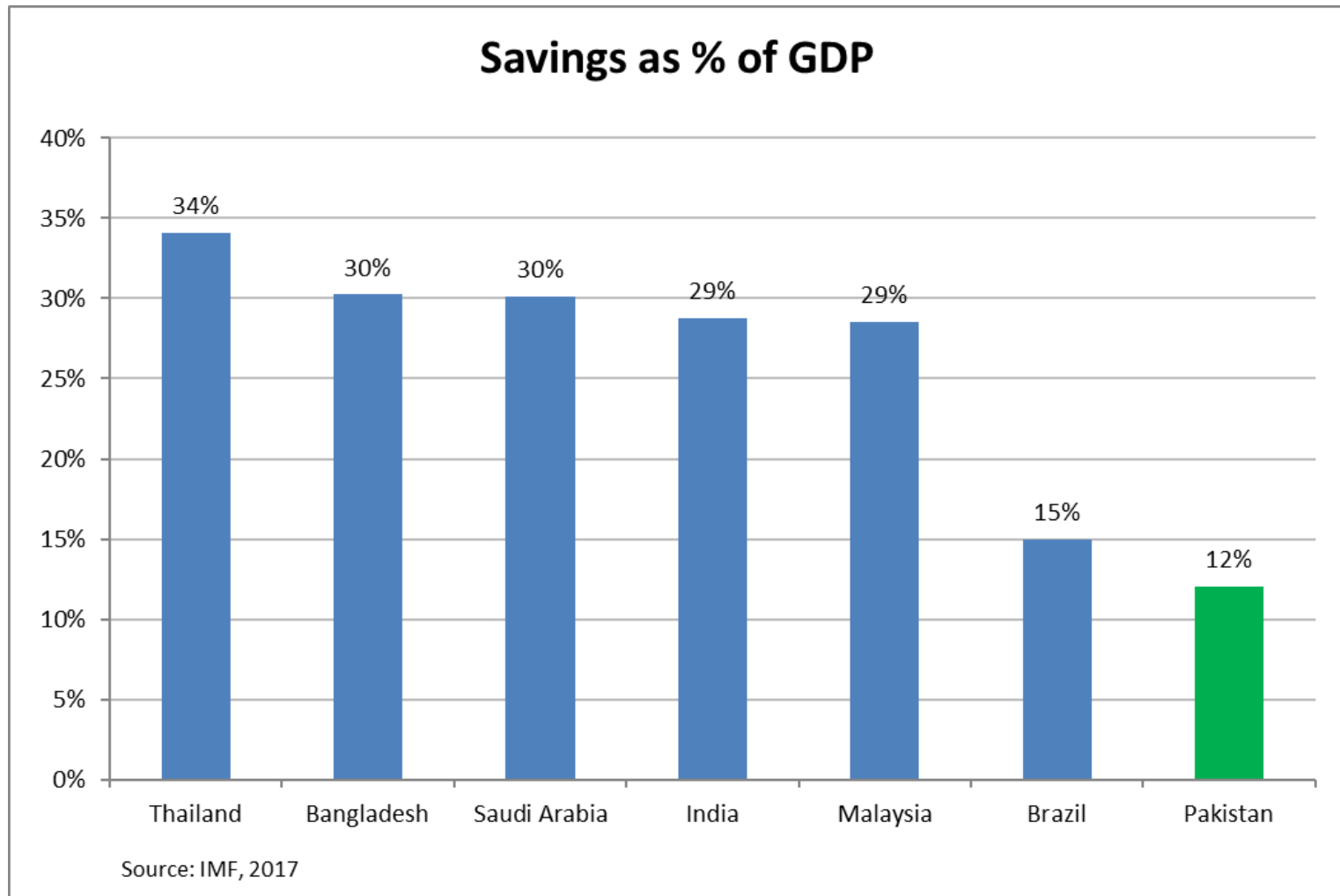


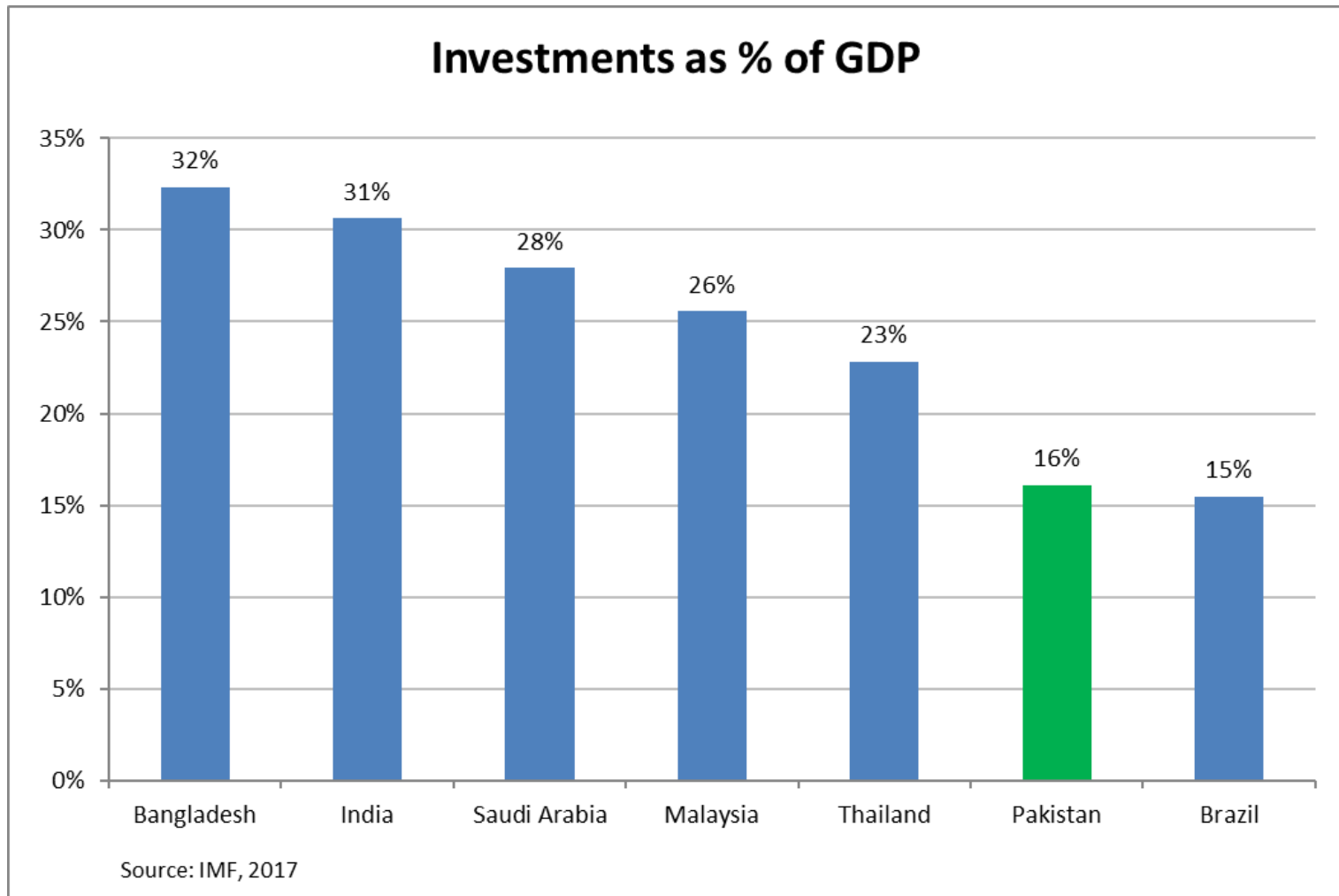
# **Role of Capital Markets in Economic Development**

