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Capital Markets of Pakistan: Historical Evolution and Literature Synthesis

Farhat Mahmood

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Farhat Mahmood
Pakistan Institute of Development Economics, Islamabad.

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Pakistan Institute of Development Economics Islamabad, Pakistan

E-mail: publications@pide.org.pk
Website: http://www.pide.org.pk
Fax: +92-51-9248065

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ABSTRACT

This study provides an in-depth review by covering more than seven decades of Pakistan's capital markets development, structural reforms and integration with global financial systems. It focuses on the growth trajectory of stock and bond markets, synthesising key empirical research studies on volatility, market efficiency, macroeconomic linkages and policy reforms. The analysis provides insights to understand how capital markets serve as mechanisms for mobilising savings, allocating capital and enabling risk sharing in order to achieve the objective of economic modernisation in line with the vision of Uraan Pakistan.

1. INTRODUCTION

Financial markets are platforms or systems where buyers and sellers participate to trade financial instruments/assets/securities[1]. The two key financial markets in Pakistan are stock and bond markets, collectively known as the capital market[2] of Pakistan. These markets create and develop financial products to provide returns to those with excess funds (lenders/investors) and to supply these funds to those who are in need i.e. borrowers. Hence, capital markets are central to mobilising savings into productive investments by enabling a risk-sharing mechanism. The aspect of information transparency is critically important in these markets in order to ensure that markets set prices efficiently[3].

Pakistan's capital markets cover numerous asset categories and follow different regulatory structures, but essentially they all work by bringing together both buyers and sellers to trade in some asset by adopting the auction or price-discovery mechanism[4]. Capital markets include many players e.g. firms approach capital markets to raise funds for their prospective investments; speculators look into different asset classes in order to make predictions on expected future prices of those assets; hedgers through the means of derivatives market try to mitigate various risks, and finally the arbitrageurs follow this market to take advantage of anomalies detected in capital markets. Furthermore, brokers usually act as intermediaries between buyers and sellers to receive fee or commissions for their services. In bond market both government and corporate bonds are traded. Government bonds are issued through auctions by the State Bank of Pakistan (SBP) on behalf of the Ministry of Finance and primary dealers (i.e. banks and designated financial institutions nominated by SBP) who participate in the competitive bidding process. Whereas, corporate bonds are issued in the primary market via public offerings or private placements with the approval of Securities and Exchange Commission of Pakistan (SECP) and often need a credit rating. However, in the stock market firms raise capital from stock market using initial public offerings (IPOs) or by issuing corporate bonds.

Capital market can be classified based on four dimensions i.e. type of claim, time duration, settlement timing, and structure. The nature of a claim determines whether it represents debt or equity. The trading of bonds/loans come under debt market while trading of shares/stocks come under equity market. Similarly, based on time duration, if the claim is short-term (less than one year), it falls under the money market, whereas long-term financing falls under the capital market. The cash market involves immediate settlement, while transactions in the futures market are settled at a predefined future date. (See Figure 1).

As far as the core functions of capital markets are concerned, they include efficient allocation of available funds, performing pivotal intermediation role between savers and borrowers while ensuring low-cost transactions and easy access to information. These capital markets also create liquidity and ensure security for dealing in financial assets. Ultimately, due to the existence of capital markets, the global economy moves more smoothly.

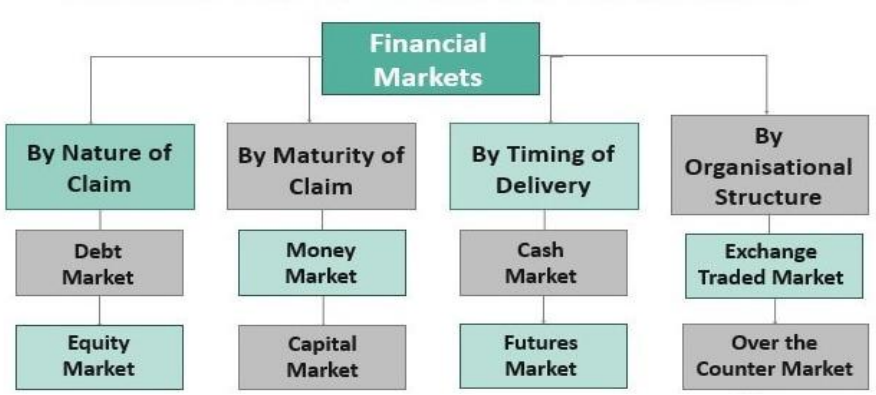
[1] Financial instruments include equities, bonds, currencies, and derivatives etc. that get its value from a contractual right or ownership claim.

[2] In finance, the term capital market refers to markets where long-term funds are raised and traded see Mishkin and Eakins (2018). Financial Markets and Institutions. Pearson.

[3] Efficient means how quickly and wholly prices of financial assets reflect all information available in the market.

[4] Auction has been done to decide bond market instruments prices while price discovery using mechanism is used for stock market.

Fig. 1. Classification of Capital Markets



Source: Adapted from Saunders & Cornett (2019), Financial Markets and Institutions.

Despite more than seven decades of the development of Pakistan's capital markets, the existing literature on capital market of Pakistan is fragmented and mostly focused on isolated aspects such as volatility, market efficiency, macroeconomic linkages, investor behaviour, market anomalies etc. (for details see Zulqarnain & Shah, 2013; Attari & Safdar, 2013; Omar, et al, 2022; Rehman, 2013; Anjum, 2020). Likewise, literature covering Pakistan's bond market (Uppal, 2024) largely investigates fiscal and institutional challenges instead of unfolding the overall evolution of the bond market in Pakistan. Consequently, an integrated approach is missing in literature that comprehensively explains the development of these markets (since 1947 till 2025), synthesises the accumulated empirical evidence across both stock and bond markets, and links these insights to contemporary national development priorities such as Uraan Pakistan. This gap limits a holistic understanding of the development of Pakistan's capital markets and, consequently, its policy implications. The present study addresses this deficiency by providing a detailed review of the evolution of Pakistan's capital markets and synthesising evidence from the existing empirical literature. Accordingly, the objective of this review is to fill this gap by giving an integrated understanding of Pakistan's capital markets development and its policy implications. To achieve this purpose, the study pursues three research objectives:

- To document the historical evolution of Pakistan's stock and bond markets from 1947 to 2025.
- To review and synthesise the existing literature on Pakistan's capital markets to highlight key findings, achievements and research gap.
- To propose policy directions and strategic interventions for aligning capital market development with the objectives of Uraan Pakistan.

Section 2 of the paper discusses the historical evolution of Pakistan's capital markets, while Section 3 provides the methodology of this review, and Section 4 gives literature review covering over several decades of empirical research to examine the factors influencing capital markets' performance. Section 5 establishes the linkage

between Pakistan's capital markets and the vision of Uraan Pakistan. Finally, Section 6 provides conclusion and key recommendations.

2. HISTORICAL EVOLUTION OF PAKISTAN'S CAPITAL MARKET

A comprehensive overview related to historical performance assessment of stock market and bond market is provided in this section.

