Chapter No. 6

Capital Markets

6.1 Introduction

Financial markets perform a key function in the form of intermediation by mobilizing savings from a large pool of small savers and channelizing these funds into productive investments by a generally much smaller number of borrowers. Trading in securities enables a match between the differing maturity preferences of lenders and borrowers. Stock markets also potentially endorse broad-basing of ownership of financial assets and the reallocation of funds among corporations and sectors. Moreover, a developed bond market helps in providing liquidity to domestic growth and credit expansion.

Across the world, an extensive transformation towards an equity culture has taken root as conventional bank financing shows a flipside to the emergence of globally interrelated capital markets. Integration proves to be beneficial in the form of a more efficient, liquid and broad securities market; innovative products and services; industrial transformation of markets; cheaper corporate financing; and enhanced risk-return frontiers. However not ignoring the downside, the ensuing globalization of financial services can also exacerbate the too-connected-to-fail problem. Indeed, the ongoing global financial mess has shown how financial innovations have enabled risk transfers that were not fully recognized by financial regulators or by institutions themselves.

The stock markets of Pakistan witnessed a boom during the 1990's, attributable to a large number of developments, including; first, the process of financial liberalization resulting in a rise and inflow of foreign portfolio investment; second, the process of privatization and the offering of new attractive shares; third, a greater measure of political stability and investor confidence; fourth, improvements in the operational efficiency of stock markets. Nevertheless, the Karachi Stock Exchange (KSE), established soon after independence in September 1947, gathered forceful momentum since 2002. During 2002-2007, even with a few episodes of mayhem down the way, the development in the KSE-100 index and market capitalization has been unparalleled and incredible.

The beginning of the fiscal year 2008 appeared promising for Pakistan's capital markets regardless of the sub-prime crisis intensifying its grip on financial systems all over the globe. The stock markets in Pakistan posted good gains and the KSE-100 index gained 11.6 percent by mid of April 2008 and reached the highest level of 15,676 points on April 18, 2008 with a gain of 1,747 points over the level of index at the start of the year 2008. Subsequent to this high time, however, the equity market has seen an episode of precipitous decline: the KSE-100 index has fallen by over 62 percent (as on December 31, 2008) since reaching its peak in April 2008. Prices have nose-dived in response to waning macro-economic fundamentals, a worsening law and order situation and international capital flight.

Notwithstanding, equity investors have embarked on a fractional recovery of their fortunes with an upsurge in the KSE-100 index of a fine 22.5 percent since the commencement of the calendar year 2009, driven up chiefly by signs of returning economic stability. A timely signing of SBA with the International Monetary Fund (IMF) in November 2008 and a commitment of pledges by

Friends of Democratic Pakistan are collectively expected to help out the economy sail through what could be a tumultuous era. It goes without saying that the government's success in managing the economy has, without a doubt, served to build a soothing outcome.

6.2 Equity Capital Markets

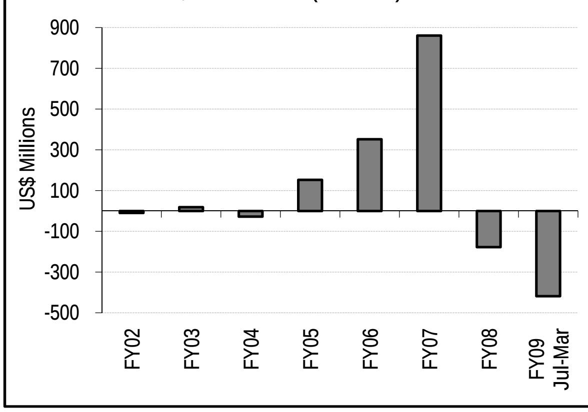
The equity markets in Pakistan are largely insulated from the first round impact of the crisis due to its rising but still low correlation with global financial markets. The stock markets in Pakistan remained largely resilient since the beginning of the millennium and this buoyancy in the local bourse was seen till April of the year 2008, when the all-time high record of 15,676 points for the KSE-100 index was achieved. During this epoch, nonetheless, the index continued to recapture lost ground with each spell of a fresh bull-run. However, the following plunge has been the most stretched bear attack engulfing the domestic equity markets in the history of Pakistan, which led the front-line regulators to take a series of measures to arrest the declining trend.

These market interventions were in no way a substitute of capital controls. The goal with these particular interventions, for example when the US banned short selling or when Vietnam reduced its circuit breaker, is to fetch some order back to the markets when there is a dislocation between fundamental values or natural market forces. The purpose and intent is to keep providing the market with some breathing space and a cooling off period. Notwithstanding; subsequent to lifting of the floor price, the improvement in the premier stock exchange index shows potential.

A surge in international capital flows in the last few years can best be explained by the outstanding performance of equity markets in addition to the macroeconomic stability of the country. This tendency is shown by a prominent increase in foreign equity investment flows during FY07, hitting the highest point of $860.7 million (See Figure-6.1). However, both the domestic quandaries and unsteady global horizon resulted in a turnaround during FY08 and FY09. As a result, the country recorded net Foreign Portfolio Investment (FPI) outflows of $177.7 million in FY08. The stock market observed gigantic FPI outflows due to the removal of the price floor mechanism in the middle of December 2008. The prospects of healthy foreign interest become twice as depressing by looking at the figure of foreign equity investment during the first nine months of the current fiscal year 2008-09. It stands at a negative $418.4 million till March 2009.

With no fresh merger and acquisition activity in the year 2008-09, the international investors remained keen to increase their ownership share. Among them, Malaysia’s Maybank bought another five percent of MCB shares for about $213 million raising its stake in the bank to 20 percent. Singapore’s sovereign wealth fund Tamasek Holdings invested a further $97.5 million in the NIB Bank via a right issue under the plan to raise the paid-up capital of the bank to Rs. 40 billion. The Unicorn Investment Bank, Bahrain, also increased its stake to 37 percent in Dawood Islamic Bank Limited (DIBL) with an investment of $13 million. Furthermore, China Mobile will invest $800 million in Pakistan.

Fig-6.1: Foreign Inflow/Outflow of Equity Investment, FY02-FY09 (Jul-Mar)



Recently, Emirates Investment Group (EIG) announced that the Sharjah-based private-sector investment company is in the process of acquiring farmland in Pakistan to export more food to the Gulf region and is seeking international partners. In addition, the Credit Suisse Group, Switzerland’s leading bank, has announced the launching of equity research and research sales business to facilitate institutional clients in Pakistan. Such a mammoth foreign interest in the local financial sector at the time when the global economies are enduring a setback and confidence on financial institutions is at its ebb proves the resilience of the country's banking industry to external shocks.

In an unfavorable move, MCB Bank and Habib Bank Limited have been permitted by SBP to commence the due diligence of RBS Pakistan. RBS Pakistan had announced in February 2009 that it was exploring new ownership for Pakistan. Moreover, the government plans to privatize some public sector industrial units. Privatization of the Qadirpur gas field has been put off for the time being. Acquisition of 93.88 percent strategic shareholdings in SME Bank Limited along with the transfer of management control is in the pipeline. At least six national and international companies have expressed their interest in setting up a joint venture with the Sindh government for mining in Thar coal field block II.

6.2.1 Global Stock Markets

"It was the best of times, it was the worst of times; it was the age of wisdom, it was the age of foolishness; it was the epoch of belief..." This adage from Charles Dickens' A Tale of Two Cities could not be more relevant to many of the stock markets around the world today. The reviewed phase can preeminently be expressed as an era of battered outlook and an interlude of sturdy adjustment.

During the fiscal year 2008-09, the leading stock markets of the world observed negative growth ranging from 50.7 percent (Pakistan) to 2.9 percent (China). Principal stock indices including US S&P 500, UK FTSE 100 and Hong Kong Hang Seng also recorded declines of 31 percent, 41 percent and 23.6 percent respectively during FY09 (See Table 6.1).

For Pakistan, a huge number of domestic and external quandaries tested economic buoyancy. Internal and external security concerns received focal importance. The benchmark Karachi Stock Exchange witnessed a sharp hitch in the rising disposition of its leading KSE-100 index. The index underwent a gigantic loss of 41.6 percent, to close at 7,177.6 points on May 15, 2009, during the current fiscal year. In terms of dollar returns, the plunge is all the more magnified by recording a downpour of 50.7 percent.

