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Impact of CPEC on Pakistan Stock Exchange

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Abstract: *The paper is written to find out the Impact on Pakistan stock exchange due to the investment of China in Pakistan with Exchange Rate. Chinese policy makers are trying to mold investor's perception towards its own region. China Pakistan Economic Corridor is the pathway of their objective. The change in the Pakistan Stock Exchange will reflect impact of the foreign direct investment. It is proved by the study that capitalization in Pakistan Stock Exchange has increased. Its reason is very clear; the policy makers focused power-sector, infrastructure, developing programs in agriculture and industry zone. Not only the investors of this region are interested and affected by the investment in the region but also other international markets are affected by this. For example, America started Sino-US trading war. As this investigation have also its limitations. The study conducted for a specific time period. The Variations in the Exchange Rates is due to monetary policy. Controlling over Exchange rate might give more favorable results. This investigation will be beneficial for the Government of Pakistan and for national and international investors.*

Keywords: *China Pakistan Economic Corridor, Foreign Direct Investment, Pakistan Stock Exchange, Exchange Rate of dollar*

Note: first two Author's (*) have equal contribution

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I. Introduction

Investors are aware of it that foreign direct investment is a prominent and most important inflow for a developing country which also cause to give a way to transfer management, human-assets powers both technical and non-technical and technology between host and target country (Chen, 1992)(Ihtisham Abdul Malik, 2013)(Kumari & Sharma, 2017)(Irfan Ullah, 2017). A study conducted by Raza et al.in 2010 mentioned, exchange rate and foreign direct investment showed a +ve impact on the stock market of Pakistan(Ihtisham Abdul Malik, 2013). FDI provided many opportunities and caused favorable environment for investors in Pakistan(Syed Ali Raza, Syed Tehseen Jawaid, Sahar Afshan, 2015). For example, inclusion of latest technology, consultancy firms, managerial services and HR solutions, Expansion and accessibility of markets and the last but not least Capital(Priya Gupta, 2016)(Irfan Ullah, 2017).There are different theories found which is strengthening the concept of FDI is a cause for bringing growth in the countries. Some are here for examples:

FDI brings growth in different areas Human Asset; that means Managerial knowledge and skills, R&D that ultimately enables long term growth(Romer 1986, 1987; Lucas 1988, 1990; Mankiw et al. 1992;Balasubramanyam et al. 1996). The other theory opposes the theory that FDI have negative impact in long term growth (Stoneman, 1975; Bornschier,1980; O' Hearn, 1990). The researchers found the reason of this theory is distribution inequality in developing countries. But, the other theory which covers both of the theories says that FDI have minor long term growth effects (Solow, 1956; Ramirez, 2000;Ram and Zhang, 2002).This is for the reason that the incometo Man powerstay diminishing progressively, and there is enormous outflow of funds in the form of remittances of profits and dividends(Priya Gupta, 2016).

An example found of FDI is that the United States of America was a market leader in FDI after 1945. USA enjoyed FDI a lot, till 1959.FDI is now participating as twenty percent worldwide GDP. As many Multinationals companies are developing infrastructure and Business units around the world the value of FDI increased day by day. Investors are trying to touch integration across borders and penetrating in other market environments. Between 1990 and 2000 Japan, European Union, USA and Canada were leader globally in FDI inflows(Gour Gobinda Goswami, 2014).

Another aspect of FDI found that one of the reasons to get Economies of Scale is FDI. Due to this, opportunities come for manufacturer increase demand and supply of production goods as services demand will also increase (Sultana and Pardhasaradhi, 2012).This will ultimately create stability in the environment for the economy and this will become the cause of investor's attraction. But foreign investors can think about the risk of currency that is exchange rate which can be used a tool to measure stability in macro-economic level. It is not a good time for investors if the exchange rate of their country depreciates/vary. Till 2013 it was the reason for decrease FDI in Pakistan. Since 2007 it was seen that value of the Pakistani rupee went down against dollar rate in the international market and currently, dollar value in Pakistani rupee is Rs. Near about Rs. 115.59(Business Recorder, 2012)(Ihtisham Abdul Malik, 2013).

