6 Capital Markets

Capital market is an important barometer of the health of an economy and important component of the financial sector. It is a vehicle whereby capital is deployed from sources where it is in excess to the sources where it is in short supply. The capital market facilitates; (i) mobilization and intermediation of private savings and (ii) allocation of medium and long-term financial resources for investment through a variety of debt and equity instruments of both private and public sectors. It plays a crucial role in mobilizing domestic resources and in channelizing them efficiently to the most productive investments. An efficient capital market can also provide a wide range of attractive opportunities for both the domestic and foreign investors.

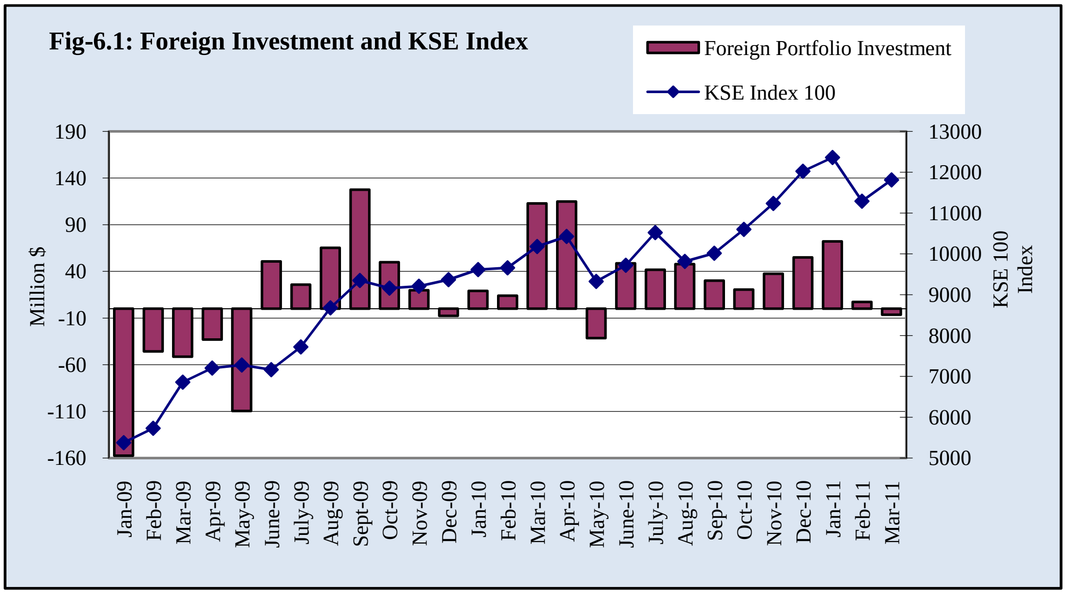
The market oriented economic and investment policies being pursued for the last two decades or more, created conducive environment for the capital markets in Pakistan. Market friendly measures introduced in the early 1990 such as privatization of various state owned enterprises/units and commercial banks, allowing private sector to set-up commercial and investment banks, and permission to foreign investors to buy and sell shares freely on the stock market with full repatriation facilities and permission to own up to 100 percent equity in a venture, served as catalyst in reviving the confidence in the country's stock market. After two decades, the aggregate market capitalization increased manifold and stood at Rs. 3,148 billion by the end-March 2011 and market patched by 15.2 percent more than last year, which transpire that Pakistan’s equity market is one of the best performing equity markets in the world for almost one decade.

During the period from July-March 2010-11, the capital markets demonstrated wavering rising trend and posted modest gains. Total 638 companies were listed at the Karachi Stock Exchange (KSE) on July-March 2010-11 with total listed capital of Rs. 920.1 billion. Pakistan’s stock markets have remained buoyant during the first two quarters of the 2010-11 in terms of market index and market capitalization, which was remained steady till January 2011.The KSE witnessed a rise of 16 percent as compared to the corresponding period of 2009-10, and main reason of this recovery is the absence of leverage products for the stock market in addition to soaring inflation levels and rising interest rates. However, volumes gathered pace and the average volume increased by 19 percent to touch 114.2 million shares per day during the third quarter of the 2010-11.

Investment in capital market during the period July-March 2010-11 by the foreign investors depicted a net inflow of US$ 301.5 million, but noteworthy contribution was made during the first two quarter of 2010-11.

Equity Capital Market

Amidst challenging economic and social environment because of security and after flood challenges, strong presence of foreign investment improved risk perception about strength and depth of the capital market which lure the investor and business community. Trading at FY12E Price Earning Ratio (PER) of 7.0x, Pakistan equities reflect 26 percent discount to historical mean of 9.5x and over 50 percent discount to regional comparable markets. Conversely put, Pakistan equities currently reflect forward earning yield of 14 percent compared to 6 percent for the region and 5 percent for India and China. Moreover, excluding very few scripts, which are currently trading at premium valuations, the rest of the market is actually as cheap as 5x forward PER and 20 percent in terms of forward earning yield.



In fact, only few companies have driven the market and shown robust growth over the years with average annual Earning per Share (EPS) growth for the market clocking in at 21 percent for the period 2003-10. Led by Energy and Petroleum, banks and fertilizer sectors, bottom line growth for 2010-11 is expected to even outperform the historical average and clock in at 24 percent. After 14 months of continuous foreign portfolio outflows, foreign investment turned positive for the first time in Jun09 –right after Pakistan's inclusion in Morgan Stanly Capital International (MSCI) Frontier Markets. Since then, Pakistan has witnessed increased net inflow of foreign investment and foreign holding as a percentage of free float weighted market capitalization now stands at an all time high of 33 percent. After marking a bottom of 4,815 in Jan-09, KSE100 has more than doubled and trading around 12,000 points in May, 2011.

During the period from July-March 2011, one company was allowed to offer for sale shares worth Rs.1.1 billion of International Steel Limited to the general public, high net worth individuals and the institutional investors through book building process.