Table 6.1: Global Stock Indices during June 30, 2008 to May 15, 2009

Sr. No.	Country	Stock Name	Index (Local Currency)		Currency			Market Return	
			30-Jun-08	15-May-09	Exchange Rate	30-Jun-08	15-May-09	Local Currency	USD
1	Pakistan	KSE 100	12,289.03	7,177.64	PKR/USD	68.36	80.91	-41.59%	-50.65%
2	India	Sensex 30	13,461.60	12,173.42	INR/USD	42.94	49.40	-9.57%	-21.38%
3	Indonesia	Jakarta Composite	2,349.10	1,750.91	IDR/USD	9260.00	10403.50	-25.46%	-33.66%
4	Taiwan	Taiwan Weighted	7,523.54	6,489.09	TWD/USD	30.35	32.92	-13.75%	-20.48%
5	South Korea	Seoul Composite	1,674.92	1,391.73	KRW/USD	0.26	0.29	-16.91%	-23.85%
6	Hong Kong	Hang Seng	22,102.01	16,790.70	HKD/USD	7.80	7.75	-24.03%	-23.58%
7	Malaysia	KLSE Composite	1,186.57	1,014.21	MYR/USD	3.27	3.55	-14.53%	-21.31%
8	Japan	Nikkei 224	13,481.38	9,265.02	JPY/USD	106.18	94.88	-31.28%	-23.09%
9	Singapore	STRAIT TIMES	2,947.54	2,139.78	SGD/USD	1.36	1.47	-27.40%	-32.72%
10	Sri Lanka	All Shares	2,457.84	1,907.67	LKR/USD	107.70	117.80	-22.38%	-29.04%
11	China	Shanghai Composite	2,736.10	2,645.26	CNY/USD	6.85	6.82	-3.32%	-2.87%
12	Philippines	PSE Composite	2,459.98	2,308.70	PHP/USD	44.87	47.60	-6.15%	-11.52%
13	Australia	All Ordinaries	5,332.90	3,758.90	AUD/USD	1.05	1.33	-29.51%	-44.54%
14	US	S & P 500	1,280.00	882.88	USD/USD	1.00	1.00	-31.03%	-31.03%
15	UK	FTSE 100	5,625.90	4,348.10	GBP/USD	0.50	0.66	-22.71%	-40.91%
16	New Zealand	NZSE 50	3,194.61	2,790.90	NZD/USD	1.31	1.70	-12.64%	-32.53%

Source: Invisor Securities

6.2.2 Karachi Stock Exchange (KSE)

The past few years have been outstanding in many ways for the emerging stock market of Pakistan. KSE-100 index has been showing consistent progress since 2002 as it registered a healthy annual growth of almost 136 percent over 2002-

2007. This is due to the liberalized policies and various reforms initiated by the government to strengthen the financial markets in Pakistan. Finally, the index broke all the previous records when it reached its peak at 15,676 points on April 18, 2008, but this buoyancy could not be maintained. As a result, the index underwent a negative growth of 11 percent in the previous fiscal year 2007-08 after six consecutive years of positive performance.

The KSE-100 index retained this descending inclination and was extremely volatile to say the least during the outgoing fiscal year 2008-09. During the year under review, the stock market shrank by 41.6 percent. KSE-100 index closed at 7,178 points on May 15, 2009 compared to 12,289 points on June 30, 2008. The aggregate market capitalization of listed companies on the Exchange was decreased by 43.4 percent during the year to stand at Rs. 2,137.3 billion on May 15, 2009 compared to Rs. 3,777.7 billion at the end of FY08 (See Figure 6.2). The magnitude of the fall in the market capital in terms of USD is comparatively greater, up to 52 percent, during the same period amid increasing rupee-dollar parity. While issues related to the macroeconomic scenario and a shaky political environment fuelled anxiety among the investor community and contributed to the fall in value, a dearth of adequate corporate governance measures aggravated the situation. Supplementing the extensive weakness was the diminishing foreign interest in the equity markets of Pakistan.

The KSE management and Securities and Exchange Commission of Pakistan (SECP) together took a number of regulatory actions to mitigate the potential technical risks confronting the equity markets:

1) In late June 2008, SECP adjusted the upper and lower circuit breakers of the trading band, to 10 percent and 1 percent, respectively, from the previous 5 percent on both sides and banned short sale in the futures market. This rule was unable to improve market sentiments as it reduced the width of exit way to 1/5 of what it was earlier. Shortly afterwards, these interim changes were reverted to the previous level in the early part of July 2008.

2) Special market sessions held on July 17, 2008 and August 02, 2008 in order to provide exit to leveraged buyers were a great success.

3) The KSE management set a floor of 9,144 points for the KSE-100 index on August 27, 2008, following heavy losses in previous days. On a positive note, this price-freeze impeded any fallout in consequence of gloomy developments on the domestic panorama over and above the precarious global horizon. Even so, this regulatory move had its own negative aftermath witnessed by record thin trading volumes during the static phase.

4) The KSE management prohibited blank-selling in Deliverable Futures Contract for October 2008 and short-selling in Ready Market for a one month period with effect from October 24, 2008.

5) Redemption was closed on open-end mutual funds.

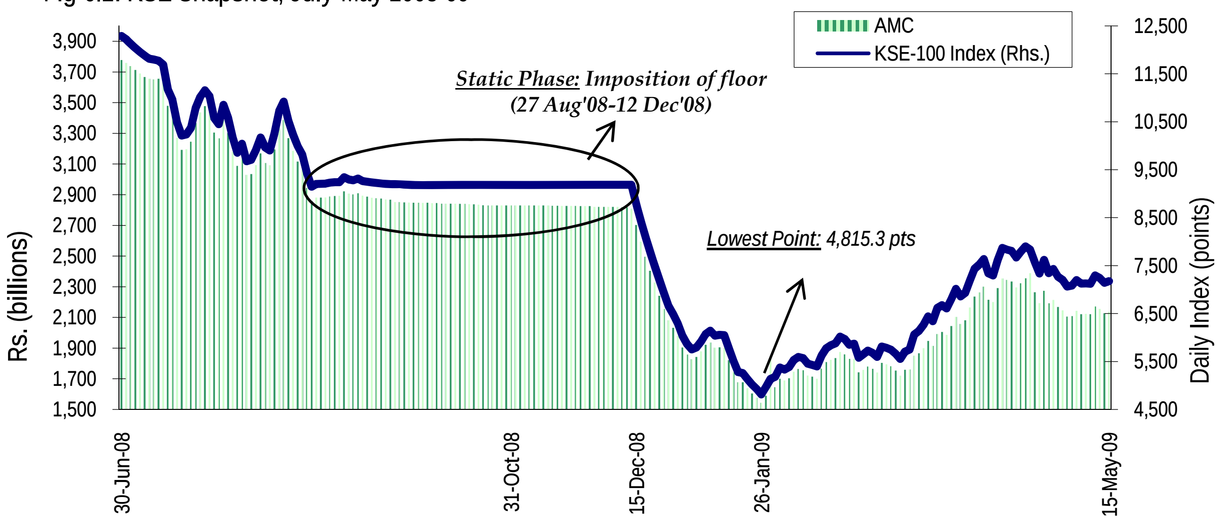
6) The unreleased Continuous Funding System (CFS) deals were reinstated as of October 09, 2008 and the working days of unreleased period were extended to a total of 44 days.

7) The Government of Pakistan announced a Rs. 20 billion open-end fund for selected scrips and a Rs. 30 billion guarantee for foreign investors choosing to avail put options.

8) The State Bank of Pakistan (SBP), in order to ensure smooth financing against shares, permitted the banks to invest up to 30 percent of their equity in shares.

9) On December 23, 2008, National Clearing Company of Pakistan Limited (NCCPL) suspended 32 of its clearing members as they failed to fulfill their monetary obligations. These stabilization measures were considered indispensable in the wake of the continued downtrend.

Fig-6.2: KSE Snapshot, July-May 2008-09



The floor imposition on KSE-100 index for about four months (August 27, 2008-December 12, 2008) resulted in a virtual halt of the stock market. The 'off market transactions' appeared to be the only yardstick of investors' sentiments in the event of a suspended regular market. Buyers remained hesitant to buy securities at the floored price, while the same stocks were available at 20-30 percent discount in the off-record market. Cautious investors took this route to dispose-off their holdings. It is interesting to note that the foreign investors also found it a feasible alternative. For this obvious reason, the average daily volumes in this market were a lot higher than cash counters and discount rates rose to as high as a record 40-50 percent. The rule also deteriorated the 'investabililty' condition of Pakistan's equity market. But at the same time, this market freeze allowed investors to avoid defaulting, which otherwise would have led to the closure of the market, an option deemed much more destabilizing than the price freeze.

Table 6.2: Leading Stock Market Indicators on KSE

Months	2007-08			2008-09(July-April)		
	KSE Index (end month)	Market Capitalization (Rs. billion) (end month)	Turnover of Shares (billion)	KSE Index (end month)	Market Capitalization (Rs. billion) (end month)	Turnover of Shares (billion)
July	13,738.9	4,028.1	7.7	10,583.6	3,301.9	2.0
August	12,214.3	3,555.2	4.5	9,208.3	2,881.6	2.1
September	13,351.8	4,050.0	4.2	9,179.7	2,847.3	0.5
October	14,319.4	4,364.3	6.6	9,182.9	2,829.6	0.3
November	13,998.5	4,328.9	5.2	9,187.1	2,820.4	0.1
December	14,075.8	4,329.9	4.7	5,865.0	1,858.7	0.9
January	14,017.0	4,297.5	5.6	5,377.4	1,700.7	3.3
February	14,934.3	4,618.9	5.1	5,727.5	1,779.5	3.2
March	15,125.3	4,622.9	5.0	6,860.2	2,057.1	3.8
April	15,122.5	4,634.8	6.4	7,202.1	2,146.0	
May	12,130.5	3,746.2	4.9			
June	12,289.0	3,777.7	3.4			

Source: KSE

The announcement of the discount rate for H1FY09 to remain at 13 percent by the SBP without any increase in CRR and SLR was lower than expected and hence revived investors' confidence. The first half of 2008-09 was characterized by the downgrades witnessed in the country's credit rating to CCC+ from B and then to CCC from CCC+ by Standard & Poor's (S&P's) and from B2 to B3 by Moody's. Besides the downgrades, S&P's and Moody's also issued a negative outlook for Pakistan bonds and currency. Later, Moody's rated a negative outlook on Pakistani banks.