2.1. Stock Market Evolution

The Stock market is a financial market used by publicly traded companies to raise capital while it is used by investors to earn returns (i.e. capital gain and dividend)[5]. Stocks are traded on stock exchanges or in OTC markets. In the primary stock market new issues of stocks are sold via IPO, subsequent trading of stocks occurs in the secondary market (where investors buy and sell already owned securities). The stock market mobilises available funds of both domestic and foreign investors across different segments of the economy. The stock market is known as the barometer[6] of the economy because it covers all industries from almost all segments of the economy. In addition, using stock market shareholders, business community, and prospective investors gain useful information.
The index of the stock market is basically a measurement of the value out of a section of the stock market and it is calculated using pricing information of the selected shares. This tool is used by investors in order to describe the stock market and for the purpose of comparison between various available investments e.g. the [7]KSE-100 index is a measurement of the value of 100 selected listed stocks on the Pakistan Stock Exchange.

KSE - 100 → KSE - 30 → KMI - 30 → KMI - All → KSE - All [8]

2.2. Major Stock Market Indices

The KSE-100 Index was introduced in 1991 with a base value of 1,000 points[9]. The index is composed of 100 companies. The selection of these 100 companies is based on their sectoral representation and the highest free-float Capitalisation, representing approximately 80 percent of the total free-float capitalisation of the listed companies.
The stock market of Pakistan has a fairly long history. The historical stock market progress is given in figure 2.

[5] The capital gain is the profit one make from selling the stock for a higher price than initially paid for it. A dividend is the disbursement of company's profit to its shareholders usually paid in terms of cash or additional shares on a periodic basis.

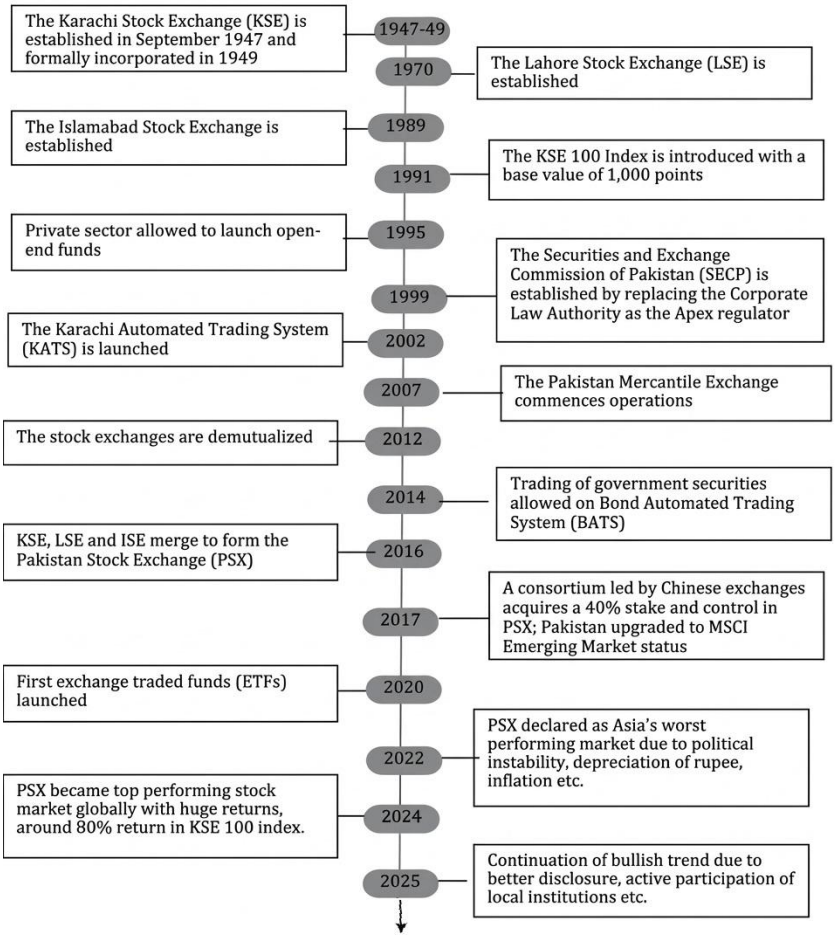
[6] A barometer that reflects the general investment climate of a country. The stock market in any country is viewed as a leading indicator of economic activity meaning that the changes in stock prices are hypothesised to temporally lead changes in economic activity over time.

[7]The KSE-100 Index tracks 100 companies listed on the Pakistan Stock Exchange (PSX).

[8] Narrower benchmarks were later introduced alongside it: the KSE-30 Index, which covers the 30 largest and most liquid companies, and the KMI-30 Index, which covers the 30 largest and most liquid Shariah-compliant companies.

[9] More broadly, the KMI All Share Index includes every Shariah-compliant listed company, while the KSE All Share Index includes all listed companies, whether Shariah-compliant or not.

Fig. 2. Pakistan's Stock Market Growth



Source: Adapted from ICMA Pakistan (2025), CFA Institute Research Foundation (2021), and Pakistan Stock Exchange (PSX), with updates.

Over 75 years, Pakistan's stock market has evolved from a small exchange with just five companies into a trillion-rupee marketplace showing gradual expansion. Paid up capital grew from just Rs. 0.04 billion to Rs. 1,727 billion in 2025 showing a massive rise in listed companies' size and investor participation (See Table 1). Likewise, the rise in market capitalisation reflects the long term expansion of Pakistan's equity market. Major jumps have been observed during the 1990s (responsible factors were liberalisation and privatisation). The post-2000 surge was due to reforms and foreign inflows while recent trend shows major reforms such as Roshan Digital Account (RDA) to include overseas Pakistanis, *Sahulat* account opening. Although the structural growth and capitalisation expanded enormously, the number of listed companies is still very low suggesting the strong need for new listings and deeper market reforms to improve investor confidence.

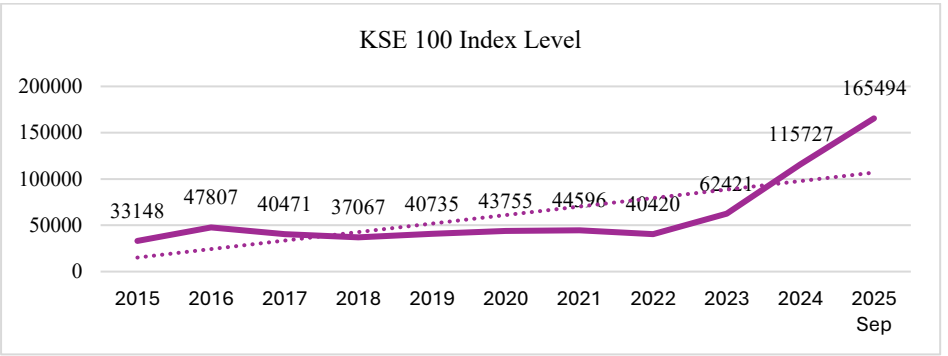
Table 1
Pakistan's Stock Market Indicators (1947-2025)

Dates	No of Listed Co.	Paid up Capital/ Listed Capital (Rs. in Billion)	Market Capitalisation (PKR Billion)
September 1947	Karachi Stock Exchange Came into Existence		
1949	5	0.04	n.a.
1950	15	0.12	n.a.
1960	81	1.00	1.87
1970	291	4	9.65
1980	314	8	9.77
1990	487	28	53.71
1997	781	209	465
2000	762	229	391.9
2010	651	815	2732
2020	531	1421	8035
2021	533	1485	8,297.3
2022	531	1553	6,500.8
2023	524	1665	9,062.9
2024	525	1716	14,496
2025	527	1727	13,996

Source: PSX

The KSE-100 Index broke all previous records by surpassing 150,000 points in 2025, delivering annual returns of over 80 percent. (Figure 3). This remarkable increase is due to strong macroeconomic indicators (i.e. lower interest rate and inflation), six new listings (three in main board and three in GEM board) were recorded and the lower price to earnings ratio compared with regional countries offer higher returns for long term investors. Moreover, the budget 2025 had also a positive impact on PSX due to no changes in capital gain and dividend taxes, while withholding tax on interest income from fixed deposits and savings increased by 5 percentage points. Finally, around 60,000 new investors registered during 2025 and daily average trading volume crossed 827 million shares per day. The remarkable performance has been observed in oil & gas, banking, cement, fertiliser while textile and engineering showed low performance (See Figure 3).