Global Equity Markets

The leading stock markets of the world observed high growth during the fiscal year 2010-11 ranging from 8.1 percent in Japan to the highest market return up to 66.8 percent as peace dividend in Sri Lanka. As Table-1 demonstrates global equity markets, witnessed a huge bullish trend as compared to last three years when most of the markets showed bearish trend with negative market returns both in local and foreign currencies. The Karachi Stock Market showed an excellent performance as its market return remains at 19.3 percent in terms of local currency in the period July-April 2010-11amidst deteriorating domestic macroeconomic conditions and political upheaval. Similarly in term of USD the return is 20.7 percent compared to negative trend in last three years. Main stock indices including US S&P 500, UK FTSE 100 and Japanese Nikkei 224 also recorded improvement. Emerging equities of Sri Lanka witnessed a healthy growth of 66.8 percent in returns followed by South Korea and Australia with 40.6 percent and 39.9 percent, respectively. Table-6.1 provides a quick snapshot of the return in terms of both domestic currency and USD for these markets.

Table 6.1: Performance of Global Stock Markets

S. No.	COUNTRY	STOCK NAME	INDEX (local currency)		CURRENCY (local currency v/s US$)		Y-O-Y 2009-10 Market Return (%)	
			30-Jun-10	19-Apr-11	30-Jun-10	19-Apr-11	Local Currency (in %)	USD Dollars (in %)
1	Pakistan	KSE 100	9,721.9	11,599.3	85.6	84.6	19.3	20.7
2	India	Sensex 30	17,700.9	19,121.8	46.4	44.5	8.0	12.8
3	Indonesia	Jakarta Composite	2,913.7	3,732.7	9,065.0	8,700.9	28.1	33.5
4	Taiwan	Taiwan Weighted	7,329.4	8,638.6	32.3	29.1	17.9	30.8
5	South Korea	Seoul Composite	1,698.3	2,122.7	1,221.9	1,086.4	25.0	40.6
6	Hong Kong	Hang Seng	20,129.0	23,520.6	7.8	7.8	16.8	17.1
7	Malaysia	KLSE Composite	1,314.0	1,521.5	3.2	3.0	15.8	24.1
8	Japan	Nikkei 224	9,382.6	9,441.0	88.5	82.4	0.6	8.1
9	Singapore	strait times	2,835.5	3,125.4	1.4	1.3	10.2	23.6
12	Srilanka	All Shares	4,612.5	7,475.2	113.6	110.4	62.1	66.8
13	China	Shanghai Composite	2,398.4	3,057.3	6.8	6.5	27.5	32.6
14	Philippines	PSE Composite	3,372.7	4,245.2	46.4	43.3	25.9	34.7
15	Australia	All Ordinaries	4,324.8	4,874.3	1.2	0.9	12.7	39.9
16	US	S & P 500	1,030.7	1,312.6	-	-	27.4	12.1
17	UK	FTSE 100	4,916.9	5,896.9	0.7	0.6	19.9	31.5
18	New Zealand	NZSE 50	2,972.1	3,440.0	1.5	1.3	15.7	32.1

Source: Invisor Securities

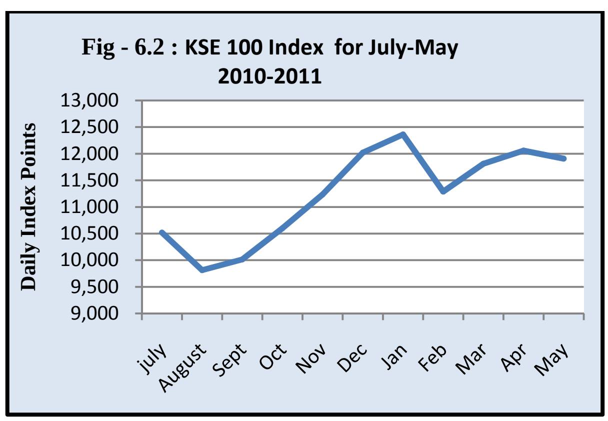
Reading the data

- *In 2009-10 the KSE-100 market return was 36 percent in local currency and 29.2 percent in USD terms.*
- *Since July-01 to 19th April, 2010-11, the KSE-100 market has yielded returns of 19.3 percent.*

Performance of Karachi Stock Exchange

In the current fiscal year, the Karachi Stock Exchange (KSE) retained its prominent position in Pakistan's capital markets, offering efficient, fair and transparent way of trading securities. This can be compared with any market in the region and enjoying full confidence of the investors. Thus in the light of its leading role, the discussion on Pakistan's Capital markets has been largely based on the performance of the Karachi market and its benchmark KSE-100 Index.

During the period July-March 2010-11, the benchmark KSE-100 index showed a steady growth subsiding the economic uncertainties like implementation of Reformed General Sale Tax (R-GST) and concerns over losses incurred by the massive floods across the country. The most concerning factor to highlight since the start of the fiscal year has been gradual deterioration of the market activity/volume. The KSE-100 index recorded a bullish trend during first half of the current fiscal year (CFY) as the market was trading around 12,000 at the end of December 2010. The KSE- 100 index however, remained steady during the third quarter of 2010-11 and after touching at 12,682 on January 17, 2011 and now trading at 11,900 points. The main reason of better performance in mid May 2011 in the stock market and gearing up the momentum in the KSE-100 is considerable foreign investment in the capital market.



The performance of KSE during last five years is narrated in Table 2. KSE is now a part of global equity market with foreign institutional investors holding a significant percentage of the free float. The positive foreign portfolio inflows and a good growth in corporate earnings led to strong market performance. Local investment during the period July10-11 remained subdued. KSE still trades at one of the lowest P/Es in the region which helped a sizeable inflow from foreign institutions. The net foreign inflow of $301.5 million was recorded during July2010- March 2011. During this period, two new debt instruments were listed. The much awaited Margin Trading, Margin Financing and Securities lending and borrowing system was implemented from March 2011.

