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THE DYNAMICS OF PAKISTAN STOCK MARKET

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NOTE FROM THE EDITOR

As we say good bye to 2016, we endorse the many challenges and opportunities 2017 brings with it. While the political debates and blame games continue amongst the political leaders, we keep watch of the real problems common people face due to failed economic policies and unwanted regulations.

This month, our market analysis shares the dynamics of the stock market in Pakistan. Although Pakistan Stock Exchange is one of the top performing stock markets around the world, the extent to which it is fulfilling its primary function of mobilising funds from domestic and foreign savings and diverting them towards public investment is still in question. The analysis digs deep into the challenges being faced and the effects of merging the three markets into one.

Pakistan's growth projections seem promising, however, several macroeconomic indicators are still not improving. FDI has decreased, owing largely to the decrease in investment from China, and exports have also declined which has surged up the trade deficit to $7.8 billion in the first 4 months of FY17. The current scenario is not very hopeful but let's hope that 2017 brings with it macroeconomic stability which can be capitalized to create economic growth.

From all of us at PRIME...have a prosperous new year!

Ali Salman
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Business Climate Review

by Ali Salman

Business Climate Review sums up important developments spanning entire federal government economic governance over last month. It discusses possible consequences of decisions, policies and regulations announced by the federal cabinet, regulators and Federal Board of Revenue for business climate of Pakistan. The analysis is based on this idea that economic freedom is good for business climate and any law that increases arbitrari ness, red-tape and size of government is counterproductive. Also, we believe that government should not choose winners and losers by legalizing exemptions or favors.

More incentive for decline!

According to a news item (Business Recorder, 22ndNovember 2016), the federal government is likely to announce an incentive package for five or six export-oriented sectors to the tune of Rs 65 -75 billion of which textile sector would be the top beneficiary. The government is expected to announce 3 percent rebate to yarn/ grey fabric, 4 percent to processed fabrics, 6 percent for home textile/knitwear and 8 percent for garments sector. According to the news, the proposed rebate for raw and semi-raw exports would be around 4 per cent and value added sectors 8 percent, respectively. It has also been proposed to remove the Regulatory Duty (RD) on key export-oriented industrial inputs including raw material and bring down custom duties to zero. Removal of import duty and sales tax on industrial machinery is also on the cards.

The government already maintains various concessions and incentives for the exporters. For the first time, the country's exports of goods has declined over a regime- down to $21 billion from $25 billion. Will more concessions and incentives help to arrest the decline?

Another news item (The News, 8th November 2016) suggests that the implementation of such schemes has created more hurdles for exporters by empowering the government officials over the business. One example is Duty and Tax Remission on Exports (DTRE) regime, which is in vogue in all regional countries. Under this regime, the exporters are allowed duty-free import of inputs in export products. In case of failure to use these inputs within a specified time (six months in case of Pakistan) the regular custom duty is charged.

The regulators in other countries are merely interested in the full use of inputs in export items because that is the main purpose of granting DTRE license. In Pakistan, the authorities raise objections if the inputs are used in any other HS code, and ask the exporters to pay the taxes for wrong use.

This attitude is against the spirit of facilitation. When regulators in other economies simply ensure that the duty-free imports are used for export purposes only; this should be the stance of our regulators as well.

While the exporters will keep complaining about the implementation, there are bigger problems. In our view, the export-led develop-concessions, rebates and incentives. Evidence is available to suggest that the biggest beneficiaries of these schemes are neither exporters nor the government, rather international buyers. Therefore, the economy like Pakistan should focus on its domestic commerce and should turn its geography into competitive advantage, rather than using

Competition over competition

There is a competition over who is custodian of competition in Pakistan's regulatory regime. According to a news item (The News, 25th November 2016), the Competition Commission of Pakistan has urged the government to review the Telecom Policy 2015 in relation to the Competition Rules for the Telecom Sector, as it is the sole jurisdiction of the CCP under the Competition Act, 2010.

In a policy note, the CCP observed that the Clause 5.1 of the Telecom Policy 2015 formulated and issued by the Ministry of Information Technology and Telecom (MoIT) provides for the making of competition rules exclusively for regulation of ex-post competition issues in the telecommunication sector by the Pakistan Telecommunication Authority (PTA).The rules will provide a process for remedying the anticompetitive behaviours (both ex-ante and ex-post) in the telecom industry.

CCP argues that the Competition Act being an act of the Parliament takes precedence over the rules being framed by MoIT, which is a subordinate legislation. It says that empowering PTA to regulate competition-related matters in the telecom sector will not only create redundant duplication of jurisdictions, but also engender legal uncertainty for the telecom operators and consumers, resulting in wastage of state resources.

In our view, if such regulations were to be introduced by other regulators like NEPRA and businesses do not engage into unfair practices like cartelization. This demands that all such matters be investigated by an independent regulator rather than sectoral regulator, which can be directly influenced by the businesses of that sector. Thus, CCP has rightly questioned the duplication and redundancy that the Telecom Policy 2015 has introduced and the government should make necessary changes. Indeed, we can argue that there is a monopoly over competition rules- and that rests with the

Fixation of finance with Forex

Finance Minister Mr. Dar is once again busy fighting over the valuation of dollar, and has attributed the recent depreciation to illegal currency dealers and speculators. According to a news item (Business Recorder, 3rd December 2016), Finance Minister Ishaq Dar has said the government would take more measures against the illegal movement of the foreign exchange and action against illegal currency exchange dealers would continue.

The minister further said the government's measures have borne fruit and the PKR gained Re1 against the dollar after it came down to Rs 107.20 from Rs 108.20. According to the Finance Minister, the exchequer losses Rs. 57 billion against an appreciation of one rupee over dollar. That is really his enigma. The Finance Minister is only concerned about the state exchequer and is not equally concerned about business revenues, which have failed to match the growth in tax revenues.

Dar said the government will minimise and eliminate the difference of exchange rates of foreign currencies between open market and interbank. Interestingly, he recounted the 1998 experience of government intervention in forex market as a success, whereas independent observers consider that freezing of forex accounts as a major blow to savers and investors.

Black markets exist when open market are closed or exploited. The presistent difference between the central bank and open market is a result of an artificial policy of keeping dollar appreciated than it should be. While Dar counts the loss to exchequer, he does not count the loss to the exporters due to an artificial appreciation. Thus, an open and free market, under a transparent regime is the only way forward to manage the forex rates.

Bring down tariffs to increase competitiveness

In 2015, PRIME Institute published a study recommending unilateral trade liberalization in order to liberalize Pakistan's trade sector and increase exports. This study, authored by Sara Javed, gave examples from Pakistan's own history, when during nineties, Pakistan liberalized its tariff unilaterally. In fact, 65% of the trade liberalization in the world's recent history has occurred by unilateral trade liberalization, as also argued by Razeen Sally. That the government has finally awakened to the role which high tariffs play in depressing a country's exports is a welcome step. According to a news item (The News, 9th November 2016), the Ministry of Commerce and the World Bank have reached an agreement where the Bank will assist Pakistan to develop a new tariff structure. The news item correctly notes that the policymakers, as a ritualistic exercise, bring forward strategic trade policy frameworks to increase exports and manage imports. However, they fail to implement the pro-growth policies. In our view, Pakistan needs to bring back bold reforms in its tariff structure, for its own good.