Pakistan has changed its economic policy in 2013. In the report of World Bank 2017 doing business report Pakistan has changed/improved its position on 144 numbers out of 190 in economies. The report recognized the reform strategy in the list of top 10 reforming economy. Analyst from different platform accepted that Pakistan stock exchange improved its performance gradually. Growth rate of GDP of Pakistan found 5028% in 2016-2017 which is greater than previous years, i.e. 405%(Economic Adviser's Wing, Finance Division, Government of Pakistan, 2018)**.**

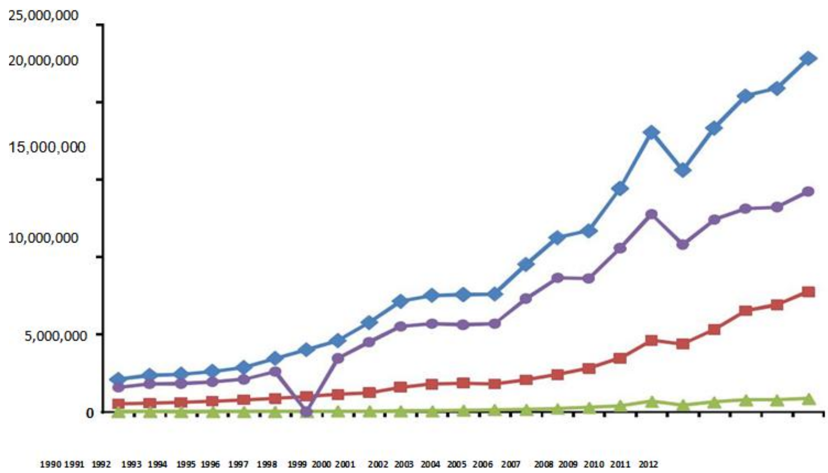
The purpose of this investigation is to find out relation of FDI and stock-marketof Pakistan after the MOU with China for investment 46 billion dollars for the project of CPEC.

II. Literature review

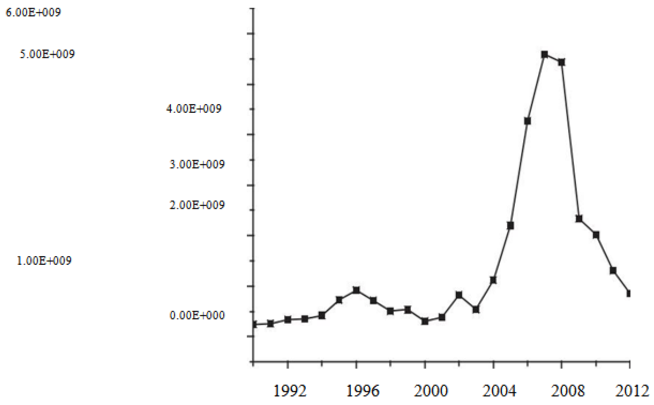
An investment of a person from one economy to other economy be made is called foreign direct investment. The least ratio of FDI is 10% in a business (OECD, 2008). It is researchers' analysis that South-Asian region Exchange rate and FDI shows direct effect on stock markets of economies (Keun Jung Lee1, 2015)(Aurangzeb, 2012).The FDI in developed economies does not show direct effect on growth. A study of emerging economy presented positive relationship between stock-market and FDI(Soumare´ and Tchana, 2011), (Krkoska, 2001; Chousa et al., 2008; Adam and Tweneboah, 2009). Shahbaz in 2008 mentioned that Pakistan stock market have a positivity in the relationship.(Rukhsana Kalim, 2009)(Gay, 2008; Levine and Zervos, 1998; Singh, 1997; Demirguc-Kunt and Levine, 1996; (Korgaonkar, 2012), (Baker et al., 2004), (Caporale et al. 2004; Nazir,2010;Boubakari and Jin, 2010). However, it is to be noted that the impact is lower in Pakistan in comparison with other economies (AzamandKhattak, 2009). The reason of this lower impact is exchange rate of the economy (Billmeier and Massa, 2007). Stock markets of developing economies provide a bridge between the growth of economy and FDI (Hermes and Lensink, 2003), (Levine and Zervos, 1996; Levine, 1996, 1997;Domarchi Veliz and Nkengapa; 2007). FDI built an infrastructure for smooth transformation of technology rather than household investments Borensztein et al. (1998). There are too much examples which describes relationship of foreign direct investment and stock markets (Ihtisham Abdul Malik, 2013).

A potential industrial environment with bundles of opportunities, foreign investments and moving towards good governance of government, these are signs of growth pattern (Tiwari, Shahbaz, & Islam, 2013)(Edwards & Muir, 2012)(Markantoni, Strijker, & Koster, 2013). These are evidences of financial development, however, as with the passage of time the process of financial development touches its peak progress income discrimination tends to perk up in rural and urban areas (Hsieh, Yang, Yang, & Yang, 2013), (Tiwari et al., 2013), (Chu, Liu, & Shi, 2015).