# Role of Capital Markets in Economic Development



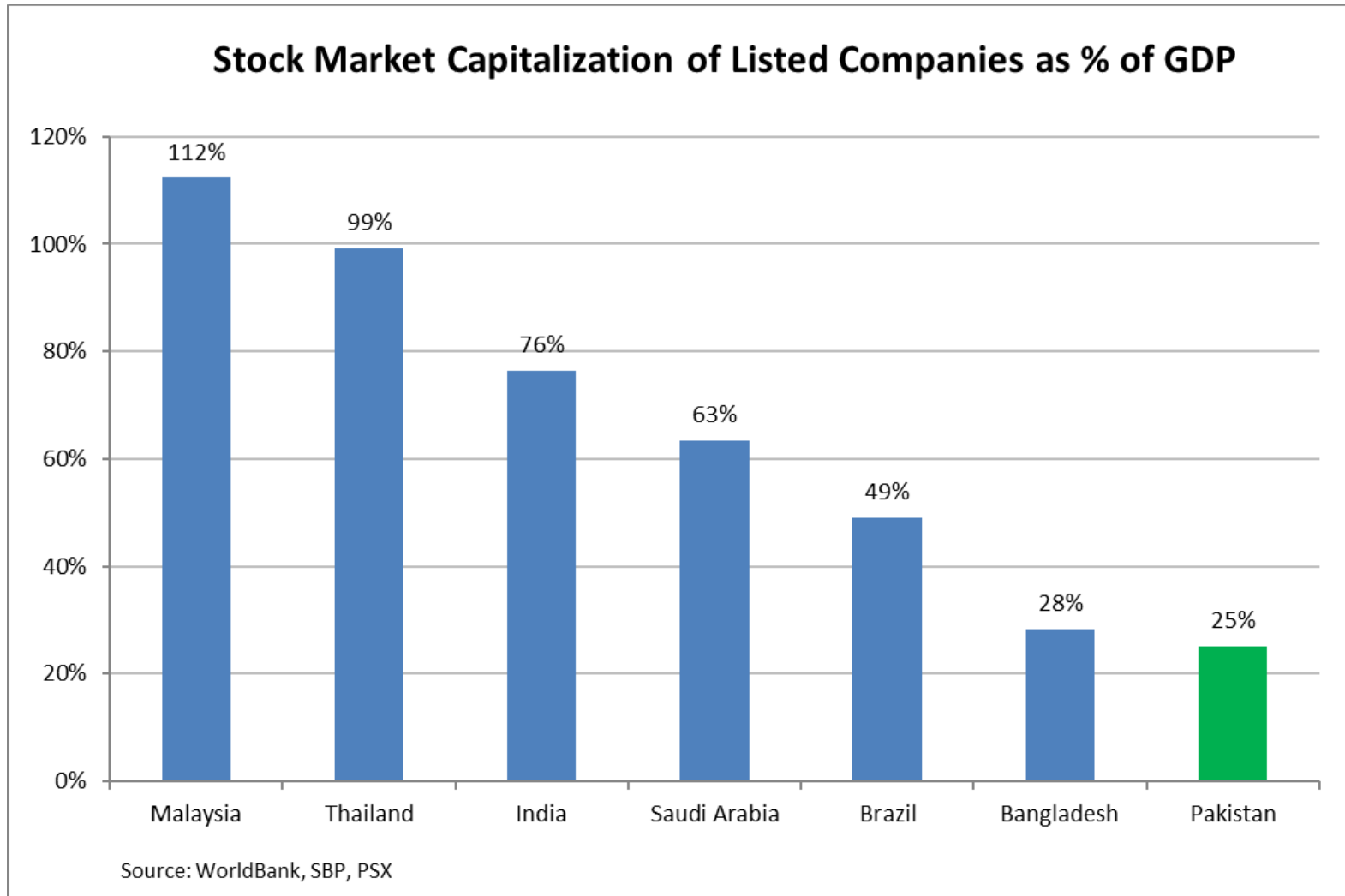
Pakistan's Savings Rates is among the lowest in the World

