ANNUAL REPORT

The Management Committee of Punjab Pension Fund is pleased to present to The Government of Punjab the Annual Report for the year ended 30 June 2012.

FUND SIZE

- A summary of changes in fund size during FY 2011-12 is given in the following table:

Rs. millions (rounded to the nearest million)

	Jul 2011 - Jun 2012
Beginning fund size (30th June 2011)	13,708
Add: contribution during the period	-
Less: transfer to Reserve Pension Fund	-
Add: gain/(loss) during the period	1,919
Less: expenses during the period	(22)
Ending fund size	**15,605**

The numbers exclude unrealized capital gains/losses

FUND'S PORTFOLIO

- The Fund's exposures to different investment types are summarized as under:

Amounts: Rs. millions (rounded to the nearest million)
%: as percentage of Total Fund Size

	30 June 2010		30 June 2011		30 June 2012	
	Amount	%	Amount	%	Amount	%
PIBs	5,737	47.4	8,942	65.2	9,480	60.7
T-Bills	3,145	26.0	1,254	9.1	139	1.0
Short term bank deposits	3,015	24.9	3,002	21.9	5,349	34.3
Corporate bonds/TFCs	176	1.5	501	3.7	501	3.2
Cash at bank	21	0.2	8	0.1	130	0.8
Other assets*	3	0.0	1	0.0	6	0.0
Total Fund Size	**12,097**	**100.0**	**13,708**	**100.0**	**15,605**	**100.0**

*Other assets include prepaid operating expenses and book value of fixed assets of PPF.

- Long-term investments consist of PIBs and TFCs whereas short-term investments consist of T-bills and bank deposits.

- PPF keeps switching exposure between T-bills & short-term bank placements in pursuit of higher rates of return.

23-D, FCC Block, Syed Maratib Ali Road, Gulberg IV, Lahore. Tel: 042-5758138

FUND'S PERFORMANCE

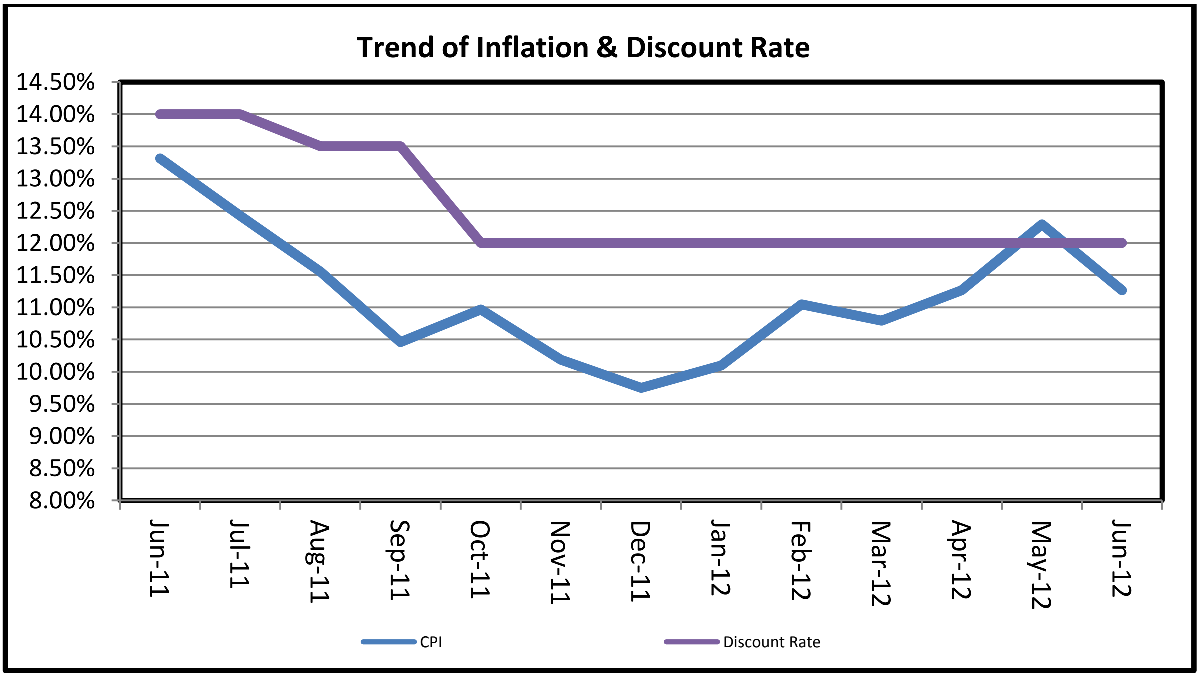
- Time Weighted Return (TWR) earned by PPF is summarized as under:

