

Development of TFC Market: Challenges and Prospects

Independent Study

By:

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Scheme of Presentation

- Need for Corporate Debt Market;
- Financial Market Maturity Model (FMM);
- Institutional Players Limiting TFC Market;
- TFC Market in Pakistan
 - Mathematical Model ('94-'04 and '94-'01);
 - Effect of NSS on TFC Market;
- Market Problems;
- TFC Market Prospects;
- Conclusion
- Questions

Need for Corporate Debt Market

• **Microeconomic Role**

- Local Borrowing - Elimination of maturity mismatch;
- Foreign Borrowing – Twin Mismatch (Maturity; FOREX Risk);
- Competition – Efficient Allocation of Resources;
- Facilitates Development of Risk Management Instruments;

• **Macroeconomic Role**

- Alternative Source of Borrowing;
- Credit Risk Dispersion;
- Risk – Possible Contagion Effect;

• **Regional Markets**

- India 3.91% of GDP vs. Pakistan 0.12% of GDP (01-02); → 0.36%
- Sri Lanka 2.2% (1999); Malaysia 25.6%; South Korea 27.83%;

Growth of Selected Corporate Debt Markets in South Asia

Year	Indian Corp. Debt Issues (IR bn)	Total Corporate Debt Issues in Pakistan (PKR bn)	Corp. Debt Issues in India (% of GDP)	Corporate Debt Issue in Pakistan (% of GDP)
99-00	658	0.896	3.43	0.03
00-01	711	5.128	3.4	0.16
01-02	710	4.06	3.39	0.12
02-03		12.501		0.36

