

**Does Hot Money Drive Pakistan's Capital and Real Estate  
Market?**

**A case from Pakistan**

Submitted to

School Of Business and Economics

In partial fulfillment of the requirements

For the degree of

**MASTER OF SICENCE**

**In Finance**

**By**

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**DECEMBER, 2017.**

**Approval page**

## Research Completion Certificate

It is certified that the research work contained in the thesis “**Does Hot Money drive Pakistan’s Capital and Real Estate Market?**” has been conducted under my supervision to my satisfaction by Isma Rasheed ID 15009096004 of MS Finance Program.

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## Declaration

I Isma Rasheed ID # 15009096004 Session 2015-17, hereby certify that this thesis is being submitted in partial fulfillment of the requirements for the MS degree in Finance

This thesis is my original work, and the data/material presented here in has not been used for the acquisition of any other degree from any institution.

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## Table of Contents

Approval page .....	ii
Acknowledgement .....	v
List of Abbreviation:.....	viii
List of Tables: .....	viii
Table 3.1 Variables Explanation.....	viii
Table 4.1 Summary Statistic of Hot money, KSE_100, Policy rate (IR), Sharp ratio and Housing price .....	viii
Table 4.2 Augmented Dickey-Fuller .....	viii
Table 4.3JJ Co integration Test.....	viii
Table 4.4 Granger Causality Test .....	viii
Table 4.5 Variance Decomposition of HP .....	viii
Table 4.6Variance Decomposition of KSE_100.....	viii
Table 4.7 Variance Decomposition of HM.....	viii
Table 4.8 Variance Decomposition of PR .....	viii
Table 4.9 Variance Decomposition of SR .....	viii
List of Graphs .....	ix
Abstract.....	1
Chapter #01.....	2
Introduction .....	2
1.1 Back ground.....	2
1.2 Hot money in Emerging Market Context:.....	<b>Error! Bookmark not defined.</b>
1.3 Linkage between the Pakistan’s Stock market and Real estate market: .....	<b>Error! Bookmark not defined.</b>
1.4 Rationale of the Study:.....	<b>Error! Bookmark not defined.</b>
1.5 Problem Statement: .....	<b>Error! Bookmark not defined.</b>
1.5.1 Research Objective: .....	<b>Error! Bookmark not defined.</b>
1.5.2 Research questions:.....	<b>Error! Bookmark not defined.</b>
1.6 Significance and Implications of the study: .....	<b>Error! Bookmark not defined.</b>
Chapter Summary .....	<b>Error! Bookmark not defined.</b>
Chapter # 02.....	<b>Error! Bookmark not defined.</b>
Literature Review .....	<b>Error! Bookmark not defined.</b>
2.1 Theoretical Frame Work .....	<b>Error! Bookmark not defined.</b>
2.2ConceptualFramework: .....	<b>Error! Bookmark not defined.</b>
2.2.1 Research hypothesis:.....	<b>Error! Bookmark not defined.</b>

Chapter Summary .....	<b>Error! Bookmark not defined.</b>
Chapter # 03.....	<b>Error! Bookmark not defined.</b>
Research Methodology .....	<b>Error! Bookmark not defined.</b>
3.1 Sample Selection.....	<b>Error! Bookmark not defined.</b>
3.2 Data Collection .....	<b>Error! Bookmark not defined.</b>
3.3 Variable Explanation: .....	<b>Error! Bookmark not defined.</b>
3.3.1 Hot Money: .....	<b>Error! Bookmark not defined.</b>
3.3.2 Housing Price:.....	<b>Error! Bookmark not defined.</b>
3.3.3 Policy rate: .....	<b>Error! Bookmark not defined.</b>
3.3.4 Index price: .....	<b>Error! Bookmark not defined.</b>
3.3.5 Sharp Ratio: .....	<b>Error! Bookmark not defined.</b>
3.4 Data Analysis Techniques:.....	<b>Error! Bookmark not defined.</b>
3.5 Basic Equation & Model:.....	<b>Error! Bookmark not defined.</b>
Chapter Summary .....	<b>Error! Bookmark not defined.</b>
Chapter # 04.....	<b>Error! Bookmark not defined.</b>
Results & Discussions.....	<b>Error! Bookmark not defined.</b>
4.1 Descriptive Statistics.....	<b>Error! Bookmark not defined.</b>
4.2 Unit Root Test.....	<b>Error! Bookmark not defined.</b>
4.3 JJ Co integration Test.....	<b>Error! Bookmark not defined.</b>
4.4 Granger causality Test: .....	<b>Error! Bookmark not defined.</b>
4.5 Impulse Response Functions.....	<b>Error! Bookmark not defined.</b>
4.6 VDC Variance Decomposition Test .....	<b>Error! Bookmark not defined.</b>
Chapter # 05.....	<b>Error! Bookmark not defined.</b>
Conclusion & Implications.....	<b>Error! Bookmark not defined.</b>
5.1 Conclusion .....	<b>Error! Bookmark not defined.</b>
5.2 Policy Recommendations: .....	<b>Error! Bookmark not defined.</b>
5.3 Future Research: .....	<b>Error! Bookmark not defined.</b>
References: .....	<b>Error! Bookmark not defined.</b>
Appendix .....	<b>Error! Bookmark not defined.</b>