The stock market made some new records including the virtual halt of the market on October 10, 2008, as this session remained flat at the pre-opening index level. Nevertheless, reduction in CRR by two percent in two phases alleviated the liquidity stress in the market and helped in slightly recovering the rupee against dollar. SBP announced a 200bps hike in the discount rate to 15 per cent on November 12, 2008. Interestingly, the stock market remained flat at 9,187.1 points for 12 consecutive trading sessions. In November 2008, Pakistan entered into a $7.6 billion, 23 month stabilization program to address the worsening balance of payment deficit situation. With the release of IMF's first tranche of $3 billion, the pressing apprehensions of sovereign default subsided as total foreign exchange reserves shored up beyond $10 billion.

The long awaited, National Investment Trust (NIT) managed, Rs. 20 billion 'State Enterprise Fund' (SEF), consisting of NIT, EOBI, NBP and SLIC, in December 2008. This state-run fund has remained active to support the index ever since its launch. Institutional and retail investors' interest increased after SBP amended Prudential Regulations regarding Forced Sale Value adjustment against banks and DFIs non-performing loans. Positive conclusions of the IMF over Pakistan's economic performance boosted the confidence of local participants. Furthermore, this affirmation can reintroduce the local economy to international investors' attentions.

Buying euphoria was witnessed supported by agreement of SECP and SBP on amortization of deficit on revaluation of equity investment of over 2 years. On the other hand, growing security concerns in the country in conjunction with liquidity costs remained the main hurdles for investment in the stock market. Intense selling activities were spurred by uncertainty over impairment issue under International Accounting Standards (IAS) 39 and 40, which was later resolved by relaxing the treatment for impairment of capital losses and its direct change to equity instead of profit and loss account. Honoring the payments of Eurobond maturity and improvement on economic indicators sparked a fresh wave of confidence. The restoration of the judiciary, the current account surplus for February, and the release of a second tranche of loan worth $840 million by the IMF were some of the positive news items that lent a helping hand to the falling index.

The recently announced favorable petroleum policy kept the market in a bullish mood. Downward revision in the rate of return on NSS allowed a substantial increase in the index. Phasing out of CFS MK-II without any replacement product and increase in T-bills rates marginalized positive sentiments at the bourse. The Swiss Credit Group's positive report further added fuel to the bullish rally in the market. The pledge of $5.28 billion by international donors in the Friends of Democratic Pakistan and donors conference was celebrated and the index registered an air pocket opening.

Moreover, in a surprise positive move, SBP relaxed the minimum capital requirement (MCR) for the banking sector to Rs. 10 billion by 2013 compared to Rs. 23 billion earlier. This step was needed particularly for smaller banks, which were facing difficulties in meeting the previous MCR and were seeking mergers with similar sized banks. In addition, S&P improved Pakistan's sovereign rating to CCC+ from CCC. The absence of a leverage window never allowed the market to cherish the decline of 100bps in the discount rate announced on April 20, 2009. The law and order situation in the country overshadowed the upbeat momentum of the market and the index reached the red zone. The growing militancy in Pakistan and end of result announcement session dragged the Karachi stock market into the bearish zone. The

Karachi stock market did recover from its previous lows as SECP allowed closed-end schemes to repurchase listed shares. The leading bourse closed on a positive note with the support it got from Pakistan's entry into Morgan Stanley Capital International (MSCI) Frontier Index at the semi-annual review and the inclusion of twelve companies in MSCI.

Table 6.3: Profile of Karachi Stock Exchange

	2004-05	2005-06	2006-07	2007-08	2008-09 (Jul-Mar)
Number of Listed Companies	659	658	658	652	652
New Companies Listed	15	14	16	7	8
Fund Mobilized (Rs billion)	54	41.4	49.7	62.9	42.3
Listed Capital (Rs billion)	438.5	496	631.1	706.4	770.7
Turnover of Shares (billion)	88.3	79.5	54	63.3	17.1
Average Daily Turnover of Shares (million)	351.9	348.5	262.5	238.2	80.2
Aggregate Market Capitalization (Rs billion)	2068.2	2801.2	4019.4	3777.7	2057.1

Source: KSE

In the future stability is expected to return to the stock market. With strong fundamentals emanating out of the enhanced economic scene, improvement in domestic politics and further softening in the monetary policy stance remain the key triggers.

6.2.2.1 Sector-wise Performance

Dismal performance caused by a confluence of factors and the dull indicators left a weighty impact on the stock market activity. In December 2008, a total of 652 companies were listed on the KSE, including 209 companies in cotton and other textiles, 166 in banks and financial institutions and 85 in miscellaneous groups. As per the annual report of the KSE 2008, a total of 19 companies were de-listed and 24 companies were merged in the period of 2006-08. In the calendar year 2008, the number of dividend paying companies was 224 compared to 267 companies in 2007. In 2008, 322 companies were making profits and 218 companies were shown as loss making. The numbers were 363 and 194 respectively in 2007 (See Table 6.4).

All trading groups except Fuel & Energy and Sugar & Allied showed a downward trend during the period under review. The total before taxation profit of the 12 trading groups, listed with the KSE, amounted to Rs. 382.7 billion in 2007, which decreased to Rs. 316.9 billion in 2008, showing a decline of 17 percent. In the year 2008, the 12 trading groups were shown as making profit ranging from Rs. 0.3 billion (Paper & Board) to Rs. 182.3 billion (Fuel & Energy). Banks and other Financial Institutions with a pre-taxation profit of Rs. 106 billion were the second largest profit-earning group in 2008 as compared to Rs. 157 billion earned in 2007.

A review of major trading groups during 2008 is outlined below.

Banks & Other Financial Institutions: During the year 2008, high public sector borrowings, mainly in the context of circular debt issue coupled with improved working capital requirements for corporates due to increased cost of doing business, kept advances on the higher side. Conversely, deposits experienced a deceleration, attributable to PKR weakening and stretched liquidity. The latter factor initiated rumors of bank defaults leading to capital flight and resulting erosion of the deposit base. Provisioning was up considerably and withdrawal of the Forced Sales Value benefit was a chief contributor to this raise. Equally responsible was a rising discount rate which resulted in cash flow problems for the corporate sector and therefore meant a hitch in terms of honoring debt servicing commitments.

Fuel & Energy: The E&P sector enjoyed solid fundamentals backed by prospects of steady demand, handsome production growth and protection from currency depreciation due to dollar denominated revenues. The petroleum policy of 2008 boded well for the Fuel & Energy sector, particularly higher gas prices. Aggressive drilling activity is expected to continue in 2009. The refinery sector presented a dim outlook based on weakening fundamentals amid government interventions that resulted in a reduction in margins. Power companies are amongst the highest dividend paying KSE-100 companies. However a big inhibitor to this practice, looking forward, is the ongoing circular debt issue resulting in lower than expected dividend yields from major Independent Power Producers (IPPs).

Transport & Communication: The years of swift telecom sector development seems to be a tale of the past now. Industry subscriber growth had declined for FY08 and it is expected to drop even more for FY09. Cellular subscriber addition is clearly staggering. Intense competition from the cellular segment has eroded fixed line market share over the years and subscriber attrition still continues. With VSS out of the way, an earnings turnaround is imminent.

Chemicals & Pharmaceuticals: Among chemicals, Polyester Staple Fiber (PSF) had undergone distressed times during the last few years with low margins and capacity under-utilization. With commodity prices relaxing, however, margins are anticipated to pick up. Paint is another segment badly impacted by economic tumult as growth shrivels in the construction and auto industries. With government focus on agriculture and budget FY09 unveiling various incentives, the fertilizer sector scrips, with sturdy earnings growth and high dividend yield remained a secure haven for investors. Going forward, the fertilizer sector remains in growth mode and is fairly protected against the economic chaos.

Table 6.4: Companies Listed on KSE and their Before Tax Profits

S. No.	Sector	No. of Companies		Profit Before Taxation (Rs billion)		Dividend Paying Companies		Profit Making Companies		Loss Making Companies	
		2007	2008	2007	2008	2007	2008	2007	2008	2007	2008
1	Cotton & other Textiles	210	209	8.2	6.9	51	36	90	68	81	95
2	Chemical & Pharmas	35	36	38.7	34.2	24	20	28	30	5	6
3	Engineering	13	14	2.3	2.2	9	6	9	8	1	1
4	Auto & Allied	25	24	13.7	9.1	10	11	17	18	4	4
5	Cables & Electric Goods	9	9	4.6	3.3	4	4	6	6	1	1
6	Sugar & Allied	37	37	-0.5	0.5	8	11	11	21	25	13
7	Paper & Board	10	10	5.4	0.3	6	4	8	6	1	3
8	Cement	22	21	4.6	-4.3	6	2	12	6	9	15
9	Fuel & Energy	27	27	116	182.3	16	17	16	18	10	8
10	Transport & Comm.	14	14	13.2	-44.2	5	4	7	6	5	5
11	Bank & Fin. Institutions	169	166	156.9	106.1	91	76	114	89	29	48
12	Miscellaneous	87	85	19.6	20.5	37	33	45	46	23	19
	Total	**658**	**652**	**382.7**	**316.9**	**267**	**224**	**363**	**322**	**194**	**218**

Source: KSE

Auto & Allied: Auto assemblers showed a lackluster performance during the year 2008, as the net profit of the auto sector declined from Rs. 13.7 billion in 2007 to Rs. 9.1 billion in 2008, reflecting a phenomenal decline of 34 percent. Declining volumetric sales in the wake of rising prices along with a standstill in auto financing facilities was the core reason behind this hasty tumble.