Financial Market Maturity Model

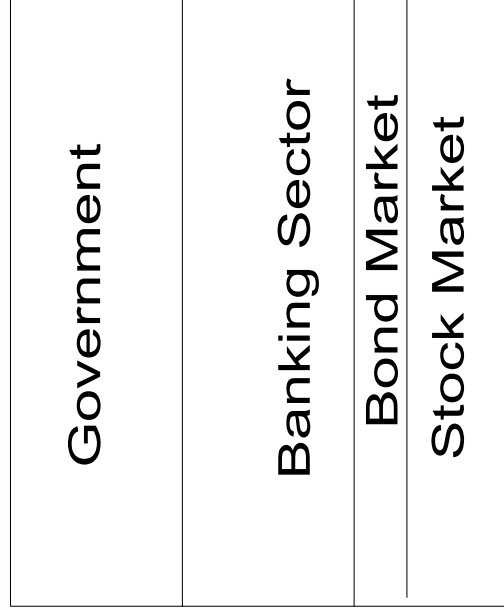
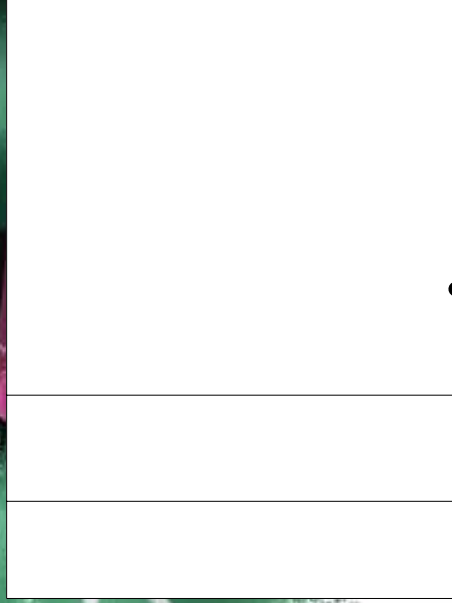
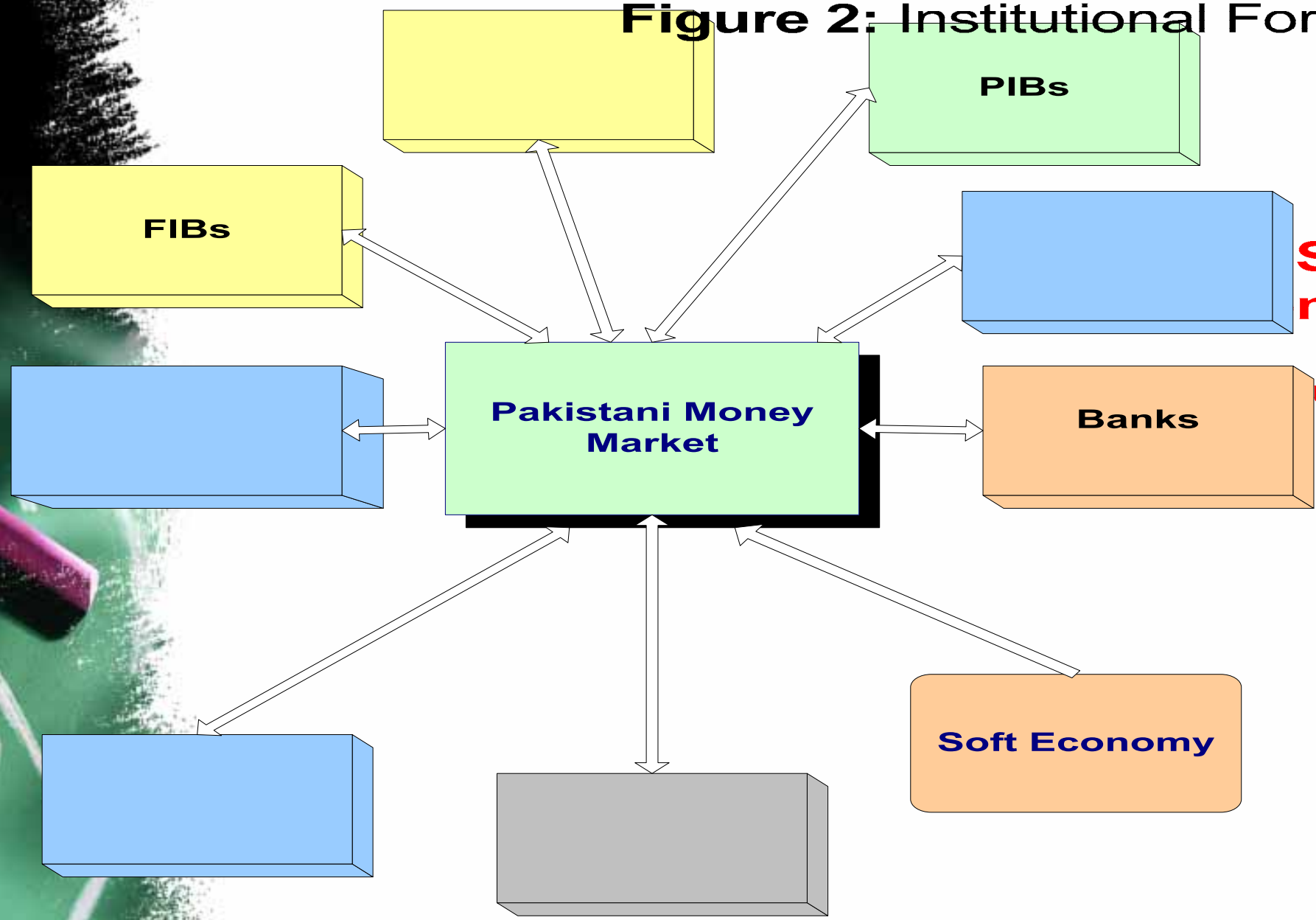


