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Issue Brief

CPEC and Pakistan's Stock Market

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The performance of Pakistani stock market has been exceptional in the last year. Improvement in security situation and the launch of development projects under the China Pakistan Economic Corridor (CPEC) have been identified as the key factors behind growing investor confidence. In June 2016, MCSI, a leading provider for insights and investment decision tools, announced that it would classify Pakistan in the Emerging Market Index. At the time of this announcement, the Pakistan Stock Exchange had risen by 15% in 2016 which made it a leading performer in Asia.¹

This announcement was warmly welcomed by government officials and financial experts. For the government, it served as a recognition for its efforts in making Pakistan an attractive market for local and foreign investors. The bullish trend in the Pakistani markets has continued from there on and is likely to persist, given the fact that security and political risks have been decreasing while work on CPEC related projects has gained momentum. More foreign inflows are expected in 2017 once the Pakistan Stock Exchange is actually listed in MCSI Emerging Market Index in 2017.

The picture might look very promising right now but caution needs to be taken when projecting Pakistan's future economic growth based on these Index figures. First of all, this is not the first time that Pakistan has achieved this status. Pakistan was part of this Index from 1994 to 2008 as well, and the economic outlook of the country in that period was quite volatile. For example, the GDP growth year in 1996 was an impressive 6.6%, but it came down to 1.7% in the following year. After a brief period of recovery, it fell to 1.96% in 2001. In 2005, the GDP growth rate was 8.96%, but again, there was no economic stability and the growth rate kept on decreasing over the next 3 years.² One of the reasons identified for Pakistan's better performance in capital markets as compared to India and China is that the Pakistan Stock Exchange is less exposed to the shocks and investor confidence in the global economy.³ The question arises that can the market keep up its performance and absorb such shocks once it generates interest from foreign investors?

The concern here is that although Pakistan Stock Exchange has performed well in recent years, the rise is mainly triggered by local and Chinese investors who have greater stakes in Pakistan's economy. With the passage of time, they have also become accustomed to the unstable environment of Pakistan and consider factors such as relatively easier access to Pakistani stock market, greater familiarity with local trends and desire to support local businesses which other foreign investors will not be taking into account. Foreign investors are more likely to pull away their funds in wake of any unfortunate

development in Pakistan. If such a trend sets in, then the Pakistani market will find it hard to compete in global indexes.

Therefore, it is crucial for the government to pay more attention on the security situation in Pakistan rather than market forecasts. It should also ensure timely completion of projects under CPEC as they will allow Pakistan to showcase itself as a strong and resilient economy for years to come.

Notes and References:

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- ¹ "Pakistan Upgraded to Emerging Markets Status". *The Express Tribune*, June 15, 2016.
<http://tribune.com.pk/story/1122910/pakistan-upgraded-emerging-markets-status/>
 - ² "Pakistan GDP Growth Rate". *Tradingeconomics.com*. Accessed: December 1, 2016.
<http://www.tradingeconomics.com/pakistan/gdp-growth>
 - ³ "Pakistan's Market Leaves India's and China's in The Dust". *Forbes*, November 28, 2016.
<http://www.forbes.com/sites/panosmourdukoutas/2016/11/28/pakistans-market-leaves-indias-and-chinas-in-the-dust/#62a4727256cd>