

New Malta Government Issues

16.05.2013



Recommendation

BUY

Offering

The Accountant General is offering an aggregate of €100mn of Malta Government Stocks (MGS) subject to an over-allotment option of €70mn in the event of over-subscription which are being offered and made available in any one or a combination of the following stocks:

Preference

4.50% MGS 2028 (II) F.I.

Bond	Price	YTM	Interest Pyt	Maturity	S&P
3.00% MGS 2019 (III) F.I.	€102.25	2.611%	22-Mar, 22-Sept	2019	BBB+
4.50% MGS 2028 (II) F.I.	€101.50	4.365%	25-Apr,25-Oct	2028	BBB+

Analysts:

Darin Pace
Simon Psaila

The bonds can be applied for in multiples of €100 not exceeding €100,000 per person. Applications for over €100,000 can be applied for via auction.

Contact Details

Telephone

+356 25 688 688

Email

Info@cc.com.mt

Website

www.cc.com.mt

3.00% MGS 2019 (III) F.I. - 1st pro rata interest payment covering period from the 27th May 2013 to the 21st September, 2013 (both dates inclusive) will be made on the 22nd September 2013 @ 0.961957%

4.50% MGS 2028 (II) F.I. – 1st pro rata interest payment covering period from the 30th May, 2013 to the 24th October, 2013 (both dates inclusive) will be made on the 25th October, 2013 @ 1.819672%

Preamble

We are of the view that an investor would benefit from adding the 2028s relative to the 2019s because we feel that investors are compensated adequately for the increased risk taken. The longer the duration* the higher the risk.

**Duration is a measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years.*

Economic Outlook

In our opinion, interest rates are expected remain low in the Eurozone for the next couple of years until we see sustainable growth in the region. Analysts are expecting the Euro area to remain in recession in 2013 and report a growth rate of 1.2% in 2014 as EU Leaders continue to remain focused on the debt problems which EU countries have and are putting growth on the back burner.

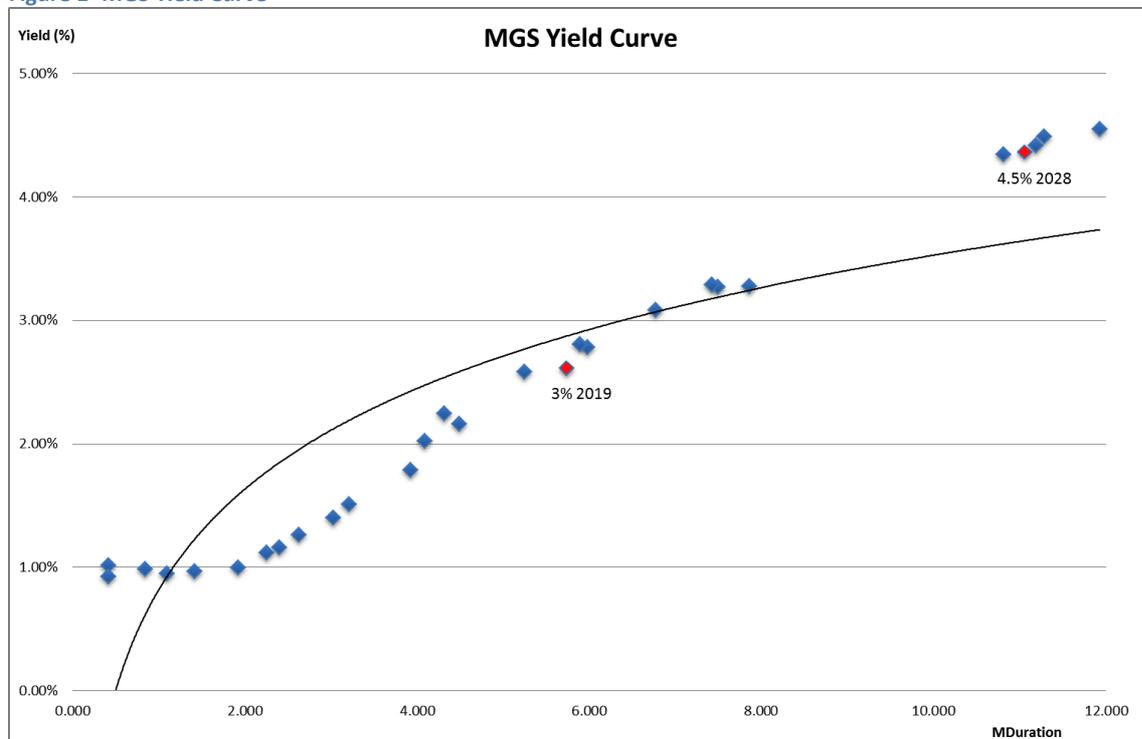
May's German ZEW survey and March's euro-zone industrial production numbers made encouraging reading; however the euro-zone remains in recession. The headline ZEW index, which measures investors' expectations for the German economy in the subsequent six months ticked up from +36.3 to +36.4. While the index was below consensus and well below March's reading of 48.5, it still points to a pick-up in annual GDP growth from Q4's 0.4% to about 2%. Other indicators point to a far more subdued rate of growth.

