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THE EMERGING ASIA PACIFIC CAPITAL MARKETS: CHALLENGES AND OPPORTUNITIES - PAKISTAN

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THE EMERGING ASIA PACIFIC CAPITAL MARKETS

Challenges and Opportunities

Larry Cao, CFA, and Luis Garcia-Feijóo, CFA, CIPM
Editors



RF EMERGING APAC CAPITAL MARKETS BRIEF

ARX and CFA Society India Webinar
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THE EMERGING APAC CAPITAL MARKETS



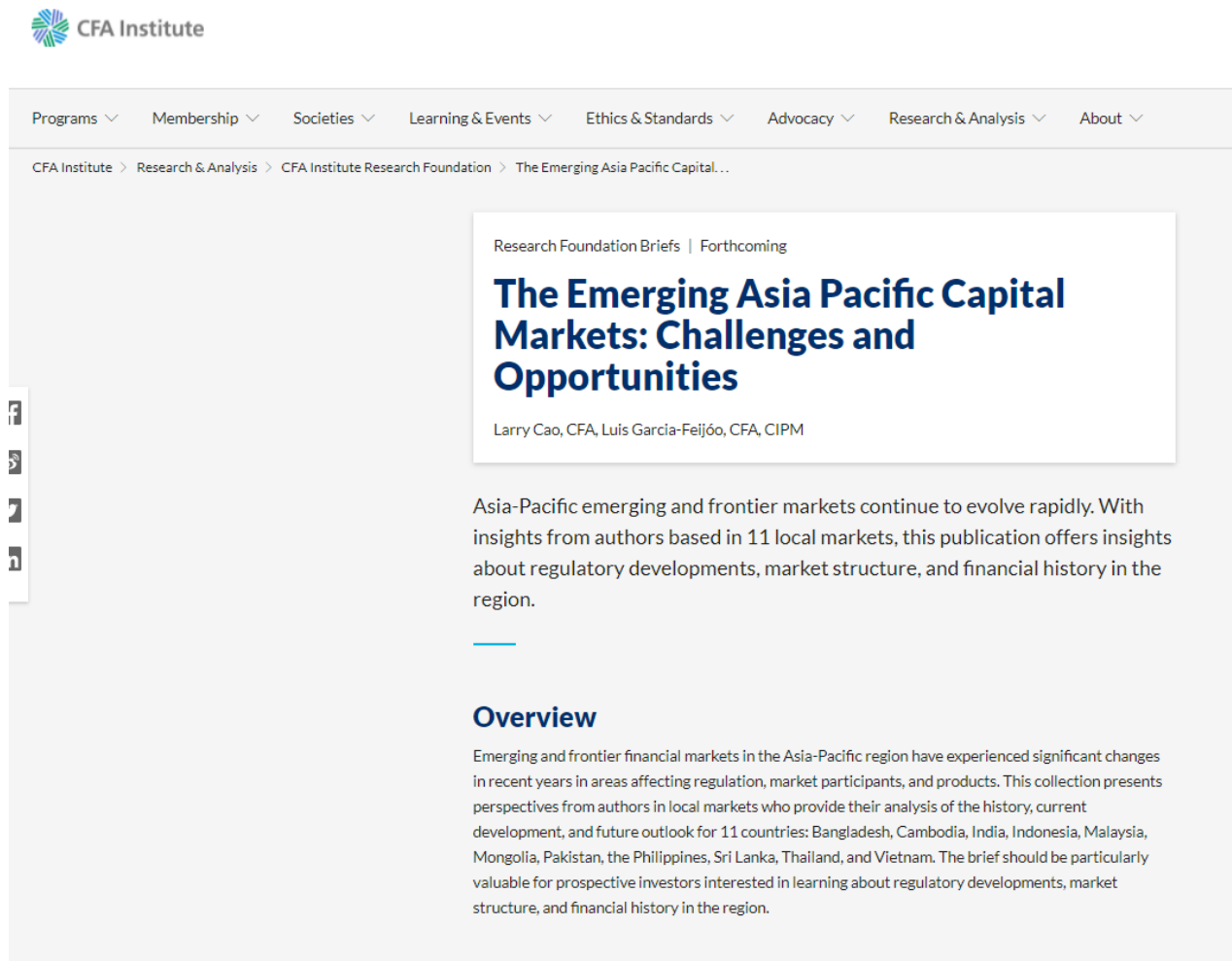
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The Emerging Asia Pacific Capital Markets: Challenges and Opportunities

Larry Cao, CFA, Luis García-Feijóo, CFA, CIPM

Asia-Pacific emerging and frontier markets continue to evolve rapidly. With insights from authors based in 11 local markets, this publication offers insights about regulatory developments, market structure, and financial history in the region.

Overview

Emerging and frontier financial markets in the Asia-Pacific region have experienced significant changes in recent years in areas affecting regulation, market participants, and products. This collection presents perspectives from authors in local markets who provide their analysis of the history, current development, and future outlook for 11 countries: Bangladesh, Cambodia, India, Indonesia, Malaysia, Mongolia, Pakistan, the Philippines, Sri Lanka, Thailand, and Vietnam. The brief should be particularly valuable for prospective investors interested in learning about regulatory developments, market structure, and financial history in the region.

THE EMERGING APAC CAPITAL MARKETS



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EMERGING CAPITAL MARKETS SERIES



OVERVIEW

Forward

The world of investing is in a state of flux with, perhaps, too much money chasing after too few assets that are perceived to be investment-ready.

A wall of liquidity – fuelled by quantitative easing – has resulted in low yields and high correlation amongst traditional assets. Trends in technology and geopolitics – exacerbated since the onset of the pandemic – continue to upend business models and supply chains. The search for “alternatives” – from private markets to crypto assets – continues apace.

At the same time, significant parts of the world fail to receive investments commensurate with their fundamentals of growth and demographics, or opportunities in infrastructure, insurance and pensions.

A critical barrier between the demand for, and supply of investment capital is the quality of the conduit that is capital markets.

It is the ecosystem of regulatory climate, market structure, history and culture of professionalism that enables match-making between sources and uses of funds. Fostering this ecosystem unleashes the power of investments to make real impact on real lives in the real economy.

A deliberate and continuous pursuit of education, ethical standards and professional excellence can fuel the flywheel of knowledge, confidence, and investment in developing markets.

I congratulate the Research Foundation for this timely and valuable contribution to the body of knowledge surrounding these eleven emerging and frontier economies in Asia. At different stages of development, virtually all of these markets provide a mix of domestic fundamentals, insulation and connectivity to the global economy. This set of detailed, country-level perspectives produced by highly qualified, in-country experts should catalyse greater understanding, debate, and inclusion of these economies in the global investment dialogue.

Lutfey Siddiqi

Managing Director, Global Regions & Society Relations

Introduction

Many have argued that the 21st century will be the Asian Century. And yet many capital markets in Asia, particularly emerging markets, remain a mystery to much of the outside world. We hope this brief will help to fill that knowledge gap.

The MSCI Emerging Markets Asia Index, launched at the beginning of the century, includes nine markets today. The relatively large and liquid capital markets of China (A shares), South Korea, and Taiwan are better known in global markets partly because of the international success of local tech giants. This brief covers the remaining six markets in the index—India, Indonesia, Malaysia, Pakistan, the Philippines, and Thailand—plus five other up-and-coming Asian markets—Bangladesh, Cambodia, Mongolia, Sri Lanka, and Vietnam. In each chapter, local authors review the history, current characteristics, and challenges and opportunities of their respective capital markets.

The selected countries exhibit certain economic and financial similarities. Having traveled to the majority of the covered countries, we believe they also have another important attribute in common: hope. These countries witnessed how neighbors such as Japan, South Korea, Singapore, and, more recently, China have improved living standards for their people since the 1960s. Their citizens share a strong belief that hard work will pay off. So, despite conditions that many from developed markets may find challenging, throughout these countries you can hear the upbeat tone in the voices and see the smiles on the faces of people going about their business.

Still, these markets are substantially different in many ways. We venture three differences here to highlight the practical value of this brief:

History

Countries such as India, Malaysia, Pakistan, the Philippines, and Sri Lanka inherited a legal system influenced by the British system. Some even had exchanges set up centuries ago. Because of their history, their capital markets are more consistent with expectations formed from investing in the US or UK markets. In contrast, Mongolia and Vietnam were part of the Soviet area of influence after the Second World War. Their regulatory systems are now in transition toward Western standards.

Economy

The size of these economies varies greatly. Based on data from the World Bank, in 2019, India's GDP was USD2,875 billion and Indonesia's was USD1,119 billion. On the other end of the spectrum, in 2019 Mongolia had a GDP of USD13.9 billion and Cambodia of USD27.1 billion. GDP per capita in 2019 ranges from USD1,285 for Pakistan to USD11,415 for Malaysia. This disparity is of course an important consideration for institutional investors because the economy is the foundation of capital markets and the main driver of their growth. Asian economies in general have experienced healthy growth in recent decades, and so have many of the covered countries, other than those that witnessed political turmoil. Consistent with these economic differences, the size of capital markets differs greatly among the 11 countries covered.

Market Maturity

Market maturity is an important factor to consider when investing in emerging and frontier markets. More-mature markets offer increased levels of information disclosure and tend to experience less dramatic swings in prices. Where data is available, authors report the share of institutional ownership in a market and other indicators of market maturity.

History buffs may find it easy to understand why in some markets banking channels play a more important role in financing, whereas in others capital markets are more important—although market maturity also has some bearing on this.

The concept of the Asian Century was not without controversy from the beginning. Whether you are a believer or a skeptic, we sincerely hope that this research brief will help you identify new opportunities and navigate risks in the Asian emerging and frontier markets.

REGIONAL EXPERTS

Larry Cao, CFA replied to Raza Jafri, CFA'S comment on this



Larry Cao, CFA

Senior Director, Industry Research at CFA Institute

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The Emerging Asia Pacific Capital Markets, a research brief published by [CFA Institute Research Foundation](#) and edited by myself and [Luis Garcia-Feijoo, Ph.D., CFA](#) is now online!