Fig. 3. KSE-100 Index Trend: 2015 – 2025



Source: PSX

However, the equity market of Pakistan is still dominated by traditional industries like textiles and manufacturing, while sectors like technology and financial sectors are emerging as strong new sectors. Because diversification is limited, therefore a few sectors account for the majority of listed companies, thus highlighting the scope for broadening the capital market participation of underrepresented industries such as agricultural processing, real estate and services (See Figure 4).

Fig. 4. Listed Companies of PSX



Source: PSX as of October 2025

As shown in Figure 5, most of the market value in Pakistan's stock market is concentrated among energy, banking, and fertiliser sectors. Oil & Gas Development Company (OGDCL) leads with the highest market capitalisation of USD 4.26 billion followed by UBL and MARI Petroleum, while other major players include Meezan Bank (MEBL), Lucky Cement (LUCK), and Fauji Fertiliser (FFC) each exceeding USD 2 billion (See Figure 5).

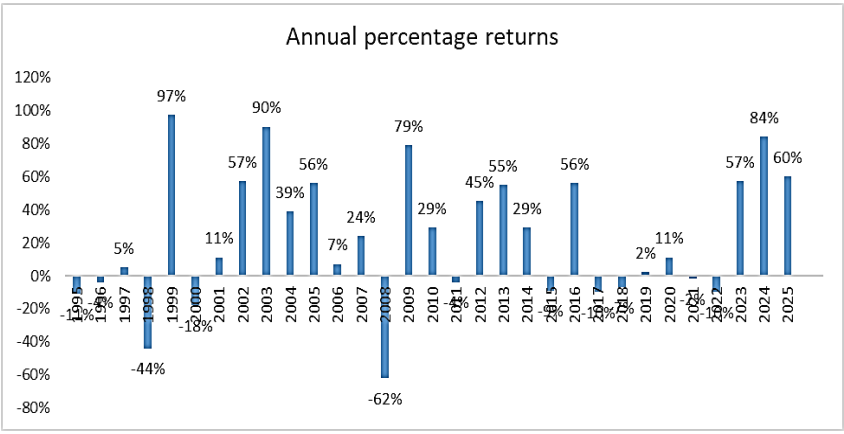
Fig. 5. PSX Market Capitalisation of Largest Companies



Source: PSX as of September 2025

The Stock Market is supposed to be the gauge of the economic and political health of an economy that discounts every material information to the pricing of securities. As shown in the Fig 6, from 2000 till 2024 the stock market remained resistant to external shocks during most of the years. Also, it outperformed any other parallel market/asset in terms of returns i.e. real estate and savings accounts (for details see also Figure 9).

Fig. 6. 30 Years Annual Percentage Return on KSE-100



Source: PSX

The high price-earnings (P/E) and Market capitalisation to gross domestic product (Market Cap/GDP) ratios of developed markets such as USA and UK showed wide investor participation and maturity. Similarly, the investor base is rising in emerging markets such as India, China and Malaysia while the underdeveloped and undervalued markets of Pakistan, Bangladesh and Sri Lanka showed very low public participation and thus highlighting untapped potential and structural challenges in the capital market development of these countries (See Table 2).

Table 2

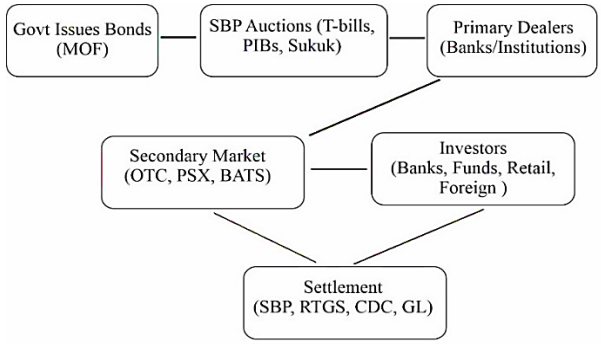
Pakistan's Stock Market vs Selected Markets 2025

Country	P/E Ratio	Market CAP/GDP	Investors/Population
Pakistan	9.30	13.30 percent	0.10 percent
India	21.77	132 percent	23 percent
Sri Lanka	9.98	19.70 percent	3.80 percent
Bangladesh	12.32	7.30 percent	1 percent
Malaysia	18.65	92.90 percent	30 percent
China	13.21	63.40 percent	18 percent
UK	14.42	83.80 percent	47 percent
USA	24.79	150 percent	65 percent

Source: PSX, World Federation of Exchanges, Business Recorder

2.3. Bond Market Evolution

The operational mechanism of the Pakistani bond market as shown in given flow chart explains that government of Pakistan (i.e. Ministry of Finance) issues bonds (T-bills, 3-12 months and PIBs, 3-30 years and Sukuk – Islamic bonds) to finance budgetary needs using auction (via primary market) system which is managed by the State Bank of Pakistan and conducted via competitive primary dealers (i.e. banks and financial institutions). Subsequently secondary market trading occurs via OTC, PSX (listed bonds and Sukuk) and Bond Automated Trading System (BATS) is used for transparent pricing. Government bonds are settled through SBP's RTGS (Real Time Gross Settlement) system and the corporate bonds held electronically with Central Depository Company (CDC) while Government securities recorded in Subsidiary General Ledger (SGL) accounts at SBP. Likewise, the corporate sector of Pakistan issues their bonds to the investors to meet their financial requirements. The Government bonds market began to develop with the issues of PIBs in 2000 while corporate bond market began to develop in 1995 with the issue of Term Finance Certificates (TFCs).



At the time of independence in 1947, Pakistan had no organised bond market and the government had to rely on borrowing from SBP and commercial banks. To mobilise domestic savings to finance public development GOP introduced various schemes and reforms (For details see Figure 7).

