

Stock Market Review

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Sovereign debt in focus

In recent weeks the finances of various countries across the world were widely discussed after the Dubai government asked creditors to grant Dubai World a six-month standstill on its repayments of nearly US\$60 billion of debt.

Dubai World then announced plans to restructure US\$26 billion of its liabilities. The international financial press was awash with news updates on the Dubai situation as financial markets took fright on the possible impact spilling over into other parts of the world.

Meanwhile the local press focused on the links between Dubai World and the Dubai government (through Dubai Holding) on their shareholdings in International Hotel Investments plc and Go plc and more importantly on possible repercussions to the SmartCity project.

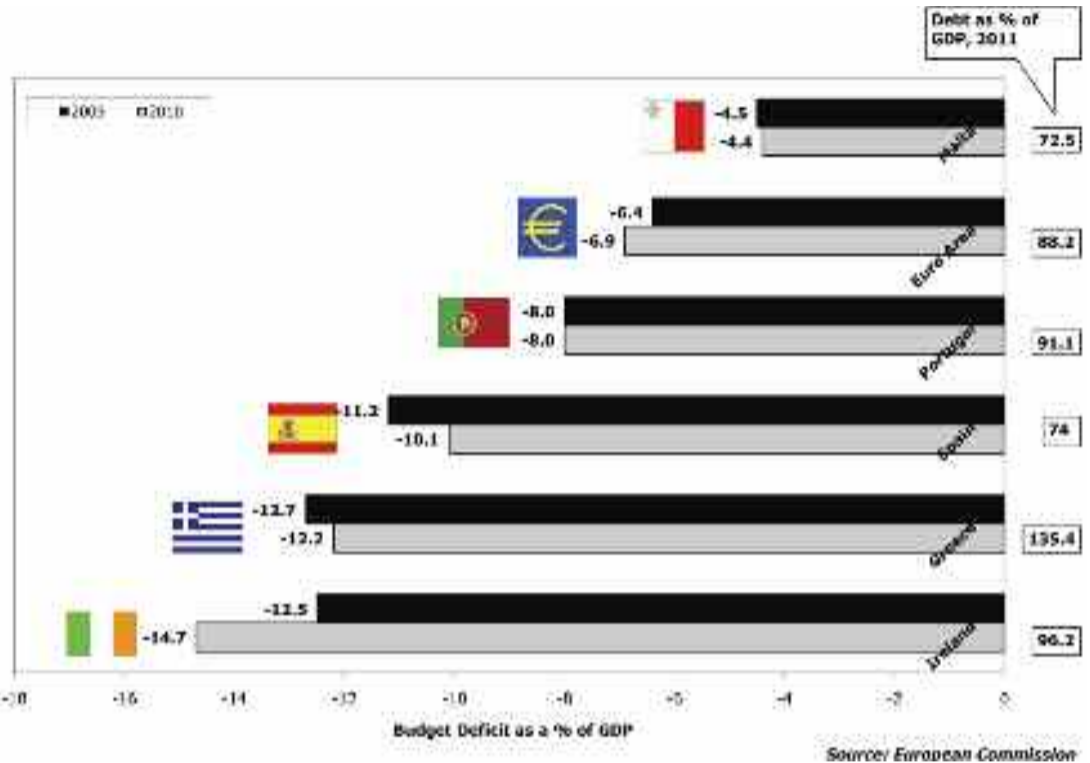
Early Monday morning, investors woke up to the news that Dubai's oil-rich neighbour, Abu Dhabi, had agreed a US\$10 billion loan to the Dubai Financial Support Fund to help Dubai World honour its US\$4.1 billion bond of its subsidiary Nakheel due for redemption on the same day.

The Abu Dhabi government and the UAE Central Bank agreed that the remaining funds would also provide for interest expenses and working capital in particular satisfying the obligations to existing trade creditors and contractors of Dubai World. The Abu Dhabi bailout vindicated various international commentators who always claimed that Dubai's "rich uncle" would support it in times of distress.