MARKET ANALYSIS

The Dynamics of Pakistan Stock Market

An efficient matching of saving and investment play a fundamental role in the economic growth of a country. One of the prerequisites for this is a well-functioning stock market which provides a platform for the mobilisation of savings and then allocates these savings for investment through a variety of debt and equity instruments. An efficient stock market requires innovative products, large number of buyers and sellers, competition, transparency, less regulatory burden andless government intervention.

Currently, Pakistan Stock Exchange (PSX) is one of the top performing stock markets in the world. It has recently been included in the Emerging Market Index provided by Morgan Stanley Capital International (MSCI). KSE 100 index has been touching record high levels since last year.

Despite being best in the region, our stock market is unable to perform its primary function of mobilising funds from domestic and foreign savings and diverting them towards public investment. Analysis presented in this study will highlight some of the challenges which inhibit our stock market from playing its due role. Since three regional stock markets of Karachi, Lahore, and Islamabad have now merged into a single stock market earlier this year, the study will also shed light on the extent to which this merger can be helpful in overcoming these challenges.

In Section I we begin with an overview of Pakistan's Stock Market. Section II will highlight some of the challenges which our stock market is facing. Section III will shed some light on the expected outcomes of the merger of three stock exchanges.

Structure of the analysis

Section 1
Overview of PSX

Section 2
Challenges facing PSX

Section 3
Outcomes of PSX

1. Overview of Pakistan's Stock Market

In Pakistan, the stock market is overseen by an apex regulator, the Security and Exchange Commission of Pakistan (SECP). The commission was established under the Securities and Exchange Commission of Pakistan Act, 1997 and became operative on January 1, 1999. The SECP is mandated with the development and regulation of stock market, the Self-Regulatory Organisations (SROs) and financial intermediaries/market participants such as credit rating agencies and brokers, which handle the transactions in the stock market on behalf of investors. The commission is also entrusted with the protection of investors.

Pakistan Stock Exchange (PSX) is now the only stock exchange in Pakistan, inaugurated on January 11, 2016 after integration of three local stock exchanges namely, Karachi Stock Exchange (KSE), Lahore Stock Exchange (LSE) and Islamabad Stock Exchange (ISE).

KSE remained the leading stock market of the country, which was established on September 18, 1947. At that time there were just 5 listed companies with a paid up capital of Rs. 37 million. Soon after its inception, KSE emerged as one of the best performing stock market in the region. It was located in the business hub of the country which was one of the major reasons behind its speedy development.

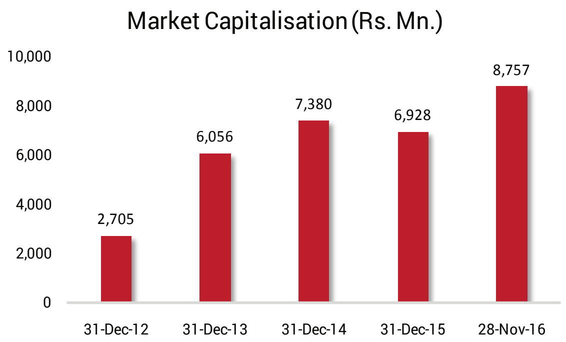
In1994, PSX was included in the Emerging Market Index provided by Morgan Stanley Capital International (MSCI). KSE-100 index which was 9,672 points on January 02, 2006, reached 15,737 points on April 20, 2008, and this performance was the best among other emerging market economies. However, it tumbled in the wake of the recession that engulfed the global markets. The KSE-100 which was at 15,210 points on April 1, 2008,faced substantial downward correction, leaving it at 9,183 pointson December 03, 2008, showing a decline of around 40 percent in just 8 months. Political unrest caused by the assassination of Pakistan's former Prime Minister, Benazir Bhutto in December 2007 and the poor economic situation of the country were other major reasons behind the crash of KSE. As a result, Pakistan was dropped from the MSCI emerging market index in 2009 and downgraded to frontier market status till this year.

During the first 3 quarters of Fiscal Year 2016, the KSE-100 index has shown a declining trend. On August 6, 2015 KSE-100 index was at 36,228 points and on February 23, 2016 it declined to 30,276 points. Pakistan Economic Survey (2015-16) attributed this bearish trend to several factors including "recession in oil prices internationally and stringent enforce-ment policy by the regulators of capital markets".

Stable political environment, better performance of economic indicators, increased government spending and the $46 billion investment under CPEC were some of the positive developments that helped Pakistan in reviving the investor's confidence in Pakistan's stock market. After almost nine months of bearish trend in FY2016, the PSX continued to an upward trajectory. During April 2016 the KSE 100 index reached up to an all-time high of 35,000 points. One of the most important factors behind these bullish trends is Pakistan's reclassification from frontier market status to emerging markets. Although this status will be effective in the next year, improvements can be seen today.

From December 31, 2015 to November 28, 2016 the KSE-100 index gained by around 31 percent. The index depicted a progress of around 90 percent when compared with the level of December 31,2012. From December 2012 to November 2016, market capitalisation of the stock market has improved by around 55 percent. Figure 1 depicts trend in the market capitalisation of PSX during the last 5 years.

Figure 1: Market Capitalization of PSX (2012-2016)



Source: Pakistan Economic Survey

Table 1 reflectsthe overall performance of stock market during the course of last five years.

The present outlook of the PSX reflects the prospects for bright future. According to Mr. Waleed Azhar, who has been closely watching the performance of stock market over the past 10 years, "If the same trend prevails then the benchmark index will easily reach up to 60,000 or even 70,000 points".

Pakistan's stock market has been outpacing many other regional stock markets since last year. According to Quartz India, a digital global news publication, KSE 100 is not only one of the Asia's best performing stock index but it is also 5th best performing stock index in the world. Bloomberg has also termed PSX as the best of the Asian Markets.

"Pakistan has regained the 'tiger' status in the region with 15 per cent rise and increasing rate of annual growth", as quoted by the Bloomberg. Table 2 depicts the performance of PSX -100 during July to April 2016 as compared to other major stock exchanges in the world.

Since stock markets around the world are facing bearish trends, foreign investors are now looking for alternatives and according to Mr. Arthur Kwong, the representative of Paribas Investment Partners, "investors are finding markets that are less correlated to the U.S. interest-rate cycle and the China macro slowdown. Pakistan, no doubt, is one of the outstanding spots."

Foreign investors are now showing a great interest in the Asia's Best Performing Stock Market. While giving an interview to the Bloomberg, Mr. Mattias Martinsson, the Chief Investment officer at Tundra Fonder- which has invested $200 million in Pakistani equities- said that "Pakistan is moving into acceptance: the nation has what it needs, a decently functional state and decent stability".