Fig. 7. Pakistan's Bond Market Growth

Pakistan gains independence; initial reliance on SBP and banks for borrowing	1947–1949	National Savings Schemes (NSS) launched including Prize Bonds and Defence Savings Certificates
Pakistan Investment Bonds (PIBs) introduced for long-term financing	1960s	State Bank establishes Public Debt Office (PDO) for managing government debt
Post-1971 separation, government relies heavily on central bank borrowing	1970s	National Savings Centres established for retail bond sales
Government Investment Bonds (GIBs) introduced	1985	Corporate Law Authority (CLA) established for regulating bond issuance

Auction system for T-Bills introduced; shift to market-based rates	1990s	Central Depository Company (CDC) established for electronic bond settlement
Securities and Exchange Commission of Pakistan (SECP) formed	1999	Start of corporate bond regulation and transparency measures
Pakistan Investment Bonds (PIBs) reintroduced with regular auctions	2000s	Term Finance Certificates (TFCs) launched as Pakistan's corporate bond instruments
Introduction of Government Ijara Sukuk (Islamic bonds)	2010	Bond Automated Trading System (BATS) launched at PSX for debt securities
Online retail participation in government securities enabled	2016–2018	Private Debt Regulations issued by SECP to facilitate corporate bond listings
WAPDA launches Pakistan's first Green Bonds	2020	Digital National Savings platform introduced for electronic investment access
Expansion of PSX debt board to include Sukuk and infrastructure bonds	2022–2023	Roshan Digital Account (RDA) Naya Pakistan Certificates deepen retail bond participation
SECP integrates RegTech for real-time bond market monitoring	2024–2025	Pakistan launches ESG-linked sovereign Sukuk and secondary market expansion

Source: SBP and MOF

Since independence, the domestic debt has been the major source to finance fiscal deficit and by 2024, it comprised 66 percent of total debt. The Domestic debt is composed of three major sources i.e. permanent debt (maturity greater than one year), floating debt (maturity up to one year), and non-funded debt (contributed by National Savings Schemes). The share of all these instruments towards domestic borrowing is given in Table 3. PIBs introduced in 2000 under market based system; 3, 5, 10 year maturities while Sukuk (Islamic bond) were initiated in 2008.

Table 3

Pakistan's Debt Market Indicators

	GOP- Domestic Debt Composition (PKR Billion)										
	1971	**1975**	**1980**	**1985**	**1990**	**2000**	**2005**	**2010**	**2015**	**2020**	**2024**
Domestic Debt	14	23	60	153	381	1645	2178	4653	12193	23283	47160
Permanent Debt											
PIBs	.	.	.	.	.	470	540	1280	3230	8900	28026
Prize Bonds	0.3	0.5	1	2.5	5.8	10	20	35	130	220	385
Sukuk	.	.	.	.	.	.	.	80	420	1780	4766
Floating Debt											
T-Bills	6	9	23	70	179	810	930	2020	5010	9500	10167
Unfunded Debt											
NSS	2	5	11	15	44	135	425	850	2600	3500	2708
SBP loan to GOP	0.3	0.8	3.2	8.6	27.5	96.4	180.7	290	145	350	475

Source: SBP and MOF

Since the contribution of T-bills and PIBs dominates in domestic borrowing of government, therefore their yield data is given in Table 4 to demonstrate the overall picture of government cost against these debt instruments.

Table 4

Weighted Average Yields on Treasury Bills and Pakistan Investment Bonds, Selected Years (1971–2024)

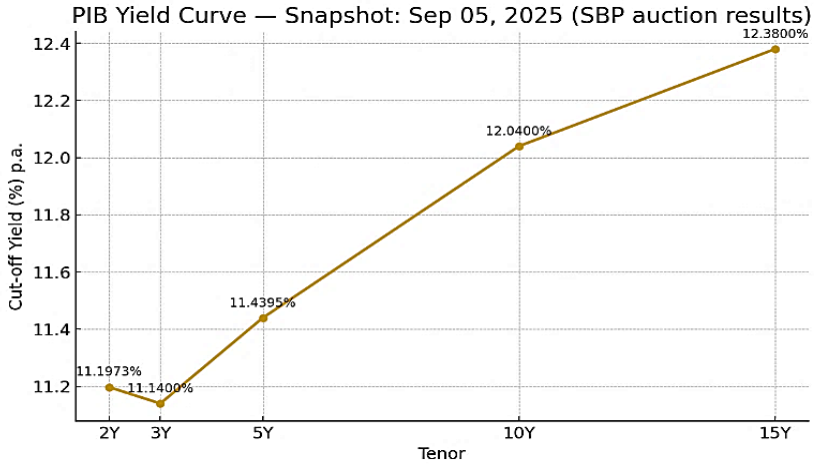
(percent per annum)

Year	T-Bills			PIBs
	3-Month	6-Month	12-Month	
1971	6	6.5	7	—
1975	8	8.3	8.5	—
1980	10.2	10.4	10.6	—
1985	11	11.3	11.5	—
1990	13	13.3	13.5	—
2000	10.4	10.7	11	11.60
2005	7.4	7.6	7.8	9.10
2010	12.1	12.3	12.5	12.20
2015	6.6	6.8	7	8.60
2020	11.5	11.7	11.9	11.50
2024	20.1	20	19.8	14.00

Source: SBP

The shape of yield curve (based on PIBs) is upward sloping indicating risk premium for longer maturities due to higher inflation or policy rate expectations. It also reflects moderate short term stability (See Figure 8).

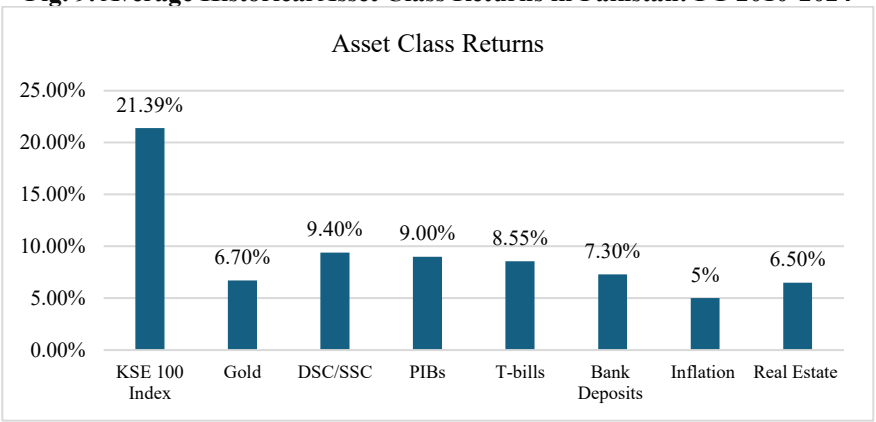
Fig. 8. PIB Yield Curve (September 2025)



Source: https://www.worldgovernmentbonds.com/country/pakistan/

Figure 9 shows average annual returns of different asset classes of Pakistan, allowing to make a comparison of how well each investment performs relative to inflation and each other. The stock market provided highest returns far more than inflation indicating strong capital gains for investors. During last 15 years, the gold asset class gave moderate returns while government backed instruments gave secure and steady hedge against inflation to risk-averse investors. PIBs also outperformed and offered fixed medium to long term returns for safe and predictable income. While, the investors interested in growth of their investment have benefited most from stock market, and conservative investors found PIBs and Special Savings Certificates (SSC) more attractive for safety and protection from inflation. Hence, diversified portfolio combining bonds, stocks and gold balanced risk and return under this environment.

Fig. 9. Average Historical Asset Class Returns in Pakistan: FY 2010-2024



Source: PSX and Business Recorder

2.4. Historical Reforms Outcome in Pakistan's Capital Markets

From above historical discussions it is evident that several reforms were introduced for the capital market of Pakistan. However, some reforms had great impact while some others had limited.

Reforms (such as CDC establishment, National Clearing Company of Pakistan Limited (NCCPL), demutualisation and PSX integration) had strong impact because these reforms reduced information asymmetries, transaction costs, settlement risks, and governance weaknesses, thereby improving market efficiency and investor confidence. For example, the establishment of the CDC addressed settlement inefficiencies and counterparty risks that previously constrained market participation. On the other hand, the regulatory reforms (such as corporate bond market, SME financing, venture capital ecosystem and retail participation) were not much successful because these reforms alone could not overcome structural constraints such as low financial literacy, weak investor culture, macroeconomic instability, limited institutional investors, and persistent government dominance in financial markets. Furthermore, capital market development of Pakistan was frequently interrupted by macroeconomic instability (such as political instability, fiscal deficits, inflation, exchange rate crises) which reduced investor

confidence and limited long-term capital formation. For example, corporate bond market development remained limited because persistent government borrowing crowded out private issuers, institutional investors preferred government securities, and issuance costs reduced incentives for corporate participation. With this backdrop the historical discussion of the paper suggests that successful capital market development requires not only regulatory reforms but also macroeconomic stability, credible institutions, investor protection, and diversified investment opportunities.

