

NCB

Independent & International

Irish economy monitor - Dec'11

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Disclosures appear at the back of this document
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General view on Ireland

Economy

- The Irish economic recovery has been and will continue to be two-tiered. Economic growth will be driven by the export sector, before multiplier effects feed through into the domestic economy. This is helped by the composition of Ireland's exports: high-value added tech & pharma products and agri products.
- The boost from domestic demand will not be material until 2013. Unemployment, currently 14.4%, will remain above 10% until 2015.
- As such, there should be no surprise that property prices continue to decline, mortgage arrears continue to rise and retail sales remain weak.
- Flexibility, wage moderation and social cohesion has helped Ireland turn its current account deficit into a current account surplus and get the budget deficit heading in the right direction.
- Ireland is showing the characteristics which are required to put the economy back on the right track. These qualities differentiate Ireland from the periphery. However, one mustn't forget that Ireland is recovering from the largest credit and housing bubble in OECD history.

EU relationship

- Ireland and its banking sector are and will continue to be heavily reliant on the EU/ECB.
- Ireland will continue to see through its EU/IMF package in full, ensuring that it is fully funded until the end of 2013.
- Our view has been that Ireland will not be able to fund itself entirely on its own two feet come 2014 and therefore will require further EU assistance.
- While sentiment to Ireland has turned, pushing in yields, Ireland will still be extremely vulnerable, on its own and also to contagion, come 2014.
- We believe that pressure will come back on Italy and Spain once the ECB steps back and hands over to the EFSF. Ultimately a more comprehensive EU/ECB package will be devised, which will provide a backstop for Euro area countries.
- A Euro area wide system/backstop would enable Ireland to retain more sovereignty over fiscal decisions.
- Regardless, we don't believe that Ireland will lose its corporate tax rate.

Significant developments since last monitor – the “new” EU fiscal plan

- We sum up the latest set of EU measures as: This time, we will actually stick to the rules that have been in place since 1992 (honestly). And, oh yeah, we are leaving the UK behind.
- The familiar 3% deficit target remains with stricter oversight and automatic sanctions for a failure to comply with the rules.
- In addition to the 3% deficit, another fiscal target will be adopted, namely; the annual structural deficit shall not exceed 0.5% of nominal GDP. The rule will contain an automatic correction mechanism that shall be triggered in the event of deviation.
 - To put this in context, Ireland’s structural deficit is forecast to be at 3.7% in 2015. Hence our comment last week that Budget 2012 is step 7 of at least 12.
- The ESM is to be brought into existence by July 2012 and will run parallel with the EFSF until June 2013, while the IMF is to be provided with €200bn in bilateral loans from EU members to enable the IMF to provide loans to troubled countries.
 - The result of the negotiations and the recent ECB announcements is that Italy/Spain will continue to access the market with support being provided on an ad-hoc basis for certain issues.
 - There will be no magic budget and the euro will remain intact.
 - Europe will be characterised by deleveraging and tight budgets for the next number of years. The system will be run to try and ensure that banks deleverage and governments pay back their debt. Not a pretty place for wealth creation or enterprises more generally.

Significant developments since last monitor – fiscal plans outlined

- The government has outlined the fiscal consolidation plan for the years 2012-2015, which will total €12.4bn. This comes on top of the €20.7bn (13.3% of 2010 GDP) Ireland has done to-date (page 19).
- Consolidation outline

Annual adjustment, €bn

	2012	2013	2014	2015
Total	3.8	3.50	3.10	2.00
Expenditure	2.2	2.25	2.00	1.30
<i>Current</i>	<i>1.45</i>	<i>1.70</i>	<i>1.90</i>	<i>1.30</i>
<i>Capital</i>	<i>0.75</i>	<i>0.55</i>	<i>0.10</i>	<i>0.00</i>
Tax	1.6	1.25	1.10	0.70

- Department of Finance assumptions are likely on the optimistic side

DoF assumptions, %

	2012	2013	2014	2015
GDP	1.3	2.4	3.0	3.0
Primary balance	-4.4	-1.9	0.8	2.8
Deficit to GDP	8.6	7.5	5.0	2.9
Debt to GDP	115.0	119.0	118.0	115.0

Forecast summary

- Despite our figures being lower than the governments there are still clearly further downside risks to our growth figures.
- Given our lower growth profile, we see the deficit to GDP figure still above the 3% mark in 2015 at 3.9% and have the debt to GDP figure at 120% of GDP in both 2013 and 2014.
- Despite the progress to-date Ireland is still extremely vulnerable to a further slow down in economic growth or fatigue in its fiscal consolidation measures (see page 22).

NCB summary forecasts, full forecasts on page 14

	2010	2011	2012	2013	2014	2015
GNP	0.3	-1.7	0.5	1.9	1.6	1.8
GDP	-0.4	0.5	1.1	2.3	2.0	2.2
Domestic demand	-4.3	-3.7	-1.5	1.1	0.7	1.2
Employment	-4.0	-1.8	-0.3	1.0	1.5	1.9
Underlying government deficit to GDP, %	-12.0%	-10.3%	-8.9%	-8.1%	-5.6%	-3.9%
Gross Government debt to GDP (GGD, %)	93.2%	107.1%	114.8%	119.9%	120.0%	118.3%
Current account (% GDP)	0.5%	1.2%	1.9%	2.4%	2.9%	3.4%

Current indicators of economic activity

- The Irish economy grew marginally in November according to our composite PMI growth measure (Chart 1).
- The NCB manufacturing PMI declined in November from 50.1 to 48.5. New export orders contracted for the second month in a row (49.9 from 49.8).
- The services sector expanded once again in November (52.7 from 51.4), and this run is expected to continue as new business reading jumped from 49.7 to 52.6.
- The unemployment rate in November rose from 14.4% to 14.5%. This is where the unemployment rate stood one year ago.

Chart 1: NCB PMI growth indicator

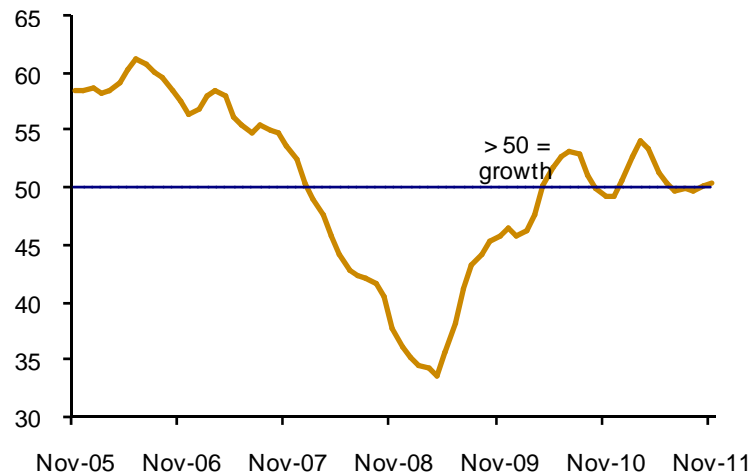


Chart 2: NCB PMIs

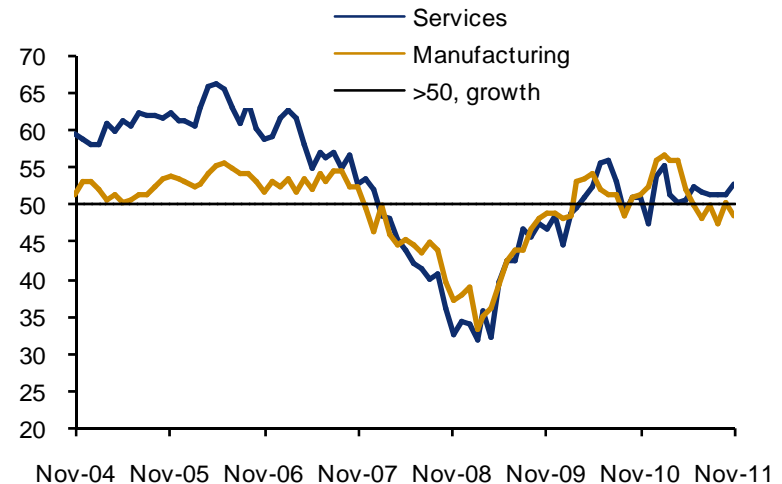
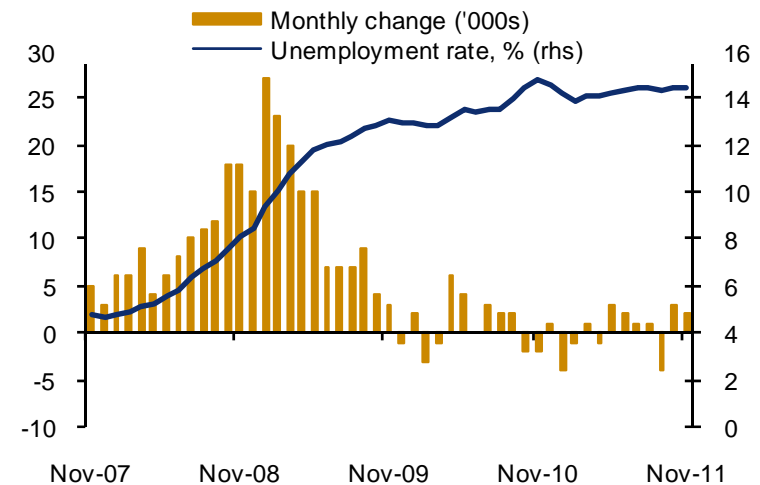