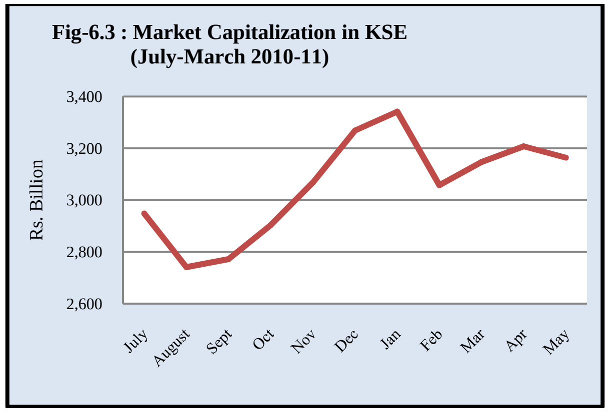


Table 6. 2: Profile of Karachi Stock Exchange

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11 (Jul-Mar)
Number of Listed Companies	658	658	652	651	652	638
New Companies Listed	14	16	7	8	8	0
Fund Mobilized (Rs billion)	41.4	49.7	62.9	44.9	135.1	14.8
Listed Capital (Rs billion)	496	631.1	706.4	781.8	909.9	920.1
Turnover of Shares (billion)	79.5	54	63.3	28.2	43.00	21.2
Average Daily Turnover of Shares (million)	348.5	262.5	238.2	115.6	173.2	114.2
Aggregate Market Capitalization (Rs billion)	2,801.2	4,019.4	3,777.7	2,143.2	2732.4	3147.6

Source: KSE

The Month wise Indicators for July-March 2010-11 are given in the Table 6.3

Table: 6. 3 Month Wise Indicators **(Rs in billion)**

Month	Listed Capital	Mkt. Capitalization	KSE 100 Index	Turnover (T+2)	Trade Value T+2 (in Rs. billion)	Turnover (Future)	Trade Value Future(in Rs. billion)
Opening	909.9	2,732.4	9721.91				
August	910.0	2,741.5	9,813.05	1.3	51.3	0.05	5.3
September	911.2	2,772.4	10,013.31	1.4	43.1	0.04	4.4
October	915.3	2,903.6	10,598.40	2.7	69.2	0.06	6.7
November	914.6	3,068.7	11,234.76	2.4	87.3	0.07	7.5
December	919.2	3,268.9	12,022.46	3.3	115.8	0.1	11.6
January	899.1	3,342.0	12,359.36	3.9	166.5	0.2	20.9
February	904.0	3,058.0	11,289.23	2.1	71.6	0.1	14.0
March	920.1	3,147.6	11,809.54	2.4	102.9	0.2	18.6
Total				21.2	768.4	0.9	96.0
Changes since July, 2010		415.2	2,087.63				
Percentage change		15.20%	21.47%				

Source: KSE

Corporate Profitability

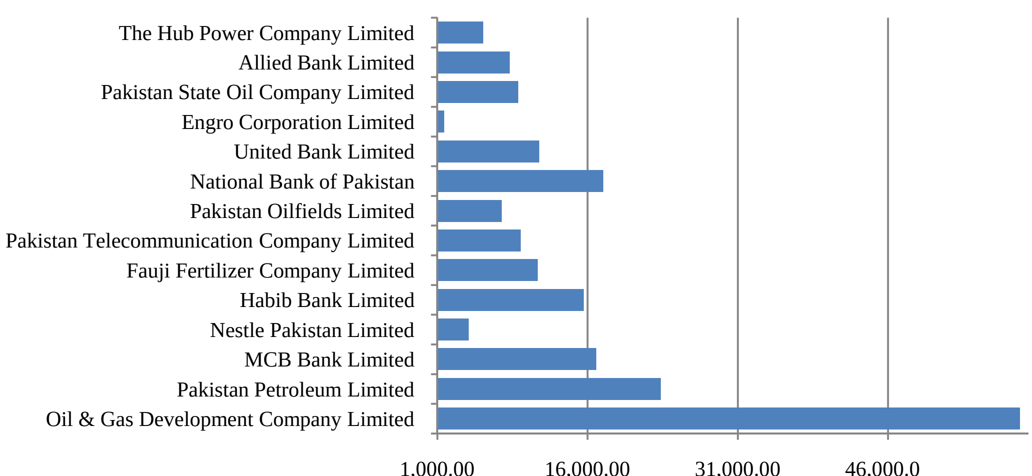
Corporate profitability has increased in 2011 but profitability concentrated in few large companies in the Energy, Telecom and Banking sectors. The corporate results are expected to report the mixed earnings for the current financial year. Oil and gas exploration companies earnings will benefit from revised well head prices due to increase in international oil prices. Oil and Gas marketing companies are also expected to benefit. Fertilizer sector has also shown positive growth, however its regular supply remained one of the issue.

Table 6.4: Price To Earning Ratio of Top Ten Companies

Sr..No	Name of Company	Paid-up Capital (Rs billion)	Profit After Tax (Rs. billion	EPS	31-Mar-2011 Market Price (Rs.)	P/E Ratio	Market Capitalization (Rs. in billion)
1.	Oil & Gas Development Company Limited	43.0	59.2	13.8	135.7	9.9	583.5
2.	Pakistan Petroleum Limited	10	23.3	23.4	211.4	9.0	210.5
3.	MCB Bank Limited	7.6	16.9	22.2	207.5	9.4	157.8
4.	Nestle Pakistan limited	0.5	4.1	90.7	3,438.0	37.9	155.9
5.	Habib Bank Limited	10.0	15.6	15.6	111.7	7.2	111.9
6.	Fauji Fertilizer Company Limited	6.8	11.0	16.3	137.9	8.5	93.6
7.	Pakistan Telecommunication Company Limited	51.0	9.3	1.8	17.0	9.3	86.7
8.	Pakistan Oilfields Limited	2.4	7.4	31.4	325.1	10.3	76.9
9.	National Bank of Pakistan	13.5	17.6	13.1	57.0	4.4	76.7
10.	United Bank Limited	12.2	11.2	9.1	61.5	6.8	75.3
11.	Engro Corporation Limited	3.3	1.7	5.1	205.8	40.2	67.4
12.	Pakistan State Oil Company Limited	1.7	9.0	52.8	277.5	5.3	47.6
13.	Allied Bank Limited	7.8	8.2	10.5	59.4	5.7	46.5
14.	The Hub Power Company Limited	11.6	5.6	4.8	37.6	7.8	43.6