3. METHODOLOGY

This study employs a structured literature review approach to synthesise the historical evolution, institutional development, and empirical evidence on Pakistan's capital markets. For this purpose, the relevant studies were identified using predefined inclusion and exclusion criteria to ensure high quality and contextual literature. Moreover, a thematic analysis has been done based on interviews of various stakeholders to compile section 5 of the study.

The inclusion and exclusion criteria applied in this review paper are given below.

3.1. Study Inclusion Criteria

- Studies focusing on Pakistan's capital markets.
- Peer-reviewed journal articles.
- Working papers from recognised institutions.
- Publications from SBP, SECP, PSX, IMF, World Bank, and similar organisations.
- Studies related to stock markets, bond markets, Sukuk, market efficiency, liquidity, investor behaviour, financial intermediation, and capital market development.

3.2. Study Exclusion Criteria

- Studies unrelated to Pakistan.
- Duplicate publications.
- Conference abstracts without full papers.
- Newspaper articles and opinion pieces.
- Studies not directly related to capital market development.

Preference has been given to studies published in Scopus-indexed, Web of Science-indexed, HEC-recognised journals, and reports issued by reputable national and international institutions such as SBP, SECP, IMF, World Bank, and ADB. Despite efforts to ensure comprehensive coverage, the review is still subject to publication bias because greater emphasis was placed on indexed academic literature and institutional reports.

4. REVIEW OF LITERATURE ON PAKISTAN'S CAPITAL MARKETS PERFORMANCE

4.1. Theoretical Literature

To provide a theoretical foundation to relate the historical evolution of Pakistan's capital market with the established theories of finance and economic development, some major financial theories have been discussed in the context of Pakistan's capital market development. Together, these theories offer an analytical framework through which the historical evolution, empirical evidence, institutional development, role of capital markets in mobilising savings, allocating capital, supporting economic development and policy relevance of Pakistan's capital markets can be examined. The discussion covers Financial Intermediation Theory, Efficient Market Hypothesis (EMH), Financial Development and Economic Growth Theory, and Capital Market Development Theory.

4.1.1 Financial Intermediation Theory

Financial Intermediation Theory pioneered by Gurley and Shaw (1960) emphasised the role of financial intermediaries in channeling funds from savers to investors. Later, Benston and Smith (1976) explored further that financial intermediation enhances economic efficiency by reducing transaction costs, risk management, productive capital allocation and information efficiency, thus facilitating efficient capital allocation. All these central concepts of this theory provide a useful framework to understand the historical discussion of capital markets of Pakistan.

4.1.2. Efficient Market Hypothesis (EMH)

The Efficient Market Hypothesis (EMH), developed by Eugene F. Fama (1970) and rooted in the earlier work on Random Walk Theory by Bachelier (1900). According to EMH[10] financial asset prices fully and immediately reflect all available information, thus making it difficult for investors to consistently earn abnormal returns by using publicly available information. Since a substantial portion of the literature on Pakistan's capital markets focuses on market efficiency, abnormal returns, event studies and information incorporation. Therefore, EMH provides the benchmark against which Pakistan's market performance can be assessed.

4.1.3. Financial Development and Economic Growth Theory

The foundation of Financial Development and Economic Growth Theory originated wherein Schumpeter (1911/1934) argued the important role of banks and financial institutions in financing innovation and entrepreneurship, thereby driving economic development. Later, this theory was strengthened by McKinnon (1973) and Shaw (1973) who emphasised that financial deepening and liberalisation promote growth by improving the efficient allocation of resources. Consistent with the concepts of this

[10] Weak Form means prices reflect all past market data, while Semi-Strong Form means prices reflect all publicly available information and finally Strong Form means prices reflect all public and private information.

theory many studies reviewed in this paper show that deeper and more efficient capital markets support economic growth.

4.1.4. Capital Market Development Theory

Capital Market Development Theory evolved from the broader finance-growth literature. Major contributors of this theory are Levine (1991, 1997) and Levine and Zervos (1998) who argued that liquid, deep and diversified capital markets enhance economic growth through efficient allocation of resources and more investor participation. Consequently, the theory explains the key challenges facing Pakistan's capital markets such as underdeveloped bond market, shallow market depth and limited SME financing.

4.2. Empirical Literature

The literature on Pakistani stock market covers various aspects associated with its performance. The major focus areas are market efficiency, investor behaviour, volatility, companies' financial performance, integration with international markets, corporate governance etc. However, the most frequently researched area is the economic impact of stock market i.e. the relationship between stock market and economic indicators such as inflation, GDP, interest rates, oil prices, exchange rate etc. Hence, major empirical studies on Pakistan's stock market have been reviewed in this study (For details see Table 5).

Table 5

Selected Literature on Stock Market of Pakistan

Author(s)	Data Interval	Method	Findings
Husain & Mahmood (2001)	1960-1999	Cointegration and error correction	The long run relationship (one-way causation from macro variables to stock prices) between stock returns and macroeconomic variables has been found. However, Pakistan's stock market cannot be a leading indicator of economic activity.
Nishat & Saghir (1991)	1964-1987	Granger causality technique	For the economy of Pakistan, the causality direction exists from stock prices to consumption (indicating the presence of wealth effect) and causality relationship is established from investment to stock prices. Moreover GDP temporarily leads stock prices.
Ali and Afzal (2012)	1990-2008	Johansen's co-integration and Granger's causality test	There is evidence of co-integration between industrial production index

			and stock exchange prices. However, no causal relationship has been observed between macro-economic indicators and stock exchange prices of Pakistan, suggesting the performance of macro-economic indicators cannot be reliably used to predict the stock prices.
Shahbaz et al. (2008)	1971-2006	J-J Co-integration and ARDL bounds testing techniques	A very significant long term bi directional relationship between stock market development and economic growth exists. At the same time, only one-way causality for short run i.e., from stock market development to economic growth exists.
Hanif (2020)	2009-2020	Johansen cointegration	The findings indicate joint long-run co-movements among the oil, gold, and currency exchange markets. For the oil market, the results support the demand-pull inflation hypothesis in Pakistan. During periods of declining stock returns, investors tend to shift their investments to the gold market. Additionally, domestic currency depreciation discourages investors from purchasing stocks.
Ahmed & Ullah (2013)	2001 – 2012	ARDL Model	Investor sentiments have positive and significant impact on KSE returns. This shows that the psychological factors are important in investor's decision making and consequently market returns of Pakistan in particular and world at large. Moreover, inflation has significantly negative impact on stock market performance.
Malik, et al. (2017)	1991 – 2015	ARIMA Model	PSX does not accomplish the necessary assumptions of weak form of market efficiency.