# Role of Capital Markets in Economic Development



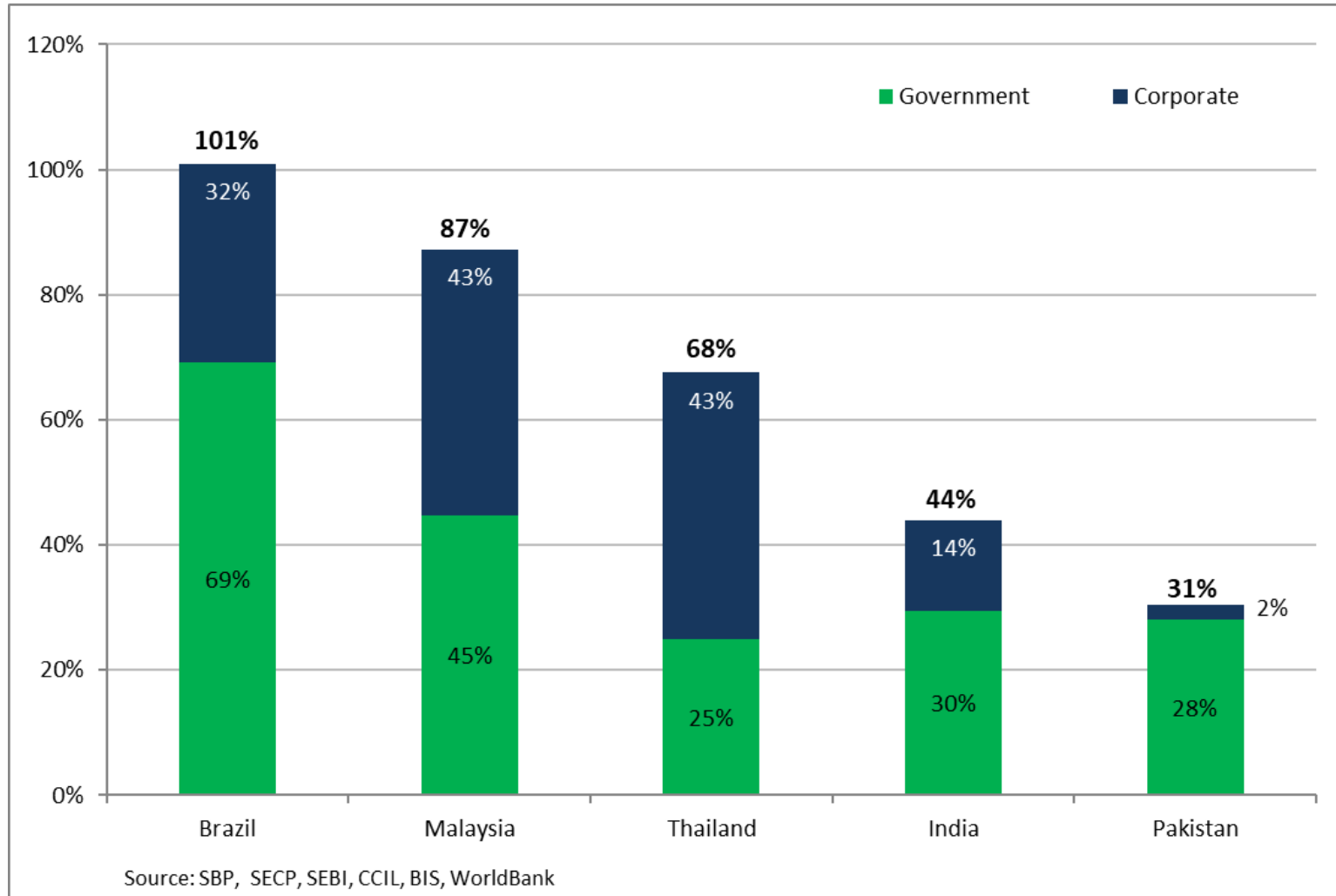
Low savings result in low investments and low economic growth