Meanwhile, the 1.0% monthly rise in euro-zone industrial production in March was much stronger than expected (consensus +0.3%) and confirmed that conditions in the sector improved during Q1. The wider economy is still likely to have contracted last quarter, and given that April's industrial surveys weakened at the start of Q2, the recent industrial recovery could soon fizzle out.

Despite the recent rally in the markets, Europe’s economy remains fragile. So much so that the ECB has cut interest rates to an all-time low of 0.5% in its May rate setting meeting in order to try and restore confidence. President Draghi commented that further downside risk continue to persist on Europe.

Analysis

Figure 1- MGS Yield Curve



As illustrated in figure 1 above, the 2028s are under-priced and the 2019s are fairly priced compared with the yield curve extrapolated from the current MGS issues. The 2028s have a higher spread above the yield curve than the 2019s, making them the preferred issue on this basis.

Years to maturity	Euro Swap Rate*1	Euro Benchmark Yield*2	MGS Yield to Maturity	Spread of MGS over Euro Swap	Spread of MGS over Euro Benchmark Yield
6 year	0.966%	0.599%	2.611%	1.645%	2.012%
15 year	2.062%	2.012%	4.365%	2.303%	2.353%

*1 - Euro Swap is the fixed for floating interest rate. The fixed rate that will be exchange for a floating rate over the years to maturity.

*2 - The Euro Benchmark is comprised of euro-denominated fixed-rate government bonds from France and Germany.

The 2028s have a wider spread (i.e. more attractive risk premium) over both benchmarks when compared to the 2019s making them the more attractive option on this basis.

Conclusion

When compared to European Yields, particularly the German Bund, which is seen as the benchmark for Europe these bonds are offering a spread premium of 205 basis points on the 2019 paper and 251 basis points on the 2028.

We view the yields offered by these securities as attractive, with clear preference for the longer dated paper as they offer more value when considering the return given the risk involved.

Like any other investment, especially for longer dated investments, these need to be monitored for when duration will in fact become a real threat. One also has to monitor whether this investment will then continue to be a valid constituent in his/her portfolio.

Additional Information – Collective Action Clauses

It is noted that these new stocks will include Collective Action Clauses (“CAC”s). In accordance with Paragraph 3 of Article 12 of the European Stability Mechanism (“ESM”) Treaty relating to all new euro area government securities with maturity above one year issued as from 1st January 2013, the inclusion of model CAC has become mandatory. In this respect, the Accountant General may consider and approve modifications of borrowing terms and conditions of the issue. In a „reserved matter“ modification, which would involve the amendment of the most important terms and conditions (including reductions in the principal or interest and changes in dates payable), modifications would require the affirmative vote of stockholders of not less than 75% of the aggregate principal amount of outstanding stock.

Concluding Remark

The views expressed in this report are opinion about these new issues, and therefore clients are encouraged to contact their investment advisor in order to ensure that these instruments fit in their portfolio in accordance to their current financial situation, risk profile and investment objectives.

Application Procedure

Application forms	Applications are available from our offices or downloadable from our website www.cc.com.mt
Opening of subscriptions	20-May-2013
Closing of subscriptions	22/05/2013 or earlier at the discretion of the Accountant General
Minimum investment	€100 nominal
Additional lots	€100
Maximum subscription	€100,000 per person in either or each of the two fixed rate stocks. Amounts above €100,000 can be applied for via auction

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