Table 1: Performance of PSX (2012-2016)

	31-Dec-12	31-Dec-13	31-Dec-14	31-Dec-15	28-Nov-16
Listed Companies	651	560	557	554	559
Listed Capital Rs. Million	814,478	1,129,787	1,168,484	1,269,703	1,296,075
Market Capitalisation- Rs. Million	2,705,879	6,056,506	7,380,531	6,928,497	8,757,630
KSE-100™ Index	9386	25261	32131	32812	43061
New Companies Listed	1	3	6	8	4
Listed Capital of New Companies - Rs. Mn.	3,000	4,545	26,973	29,942	5,490
New Debt Instruments Listed	179.88	6	6	2	1
Listed Cap. New Debt Instruments Rs. Mn.	7,450	9,779	15,000	25,000	10,000
Avg. Daily Turnover (Share in Million)	1.03	238	218	258	285
Average value of daily turnover - Rs. Mn.	90	7,604	9,402	11,465	11,074

Source: Pakistan Economic Survey

Table 2: Global Stock Indices (Jul-Apr FY16)

Country	Stock name	Date		Change Jul -Apr FY16	
		30-Jun-15	30-Apr-16	Points	%
Pakistan	KSE-100	34,398	34,719	320	0.9
India	Sensex	27,780	25,606	-2,174	-7.8
UK	FTSE 100	6,521	6,241	-279	-4.3
Hong Kong	Hang Seng	26,250	21,067	-5,183	-19.7
China	Shanghai composite	4,277	2,938	-1,338	-31.3
Sri Lanka	CSEALL index	7,020	6,516	-504	-7.2
US	Nasdaq composite	4,986	4,775	-211	-4.2
Malaysia	FBMKLCI	1,706	1,672	-33	-2.0

Source: Pakistan Economic Survey

2. Challenges faced by Pakistani Stock Market

The previous section shows that Pakistani Stock market is performing really well in terms of profit generation and those who are investing in the stock market are earning huge profits. Yet, the stock market is facing multiple challenges in serving its primary function of mobilising resources from surplus areas and diverting them in to capital formation. Some of these challenges are summarised below:

Savings create capital

When people save more they increase the amount of loanable funds available in the economy. Borrowers then utilise these loanable funds and build the capital. Besides borrowing from banks, borrowers can also borrow by issuing securities. Savers buy these securities and in this way, funds are then transferred to the borrowers.

Stock market provides a platform through which funds move from surplus areas to deficit areas of the economy. However, if the nation saves less, then a stock market cannot play its primary role in an efficient way. One of the fundamental challenges which our stock market is facing is the low saving rate in the country. Unfortunately, culture of savings in the country is still in its infancy. According to World Bank's data, during the past 10 years the average savings rate as a percentage of GDP was 21 percent in Pakistan, as compared to 49 percent in China, 36 percent in Bangladesh, 34 percent in India and 33 percent in Malaysia. How can a stock market mobilise funds for the businesses if the funds, in the first place, are not flowing into the market?

Lack of innovative products

There is a lack of innovative financial products in Pakistan. The existing products in the market are unable to meet the investment and funding needs of the lenders and borrowers respectively. As a result, our stock market is able to attract a very small chunk of an already limited amount of savings available in the economy. Banking and non-banking sectors, which can play a major part in product innovation, have not played their due role in this area. As a result, investment is just flowing towards few segments of the economy such as government papers, banking sector and also towards few large scale enterprises.

Lack of confidence in stock market

Investors' confidence in the stock marketplays a significant role in efficient functioning of the stock market. The stock market crashes of 2000, 2002, 2005, 2006 and then in 2008 swept over trillion rupees from the market and no participant could escape the damage. The inefficient role played by SECP in handling these crashes has also shattered the confidence of the investors. For instance, when the KSE-100 index plunged by 55 percent during April to August 2008, a floor was placed- at the level of 9144 points- from August 2008 to December 2008.

The floor, which remained in place for 108 days, closed the exit door of the market- a violation of basic principles of free market mechanism. As a result, all investors were trapped in the stock market. When the floor was lifted on December 14, 2008, investors rushed away from the

[10] Ibid.
[11] Land of investment: Pakistan turning into Chinese economy. Shafaqna.com.

from the market to save their remaining money. The index crashed down to the level of 4782 points in just fifteen days. The market capitalisation which was at Rs. 2.9 trillion on August 8, 2008, declined to Rs. 1.6 trillion on January 24, 2009. As a result, Rs. 1.4 trillion was swept off the market in just 5 months.

According to an interview reported in Dawn on January 09, 2012 a former official of SECP stated that No accountability or even the identification of perpetrators of the 2008 crisis has been a big blow to investor confidence".

The official also stated that "the earlier stock crisis of 2000 was put to investigation that brought out the 'Etrat Rizvi Report'. The task to conduct enquiry into 2005 crisis was given to Justice Saleem Akhtar as well as a US forensic investigators' firm."If proper investigations are conducted, then it might be helpful in regaining the confidence of investors.

Lack of depth

Depth of a market is related to the number of "buy" and "sell" orders available at different prices. Higher the depth of the market, higher will be the number of buy and sell orders at each price and ultimately, there will be low volatility of prices in the market. Market depth is an indication of liquidity of a stock and also its ability to maintain price level. So, if the stock is highly liquid and has a large number of buyers and sellers, trading of shares then does not cause any noticeable price shocks.

Growth in an economy has a tendency to increase the trading at the stock market- increase in the number of buy and sell orders. Market capitalisation as a percentage of GDP is therefore commonly used in the literature to approximate the depth of stock markets. Although our stock market is showing a tremendous performance, it is far behind other regional economies in terms of market depth. As per the most recent available data, the market capitalisation as a percentage of GDP was around 24 percent in Pakistan, 86 percent in India, 98 percent in China and 135 percent in Malaysia. Due to lack of depth, fewer choices are available for the investors to invest in the market and therefore it is discouraging portfolio investment.

Low investor base

Lack of investors is also one major reason behind low depth of stock market in Pakistan. There are just 250,000 investors in the capital market which represents just 0.125 percent of total population- far less than the real potential. Whereas, there are 4 million investors in capital market of Iran, 2 million in Bangladesh and 22 million in India.[1]

This also indicates concentration of shares in just a few hands which is hindering the free flow of shares and lack of liquidity in the capital markets. This eventually raises the transaction cost in the market. Nadeem Naqvi, Managing Director, KSE said, "This needs to change because a narrow investor (base) not only creates market volatility and low liquidity but also renders the price discovery mechanism inefficient."[2]

Low investors base is adversely effecting market liquidity and trading volumes of our stock market. It is also creating difficulties in fund raising by companies seeking capital.

Crowding out effect

Crowding out is a phenomeon that occurs when

[1] The figures were presented by Haroon Askari, Deputy Managing Director (MD), Pakistan Stock Exchange (PSX), during a seminar at Islamabad Chamber of Commerce and Industry on February 15, 2016.

[2] Ibid.

increase in the government involvement in a sector crowds out private investors from that particular sector. Experts believe that government borrowing through the stock market is crowding out private investors from the stock market of Pakistan.In an article, Mr. Wasful Hassan Siqqidi, an expert on capital markets stated that, “Even the pension funds, government securities and related funds have been used for borrowing by the government.”[3]

As of October 31,2016 the debt raised through the stock market was 31 percent of the total debt of the central government. As per the auction calendar, for the period November 2016 to December 2017, issued by the State Bank of Pakistan, the government will raise Rs.1.45 trillion through the sale of T-bills, whereas Rs. 150 billion will be raised through the issuance of Pakistan Investment Bonds. It is expected that this type of government involvement in the stock market will crowd out private investment, as it happened in the past.