Period	Annualized Return for the period		Year End Discount Rate	CPI Inflation	Long-term Benchmark
	Gross Return	Net Return*			CPI Inflation + 3%
FY 2008-09	15.21%	15.00%	14.00%	13.14%	16.14%
FY 2009-10	13.79%	13.61%	12.50%	12.69%	15.69%
FY 2010-11	13.48%	13.32%	14.00%	13.13%	16.13%
FY 2011-12	13.96%	13.79%	12.00%	11.26%	14.26%
Jul 2008 – Jun 2012 (CAGR)**	14.10%	13.92%	13.09%	12.54%	15.54%

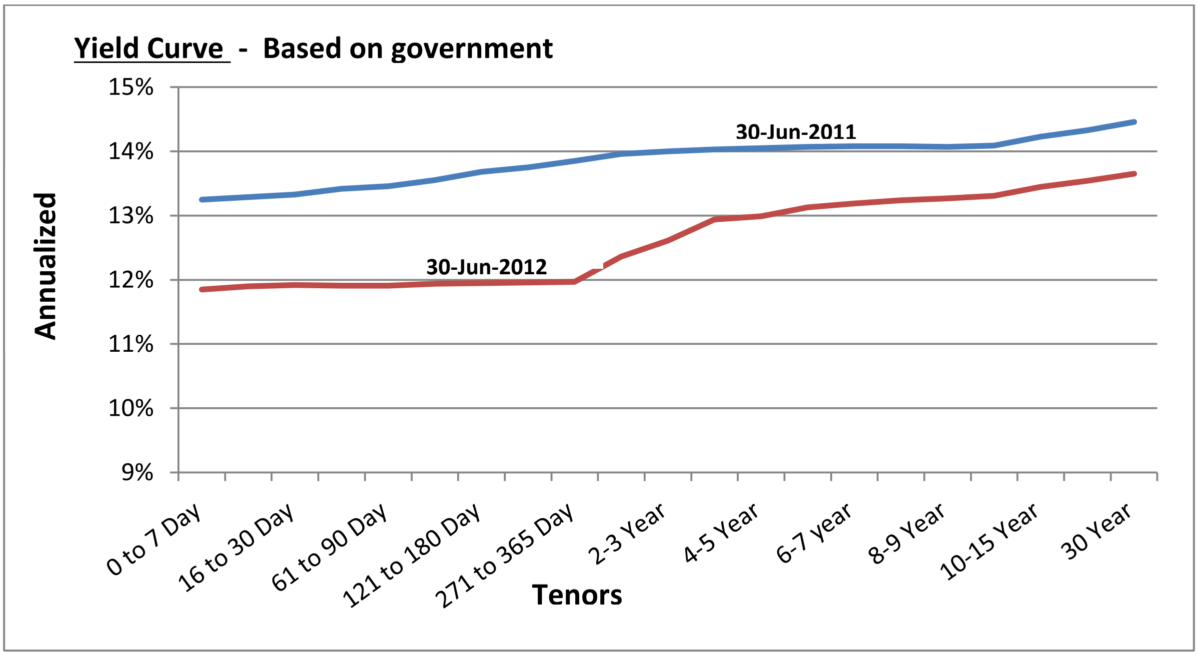
*Net Return means the return after deducting expenses incurred on management of PPF

**CAGR means Compound Annualized Growth Rate

- Inflation rates over the last 3-4 years have been much higher than our long-term inflation expectations of 9%-10% p.a. Interest rates have also been higher than our long-term expectations.
- In order to lock-in high yields for a long period of time, the Fund has invested a large proportion of its assets in long-term fixed-rate instruments consisting mainly of PIBs. The Fund's exposure to long-term PIBs stands at 60.7% of Fund size at the end of June 2012.
- During the current financial year, inflation and interest rates declined considerably. Despite that, PPF has earned a net rate of return of 13.79% due to its large PIB portfolio and timely placement of a sizeable amount in TDRs at attractive rates. The following charts show the decline in inflation and discount rate and the resulting downward shift in yield curve since Jun 2011:



23-D, FCC Block, Syed Maratib Ali Road, Gulberg IV, Lahore. Tel: 042-5758138



GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- As per the last Actuarial Assessment Report, the present value of pension liabilities of the Government of the Punjab stood at Rs. 688 billion as on 30 June 2010. Although, a fresh Actuarial Valuation will provided a more reliable figure, a conservative estimate of the present value of the pension liabilities as on 30 June 2012 is Rs. 800 billion.

