



A deeper analysis of the PTA bond coupon structure

Hardly a month after the issuance of the RBM bond PTA bank embarked on a bond issue aimed at raising money to enable it lend to its clients in local currency, develop a sustainable tool for eliminating exchange risk, and to contribute to the development of the Malawi capital market. One differentiating feature between the PTA bond and the RBM bond is the structure of the coupon payment. PTA bank will offer a floating coupon payment that will be reset semiannually at 1 percent above the weighted average yield of the most recent results of the 91 day Treasury bill.

Interest rate structure

The structure of interest rates is normally defined by the following equation; r = Real risk-free interest rate + Inflation premium + Default risk premium + Liquidity premium + Maturity premium

The inflation premium protects investors against inflation which has the effect of reducing the purchasing power of currency. The default risk premium protects investors from possible default on payments by the issuer of debt. The Liquidity premium protects an investor from the risk of loss if the investor urgently needs to convert his asset to cash. While the maturity premium protects investors from the possible decline in the market value of debt as the maturity period increases.

Putting PTA bank bond coupon structure in perspective

Since the PTA bond coupon has been attached to the 91 day Treasury bill yield whose interest rate includes the real risk-free rate and the inflation premium (nominal interest rate) over a specific time horizon then the first two elements of the equation have been taken care of. PTA Bank has been classified as having an exceptionally strong capacity to meet its financial obligations and hence eliminating the default risk element in the equation. However, secondary trading of the bond will be very unlikely as has been the case with other bonds on the Malawi market and as such investors may be faced with the risk of having to sell the bond at a value lower than its fair value when the urgent need for cash arises. Also because the life span of the bond is quiet long (7 years) there is need for a maturity risk premium to be incorporated in the interest rate. As per the PTA bond coupon formulation then the 1 percent premium comprises both the liquidity and maturity risks.

Conclusion

Coming soon after the RBM bond which fetched interest rates as high as 20.5 percent the coupon rate on the PTA bond presents quite a challenge as it is unlikely to rise above 16 percent. The main question is whether the 1 percent premium is a true indication of the liquidity risk and maturity risk involved? On the other hand, the bond should act as an eye opener to other institutions as to other alternatives for raising funds.

MARKET STATISTICS

Treasury Bill Yields

Table with Treasury Bill Yields for weeks ended 29th August 2008, showing tenors of 91, 182, and 273 days with previous and current yields.

RBM Bill Yields

Table with RBM Bill Yields for week ending 5th September 2008, showing tenors of 63 and 91 days with previous and current yields.

CDH Investment Rates

Value date: 3rd September 2008

Table with CDH Investment Rates for various tenors from 7 days to 185 days, showing rates in percent.

Inflation Rates

Table with Inflation Rates for June and July 08, showing rates for National, Urban, and Rural areas.

Middle Exchange Rates

Table with Middle Exchange Rates for USD, GBP, ZAR, and EUR as of 27.08.08 and 03.09.08.

Stock Exchange

Week ended 29th August 2008

Table with Stock Exchange Index (MASI, DSI, FSI) showing previous and current points.

African proverb: "Strategy is better than strength". Consult CDH: Diversity in Financial Solutions