DEBT MANAGEMENT DIRECTORATE

Introduction

The Directorate was set up in December 2006 to carry out the key objectives in debt management activity, focused primarily to ensure that:

- the funding requirements for the Central Government borrowing programme (short and long term) can be financed prudently and cost effectively;
- the annual debt servicing costs are met at the lowest possible cost; and
- the development of the domestic financial markets is given the necessary support.

The integration of Malta into the euro area on 1 January 2008 posed new challenges and opportunities in achieving the above stated objectives. To date, in order to meet the borrowing requirements, the Government's policy has been that of relying, almost exclusively, on issuing euro-denominated stocks in the domestic market, rather than raising funds on the international markets.

Furthermore, as part of its cash management activity to cover any short-term revenue shortfalls, the Government conducts weekly auctions for the issue of Treasury bills. These serve as *temporary borrowing* tools and usually carry a tenor of: 28 days; 91 days; 182 days; 273 days; and 364 days.

The Government of Malta's debt portfolio also includes foreign loans, set up as bilateral agreements with foreign governments and international institutions. To date, the Directorate does not borrow for lending activities.

In the course of the year under review, the Directorate continued to implement the recruitment programme initiated during 2008 with a view to build a strong analytical capability with the appropriate technical staff over a medium to long term process. The engagement of two Economics Officers marked the first steps towards creating a functional middle office environment within the Directorate. Eventually, a fully functional middle office will enable the Directorate to embark upon initiatives that have been entrusted to its remit.

International Institutions

As in previous years, the Debt Management Office contributed to meetings with representatives from credit rating agencies such as Standard & Poor's, Moody's and Fitch. As the credit ratings assigned to Malta bear a direct influence on the interest rate charged on loans raised from international markets, the Directorate assigns significant importance to its interaction with these agencies.

In addition, during 2009, the Debt Management Office participated in discussions held with representatives from the International Monetary Fund (IMF) who visited Malta in June and November for the Article IV consultation.

Economic and Financial Committee (EFC)

During the year 2009, the Directorate attended three meetings of the Economic and Financial Committee (EFC) Sub-committee on EU *Government Bills and Bonds* Markets whose main objectives are to promote further the integration and achieve a better functioning of the EU government bond markets. The Sub-committee deals also with other important issues of public debt management, holds discussions that promote the sharing of experiences among the 27 EU Member States related to debt management and also supports Member States in identifying and implementing best practice in government debt management.

Debt Management Operations

Treasury Bills

The issuance of Treasury bills serves a dual role- primarily to cover for temporary revenue shortfalls incurred by the Government and secondly, to maintain liquidity in the domestic Treasury bill market.

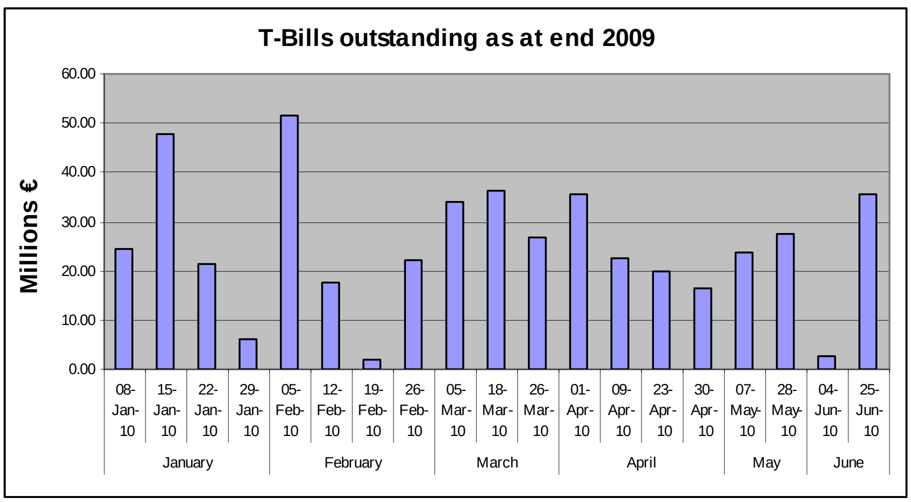
Treasury bills are offered by public auction on a weekly basis, normally on Tuesday of the auction week and are issued in denominations of €1,000 with tenors ranging from 28 days, 91 days, 182 days, 273 days and 364 days. A mix of different tenors can be offered in any auction.

As from 1 April 2007 Treasury bills were dematerialised and were admitted to listing and trading on the Malta Stock Exchange. Yields on Treasury bills started to be computed on an '*Actual/360 days*' basis.

The maximum amount of outstanding Treasury bills is established by Parliamentary Resolution. In 2002 the maximum amount was set at Lm300 million, equivalent to €698.80 million.

Chart 1 illustrates the maturity profile of the outstanding balance of Treasury bills which at end of 2009 reached €474.14 million, representing an increase of €108.33 million over the amount outstanding at end of 2008.