- The actual assets of PPF stood at Rs. 15.6 billion as on 30 Jun 2012. This translates into a Funding Ratio (Assets / Liabilities) of 1.95%.

- If PPF were envisaged as a fully funded pension plan, the value of its assets would match the value of the total pension liability of the Government of the Punjab, and the Funding Ratio would equal 100%. This would mean that for the accrued pension liabilities, the Government of the Punjab would not have to earmark any budgetary resources because these would be met by PPF from the return on its assets.

- Currently the Government of the Punjab does not have an explicit target for the Funding Ratio. The desired Funding Ratio can be inferred from the projected injections of funds in PPF by the government as stated in the Medium Term Budgetary Framework 2009-12 announced by Government of the Punjab. If the injections of funds stay on course and there are no withdrawals then at the current average rate of return on PPF funds, the projected funding ratio in 2016 will be 2.3%. Thereafter, this ratio is expected to stay in the range of 2%-2.5%.

- When interest rates go down the rate of return on assets also goes down and the pension plan needs a larger amount of assets to pay the pension liabilities promised to the employees. Thus a decline in interest rates can lower the Funding Ratio of a pension plan further.

- In order to properly manage a pension plan, two things are important.

- Firstly, the Funding Ratio of the pension plan should be high so that sufficient assets vis-à-vis the liabilities are available. A Funding Ratio of 100% is ideal.
    - Currently, the Funding Ratio of the pension plan is less than 2% which means that the current level of assets is sufficient to meet less than 2% of accrued pension liabilities of the Government of the Punjab.
    - This Funding Ratio is clearly quite low and the government may consider increasing this ratio. To make PPF fully funded would need an asset base of about Rs 800 billion as on June 30, 2012. To achieve this magnitude of asset base would require a long-term and sustainable plan of gradual injection of funds into the pension plan.

- Secondly, the Fund should preferably make long-term fixed-rate investments whose maturity is as close as possible to the maturity of pension liabilities. With fixed-rate investments the rate of return on the assets of the Fund will be less vulnerable to the fluctuations in the market rate of interest.
    - Considering the importance of long-term fixed-rate investments, PPF has invested more than 60% of its assets in long-term fixed-rate bonds and remains ready to invest further as opportunities to invest long-term at attractive fixed rates arise.

INFLATION

- A summary of a few important measures of inflation during FY 2010-11 is given below:

	YOY Inflation (%)				
	CPI			NFNE[1]	Trimmed[2]
	overall	Food	non-food		
June 2012	11.3	10.3	12.0	11.5	11.1
12m high	12.4	17.1	13.0	11.5	12.4
12m low	9.7	9.2	9.3	9.6	10.4
12mma[3]	11.0	11.0	11.0	10.6	11.5

[1]NFNE stands for non-food non-energy measure of core inflation

[2]Trimmed Mean measure of core inflation excludes 20% of the items in the CPI basket (10% items showing highest increases in price & 10% items showing lowest increases or negative changes in price)

[3]Twelve month moving average

Source: SBP

- Headline CPI inflation as well as both the measures of core inflation closed the year above 11%. CPI inflation and Trimmed Mean inflation were lower in June 2012 as compared with June 2011 (CPI 13.1%, Trimmed Mean 12.0%) whereas NFNE inflation was higher in June 2012 as compared with June 2011 (10.4%). This suggests that in FY12, inflationary pressures were relatively higher in Non-food Non-energy items.

23-D, FCC Block, Syed Maratib Ali Road, Gulberg IV, Lahore. Tel: 042-5758138

INTEREST RATES

- A summary of important interest rates for FY 2011-12 is given below:

	Yields (% p.a.)		
	1-yr T-bill	10-yr PIB	6-m KIBOR
June 2012	11.97	13.31	12.06
12m high	13.90	14.01	13.81
12m low	11.69	12.04	11.82
12mma	12.28	13.03	12.33

Source: SBP, Reuters

- SBP reduced the discount rate by 2% from 14% to 12% during the year. The difference between 12-month high and end-of-June rates shows that reduction in discount rate impacted short-term rates (e.g. 1-yr T-bill yield) more than the long-term rates (e.g. 10-yr PIB yield).
- The relatively smaller decline in long-term bond yields suggests that bond markets still expect higher long-term inflation.

OUTLOOK FOR FY 2012-13

GDP Growth:

- The country achieved GDP growth rate of 3.7% in FY12 which was an improvement over previous year's (FY11) revised growth rate of 3.0%.