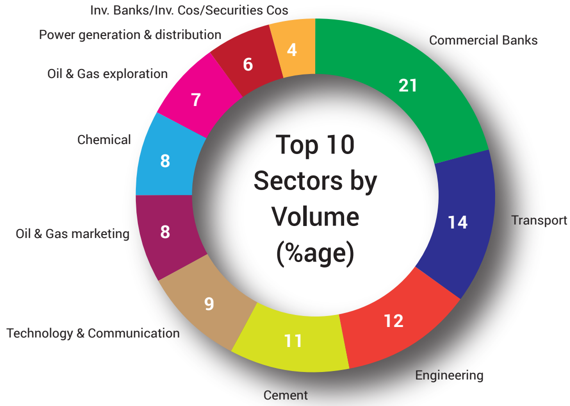
Lack of breath

Despite brilliant performance of Pakistan’s stock market, the total stocks traded in the stock market which contribute to the overall performance of the stock market are still low.

On December 13, 2016 KSE 100 index recorded a rise of around 1.04 percent or 470.66 points. However, only 36 percent of the total traded stocks participated in this improvement. Whereas, 59 percent stocks faced a decline and 6 percent of the total stocks remained stagnant. The same trend can be observed in the past several years.

This means that the performance of stock market is largely driven by few sectors and the bullish performance of the stock market does not have a strong foundation. Any effect on these sectors might make the situation worse. As shown in Figure 2 there are just 10 sectors out of 35, which contribute more than 80 percent of the market volume.

Figure 2: Top 10 Sectors of Pakistan Stock Exchange



Source: www.psx.com.pk

As highlighted in the Capital Market Development Plan (2016-2018) “there are only a few hundred listed companies and perhaps an aggregate of a couple of hundred thousand of investors in such companies. The bulk of the market capitalization of the capital market is represented by either state-owned enterprises or privatized companies.”

Delinked with the real economy

It is widely believed that our stock market is not the true representative of the real economy. The sectors which are major contributors of our stock market growthare not the major contributors to our economic growth. Manufacturing, livestock, transport storage and communication, wholesale and retail trade and crops are

[3] The article titled, “Capital Markets” authored by Mr. Wasful Hassan Siddiqi, was published in Business Recorder on January 18, 2012.

drivers of our GDP growth. Around 71 percent of GDP growth came from these five sectors.

Contrarily, our stock market performance is largely driven by Oil and Gas sector, food producers, commercial banks and construction sector. 64 percent of the total market capital is represented by these 4 sectors.[4] There are total 119 companies listed in these sectors which are just 21 percent of the total capital and these 119 companies represent 64 percent of the total market capitalisation of our stock market. Going further if we look at the top 15 performers of the stock market we can find out that just 2 percent of total listed companies capture more than 50 percent of the total market capitalisation.

3. Pakistan stock exchange: Expected implication of merger

Prior to January 11, 2016 when the PSX was not operational, the three stock exchanges did not have any mutual linkages with each other. Their trading interfaces, indexes, management etc. were separate and the exchanges were operating under a mutualised structure, under which the members of these organisations have both trading and ownership rights.

Conflict of interest was inevitable in this structure and it was believed that this structure is jeopardising the interest of investors. The problem with this type of structure is that only one stakeholder i.e. members of exchange -who can also be a broker- can control the exchange.

Corporatisation, Demutualisation and Integration Act was promulgated in year 2012 and all the three exchanges were merged into Pakistan Stock Exchange, which has been operational since January 11, 2016.

Under the new demutualised structure Trading Rights Entitlement Certificates (TRECs), PSX ownership shares were issued. In this way the ownership rights are segregated from the trading rights, which will help in removing barriers to entry for new brokers. Moreover, the persons representing TREC holders are not allowed to hold majority in the board of directors. Under this act, commercial functions are also separated from regulatory functions so that regulatory obligations cannot be compromised for the sake of profit earning.

Demutualisation is arguably considered as a most integral step in the efficient functioning of a stock market. NYSE, NASDAQ, London Stock Exchange, Bombay Stock Exchange etc. have been demutualised. Hong Kong Stock Exchange was demutualised in year 2000 and within a year its net income rose by around 42 percent. Tokyo Stock Exchange also observed the same trend in its income after demutualised in 2001.

Economies of scale

The merger of three stock exchanges in to one stock exchange has resulted in economies of scale which will not only bring efficiency in the regulatory and administrative functions but it will also reduce cost of core exchange functions.

Greater accessibility

One other benefit of the unified stock exchange is that it would be helpful in providing trading facilities throughout Pakistan regardless of location. Thus, it will enhance the accessibility. However, there is still a problem of limited outreach of the PSX. Head office and the regional offices of PSX are located in the urban hearts of three main cities (Karachi, Lahore and Islamabad) and most of the brokerage houses are also located in these areas. As a result, the outreach of PSX is largely limited. The number

[4] www.psx.com.pk

of investors cannot be enhanced without enhancing the outreach of PSX to other areas of the country.

Reduction in cost of raising capital

Previously, the companies listed at all the three stock exchanges had to comply with the regulatory and disclosure requirements of all the exchanges separately. Also, companies had to pay listing and annual fees at all the exchanges separately. The unification of stock exchange has reduced the cost of raising capital by reducing the direct and indirect costs such as listing fees, compliance costs etc.

Competition in the stock market

It was also perceived that the merger of stock exchanges will reduce the necessary competition between the stock exchanges. However, Table 3 depicts that prior to the merger, KSE remained dominant exchange in terms of traded volume, market capitalisation, number of listed companies etc. It is also clear from the table that the ISE and LSE did not pose any competitive threat to KSE.

Prior to the merger all the trading activities were concentrated in KSE. As a result, clients of ISE and LSE brokers had to pay additional cost in order to execute their orders through KSE brokers. Unification of stock exchanges has therefore not only facilitated equal access and reduced transaction costs but it has also enhanced the competition between the brokers.

There was no competition between the three stock markets in the past. However, in a single stock market there is a competition between the brokers which is very beneficial for the market participants.

Enhancement in the liquidity

After the merger of three stock exchanges all the investors can operate from one trading platform. This will accelerate the speed of sale and purchase and enhanced liquidity. Since investors prefer those exchanges which are more liquid, it will attract investors and expand the trading volume which will not only attract more and more foreign and domestic investors but it will also attract more companies seeking capital.

Increase in the availability of funds

Listed companies have risen around Rs. 1.16 trillion during the last 10 years from the capital markets.[5] From the demand side perspectives,

Table 3: Contribution of Stock Exchanges to the Total Market Value and Volume

Stock Exchange	Traded Volume (Percentage)			Trade Value (Percentage)		
	2014-15	2013-14	2012-13	2014-15	2013-14	2012-13
KSE	99.73	99.41	99.10	99.91	99.81	99.65
LSE	0.25	0.55	0.87	0.08	0.18	0.34
ISE	0.02	0.04	0.03	0.01	0.02	0.01

Source: Pakistan Stock Exchange

[5] Source: http://www.brecorder.com/articles-a-letters/187/56348/

it is expected that a single market (PSX) will provide access to the large pool of savings available for future investment.

To summarise, there are several studies available which are based on the analysis of the impacts of merger on the stock markets.[6] Most of the studies found that the stock market mergers have a significant positive impact on market efficiency, trading volume, investor base, market liquidity and competition between brokers. It is believed that a unified stock market will expand investor base. It will enhance the market depth and breadth.