Source: KSE

Fig-6.4: After Tax Profit of Top Ten Companies July-March 2010-11



Source: KSE

Sector Wise Performance:

Extraordinary performance in the stock markets during the outgoing fiscal year was driven by some major sectors of the economy including Oil & Gas producer, Banks, Personal Goods and other chemicals and pharmaceuticals sectors. Performances of some of the major sectors are mentioned below:

Oil & Gas Producer

In this sector 12 companies are listed at the Stock exchange. The sector is performing doing well because of rising demand, higher exploration and global prices. Its index fluctuated between12, 523 to 12,166 between July-March 2010-11 and market capitalization inched up from Rs. 1,042.3 million to Rs. 1,051.7 million. Pakistan based oil and gas sector have shown healthy profits due to upward movement of prices. During the year sector shows the profit after tax of Rs.104.2 billion. The sector also has the largest paid companies like OGDCL, PPL, POL, etc. and the total paid up capital of this sector is Rs.65.2 billion. Oil and Gas sector continued to be one of the major market players.

Chemical Sector

With this sector 36 companies are listed. Net income of this sector after tax in 2010-11 stood at Rs. 32.1 billion and its share index has decreased by 2.8 percent. Its market capitalization improved by Rs.113.6 billion during the July-March 2010-11 and stood at Rs. 392.9 billion. This sector showed good profits due to tight –demand supply situation and rising fertilizers prices.

Automobile and Parts

The share index comprised of 19 listed companies with KSE decreased by 11.2 percent and market capitalization decreased by 10.5 percent during the first nine months of the 2010-11. Sales statistics shows that the demand is gradually tapering off in the large automobile sector. Increase in the price of cars, rising interest rates and risk averse policy of banks amidst growing non-performing loans in the sector have contributed to this marked slowdown. The sector posted the profit of Rs.4.2 billion in the first nine months of the CFY.

Personal goods

The index of the sector comprising of 211 listed companies (mostly related to the textile sector) increased from 9,705 to 10,441 and market capitalization stood at Rs. 132 billion during July-March 2010-11. The increase is mainly driven by the enhanced demand of yarn and cotton products and higher prices of finished products. The sector has shown the after tax profit of Rs. 24.1 billion.

Construction and Material

Cement manufacturers is dominated sector comprised of 37 companies posted after tax loss of Rs. 5.1 billion during the period under review. Accordingly, its share index is down by 10.2 percent and market capitalization at Rs. 63.3 billion is down by 8.1 percent during July-April 2010-11. This is a reflection of cement production and exports performance.

Banks

The sector comprised of 27 banks listed with the KSE. Its share index is down from 8,719 in July 2010 to 8015 in March 2011 whereas its market capitalization increased by 1.8 percent. Decline in the credit cycle, higher interest rates, and cautious lending stance given the experience with loan defaults in some sectors are primary reasons for the slowdown. However, the credit quality is still much better than other regional countries with lower NPL ratio. During the year, the sector shows the after tax profit of Rs.70.6 billion.

Fixed Line Communication

The sector of 5 companies is affected by saturation of mobile communication in the country and the total after tax profit was Rs.7 billion. Market capitalization of the sector decreased from Rs. 83.8 billion to 69 billion during July-March 2010-11. Its share index also decreased to 8392 points from 10191 points at the end of March 2011.

Food Producers.

The sector having 61 sugar dominated companies posted total after tax profit of Rs.11.9 billion. The share index moved up from 12,625 to 19,824 during July-March 2010-11. Its market capitalization increased by 58.2 percent to 282.9 billion.

Pharma & Biotech

The sector of 9 companies showed profit after tax of Rs. 3.2 billion in year 2010. Its share index increased from 8241 to 8327 and market capitalization increased from Rs. 30.6 billion to

Rs31.4 billion in the period under review.

Box-1: Capital Market Reforms

In order to strengthen the Pakistani capital market and to have improved risk management, increased transparency, improved investor protection and for the introduction of new products to provide depth to the market, SECP initiated following measures,

- In order to cater to the financing needs of the market and to bring in liquidity, the securities (Leveraged Markets and Pledging) Rules were finalized in coordination with the relevant stakeholders and promulgated on February 18, 2011. Rules provided the broader regulatory cover to the products of Margin Financing, Margin Trading and Securities Lending and Borrowing. Subsequently, the regulatory framework of the stock exchanges, the National Clearing Company of Pakistan limited (NCCPL) and the Central Depository Company of Pakistan Limited (CDC) was also amended to provide for the operational aspects of the said mechanisms.
- Under the "Automation of Securities Settlement Project" at the CDC. Under this system, book entry securities are automatically transferred from the respective sellers' account to the respective buyers' account instead of being routed through the member's main account.
- The SECP formulated a comprehensive policy for dealing with companies in default of securities market laws to protect the investor, enhance transparency and improve member listing.
- Efforts were made to enhance the product portfolio of the National Commodity Exchange Limited (NCEL), with a view to catering to the hedging and speculative needs of various target groups.
- A committee of stakeholders was constituted to give recommendations for promoting activity at the earlier introduced Bonds Automated Trading System (BATS) for trading of corporate bonds, and for augmenting the said System with enhanced functionalities to bring it at par with the international systems for corporate debt market.

Lahore Stock Exchange

The leading market indicators witnessed mixed trends in Lahore Stock Exchange. The LSE - 25Index, which was 3093 on 30 June 2010, increased to 3343 points as on March 31, 2011with total paid up capital increased from Rs 842.6 billion to Rs 854.4 billion.