Alam & Rashid (2014)	2001 – 2011	GARCH Model	Consumer price index, money supply, exchange rates, and interest rates exhibit a negative relationship with stock returns, whereas the Industrial Production Index shows a positive association. Furthermore, the findings indicate that, in the long run, the Pakistani stock market responds to changes in macroeconomic indicators.
Ahmad, et al. (2017)	The returns of 120 days before the projected time window are taken as the benchmark.	Event study methodology is used to calculate Average Abnormal Returns (AAR) and Cumulative Average Abnormal Returns (CAAR) for the time window of 41 days the 20 days before and 20 days after the event (Sit-in) date data have been taken.	The Pakistani stock market is inefficient which fails to fully reflect public information indicating inefficient behaviour to political event (Sit-in). The results of the study also show that the investors who invest their money in financial sector may earn excess abnormal returns than Non-financial sector
Akbar & Baig (2010)	2004-2007	Event Study	The findings indicate that the average abnormal returns (AAR) and cumulative average abnormal returns (CAAR) associated with stock and simultaneous cash and stock dividend announcements are statistically significant and are generally positive.
Iqbal, et al. (2011)	2003-2009	Johansen and Juselius Cointegration	No cointegration has been found among three selected stock markets i.e. Pakistan, USA, and India, while Granger-causality test showed unidirectional causality running from New York stock exchange to Bombay and Karachi stock exchanges.
Ali & Amir (2014)	1991-2011	GLS regression analysis	The GDP per capita is significantly explained by Foreign direct investment, gross domestic savings, Market capitalisation ratio and gross national expenditure.

Husain (1998)	1989-1993	Descriptive Statistics	The shape of distribution of stock returns in Pakistan equity market does not follow normal distribution shape.
Clark, et al. (2008)	1947-2001 Primary data collection from 200 prominent historians, economists, politicians, government officials, investors, senior bankers, stock market analysts and other individuals involved in the Pakistani stock market	Bayesian hierarchical modelling and Markov Chain Monte Carlo (MCMC) techniques	The study assessed Pakistan's political risk and its impact on the stock market from 1947 to 2001. The likelihood of a major political event influencing the stock market in any given year is high, with an average of 1.5 events per year, contributing a risk premium of approximately 12 percent.
Kiran, et al. (2020)	2004-2020	cross-sectional standard deviation (CSSD) and cross-sectional absolute deviation (CSAD)	The results show absence of herding behaviour in Pakistani stock market and it is selected data firms of different sectors which may follow their respective industry portfolios and so not the overall market.
Hassan & Kalim (2017)	1989-2013	Mean and common mean group estimators on the sample from 1989 to 2013	The findings indicate that only credit to the private sector has a positive and significant impact on economic growth through its interaction with the three proxies of stock market development. In contrast, traded stocks and turnover ratio meaningfully enhance economic growth, particularly when combined with banking sector development. Moreover, both stock market and banking sector development are jointly important to promote economic growth in countries with low human development, such as Pakistan
Shah et al. (2021)	2006 – 2018	Cross sectional regression methodology	The beta cannot explain expected returns. However, both CAPM and three factor model do well in explaining expected returns.
Kanasro et al. (2009)	1985 to 2000	Descriptive statistics	It has been observed that less liquidity creates less

			synchronicity in stock prices and so attracting fewer investors and because of it market size remained low.
Haque (1997)	1985 to 1997	Descriptive statistics	The stock market development, is positively associated with current and future economic growth, capital accumulation, and productivity improvement. Moreover, financial sector policies should be of enhancing, rather than inhibiting in nature.
Ahmad (1996)	1980s–1990s	Unit-root/variance-ratio tests	There exists weak-form of market inefficiency in thinly traded Pakistani stock market.
Hamid et al. (2010)	2000–2009	ADF, PP tests; ARMA	The phenomenon of random walk has been found in KSE-100 across certain periods but not in all periods.
Masood, et al. (2012)	2000–2012	ARIMA/GARCH	There exists persistence in PSX volatility because big moves tend to follow big moves while small moves tend to follow small moves – an indication of classic GARCH.
Hamid (2016)	2000–2015	GARCH/EGARCH	KSE returns are affected by both asymmetric volatility and leverage effects.
Joyo & Lefen (2019)	2005–2017	OLS, DOLS, FMOLS	Time-varying integration of Pakistan's market with trading partners showed that there exists increased co-movement in crises.
Aziz and Iqbal (2017)	1997-2012	Johansen cointegration, Granger causality	There exists limited long run cointegration while short run links exist with large economies.
Ghani et al. (2022)	2000–2020	GARCH-MIDAS	The index of economic policy uncertainty (EPU) is able to predict volatility in stock market of Pakistan i.e. higher EPU tends to correspond with higher future volatility.
Kashif (2023)	2000–2022	Fama-French style regressions	Some of the cross-sectional returns could be explained by firm size, value and momentum.

Malik & Umar (2015)	2005–2015	Spillover index	During 2008 crisis, PSX transmits and receives volatility shocks regionally.
Parveen (2020)	2000–2020	Attention index regressions	Higher level of investor attention/sentiment cause short run pressure on stock prices and overreaction followed by negative return reversals i.e. higher attention brings lower subsequent returns.
Sohail (2016)	2001–2015	Cointegration analysis	During certain periods some kind of co-integration with Asian Pacific markets has been observed.
Alim & Raza (2020)	2005–2018	Time-series regressions	Political instability significantly increases volatility and reduces returns.
Jebran et al. (2017)	2000–2014	VAR/GARCH	Sectoral returns are affected by oil price and exchange rate shocks.
Khan (2010)	2000–2008	Trading rule tests	Transaction costs reduced profitable opportunities.
Hassan & Javed (2015)	2008–2015	Event-study	There exists significant abnormal returns around events due to corporate announcements.
Sharif & Joyo (2017)	2012–2017	Liquidity metrics, spreads	There exists mixed evidence on PSX depth due to demutualisation, however it altered liquidity and trading costs.
Khalid & Akram (2019)	2015–2018	HAR/realized volatility	News shocks and intraday patterns matter for volatility.
Yasmeen & Anwar (2015)	2008–2014	Comparative index analysis	Sharia-compliant indices show different volatility/return profiles compared with regular indices.
Ahamed et al. (2015)	2005–2015	GARCH-VaR	PSX exhibits pronounced tail risk (chance of experiencing extremely large losses or gains) in crisis periods.
Raza & Shafique (2020)	2008-2020	Cointegration/causality	The PSX and global markets may move independently most of the time but during crisis, major political or trade shock they suddenly start to move in the same direction i.e. both rising and falling together.

Shah & Butt (2014)	2004-2013	Panel regressions	Better governance associated with lower cost of capital and higher valuations.
Khan & Saeed (2015)	2000-2014	Panel regressions	Higher market returns, clear regulations and greater liquidity attract foreign portfolio investments.
Tauseef (2020)	2015-2019	Sentiment regressions	Investor sentiment explains short-term return variation.
Memon and Yao (2019)	2010-2019	Network/graph methods	Some specific stocks in the market play a more influential role and so cause disturbance across various other stocks in the market.
Rehman & Ali (2018)	2012-2017	Descriptive & event	Financial derivatives like futures, options or forward contracts designed to help investors from price risks have shown only little positive impact in reducing risk. Also only small number of investors trade in derivatives.
Khalid & Hussain (2023)	2016-2022	Event/descriptive	Comparing to large companies (listed on main board) the SME shares are traded less frequently due to less number of buyers and sellers and most often bid-ask spread are wider.
Hafeez (2010)	2004-2009	Disclosure index regression	The higher disclosure quality is linked with reduced volatility and more informative prices.