The system of financial reporting is very inefficient in the companies listed on stock exchange. Due to which it is very difficult for the investors to compare the financial strength of different companies. Therefore, there is an acute need of improvement in the government regulations regarding financial reporting and accounting profession.

It is the responsibility of the government to stop looking at the stock markets to finance its budget deficit. The regulator should also reduce the regulatory burden imposed on the participants of the stock market. SECP as an apex regulator is responsible for "fair play, transparency and strong compliance of all aspects of capital market operations while performing its developmental role equally strongly."

Conclusion

Stock markets play a fundamental role in the growth of an economy by providing a platform through which the suppliers of credit interact with those who need that credit. In this way stock market enhance the volume of capital formation in the country.

This study concludes that the stock market of Pakistan is facing multiple challenges such as lack of depth and breadth, meagre numbers of investors, less liquidity, low saving rate, government intervention in the stock market, regulatory burden on the participants of the stock market, lack of innovative products etc. The analysis also highlights that our stock market is highly delinked with the real economy. Major contributors of the GDP are not the active participants of our stock market.

It is believed that the merger of the stock exchanges will be helpful in enhancement of investor base, competition between brokers, liquidity, and it will also help in increasing the depth of stock market. The unification of stock market will decrease the compliance cost and it will also reduce the cost of raising capital.

However, it is the responsibility of the government to minimise intervention in the stock market. It is also the responsibility of the regulator to reduce the regulatory burden and facilitate participation in the stock market. Banking and non-banking financial institution should also come forward for the provision of innovative products to the financial intermediaries.

[6] For instance, there is a study titled, "Stock Market Merger and Market Efficiency" authored by Charles et. al (2014).

SNAPSHOT OF KEY ECONOMIC INDICATORS

Growth prediction amidst Underperforming Macroeconomy

The Asian Development Bank revised Pakistan's growth forecast up from 4.8 percent to 5.2 percent for the year 2017. Likely recovery in the agriculture sector, infrastructure development and improved energy supply are some of the major factors behind this positive projection. However, there are certain underperforming macroeconomic indicators which can affect the expected future outlook of Pakistan's economy.

As depicted in the Doing Business Index of World Bank, the cost of doing business in the country is still very high- a disincentive for local and foreign investors.

During the first five months of the current fiscal year, the foreign direct investment declined by around 45 percent as compared to the same time period in the last fiscal year. Chinese investment declined by around 59 percent which is a major contributor behind the overall decline in the FDI.

Large scale manufacturing industries were growing at a rate of around 8 percent during the first quarter of FY14, it came down to 3.89 in the same time period of FY16 and it further decelerated to 2.2 percent in the first quarter of this fiscal year.

Exports of food items, textile, petroleum products and other manufacturing products have been declining. Our trade deficit surged up to $7.8 billion in the first 4 months of FY17 as compared $6.9 billion in the same time period in the FY16.

Table 1: Economic Snapshot

Particular	Reporting Period	Value
T-Bill		**(%)**
03-M	Nov-16	5.8
06-M	Nov-16	5.9
12-M	Nov-16	5.9
PIB 10-years	Nov-16	8.0
6-M Kibor	Nov-16	6.1
Discount Rate	Nov-16	5.8
Inflation	**Nov-16**	**3.8**
External Indicatror		**($ Bn)**
Export	Oct-16	2.3
Import	Oct-16	4.0
Trade Deficit	Oct-16	-1.7
Home Remittances	Oct-16	1.6
Current Account	Oct-16	-381
FDI	Oct-16	67
Public Finance		**(Rs. Bn)**
Tax Collection	Jun-16	47
Direct Taxes	Jun-16	20
Indirect Taxes	Jun-16	27
Credit to Private Scetor (Rs. Bn)	As of Oct-16	4,023
LSM Growth (%)	Oct-16	2.4
FX Reserves ($ Bn)	9-Dec-16	23.2

Sources: SBP, Finance Ministry

Table 2: Key Targets and Projections

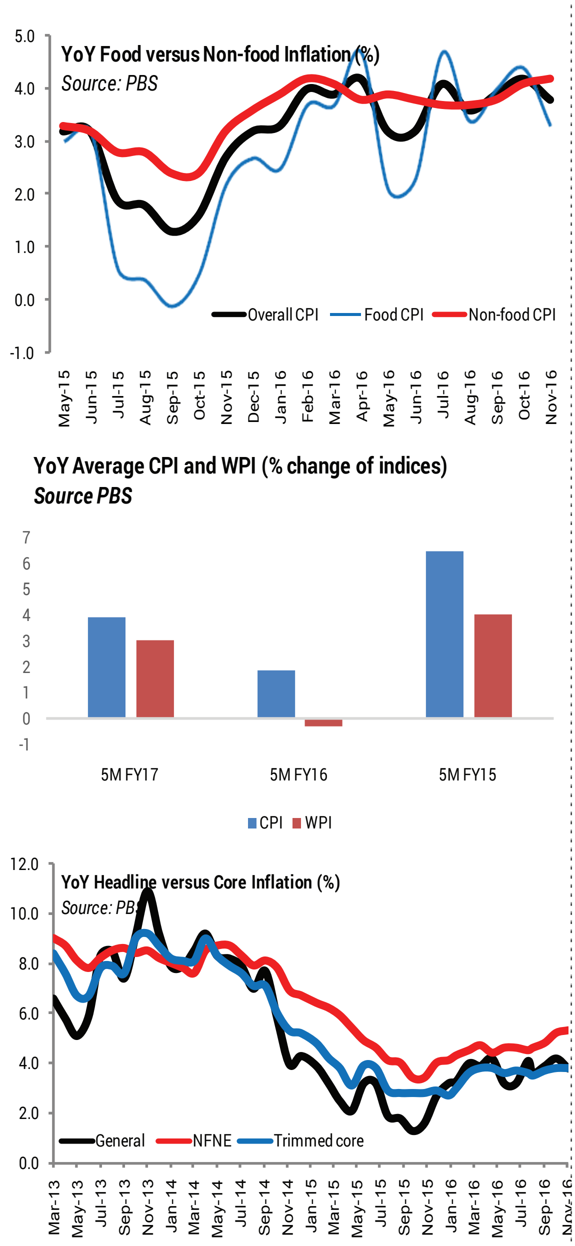
	Govt Target*	SBP Projection**	IMF Projection***	ADB Forecast****
		Percent		
Real GDP Growth	5.7	5.7	5	4.8
CPI- Full year average	6	4.5 - 5.5	5.2	4.5
		% change		
Export	n.a	n.a	4.1	n.a
Import	n.a	n.a	9.9	n.a
		% of GDP		
Current a/c Balance	n.a	n.a	-1.8	-1.2
Fiscal Balance	-3.8	n.a	-3.8	-5.3
Remittances ($ Bn)	n.a	n.a	20	n.a
Tax Revenue (Rs. Bn)	3,956	n.a	4,244	n.a

*Sources: *Budget in Brie 2016-17, **Monetary Policy Statement, ***IMF Country Report (June 2016), ****AsianDevelopment Outlook 2016*