Chart 3: Live register



Irish consumer



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- Consumer confidence dipped in September, but remains well above the recent EU/IMF bailout low.
- CPI at 2.9% in September was primarily driven by interest rate increases and energy increases. Our core measure at 0.8% highlights wage moderation.
- Irish consumption remains weak with retail sales down 1.9% q/q in the 3 months to October with the ex.motors component down -0.7% q/q.

Chart 4: ESRI/IIB consumer confidence, index

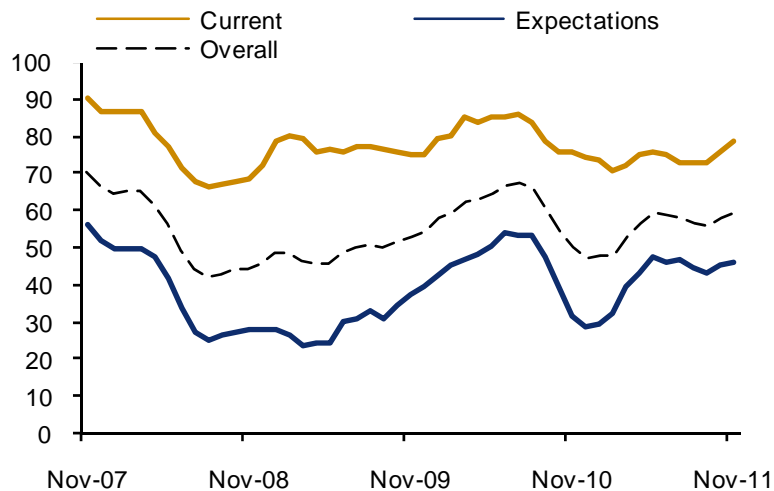


Chart 5: Irish inflation, y/y%

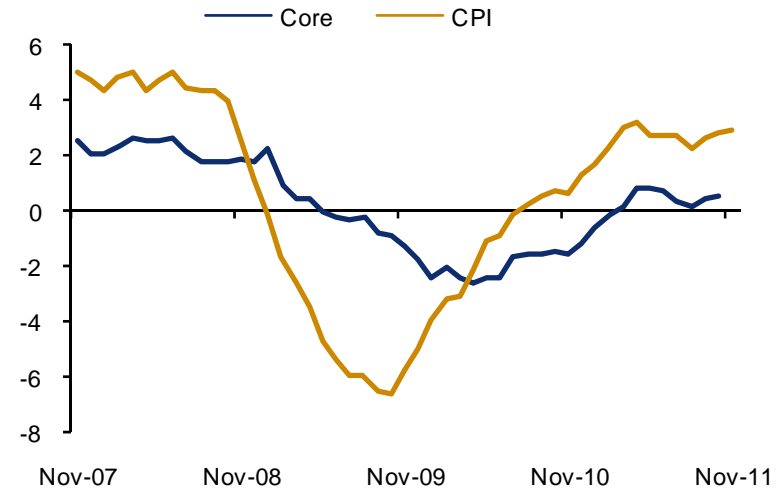
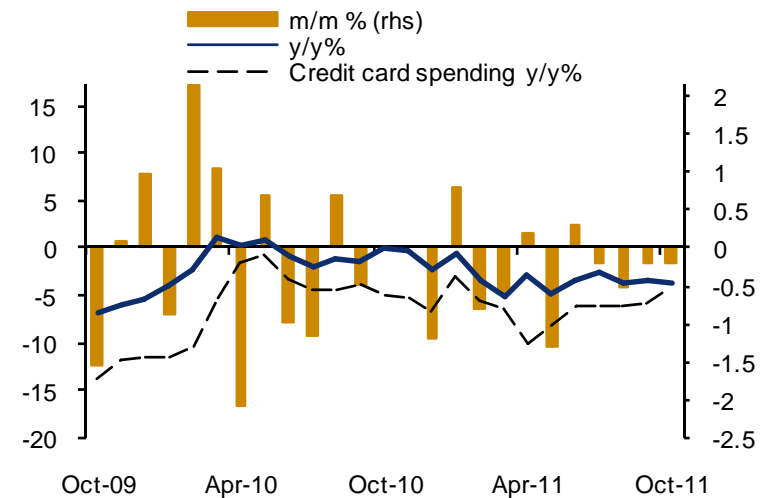


Chart 6: Retail sales ex.motors



Household savings and debt pay down

Chart 7: Household gross saving rate, %

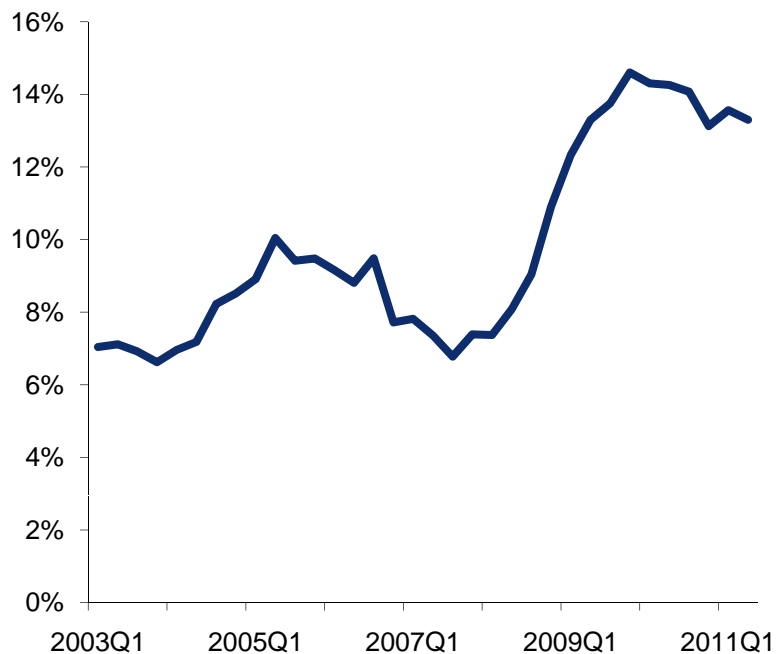
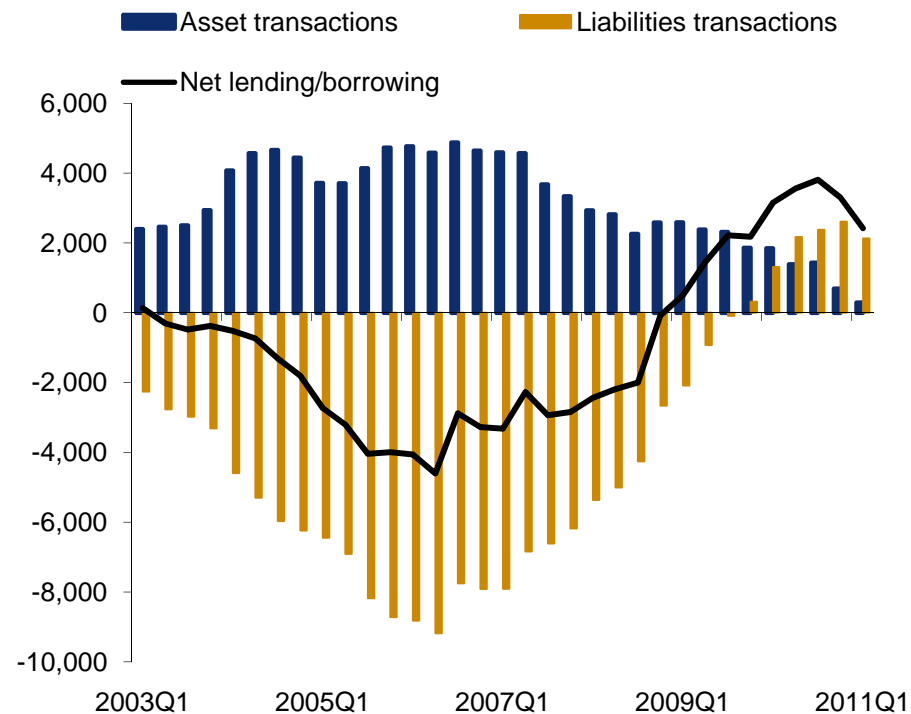


Chart 8: Household net lending/borrowing, €mn



Source: NCB, CSO, Central Bank

Housing market

- Property prices fell -2.2% m/m after -1.5% m/m in September to leave the peak to trough decline at 45%.