6.2.3 Performance of Selected Blue Chips

During the first three quarters of the fiscal year 2008-09, the combined paid-up capital of ten big companies (Oil & Gas Development Company Limited, Fauji Fertilizer Ltd, Hub Power Company Ltd, Habib Bank Ltd, Pakistan Petroleum Ltd, MCB Bank Ltd, Jahangir Siddique & Company Ltd, National Bank of Pakistan, Pakistan Telecommunication Company Ltd and United Bank Ltd) was Rs. 153.2 billion, which constituted about 20 percent of the total listed capital at KSE.

These ten companies earned a profit after taxation of Rs. 142 billion in the fiscal year up to March 2009. Out of the total profit after tax, the share of OGDCL and PPL was Rs. 69.32 billion representing 48.8 percent of the ten big companies. For the period ending March 31, 2009, JS's after-tax profit was Rs. 17.2 billion. Earnings per share of the top rated companies ranged from a negative 0.55 in the case of PTCL to 77.48 in respect of JS. This indicates that the business environment in the fiscal year 2008-09 has improved appreciably for the blue chip companies (See Table 6.5).

Table 6.5: Price Earning Ratio, July 2008 – March 2009

Company	Paid-up Capital (Rs. billion)	Profit after Tax (Rs. billion)	EPS (Rs)
Oil & Gas Development Co. Ltd	43.01	49.61	11.54
Fauji Fertilizer Ltd.	4.93	6.53	13.22
The Hub Power Co. Ltd	11.57	2.6	2.25
Habib Bank Ltd	7.59	10	13.18
Pakistan Petroleum Ltd	7.54	19.71	26.12
MCB Bank Ltd.	6.28	15.37	24.47
Jahangir Siddique & Co. Ltd	2.22	17.2	77.48
National Bank of Pakistan Ltd	8.97	15.46	17.23
Pakistan Telecommunication Co. Ltd	51	-2.82	-0.55
United Bank Limited	10.11	8.33	8.24
Total/Average	**153.22**	**141.99**	**19.32**

Source: KSE

6.2.4 Lahore Stock Exchange (LSE)

The top indicators observed varied movements at the LSE. The turnover of shares on the exchange during July-March 2008-09 was 1.5 billion. Total paid up capital with the LSE increased from Rs. 664.5 billion in June 2008 to Rs. 721.1 billion in March 2009. The LSE-25 index, which was 3,868.8 points in June 2008, decreased to 2,085.2 points in March 2009. The market capitalization of the LSE has reduced from Rs. 3,514.2 billion in June 2008 to Rs. 1,953.1 billion in March 2009. Two new companies and two open-ended funds were listed with the LSE during July-March 2008-09, as compared to two companies in the fiscal year 2007-08 (See Table 6.6).

Table-6.6: Profile of Lahore Stock Exchange

	2004-05	2005-06	2006-07	2007-08	2008-09 (Jul-Mar)
Number of Listed Companies	524	518	520	514	512
New Companies Listed	5	7	10	2	2
Fund Mobilized (Rs billion)	42.1	24.5	38.8	29.7	30.7
Listed Capital (Rs billion)	403	469.5	594.6	664.5	721.1
Turnover of Shares (billion)	17.5	15	8.2	6.5	1.5
LSE Index	3762.3	4379.3	4849.9	3868.8	2085.2
Aggregate Market Capitalization (Rs billion)	1995.3	2693.3	3859.8	3514.2	1953.1

Source: LSE

6.2.5 Islamabad Stock Exchange (ISE)

The ISE also underwent non-uniform trading patterns during the first nine months of 2008-09. The ISE-10 index began the fiscal year at 2,742.2 points and ended the third quarter at 1,583 points portraying a massive contraction of 42.3 percent.

The lowest level of index was recorded at 1,015.1 points as on January 26, 2009 in line with the benchmark KSE-100 index. The total turnover during this period was 0.2 billion shares (See Table 6.7).

The total funds mobilized during July-March 2008-09 in the three stock exchanges (KSE, LSE & ISE) amounted to Rs. 97.8 billion, as compared to Rs. 117.2 billion in the last fiscal year. The total turnover of shares in the three stock exchanges during the same period was 18.8 billion, compared to 70.4 billion shares in the previous fiscal year.

Table 6.7: Profile of Islamabad Stock Exchange

	2004-05	2005-06	2006-07	2007-08	2008-09 (Jul-Mar)
Number of Listed Companies	236	240	246	248	240
New Companies Listed	6	6	12	7	4
Fund Mobilized (Rs. billion)	27.6	5.2	30.7	24.6	24.8
Listed Capital (Rs. billion)	337	374.5	488.6	551	590.5
Turnover of Shares (billion)	0.7	0.4	0.2	0.6	0.2
ISE Index	2432.6	2633.9	2716	2749.6	1582.9
Aggregate Market Capitalization (Rs billion)	1558.4	2101.6	3060.6	2872.4	1589.3

Source: ISE

6.2.6 KSE Meezan Index (KMI-30)

On the 1st of Ramazan (September 02, 2008), KSE launched KMI-30 in collaboration with the Al-Meezan group. KMI-30 is the first Islamic index other than Dow Jones Islamic Index to provide investors with a suitable benchmark for comparing returns on their Shariah compliant equity investments. KSE Meezan Index comprises of 30 companies that qualify the KSE Meezan Index Shariah screening criteria and are weighted by float adjusted market capitalization subject to a 12 percent cap on weights of individual securities.

The KMI-30, since its inception, has efficiently absorbed the positive and negative counts on all fronts and has registered a reduction of 1,141.4 points or 10 percent and closed at 10,227.1 points as of May 15, 2009 compared to 11,368.5 points on September 02, 2008. The introduction of an Islamic index will surely augment the investor base essential for the growth of Pakistan's capital markets.

6.3 Debt Capital Markets

The debt capital markets in Pakistan cover debt securities issued by the government, statutory corporations and corporate entities in addition to the national savings instruments. The market is at an early stage of development and the size is definitely not very large, but its prospects appear promising. Pakistan needs a viable bond market in order to mobilize private savings efficiently for long-term investments. Moreover, the government and the financial community have recently taken important steps to foster capital market development. While this support is important, even crucial, there are a number of areas requiring greater attention in order for a robust bond market to develop.

6.3.1 Government Securities

A sizable portion of government's financing needs is met by raising funds through *Pakistan Investment Bonds (PIBs)*. Borrowing through PIBs facilitates the government in branching out its debt portfolio in addition to lengthening its maturity. After a long gap, PIB issuance was recommenced in FY06. During FY07 and FY08, the SBP conducted five and seven auctions respectively; raising Rs. 87.9 billion and Rs. 73.6 billion against the aggregate targets of Rs. 100 billion each correspondingly (See Table 6.8). This issuance included short selling and non-competitive bids. Notwithstanding the shortfall, confidence of the market players was sustained in the dedication of the government to build up the local debt market. Additionally, the yield curve was extended to 30 years in FY07.

Table 6.8: Snapshot Analysis of PIBs: FY07, FY08 & FY09 (Jul-Apr)

Tenor	2006-07 *(Rs. billion)*	Percentage Share	2007-08 *(Rs. billion)*	Percentage Share	2008-09 *(Rs. billion)*	Percentage Share
3-Years	10.88	12.38%	5.17	7.03%	7.24	14.81%
5-Years	10.17	11.58%	10.78	14.65%	5.85	11.97%
7-Years	0.00	0.00%	0.00	0.00%	5.53	11.31%
10-Years	30.21	34.38%	23.87	32.44%	22.66	46.36%
15-Years	9.25	10.53%	8.61	11.70%	1.30	2.66%
20-Years	11.25	12.80%	9.05	12.30%	1.70	3.48%
30-Years	16.10	18.32%	16.10	21.88%	4.60	9.41%
Total	**87.86**	**100%**	**73.58**	**100%**	**48.88**	**100%**

Source: SBP

A few traits were added to the PIB market in the beginning of FY09. These included expansion of the PIB portfolio with the insertion of a 7-years paper and revision of coupon rates taking into consideration rises in discount rate (See Table 6.9). In addition to these measures, an auction calendar for FY09 was prepared and later reworked by the SBP for H2FY09.