Table 3: Balance of Payment Account - Key Items Only

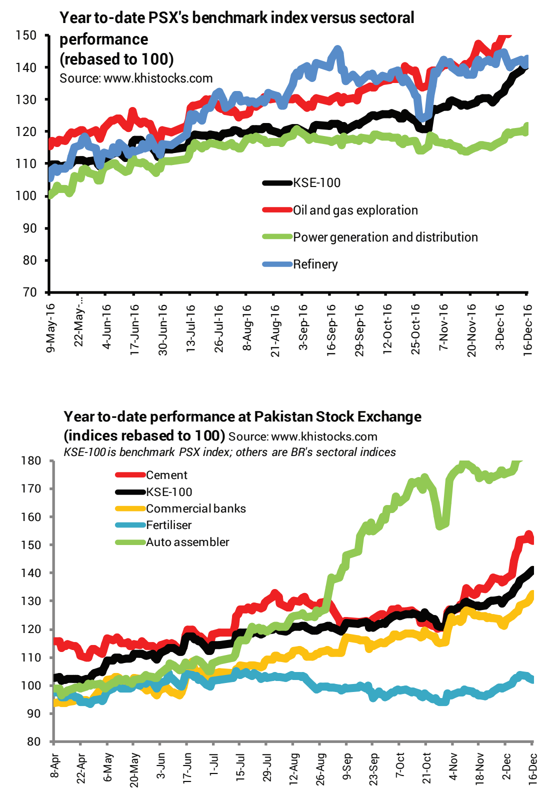
$ (Mn)	4M (FY17)	4M (FY16)	% change
Current Account Balance	(1,762)	-1,078	n.a
Balance on Trade in Goods	-6,697	-6,190	
Exports of Goods FOB	6,861	7,090	-3%
Imports of Goods FOB	13,558	13,280	2%
Balance on Trade in Services	-1,099	-714	
Exports of services	1,613	2,140	-25%
CSF inflows	73	80	-9%
Imports of services	2,712	2,854	-5%
	5M (FY17)	5M (FY16)	
Workers' Remittances	7,874	8,072	-2%
U.S.A	981	1096	-10%
U.K	912	1060	-14%
Saudi Arabia	2,259	2,393	-6%
UAE	1,777	1,833	-3%
	5M (FY17)	5M (FY16)	
Direct Investment in Pakistan	460	840	-45%
U.S.A	60	-38	n.a
U.K	39	67	-42%
Saudi Arabia	64	59	8%
China	156	376	-59%
Portfolio Investment in Pakistan	95	192	n.a
Equity	95	192	n.a
Debt	n.a	n.a	n.a

Figure 1: Trends in Inflation



Source: PBS

Figure 2: Performance at Stock Market



Source: www.khistocks.com
KSE-100 is benchmark, PSX index, others are sectoral indices

Table 4: KEY EXPORT CATEGORIES - PERCENTAGE CHANGE 3M FY17 over 3M FY16

Key Export Categories					
Commodities (units)	**Quantity 3M FY17**	**Price ($ Mn) 3M FY17**	**Price (% change)**	**Quantity (% change)**	**APR* (% change)**
Total	n.a	4,675	-9.0%	n.a	n.a
Food (M.T)	**n.a**	**634**	**-20%**	**-23%**	**n.a.**
Rice	497,640	243	-28%	-31%	-6%
Basmati	86,615	76	-40%	-21%	-13%
Non-Basmati	411,025	166	-21%	-100%	1%
Sugar	0	0	-100%		-100%
Textile	n.a	3,028	-6%	n.a	n.a
Raw cotton (M.T)	10,299	17	-69%	-71%	7%
Cotton yarn (M.T)	116,685	304	-21%	-6%	-15%
Cotton cloth (TH.SQM)	461,282	539	-4%	-13%	11%
Knitwear (TH.DOZ)	32,899	606	-4%	18%	-19%
Bedwear (M.T)	86,889	529	3%	8%	-5%
Towel (M.T)	39,735	178	-17%	-18%	2%
Readymade garments (TH.DOZ)	7,222	522	3%	-1%	4%
Art, silk & synthetic textile (TH.SQM)	22,432	50	-34%	-74%	151%
Petroleum products	n.a	3	-93%	n	n.a
Naphtha (M.T)	7,782	2	100%	100	100%
Other manufacturing goods	n.a	754	-11%	n.a	n.a
Sports good	n.a	67	-10%	n.a	n.a
Football (TH.DOZ)	749	35	-11%	-4%	-7%
Gloves (TH.DOZ)	443	21	-20%	-26%	9%
Leather tanned (TH.SQM)	3,392	86	-12%	-26%	18%
Leather products	n.a	125	-9%	n.a	n.a
Leather garments (TH.DOZ)	221	809	-4%	-3%	-0.2%
Leather gloves (TH.DOZ)	1,172	41	-18%	-21%	4%
Footwear (TH.Paris)	2,588	26	-0.1%	0%	-0.4%
Surgical goods	n.a	75	-9%	n.a	n.a
Chemical & pharma products	n.a	205	-15%	n.a	n.a
Plastic material (M.T)	27,240	49	-6%	-34%	42%
Engineering goods (TH.NOS)	n.a	44	2%	n.a	n.a
Cement (M.T)	1,487,299	77	-12%	-3%	-9%
All other items	n.a	222	-4%	n,a.	n.a

*ARP= Average Realised Price

Sources: PBS

Table 5: KEY IMPORT ITEMS - PERCENTAGE CHANGE 3M FY17 over 3M FY16

Key Import Items					
Commodities (units)	**Quantity 3M FY17**	**Price 3M FY17**	**Price (% change)**	**Quantity (% change)**	**APR* (% change)**
Total		11,724	10%		
Food (M.T)	n.a	1,359	10%	n.a	n.a
Tea	57,916	134	11%	46%	-24%
Palm Oil	542,532	368	-16%	-20%	4.6%
Pulses	205,363	183	34%	-11%	49.9%
All other food items	n.a	495	30%	n.a	n.a
Machinery group	n.a	2,735	60%	n.a	n.a
Power generation	n.a	795	152%	n.a	n.a
Textile group	n.a	116	6%	n.a	n.a
Electrical	n.a	448	32%	n.a	n.a
Telecom	n.a	278	-11%	n.a	n.a
Transport group	n.a	692	8%	n.a	n.a
Road motor	n.a	572	27%	n.a	n.a
CBU Heavy vehicles	n.a	69	80%	n.a	n.a
CBU Motor cars	n.a	73	2%	n.a	n.a
CKD Heavy vehicles	n.a	75	30%	n.a	n.a
CKD Motor cars	n.a	158	26%	n.a	n.a
Other transport	n.a	67	98%	n.a	n.a
Petroleum group (M.T)	n.a	2,356	-5%	n.a	n.a
Petroleum products	4,934,776	1,500	4%	100%	-48%
Petroleum crude	2,042,937	562	-36%	49%	-57%
Textile group (M.T)	n.a	688	9%	n.a	n.a
Agriculture group	n.a	1,764	`	n.a	n.a
Metal group	n.a	929	4%	n.a	n.a
Iron and Steel (M.T)	768,948	445	0.1%	18%	-15%
Miscelleanous group	n.a	283	1%	n.a	n.a
All other items	n.a	917	-5%	n.a	n.a