Total turnover of the shares on LSE during July-March 2010-11 is 0.9 billion shares as compared to 3.4 billion shares in the corresponding last period, with Fund mobilization of Rs 8.2 billion and market capitalization is Rs.2921.5 billion during July-March 2010-11.Only six new companies were listed in the period under consideration as compared to 25 companies in the fiscal year 2009-10. A profile of LSE is given in the following table with a graphical presentation of index performance.

Fig - 6.5 : Tends in LSE-25 Index for July -5 May 2010-2011

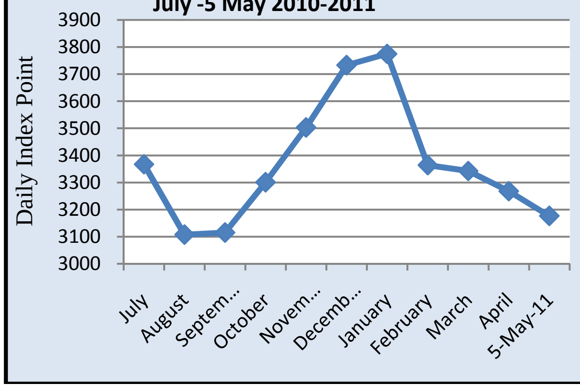


Table 6.5: Profile of Lahore Stock Exchange

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11 (jul-mar)
Number of Listed Companies	518	520	514	511	510	497
New Companies Listed	7	10	2	9	25	6

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11 (jul-mar)
Fund Mobilized (Rs billion)	24.5	38.8	29.7	32.8	67.5	8.222
Listed Capital (Rs billion)	469.5	594.6	664.5	728.3	842.6	854.370
Turnover of Shares (billion)	15	8.2	6.5	2.7	3.4	0.923
LSE 25 Index	4,379.3	4,849.9	3,868.8	2,132.3	3092.7	3342.56
Aggregate Market Capitalization (Rs billion)	2,693.3	3,859.8	3,514.2	2,018.2	2622.9	2921.5

Source: LSE

Islamabad Stock Exchange

Islamabad Stock Exchange (Guarantee) Limited (ISE), being the youngest stock exchange of three stock exchanges of Pakistan, has been playing an important role in the development of equity market in Pakistan along with other two exchanges to create value for their investors and listed companies through dynamic market operations, fair and transparent business practices and effective management.

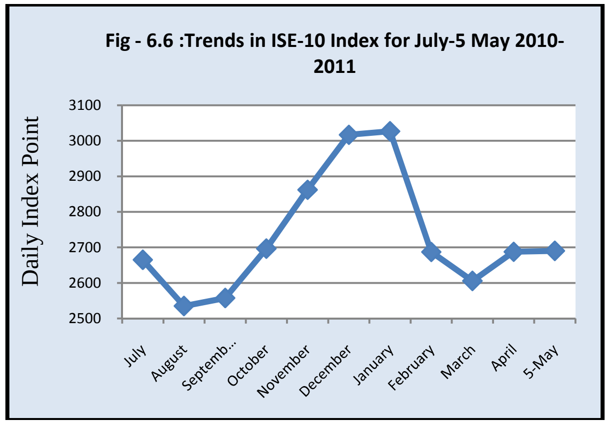


Table 6.6: Profile of Islamabad Stock Exchange

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11 (Jul-Mar)
Number of Listed Companies	240	246	248	261	244	236
New Companies Listed	6	12	7	15	2	-
Fund Mobilized (Rs. billion)	5.2	30.7	24.6	24.8	73.0	7.4
Listed Capital (Rs. billion)	374.5	488.6	551	608.6	715.7	710.3
Turnover of Shares (billion)	0.4	0.2	0.6	0.3	0.2	0.034
ISE 10 Index	2,633.9	2,716	2,749.6	1,713	2,441.2	2605.4
Aggregate Market Capitalization (Rs billion)	2,101.6	3,060.6	2,872.4	1,705.1	2,261.7	2531.5

Source: ISE

The first half of the current fiscal year remained sluggish however, in the third quarter it picked up momentum and remained steady. The average daily trading volume during the last nine months remained at 0.18 million shares at ISE. The ISE-10 Index inched up from end-June 2010 level of 2445 points to 2605 points on end-March 2011, thereby showing a net increase of 6.5 percent.

Debt Capital Markets

Debt Capital Market is a market for trading debt securities where business enterprises (companies) and governments can raise long-term funds. This includes private placement as well as organized markets and exchanges. The debt capital market trades in such financial instruments which pays interest. There are bonds and several loans which act as the prime financial instrument of this market. Because of this interest factor, it is also known as fixed income market.

Government Securities

Pakistan Investment Bonds (PIBs) as fixed rate government securities provide a benchmark for debt capital market. The government is committed to provide sufficient supply of long term papers in the market to develop the longer end of the government debt yield curve. The government is educating the investor base especially the institutional investors to manage their balance sheets in a more innovative way by diverting resources from working capital needs towards investment. PIBs together with the NSS instruments primarily hold a larger portion of local fixed-income market. They provide the government with long-term maturity debt. SBP held seven auctions in 2007-08, four in 2008-09, fourteen in 2009-10 and seven in 2010-11. Government amassed Rs. 64.7 billion through PIB auctions in 2009-10 and Rs. 83.4 billion in 2010-11.