The following chart is a report of FDI in developing countries during 1990 to 2012 worldwide, which is mentioning that developing economies more depend on FDI than developing countries. In the early time period of these the amount was less comparatively with end years of the time period. Out of US $208 billion 35 US billion $ were for developing economies (Reenu Kumari, 2017)**.**



Source: (UNCTAD, World Investment Reports various issues(Reenu Kumari, 2017)



The graph shows FDI inflows in Pakistan during the time period from 1990 to 2012. (Reenu Kumari, 2017)

After discussing the importance of FDI it is necessary to mention relationship of China and Pakistan as China planned to invest 46 billion dollars in Pakistan. From 1951 both countries China and Pakistan have diplomatic relationships. This is loud and clear how important both are for each other strategically. Diplomatic relations were always good since started. Both countries worked on multifaceted grounds like infrastructural, economically ventures and also on developmental projects (Relations, Reviewed, Quarter, Affairs & Url, 2012), (Khalid, 2014).

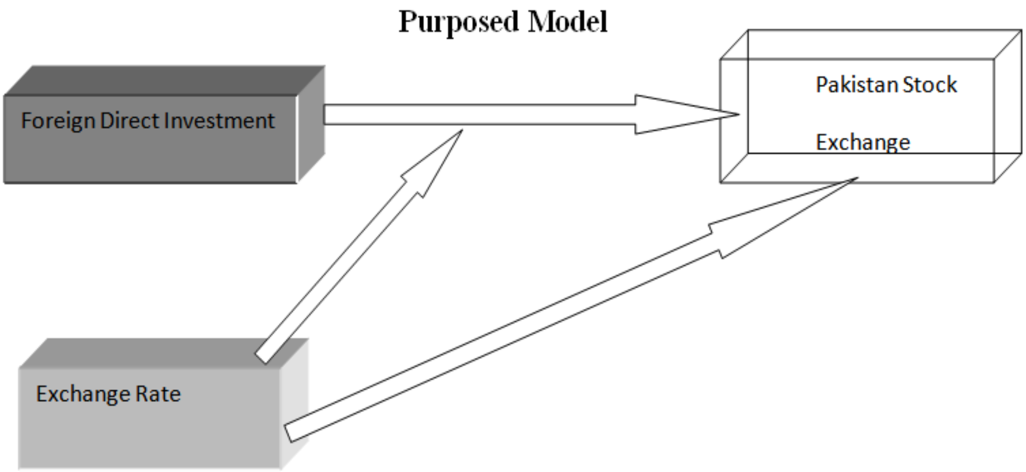
Not only the both of governments knows the value of this route (CPEC) but, it is known at global level and every analyst, investors and policy makers are well aware of this. This route is the basic root of future planning for both countries. This route not only beneficial for two countries, their positive effects are for the region. The route will open much many opportunities like infrastructure, energy sector development, industrial zones and many more areas. Authorities of both the countries planned developmental time period from 2017 to 2030. In previous years China always become a source of bringing FDI in Pakistan. Now after the MOU bilateral investment programs are scheduled and also China will become the main source of FDI in Pakistan. Due to the designed route of CPEC, it created and in future it will provide best attractive environment for investors by opening international market doors to come forward for the project participation. On the basis of the above discussion analysts are saying that the current macroeconomic stability was never seen before(Pakistan, Ministry of Planning Development & Reform Government of).

After the investment MOU between Pakistan and China, the study is going to investigate impacts of FDI on Stock market and the role of exchange rate dollar. Therefore, following are the hypothesis of the study:

H1. Foreign Direct Investment has a rapid positive direct impact on Pakistan stock exchange.

H2. Exchange Rate of dollar has a negative impact on Pakistan stock exchange.

H3. Exchange rate of dollars effects on the relationship of foreign direct investment and Pakistan stock exchange.



III. Methodology

In the investigation secondary data retrieved from Pakistan stock exchange, official website of Board of Investment Prime Minister's office Government of Pakistan and www.forex.pk. The data collected for 5 years from 2014-2018` time series based.The data of FDI and PSX is in million. The value of Total Market of Capitalization is selected as dependent variable to see the impact on PSX. The values of FDI as independent variable collected as total FDI including private proceeds and the exchange rate as an independent and moderator variable based on Pakistani rupees in international market.

This investigation will prove that foreign direct investment is the factor which has clear impact on PSX. The data after collection and interpretation entered and coded into SPSS software to get results of regression analysis.

Linear regression is used as to find out the relation of variables. The equation of linear regression is following

$$Y=a+bX$$

Here,
Y is used as Dependent variable
X is used as Independent variable
b is used as slope
and
a is used as y intercept

IV. Results and discussion

To measure the long run relationship of different variable regression analysis is used. The relationship between PSX, FDI and ER has been studied. The following tables information are proves of the above mentioned hypothesis.