n.a = not available; PBS does not release data *ARP= Average Realised Price

Sources: PBS

Figure 3: Trends in Exchange Rate

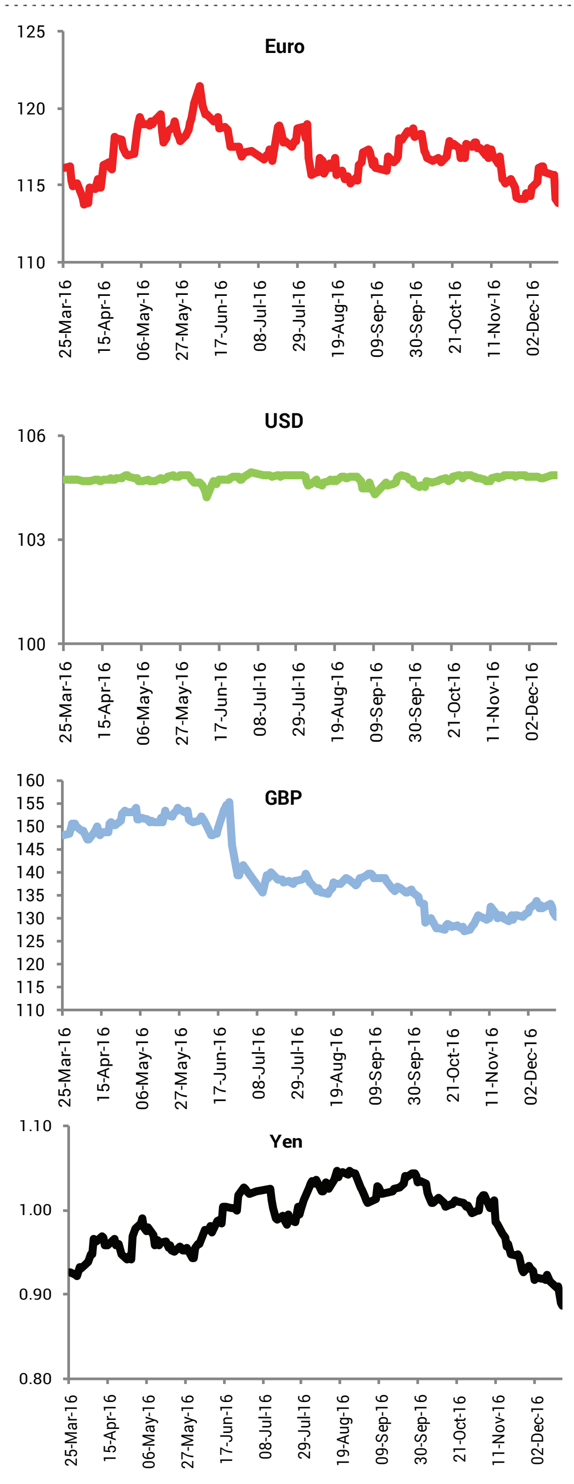


Figure 4: Key Commodities World Market

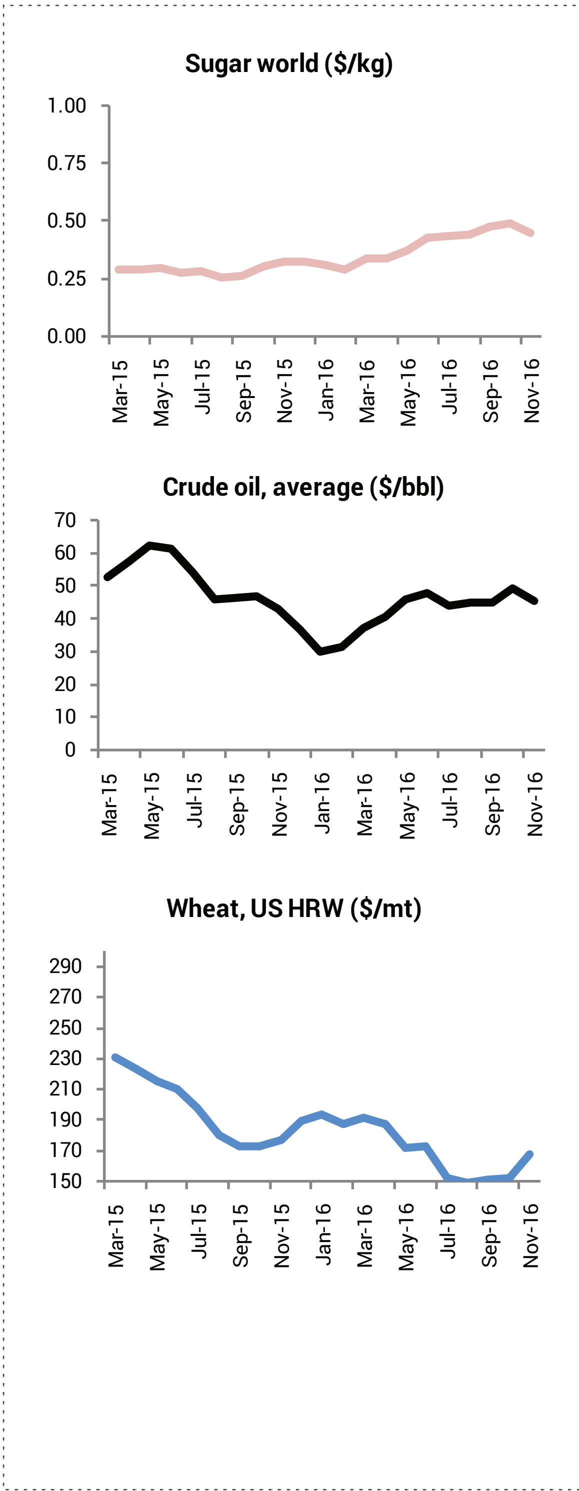


Figure 4: Key Commodities World Market

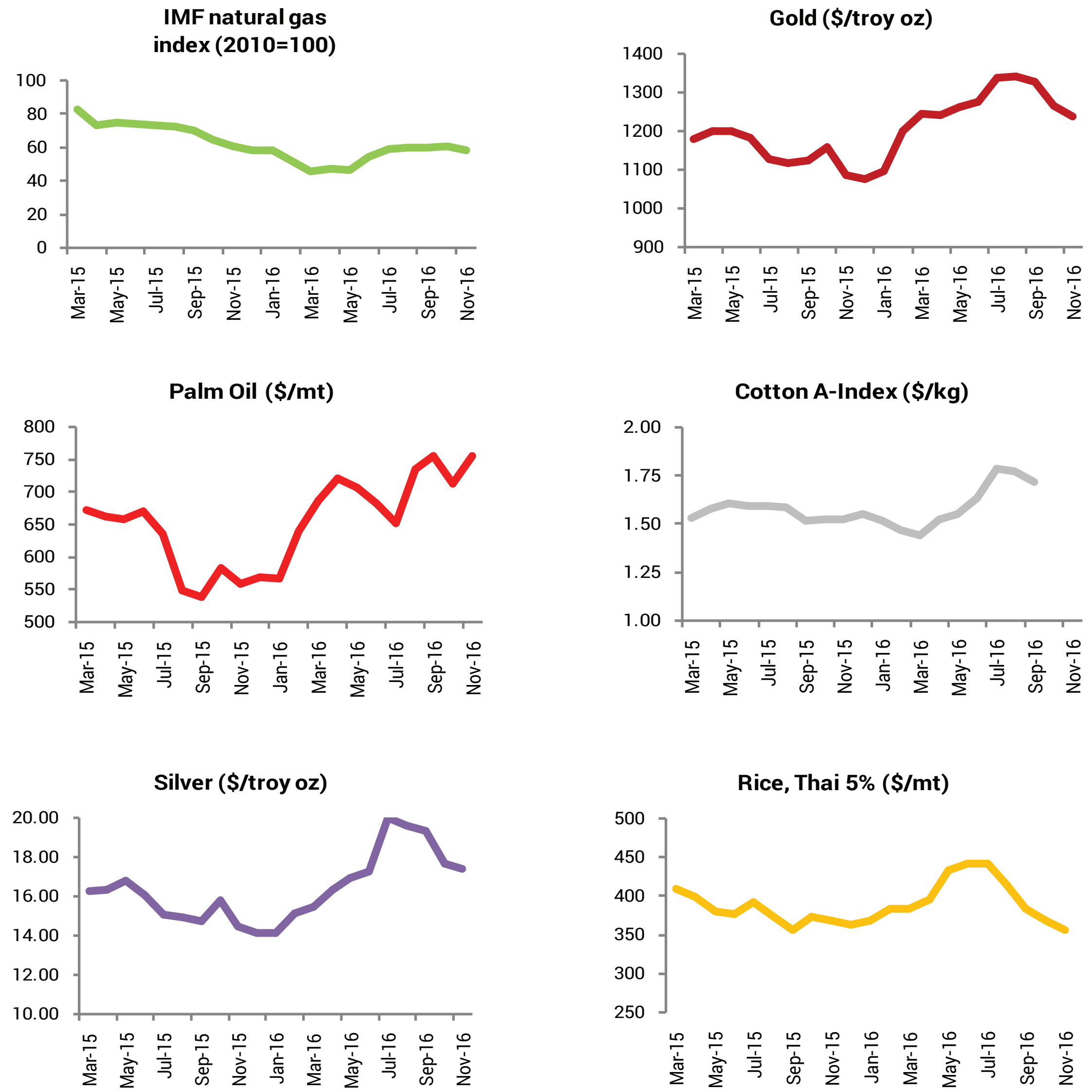


Table 6: Ease of Doing Business Index

Doing Business Rankings - Key Indices only								
	Starting a business	Dealing with construction permits	Getting electricity	Registering property	Getting credit	Trading across border	Paying taxes	Enforcing contracts
Pakistan	122	61	157	137	133	169	171	151
India	155	183	70	138	42	133	157	178
Bangladesh	117	118	189	185	133	172	86	188
Singapore	10	1	6	17	19	41	5	1
Vietnam	119	12	108	58	28	99	168	74
Turkey	94	98	36	52	79	62	61	36

Source: Doing Business

Performance of Large and Medium Scale Enterprises

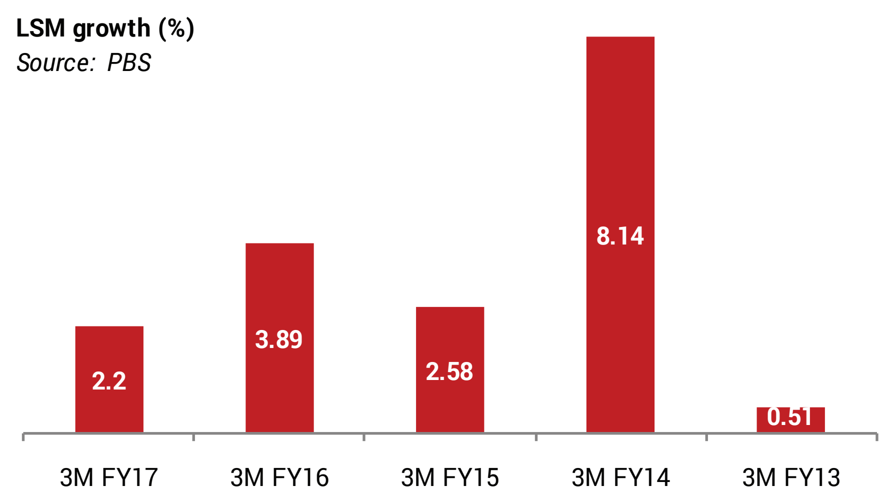
Major LSM Drivers

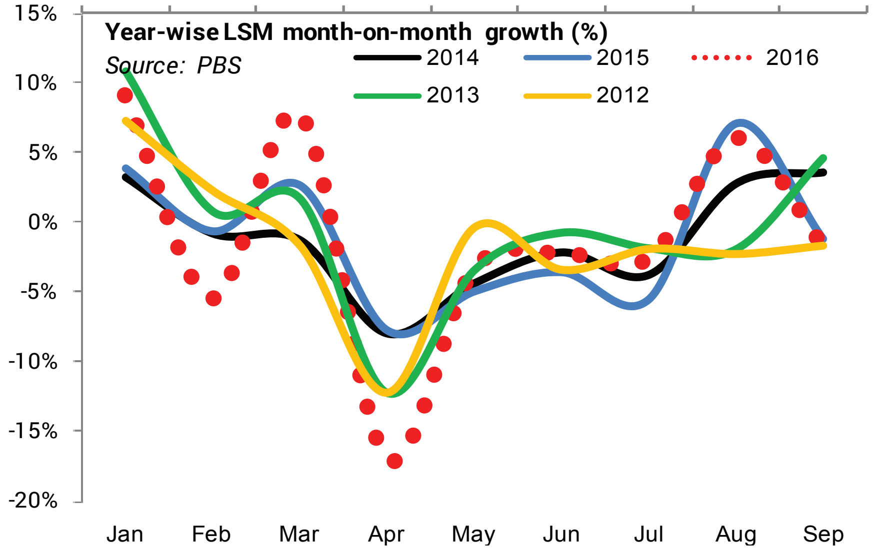
		Percentage change	