We thank [Lutfey Siddiqi](#) for endorsing the project in the forward he wrote for this brief.

We thank the contributors from each of the 11 markets for their diligent research work:
[Md Shah Naoaj, CFA](#) [Asif Khan, CFA](#) [Nazmul Ahsan, CFA](#) [Chakara Sisowath, CFA](#) [THOEUN SC Varabott Ho Rajendra Kalur, CFA](#) [Shwetabh Sameer, CFA, FRM, CIPM](#) [Ignatius Denny Wicaksono, ST, MBA, CFA, FRM, CIPM](#) [Jin Yoong Chong, CFA](#) [Bayarsaikhan Davaadorj, CFA](#) [Bujinlkham Boldbaatar Mohammad Shoaib Raza Jafri, CFA](#) [Sateesh Balani, CFA](#) [April Lee-Tan Mark Ilao Vidushan Premathiratne, CFA](#) [Dr. Nattawut Jenwittayaroje, CFA](#) [Thitiphong Amonthumnyom Luc Can Dung Nguyen](#)

We thank our colleagues from the global research team for support and colleagues from the APAC office for help with identifying contributors and organizing events for editors and contributors to share the research with a broad audience. Stay tuned!

[Rhodri Preece, CFA](#) [Bud Haslett, CFA](#) [Jessica Lawson Brenda Hou, CFA, ACMA, CGMA, GAICD](#) [Reseena Abdullah Stratos Pourzitakis, PhD](#) (and initially [William Boivin, PMP](#) [Scott Lee Vidhu Shekhar, CFA, CIPM](#) [Sivananth Ramachandran, CFA](#))




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THE EMERGING ASIA PACIFIC CAPITAL MARKETS: PAKISTAN

CFA Society Pakistan
5 August 2021



CONTENTS

- 01 Key Information
- 02 Equities
- 03 Foreign Investors
- 04 Bonds
- 05 Challenges, Opportunities & The Way Forward
- 06 Appendix



Pakistan: Snapshot



Population	208mn, 5th Largest
Population (< 25 yrs)	130mn (63%)
GDP Size	c. US\$300 bn
GDP Composition	Agriculture (19%), Industrial (20%), Services (61%)
Neighbors	India, China, Iran, Afghanistan
Form of Government	Parliamentary Democracy
Official Languages	English, Urdu
Major Exports	Textiles, Rice, Chemicals, Sports Goods & Surgical Instruments
Major Imports	Petroleum Products, Electrical Machinery, Cotton, Automobile Kits & Mobile Phones
Last 5 yrs GDP Growth	3.5% per annum on average
Next 5 yrs GDP Growth	4% - 5% per annum (IMF)
Credit Rating (Moody's)	B3, Stable Outlook
Total Debt to GDP (%)	85%

EQUITIES



Timeline

1947-49	Karachi Stock Exchange (KSE) is established in Sep 1947 and incorporated in Mar 1949
1991	The KSE-100 Index is introduced in November 1991 with a base value of 1,000 points
1997	The Central Depository Company of Pakistan is formed
2002	The automated trading system KATS is launched
2012	Stock exchanges are demutualized
2016	A consortium led by Chinese exchanges acquires a 40% stake and control in the PSX
2017	Pakistan upgraded to MSCI Emerging Markets status



Key Statistics

47.5 Bn **Equity Market Capitalization (USD)**

18% **Equity Market Cap/GDP**

302 Mn **Equity Market Share Volume Traded**

530 **Number of Listed Companies**

An Investable Market

Nearly 100 stocks have market capitalization above USD 100 million (12 stocks above USD 1 bn). Daily turnover is above USD 110 mn and 50 stocks trade above USD 0.5 mn per day

Top Stocks

MCAP	(US\$mn)		CYTD Turnover
			(USmn)
Oil & Gas Co.	2,587	TRG Pakistan	23.84
Pakistan Tobacco	2,084	Netsol Tech	8.77
Lucky Cement	1,916	Attock Refinery	7.08
Nestle Pakistan	1,663	National Refinery	6.28
Pak Petroleum	1,542	Unity Foods	4.57
Mari Petroleum	1,322	Lucky Cement	3.69
MCB Bank	1,258	Pakistan Refinery	3.11
Habib Bank	1,249	DG Khan Cement	3.09
Colgate Pakistan	1,165	Maple Leaf Cmnt	2.49
Engro Corp.	1,160	Ghani Global	2.42
Meezan Bank	1,022	Azgard Nine	2.35
United Bank	1,019	Oil & Gas Co.	2.17
Fauji Fertilizer	874	Pak State Oil	2.07

Several major multinational companies are listed in Pakistan, particularly in the Food, Pharmaceutical and Automobile sectors.

Several Listed MNCs



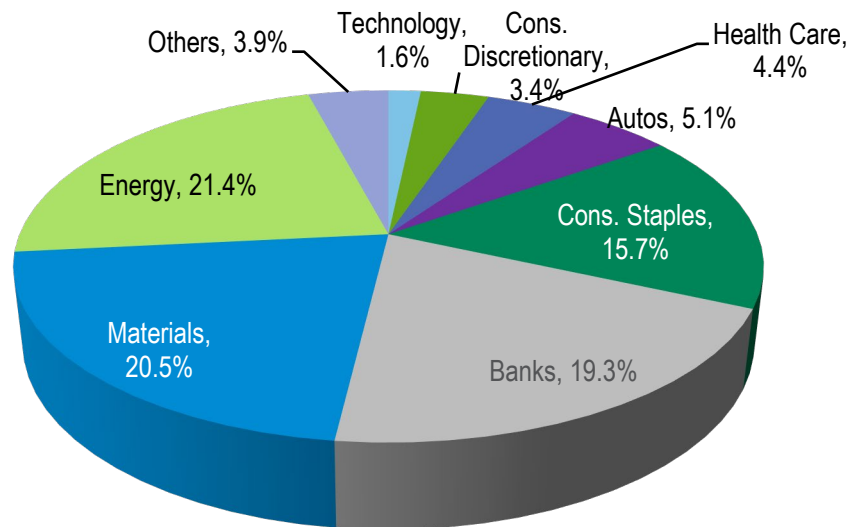
Main Indices

Conventional			Islamic	
KSE100 Index Since 1991	KSE30 Index Since 2006	KSE All-Share Index Since 1995	KMI30 Index Since 2008	KMI All- Share Index Since 2015
<ul style="list-style-type: none"> ➤ Base value of 1,000 points ➤ Comprised of 100 companies selected on the basis of sector representation and free float. ➤ Accounts for 70-80% of All Share market cap. ➤ This is a total return index i.e. payouts are adjusted. 			<ul style="list-style-type: none"> ➤ Base value of 15,000 points ➤ Purpose is to measure the performance of Shariah compliant equities ➤ Comprised of 30 companies selected on the basis of free float and impact cost. ➤ This is a total return index i.e. payouts are adjusted. 	

Sector Weights

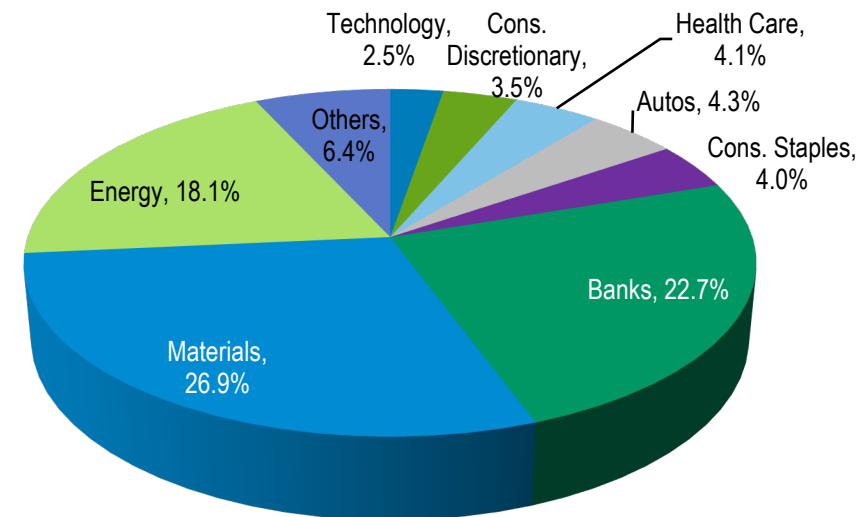
The largest sectors by market capitalization are Energy, Banks, Materials and Consumer Staples. The latter is dominated by several MNCs, that have been present in Pakistan for decades.