- The dichotomy between apartments and houses is evident in the figures with apartment prices in Dublin down 60% and house prices in Dublin down 51%. We expect a decline in Irish residential prices of between 50-55%, which still looks reasonable, although the outer boundary of the stress tests at a 60% decline certainly can't be ruled out.

- Mortgage drawdown's and house building remain anaemic and will not contribute much to the near term recovery.

Chart 9: CSO house price index

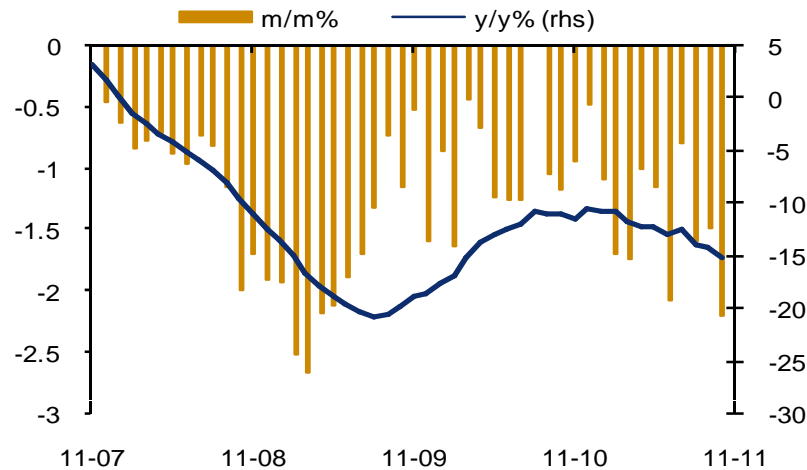


Chart 10: IBF mortgage drawdowns, sa annualised '000s

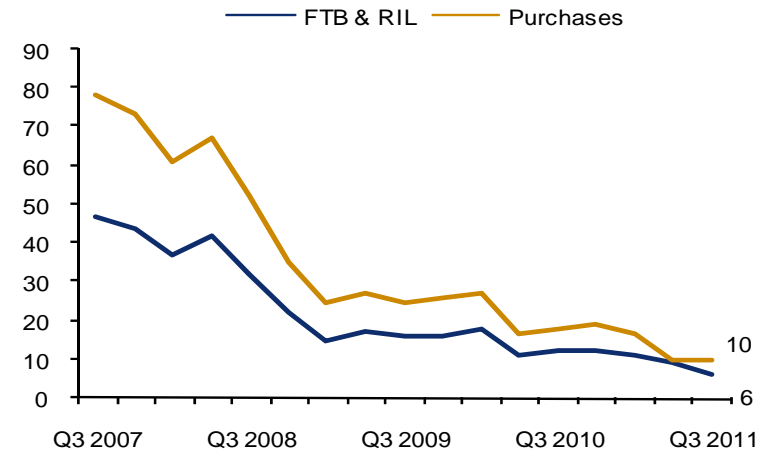
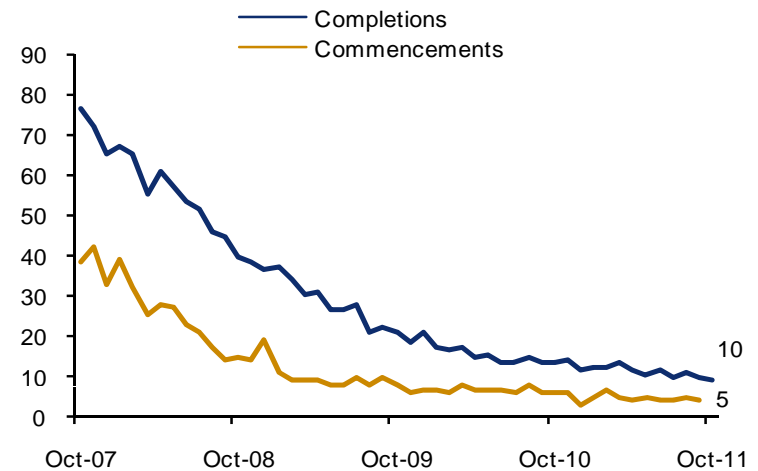


Chart 11: House building, sa annualised '000s



Industry and exports



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- In the three months to October industrial production was up 5.9% q/q and 7.8% y/y.

- The slowdown in the pace of y/y expansion in industrial production and exports was inevitable, but the recent slowdown in the quarterly data and the new export order components of the PMIs are a worrying development for Ireland.

- The fall off in machinery & equipment exports also signifies the increase in risk aversion and also the slowdown in global economic activity.

Chart 12: Industrial production, 3ma y/y%

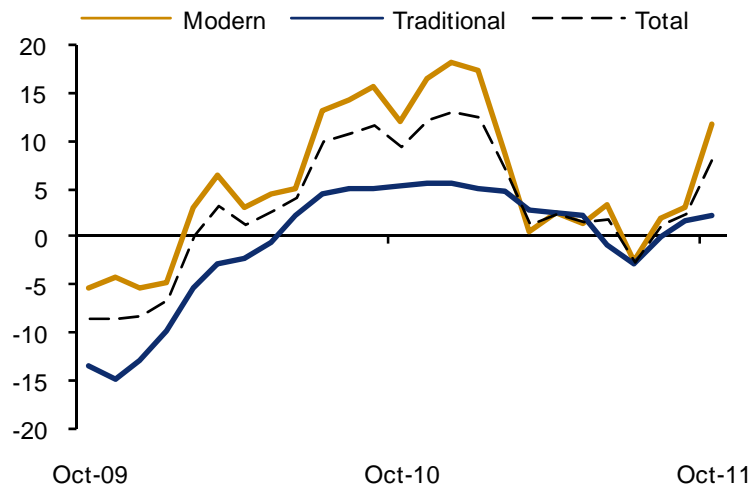


Chart 13: Merchandise exports, volume 3ma

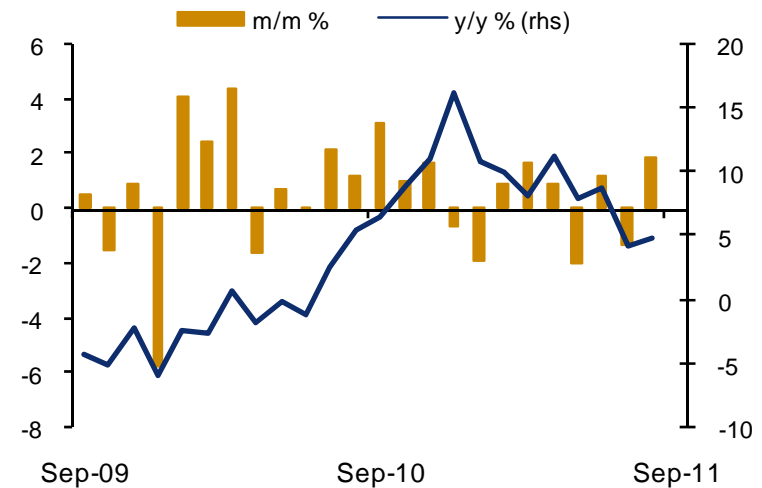
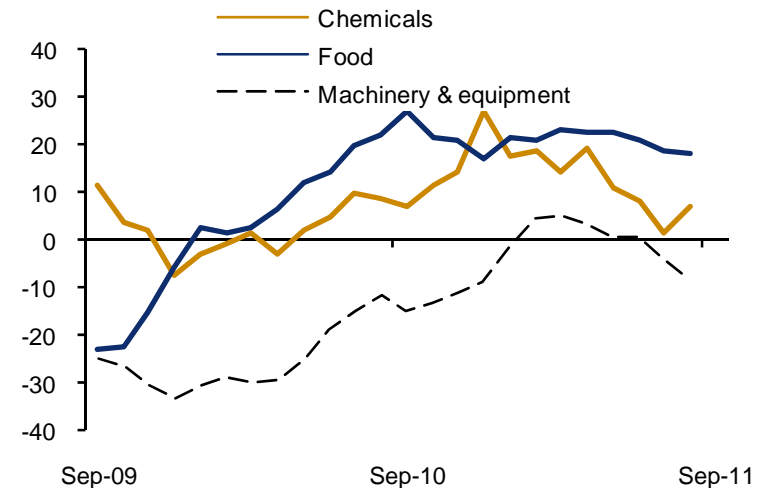


