier in the year and was primed for a pullback. We are reluctant to extend that pullback further, however, as there is currently a rush to build pipelines to bring more oil and gas to refineries, storage facilities and export terminals along the Gulf Coast. Spending for capital equipment is expected to bounce back in Q4 but moderate thereafter, reflecting tightening profit margins and slower global economic growth.

More Modest Growth Should Restrain Inflation

The moderation in growth that we are expecting over the next few quarters should help restrain inflation. Growth is still expected to exceed the sum of labor force and productivity growth in 2019, which means the unemployment rate will trend lower and inflation will inch a little higher. The headline price indices are likely to rise around 2.5% next year, while core inflation rises around 2.2%. That would not be enough of an uptick in inflation to cause the Fed to increase the pace or ultimate magnitude of interest rate hikes. Long-term rates would continue to trend higher.





Source: U.S. Department of Commerce, University of Michigan and Wells Fargo Securities

Wells Fargo U.S. Economic Forecast

	Actual							Forecast									Actual	Forecast		
	2017				2018				2019				2020				2017	2018	2019	2020
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product (a)	1.8	3.0	2.8	2.3	2.2	4.2	3.5	2.5	2.3	2.6	2.5	2.3	2.1	2.0	1.8	1.8	2.2	2.9	2.7	2.2
Personal Consumption	1.8	2.9	2.2	3.9	0.5	3.8	4.0	2.8	2.2	2.9	2.6	2.5	2.1	2.2	1.8	1.7	2.5	2.7	2.8	2.2
Business Fixed Investment	9.6	7.3	3.4	4.8	11.5	8.7	0.8	6.6	4.7	4.9	4.4	4.0	3.7	3.6	2.9	2.8	5.3	6.8	4.8	3.7
Equipment	9.1	9.7	9.8	9.9	8.5	4.6	0.4	7.7	3.8	4.2	3.7	3.1	2.7	2.6	2.1	2.0	6.1	7.1	4.1	2.8
Intellectual Property Products	8.0	6.6	1.7	0.7	14.1	10.5	7.9	7.4	4.8	5.3	4.7	4.6	4.7	4.6	3.7	3.6	4.6	7.6	6.1	4.5
Structures	12.8	3.8	-5.7	1.3	13.9	14.5	-7.9	3.0	6.5	6.0	5.5	5.0	4.5	4.0	3.5	3.5	4.6	4.8	4.1	4.5
Residential Construction	11.1	-5.5	-0.5	11.1	-3.4	-1.3	-4.0	0.0	1.5	2.0	2.5	2.5	2.5	2.5	2.0	2.0	3.3	-0.1	0.6	2.4
Government Purchases	-0.8	0.0	-1.0	2.4	1.5	2.5	3.3	3.2	2.7	2.2	1.6	0.8	0.7	0.5	0.3	0.1	-0.1	1.8	2.5	0.8