Table: 1

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.854[a]	.729	.458	825244.78391

a. Predictors: (Constant), Exchange Rate, Foreign Direct Investment

In the above Table 1, the model summary gives the value of R as positive correlation. The value of R is more near about +1. It means FDI, ER has strong positive relationship with PSX.There will be change in PSX as FDI or ER change positively or negatively accordingly. The value of R^2 is more than 72% or 0.7 near to 1. It means that the data around the regression line and it is a good value of $R^{2.}$ The adjusted R square value is also positive here which indicate that model is a better fit.

Table: 2

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	1014588.496	6081223.164		.167	.883
1	Foreign Direct Investment	994.481	752.757	.599	1.321	.317
	Exchange Rate	51241.491	65983.709	.352	.777	.519

a. Dependent Variable: Pakistan Stock Exchange

According to the results (in the Table: 2) of the study the variable of foreign direct investment have a significant positive relationship with tendency to Pakistan stock exchange. It has a significant positive relationship with ($\beta = 0.599$) and ($p > 0.317$). This means the FDI contribute more than 59% to tendency to Pakistan stock exchange. Result of the current study validates.

According to the result of the study the variable of Exchange rate have a significant positive relationship with tendency to Pakistan stock exchange. It has a significant positive relationship with ($\beta = 0.352$) and ($p > 0.519$). This means the Exchange rate contribute more than 35% to tendency to Pakistan stock exchange. Result of the current study validates.

Table: 3

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.988[a]	.977	.907	341134.09323

a. Predictors: (Constant), Moderator, Exchange Rate, Foreign Direct Investment

The above is the model summary to measure the Moderator effect on the relationship of FDI and PSX. The value of R is about at its maximum positive range and enhanced comparatively with previous summary of the model. Therefore, we can say that the model summary gives true values here. As the table gives R^2 value approximately about to 100% or 1 which means data is better fitted on the regression line. Adjusted R square values are also positive here.

Table: 4

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
Moderator	-3430892.268	1048643.847	-1.169	-3.272	.189

a. Dependent Variable: Pakistan Stock Exchange

According to the results (Table: 4) of the study the variable of FDI have a significant negative impact relationship with tendency to PSX as ER moderator variable. It has a significant negative relationship with (β = -1.169) and ($p > 0.189$). This means the FDI contribute negative tendency toPSX with moderator variable ER. Therefore, Result of the current study do not validate ER as moderator variable.

V. Conclusions

The study investigated the impact of Foreign Direct Investment by China for China Pakistan Economic Corridor Project, in a specific time period on the Pakistan Stock Exchange after CPEC MOU between the Government of Pakistan and China. The report of Pakistan Stock Exchange of the study clearly shows the increased capitalization in the Pakistan Stock Exchange(Pakistan Stock Exchange) which is due to attractive environment built after the investment made by the Chinese Government. The investment attracted foreign investors to invest in PSX. Analysts are saying that this investment and the project is a game changer for the region(Pak - China Investment & Business Prospects)(Mustaf & Zafar, 2017). This is not just an investment of 46$ billion; in the scenario of China Pakistan relationship this agreement will lead investments beyond this initial investment of China for the project(Pak - China Investment & Business Prospects)(Mustaf & Zafar, 2017). The regression analysis showed strong positive relations of independent variables FDI and ER on dependent variable PSX. FDI has much bigger impact of bringing Market Capitalization of PSX for Business investment in Pakistan. In a previous s study the impact of ER was negative on PSX capitalization (Ihtisham Abdul Malik, 2013). But, in this investigation refused the study and it is found that ER also has positive impact on the development of PSX capitalization. If there would be a change in exchange rate there would be a change in PSX (Capitalization).

But from the results foreign direct investment (impact approximate 60%) has more participative then Exchange rate (impact approximate 35%). Therefore, government should take action to make favorable policies for foreign direct investment. It must be analyzed and revised to create better environment to attract foreign direct investment. The CPEC Project has its main focus on infrastructure, energy, Trade and industrial areas, to make Pakistan a suitable and attractive Business Zone(Pak - China Investment & Business Prospects). This is the reason of the foreign investors are coming to invest in the Pakistan Stock Exchange. The government must look into relevant matters and litigation regardingforeign investors. Monitory policy also must be revised because it’s a hot issue today. Exchange rate is disturbing the economy, which can be a cause of decrease in the stock market investment and could be a reason to break the confidence of investors. Monetary policy must be made as to strictly control the exchange rate of dollars in true spirit to evaluate foreign investor’s risk. In the last but not least if security measures are resolved with the collaboration government institutes which is creates more charming environment for investors.

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