Table-6.9: PIB Coupon Rates for FY 2008-09

Tenor	Revised Coupons	Previous Coupons
3-Years	11.25%	9.10%
5-Years	11.50%	9.30%
7-Years	11.75%	N/A
10-Years	12.00%	9.60%
15-Years	12.50%	10.00%
20-Years	13.00%	10.50%
30-Years	13.75%	11.00%

Source: SBP

In FY09 (July 2008-April 2009), a handsome amount of Rs. 44.5 billion (excluding short selling and non-competitive bids) was mopped up against the target of Rs. 60 billion (See Table 6.10). However, the two halves of the fiscal year depicted contrasting performance. During the first half of the ongoing fiscal year, only one auction in the month of August 2008 was carried out in which the market showed little interest and offered only Rs. 6.2 billion, the prime cause being perception of further hike in discount rate. The highest amount was received in 30-years maturity which was wholly accepted by SBP. Interestingly, no bid was received for 20-years paper. Out of the total, SBP accepted just Rs. 3.2 billion. For the remaining period, the market was dry and bleak. The government retired the scheduled maturity of Rs. 16.2 billion in October 2008.

Table 6.11: Maturity Profile of PIBs 2008-09
(Rs. billions)

	3-Years	5-Years	Total
July			
August			
September			
Quarter 1 Total			
October		16.16	16.16
November			
December			
Quarter 2 Total		16.16	16.16
January			
February			
March			
Quarter 3 Total			
April		11.6	11.6
May	14.09		14.09
June			
Quarter 4 Total	14.09	11.6	25.69
Grand Total	**14.09**	**27.76**	**41.85**

Source: SBP

On the other hand, reinvigoration remained the underlying theme of the government securities market during H2FY09. It was possible only after the announcement of a 15 percent policy rate in

November 2008 on top of the SBP moves to arrest the cash starved market in October 2008. So far, two auctions have been held, one in February 2009 and the other in April 2009. Both auctions were successful and overwhelming participation was witnessed due to a probable cut in the interest rates in April 2009. On February 18, 2009, the primary dealers offered Rs. 55.99 billion, 180 percent more than pre-auction targets of Rs. 20 billion. However, out of the received bids the central bank accepted Rs. 20.005 billion, resulting in a surplus of Rs. 5 million. In the April 2009 auction, the SBP received Rs. 49.325 billion worth of bids, nearly 250 percent of the target amount. Rs. 21.325 billion were finally accepted. Such forceful participation gives a glimpse of the appetite for investments in PIBs in the near future. The last auction of the fiscal year 2008-09 is scheduled to be held in the last week of May 2009. The upcoming maturity of PIBs in FY09 is in the month of May 2009 worth Rs. 25.7 billion (See Table 6.11).

Table 6.10: PIB Auction Results, Jul-Apr 2008-09

Date	Tenor (1)	*(Rs. billion)*				*(percent)*	
		Target (2)	**Offered Amount (3)**	**Accepted Amount (4)**	**Variance (4-2)**	**Cut-off Yields**	**W. Avg. Yields**
29 Aug '08	3-Years	2.50	0.375	0.125	-2.375	13.6973	13.6973
	5-Years	2.50	0.45	0.00	-2.50	-	0.0000
	7-Years	2.50	0.325	0.125	-2.375	14.3398	14.3278
	10-Years	5.00	2.49	0.38	-4.62	14.5493	14.4724
	15-Years	2.50	0.05	0.05	-2.45	14.7500	14.7500
	20-Years	2.50	0.00	0.00	-2.50	-	0.0000
	30-Years	2.50	2.50	2.50	0.00	14.9384	14.6078
Total		20.00	6.19	3.18	-16.82		
18 Feb '09	3-Years	2.50	11.175	2.95	0.45	13.9530	13.8806
	5-Years	2.50	8.65	2.60	0.10	14.3692	14.3350
	7-Years	2.50	3.925	2.65	0.15	14.7973	14.7030
	10-Years	5.00	21.76	7.125	2.125	14.9444	14.8642
	15-Years	2.50	2.48	1.18	-1.32	15.4995	15.3557
	20-Years	2.50	3.50	1.50	-1.00	15.8998	15.7002
	30-Years	2.50	4.50	2.00	-0.50	16.4496	16.2248
Total		20.00	55.99	20.005	0.005		
15 Apr '09	3-Years	2.50	5.746	2.696	0.196	12.9385	12.7670
	5-Years	2.50	6.579	2.604	0.104	12.9495	12.8620
	7-Years	2.50	4.975	2.425	-0.075	13.1395	13.0505
	10-Years	5.00	27.425	13.25	8.25	13.2409	13.0672
	15-Years	2.50	1.80	0.05	-2.45	13.8007	13.8007
	20-Years	2.50	1.30	0.20	-2.30	14.2492	14.2492
	30-Years	2.50	1.50	0.10	-2.40	14.4995	14.4995
Total		20.00	49.325	21.325	1.325		
Grand Total		**60.00**	**111.51**	**44.51**	**-15.49**		

Source: SBP

A snapshot of the interest rate structure depicted an upsurge in the yields on all tenors in the range of 69bps to 141bps for the first half. Highest increase was in 3-years tenor and lowest was recorded in 30-years PIB. However in the second half of the current fiscal year, most of the tenors witnessed reduction in the cut-off yields varying from 44bps to 131bps whereas the rates on 5 & 20-years PIB, bids of which were either rejected or not received in the preceding period, were mounted by 215bps and 31bps accordingly (See Table 6.12).

The overall scenario portrayed a healthy picture with the highest rise of 215bps for the 5-years tenor, followed by a reasonable 65bps in the 3-years PIB with an addition of just 19-31bps for the longer maturities of 15, 20 & 30-years. Contrary to this, the cut-off yield on newly issued 7-years paper declined by 120bps. The 10-years paper registered a cut of 18bps for the period of July 2008-April 2009.

Table 6.12: Interest Rate Structure, FY 2008-09

Tenors	1st Jul'08 (%)	31st Dec'08 (%)	Variance (H1FY09) bps	31st Apr'09 (%)	Variance (H2FY09) bps	Variance (Apr-Jul) bps
3-Years	12.29	13.70	141	12.94	-76	65
5-Years	10.80	10.80	0	12.95	215	215
7-Years	N/A	14.34	N/A	13.14	-120	-120
10-Years	13.42	14.55	113	13.24	-131	-18
15-Years	13.61	14.75	114	13.80	-95	19
20-Years	13.94	13.94	0	14.25	31	31
30-Years	14.25	14.94	69	14.50	-44	25

The practice of re-opening previous issues supported the increase in the average size of the issuances whilst enhancing liquidity in the secondary market. This vigorous interest in the PIB market, if maintained from both demand and supply sides, will help in kicking out distortions in the benchmark yield curve and at the same time will definitely permit SBP to minimize the stock of MRTBs to relieve the strain on the reserve money growth.

The Government of Pakistan issued its first *3-Year Ijara Sukuk Bond* in the month of September 2008 in order to diversify the investor base and to tap the potential underlying the Islamic financial industry. The purpose of issuance was to raise money from Islamic banking which has grown substantially in Pakistan in recent years. Moreover, issuance of Sukuk has emerged out as an acceptable addition to limited investment avenues for Islamic banks to meet their SLR eligibility. So far, three auctions, one in each quarter, have been conducted by the SBP. Collectively, Rs. 27.85 billion was mopped up against the total target of Rs. 30 billion. On aggregate, Rs. 38.3 billion was offered which is evidence of the profound interest exhibited by the market. The semi-annual profit is benchmarked against the latest weighted average yield of the 6-months Market Treasury Bills (MTBs) and the cut-off margin as on September 15, 2008 was 45bps. However, there was a 30bps rise in the margin for the December 20, 2008 issue. The cut-off margin on March 04, 2009 was zero (See Table 6.13).

Table 6.13: 3-Year Ijara Sukuk Auctions Result For FY09 ***(Rs. billions)***

Date	Target	Offered Amount	Accepted Amount	Cut-off Margin	Variance of Acceptance against Target
15 Sep'08	10	9.52	6.52	45bps	-3.48
20 Dec'08	10	7.35	6	75bps	-4
04 Mar '09	10	21.43	15.33	0bps	5.33
Total	30	38.30	27.85		-2.15

Source: SBP

6.3.2. National Savings Scheme (NSS)

The NSS is run by the Central Directorate of National Savings (CDNS), an attached department of the Finance Division, which is responsible for the sale of NSS products to the general public through a network of 367 branches across the country. The instruments that fall under the general umbrella of the NSS are long-term government papers, which benefit from both high yields and an implicit put option, whereby the investor is able to resell before maturity albeit with penalties. As of March 31, 2009, the total outstanding balance of

NSS instruments was Rs. 1324 billion, equivalent to 35 percent of total domestic debt. The government's decision to re-allow institutional investors to invest in these instruments, from which they had been barred in the year 2000, was a major reason behind this increasing share of unfunded schemes in the debt stock.