Chart 14: Value of exports by sector, 3ma y/y%



The importance of exports

Chart 15: Net exports contribution to GDP, %

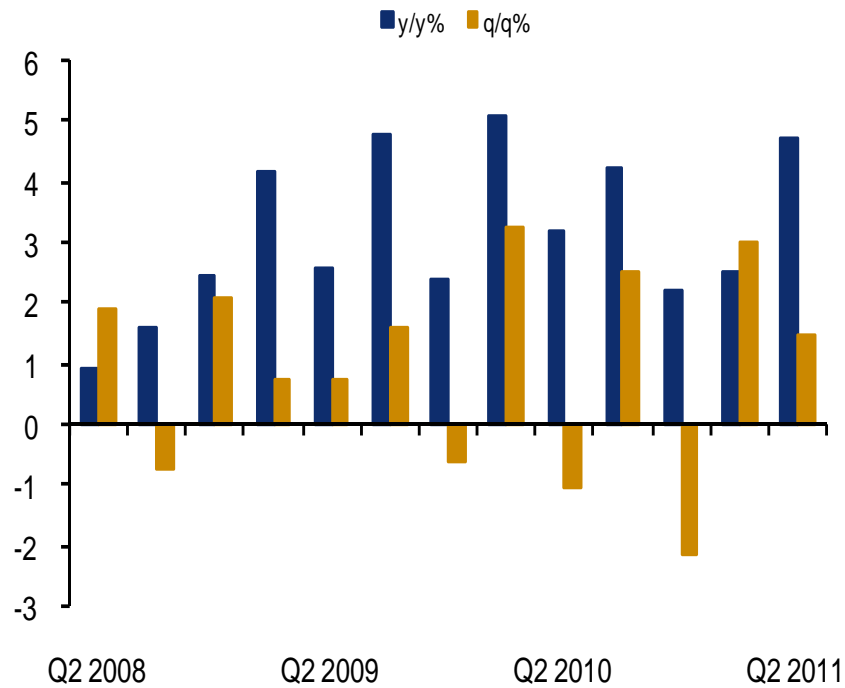
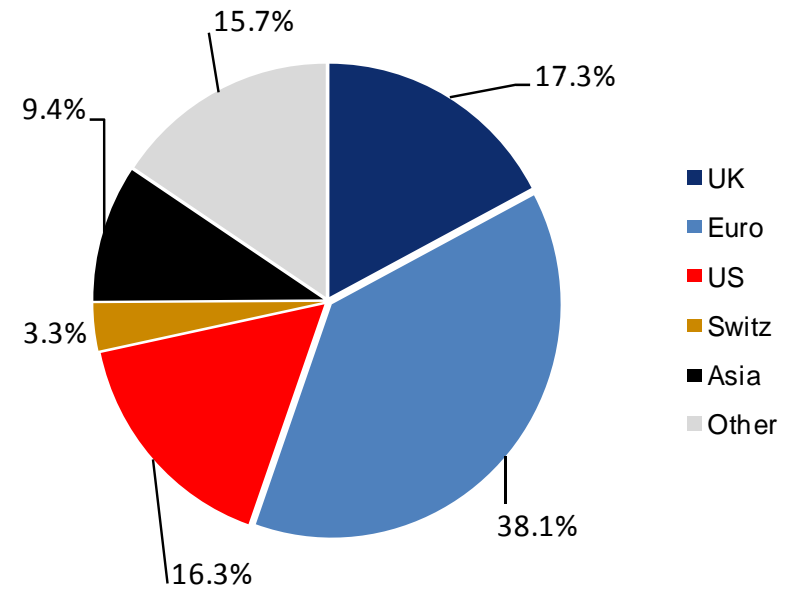


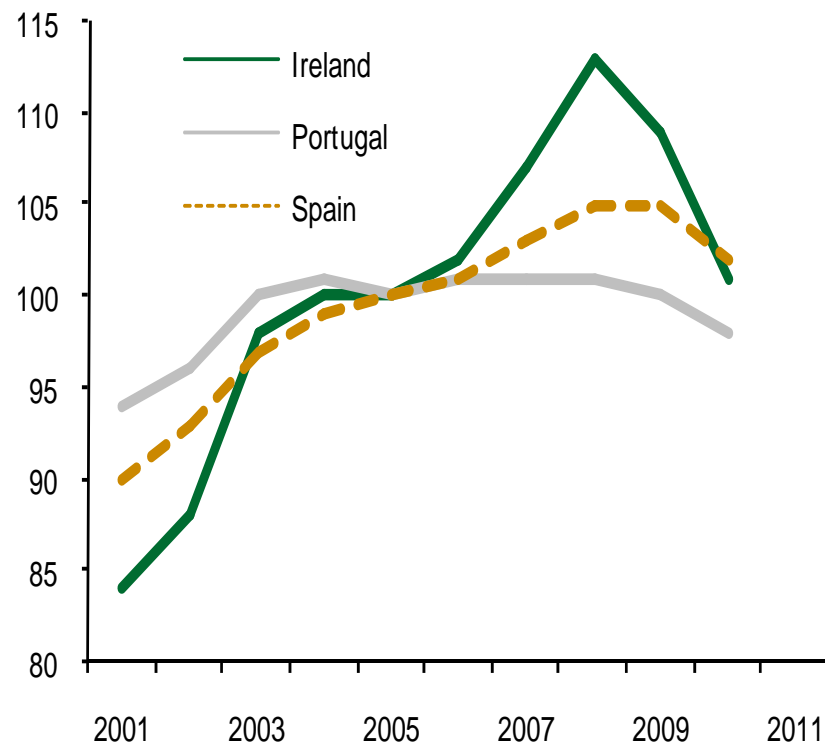
Chart 16: Breakdown of export locations



Source: NCB

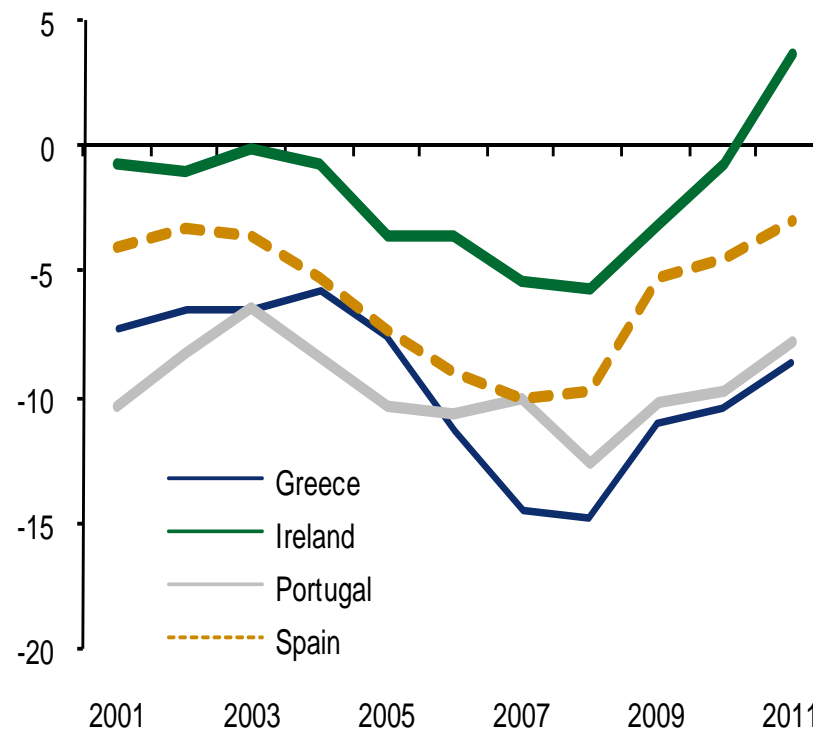
Current account deficit to surplus

Chart 17: REER, CPI adjusted



Source: OECD

Chart 18: Current account, % of GDP



The logo for NCB, consisting of the letters 'NCB' in a white, serif font centered within a solid blue rectangular background.

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A dark gray horizontal bar with the word 'Forecasts' written in white, serif font on the right side.