Weight on Full Market Cap

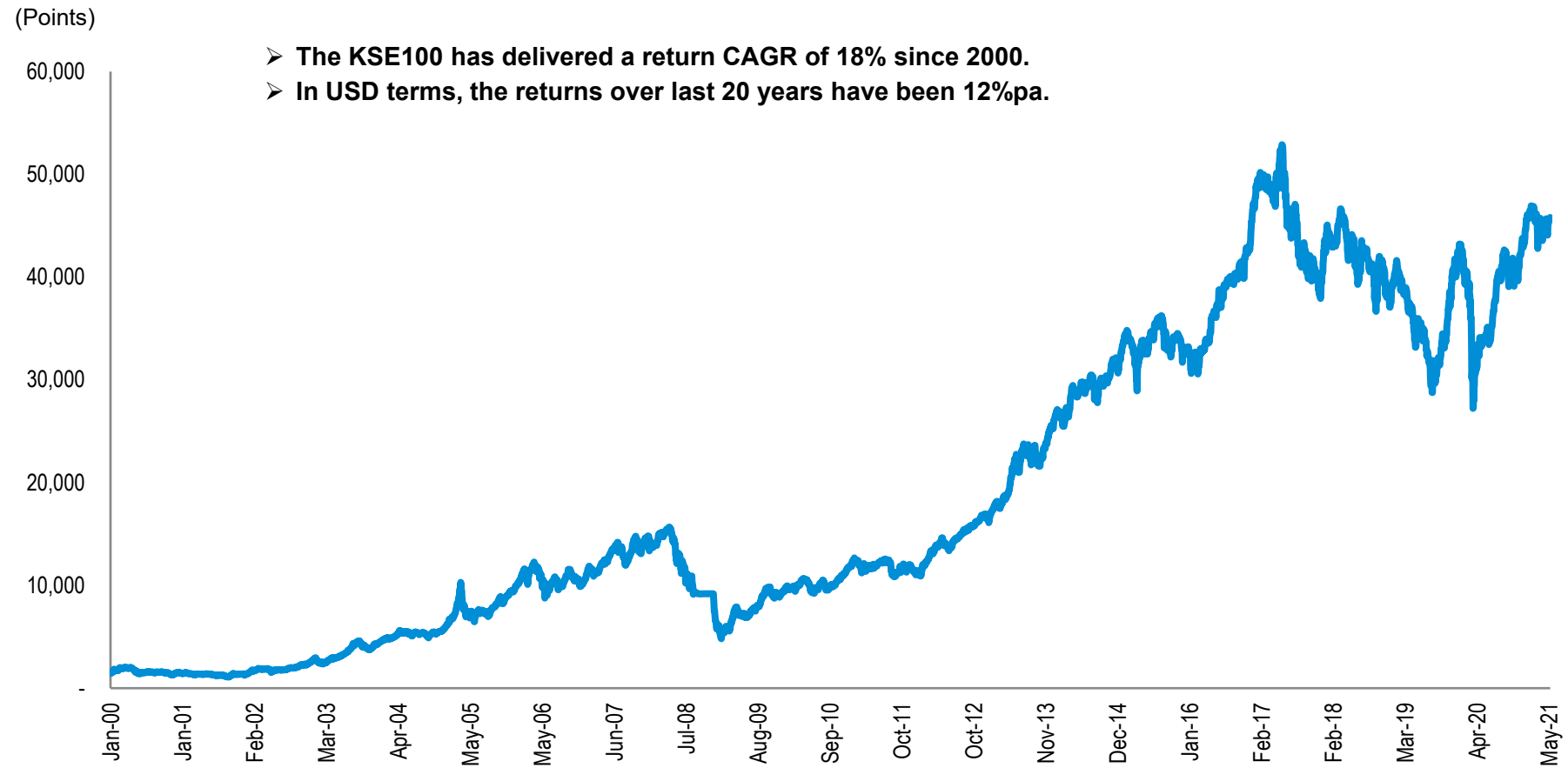


On free float market capitalization, the weight of Consumer Staples drastically reduces. New listings need at least 12.5% free float but this does not apply to previously listed companies.

Weight on Free Float Market Cap



KSE100 Index



Valuations Trend

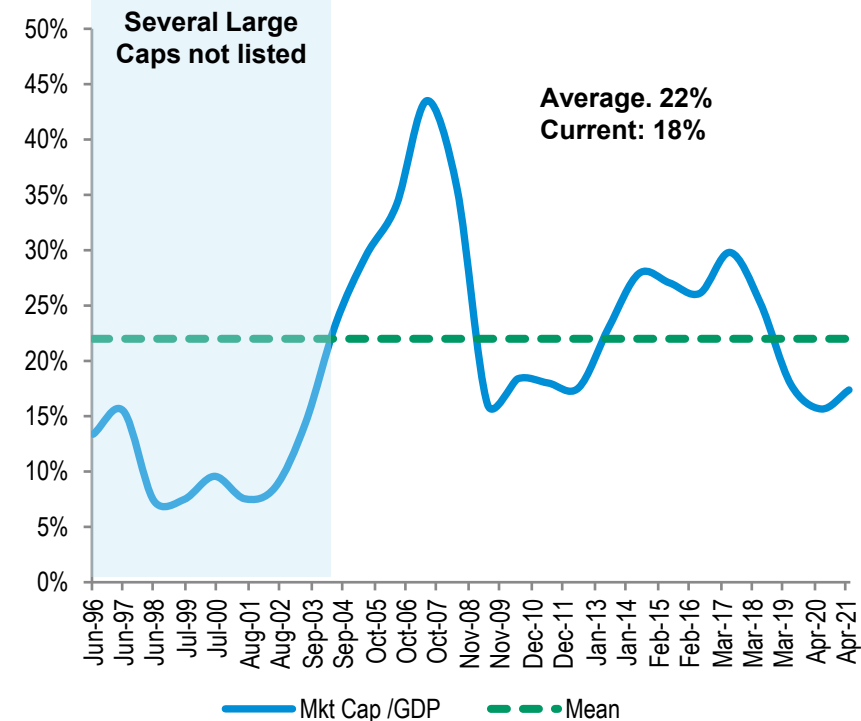
The KSE100 has traded between a forward P/E range of 6x-12x with a long term mean of 9x as compared to MSCI EM P/E range of 4.8x to 19.9x in the same period (and mean of 12.0x).

KSE100 Forward P/E



Market capitalization to GDP peaked at 45% in 2007. It currently stands at 17% vs. a long term average of 22%. It has not fallen into single digits after the early 2000s.

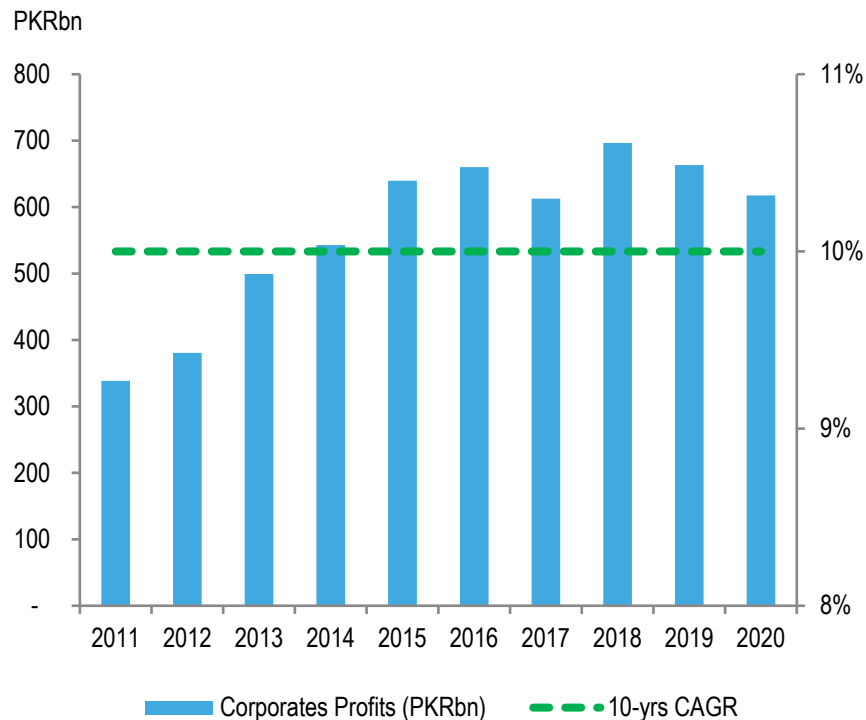
Market Cap to GDP (%)



Corporate Profitability Trend

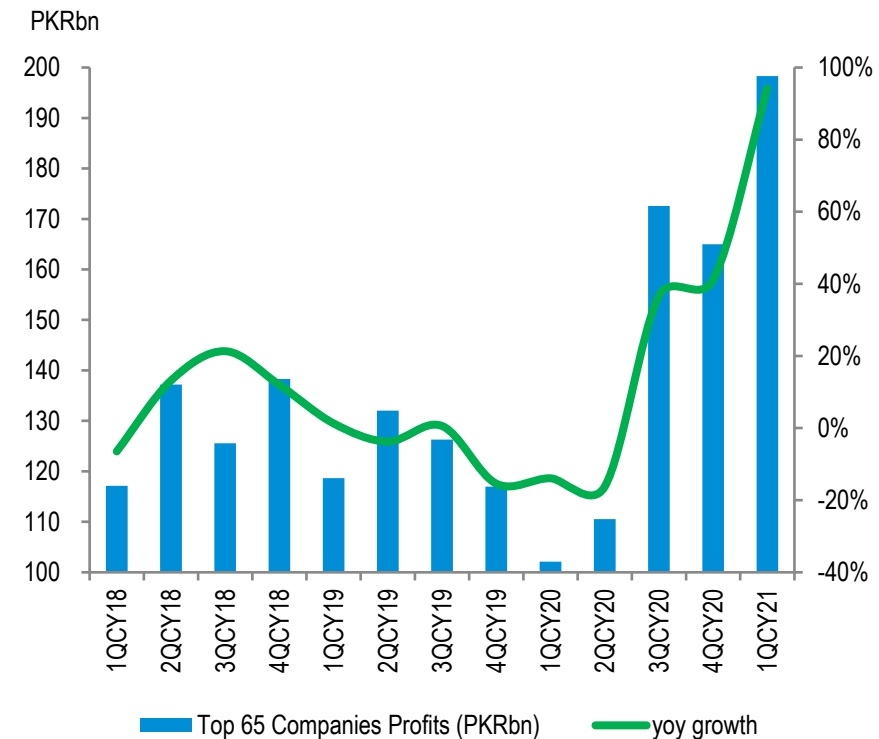
Corporate profitability in Pakistan has grown at a double-digit clip in the last decade. For the KSE100 companies, the 10yr profit CAGR is 16% (for KSE AllShare, it is 10%pa).