**List of Abbreviation:**

HM: Hot Money

HP: Housing Price

SR: Sharp Ratio

PR: Policy Rate (Base Rate given by State Bank of Pakistan)

KSE\_100: Pakistan stock Index (PSX)

VDC: Variance Decomposition Analysis

IRF: Impulse Response Functions

ADF: Augmented Dickey-Fuller

**List of Tables:**

Table 3.1 Variables Explanation

Table 4.1 Summary Statistic of Hot money, KSE\_100, Policy rate (IR), Sharp ratio and Housing price

Table 4.2 Augmented Dickey-Fuller

Table 4.3 JJ Co integration Test

Table 4.4 Granger Causality Test

Table 4.5 Variance Decomposition of HP

Table 4.6 Variance Decomposition of KSE\_100

Table 4.7 Variance Decomposition of HM

Table 4.8 Variance Decomposition of PR

Table 4.9 Variance Decomposition of SR

**List of Graphs**

Graph A<sub>1</sub> (over the period trend in Stock index)

Graph A<sub>2</sub> (over the period trend in Housing price)

Graph A<sub>3</sub> (over the period trend in Hot money)

## **Abstract**

The primary purpose of this study is to examine the impact of hot money on major economic markets of Pakistan such as stock market, and real estate market. Hot money or speculative cash inflow is generally associated with higher volatility. It can create financial bubbles. Particularly in emerging economies, hot money or speculative cash inflows are considered as major influential factor on these major markets. In order to ascertain the evidence of underlying facts we have used hot money as dependent variable and two major economic indicators KSE\_100 and Housing price as independent variable. Sharp Ratio and policy rate are taken as control variable. Monthly data is collected from January 2011 to December 2016. To determine the impact of hot money on these economic markets robust time series techniques such as Augmented Dickey-Fuller test, JJ co integration, Granger causality, Impulse response function and Variance decomposition tests are applied. Test results indicate that hot money has marginal influence to explain volatility in real estate and capital market of Pakistan. Our economic conditions affect the behavior pattern of investors. Study results also depict a very little contribution of short term speculative funds for these two markets. The volatility and rise in these two markets may be the cause of GDP growth, bank lending's, rural-urban migration and urbanization. There might be a functional role of terrorism, peace conditions in Pakistan, political instability; higher level of remittances, family owned business set up of Pakistan can be the reason of marginal influence of hot money in Pakistan.

**Key Words:** Hot Money, Capital Index, Real estate market, VDC, IRF, Policy Rate (IR), Sharp Ratio

## **Chapter #01**

### **Introduction**

#### **1.1 Back ground**

Hot money is the flow of capital or funds from one country to another mainly to earn a short term profit or anticipated exchange rate shifts or due to the difference in interest rates. The speculative funds inflow is having ability to fueled inflation in a country and rise in stock prices and it can generate or accelerate bubble in real estate market (Zhang & Fung 2006).

Chari and Kehoe (2003) advocate the above argument that booms and crises in emerging economies are highly linked with speculative funds inflow from another country. Large amount of funds inflow may result in boom in financial market and out flow of international capital funds may cause financial crises. Short term speculative funds are controlled by investors who actively seek short-term returns. These investors scan the market for short-term, high interest rate investment opportunities.