Forecasts

Economic forecasts, % change

		2007	2008	2009	2010	2011	2012	2013	2014	2015
1	GNP	4.5	-3.5	-10.7	0.3	-1.7	0.5	1.9	1.6	1.8
2	GDP	5.6	-3.5	-7.6	-0.4	0.5	1.1	2.3	2.0	2.2
	Components of GDP									
3	Consumption	6.4	-1.5	-7.0	-0.8	-3.5	-0.5	1.6	1.0	1.5
4	Government consumption	6.9	2.2	-4.4	-3.8	-3.5	-3.4	-2.5	-2.4	-2.4
5	Investment	2.8	-14.3	-31.0	-24.9	-9.3	-3.3	4.0	3.7	4.5
6	Gross Domestic expenditure	4.7	-4.9	-12.7	-4.3	-3.7	-1.5	1.1	0.7	1.2
7	Exports	8.2	-0.8	-4.1	6.3	4.8	3.3	3.7	4.0	3.5
8	Imports	7.8	-2.9	-9.7	2.7	2.3	1.3	3.0	3.4	3.0
	Prices									
9	CPI	4.9	4.1	-4.3	-1.0	2.3	2.2	1.7	2.3	2.6
10	HICP	2.9	3.1	-1.9	-1.6	1.6	1.8	1.7	2.0	2.2
	Labour market indicators									
11	Employment	2.9	-4.0	-7.7	-4.0	-1.8	-0.3	1.0	1.5	1.9
12	Unemployment rate (year avg)	4.6	6.3	12.2	13.6	14.3	14.0	13.2	11.8	10.4

Government finance forecasts

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		2008	2009	2010	2011	2012	2013	2014	2015
1	GNP	-3.5	-10.7	0.3	-1.7	0.5	1.9	1.6	1.8
2	GDP	-3.5	-7.6	-0.4	0.5	1.1	2.3	2.0	2.2
3	Revenue receipts (€ millions)	43,022	35,344	36,231	39,523	39,980	41,765	43,990	45,529
4	Expenditure outlays (€ millions)	55,735	59,985	54,775	64,982	59,260	56,760	55,258	54,132
5	Exchequer balance (€ millions)	-12,714	-24,641	-18,744	-25,459	-19,280	-14,995	-11,267	-8,603
6	Bond redemptions (€ millions)			1,200	4,390	5,576	6,028	11,357	3,097
7	Gross funding need (€ millions)			20,027	29,849	24,856	21,023	22,624	11,700
8	General government deficit, (€ millions)	-13,198	-23,350	-49,644	-15,979	-14,070	-13,305	-9,547	-6,798
9	General government deficit to GDP	-6.9%	-14.6%	-31.8%	-10.3%	-8.9%	-8.1%	-5.6%	-3.9%
10	General government deficit to GDP (excluding financial interventions)	-6.9%	-11.8%	-12.0%	-10.3%	-8.9%	-8.1%	-5.6%	-3.9%
11	Gross Government debt to GDP (GGD, %)	41.5%	66.5%	93.2%	107.1%	114.8%	119.9%	120.0%	118.3%
12	GGD to GNP, %	48.7%	80.3%	113.6%	130.6%	140.3%	146.3%	147.0%	144.5%
13	NAMA bonds			30,949	27,900	25,000	22,650	20,385	18,120
14	NAMA bonds, % GDP			19.8%	18.0%	15.8%	13.8%	12.0%	10.3%
15	State liabilities (GGD plus NAMA bonds)			113.0%	125.0%	130.6%	133.8%	132.0%	128.6%
16	Net debt (GGD less NPRF, cash), % GDP			73.5%	96.8%	104.6%	110.0%	111.9%	111.9%
17	Net debt, % GNP			90.9%	118.0%	127.9%	134.2%	137.1%	136.7%

The logo for NCB (National Council for Business) features the letters 'NCB' in a white, serif font, centered within a solid blue rectangular background.

NCB

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Government finances

A light grey horizontal bar located below the 'Government finances' title bar.

Government statistics – current run rate

- Tax receipts at €31.8bn in the year to November were 1.6% or €520mn behind target (Table 2)

- Voted current expenditure at €40.6bn is 2.4% below the budgeted amount, while voted capital expenditure at €3.1bn is 11.7% below the budgeted amount in the year to November (Table 3).

- The exchequer deficit of €31.8bn for 2011 includes the costs of recapitalising the banks. These sums are stripped out of the general government deficit figures. The general government deficit is expected to register 10.3% this year after 12.0% in 2010, highlighting a modest improvement (Table 1).

Table 1: Targets and forecasts

	2011		2012	
	DoF	NCB	DoF	NCB
Tax revenue, €mn	34,175	34,429	35,825	35,680
Net voted spending, €mn	46,190	46,197	44,145	44,191
Exchequer deficit, €mn	- 25,205	-25,459	-18,860	-19,280
General government deficit, %	-10.1%	-10.3%	-8.6%	-8.9%
General government debt, %	107.0%	107.1%	115.0%	114.8%

Table 2: Tax take, cumulative to November '11

	€mn	% behind (-) target
Income Tax	12,709	-2.1%
VAT	9,550	-4.6%
Corporation Tax	3,510	-6.3%
Excise	4,130	0.4%
Stamps	1,297	51.6%
Capital Gains Tax	135	-18.4%
Capital Acquisitions Tax	233	-4.1%
Customs	220	2.0%
Total	31,814	-1.6%

Table 3: Net voted spending, cumulative to November '11

	€mn	% ahead (+) target
Voted Spending	40,661	-2.4%
Current expenditure	37,585	-1.6%
Capital expenditure	3,076	-11.7%

Government deficits and debt forecasts

Chart 19: Government deficit to GDP, %

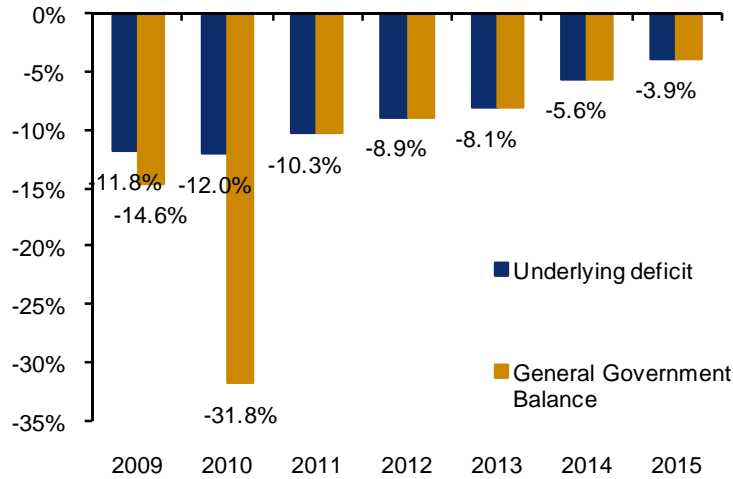


Chart 20: Interest on GGD to tax revenue, %

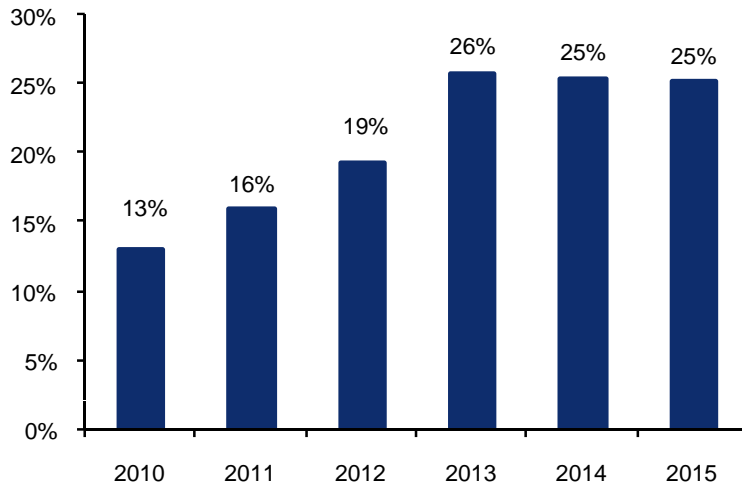


Chart 21: Gross general government debt (GGD)