KSE All Share Profits (PKRbn)



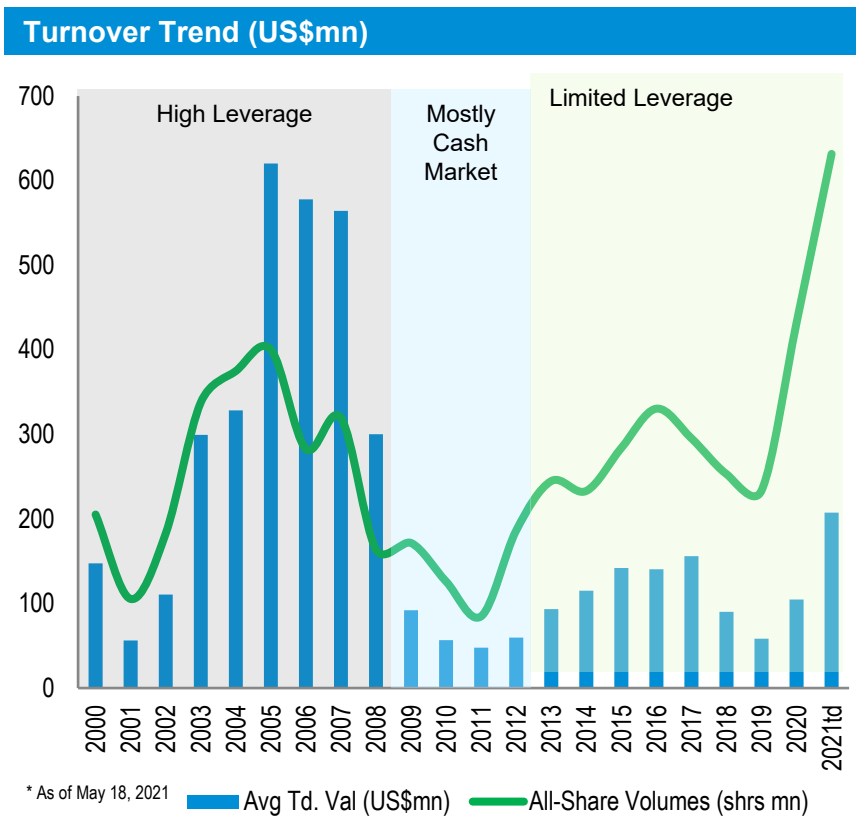
Corporate profitability has accelerated in end 2020/early 2021 despite the ongoing coronavirus pandemic. Growth in 1QCY21 was nearly 100%!

Top Companies Profits (PKRbn)

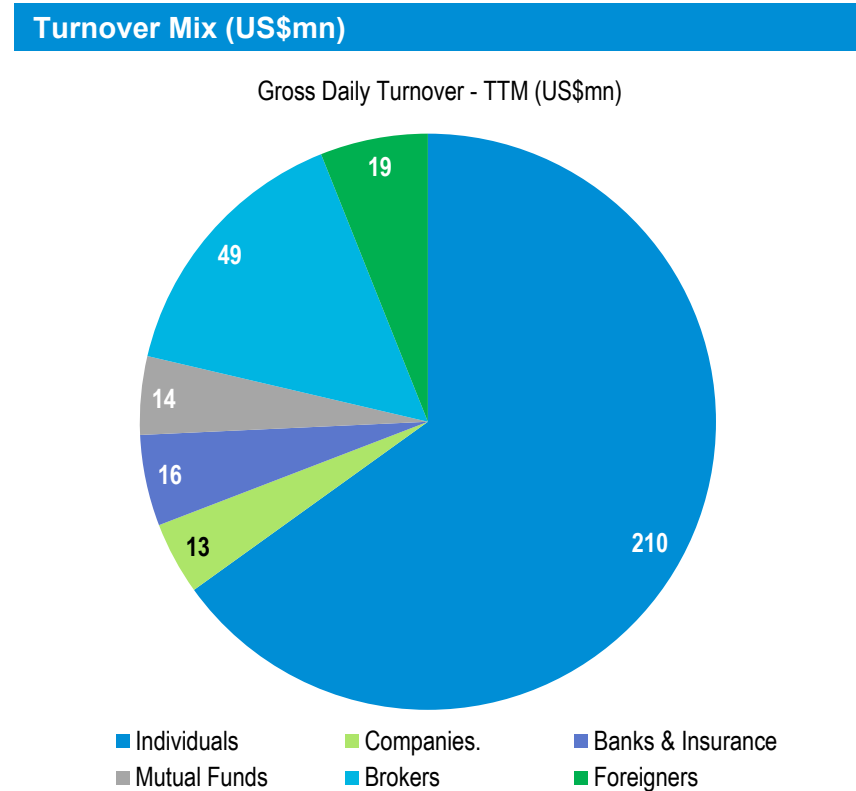


Market Liquidity

Market liquidity is at its peak for the last 13 years. The last peak was prior to the global financial crisis. Hence investors face low liquidity risk.



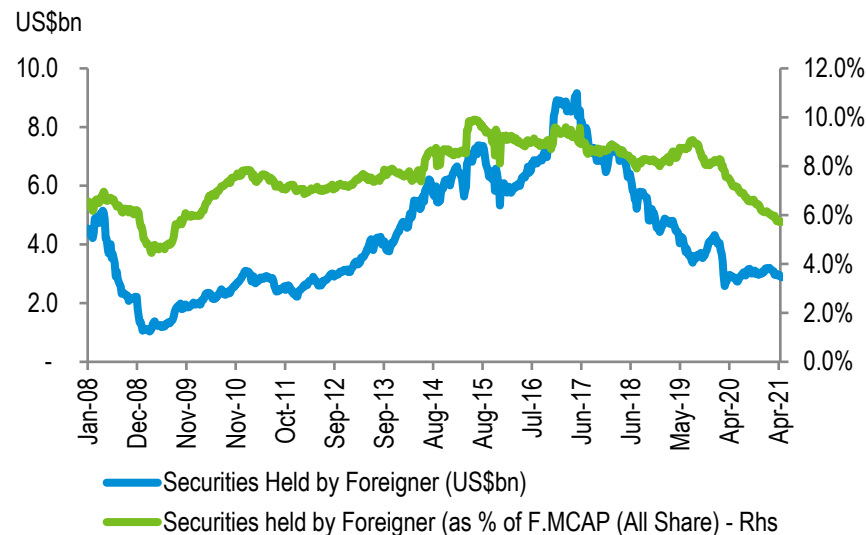
Domestic individuals account for two-thirds of turnover. That also demonstrates that since local liquidity is high, liquidity risk for international investors is low.



Foreign Investors

- Free and full investment and repatriation allowed to foreign investors unlike many developing markets
- Foreign investors have been active in Pakistan since the 1990s
- Pakistan was first made part of MSCI EM in 1994 and was upgraded back to EM in 2016/17
- Foreigners currently own USD 3bn of Pakistan equities (6% of market cap; 25% of free float). At peak, this was more than USD 8bn
- No FOL limits in place
- Same tax treatment as domestic investors
- Pakistan has a small 2-3bps weight in MSCI EM Index. Before upgrade, Pakistan had an 8% weight in MSCI FM Index
- A few GDRs are listed abroad. Global ETFs tracking Pakistan are also available.

Foreign Ownership in Pakistan Equities



Selected foreign funds invested in Pakistan



A wide-angle photograph of a city street at dusk. On the left, a modern building with a glass facade reflects the sky and other buildings. On the right, a classical building with many windows is visible. The street is filled with cars and a motorcycle. The sky is a mix of orange and blue.

BONDS



Key Statistics

113.7 Bn Debt Market Capitalization (USD)

45% Domestic Debt Market Cap/GDP

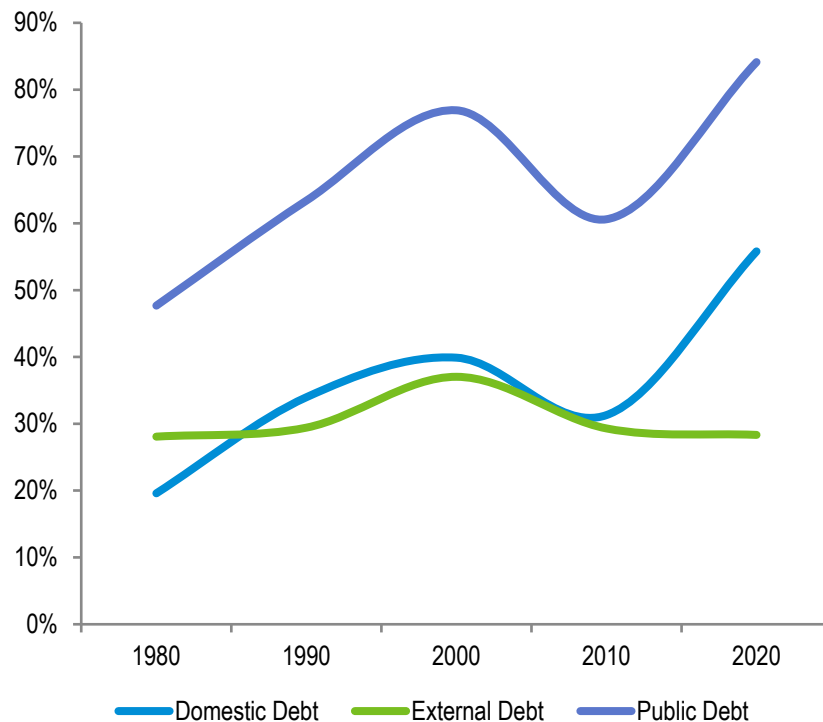
940 Mn Debt Market Instrument Volume Traded (USD)

106 Number of Corporate Issuers

Evolution of Government Debt

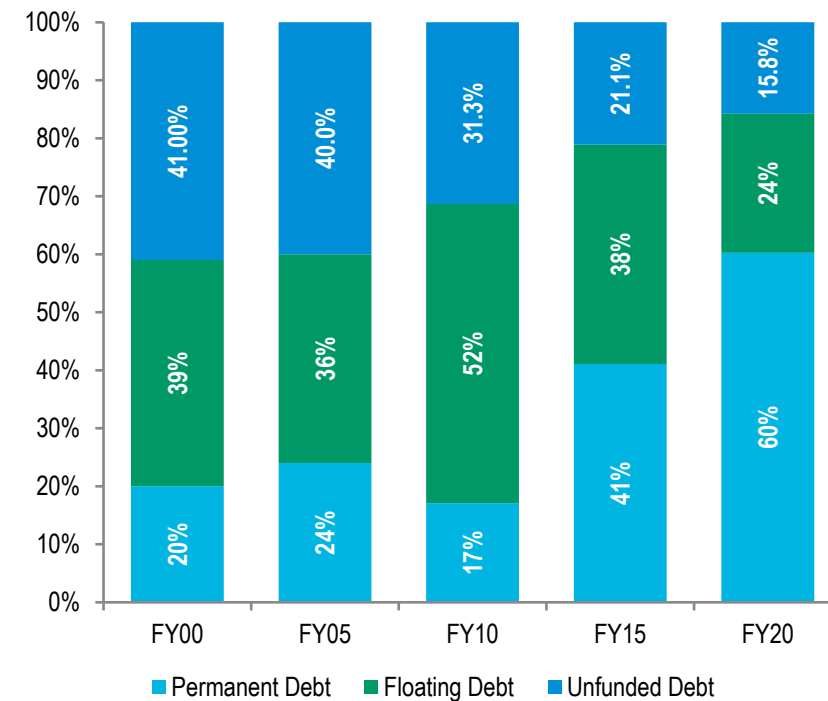
External debt has remained c30% of GDP. However, domestic debt climbed in the 2010s, taking total debt to GDP to more than 80%.