Table 6.14: Net Accruals by National Savings Schemes *(Rs. billions)*

	2003-04	2004-05	2005-06	2006-07	2007-08	July-March	
						2007-08	2008-09
Defence Savings Certificates	3.2	-8.7	-7.6	-5.8	-4.3	0.4	-15.7
Special Savings Certificates (R)	-13.2	-83.3	-57.7	7.0	13.8	12.1	78.5
Savings Accounts	-0.7	-2.9	0.2	9.2	9.0	-4.2	-10.3
Special Savings Accounts	2.9	-1.9	-0.7	6.5	5.5	3.5	13.4
Regular Income Certificates	-49.1	-40.7	-15.6	-17.0	-0.3	-0.9	26.4
Pensioner's Benefit Accounts	13.2	17.7	16.4	11.5	18.7	15.0	16.4
Bahbood Savings Certificates	22.7	60.7	59.6	47.2	38.8	32.8	57.6
National Prize Bonds	22.8	9.4	3.3	9.0	8.3	8.7	7.0
Postal Life Insurance	8.7	10.3	10.8	-	-	-	-
Grand Total	10.5	-39.4	8.7	67.6	89.5	67.4	173.3

Source: CDNS

During the fiscal year 2007-08, net deposits with NSS increased by Rs. 89.5 billion as compared to a net increase of Rs. 67.6 billion in 2006-07 (See Table 6.14). In 2007-08 modest retirements were made in the case of Defence Savings Certificates (Rs. 4.3 billion) and Regular Income Certificates (Rs. 0.3 billion). Net accruals on the other hand increased in respect of Bahbood Savings Certificates (Rs. 38.8 billion), Pensioners' Benefit Accounts (Rs. 18.7 billion), Savings Accounts (Rs. 9 billion) and National Prize Bonds (Rs. 8.3 billion).

Net accruals of Special Savings Certificates increased substantially by Rs. 78.5 billion during July-March 2008-09 as compared to a minute increase of Rs. 12.1 billion in the same period last year. Similarly, Pensioners' Benefit Accounts and Bahbood Savings Certificates attracted Rs. 16 billion and Rs. 57.6 billion respectively on net accrual basis during the same period. These three instruments attracted almost Rs. 152 billion during July-March 2008-09, constituting about 88 percent of the total investment of Rs. 173.3 billion. Surprisingly, Regular Income Certificates underwent a turnaround by accruing a handsome amount of Rs. 26.4 billion compared to a scanty net negative investment of Rs. 0.9 billion.

Keeping in view the trend of rising interest rates, the government has raised the nominal rates of return on most of the savings schemes on a quarterly basis during the outgoing fiscal year. In the case of Special Savings Certificates, the nominal rate of return has been increased from 9.25 percent last year to 13.2 percent this year. The nominal rate on Defence Savings Certificates has been increased from 10.15 percent last year to 12.15 percent this year while nominal returns on Bahbood Savings Certificates and Pensioners' Benefit Accounts are raised from 11.64 percent to 16.1 percent. As a result of these increases, real deposit rates became positive for all schemes except Special Savings Certificates, Savings Accounts and Prize Bonds (See Table 6.15). During 2007-08 and 2008-09, the weighted average of the real deposit rate remained negative indicating that an additional increase in profit rates on all schemes are needed to convert the investment vehicle to a profitable avenue.

Table 6.15: Nominal and Real Deposit Rates on Savings Schemes during 2004-2009								*(percent)*
Scheme	**2005-06**		**2006-07**		**2007-08**		**2008-09**	
	Nominal Rate (p.a.)	**Real Rate**	**Nominal Rate (p.a.)**	**Real Rate**	**Nominal Rate (p.a.)**	**Real Rate**	**Nominal Rate (p.a.)**	**Real Rate**
Defence Savings Certificates	9.46	1.56	10.03	2.23	10.15	-1.75	12.15	-10.85
Special Savings Certificate (R)	8.6	0.7	9.34	1.54	9.25	-2.65	13.2	-9.8
Regular Income Certificates	8.88	0.98	9.24	1.44	9.54	-2.36	13.6	-9.4
Mahana Amdani Accounts	10.41	2.51	10.41	2.61	10.41	-1.49	10.41	-12.59
Savings Accounts	5	-2.9	6	-1.8	6.5	-5.4	9	-14
Pensioners' Benefit Accounts	11.04	3.14	11.52	3.72	11.64	-0.26	16.1	-6.9
Bahbood Savings Certificates	11.04	3.14	11.52	3.72	11.64	-0.26	16.1	-6.9
National Prize Bonds	5	-2.9	6.5	-1.3	6.5	-5.4	10	-13
Weighted Average	8.69	0.79	9.55	1.75	9.71	-2.19	11.89	-11.11

Source: CDNS

Average inflation was 7.9% during 2005-06, 7.8% during 2006-07 and 11.9% during 2007-08, 23.0% during Jul-Mar 2008-09

Source: CDNS

6.3.3 Corporate Bonds

Government securities (T-bills and PIBs) together with the NSS instruments primarily hold a larger portion of the local fixed-income market. The listed corporate bond (or TFC) market represents an infinitesimal fraction of total financial assets. Here too, like the government papers market, banks and other financial institutions dominate most of the issuances to meet their tier 2 capital requirements.

Table 6.16: Floatation of TFCs, July 08-March 09 *(Rs. billions)*		
Name of Company	**Listed at**	**Issue Size**
Mobilink	KSE	5.5
Trust Investment Bank Ltd.	LSE	0.6
Worldcall Telecom Ltd.	LSE	4.0
Total		10.1

Source: SECP

Total outstanding listed Term Finance Certificates (TFCs) as of end-FY08 amounted to Rs. 123 billion. Furthermore, during the period July 2008–March 2009, one company issued TFCs at the KSE and two at the LSE (See Table 6.16). Interestingly, the non-bank market remained the principal issuers this time with no floatation related to the financial sector. Unlike an undersized listed market, privately placed TFCs and Sukuks have witnessed improved activity over time. A total of thirty corporate Sukuks worth Rs. 63 billion were outstanding as of December 2008. Among them, WAPDA Sukuks dominate the market with the largest issue size of Rs. 8 billion (See Table 6.17).

Despite some progress in the primary market, the secondary market for TFCs is still illiquid in the midst of a multitude of factors. These include small size issues, buy-and-hold approach of the investors, deficiency of well functioning secondary markets and the market making system.

6.4 Investor Base

Traditionally, a variety of financial needs of the economy have been met by the Non-Bank Financial Institutions (NBFIs). In this way, NBFIs add to the economic progress along with enabling a more mature financial system. Nevertheless, this sector has been confronted with a tough operating environment in view of the universal banking approach and banks' competitive advantage over the NBFCs in their capacity to generate cost-effective funds. Recent regulations by SECP that emphasize on increasing the minimum capital base and strict requirements for the classification of non-performing loans are anticipated to augment the strength of the NBFC sector.

Table 6.17: Sukuk Issuances, December 2008 *(Rs. billion)*

Name of Company	Issue Size	Name of Company	Issue Size
KSEW	4.20	New Allied Electronic -1	0.60
National Industrial Park	2.00	New Allied Electronic -2	0.75
WAPDA - 1	8.00	Orix Leasing Pakistan	0.53
WAPDA - 2	8.00	Pak American Fertilizers	1.60
Amtex Ltd	0.65	Pak Electron	1.20
Arzoo Textile Mills	0.74	Quetta Textile Mills	1.39
Century Paper & Board Mills	3.50	Security Leasing Corporation	0.75
Dawood Hercules Chemicals	6.50	Shahmurad Sugar Mills	0.50
Eden Builders	2.00	Shahraj Fabrics	0.55
Eden Housing	1.63	Sitara Chemical Industries-1	0.63
Engro Chemical Pakistan	3.00	Sitara Chemical Industries-2	1.10
Haq Bahu Sugar Mills	0.34	Sitara Energy	0.60
HBFC	1.50	SSGC – 1	1.00
JWD Suger Mills	0.50	SSGC – 2	2.00
Kohat Cement	2.50	SSGC – 3	4.70
	Grand Total		**62.95**

Source: SBP

6.4.1 Mutual Funds

The mutual funds industry has become a flourishing segment of the financial sector, with an astounding expansion in both numbers and volumes. As such, it accounted for the largest lump in total financial assets excluding those of the banks. This phenomenal progress, in recent years, is partly due to the liberalization policies of the government. Adding to it is a booming stock market along with strong economic growth and macroeconomic stability. Open-end funds dominate the sector due to investors' preference for ease of exit and the flexibility this option offers while closed-end mutual funds attract long-term investors.

By end-March FY09, there were 99 mutual funds out of which 76 were open-end funds and 23 were closed-end funds. Total assets of mutual funds stood at Rs. 183.6 billion. No new funds have so far been launched during the current financial year primarily due to the extraordinary circumstances prevailing in the market. During the period two new licenses were issued to Mashreq Asset Management Limited and First Capital Investments Limited to undertake Asset Management Services.

6.4.2 Leasing

Leasing companies meet the short to medium term funding requirements of businesses and provide a flexible, tax efficient and economic mode of raising funds. As on March 31, 2009, there were 11 active licensed leasing companies and their major financial indicators are summarized in **Table-6.18**. The leasing industry is striving to grow by mitigating various risk factors that include fierce competition among different segments of the financial sector, increasing funding cost in the wake of rising interest rates and a rising trend of consolidation in the leasing sector. Diversifying the product range is a strategic challenge for leasing companies in order to become competitive in a fast augmenting financial sector. One of the potential markets for leasing companies can be micro and rural leasing.