# Role of Capital Markets in Economic Development

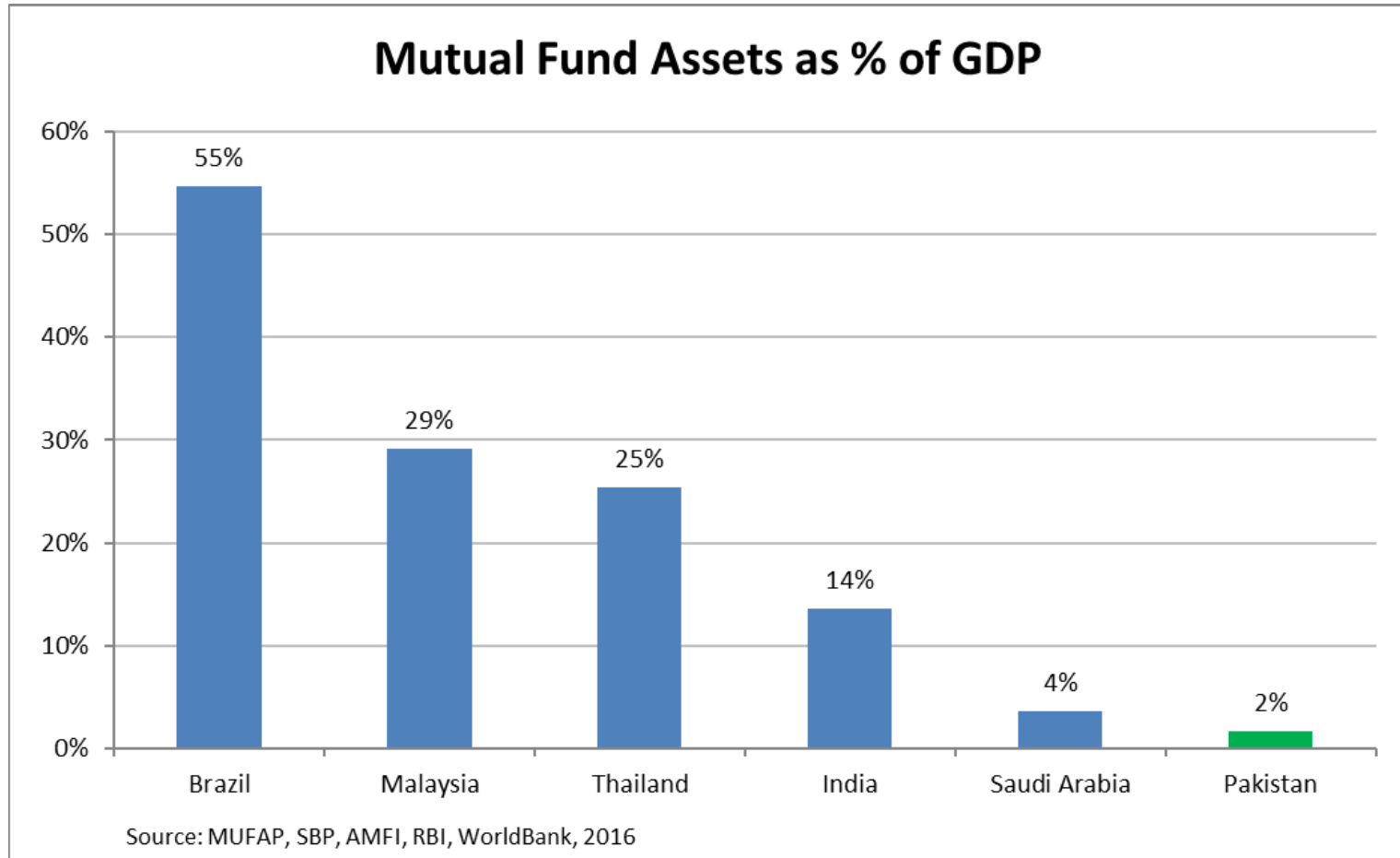


# Role of Capital Markets in Economic Development