Figure 2: Institutional Forces I



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Real Estate Market

TFC Market in Pakistan

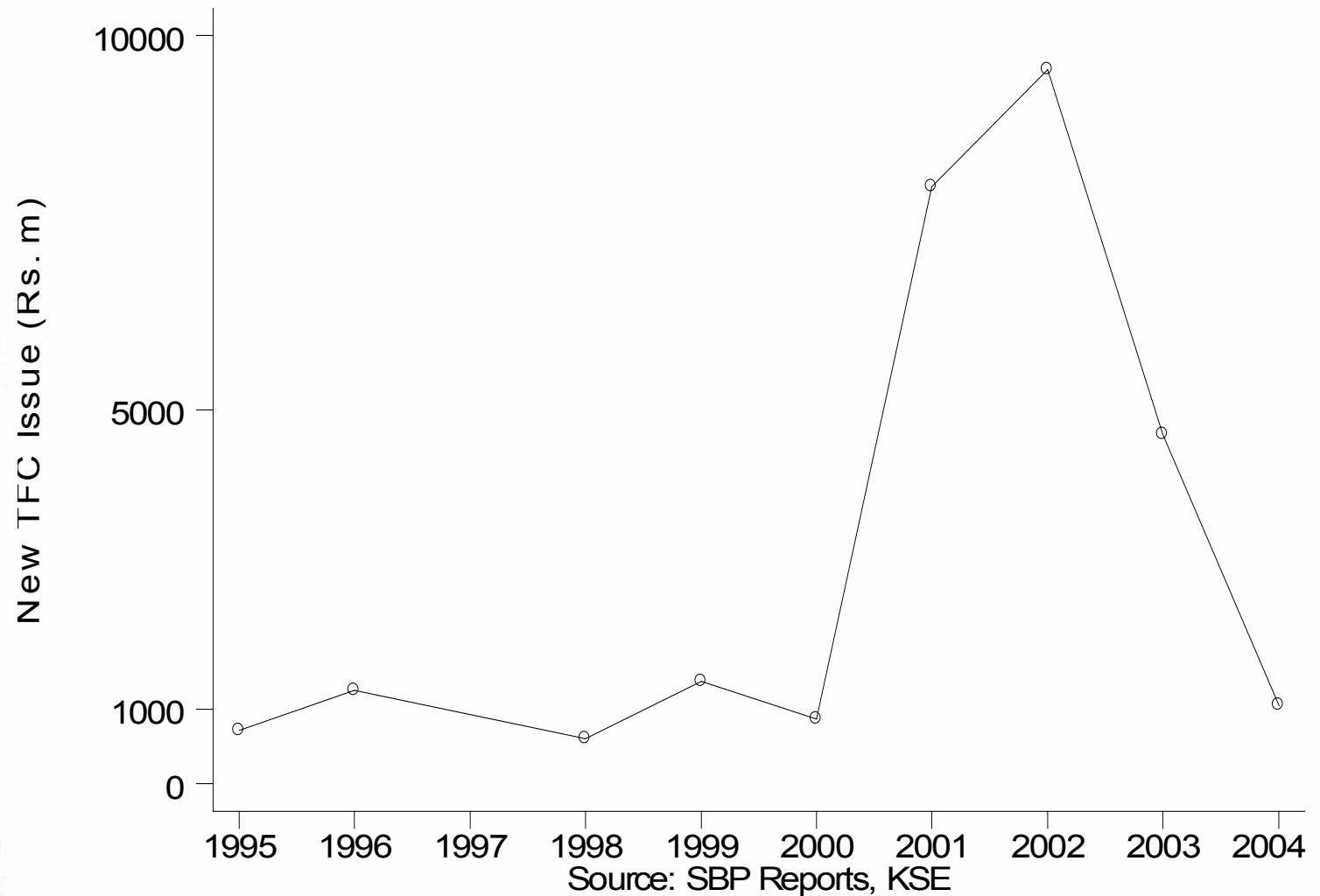
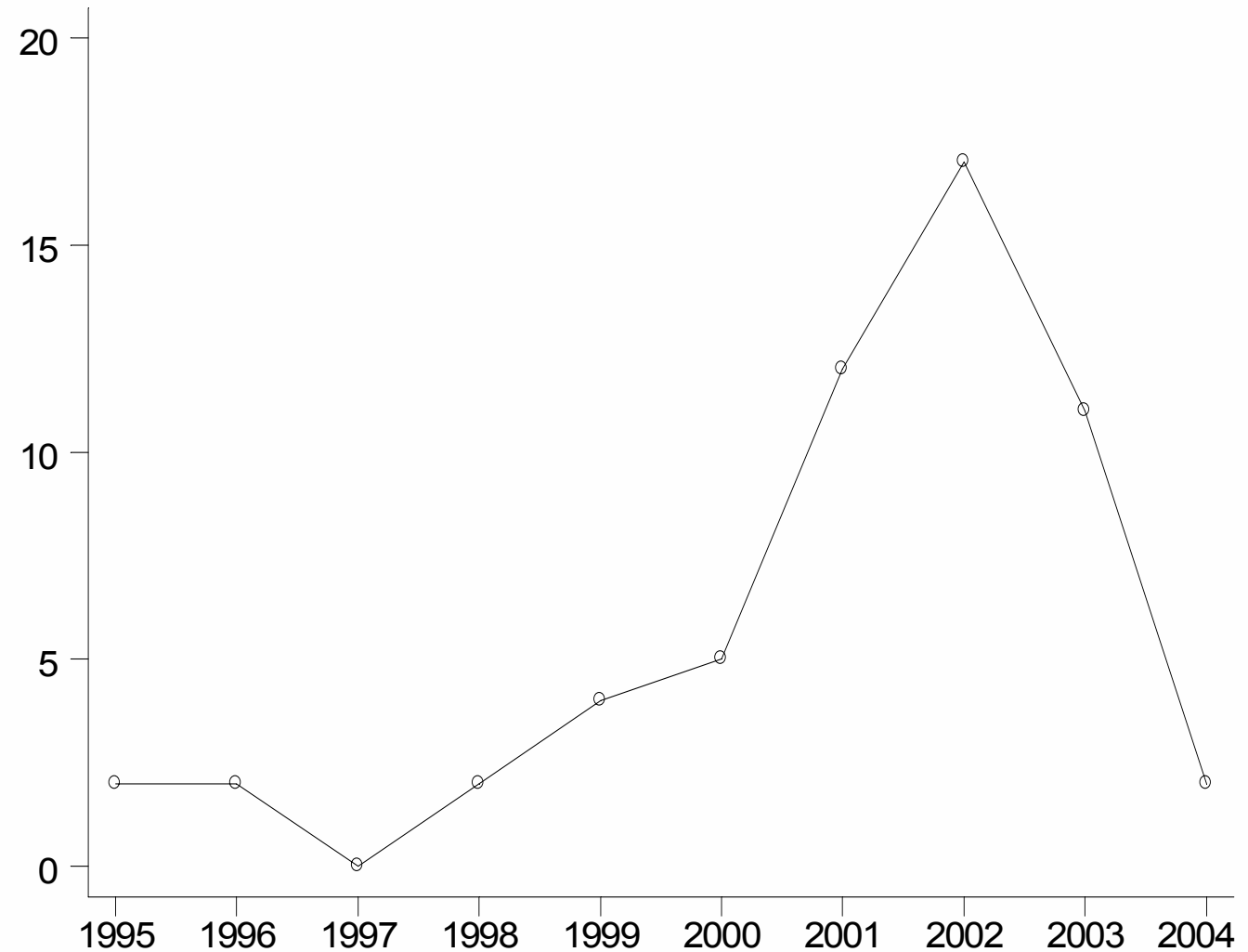