Chart 1 - Level of T-bill stocks in market hands as at end 2009



I. Treasury Bills Issuance Programme

The issuances focused mainly on the 91-day, followed by the 182-day tenor (representing 66.4% and 25.7% of total volume issued respectively). Yields for the 91-day T-bill fluctuated between 2.659% (on 9 January 2009) and 1.403% (on 4 December 2009). The yield of the 182-day T-bill peaked at 2.653% (on 5 January 2009) and was lowest at 1.516% (on 4 December 2009). Such interest rates for temporary borrowing are determined by the money market which in turn is influenced by the repo market rates.

Total offers accepted by the Treasury throughout the year 2009 amounted to €1,624.88 million, categorised by tenor and volume as shown in Table 1.

Table 1 - Gross Issuance of Treasury Bills 2009			
Tenor	**% Share of Total Volume**	**Nominal Amount (€ 000)**	**Weighted Average Yield (%)**
28 days	0.98	16,000	1.424
91 days	66.40	1,078,896	1.910
182 days	25.72	417,885	1.865
273 days	6.90	112,096	1.676
364 days	-	-	-

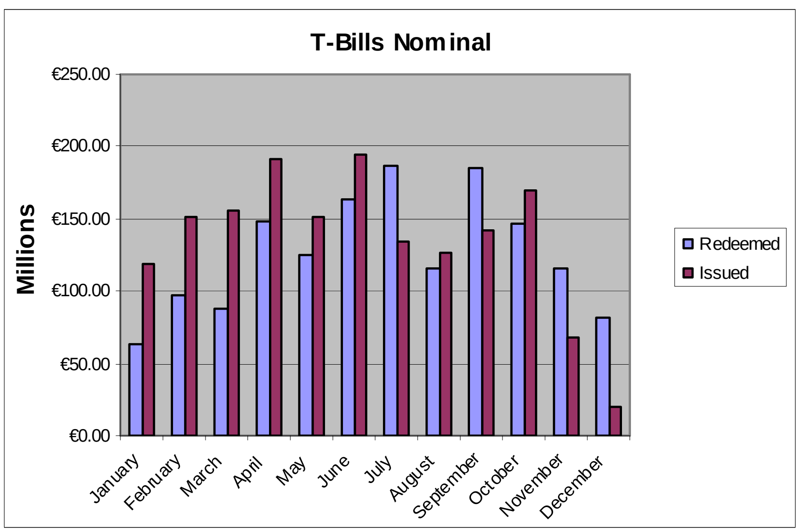
The cost of borrowing in 2009 amounted to €10.50 million, equal to a weighted average yield of 1.787%.

II) Redemptions on Maturity

Throughout the year 2009, the Treasury redeemed €1,516.54 million worth of Treasury bills, carrying a cost of borrowing equal to €13.80 million equivalent to a weighted average yield of 2.547%.

Chart 2 shows the scale of monthly movements in gross issuance and redemptions of Treasury bills, and highlights the sharp increase in net issuance during the first six months of the year.

Chart 2 - Gross monthly issuance & redemptions



Malta Government Stocks

The Budget Measures Implementation Act (Act No.II of 2009) which establishes the issuance target of Malta Government Stock for financial year 2009 was capped at €500 million. The issuance programme was applied for the purpose of:

- financing the Central Government borrowing requirements for 2009;
- redeeming Malta Government Stocks (MGSs) maturing during the year; and
- effecting changes in Central Government debt portfolio as and when required in line with Government's debt management policies.

I. Issuance of MGS

The Directorate continued to issue a combined prospectus which regulates the entire sum on issue when it is offered under two or more different stocks without the respective amount for each stock being specified. The offer price for each issuance is usually announced three days in advance of the opening of the applications and the results of the bids by auction are announced within two hours from closing time of auction.

The total sum raised through the MGS issuance programme during 2009 reached €459.31 million. There were five MGS issues during 2009, having a medium to long term maturity horizon as shown in Table 2.

Table 2 - MGS Issuances in 2009

Issuance	Issuance Strategy (€ Millions)				Bid-to-cover ratio
	4-year	11-year	12-year	5-year FRN (Euribor +80bp)	
March	59.02		35.99		3.47
April	63.05				1.17
June	82.82	25.55			1.29
August	56.64		33.15		1.01
November	25.50	44.70		29.80	2.1

In addition to the above issuances, a placement of one MGS amounting to €13.670 million towards the partial settlement of ex-Church property was issued in June 2009.