Net Exports	-845.5	-844.1	-845.9	-899.2	-902.4	-841.0	-939.0	-968.7	-983.5	-1006.4	-1021.6	-1032.5	-1034.3	-1044.2	-1042.0	-1036.4	-858.7	-912.7	-1011.0	-1039.2
Pct. Point Contribution to GDP	-0.1	0.1	0.0	-0.9	0.0	1.2	-1.8	-0.6	-0.3	-0.5	-0.3	-0.2	0.0	-0.2	0.0	0.1	-0.4	-0.3	-0.5	-0.1
Inventory Change	-2.4	11.9	64.4	16.1	30.3	-36.8	76.3	75.0	71.0	70.0	71.0	71.0	70.0	69.0	69.0	69.0	22.5	36.2	70.8	69.3
Pct. Point Contribution to GDP	-0.8	0.2	1.0	-0.9	0.3	-1.2	2.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.0
Nominal GDP (a)	3.9	4.2	4.8	5.1	4.3	7.6	4.9	4.8	5.5	5.3	5.2	4.9	4.5	4.6	4.1	4.4	4.2	5.2	5.3	4.7
Real Final Sales	2.6	2.8	1.8	3.2	1.9	5.4	1.4	2.8	2.4	2.7	2.5	2.4	2.2	2.0	1.8	1.8	2.2	2.8	2.6	2.2
Retail Sales (b)	4.9	4.1	4.2	5.6	4.5	5.7	5.9	4.5	5.0	4.4	4.2	4.5	4.5	4.4	4.4	3.7	4.7	5.2	4.5	4.2
Inflation Indicators (b)																				
PCE Deflator	2.0	1.6	1.6	1.8	1.9	2.2	2.2	2.1	2.3	2.4	2.7	2.7	2.5	2.5	2.4	2.4	1.8	2.1	2.5	2.4
"Core" PCE Deflator	1.8	1.6	1.5	1.6	1.7	1.9	2.0	2.0	2.1	2.2	2.3	2.3	2.2	2.2	2.2	2.1	1.6	1.9	2.2	2.2
Consumer Price Index	2.6	1.9	2.0	2.1	2.3	2.6	2.6	2.4	2.4	2.6	2.9	2.9	2.7	2.7	2.5	2.5	2.1	2.5	2.7	2.6
"Core" Consumer Price Index	2.1	1.8	1.7	1.7	1.9	2.2	2.2	2.3	2.3	2.6	2.7	2.7	2.5	2.3	2.4	2.4	1.8	2.2	2.6	2.4
Producer Price Index (Final Demand)	2.0	2.2	2.4	2.8	2.8	3.0	2.9	2.6	2.6	2.6	2.9	3.1	2.9	2.9	2.7	2.6	2.3	2.8	2.8	2.8
Employment Cost Index	2.4	2.4	2.5	2.6	2.7	2.8	2.8	2.9	2.9	3.1	3.1	3.2	3.2	3.3	3.3	3.3	2.5	2.8	3.1	3.3
Real Disposable Income (a)	4.5	2.2	2.2	2.3	4.4	2.5	2.5	2.5	2.8	2.6	2.6	2.6	2.6	2.5	2.2	2.0	2.6	2.9	2.6	2.5
Nominal Personal Income (b)	4.1	4.3	4.5	4.6	4.3	4.7	4.6	4.3	4.5	4.8	4.8	4.8	4.6	4.3	4.2	3.9	4.4	4.5	4.7	4.2
Industrial Production (a)	1.0	5.0	-1.5	7.7	2.5	5.3	3.3	3.6	2.4	4.2	1.2	4.0	2.5	4.7	0.7	0.1	1.6	3.8	3.2	2.8
Capacity Utilization	75.4	76.2	75.8	77.0	77.2	77.8	78.0	78.3	78.5	78.6	78.6	78.8	78.9	79.1	79.0	78.9	76.1	77.8	78.6	79.0
Corporate Profits Before Taxes (b)	3.0	3.6	2.8	3.3	5.9	7.3	8.0	6.2	5.6	1.8	0.5	-0.8	-1.6	-2.2	-2.6	-3.4	3.2	6.9	1.7	-2.4
Corporate Profits After Taxes	6.0	6.2	6.4	7.3	15.1	15.8	17.0	12.5	4.7	1.9	0.3	-1.0	-1.8	-2.4	-2.9	-3.7	6.5	15.1	1.4	-2.7