Figure1. New TFC Issues in Pakistan

TFC Market in Pakistan

New Listed IFC Issues



Source: SBP Reports, KSE, SECP

Figure 2. New TFC Issues in Pakistan

TFC Market in Pakistan

- **Mathematical Models:**

Model: $TFC = a \times GDP + b \times NSS + c$

Estimate of $a=12.07$; Estimate of $b=-0.0808$; Estimate of $c = -18812.96$

SE (a) = 0.2.441512; SE (b) = 0.0489756; SE (c) = 6620.151

**This model explains 73.72% of the variations in the TFC market despite the fact that the coefficient of NSS is statistically significant at 15%.
(Data 1995-2004).**

TFC Market in Pakistan

Source	SS	df	MS	Number of obs =	7
-----+-----				F(2,4) = 37.87	
Model	57580287.8	2	28790143.9	Prob > F	= 0.0025
Res.	3040580.23	4	760145.056	R-squared	= 0.9498
-----+-----				Adj R-squared = 0.9248	
Total	60620868.0	6	10103478.0	Root MSE	= 871.86

TFC	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
-----+-----						
GDP	6.442085	.7411744	8.692	0.001	4.384255	8.499915
NSS	-.0371145	.0105374	-3.522	0.024	-.0663711	-.0078578
_cons	-9445.97	1651.785	-5.719	0.005	-14032.06	-4859.881

Hypothesis: $H_0: a = b = 0$; $H_a: a \neq b \neq 0$

From F – Table, $_{0.01} F_{(2,4)} = 21.2$; As $F > F$ critical,

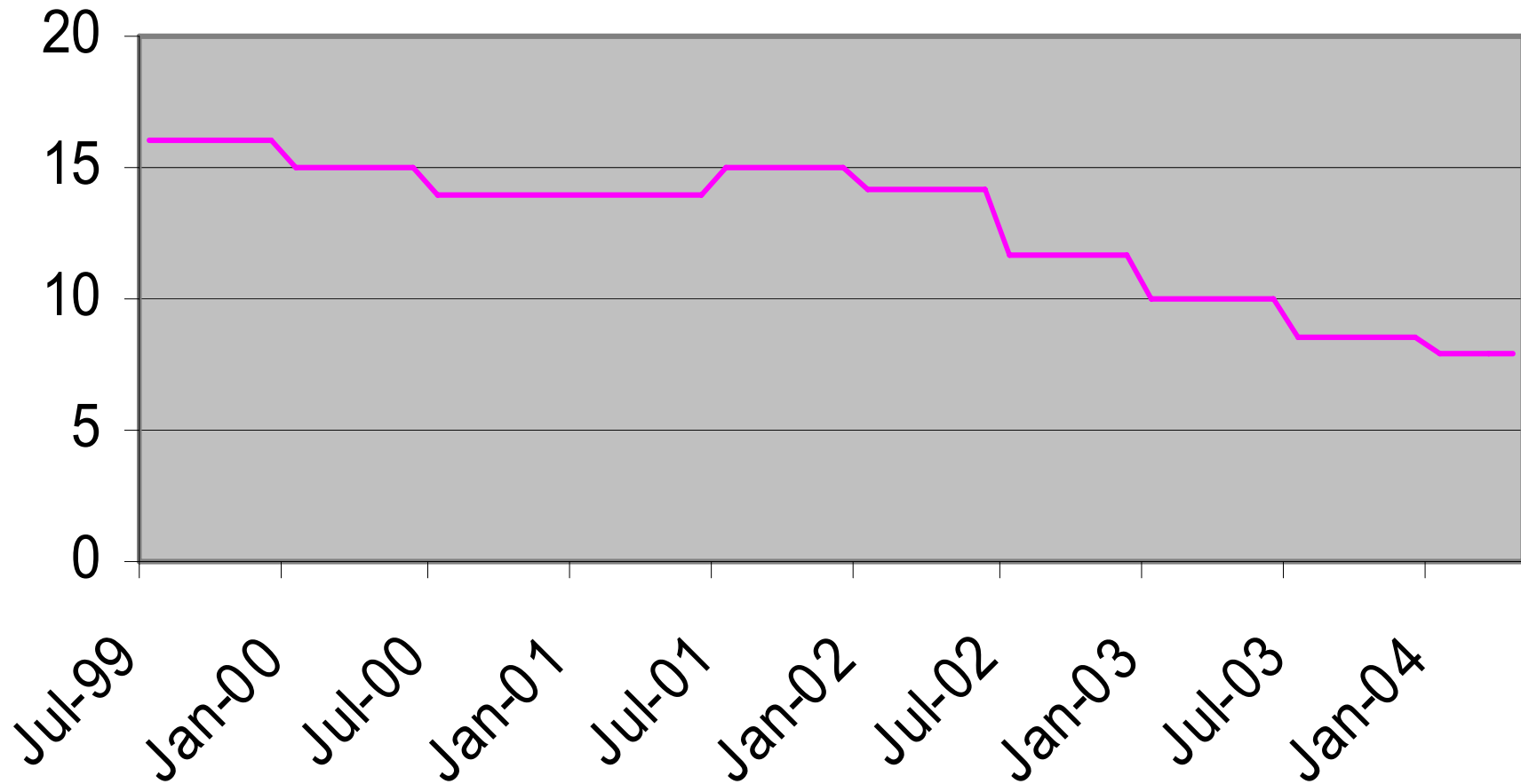
Null hypothesis is rejected.