Public Debt as a % of GDP

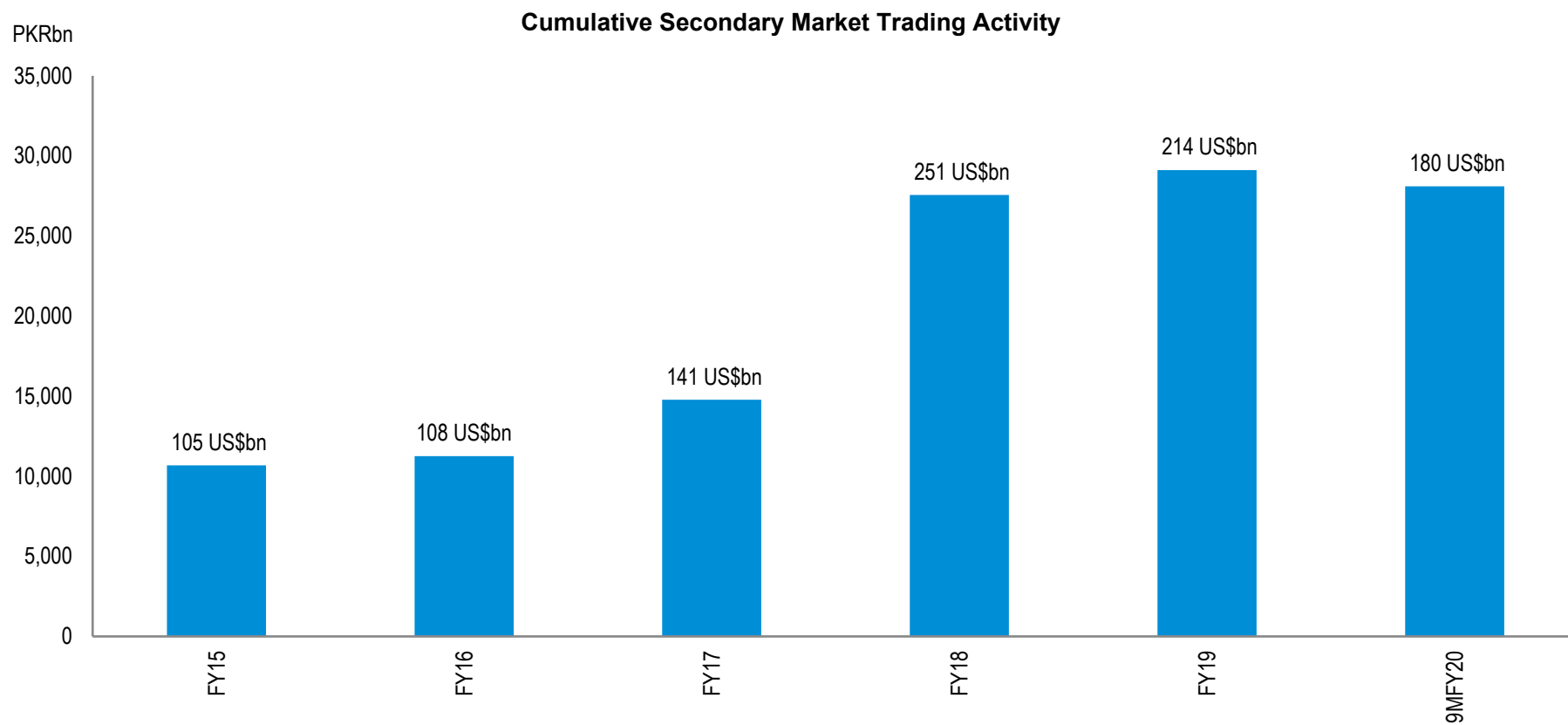


In the last 10yrs, the government has attempted to elongate the maturity profile of its borrowing. Permanent debt (mostly long-term PIBs) is now 60% of its domestic debt mix.

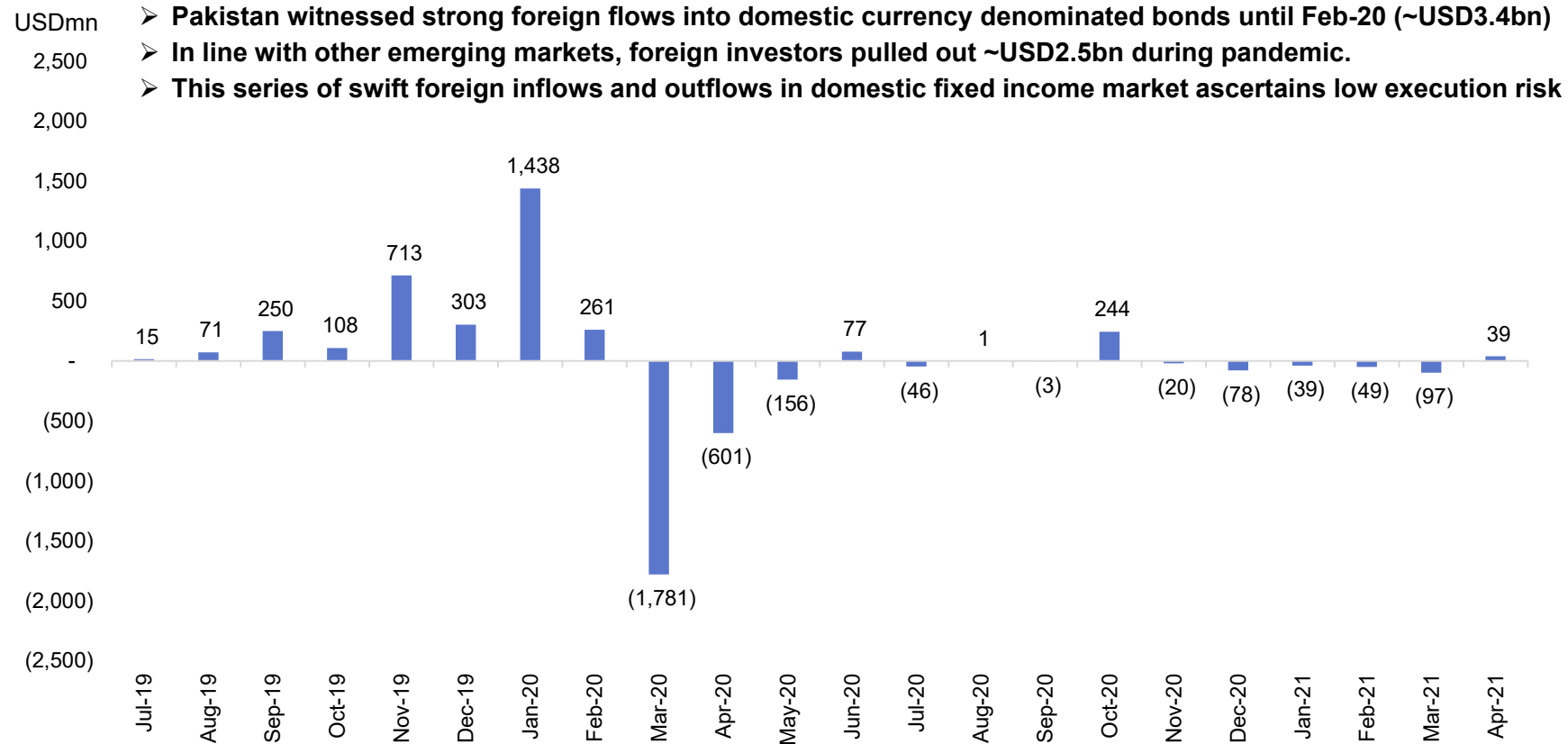
Domestic Debt Mix



Government Debt – Trading Activity



Foreign Investment in Government Bonds



Eurobonds & Global Sukuks

Pakistan has been an active issuer in Eurobond and Sukuk market since 2005

Currently there are seven outstanding issues of USD6.3bn with weighted average maturity of 7 years.