## Outstanding Debt Securities as % of GDP



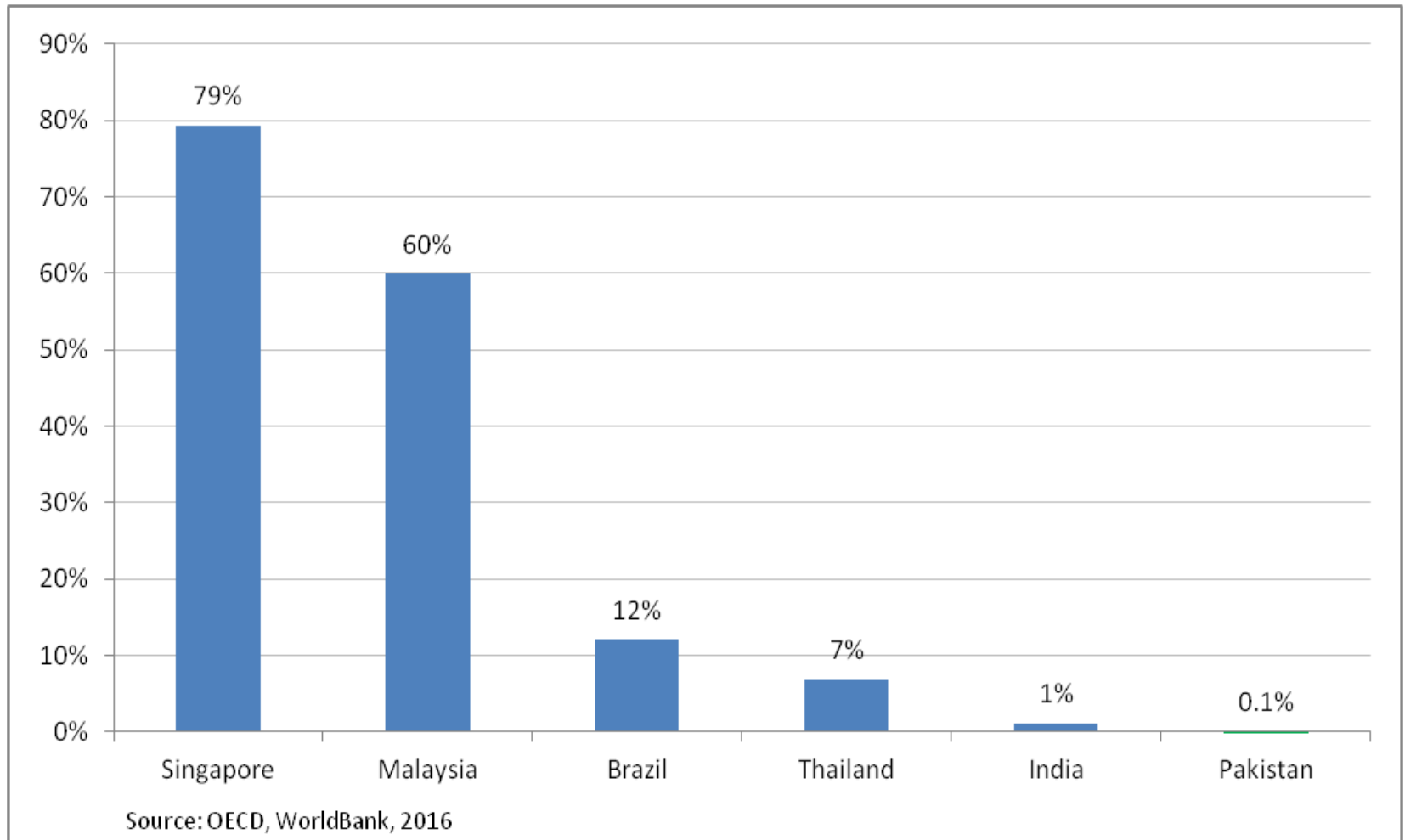
# Role of Capital Markets in Economic Development