Federal Budget Balance (c)	-317	4	-143	-225	-375	-7	-172	-321	-396	-63	-270	-337	-416	-63	-283	-364	-666	-779	-1050	-1100
Trade Weighted Dollar Index (d)	94.0	90.5	88.1	87.5	86.3	90.0	90.1	92.0	91.0	89.3	88.3	87.0	86.0	85.0	84.0	83.0	91.1	89.6	88.9	84.5
Nonfarm Payroll Change (e)	177	190	142	221	218	217	190	203	170	170	160	160	150	140	100	90	182	207	165	120
Unemployment Rate	4.7	4.3	4.3	4.1	4.1	3.9	3.8	3.7	3.7	3.6	3.6	3.5	3.4	3.3	3.3	3.3	4.4	3.9	3.6	3.3
Housing Starts (f)	1.23	1.17	1.17	1.26	1.32	1.26	1.22	1.29	1.30	1.31	1.32	1.32	1.33	1.34	1.34	1.35	1.20	1.27	1.31	1.34
Light Vehicle Sales (g)	17.1	16.8	17.1	17.6	17.1	17.2	16.9	17.0	16.8	16.7	16.7	16.6	16.6	16.5	16.4	16.3	17.1	17.1	16.7	16.5
Crude Oil - Brent - Front Contract (h)	54.6	50.8	52.2	61.4	66.9	74.6	75.8	78.0	80.0	85.0	88.0	82.0	80.0	74.0	70.0	70.0	54.7	73.9	83.8	73.5
Quarter-End Interest Rates (i)																				
Federal Funds Target Rate	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.25	3.25	3.25	3.00	1.13	2.13	3.06	3.19
3 Month LIBOR	1.15	1.30	1.33	1.69	2.31	2.34	2.40	2.70	2.95	3.15	3.40	3.40	3.40	3.40	3.40	3.15	1.26	2.44	3.23	3.34
Prime Rate	4.00	4.25	4.25	4.50	4.75	5.00	5.25	5.50	5.75	6.00	6.25	6.25	6.25	6.25	6.25	6.00	4.13	5.13	6.06	6.19
Conventional Mortgage Rate	4.20	3.90	3.81	3.94	4.44	4.57	4.63	4.90	5.05	5.15	5.25	5.30	5.30	5.25	5.20	5.15	3.99	4.63	5.19	5.23
3 Month Bill	0.76	1.03	1.06	1.39	1.73	1.93	2.19	2.40	2.65	2.90	3.05	3.10	3.05	3.00	2.95	2.75	0.95	2.06	2.93	2.94
6 Month Bill	0.91	1.14	1.20	1.53	1.93	2.11	2.36	2.60	2.85	2.95	3.10	3.15	3.10	3.05	3.00	2.80	1.07	2.25	3.01	2.99
1 Year Bill	1.03	1.24	1.31	1.76	2.09	2.33	2.59	2.75	3.00	3.05	3.15	3.20	3.15	3.10	3.05	2.90	1.20	2.44	3.10	3.05
2 Year Note	1.27	1.38	1.47	1.89	2.27	2.52	2.81	2.95	3.10	3.15	3.25	3.25	3.20	3.15	3.10	3.00	1.40	2.64	3.19	3.11
5 Year Note	1.93	1.89	1.92	2.20	2.56	2.73	2.94	3.10	3.25	3.35	3.45	3.50	3.45	3.40	3.35	3.25	1.91	2.83	3.39	3.36
10 Year Note	2.40	2.31	2.33	2.40	2.74	2.85	3.05	3.30	3.45	3.55	3.65	3.70	3.70	3.65	3.60	3.55	2.33	2.99	3.59	3.63
30 Year Bond	3.02	2.84	2.86	2.74	2.97	2.98	3.19	3.50	3.65	3.80	3.90	3.95	4.00	4.00	3.95	3.90	2.89	3.16	3.83	3.96