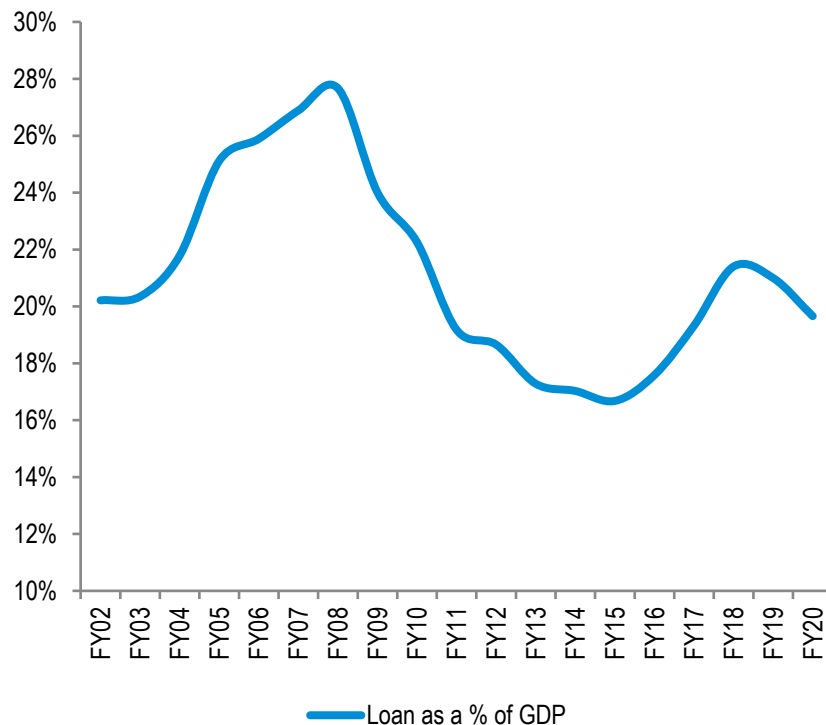
Most recent Eurobond issue was completed in Mar-21 of USD2.5bn split in 5, 10 and 30 year tenors. Government also plans to issue Sukuk in the upcoming months

Category	Year of issue	Tenor (years)	Amount (USDmn)	Yield (%)	Maturity
Eurobond	2005	5.0	500.0	6.750	2010
Sukuk	2006	5.0	500.0	6M LIBOR + 220bps	2011
Eurobond	2006	30.0	300.0	7.875	2036
Eurobond	2007	10.0	500.0	7.125	2017
Eurobond	2014	5.0	1,000.0	7.250	2019
Sukuk	2014	5.0	1,000.0	6.750	2019
Eurobond	2014	10.0	1,000.0	8.250	2024
Eurobond	2015	5.0	500.0	8.250	2020
Sukuk	2016	5.0	1,000.0	5.500	2021
Sukuk	2017	5.0	1,000.0	5.625	2022
Eurobond	2017	10.0	1,500.0	6.875	2027
Eurobond	2021	5.0	1,000.0	6.000	2026
Eurobond	2021	10.0	1,000.0	7.375	2031
Eurobond	2021	30.0	500.0	8.875	2051

Corporate Debt

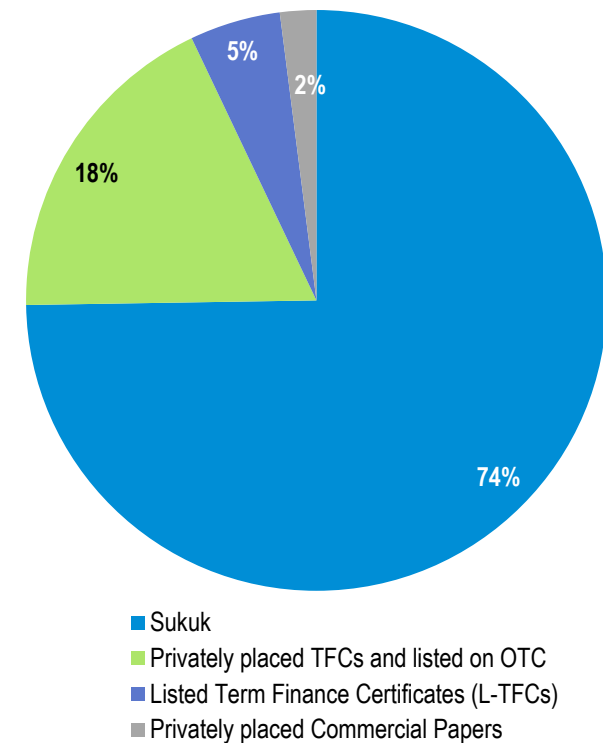
Bank lending to the private sector has been crowded out in the last 10 years, giving rise to more corporates raising debt. However, the number of issues is still only just above 100.

Loan as a % of GDP



Domestic corporate debt is dominated by sukuk, due to availability of liquidity with Islamic institutions (cannot invest in PIBs or T-Bills) and public preference for Islamic instruments.

Domestic Corporate Debt Mix



A scenic view of a turquoise lake with a colorful boat in the foreground and snow-capped mountains in the background. The boat is decorated with various colored cloths and has a yellow flag on its mast. The water is a vibrant blue, and the mountains are rugged and brown, with some snow visible in the distance. The sky is clear and blue.

CHALLENGES, OPPORTUNITIES & THE WAY FORWARD

The Perception Arbitrage - I

“One of the most common questions we get is: How come you are so positive towards Pakistan? There are two key reasons:

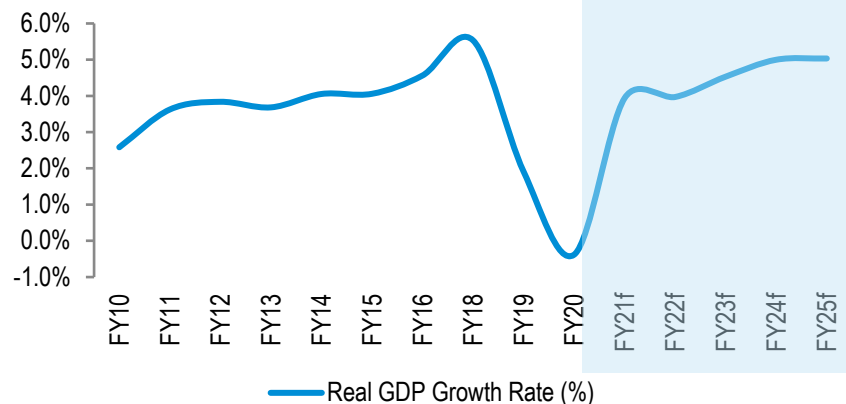
(1) Its financial infrastructure for investors in listed equities is among the best in our universe. You can choose a sector and favorite company within that sector, as opposed to investing in whatever is available in similar markets.

(2) The Perception Arbitrage – As a local entrepreneur put it: “95% of what is written about Pakistan is about the 5% negative.” I should not have to explain that when most investors are negative without even looking, it leaves a lot of potential on the table for those that take a neutral stance.

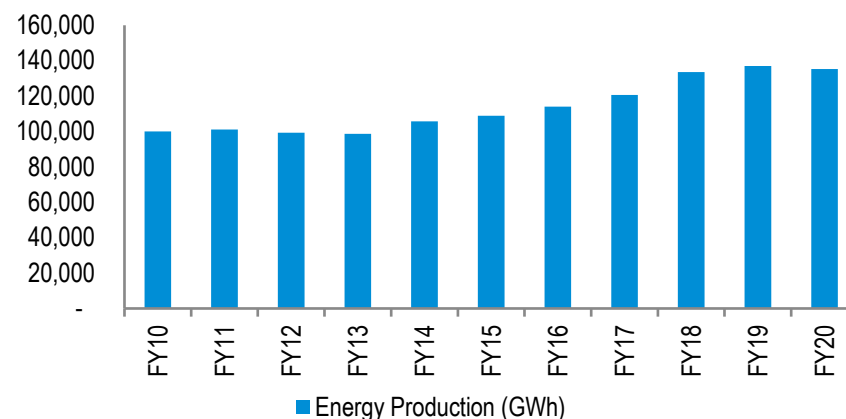
Source - Interview: Mattias Martinsson (CIO & Founding Partner at Tundra Fonder AB), “DeepDive: Investing in Pakistani Equities,” 7 July 2020.

The Perception Arbitrage - II

GDP Growth is bouncing back



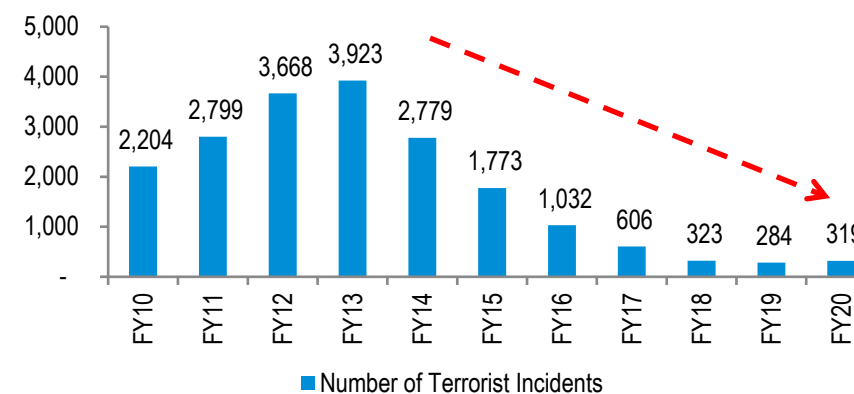
Energy deficiency is over



Democracy is enduring

1980s	Military Rule
1990s	No Democratic Government Completes Full Term
1999-2007	Military Rule
2008-2013	Pakistan Peoples Party Parliamentarians (Full Term)
2013-2018	Pakistan Muslim League – Nawaz (Full Term)
2018- Onwards	Pakistan Tehreek-e-Insaf

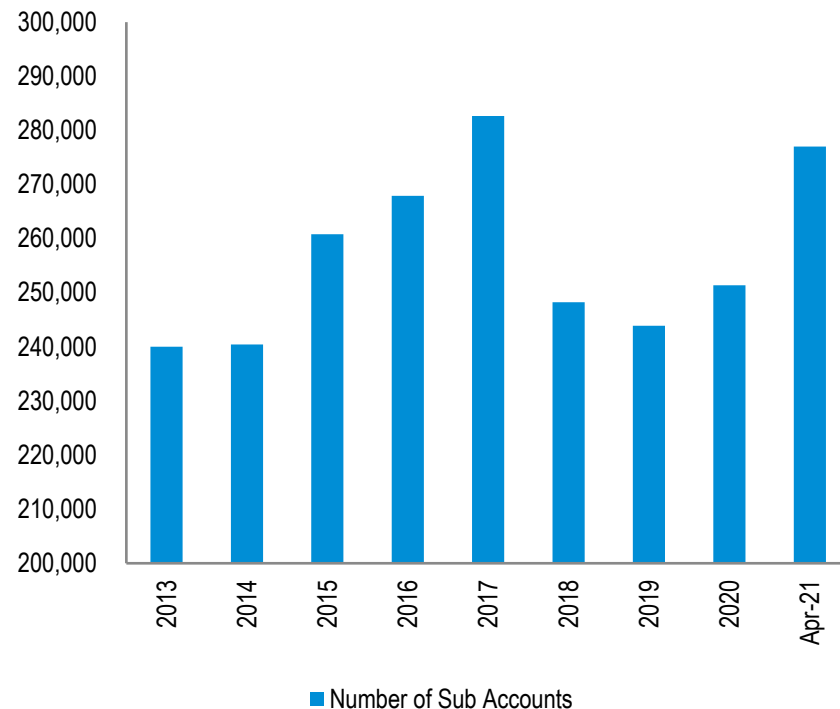
Significant improvement in Security Conditions