Table 6.7: Snapshot Analysis of PIBs

Tenor	2008-09		2009-10		2010-11*	
	(Rs. billion)	**Percentage Share**	*(Rs. billion)*	**Percentage Share**	*(Rs. billion)*	**Percentage Share**
3-Years	10.1	14.1	11.7	18.0	18.7	22.4
5-Years	8.8	12.4	7.2	11.1	6.7	8.0
7-Years	7.3	10.3	2.2	3.4	0	0.0
10-Years	35.0	49.2	39.4	60.9	57.5	69.0
15-Years	1.4	2.0	1.0	1.6	0	0.0
20-Years	1.9	2.7	1.5	2.4	0.5	0.6
30-Years	6.6	9.3	1.8	2.7	0	0.0
Total	**71.2**	**100**	**64.7**	**100**	**83.4**	**100.0**

* July-March *Source: SBP*

The government showed greater craving for borrowing through long term securities, and set the target of Rs 60 billion against a maturity of Rs 6.9 billion during 2010-11. Keeping in view the widening deficit gap of the government, from the demand side, market players offered Rs 134.4 billion and Rs 83.4 billion net of maturities was accepted as long term financing during 2010-11 as against Rs 51 billion net of maturities accepted in 2009-10 in the same corresponding period. Government generated resources from 10-years PIBs, and accepted 69 percent of the amount through this single maturity. This was followed by 3, 5-year PIBs with a share of 22.4 and 8 percent, respectively of the amount accepted in 2010-11. PIBs with 20 -year maturity accounted for a share of 0.6 percent and 10-year PIB has shown a huge increase as compared to previous fiscal year as its percentage share in 2009-10 was 60.9 percent and 3-years PIB has also witnessed an increase from 18 percent in 2009-10 to 22.4 percent in 2010-11. On the other side shares of 5 and 20–years PIBs declined shares to 8 and 0.6 percent, respectively in 2011. The share of 10 year PIB is amount to Rs. 57.5 billion in the 2010-11 as compared to Rs.39.4 billion in previous fiscal year. Amount received by 3-years PIB is Rs.18.7 billion in 2011 as compared Rs. 11.7 billion in 2009-10. The share of 7, 15 and 30-year PIB has declined in the current financial year as shown in Table 6.7.

Table 6.8: PIB Coupon Rates for 1H-FY11

Tenor	Previous coupon Rate (at 30Jun 10)	Current Coupon Rate
3-Years	11.25%	11.25%
5-Years	11.50%	11.50%
7-Years	11.75%	11.75%
10-Years	12.00%	12.00%
15-Years	12.50%	12.50%
20-Years	13.00%	13.00%
30-Years	13.75%	13.75%

Source: SBP

Table-6.9:

PIB Auction Cut-off Rates, July-December 2010-11				PIB Auction Cut-off Rates, 2H-2010-11		
Tenors	**14-Oct-10**	**22-Dec-10**	**Variance Bps**	**17-Feb-11**	**17-Mar-11**	**Variance Bps**
3-years	13.90	14.25	35	14.25	14.08	-17
5-years	14.00	14.30	30	14.29	14.11	-18
7-years	-	-	-	-	-	-
10-years	14.10	14.36	26	14.27	14.12	-15

Source: SBP

Government and the central bank worked together to launch the GoP *Ijara Sukuk* in order to support efforts to diversify the borrowings mix to ensure financial stability. Islamic Banks have been aggressively mobilizing deposits, and play a significant role particularly after the introduction of the minimum deposit rate and easing of reserve ratios. To cope with the liquidity requirements of *Shariah* compliant banking institutions, the target for the auction of fourth GoP *Ijara Sukuk* is set at Rs 40 billion during Fiscal Year 2010-11 while it was 20.4 billion in revised budget in FY 2010. Increasing zeal for investment in these instruments was observed. Three auctions were held in July-March 2010-11 and targets for these were set at Rs.40, 40 and 45 billion, respectively. Total amount offered for the said bids was Rs.179.3 billion against target of Rs.125 billion while Rs.136.5 billion were accepted which reflects strong liquidity position of Islamic banks and their investment appetite for this asset class. The maturity of the *Sukuk* will be of one, two and three years.

Table 6.10: 3-Year Ijara Sukuk Auctions Result For FY10-11 **(Rs. billions)**

Date	Target	Offered Amount	Accepted Amount	Cut-off Margin	Variance of Acceptance against Target
8-Nov-10	40.00	64.7	51.8	0.00	11.8
13-Dec-10	40.00	57.8	37.2	0.00	-2.8
1-Mar-11	45.00	56.8	47.5	0.00	2.5
Total	125	179.3	136.6	0.00	

Source: SBP

Table-16.11 depicts that SBP has increased the interest rates for 3, 5 and 10 years PIBs in 2010-11. For three years PIB interest rate is increased to 14.05 percent in March 2011 up from 12.66 in July 2010. Similarly interest rate for 5 and 10 years are 14.08 percent at the end of third quarter of the ongoing fiscal year as compared to 12.75 and 12.93 in July 2010.

Table-6.11: Interest Rate Structure, FY 2010-11

Tenors	**3-Sep-09 %**	**11-Nov-09 %**	**Variance (H1FY10) bps**	**JUL-10 %**	**Mar-11 %**	**Variance (FY10-11) (Jul-mar) Bps**
3-Years	12.29	12.26	-0.03	12.66	14.05	1.39
5-Years	12.36	12.40	0.04	12.75	14.08	1.33
10-Years	12.5	12.44	-0.06	12.93	14.08	1.15

Source: SBP

National Savings Schemes (NSS)

The Central Directorate of National Savings (CDNS) performs deposit bank functions by selling government securities through a network of 372 savings centers, spread all over the country. As of March 31, 2011 there were 3.8 million investors with different National Saving Schemes (NSS). During the fiscal year July-March 2010-11, net deposits with National Saving Schemes increased to Rs 1,822.4 billion. The unfunded category of domestic debt, comprised of NSS instruments, has recorded an expansion of 10.2 percent in this period. *Bahbood* Savings Certificates attracted Rs 45.3 billion, followed by Special Saving Scheme and Regular Income Certificate. Defense saving certificate attracted net investment of Rs 6.6 billion against the target of retirement of 2.6 billion. The NSS contains a number of instruments with significant concentration on individual investment, NSS scheme are available with the maturity period of 3 years, 5 years, and ten years. It is also worth mentioning that segment of subsidized scheme i.e. Pensioner Benefit Account and *Behbood* Saving

Certificate, contribute Rs. 58.8 billion in the total net investment of Rs. 168.7 billion till March 2011.