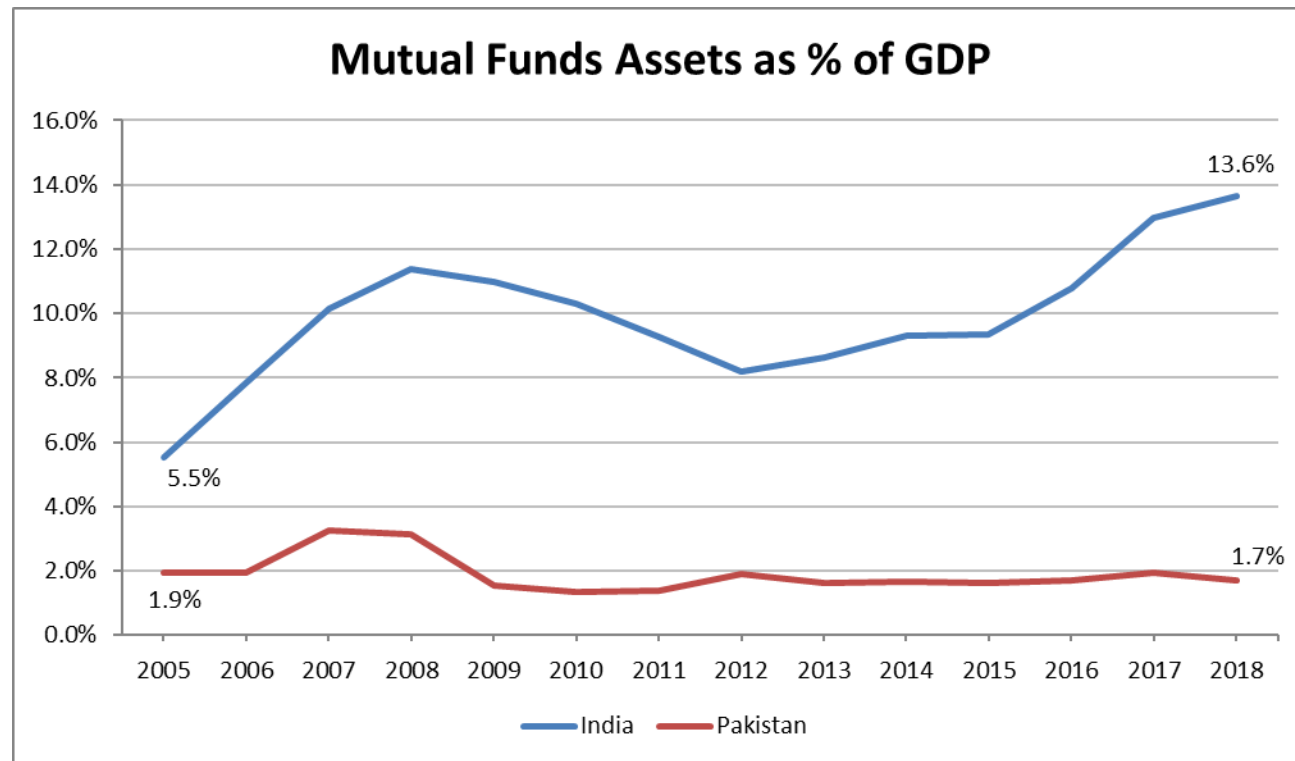
Mutual Fund industry is playing a marginal role in improving savings and investments in the Country.

# Role of Capital Markets in Economic Development

## Pension Fund Assets as % of GDP



# Role of Capital Markets in Economic Development



- If assets of Pakistan mutual fund industry had also grown to 14% of its GDP, as in India, our industry size would have been US\$ 39 billion instead of US\$ 5 billion.
- Currently there are 75 million investors folios in India as compared to mere 0.3 million in Pakistan.
- Resultantly, Pakistan's savings and investment rate would have been substantially higher, and Pakistan's reliance on foreign borrowing and foreign multilateral agencies and donor countries would have been substantially lower.

Source: MUFAP, AMFI, SBP, RBI



# Key Impediments



# Key Impediments

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- National Saving Schemes
- Regulatory Impediments – now removed
- Lack of initiative by NBFIs – development of retail distribution network
- Awareness among Retail Investors

# Excess Rate by GOP relative to Bank Deposits Rate

<b>Scheme Name</b>	<b>Outstanding Amount (Rs. billion)</b>	<b>Years</b>	<b>Returns on Saving Schemes (Rating: AAA)</b>	<b>Average Bank Deposit Rate (AAA Rated Banks Only)</b>	<b>Difference between NSS and bank deposits</b>	<b>Excess payment by GOP (Rs. billion)</b>
SSC / SSA	827	3	12.9%	10.9%	2.0%	17
RIC	490	5	13.0%	11.4%	1.6%	8
Bahbood / PBA	1,223	10	14.8%	12.5%	2.3%	28
DSC	393	10	13.0%	12.5%	0.5%	2
<b>Weighted Average / Total</b>	<b>2,933</b>		<b>13.7%</b>	<b>11.9%</b>	<b>1.8%</b>	<b>55</b>

Source: NSS. AAA rated banks are: NBP, SCB, HBL, UBL, ABL and MCB

GOP can save about Rs. 55 billion p.a. in interest payments on NSS by pricing the instruments based on market i.e. bank deposit rates of various maturities.

Historically, the difference between NSS and comparable bank deposit rate has been about 3%.