Retail Under-Penetration

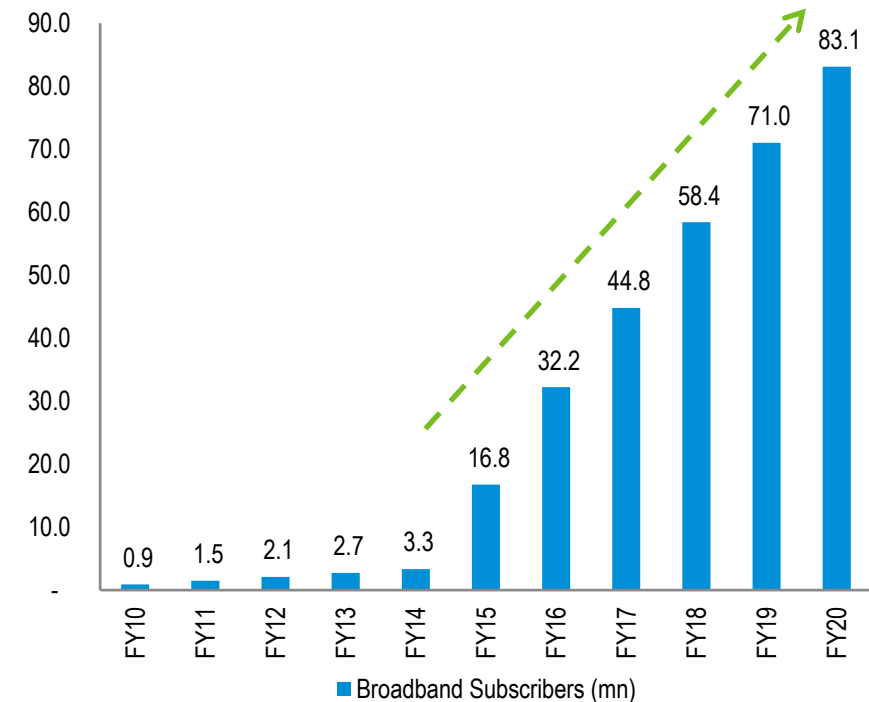
The total number of investors in Pakistan is less than 300,000 (0.1% of the population), investing either directly or through mutual funds (ex-those investing through retirement funds).

Retail investing is ripe for disruption...



Accelerated growth is possible due to (i) a young and tech savvy population, (ii) increasing number of 3G/4G subscribers, (iii) more awareness after the global retail trading boom.

...as the population is young and increasingly tech savvy

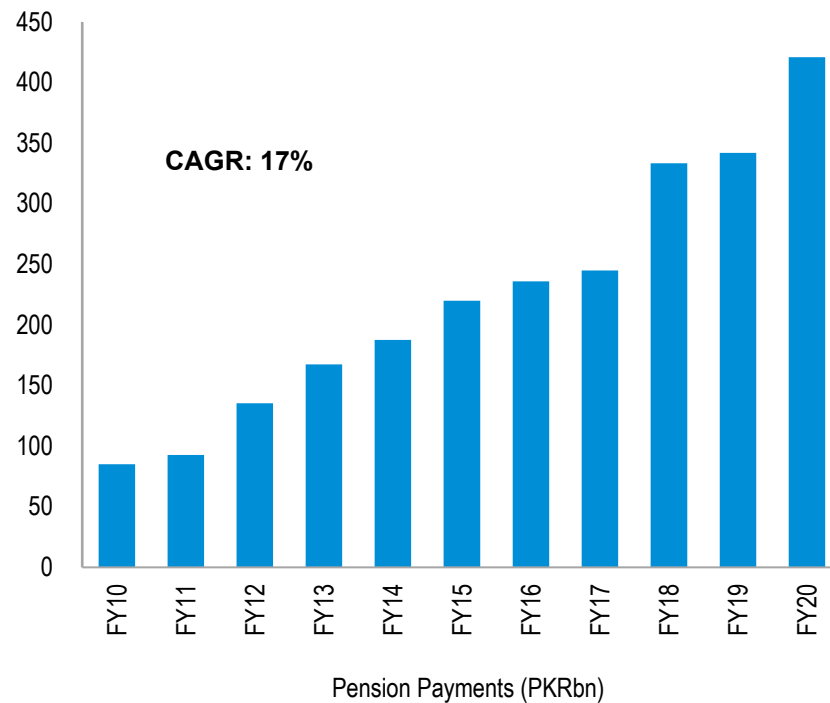


Unfunded Retirement Plans

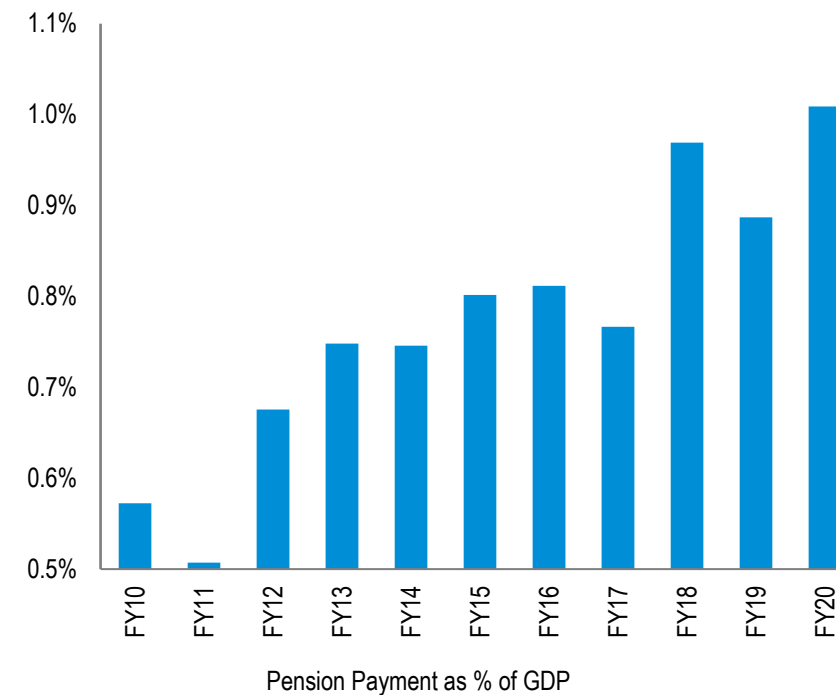
Pakistan uses defined benefit pensions, that are largely unfunded and on pay-as-you-go basis. Pension payments are currently 1% of GDP, sizeable given tax to GDP is about 10%.

The government has recently been seen to tackle the area of pension reform, and may soon approve a shift to a contributory pension system. The World Bank is assisting with this project.

Pension payments have increased 5x in 10yrs...



...,and pension payments have doubled to 1% of GDP

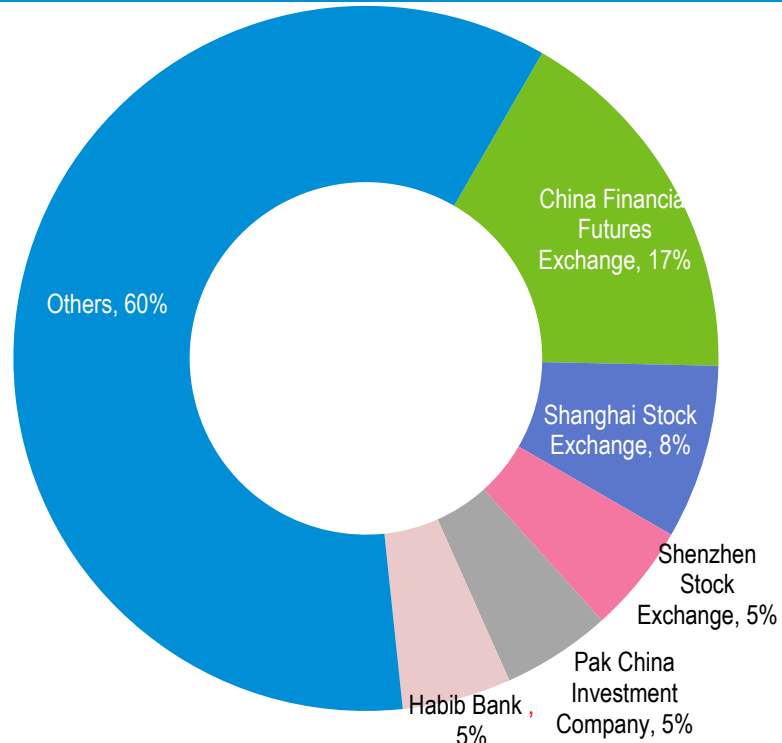


Chinese Sponsors at the PSX

Three Chinese exchanges together own 30% of the PSX (40% together with local partners). The acquisition occurred in 2016, following demutualization in 2012.

The government has recently been seen to tackle the area of pension reform, and may soon approve a shift to a contributory pension system. The World Bank is assisting with this project.