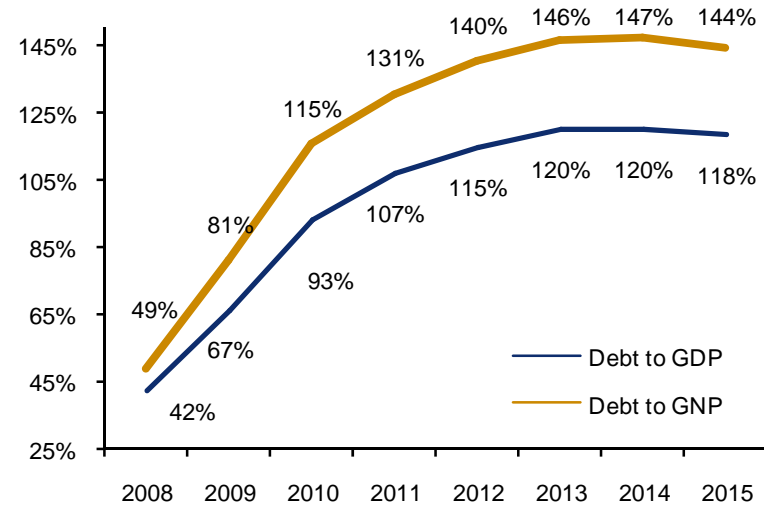
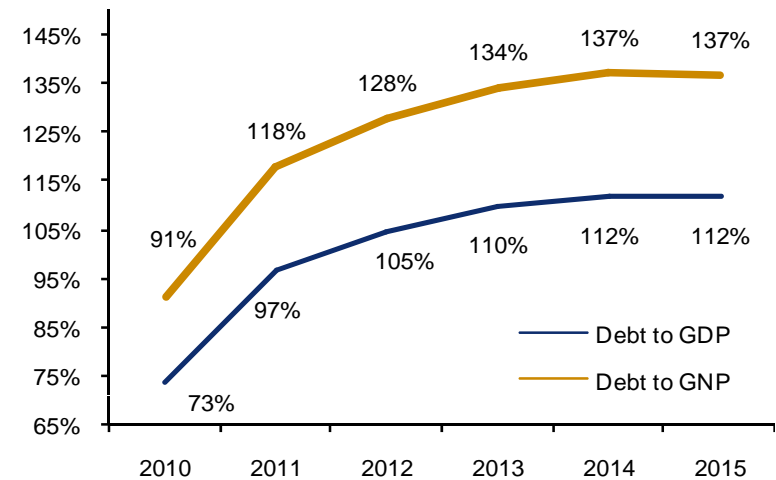


Chart 22: Net debt (GGD minus cash and non-banks NPRF)



How is the consolidation being done?

Date	Area	Main measures	Saving €mn	% of 2010 GDP
July 2008	Expenditure	Efficiency savings	1,000	0.6%
Budget 2009	Revenue	Income levy	2,000	1.3%
February 2009	Expenditure	Pension levy	2,100	1.3%
Supplementary Budget 2009	Expenditure	Capital 1/3rd. Current expenditure 2/3rd	1,800	1.2%
	Revenue	Increase in income levy and changes to PRSI, health levy	3,600	2.3%
Budget 2010	Expenditure	Social reductions - 4% reduction in welfare payments and 10% reduction in child benefit; Pay reduction on average 6.5%; €975mn in other spending and €960mn in capital expenditure cuts	4,100	2.6%
Budget 2011	Expenditure	€1.9bn capital, €2.1bn current	4,000	2.6%
	Revenue	Income taxes	1,400	0.9%
	Other	State asset sales, dividends	700	0.4%
Total to date			20,700	13.3%
To come as outlined by government			12,400	7.9%
Budget 2012	Revenue	VAT increases; Reduction in private pension tax relief; Property tax (flat rate); increase in carbon tax;	1,600	1.0%
	Expenditure	Social expenditure reductions; Reduction of public service numbers and pension adjustments; other current and capital expenditure	2,200	1.4%
Budget 2013	Revenue	Lowering of income tax bands and credits; Increase in property tax	1,250	0.8%
	Expenditure	Social expenditure reductions; Reduction of public service numbers and pension adjustments; other current and capital expenditure	2,250	1.4%
Budget 2014	Revenue		1,100	0.7%
	Expenditure		2,000	1.3%
Budget 2015	Revenue		700	0.4%
	Expenditure		1,300	0.8%

Government debt composition and maturity



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Chart 23 : Irish government debt 2013, €197bn

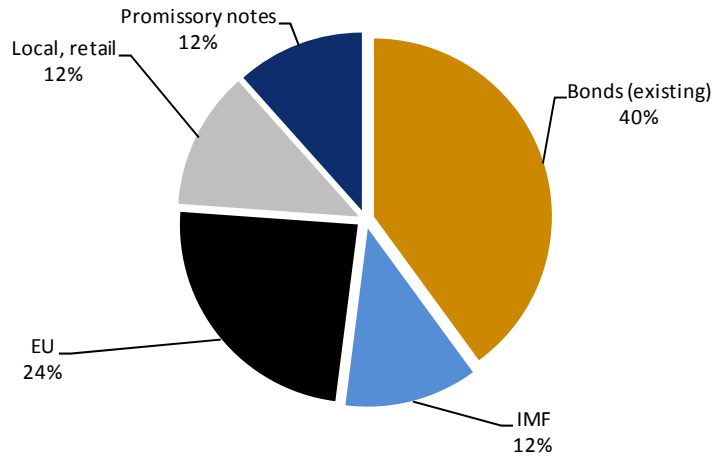


Chart 25: Irish government interest payments 2013, % of total

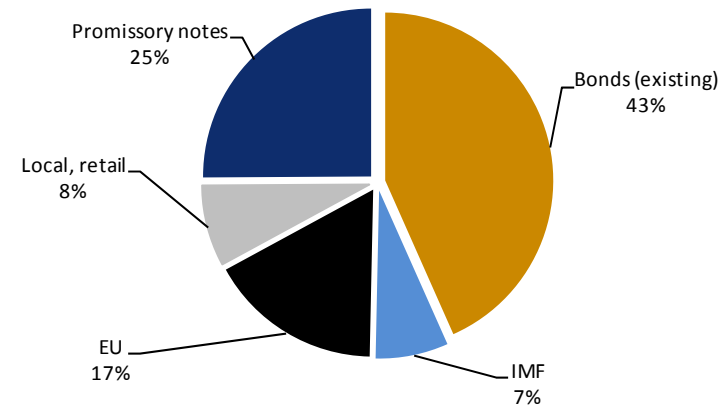


Chart 24: Maturity profile of existing bonds, €bn

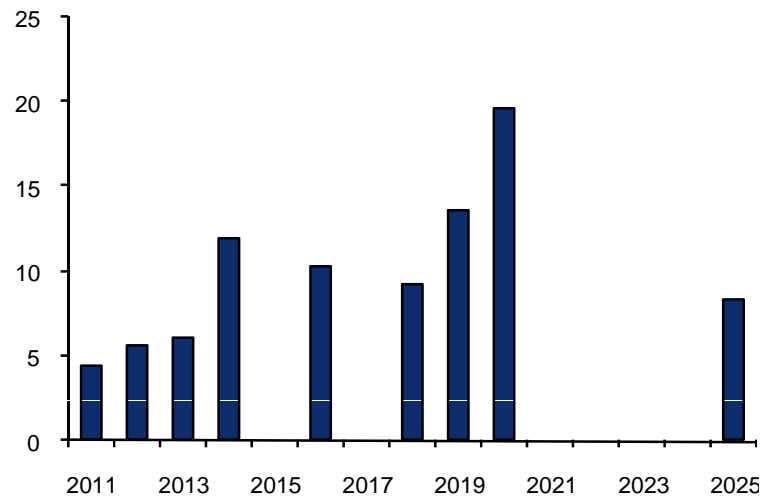
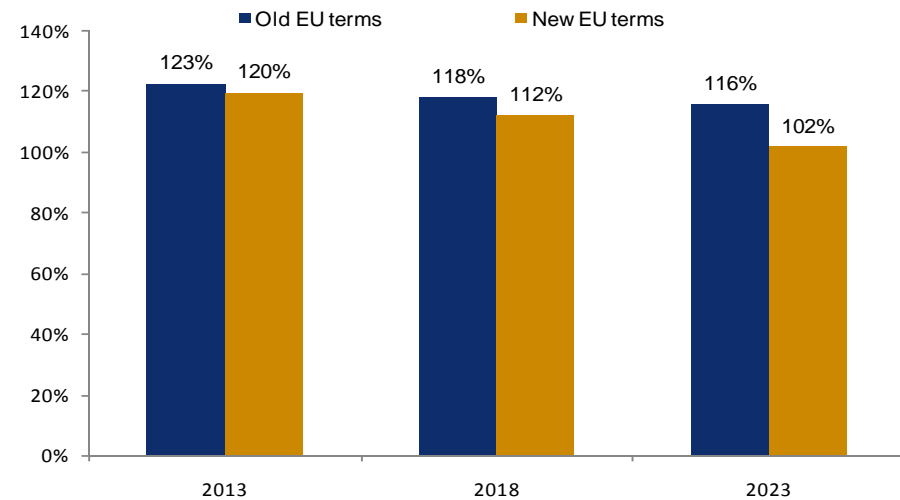
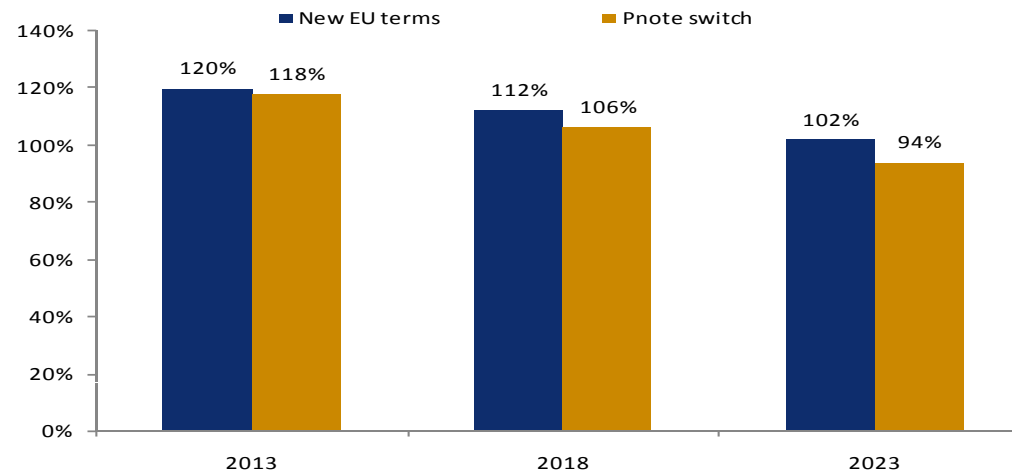


