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A Subsidiary of National Bank of Pakistan

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Pakistan Sovereign Bond Market in a Sweet Spot

The Fixed Income market in Pakistan broadly consists of two sub-markets i.e. money market and bond market. The difference between the two is that money market comprises short-term debt securities with maximum maturity of one year. Whereas, the bond market constitutes medium to long-term debt with maturity of one year and above. Money market securities overwhelmingly consist of Treasury Bills (T-bills), as private sector short-term debt issues are extremely scarce. Being ultra liquid and exceptionally safe, money market securities normally offer relatively low returns.

Bonds can be classified into corporate bonds and sovereign bonds. By and large, bonds offer higher yield than that of money market instruments depending upon the capital market conditions especially interest rate and liquidity factors. Due to longer duration, bonds entail higher interest rate/pricing risk – the risk that a change in interest rates will cause the value of the bond to fluctuate. The market price of bonds will decrease in value when the prevailing market interest rates rise, and vice versa. Size of the T-bills and PIBs market at present is Rs. 2,047 billion and 3,011 billion respectively.

In Pakistan, sovereign bond market is dominated by Pakistan Investment Bonds (PIBs). Since PIBs have longer duration (maturity) than the T-bills, they are exposed to higher pricing risk. However, market inefficiencies sometimes create anomalies which could distort the risk-reward relationship, causing investors to earn lower return than warranted by the level of risk involved.

The yield curve is simply the yields on bonds of varying maturities typically from three months to 30 years. During the last 5 years, the Pakistani domestic yield curve remained largely flat with little difference between the yield on 6-month and 3-year government securities. Thus, investors were not getting any meaningful extra yield for investing in long-term government debt. However, over the last couple of months, the yield curve has sharply steepened. Currently, 6-month T-Bills are offering around 10% yield as compared with 12.2% yield on 3- years PIBs. Consequently, the yield advantage of investing in 3-year government bond over 6-month T-bill has risen from just 0.4% in June 2013 to 2.2% in June 2014. Further, with inflation likely to remain subdued over the next 12 months, we expect interest rates to remain stable or slightly decline over the next 12 months. Thus, we believe that the pricing risk for investing in bonds is very low at present.

For our investors, to take advantage of the yield curve differential, while still maintaining a relatively low risk level, NAFA is launching a new Fund namely NAFA Government Securities Savings Fund (NGSSF) with the objective of providing attractive returns by investing primarily in PIBs. We expect this Fund to offer an attractive return of around 9.5% p.a. net of management fee and all other expenses based on the present capital market conditions. We invite our investors to invest in this Fund.