	Weight	3MFY17	3MFY16
Textile	20.91	(0.06)	0.7
Food, Beverages & Tobacco	12.37	(0.89)	4.31
Coke & Petroleum Products	5.51	(3.42)	4.51
Pharmaceuticals	3.26	7.95	7.18
Chemicals	1.72	(3.60)	13.77
Automobiles	4.61	3.79	31.36
Iron & Steel Products	5.39	12.98	(5.32)
Electronics	1.96	12.27	(8.33)
Leather Products	0.86	-19.11	(0.25)
Paper & Board	2.31	6.12	(22.56)
Engineering Products	0.40	(17.75)	(19.28)
Rubber Products	0.26	0.27	12.24
Non-Metalic Mineral Products	5.36	9.24	4.75
Wood Products	0.59	(97.83)	-10.66

Source: PBS

Performance of Large and Medium Scale Enterprises

LSM Growth (%)





INDICATIVE TOPICS FOR PPR

01. Taxes
02. Credit Market
03. Capital Market
04. Investment Policy
05. Business Regulations
06. Civil Service Reforms
07. Research and Innovation
08. Tariffs and Trade Barriers
09. Inflation and Sound Money
10. State Owned Enterprises
11. Legal System and Property Rights
12. Human Capital, Labour Market and Regulations

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