Table 6.18: Key Financials of NBFCs, March 31 2009 *(Rs. Billions)*

	Leasing	Inv. Banks	Modarabas
Total Assets	60.26	34.80	27.00
Total Liabilities	52.49	28.22	-
Total Equity	7.77	6.58	11.40
Total Deposits	8.50	9.43	-

Source: SECP

6.4.3 Investment Banks

Investment banks perform a number of functions which include providing strategic advisory services on takeover bids and mergers & acquisition, mobilizing long term funds for the implementation of Greenfield projects and equity and bond trading in capital markets. On March 31, 2009, there were 10 active licensed investment banks (See Table 6.18). In recent years, a number of investment banks have merged their operations with banks as it has become hard in sustaining investment finance services on a stand-alone basis in an increasingly competitive business environment.

6.4.4 Modarabas

In order to catalyze the promotion and growth of Modarabas, various policy initiatives have been introduced ever since their commencement. The policy decision to raise the upper limit of the profits required to be taken into statutory reserves, from 30 percent to 50 percent, has served to strengthen the equity base. Modarabas are permitted to generate funds by issuing Certificates of Investment and Musharaka-based Term Finance Certificates that in turn lessen their reliance on debt for financing their asset growth. It is expected that the newly introduced modes of financing would not only develop product diversification but would also assist in drawing other business opportunities. On March 31, 2009, there were 41 registered Modaraba companies managing 27 Modarabas (See **Table 6.18**). During the period, a new Modaraba company was incorporated and it will float a Modaraba shortly.

6.4.5 Real Estate Investment Trusts (REITs)

Introduction of REITs will provide an additional product choice to retail investors and added flexibility to investment managers. Pakistan has witnessed a property boom in the last decade and the launching of REITs as a new investment product will provide retail investors the opportunity to share the dividends from the robust real-estate sector and facilitate professional developers in undertaking mega-construction projects without the traditional liquidity issues that property development companies are confronted with. It will also maximize the efficiency of property utilization by creating equilibrium between demand and supply of property on the one hand and provide more efficiently managed shared use rental properties on the other. For capital market participants, REITs will provide an alternative asset class which will increase the supply of securities with the combined benefits of an ‘equity security’ and ‘real estate’. In March 2009, the SECP granted permissions for incorporation of Arif Habib REIT Management Limited and AKD REIT Management Company Limited which will launch REIT schemes after obtaining the license of REIT Management Services.

6.4.6 Private Equity and Venture Capital Fund (PE&VCF)

Private equity can play a vital role in the economy by supplying capital to the domestic corporate sector, besides patronizing entrepreneurship and fueling the privatization process. Private equity will unlock the hidden value of private companies by providing managerial skills for growth and expansion. It is expected that the conducive regulatory framework combined with the tax incentives provided by the government for PE&VCF will attract large amounts of foreign direct investment in the country.

6.4.7 Voluntary Pension System (VPS)

Seven pension funds (four Islamic and three conventional) have so far been launched under the VPS which attracted a total amount of Rs. 70 million. As on March 31, 2009, the total funds size is about Rs. 8.24 billion.

6.4.8 Occupational Savings Schemes

Subsequent to the workshop and survey of the Occupational Savings Schemes, an amendment was made in the SECP Act 1997 that states which functions as to promotion and regulation of occupational savings schemes relating to companies and state owned corporations have been given to SECP. In this connection, a framework for Occupational Savings Schemes shall be developed in consultation with the stakeholders. SECP is also liaising with the ADB for hiring a consultant for this assignment.

6.4.9 Development Finance Institutions (DFIs)

With the shifting financial backdrop following the reforms initiated in the 1990s, DFIs have mapped their own course in response to the evolving business environment. The risk profile of the DFIs is similar to those of the banks and they share the same regulatory framework under SBP. Private companies need to be inserted in order to instill vigor into the sector. For this purpose, a gradual divestiture of the government's stake in DFIs has been envisaged.

It is expected that once all the NBFCs are in compliance with the requirements laid out in the NBFCs Regulations 2008, they would be at a better position to compete and operate in the rapidly expanding financial sector.

6.5 Settlement System

SBP has shifted from the conventional Net Settlement System to a large-value electronic payment system named Pakistan Real-time Inter-bank Settlement Mechanism (PRISM) with effect from July 1, 2008. Initially, PRISM was used for the settlement of interbank money market transactions and the domestic leg of foreign exchange market. Since then, its capacity has been enhanced by introducing the settlement of interbank government securities' transactions and net settlement positions from retail clearing and bank cards clearing. In addition to risk management in payment systems, PRISM also makes possible connectivity with international payment systems for carrying out transactions linked to foreign exchange, government securities/bonds, and settlement of equity investments. In due course, PRISM is expected to reinforce SBP's competence to perform open market operations and to supervise inter-bank transactions.

6.6 Capital Market Reforms

Capital market reforms enable the capital markets to embrace new ideas and techniques affecting it. These reforms are an integral component of the structural reforms being supported by the government to restore macroeconomic stability and to build up the banking system, while developing a more contributing incentive regime for financial industry. Significant progress has been made on capital market reforms, including adoption of international standards and market practices and the streamlining of regulatory infrastructure to enhance surveillance and enforcement.

The SECP, as an apex regulator of the country's capital markets, launched different reform programs during the period under review which are mentioned below.

6.6.1 Regulatory Reforms

SECP has promulgated the Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Regulations, 2008 to provide for a fair, transparent and efficient system for acquisition of substantial voting shares and takeovers of listed companies in line with the Takeovers Ordinance. Furthermore, in order to strengthen the risk management framework, increase investor protection and awareness, and promote equity investment in the country, various reforms were carried out by the SECP in the regulatory framework of the three Stock Exchanges, the National Clearing Company of Pakistan Limited and the Central Depository Company of Pakistan Limited.

6.6.2 Developmental Activities

During the year 2008-09, SECP has progressed to promulgate the Stock Exchanges (Corporatization, Demutualization and Integration) Act, 2008. The National Assembly Standing Committee on Finance, Revenue, Economic Affairs and Statistics approved the Act on January 26, 2009 and the Act is expected to be placed before the National Assembly for its approval. The Act provides for conversion of the existing non-profit, mutually owned stock exchanges to for-profit entities owned by the shareholders. This would enable segregation of ownership and trading rights and will bring a balance among interests of different stakeholders of a stock exchange. Demutualization of the stock exchanges will also ensure cost efficiency and improved governance at the stock exchanges.

6.6.3 Corporate Debt Market Reforms

Development of a corporate debt market has been a top priority area for SECP and a number of measures have been taken in this regard in the recent past. The rate of stamp duty on the issuance of corporate bonds and transfer of securitized assets has been reduced. However, difference in the rate of stamp duty amongst different provinces still exists which needs to be rationalized for the harmonious development of the corporate debt market. SECP has also abolished the mandatory listing requirement for public offering of corporate bonds to encourage public offering of corporate bonds with lesser regulatory requirements and lower cost of issuance.

The SECP is also working closely with the stock exchanges and the Mutual Fund Association of Pakistan to provide a regulatory regime which would facilitate the listing and trading of corporate debt instruments. Work is underway to introduce the concept of Qualified Institutional Buyers and shelf registration procedures for corporate debt instruments. The SECP has also issued a circular to obtain data of privately placed TFCs from the issuers for future planning to develop the domestic corporate debt market.

6.6.4 Work in Progress

The SECP has developed a new risk based Capital Adequacy Regime (CAR) in line with international best standards and practices for determination of capital adequacy which accurately reflects the risk profile of an intermediary. Following rules and regulations have been drafted and will be notified after necessary review and due deliberation by SECP: (1) Balloters and Securities Registrars Rules, (2) Underwriter (Registration and Regulation) Rules, (3) Bankers to an Issue Regulations, and (4) Debenture Trustee Regulations.

The existing Listed Companies (Buy Back of Shares) Rules, 2001 are being revised and replaced with the regulations which shall allow the listed companies to retain the repurchased shares as treasury stock. The existing Companies (Issue of Capital) Rules, 1996 are being revised in order to facilitate the issuers making public offer of shares through the book building process and to remove the practical difficulties being faced by the issuers while complying with various requirements of these rules.

In order to further broaden the scope of trading activity at the bourses, SECP in collaboration with the Stock Exchanges, is working on the introduction of new derivative products such as Index Options and Stock Options.

6.7 Concluding Remarks

The demand for financing is ever-increasing. With the appreciation that debt markets can potentially provide an attractive alternative source of funds, there is considerable room for growth over the medium term. The government is keen to maintain the momentum to strengthen, deepen and broaden the base of capital markets. As a further step to fulfill this objective, the SECP has revived the Consultative Group on Capital Markets to suggest measures for growth and development of capital markets. The group will act as an independent think tank for important policy decisions in relation to the development of capital markets in Pakistan. The group shall be reviewing international best practices and suggest measures for the overall growth and development of capital markets particularly in the areas of new product development including alternative leverage products, debt capital market, new listings, risk management and market monitoring and surveillance, etc. The SECP has also announced activation of the co-ordination committee of the three stock exchanges and SECP. This committee will be meeting regularly to discuss issues of mutual importance and pave the way for improved co-ordination amongst the apex and the frontline regulators.