# Penalty on NSS

<b>Scheme Name</b>	<b>Outstanding Amount (Rs. billion)</b>	<b>Maturity (Years)</b>	<b>No Penalty after</b>
Special Saving Certificates / Special Saving Accounts	827	3	6 months
Regular Income Certificates	490	5	4 years
Bahbood Saving Certificates / Pensioners Benefit Accounts	1,223	10	4 years
Defense Saving Certificates	393	10	1 year*
<b>Weighted Average / Total</b>	<b>2,933</b>		

Source: NSS

NSS have zero/minimal penalties on withdrawal before maturity.

\* No profit is payable if encashment is made before completion of one complete year. Furthermore, the effective profit rate increases for each completed year.

# Impact of rise of in interest rates – 5.75% in last one year

<b>PIB</b>	<b>Outstanding Amount (Rs. billion) – Apr 2019</b>	<b>Impact on GoP (Rs. billion)</b>
PIBs	<b>3,142</b>	0

<b>Scheme Name</b>	<b>Outstanding Amount (Rs. billion) – May 2019</b>	<b>Maturity Years</b>	<b>No penalty on reinvestment after</b>	<b>Increase in interest rates – net of penalty</b>	<b>Percentage of certificates renewed (Estimate)</b>	<b>Impact on GoP (Rs. billion per annum)</b>
SSC /SSA	827	3	6 months	5.75%	83%	39.5
RIC	490	5	4 years	4.50%	20%	4.4
Bahbood/PBA	1,223	10	0 months	5.75%	100%	70.3
DSC	393	10	1 year	5.75%	8%	1.9
<b>Total</b>	<b>2,933</b>					<b>116.2</b>

Source: SBP, NSS as of 15<sup>th</sup> July 2019.

In case of GoP fixed-rate bonds, the entire interest rate risk is with investors.

In case of NSS, the entire interest rate risk is borne by the Government.

It is not in GoP's interest to raise funding through NSS and pass on the entire interest rate/pricing risk to itself. Fixed rate government bonds/sukuks are a much cheaper option. Very few countries in the world rely on such saving schemes. In India, NSS size is 13% of Govt Treasuries vs 40% in Pakistan.

Limited amounts raised by NSS should be at rates linked to AAA rated bank deposit rates of same maturity.



# National Savings Bonds

- National Savings Bonds (NSBs) of 3, 5 & 10 years maturity were launched by CDNS in January, 2010.
- Only a meager amount of Rs. 3.6 Bln were raised in NSBs as investors were smart enough to not take the pricing risk in the presence of NSSs offering almost the same return, but without any downside risk.
- NSBs failed, and no further issues were launched.
- If NSS will offer about the same rates as bonds of equal maturity, while carrying no downside risk, then no rational investor will invest in bonds.
- NSS is like buying a bond with a free put option offered by the government.
- GoP offers around 95% rate on NSS versus PIBs of the same maturity.



# Drawbacks of Very High NSS Rates

- “More net flows towards NSS limits the banks ability to finance investment in medium-term projects” (SBP)
- Crowding out of the private sector: GOP borrowing at 13%-14% forces the private sector to borrow at even higher rates.
- Hinders growth of mutual funds / banking industry / bond market.
- The Debt Capital Market Committee (DCMC) formed by SBP states that NSS poses a major challenge in reforming debt capital markets. NSS has “**historically been a costly source of funding for the government**” due to the inefficient pricing structure and the free embedded put option. The built-in option allows investors to redeem the investments at any point in time at nominal redemption charges.



# Recommendations for the Government

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- In Pakistan there is too much reliance on NSS versus Government Bonds. In India, NSS is 13% of Government Treasuries vs 40% in Pakistan.
- Amounts raised in NSS should be at rates linked to AAA rated bank deposit rates of same maturity, as is the case in India.
- GoP can save about Rs. 100 billion by removing pricing and tax anomalies in NSS. In this amount, about 8.3 million out-of-school children can be admitted to schools at a fee of Rs. 1,000 per child per month.
- Government should set up an NSS Pricing Committee constituting economists / retired bankers / academics, who should meet on a regular basis, and recommend pricing / rates on National Saving Schemes to the Government, based on the prevailing capital markets conditions.