Chart 26: Debt, projections, new EU terms



Ireland looking to renegotiate promissory notes

- €30.7bn of promissory notes were injected into Anglo Irish and Irish Nationwide in order to recapitalise these banks.
- These notes are IOUs and liabilities of the Irish State. The principal is paid down in instalments over 10 years and an interest payment is due on any outstanding principal.
- The interest rate payable on these notes was based off the Irish ten year government bond at the time of their issue – ranging from 4.5% to 10%. An interest payment holiday in 2011 and 2012 leaves the effective interest rate payable in 2013 at approximately 10%.
- The Irish government is seeking to renegotiate the terms of these notes – e.g. lower interest rate payable and/or lengthening maturity.
- The chart below depicts Gross Government Debt to GDP on the assumption that the promissory maturity is extended to 22.5 years and the rate payable on the debt is equivalent to that on the EFSF funds (4%).
- If the renegotiations are successful the Gross General Government Debt profile would look more attractive. This is the measure that eurostat and the market focus their attentions on. This will be a positive catalyst for making that measure of debt more attractive, but it is simply an inter-State transfer.



Sustainability in a linear world

Debt to GDP, 2030 assuming Primary Balance constant at +3.1%

		Avg interest rate				
		4.0%	4.5%	5.0%	5.5%	6.0%
GDP growth, nominal	3.0%	88%	97%	107%	117%	128%
	3.5%	80%	88%	97%	107%	117%
	4.0%	73%	80%	89%	100%	106%
	4.5%	66%	73%	80%	89%	100%
	5.0%	59%	66%	73%	80%	89%

But we don't live in a linear world....

	Baseline						No policy change from 2013	Shock
	2013	2014	2015	2016	2017	2018	2018	2018
Debt to GDP	119.9%	120.0%	118.3%	116.4%	114.9%	112.9%	139.1%	134.5%
Primary deficit	2.1%	-0.4%	-2.2%	-3.1%	-3.1%	-3.1%	2.1%	-2.1%
<i>Contribution to debt/GDP</i>								
Interest rate (real)	4.5%	4.5%	4.5%	4.3%	4.5%	4.0%	4.8%	5.7%
Real GDP growth	-2.6%	-2.4%	-2.6%	-3.0%	-2.9%	-2.9%	-3.4%	-1.7%

Shock: Real GDP is 1.25% less than in base, primary balance is 1% less than in base and real interest rate is 80bps higher than in base

Ireland's relative advantages

OECD potential GDP projections and drivers, average annual % change 2016-2025

	Potential GDP	Potential productivity	Potential employment	Working age population
Belgium	1.6	1.6	0	0
France	1.7	1.5	0.2	0
Germany	1.2	1.7	-0.5	-0.6
Greece	1.4	1.5	-0.1	-0.3
Ireland	2.7	1.8	0.9	1
Italy	1.5	1.5	0	-0.1
Netherlands	1.4	1.5	-0.1	-0.3
Portugal	2.1	1.9	0.2	0
Spain	2.3	1.5	0.8	0.3

Source: OECD

Ireland's relative advantages

	Institutions	Infrastructure	Health and Primary Education	Higher education and training	Goods market efficiency	Labour market efficiency	Technological readiness	Innovation and sophistication
Belgium	27	17	2	5	14	44	11	14
Finland	4	19	1	1	21	15	12	4
France	28	4	16	20	38	68	13	17
Germany	19	2	23	7	26	64	14	5
Greece	96	45	37	46	107	126	47	81
Ireland	23	29	12	22	13	17	17	23
Italy	88	32	20	41	59	123	42	30
Netherlands	10	7	7	8	9	23	5	9
Portugal	51	23	34	35	62	122	19	38
Spain	49	12	44	32	66	119	28	33

Source: WEF

The logo for NCB (National Consumer Bank) features the letters 'NCB' in a white, serif font, centered within a solid blue rectangular background.

NCB

Independent & International

A dark grey horizontal bar containing the title text in a white serif font.

Irish banking system and NAMA

A solid light grey horizontal bar at the bottom of the slide.

The covered banks – AIB/EBS, BoI, Anglo/INBS and IL&P

- Asset deleveraging, consumer pay down and NAMA transfers have seen total assets decline by circa €125bn (Chart 27)

- Corporate and international deposit outflows in 2010 and early 2011 put immense pressure on the banks funding profile and drove them to the ECB and ICB (Chart 2). The lack of wholesale funding also exacerbated this problem leading to the government guarantee (slide 28).

- Both the demand and supply of credit remains weak in the current environment (overleaf).