TABLE 6.1

NUMBER OF LISTED COMPANIES, FUND MOBILISED AND TOTAL TURNOVER OF SHARES IN VARIOUS STOCK EXCHANGES

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	Jul-Mar 2008-09
KARACHI STOCK EXCHANGE											
i) Total Listed Companies	765	762	747	712	702	668	659	658	658	652	652
ii) New Companies Listed	-	1	4	4	2	16	15	14	12	5	8
iii) Fund Mobilized											
(Rs billion)	1.6	0.4	3.6	15.2	23.8	4.2	54.0	41.4	49.7	49.2	42.3
iv) Total Turnover of Shares											
(In billion)	25.5	48.1	29.2	29.1	53.1	97.0	88.3	104.7	68.8	56.9	17.1
LAHORE STOCK EXCHANGE											
i) Total Listed Companies	-	-	614	581	561	647	524	518	520	514	512
ii) New Companies Listed	1	2	3	3	2	18	5	6	8	2	2
ii) Fund Mobilized											
(Rs billion)	-	0.4	2.5	14.2	4.1	3.1	42.1	24.5	38.8	28.1	35.3
iv) Total Turnover of Shares											
(In billion)	9.8	1.6	7.8	18.3	28.2	19.9	17.5	15.0	8.3	5.4	1.5
ISLAMABAD STOCK EXCHANGE											
i) Total Listed Companies	-	-	281	267	260	251	232	240	246	247	240
ii) New Companies Listed	1	0	5	3	1	8	5	2	7	3	4
ii) Fund Mobilized											
(Rs billion)	5.0	0	0.8	3.7	11.5	2.6	27.6	5.2	30.7	28.1	24.8
iv) Total Turnover of Shares											
(In billion)	3.3	3.1	1.4	2.7	2.1	1.4	0.7	0.4	0.3	0.9	0.158

Source: SECP, KSE, LSE, ISE.

TABLE 6.2

NATIONAL SAVING SCHEMES (NET INVESTMENT)

(Rs. Million)

	Name of Scheme	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	July-March 2007-08	July-March 2008-09
1	Defence Savings Certificates	16,580.3	22,037.3	21,990.5	3,238.3	(8,759.1)	(7,551.0)	(6,976.8)	(4,317.4)	401.4	(15,745.1)
2	National Deposit Scheme	(21.5)	(6.3)	(5.7)	(6.8)	(1.3)	(2.5)	(1.1)	0.0	(0.7)	(2.2)
3	Khaas Deposit Scheme	(51.1)	(12.1)	(13.5)	(23.4)	(5.4)	(2.8)	(5.6)	(2.1)	(6.9)	(1.1)
4	Premium Savings Scheme	-	-	-	-	-	-	-	-	-	-
5	Special Savings Certificates (R)	9,431.1	36,443.2	84,899.1	(13,199.3)	(83,311.9)	(57,737.1)	6,667.5	13,800.6	12,092.1	78,542.0
6	Special Savings Certificates (B)	196.3	(203.3)	(11.1)	(2.6)	(4.6)	(0.6)	(0.1)	(0.2)	(0.2)	(8.53)
7	Regular Income Certificates	8,643.2	11,046.3	(14,923.9)	(49,090.5)	(40,663.0)	(15,563.9)	18,369.1	(273.5)	935.5	26,426.4
8	Pensioners' Benefit Account	-	-	10,170.0	13,209.3	17,737.2	16,382.9	11,468.6	18,695.9	3,524.9	16,362.4
9	Savings Accounts	(2,105.0)	(329.8)	1,638.1	(729.6)	(2,891.4)	(202.7)	12,825.7	8,989.1	(4,214.3)	(10,348.7)
10	Special Savings Accounts	3,626.5	4,266.9	5,135.0	2,894.1	(19,048.0)	(709.6)	9,417.6	5,521.5	3,524.9	13,393.6
11	Bahbood Saving Certificates	-	-	-	22,691.0	60,654.6	59,636.6	47,214.5	38,799.7	32,767.4	57,580.9
12	Mahana Amdani Accounts	52.8	92.8	129.5	120.9	85.9	45.7	56.9	(25.0)	(13.8)	(63.3)
13	Prize Bonds	10,390.6	11,588.0	26,840.1	22,841.9	9,357.0	3,325.8	9,007.3	8,277.1	8,727.5	6,961.6
14	Postal Life Insurance	4,377.4	6,448.3	7,367.7	8,668.7	10,335.2	10,804.5	-	-	-	-
	Grand Total	51,120.5	91,371.3	143,215.8	10,612.0	(39,371.6)	8,830.7	71,305.5	44,625.5	67,375.2	173,098.2

Figures in Parenthesis represent negative signs

Source : CDNS

Table 6.3

LOANS DISBURSED BY DFIs AND OTHER FINANCIAL INSTITUTIONS

(Rs. Billion)

	Name of Institutions	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	Jul-Mar 2008-09
1.	DFIs	2.9	8.7	13.1	24.7	10.6*	-	-	-
2.	Special Banks	11.3	25.2	38.8	47.0	23.1*	-	-	-
3.	Islamic Banks	2.5	11.1	17.9	43.4	24.4*	-	-	-
4.	Khushadi Bank	0.2	1.6	1.3	2.3	2.92	3.61	2.59	-
5.	Micro Credit Bank	0.0	0.1	0.3	0.5	0.94	2.50	2.30	-
6.	Leasing Companies	15.9	16.0	18.6	16.5	29.1	22.85	14.99	8.82
7.	Investment Banks	4.4	7.6	7.5	7.4	10.4	5.90	6.13	2.10
8.	Modarabas	4.8	6.1	6.5	7.3	9.6	9.75	5.97	5.91
9.	Housing Finance	0.1	0.8	2.4	0.3	0.4	0.10	0.004	-
10.	Discount Houses	0.1	0.2	2.7	2.6	1.3	1.00	0.13	-

* July-December 2005-06

Source: SBP & SECP.

TABLE 6.4

MARK UP RATE/PROFIT RATE ON DEBT INSTRUMENTS CURRENTLY AVAILABLE IN THE MARKET

S.No.	Schemes	Markup/Profit Rate	Maturity Period	Tax Status
1.	Foreign Exchange Bearer Certificate (FEBC)			
	a. If Certificate of Rs 1000 encashed before 1 year investor will get Rs 1000 (face value)			
	b. If Certificate of Rs 1000 encashed after 1 year investor will get Rs 1145			
	c. If Certificate of Rs 1000 encashed after 2 year investor will get Rs 1310			Sale under this scheme has already been discontinued, from December 1999 however, on outstanding balance till maturity, rate will be applicable
	d. If Certificate of Rs 1000 encashed after 3 year investor will get Rs 1520			
	e. If Certificate of Rs 1000 encashed after 4 year investor will get Rs 1740			
	f. If Certificate of Rs 1000 encashed after 5 year investor will get Rs 1990			
	g. If Certificate of Rs 1000 encashed after 6 year investor will get Rs 2310			
2.	Foreign Currency Bearer Certificate (FCBC), 5 years	Scheme has already been discontinued w.e.f. February 1999. Only repayment is made		
3.	Special US$ Bonds		The rates are effective form Sept. 1999. If bonds are encashed before one year no profit will be paid. Profit is payable @ LIBOR + 2 on bonds reinvested for 3 years on Special US$ Bonds redeemed against 3 and 7 years maturity. However, the facility of reinvestment has been discontinued since October 2002.	
	a) 3 year maturity	LIBOR+1.00%		
	b) 5 year maturity	LIBOR+1.50%		
	c) 7 year matu 0	LIBOR+2.00%		
4.	<u>Pakistan Investment Bonds</u>			
	<u>Tenor</u>	<u>Rate of Profit</u>		
	3-Year Maturity	11.25% p.a	Coupon rate are given for 30th August 2008 issue.	
	5-Year Maturity	11.50% p.a		
Table (	7-Year Maturity	11.75% p.a		
	10-Year Maturity	12.00% p.a		
	15-Year Maturity	12.50% p.a		
	20-Year Maturity	13.00% p.a		
	30-Year Maturity	13.75% p.a		
5.	<u>Unfunded Debt</u>			
	Defence Saving Certificates	12.15% p.a (m)	10 Years	Taxable for deposits exceeding Rs.150,000 made on or after 01-07-2002
	National Deposits Schemes	13.00% p.a.	7 Years	Taxable and discontinued
	Special Saving Certificates (R)		3 Years	Taxable for deposits exceeding Rs.150,000 made on or after 01-07-2002
	for each of 1st five profit	13.00% p.a.		
	for the last one porfit	14.20% p.a.		
	Special Saving Certificates (B)	12.36% p.a.(m)	3 Years	Taxable and discontinued
	Regular Income Certificates	13.06% p.a	5 Years	Taxable
	Khas Deposit Scheme	13.42% p.a.	3 Years	Taxable and discontinued
	Mahana Amdani Accounts	10.41% p.a.(m)	7 Years	Taxable and discontinued
	Saving Accounts	9.0% p.a.	Running Account	Taxable for deposits exceeding Rs 150,000
	Bahbood Savings Certificate	16.10% p.a.		
	Pensioners' Benefit Account	16.10% p.a.	10 Years	
	Prize Bonds	10.00% p.a.		

Source: SBP and Directorate of National Savings

p.a. Per annum
B Bearer
R Registered
m on maturity