Table 6.12: National Savings Schemes (Net Investment) **(Rs. Billion)**

S.#.	Name of Scheme	2007-08	2008-09	2009-10	2010-11 (Jun- Mar)
1	Defence Savings certificates	(4.3)	(27.4)	(32.5)	6.6
2	Special Savings Certificates(R)	13.8	128.5	61.9	34.1
3	Regular Income Certificates	(0.3)	40.1	44.5	35.8
4	Bahbood Savings Certificates	38.8	78.5	59.3	45.3
5	Pensioners 'Benefit Account	18.7	22.2	18.2	13.6
6	Savings Accounts	9.0	(10.9)	1.0	(4.8)
7	Special Savings Account	5.5	21.6	31.4	10.9
8	Prize Bonds	8.3	14.6	38.6	27.2
9	National Saving Bonds	--	--	3.6	--
10	Others	(0.03)	(0.06)	(0.2)	(0.06)
	Grand Total	89.5	267.2	225.7	168.8

Source: Central Directorate of National Savings

Corporate Debt Market

A well functioning corporate bond market provides an additional avenue to corporate sector for raising funds for meeting their financial requirements. During the period July-March 2010-11 one listed debt instrument was offered to the general public i.e. offering of Rs 4 billion Term Finance Certificate (TFC) by Engro Corporation Ltd. The TFC was offered only to retail investors and was fully subscribed. Out of the said Rs.4 billion, 74 percent were subscribed by the individuals, 20% by employees fund and balance by the others.

Table: 6.13 Floatation of TFCs, July-March 2010-11 **(Rs. Billion)**

Name of Company	Listed at	Issue Size
Engro Corporation Limited	KSE	Rs. 4 billion

Source: SECP

During the period a total of 07 debt securities issued through private placement. The break-up of these privately placed corporate debt issues are as follows.

Table-6.14: TFC's Offered During 2010-11

S.No	Name of Security	No	Amount (Rs billion)
i	Privately placed Term Finance Certificates	01	0.5
ii	Sukuks*	03	134.6
iii	Commercial Papers	03	1.8
	Total	07	136.9

Source: SECP

* All the three *Sukuk* were issued by Pakistan Domestic Sukuk Company Limited

As on December 31, 2010 a total of 142 corporate debt securities were issued with an outstanding amount of Rs 379.4 billion as follows,

Table 6.15: Outstanding TFCs

S.No	Name of Security	No	Amount outstanding (Rs. billion)
i.	Listed Term Finance Certificates (L-TFCs)	38	66.2
ii.	Privately placed Term Finance Certificates (PP-TFCs)	48	87.7
iii.	Sukuks	55	224.4
iv.	Commercial Papers	01	1.0
	Total	142	379.4

Source: SECP

Box-2: Measures for development Debt Markets

- Listing of government debt instruments at the stock exchanges would greatly enrich development of the debt market.
- At present, the debt securities though listed at the stock exchanges are not actively traded as the Capital Value Tax (CVT) collection hinders the growth in the secondary market for debt securities which can be lowered.
- Rationalize the cost of issue of corporate bonds, the rate of stamp duty applicable on issue and transfer of Term Finance Certificates and Commercial Papers may be reduced further.
- In order to strengthen the regulatory framework and to develop the rating process in Pakistan, services of an international consultant were hired by the SECP to provide technical assistance with respect to the operations and regulations of Credit Rating Agencies. The consultants gave their recommendations, which are being implemented.

Source: SECP 2011

Mutual Funds :

Mutual funds ascended with an increased thrust as evidenced by a surge in total assets of over 10 percent and reached to Rs 275 billion during July-March 2010-11 as against 4.4 percent growth for 2009-10. As on March 31, 2011, the number of mutual funds in the industry stood at 137 compared to 116 in January 2010 and this uptrend in the mutual funds industry is primarily because of soaring investor confidence in the backdrop of positive stock market movement and improving debt market.

SECP extended the time period for maintaining equity portfolios held by Asset Management Companies (AMCs) till June 30, 2011 in an attempt to provide cushion to the AMCs whose equity positions otherwise would have been adversely affected.

Table 6.16: Snapshot of key financials as of March 31, 2011 **(in million rupees)**

	Leasing Companies	Investment Banks	Modarabas
Total Assets	34,528	25,745	25,797
Total Liabilities	29,603	20,867	13,668
Total Equity	4,821	4,794	12,128
Total Deposits	**4,477**	**6,108**	**2,697**

Source:SECP

Modarabas :

Being a distinctive Islamic business model, the *modaraba* sector has contributed significantly towards the development of non-banking finance sector and achieved a phenomenal growth in terms of profitability. The *modaraba* sector has enrolled its place in the financial intermediaries and has been able to create a market niche for itself in the financial sector.

As compared to other financial sector of Pakistan the *modarabas* have strongly faced the financial turmoil without any shrinkage in its assets size, number and employment. It may be because of the inherent strength of the Islamic financial system. The strength of *modarabas* is visible from its stable assets size of Rs 25.8 billion as of March 31, 2011 as compared to Rs 23.0 billion corresponding period last year. The equity of the *modarabas* showed slight declined and remained at Rs 10.9 billion as of December, 2010 as compared to Rs 11.6 billion last year. The decrease of Rs 615 million has been recorded due to impairment losses on investments in listed securities.

Though there is a declining tendency of the financial sector, 17 out of 26 *modarabas* declared cash dividends to their certificate holders. During the last nine month, the SECP issued various circulars and directives to further improve the regulatory framework for the *modaraba* sector. In addition, revised guidelines to tackle money laundering issues for *modarabas* were also issued.

A committee has been formed to discuss and propose measures to improve performance of *modaraba* sector and to explore the ways and means to address liquidity problems faced by *modarabas* to enhance corporate governance and to develop new resource mobilization and financing products for the *modarabas*.