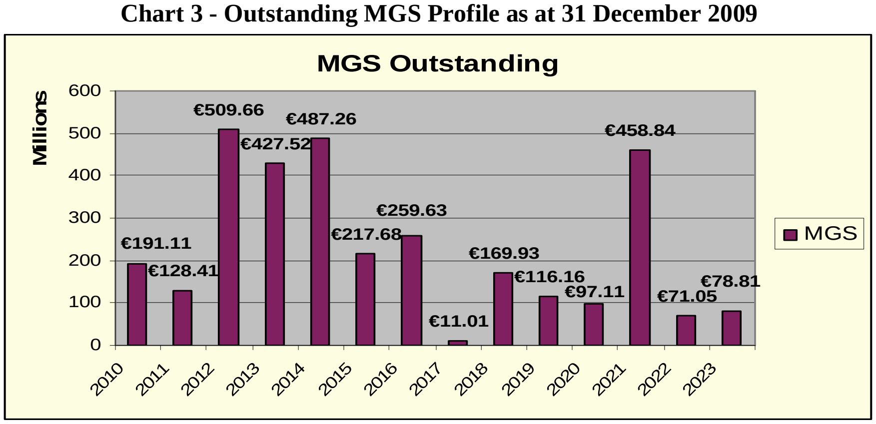
In line with Government's debt management strategy, the Directorate has systematically issued fungible MGS with the aim to contribute to a further deepening in the liquidity of current benchmark issues.

In November 2009, after consultations with financial institutions, the Treasury offered for the first time a structured financial debt security in the form of a medium-term Floating Rate MGS (FRN) linked to the six-month Euribor. The FRN had an embedded collar which guaranteed a floor of 1.78% per annum and established a cap of 5.22% per annum. Its first coupon payment was set at 1.787% and is to be paid on 25 April 2010. The FRN was positively received by institutional investors.

Debt Servicing

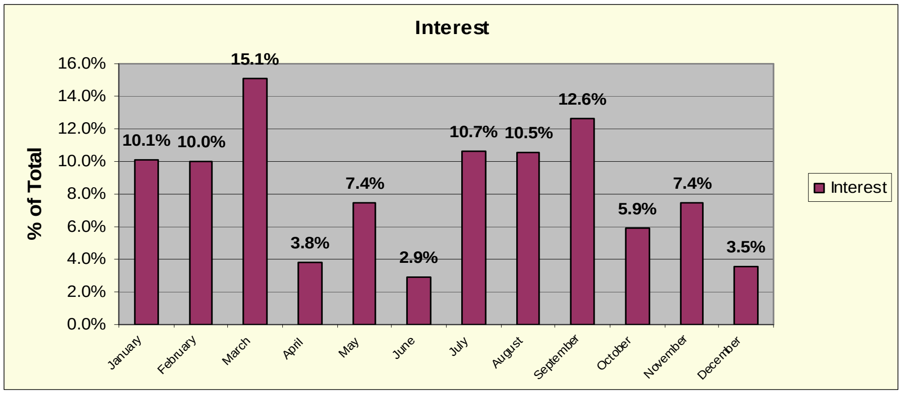
Three MGS matured in 2009, totalling €208.18 million. The outstanding nominal value of MGS as at year end reached € 3,224.18 million. Chart 3 indicates that a concentration of maturities lies in the 2012-2014 area (with 44.18% of outstanding debt maturing in the three year period ending 2014).

Chart 3 - Outstanding MGS Profile as at 31 December 2009



The Directorate services the half-yearly interest payments to existing stockholders which during 2009 amounted to €172.78 million. Payments of interest throughout the year were spread as illustrated in Chart 4.

Chart 4 - Monthly Distribution of Interest Payments on MGS



Foreign Loans

Bilateral loans with foreign entities are specifically undertaken to finance large capital projects. A total of €13.43 million was repaid throughout the year according to the repayment schedule, resulting in an end-of-year balance of €100.56 million.

Interest paid on these loans amounted to €5.04 million. During the year 2009, the loan agreed with the Republic of Italy (1986) was paid in full leaving the Government of Malta with nine foreign loans pending.

Staff Training and Development

The Directorate continued to invest in the training of its human resources, both through in-house programmes and through external courses organised by local and foreign institutions. During the year 2009 a number of training initiatives were undertaken and various opportunities were offered to its staff to attend training courses, seminars and annual conferences organised by institutions both locally and abroad. These included:

- Risk Management in Government Departments;
- Training Seminar on Prevention of Money Laundering and the Financing of Terrorism;
- Training for Effective Treasury Management;
- EPDA's 4th Annual European Government Bond Conference; and
- Finance Malta 2nd Annual Conference.

Support Services

As in previous years, the Directorate continued to offer guidance and provide the necessary service to the heirs of deceased stockholders so that the heirs can have any inherited stocks transferred in their name by a procedure initiated through the heirs' own legal adviser.

Other Initiatives

With a view to maximise the potential benefits of Malta's membership of the euro area the Treasury set up a working group comprising officials from the Treasury, the Economic Planning Division, the Central Bank and the Stock Exchange. The role of this working group is to assess the various strategic options available and how best to achieve the key objectives of debt management, particularly in the light of the current international economic situation. In this regard, ongoing meetings and teleconferences are held with a number of foreign financial institutions.

Moreover, a Legal Team was set up in October 2008 to review existing legislation on government borrowing and to prepare draft legislation on debt management in line with best practice.