Forecast as of: November 7, 2018

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter
(b) Year-over-Year Percentage Change
(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Yr.
(d) Federal Reserve Major Currency Index, 1973=100 - Quarter End
(e) Average Monthly Change
(f) Millions of Units - Annual Data - Not Seasonally Adjusted
(g) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
(h) Quarterly Average of Daily Close
(i) Annual Numbers Represent Averages

Source: Federal Reserve Board, IHS Markit, U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities

Global Growth May Be Starting to Slow

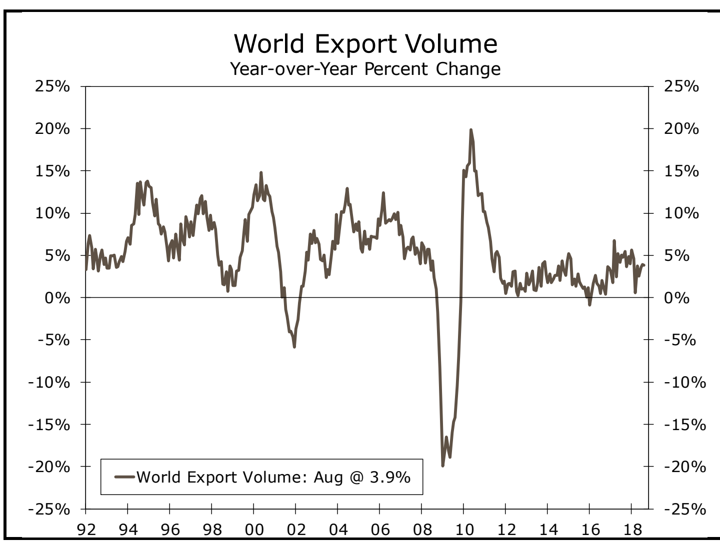
Our outlook for the global economy is little changed from our last update, although we now see a further deceleration in global GDP growth in 2019. To reflect this, we have slightly lowered our global GDP forecast for 2019 to 3.6% from 3.7%, while leaving our forecast for 2020 unchanged at 3.4%. We believe headwinds due to escalating trade tensions between the U.S. and China, along with the removal of accommodative monetary policy, will weigh on the global growth outlook, with the impact largely being felt in 2019. With that said, G20 economies have continued to grow at a reasonable pace throughout 2018, while global economic activity remains resilient evidenced by solid global export volumes. Despite headwinds of more protectionist and inward-looking trade policies, global export volumes increased 3.9% year-over-year in August, slightly below the 2017 average, but sturdy nonetheless.

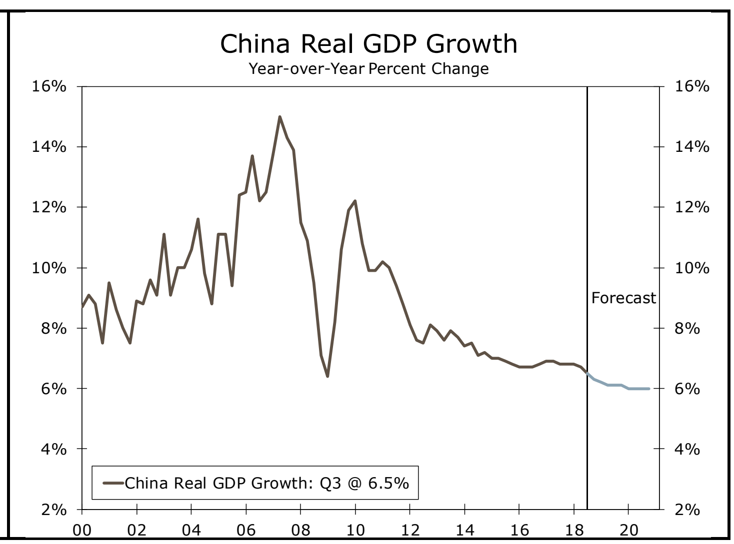
Although we continue to believe global growth will be led by developing economies in 2019, one of our primary concerns is a sharper than expected growth slowdown in China. We believe this will result in a material slowdown to developing economies, which we also believe may weigh on global growth in 2019. In contrast to the U.S., stimulus efforts to boost China's economy have been less impactful and their effects are beginning to fade. A weaker than expected Q3-2018 GDP print of 6.5%, paired with slowing economic activity indictors, has led us to adjust our 2019 growth outlook for China to 6.1% from 6.3%. While the government and the People's Bank of China have promised additional stimulus measures to support growth, escalating trade tensions with the U.S. may start to have more material impacts on the Chinese economy in 2019, and offset any new policy accommodation from authorities.

Sticking with the theme of slowing economic growth, we have also lowered our 2018, as well as 2019, growth forecasts for the Eurozone. GDP, sentiment and economic activity data have been softer than expected in Q3, leading us to revise our 2018 GDP growth forecast to under 2%, the lowest since 2016. Despite this weaker data, we still believe the European Central Bank is on pace to begin hiking rates towards the end of 2019. Higher policy rates may also create headwinds for the Eurozone and lead to slower growth, while also restraining inflation throughout broader Europe.