Therefore, at least one of the two coefficients (a, b) is non-zero.

Model is found to be suitable for explaining the variation in the size of TFC market in Pakistan for the period under consideration (1995-2001) at 2.4% significance level.

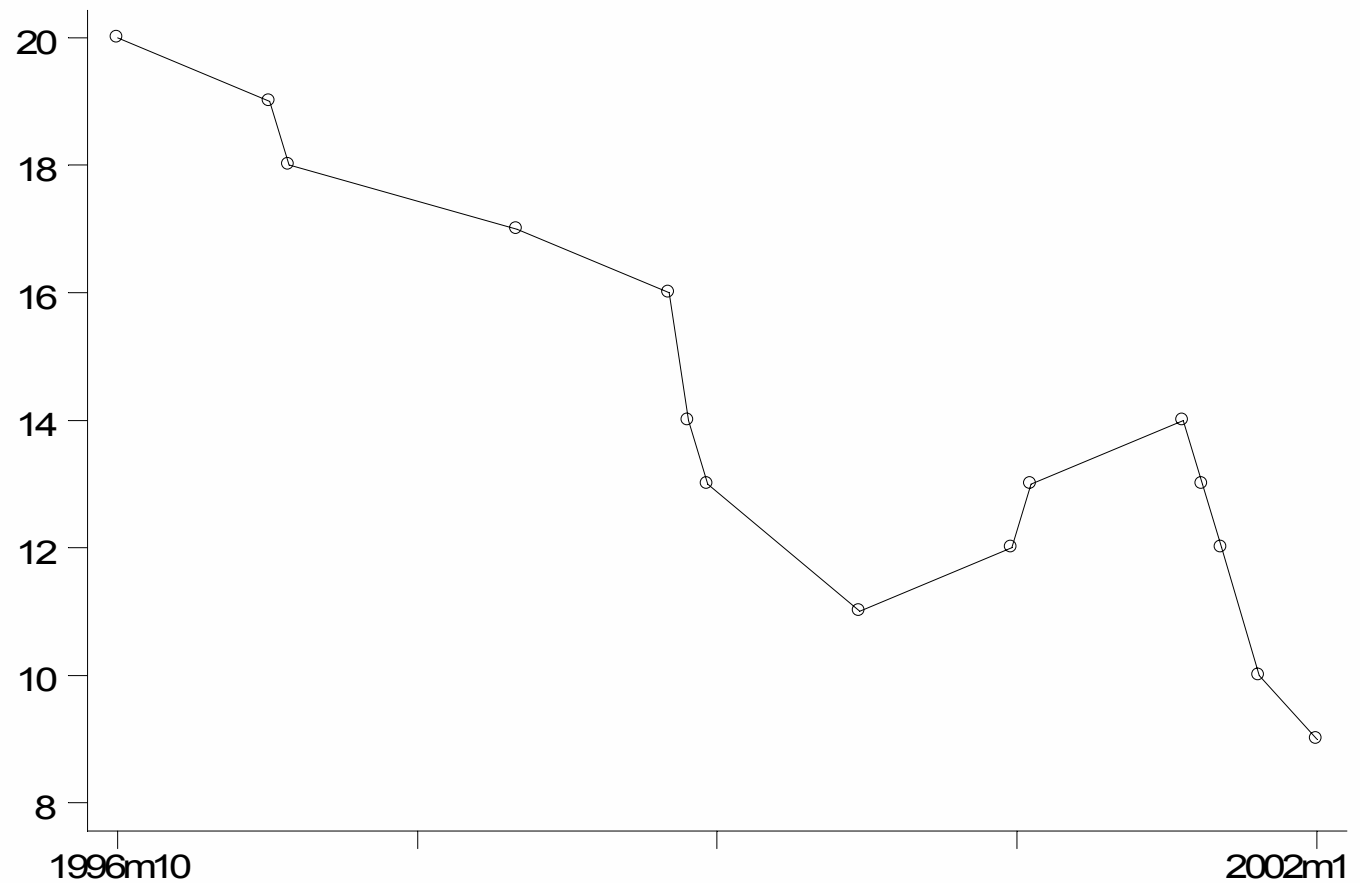
Effect of NSS on TFC Market

Defence Savings Rate



TFC Market Benchmark

SBP Discount Rate (percent)