Chart 28 : Deposits, €mn

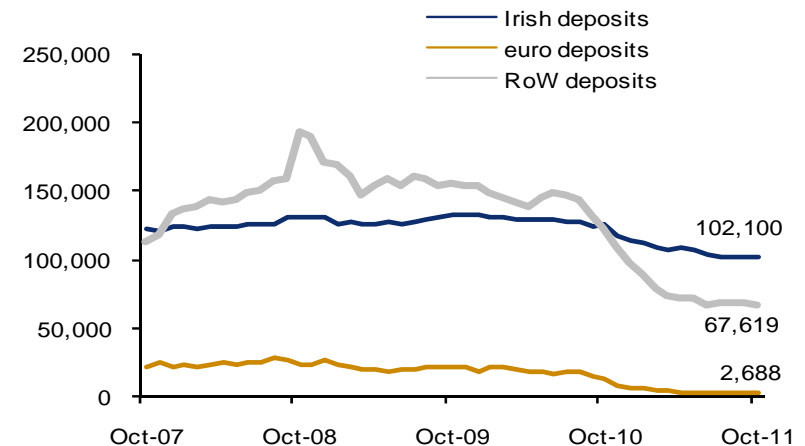


Chart 27 : Assets, €mn

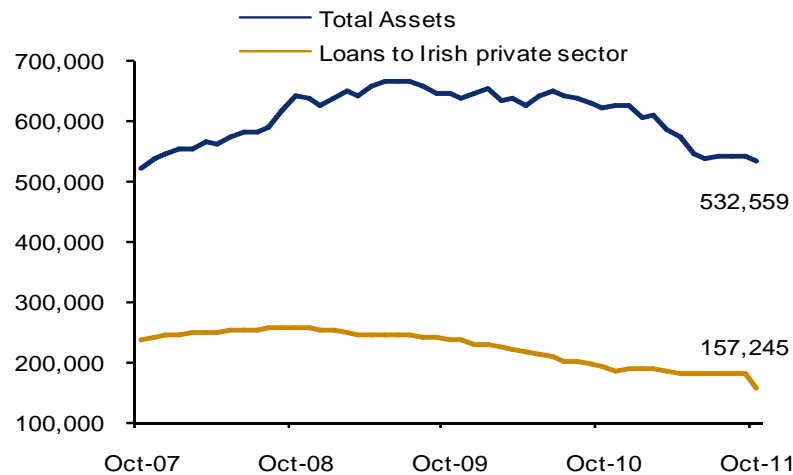
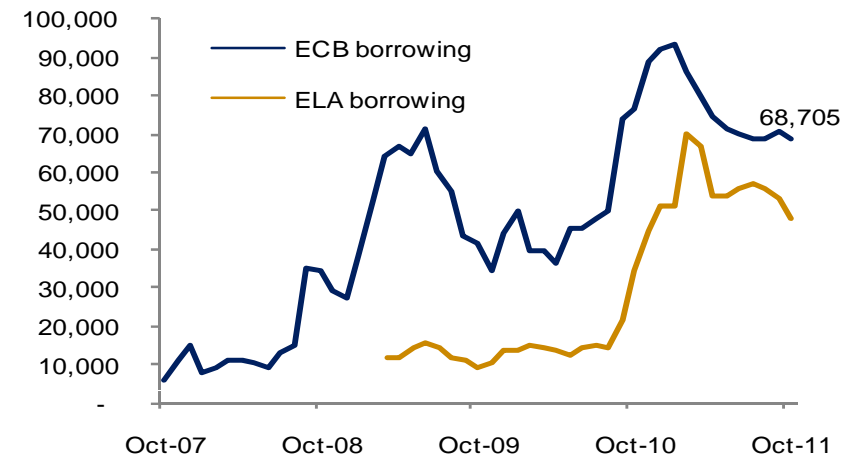


Chart 29 : Central bank funding, €mn



Private sector credit

Chart 30: Private sector credit, y/y%

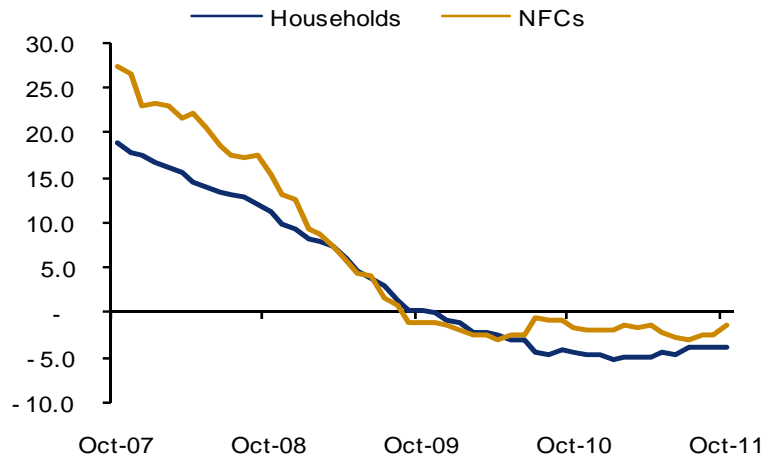


Chart 32: ELG covered ("Irish") banks

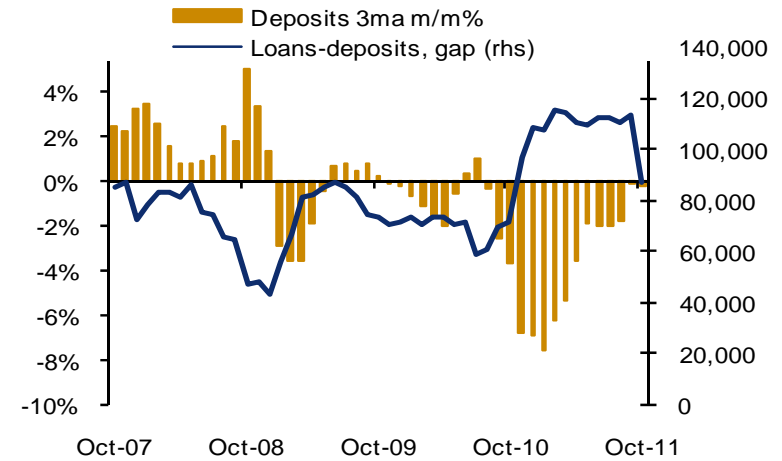


Chart 31: Various interest rates, %

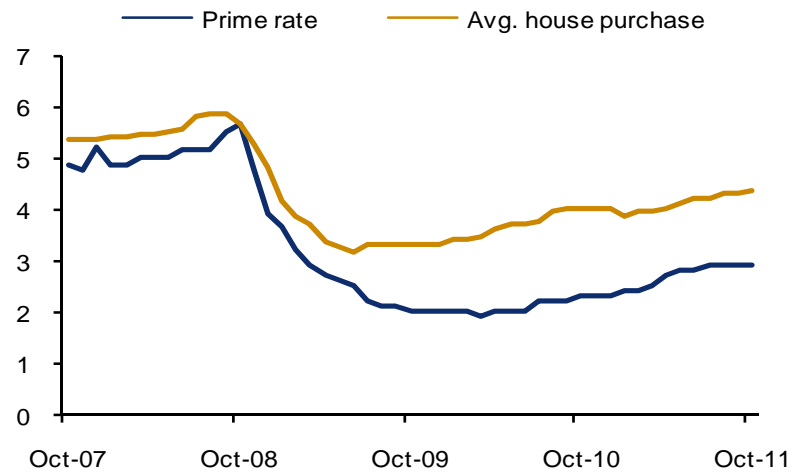
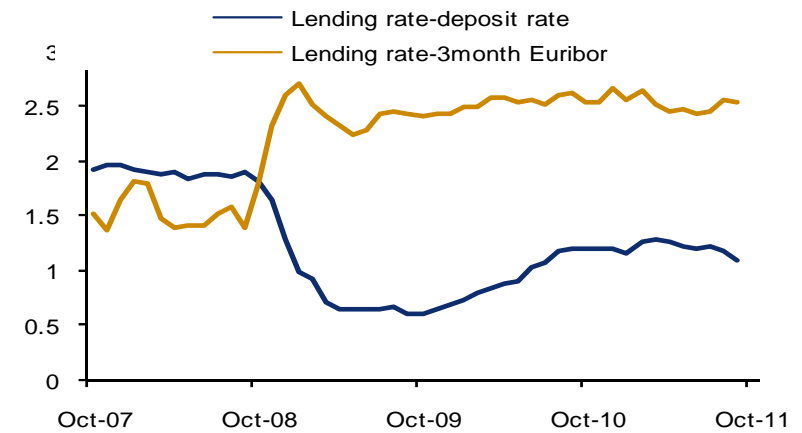


Chart 33: Spread b/w lending rates and deposit/interbank rates



ELG government guarantee scheme

NCB

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- Will be extended until December 2012, subject to EU approval (which should be forthcoming).
- At the end of Q3 2011 there was €100bn in liabilities guaranteed
 - €38bn in bonds
 - €62bn in deposits
- The ELG bank bonds currently trade at a significant discount to Irish sovereign bonds. We believe this discount is unjustified. The guarantee on ELG bank bonds is the exact same guarantee that backs Irish sovereign debt. See our piece [Irish government guaranteed bank bonds are compelling](#) for more.
- Facts about bank bonds guaranteed under the ELG scheme
 - If the bank in question is unable to make whole on their obligations in respect of the bond, the holder, may “demand payment” for the amount due and payable from the Irish government (the Guarantor).
 - The guarantee exists for the entire life of the security
 - The ELG guarantee given by the Minister is “unconditional and irrevocable and provide for timely payment”.

- Nominal value of loans outstanding Q2 2011 - €71.4bn
 - NAMA accounting value of these loans is €27.4bn (uplift for long term economic value of 9.3% given, hence difference between bonds outstanding and NAMA value)
 - 77% of loans by loan nominal are non-performing
 - 79% of non-performing loans by loan nominal are 120+ days in arrears

- Breakdown by asset classification – Land 24%, Residential for resale 12%, Investment property 48%, Hotels 12%, Development 4%.

- Breakdown by geography – Ireland 54%, UK 38%, Europe 7%, US/Canada 1%

- NAMA debt securities outstanding Q2 2011 €29.9bn, of which €1.5bn are subordinated.
 - Anglo €12.8bn
 - AIB €8.6bn
 - BoI €5.2bn
 - INBS €3.0bn
 - EBS €0.3bn

- NAMA has paid down €1.6bn of NAMA bonds in the period to Q2 2011.

For disclosures, please see: <http://www.ncb.ie/disclosures.htm>

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