The removal of accommodative monetary policy from major central banks will also play an important factor in the outlook for growth across the globe. Despite varying degrees of economic performance, major central banks have begun the process of normalizing policy rates and removing more accommodative monetary policy. Although led by U.S. Federal Reserve, the Bank of Canada has also implemented three rate hikes this year, while other major central banks have provided forward guidance indicating monetary tightening is on the horizon. Recent comments from the Bank of England highlighting an improving U.K. economy may lead to quicker than anticipated rate hikes, while the Czech National Bank continues on its path towards higher policy rates.

Risks to the outlook seem to be tilted to the downside, which may result in slower global economic growth than we are currently forecasting. The primary concern being a further escalation in trade tensions between the U.S. and China. This escalation could come in many forms, although the most conceivable being the imposition of tariffs on the remaining $267B of Chinese exports to the U.S., along with higher rates on existing tariffs. Analyst estimates indicate this scenario may cut another 80-100 bps off China GDP growth, which could have large implications for global activity. There is also some possibility of faster monetary tightening, especially in the U.S. and Canada, if labor markets improve and wage pressures continue to increase. This may lead to central banks removing accommodative policy conditions at a quicker pace than currently expected. If this were to occur, the global slowdown could be faster than we currently forecast, while financial markets could experience significant levels of volatility.





Source: IHS Markit, Bloomberg LP and Wells Fargo Securities

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	2018	2019	2020	2018	2019	2020
Global (PPP Weights)	3.8%	3.6%	3.4%	3.6%	3.8%	3.7%
Advanced Economies[1]	2.5%	2.4%	2.0%	2.2%	2.3%	2.3%
United States	2.9%	2.7%	2.2%	2.5%	2.7%	2.6%
Eurozone	1.9%	1.9%	1.7%	1.8%	1.8%	1.8%
United Kingdom	1.2%	1.6%	1.6%	2.4%	2.1%	2.0%
Japan	1.2%	1.1%	0.4%	1.0%	1.1%	1.9%
Canada	2.2%	2.2%	1.7%	2.4%	2.2%	2.0%
Developing Economies[1]	4.7%	4.5%	4.4%	4.5%	4.8%	4.6%
China	6.6%	6.1%	6.0%	2.1%	2.3%	2.2%
India	7.7%	7.5%	7.3%	4.6%	5.1%	4.8%
Mexico	2.2%	2.4%	2.3%	4.9%	4.1%	3.7%

Forecast as of: November 7, 2018

[1]Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR						10-Year Bond					
	2018	2019				2020	2018	2019				2020
	Q4	Q1	Q2	Q3	Q4	Q1	Q4	Q1	Q2	Q3	Q4	Q1
U.S.	2.70%	2.95%	3.15%	3.40%	3.40%	3.40%	3.30%	3.45%	3.55%	3.65%	3.70%	3.70%
Japan	-0.01%	0.00%	0.00%	0.00%	0.01%	0.01%	0.16%	0.20%	0.24%	0.27%	0.30%	0.30%
Euroland[1]	-0.35%	-0.35%	-0.30%	-0.10%	0.15%	0.40%	0.55%	0.70%	0.90%	1.00%	1.10%	1.20%
U.K.	0.85%	0.85%	1.10%	1.10%	1.35%	1.35%	1.55%	1.65%	1.90%	2.00%	2.10%	2.20%
Canada[2]	2.20%	2.45%	2.70%	2.95%	2.95%	2.95%	2.65%	2.80%	2.90%	3.00%	3.05%	3.05%

Forecast as of: November 7, 2018

[1] 10-year German Government Bond Yield [2] 3-Month Canada Bankers' Acceptances

Source: International Monetary Fund and Wells Fargo Securities

Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Macro Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Erik Nelson	Macro Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Abigail Kinnaman	Economic Analyst	(704) 410-1570	abigail.kinnaman@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

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