Source: SBP Reports, IP Research

Figure 5. SBP's Discount Rate

TFC Market Benchmark

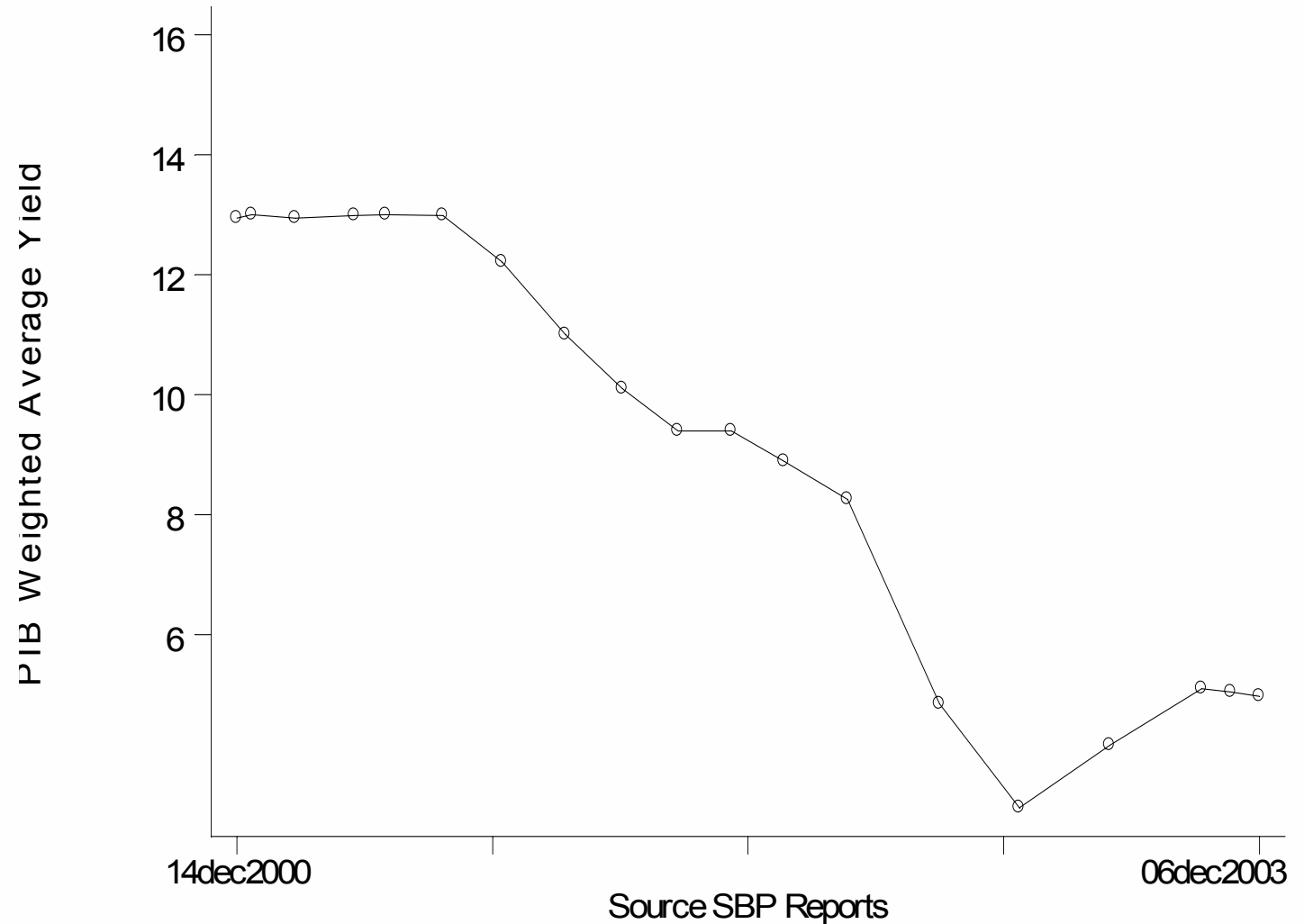



Figure 7. PIB Weighted Average Yield

Problems of TFC Market

- High Cost of Issuance (Adil and Hirani 1.8%);
- Inactive Secondary market;
- Weak Market Infrastructure (buying, selling, settlement);
- Confusion whether TFC is Islamic or otherwise;
- Expectations of inflation and frequent devaluation of PKR hindered the foreign investment;
- Lack of Benchmark in the market –Valuation Problems (PIB- 3,5,10 year);
- Family owned business reluctant to disclose information and prefer either bank lending or private placement;
- Strong Credit Rating Agencies;



Problems of TFC Market

- 
- Need for capacity building of the SBP and SECP;
 - Infrastructure and Legal framework (strong and transparent courts);
 - Pakistan has seen policy shifts strongly correlated with the political instability in the country;
 - Need for long term policies relating to taxation, income tax and stamp duties;
 - Average issuance time of a TFC (Adil and Hirani 2001) = 20 weeks;
 - High returns on NSS Schemes;
 - Relatively new instruments- not well understood by an average investor;
 - Need for technological developments - transparency and liquidity;
 - Economic volatility – Investor Bias for Short Term;

TFC Market Prospects

- Bar on Institutional Investors (NSS);
- Primary TFC market crossed Rs. 28 billion issues;
- Estimated size Rs. 250 billion (Adil and Hirani 2002);
- Reduction in stamp duty (4.5%-0.5%) on issuance & 0.1% on transfer;
- Infrastructure Development (CMDP);
- Benchmark / facilitation by PIBs;
- Low Interest & interest rates will promote TFC issuance;
- Stability and Economic Growth will improve the Size of TFC Market

Conclusion

- Positive Policy Interventions by the Government;
- Requires greater facilitation from Regulatory Agency;
- Issuance Time and Cost is High (20weeks & 1.8%);
- Need for strengthening of infrastructure (market, legal, judicial and enforcement);
- Need for Educating Investors;
- Future Prospects are promising;





Questions