The literature on bond market of Pakistan has been focused on the issues and challenges of bond market and most frequently the development phases of it have been discussed at length from the perspective of government budget deficit. Moreover, findings for Pakistan's bond market such as government securities, PIBs, T-Bills, Sukuk, yield curve, market microstructure and policy effects have been added (For details see Table 6).

Table 6

Selected Literature on Bond Market of Pakistan

Author(s)	Data Interval	Method	Findings
Arif (2007)	2007	Descriptive Statistics	The borrowing from SBP at highly low rates and huge statutory pre-emptions enabled the Government of Pakistan to finance their large fiscal deficits.
Uppal (2024)	2011	Descriptive Statistics	A sound fiscal policy is a prerequisite for the bond market development.

			Although stable political set up and improved governance are the prerequisites for bond market performance but at the same time an active and liquid bond market can play a vital role in fiscal discipline.
Khalid (2007)	2007	Descriptive Statistics	Pakistan needs to satisfy a set of pre-requisites (e.g. fiscal discipline, building bond market participants and monetary stability) in order to achieve some meaningful development in its bond market.
Arif (2017)	2017	Descriptive Statistics	The major challenges to bond market development include large fiscal and trade deficits, law and order issues, limited awareness of new financial products, lack of automation, and inconsistent supply coupled with the small size of government bonds. Additionally, the corporate bond market is not cost-effective due to stamp duties imposed by provincial governments, various issuance fees, and time-consuming approval procedures.
Rehman & Khilji (2017)	2017	Descriptive Statistics	The E-bond platform facilitates complete trading of sovereign bonds, including T-bills, PIBs, and Ijarah Sukuk. Data indicate that, through this platform, cumulative trading of sovereign securities accounted for 66 percent of the total trading volume by the end of 2010.
Maqbool-ur-Rehman (2015)	2015	Descriptive Statistics	In Pakistan, the bond market remains shallow and narrow, despite significant efforts during the financial sector reforms of the early 1990s. The presence of institutional investors is positively associated with bond market development. Furthermore, banking sector development and bond market development appear to be complementary, particularly for the private non-financial sector.
Sahi & Rasheed (2017)	1995-2015	Correlation and Regression	A negative correlation exists between bond yields and sovereign credit rating, inflation rate, and current account balances, indicating that a decline in any of these variables results in an increase in bond yields. Conversely, bond yields are positively correlated with country risk, implying that lower

			country risk leads to reduced bond yields.
Qayyum, et al. (2005)	1990-2005	VAR, ARIMA, yield-curve analysis	T-bill yields closely track policy rate while monetary policy shocks quickly transmit to short run yields.
Arif (2007)	2000-2007	Order flow, liquidity metrics	The electronic settlement and CDC reduced settlement risk and liquidity concentrated in benchmark issues.
State Bank of Pakistan (2017)	1995-2015	Nelson-Siegel / Svensson models	The yield curve movements in Pakistan are linked to investors' views on country's future economic conditions.
Government of Pakistan, Ministry of Finance (2019)	1980-2010	Time-series regressions	Heavy fiscal deficits crowd out private credit and distort yield structures.
State Bank of Pakistan (2011)	2005-2011	Event-study, liquidity measures	SBP auctions have significant impact on secondary market liquidity both positive or negative depending on the auction design and timings.
Hina, et al. (2022)	2000-2022	Credit spread regressions	Political risk and external imbalances widen sovereign spreads; IMF programmes compress spreads temporarily.
International Monetary Fund (2018)	2000-2018	Survey	National Savings and prize bonds provide a large retail buffer, limiting secondary market depth for government securities.
IOSCO & SECP (2015)	2003-2015	Cointegration, ECM	Evidence of efficient price formation in benchmark maturities; thinness at long end causes frictions.
Nasir & Farooq (2017)	2012-2017	Comparative returns and volatility analysis	Sukuk exhibit lower volatility and slightly different yield dynamics due to cash-flow structure.
Shoaib, et al. (2021)	2005-2021	Panel regressions, flow analysis	Foreign flows respond to interest differentials and exchange-rate expectations while regulatory ease increases foreign inflows.
Hanif & Khan (2012)	2000-2012	Event-study on yields and spreads	Policy rate announcements cause immediate repricing across short and medium tenors.
Ahmed & Shah (2010)	1990-2010	Policy analysis and simulations	Indexed bonds could help manage inflation risk but it requires both market depth and investor education.
Malik & Ahmed (2014)	2008-2014	Microstructure analysis	Primary dealers' behaviour and post-crisis regulatory changes altered dealer inventory dynamics.
Khan & Samad (2016)	2014-2016	Case-study and trading data analysis	Electronic platforms improved price discovery and transparency for government securities.
Ullah and Bari (2018)	1995-2018	Affine term-structure models	Term premium is time-varying and increases with fiscal uncertainty.

Ansari & Ahmad Ansari (2024)	2015-2023	Liquidity metrics, trade counts	Sukuk trading remains concentrated while secondary market underdeveloped relative to conventional bonds.
Waheed & Hyder (2023)	2003-2022	Event-study on spreads	Negative bond ratings lead to immediate spread widening while magnitude remained dependent on global risk appetite.
Tahir & Hayat (2023)	1980-2005	Historical policy analysis	Controlling interest rates and directing credit to specific sectors in the long run undermine financial market efficiency and depth by masking real economic and risk signals.
Nihal, et al. (2023)	2010-2022	Cross-country panel, econometrics	Pakistan's Sukuk pricing influenced by regional benchmarks and liquidity premia.
Sundus, et al. (2022)	1998-2020	Policy evaluation, empirical time-series	Active debt management stabilises yield volatility but also depends on credible fiscal policy.
Hameed (2006)	2006	Descriptive & empirical pricing	Term Finance Certificates provided corporate funding but suffered from limited investor base and default events.
Government of Pakistan, Finance Division (2016)	2005-2016	Transaction-cost analysis	High transaction costs discourage frequent trading, however reforms such as improvement in trading infrastructure, lower settlement fees and tighter spreads have reduced some of these costs.
Shafique, et al. (2022)	2018-2022	Case studies and early empirical analysis	The issuance of nascent Green bonds in Pakistan **(**backed by multilateral guarantees or support from development institutions) carry lower yields than similar conventional bonds.

4.3. Major Areas of Consensus/Contradiction in the Literature

To provide the structured synthesis of the literature presented in Tables 5 & 6 about capital markets of Pakistan in this sub section, the paper summarises the major patterns identified in literature and the research gap existing in the literature.

The reviewed literature shows general consensus that capital market development positively contributes to economic growth, political instability negatively affects market performance, market volatility is persistent, liquidity remains an important determinant of market development and investor sentiment influences short-run returns. On the other hand, the literature produces contradictory/mixed evidence regarding e.g. weak-form inefficiency, random walk characteristics, herding behaviour, and the explanatory power of capital asset pricing model.

As far as the literature on bond market is concerned, most of the studies agreed that Pakistan's bond market remains shallow, government securities dominate the market,

corporate bond markets remain underdeveloped, fiscal deficits significantly influence bond market outcomes and liquidity remains concentrated in a few benchmark instruments. Moreover, recent studies indicate emerging trends in digital trading platforms, Sukuk, green bonds, yield curve dynamics and foreign investor participation. However, important gaps remain in SME debt financing, retail investor participation, climate finance instruments, venture financing mechanisms, comparative analysis of conventional and Islamic capital markets and the role of capital market to support national development agendas such as Uraan Pakistan.

