

Stock Market Review



Edward Rizzo

Mr Rizzo is director of Rizzo, Farrugia & Co. (Stockbrokers) Ltd.

The state of the local bond market

For the first time in many years, last month's Malta Government Stock offerings in the primary market were over-subscribed by members of the public at the fixed offer price leaving no balance available for the auction process where financial institutions and insurance companies normally bid for amounts larger than €100,000.

As the news broke out of this large demand on November 11, bloggers on the timesofmalta.com website posted their comments with some downplaying the significance of this event stating that the stocks were taken up "by stockbrokers". This statement is incorrect as stockbrokers do not acquire such large sums for their own account. Stockbrokers mainly act as intermediaries between their clients (private individuals and local companies) and the issuers of financial instruments, in this case the Treasury, on behalf of the Government of Malta.

The statistics published by the Treasury indicate that almost 5,000 applications were lodged for the five-year and the 20-year paper with total demand amounting to €152.7 million (an average of €30,540 per application). Since the total amount on offer was of €100 million, the Treasury adopted a heavy scaling down exercise leaving many investors disappointed at the low level of allotment in the 20-year paper.

This is a strong vote of confidence in the sovereign state of Malta by the Maltese investing public at a time when a peripheral eurozone sovereign debt crisis is unfolding. In fact, Ireland is the second country after Greece which needed and accepted a bailout by the ECB and the IMF. Despite the global economic imbalances, Malta's Budget deficit is expected to fall to a very respectable 3.9 per cent of GDP in 2010 improving to 2.8 per cent of GDP next year. As I highlighted in one of my recent articles, this compares very favourably with many other larger European nations whose Budget deficits have climbed to unsustainable levels thereby negatively affecting their ability to borrow from the financial markets.

In fact, the extra return being demanded by investors to hold on to government bonds of the eurozone periphery nations of Greece, Ireland, Spain and Portugal has reached record levels in recent weeks. The yield on a 10-year Greek bond rose to over 11.5 per cent, with Ireland's 10-year bond yield climbing to 8.9 per cent from 6.9 per cent in October. On the other hand, the yield on the 10-year Malta Government Stock fell to four per cent from 4.55 per cent at the beginning of 2010 signifying the ability of the Government of Malta to borrow at low interest rate levels. The recent



The public response to last month's Malta Government Stock offerings is a strong vote of confidence in the sovereign state of Malta by the Maltese investing public at a time when a peripheral eurozone sovereign debt crisis is unfolding.

improvements registered in the Malta government's finances was also highlighted by the international credit rating agency Fitch as it recently maintained Malta's rating at A+ with a stable outlook.

The Fitch analysis reflects Malta's "smooth passage through the recession, with limited fiscal damage, demonstrable financial sector resilience and signs of a strong economic recovery".

Fitch also noted that Malta's domestic banking system required no financial assistance from the government due to the conservative approach to banking and its supervision.

The strong demand by the public for the recent Malta Government Stock issues should also be looked at in the context of the primary bond market issuance that has already hit the market this year. After a strong year for the bond market in 2009 when a total of €810 million was issued (of which €295 million by corporates), the increased appetite for fixed interest securities was once again evident this year. A total of €879 million was raised in the past 11 months (€299 million from corporates) with some companies approaching the market for the first time.

This strong demand in the primary market very clearly indicates that the Maltese investing public has warmed up to investing locally rather than overseas. Unfortunately this could also be a result of some very sour experiences by numerous investors over the past two years with various international bonds among which those of Lehman Brothers and perpetual bonds issued by UK banks.

While this increased preference to investing locally rather than internationally is positive for the local economy, this strong appetite for

local fixed-interest investments may pose some problems going forward.

Currently, the secondary market in Malta is not liquid enough to absorb the consistent demand for local fixed-interest securities leaving investors unable to purchase the quantities required from those bonds already listed on the Malta Stock Exchange. It is therefore becoming extremely important that a more liquid secondary market develops to cater for this consistent demand.

As many retail investors buy bonds to help them improve their income, thereby generally holding these securities for longish periods, the participation of financial institutions is needed to help create a two-way market. Regrettably, many financial institutions which hold large amounts of securities in the secondary market (including the Central Bank of Malta) are still not willing to trade regularly thereby creating the much needed liquidity in the market.

Without an adequately liquid secondary market in place, a consistent new issuance programme from the government as well as from existing and new corporate bond issuers would need to materialise to satisfy current investor appetite as was evident once again in last month's MGS issue.

A set of new policies issued by the Malta Financial Services Authority on August 16 could lead to a lower number of new issues coming to the market in 2011. These policies regulate the setting up and the management of a sinking fund and also cater for additional safeguards on the financial soundness of applicants for a bond issue that are non-banking institutions. Financial market observers are not surprised that the only two bond issues coming to the market since these Listing Policies

came into force were from Mediterranean Bank plc and FimBank plc as these were not impacted by the new regulations. Observers believe that the new MFSA requirements could in fact deter companies from using the bond market to raise funds to grow their business.

Should the government and other local companies not offer new investment opportunities in the form of new bonds, investors will be left with no option but to invest overseas once again, to the detriment of the local economy.

Yields of highly rated international bonds with a determined maturity date are at record lows and few investors are willing to go for such low yields. As a result some investors are regrettably resorting to lowly rated hybrid securities (such as perpetuums or non-cumulative fixed-interest preference shares) at higher risk without realising the possible consequences of such decisions. Investors who hold such securities issued by Lloyds Banking Group plc come to mind.

In my view, it was not the intention of the MFSA to introduce policies which could hinder new issues coming to the market, so perhaps a further consultation process between the MFSA, the MSE, market practitioners and the Ministry of Finance on the new policies issued last summer would be beneficial. Such a debate should help to ensure that the growth momentum experienced by the MSE in new bond listings over the past two years which investors are so keen to participate in, is not stalled unnecessarily. Malta needs its stockmarket to grow and provide local residents with local investment opportunities. This should also help the government achieve its aspirations of making Malta a financial services centre of excellence by 2015.

A further consultation process between the MFSA, the MSE, market practitioners and the Ministry of Finance on the new policies issued last summer would be beneficial.

Rizzo, Farrugia & Co. (Stockbrokers) Ltd, "RFC", is a member of the Malta Stock Exchange and licensed by the Malta Financial Services Authority. This report has been prepared in accordance with legal requirements. It has not been disclosed to the issuer/s herein mentioned before its publication. It is based on public information only and is published solely for informational purposes and is not to be construed as a

solicitation or an offer to buy or sell any securities or related financial instruments. The author and other relevant persons may not trade in the securities to which this report relates (other than executing unsolicited client orders) until such time as the recipients of this report have had a reasonable opportunity to act thereon. RFC, its directors, the author of this report, other employees or RFC on behalf of its clients, have

holdings in the securities herein mentioned and may at any time make purchases and/or sales in them as principal or agent. Stock markets are volatile and subject to fluctuations which cannot be reasonably foreseen. Past performance is not necessarily indicative of future results. Neither RFC, nor any of its directors or employees accept any liability for any loss or damage arising out of the use of all or any part thereof and no

representation or warranty is provided in respect of the reliability of the information contained in this report.

© 2010 Rizzo, Farrugia & Co. (Stockbrokers) Ltd. All rights reserved
www.rizzofarrugia.com