Table 6.17: Snapshot of Key Financials as of March 31, 2011 **In million rupees)**

	Leasing Companies	Investment Banks	Modarabas
Number of companies	9	7	26
Total Assets	34,528	25,746	25,797
Total Liabilities	29,603	20,867	13,668
Total Equity	4,821	4,794	12,128
Total Deposits	4,477	6,108	2,697

Source: SECP

Investment Banks :

Investment banks are facing multiple problems like low capitalization, high cost of funds and limited avenues for resources mobilization. In order to encourage investment banks through non-fee-based financial services and to take a more active role in capital markets, the SECP in April 2010 amended the regulatory framework. Hence, investment banks were allowed to undertake brokerage business from their own platform instead of forming a separate company with certain restrictions. As on March 31, 2011 there are 7 active licensed investment bank with total assets of Rs 25.7 billion and equity of Rs 4.8 billion.

Leasing

The leasing sector in Pakistan faces multitude problems like liquidity issues, low capitalization, limited sources for resource mobilization, high cost of funds, level of non-performing assets and limited outreach. SECP enhanced the validity of licenses issued to Non-Banking Financial Companies (NBFCs) from one year to three years for providing operational flexibility to them. The timeline for meeting prescribed minimum equity requirement was also extended to June 2011. On March 31, 2011 the total assets of the sector stood at Rs. 34.5 billion as compared to Rs. 35.0 billion as of December 31, 2010, showing marginal decline of 1.5 percent. However, the equity has shown a slight improvement of 0.7 percent as it has increased from Rs.4.8 billion on December 31, 2010 to Rs.4.8 billion on March 31, 2011. Further, deposits of the leasing companies have shown improvement of 1.4 percent as they increased from Rs.3. 9 billion to Rs4.5 billion.

Voluntary Pension System.

The government has been considering reforming the current pension system. Luckily, the dependency ratio at this point of time is extremely favorable for Pakistan to shift from defined benefit system to defined contribution system. While reforms at the national level will take some time, a Voluntary Pension System (VPS) is being introduced. VPS envisages contributions by Pakistani nationals in a pension fund approved by the SECP. The pension fund promises a stream of income to its members after retirement. The government has given tax incentives to individuals under the current tax regime.

The penetration of VPS is low at the moment, being new to Pakistan and non-binding upon employers and individuals. It is hoped that, with the passage of time and complimentary reforms in defined benefit retirement schemes, the system would gain grip and substance. So far, nine pension funds have been launched under the VPS. The size of pension funds has grown as under:-

Table 6.18: Number of Pension Funds with Net Assets

Date	Number of Pension Funds	Net Assets in Million Rupees
30-Jun-07	4	7,420
30-Jun-08	7	766
30-Jun-09	7	870
30-Jun-10	9	1,301
30-Dec-10	9	1,364
31-March-11	-	1,1421

Real Estate Investment Trusts (REITs).

REITs are new investment instrument for Pakistan's capital market. Therefore, the framework would need adjustments before it takes roots in the investing community. In order to alleviate some of the concerns hindering evolution of REITs a number of amendments were made to REITs Regulations in 2010. The reduction in the fund size from Rs.5 billion to Rs.2 billion was done to accommodate the capital constraint for launching of REITs projects in addition to introduction of concept of hybrid REITs.

The rates of stamp duty and registration fee for REITs properties in Punjab and Sindh are reduced. In Punjab, the stamp duty for REITs property purchase has been reduced from 2 percent to 0.5 percent and on sale of property from 2 percent to 1 percent. In Sindh the stamp duty has been reduced from 3 percent to 0.5 percent. In both provinces, registration fee on purchase of property by REITs has been waived and reduced from 1 percent to 0.5 percent on sale by REITs.

Settlement System:

The development of PRISM (Pakistan Real time Interbank Settlement Mechanism) system started as a response to the growing awareness of the need for sound risk management in settlement of larger-value funds transfers in Pakistan. PRISM systems operated by State Bank of Pakistan offers a powerful mechanism for limiting settlement and systemic risks in the interbank settlement process by providing settlement on gross basis and in real time. In addition, PRISM also contributes to the reduction of settlement risk in security transactions by providing a basis for Delivery Versus payment (DVP) mechanisms.

Employees Stock Option Scheme

Employees Stock Options are used not only to reward employees but also as retention tools and to build long term loyalty of employees to their workplace. To reward performance, encourage productivity and increase employee's involvement, companies in Pakistan have increasingly started offering stock options to its employees. The Stock Option Schemes are regulated under the "Public Companies (Employees Stock Option Scheme) Rules, 1999". During 2010-11, 2 Employees Stock Option Scheme of JDW Sugar Mills Limited and NIB Bank Limited were launched.

Pakistan Mercantile Exchange Limited

Pakistan Mercantile Exchange Limited (PMEX) formerly known as the National Commodity Exchange Limited (NCEL) is Pakistan's first demutualized online commodity exchange. It was established in April 2002 and commenced operations in May 2007. PMEX provides a regulated platform for trading of futures contract in commodities and currencies. The product portfolio of PMEX has been designed to cater for the hedging and speculative needs of various stakeholders/investor groups. The futures contracts presently available at the exchange include varying sizes of gold and silver contracts, rice, palm oil, crude oil, sugar, and cotton and interest rate contracts.

The trading volumes at PMEX showed an exponential rise during the period under review. The total traded value of contracts climbed up to Rs380.9 billion in 2010-11 compared to Rs54.7 billion in 2009-10 with the number of contracts traded rising to 1.2 million from 0.3 million traded in the 2009-10 implying 556 percent in traded value and 315 percent in the number of contracts traded during the year.

Derivative Markets

In order to provide investors with basic hedging instruments, financing options and increased investment alternatives, deliverable futures contracts and cash-settled futures contracts are available for trading at the three stock exchanges. Additionally stock index Futures Contract based on the KSE 30 Index and Sectoral Indices for oil and gas sector and banking sector are available at the Karachi Stock Exchange (KSE). Under the cash settled futures, 90, 30 and 7-days cash-settled futures contracts are available.