Chinese ownership of the PSX



Recent Changes at the PSX

Under Chinese Sponsors

No stop during Covid	Trading has not been stopped since 2008
ETFs are launched	Launched in 2020. There are now 4 ETFs
Index halts introduced	If KSE30 is +/- 5% for consecutive 5 minutes
Circuit breaks widened	+/- 7.5%. To be increased to +/- 10%
New trading system	Currently being implemented
PES-II is listed	First debt issuance through book building

Possible Future Developments

Cross-border listings	
FPI flows from China	Most FPI flows originate from the West

Conclusion & Outlook

Conclusion

Pakistan's equities are liquid, investable and cheap.

Foreign investors are treated at par with domestic investors.

The KSE100 has returned 18%pa since 2000, making equities the best asset class in Pakistan.

Corporate profitability (KSE100 companies) have grown at a 16% CAGR in the last 10yrs

The corporate debt market is less developed but sukuks are finding increasing traction.

The government is focusing on elongating the maturing profile of its debt and has achieved some success in the last 5yrs.

Outlook

Chinese ownership at the PSX can lead to technological and product innovation. Cross-border listings and increasing FPI from China are possibilities.

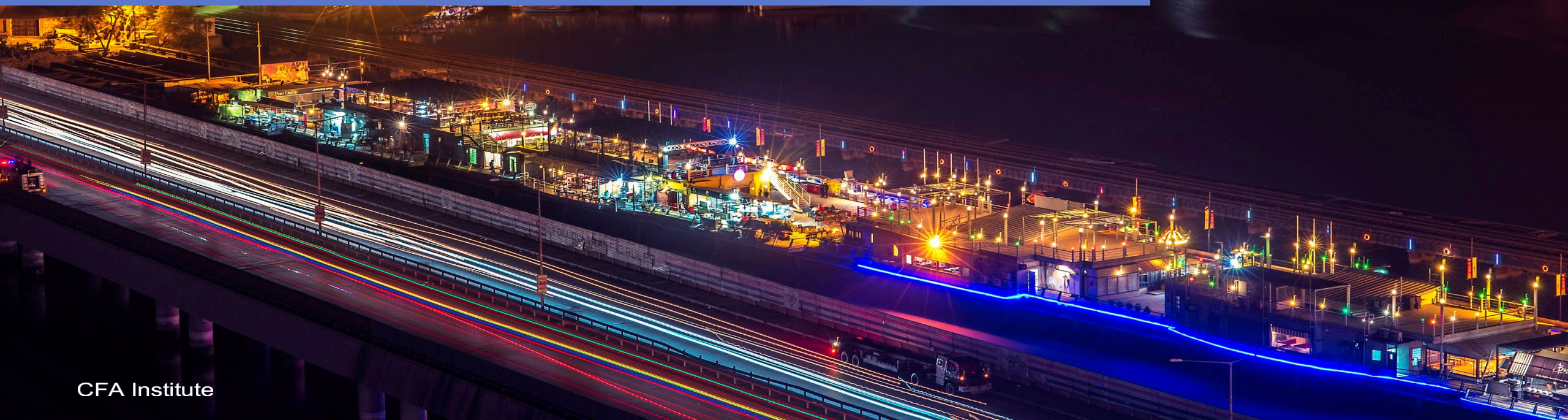
The retail market is ripe for disruption given the population is young and increasingly tech savvy. A step increase in the number of retail investors is possible.

Unfunded pension liabilities are a problem that the government is looking to address. This can encourage a savings culture and increase investment in public equities.

Pakistan's economy is back on the growth path. There is a lot of room for the equity market to come up for the underperformance in the last few years.



APPENDIX



Contact the Authors

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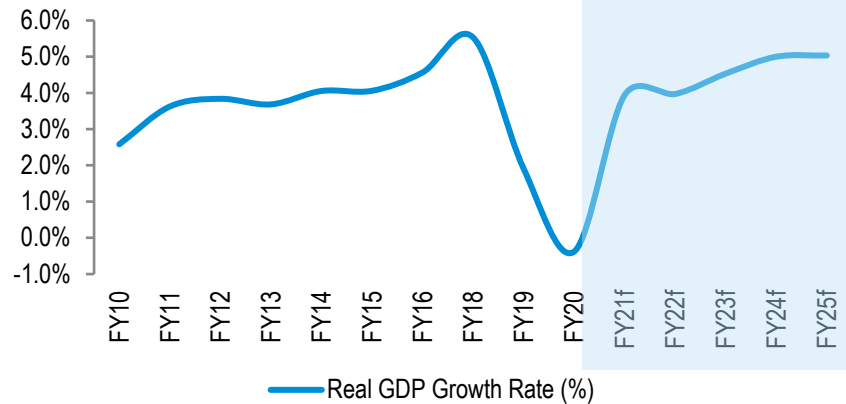


Key Information

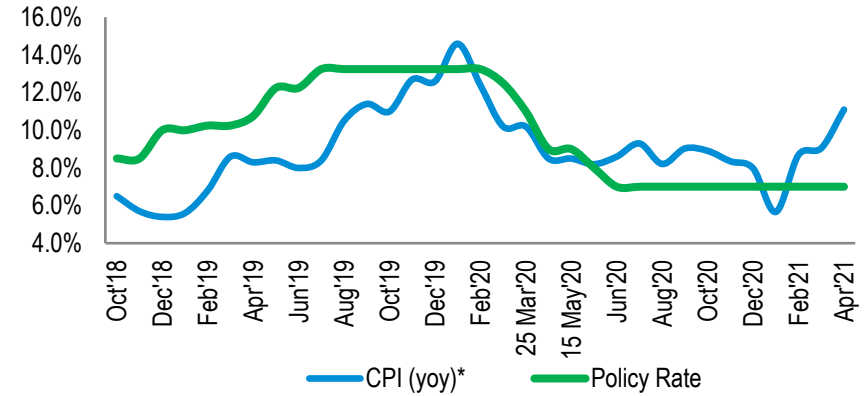
Major Indices	KSE-100 Index; 80% of All Share Market Cap
No of Listed Companies	533 Companies; 25 have market capitalization > USD 500mn; 55 have TTM ADTV > USD 0.5mn
Total Market Cap	US\$51.7bn (All Share)
Free Float Market Cap	US\$15.0bn (All Share)
Avg. Daily Turnover	US\$155mn (TTM)
Market Cap to GDP	17.3% (peak of c 45% in 2007)
Market Return (20-yrs CAGR)	18.3% p.a (12.4% in USD)
MSCI Status	Emerging Market (3bps weight)
Main MSCI Stocks	MCB, HBL, LUCK PA are part of MSCI EM Standard Index. MSCI EM Small Cap has more than 20 Pakistani stocks.
Foreign Access	Full convertibility (including dividend repatriation) through SCRA account; no FOL; parity on tax treatment
Products	Regular, Future, NDM, Odd Lot, SQR & MTS
Circuit Breakers	+/- 7.5% or PkR1/share (whichever is higher), both ways
Index Halts	Yes, if KSE30 is +/- 5% for consecutive 5mins
Settlement	Regular is T+2 & T+1 for Spot transactions. Handled by National Clearing Company of Pakistan Ltd (NCCPL)
Delivery	Electronic; Physical also possible. Custody with Central Depository Company of Pakistan (CDC)
Major Custodian Banks	Citibank, Deutsche Bank, Standard Chartered
Central Depository	Yes
Charges	15bps brokerage commission floor, 13% SST on brokerage charges
Capital Gains Tax	15% for filers & 30% for non-filers.
Regulators	Pakistan Stock Exchange (PSX); Securities and Exchange Commission of Pakistan (SECP)

Economic Snapshot

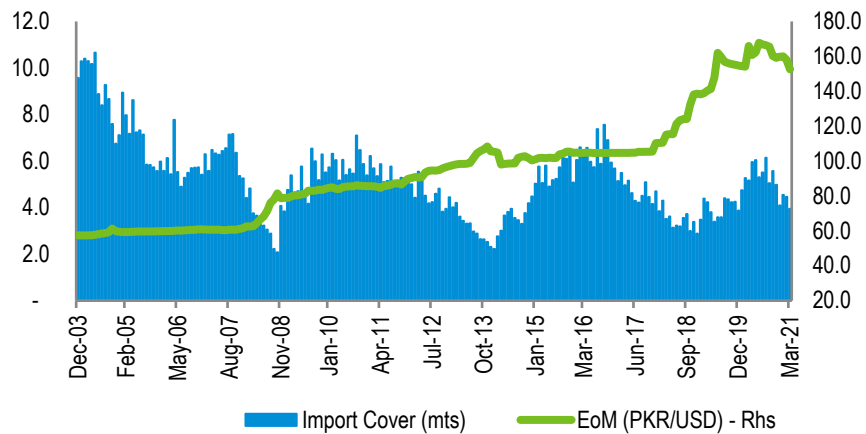
Real GDP Growth Rate



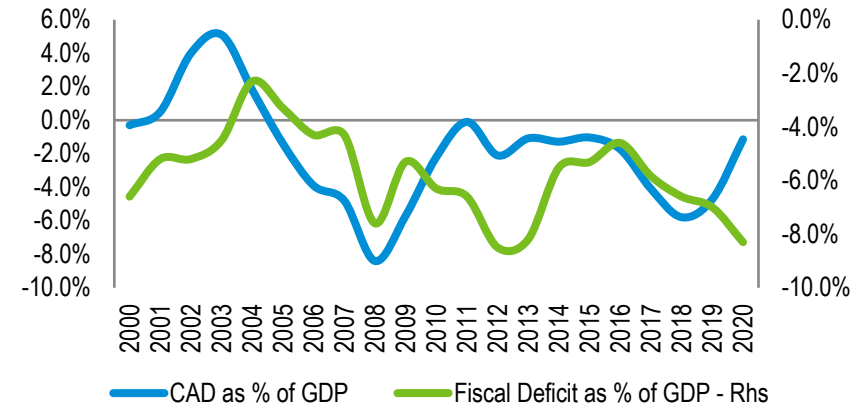
Inflation & Interest Rates



Exchange Rate vs. Import Cover



Twin Deficits





CFA Institute
Research
Foundation



CFA Society
Pakistan

The Emerging Asia Pacific Capital Markets: Challenges and Opportunities - Pakistan

Panel Discussion



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THANK YOU