Existing studies on Pakistan capital markets (as shown in Tables 5 & 6) largely examine isolated aspects of Pakistan's stock and bond markets. Some focus on efficiency, others on volatility, integration, liquidity, governance, or debt market development. However, no study has synthesised these fragmented strands of literature into a comprehensive review that links historical evolution, empirical evidence, and future strategic directions for capital market development in Pakistan especially in the context of Uraan Pakistan, which this study seeks to address.

5. ALIGNMENT OF CAPITAL MARKETS WITH URAAN PAKISTAN VISION

The Uraan Pakistan vision/national reform agenda is based on Pakistan's 13th Five-Year Plan (2024 -2029) developed by the Ministry of Planning, Development & Special Initiatives, and launched in December 2024. The vision is structured around the Five Es signaling the priorities of 13th Plan. Following are the 5 Es.

- Equity
- Exports
- Energy
- Environment
- Education

In this study, a thematic analysis of the existing literature has been conducted (based on interviews from various stakeholders) to examine how capital markets can be used to support the 5 Es of Uraan Pakistan.

The agenda of Uraan Pakistan can be used to transform and modernise Pakistan's capital market so that it becomes more inclusive, innovative and growth oriented.

5.1. Effect of Capital Market Development on Equity

Equity under Uraan framework from a capital market development perspective means financial inclusion, access to finance and equal economic opportunities. These objectives can be achieved by enhancing listing of SMEs under GEM board[11], similar to SME trading board various other boards such as startup board, venture capital board along with Sukuk market for these specialised boards might solve financing needs of small businesses of Pakistan. Moreover, low cost mutual funds (i.e. small investors can buy fractional shares or bonds), female entrepreneurship bonds can be part of the strategy to improve equity. For example, India's SME platforms of the National Stock Exchange

[11] To facilitate SMEs and high growth companies in raising capital using equity listings on the PSX the GEM board was launched in 2021.

(NSE) and Bombay Stock Exchange (BSE) have enabled hundreds of small and medium enterprises to raise capital through dedicated SME listing platforms (NSE Emerge; BSE SME)[12].

5.2. Effect of Capital Market Development on Exports

Capital markets provide long-term finance to export oriented firms in order to upgrade technology and so by improving productivity they can expand globally. For this purpose, firms committed to improve their export volumes can issue export Sukuk/trade bonds. Moreover, Special Economic Zones (SEZs) can raise capital through PSX. Exporters can use hedged financial products.

5.3. Effect of Capital Market Development on Energy

The energy transition projects require massive financing which is usually unavailable through traditional banking. Therefore, green bonds/infrastructure Sukuk using capital markets platform can mobilise funds to energy related projects. For example, Indonesia raised more than USD 3 billion through sovereign green Sukuk for renewable energy and climate projects (UNDP, 2020)[13], and Malaysia's DanaInfra Nasional issued a retail Sukuk to mobilise small investors for infrastructure financing (DanaInfra Nasional Berhad, 2013)[14]; Pakistan could also replicate these models through PSX.

5.4. Effect of Capital Market Development on Environment

Capital markets can indirectly support environmental sustainability through green financing instruments, sustainable market practices, and digital innovations which can enable Pakistan to align its economic modernisation with global sustainability commitments.

5.5. Effect of Capital Market Development on Education

The Uraan Pakistan envisions inclusive knowledge-based economy that leverages financial innovation to empower individuals. To achieve this, capital markets play a vital role in terms of financial literacy programmes sponsored by SECP and PSX. Moreover, capital markets can mobilise long-term capital for the education sector without imposing additional pressure on the fiscal budget, while enhancing equitable access to learning opportunities for all.

The linkage between the Uraan Pakistan initiative and capital markets is of considerable policy relevance. As discussed above, most previous studies reviewed in this paper examine aspects of capital markets like efficiency, volatility, liquidity, or market performance. The present review extends this literature by demonstrating (see Table 7) how capital markets can serve as a strategic financing platform for national development priorities exemplified in the Uraan Pakistan framework.

[12]BSE Limited. (2025, August 5). BSE SME platform crosses milestone of 600 listings [Media release]. BSE media release on 600 SME listings

[13]United Nations Development Programme. (2020). Strengthening Indonesia's climate finance governance through climate budget tagging and Green Sukuk issuance. UNDP Sustainable Finance Hub

[14]DanaInfra Nasional Berhad. (2013). DanaInfra Retail Sukuk. DanaInfra Retail Sukuk

One of the major functions of capital market (i.e. financing productive investment) is directly aligned with the objectives of Uraan Pakistan particularly in relation to investment promotion, export expansion, energy transition, environmental sustainability, human capital development, and inclusive economic growth. Table 7 provides possible strategies to meet the vision of Uraan Pakistan by utilising the Pakistan's capital markets platform.

Table 7

Capital Markets as a Financing Mechanism for Uraan Pakistan

Uraan Priority (5Es)	Financing Need	Capital Market Instrument
Exports	Export expansion financing	Export bonds and SME IPOs
Energy	Infrastructure investment	Green bonds and Energy Sukuk
Environment	Climate finance	Green Sukuk
Education	Human capital investment	Education bonds/Sukuk
Equity/Inclusion	Financial inclusion	Retail participation and SME listings

Source: Thematic analysis of 5Es

Overall, the policy agenda of Uraan aims to transform Pakistan's export, energy, environment, and education sectors by expanding financial inclusion. To achieve these objectives, substantial long-term financing is required, which cannot be met merely through the banking sector. In this connection, a well-developed capital market can provide an efficient and sustainable source of long-term funds for both public and private sector investments in these priority areas. Therefore, capital market development serves as a critical financing channel for the successful implementation of Uraan and the achievement of its broader economic transformation goals.

6. CONCLUSION AND KEY RECOMMENDATIONS

The capital markets of Pakistan have expanded significantly in terms of size and instruments but remained shallow in diversification and participation. The stock market does not yet function effectively as an economic barometer because of the limited listings and weak investor confidence. Similarly, bond market has remained underdeveloped and dominated by government securities while corporate bonds and Sukuk markets are still in their early stages. Moreover, the yield curve remains skewed toward short-term maturities and does not adequately reflect long-term macroeconomic expectations.

Drawing on the findings of this review, a number of significant policy recommendations are proposed to support the development of Pakistan's capital markets. First of all, for the segment of equity market, it is imperative to enhance financial literacy in order to broaden investor participation and deepen market inclusiveness. Moreover, the Pakistan Stock Exchange should actively encourage new listings, especially SMEs and startups through targeted regulatory reforms and fiscal incentives.

Secondly, the debt and Sukuk markets also need expansion through government-led tax incentives and the reduction of transaction costs to stimulate corporate bonds and Islamic financing instruments (i.e. Sukuk).

Finally, the capital market should be strategically leveraged to finance the five priority pillars of national development—Equity, Exports, Energy, Environment, and Education—as envisioned under the Uraan Pakistan framework**.** This can be achieved by introducing

innovative instruments such as green Sukuk, education Sukuk, and export-linked bonds**,** thereby ensuring that capital market growth remains aligned with Pakistan's broader socio-economic and sustainable development goals**.**

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Pakistan Institute of Development Economics
Post Box No. 1091, Islamabad, Pakistan

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