This outcome naturally left a positive impact on global financial markets and in particular on Middle Eastern markets which had fallen heavily following the initial news some weeks ago.

In the meantime, the fiscal spotlight turned from Dubai onto Greece following the decision by international credit rating agency Fitch on December 8 to cut Greece's sovereign debt rating to BBB+ from A- with a negative outlook.

This decision also unsettled European markets as it was the first time in 10 years that a major rating agency placed Greece below an A grade. The rating agency cited the findings by the new Greek government of the country's fiscal deterioration as the reason behind their decision. Shortly after being elected, the new Socialist government revealed that the budget deficit would climb to 12.7 per cent of



GDP in 2009, twice the level forecast by the outgoing regime. Although the Greek government expects the deficit to reduce to 9.1 per cent in 2010, the European Commission does not share the same view and estimates that the deficit will fall only marginally to 12.2 per cent.

The extent of the ballooning deficit is also reflected in the total level of outstanding debt which is estimated to rise to 135 per cent of GDP by 2011. The immediate negative reaction in financial markets was evident as Greek government bond prices tumbled with investors seeking a higher yield given the increased risk attached to Greek paper.

The revelations of the sudden deterioration in the country's finances forced the spread between 10-year Greek bonds and the euro benchmark German Bund to widen to 209 basis points.

The precarious state of Greece's finances also led many international commentators to air their views on its potential impact for the whole eurozone region.

Some claimed that the larger EU member states such as Germany or France may consider bailing-out the nation while others argued whether the potential default of Greece would force it to drop out of the eurozone.

The increased focus on sovereign debt escalated further last week when only 24 hours after the Greek news, another international rating agency, Standard & Poor's, announced that it was

changing its outlook to "negative" on Spain's sovereign rating, which is presently AA+. S&P said that Spain faced a deeper deterioration in public finances and a longer period of economic weakness than it had expected when it lowered Spain's sovereign rating in January to AA+ from AAA.

Although the country's debt burden surged from only 39.7 per cent of GDP in 2008 to over 80 per cent in 2009, Spain's public debt is lower than the European average and it is expected to decline to 74 per cent in 2011.

On the other hand, its budget deficit is forecast to be one of the highest in the eurozone. Standard & Poor's expects a budget deficit of 11.2 per cent of GDP in 2009 easing to 10.1 per cent next year.

The Spanish government has a deadline to bring the deficit in line with the EU's three per cent limit by 2013.

So did Britain and America come under the fiscal spotlight from credit rating agencies as Moody's noted that both countries might "test the boundaries" of their AAA ratings.

Although Moody's concluded that both are likely to survive the trial, the bond market took fright and the UK's 10-year Treasury gilts sank, taking the spread between the interest rate they offer and that provided by eurozone bonds to its widest in a year.

With all this attention turned to sovereign risk it may be opportune to place Malta's budgetary situation in perspective.

According to the European Commission, Malta's 2009 budget deficit is expected to amount to 4.5 per cent of GDP and this is expected to ease to 4.4 per cent in 2010. Public debt is expected to reach 67 per cent of GDP in 2009 rising to 68.7 per cent in 2010 and 72.5 per cent in 2011.

Although Malta's public finances compare favourably with many of the eurozone members, this should not make us complacent. We should not postpone the necessary reforms to adhere to the three per cent limit recommended by the European Commission.

In the latest Budget speech the government of Malta's projections indicate that the three per cent limit should be achievable by 2012.

Achieving these forecasts would be positively viewed by the many investors who continue to support the various Malta Government Stock issues when the Treasury periodically taps the market.

The draft Bill presented to Parliament this week implementing the Budget measures authorises the government to raise up to €550 million in new Malta Government Stocks next year.

The proceeds will finance the budget deficit estimated at €239 million and stock maturities totalling €191 million in February, June and November 2010. Changes to the overall debt structure of the government by issuing additional MGS as opposed to using Treasury bills is also likely.

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