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SBP GOVERNOR STRESSES THE NEED FOR THE DEVELOPMENT OF FIXED INCOME MARKET

‘Fixed income market development is the key agenda for the next phase of the financial sector reforms in Pakistan. New approaches and instruments need to be promoted to enhance the depth and accessibility of fixed income markets’. This was stated by the Governor, State Bank of Pakistan, Dr. Shamshad Akhtar while delivering her keynote address at a two-day international conference on ‘Fixed Income Market Development in Emerging Market Economies’ at SBP, Karachi today.

A well developed fixed income market helps expose banks to competition which in turn helps improve their efficiency. Indeed, extraordinary banking spreads in Pakistan in recent years is an evidence of lack of competition and efficiency in Pakistan’s financial markets, she observed.

Dr. Akhtar said: ‘Banks can promote supply of bonds in the market through issuance of bonds to supplement commercial banks’ liquidity beyond their deposit base which then helps banks finance the corporate requirements and finance Tier II capital which facilitates eventually banks compliance with Basel II requirements. Moreover, banks’ ability to pack off and spin their nonperforming loans as recapitalization or junk bonds allows them space to lend by relieving banks of these bad debts’.

She said that the banks were often among the most important issuers, holders, dealers, advisers, underwriters and guarantors in the market. ‘Banks can issue long-term bonds for Asset Liability Management (ALM). This is particularly relevant from the perspective of financing long term projects. To further manage their risk profiles in changing interest rate environments, there are now sophisticated risk-management tools such as Interest Rate Swaps (IRS) at their disposal’, the Governor added.

Dr. Akhtar said that Pakistan’s private corporate debt market remains underdeveloped and is below one percent of GDP. The major drivers of financial assets in Pakistan are deposits and government bonds, whereas corporate bond issuances remain a miniscule portion, with the total outstanding issues at Rs49.3 billion (0.64% of GDP) at end FY06, in comparison with Korea at 21.1% and Malaysia at 38.2%. Pakistan’s corporate debt history is relatively short as issuance of “Term Finance Certificates” (TFCs), popular corporate paper, was allowed only from 1995 onwards.

Like other central banks, SBP as a first step has been preoccupied with the development of government securities market which is a prerequisite for development of debt markets. Efforts of SBP have facilitated development of an effective market determined yield curve for government securities which sets the stage for corporate debt market, she observed

Pakistan Investment Bonds (PIBs), introduced in 2000, is now the longest tenor sovereign bonds, providing the benchmark yield curve for private issuances. The National Savings Schemes (NSS), on the other hand, with tenors upto 10 years, provide risk-free investment options to retail and institutional investors, the Governor added.

Dr. Akhtar disclosed that a committee was now deliberating on a number of issues and expected to provide a set of recommendations to promote debt market. The recent revival of PIB auctions with recent announcement of 30 years PIB float give an indication of the Government's inclination to develop the long-term yield curve.

In conclusion, going forward there is a broad recognition in Pakistan that fixed income market development is the key agenda for the next phase of the financial sector reforms. Besides alleviating the key impediments of the government securities market highlighted earlier, new approaches and instruments need to be promoted to enhance the depth and accessibility of fixed income markets.

In this context, there has to be recognition that while banks benefit in a number of ways from debt market development including opportunities it offers for risk diversification, but equally importantly banks can be used to reinforce bond market development. For instance, banks can promote supply of bonds in the market through issuance of bonds to supplement commercial banks' liquidity beyond their deposit base which then helps banks finance the corporate requirements and finance Tier II capital which facilitates eventually banks compliance with Basel II requirements. Moreover, banks' ability to pack off and spin their nonperforming loans as recapitalization or junk bonds allows them space to lend by relieving banks of these bad debts.

The Governor said that the Infrastructure Project Development Facility (IPDF) and the Public Private Partnership (PPP) approach of allowing the private sector to bid for and execute the design, building and operating of large-scale public projects will be critical to evolve infrastructure finance structures. 'Not only will this help arrange financing for the infrastructure projects, but add to the demand for fixed-income bond issuances and increasing the pool of assets available for securitization,' she observed.

In the housing sector, SBP is working closely with housing advisory group which includes all stakeholders to resolve some of the major impediments holding back housing finance development. Among others, there is need for (i) overhauling the land registration system across provinces, (ii) develop supportive institutions and infrastructure to pool loan originators' long term funding requirements, (iii) provide resources by on-lending capital raised on bond market, (iv) develop long term mortgage financing support – in this context SBP would be exploring options for setting up of a mortgage refinancing company which provides a refinance facility where lendings offered to mortgage originators are collateralized by the underlying mortgages, the Governor added.

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