- The average GDP growth rate of last four years is 2.87% which is lowest during the last 5 decades.

- For FY 2012-13, the Government has set a GDP growth target of 4.3% whereas the economy needs a growth rate of 5-6% p.a. in coming years in order to meet the growing requirement of employment.

- The economic performance of the country is expected to remain weak due to both domestic and external factors.
  - Domestically, continuing energy sector crises, poor law and order situation, inability of the Government in implementing tax reforms and high government borrowings are constraining economic growth.
  - Externally, slow global economic growth, combined with high oil prices due to geo-political reasons, create an unfavorable economic environment.

Fiscal Balance:

- Total deficit of Pakistan in FY12 stood at 6.6% of GDP which excludes payment of Rs. 391 billion made to settle a portion of the circular debt. If that amount is included, the budget deficit climbs to a staggering 8.5% of GDP.

- The Government has set a budget deficit target of 4.7% for FY 2012-13 which is unlikely to be achieved considering that it is an election year and the government would prefer to focus on higher expenditures (especially development expenditures) rather than following the politically unpopular course of raising more taxes.

23-D, FCC Block, Syed Maratib Ali Road, Gulberg IV, Lahore. Tel: 042-5758138

External Account:

- During FY12, Current Account Deficit increased sharply and reached at USD 4.52 billion as compared to a surplus of USD 214 million during FY11. Capital & Financial Account Surplus of USD 1.5 billion was insufficient to balance the Current Account Deficit of USD 4.52 billion and the overall External Account Deficit of USD 3.28 had to be financed through reserves which resulted in downward pressure on the exchange rate.

- State Bank of Pakistan projects the Trade Deficit in FY13 to be similar to the FY12 outcome i.e. around USD 15 billion. However, as per State Bank's estimates, the recent receipt of $1.12 billion in Coalition Support Funds and the expected receipt of much delayed auction proceeds of 3G licenses could reduce the external current account deficit to $2.5 billion or 1 percent of GDP in FY13.

Inflation:

- Government has set the inflation target at 9.5% for FY 2012-13.

- There has been some deceleration in inflation during July and August 2012. However, stickiness in both the core inflation measures points towards the persistence of inflation in low double digits. State Bank of Pakistan projects average CPI inflation for FY13 to remain in the range of 10 to 11 percent, which is higher than the Government's announced target of 9.5 percent.

Interest rates:

- SBP has already lowered the discount rate by 1.5% from 12% to 10.5% during its Monetary Policy decision announced in August 2012. SBP justified its decision on the basis of lower inflation and the need to revive private sector credit and investment.
- However, future course of interest rates remains quite uncertain.
    - On one hand, recent decrease in headline inflation and SBP's renewed emphasis on reviving private sector credit suggests that interest rates may remain at these levels or even decline further in the near future.
    - On the other hand, the underlying fundamentals of the economy, including high fiscal deficit, power shortages, rising oil prices and fragile external account position & exchange rate, suggest that inflation and interest rates are set to rise within a few months.

INVESTMENT STRATEGY

- During the past few years, inflation as well as interest rates had been quite high. In order to take advantage of high interest rates, Fund's strategy has been mainly to invest at fixed rates of return for longer periods.
- Considering the continuing economic uncertainties, the current strategy is to invest the liquid funds in short-term fixed income instruments and wait for the right opportunity to invest long-term at higher rates.
- A few amendments to the governing documents may also be proposed during FY13. The amendments are aimed at expanding the investment options, improving the investment process and providing more flexibility in pursuing investment strategies according to the prevailing economic environment.

AUDITORS

The Government of Punjab appointed M/S KPMG Taseer Hadi & Co., Chartered Accountants, as Auditors of the Fund. The Auditors have completed the audit for the year ended 30 June 2012 and have given clean report to the Management Committee.

TRUSTEE

The Management Committee with the approval of The Government of Punjab appointed M/s Central Depository Company of Pakistan Limited as Trustee of the Fund on 27 September 2011. After signing of the Trust Deed custody of all the assets of the Fund are held by the Trustee.

The Trustee in its report has opined that the Punjab Pension Fund has in all material respect managed the Trust during the period from 27 September 2011 to 30 June 2012 in accordance with its Trust Deed and the Governing Laws.

ACKNOWLEDEMENT

The Management Committee takes this opportunity to thank its members for valuable contributions to the Fund.

The Management Committee also wishes to place on record its appreciation for the hard work and dedication shown by the employees of the Fund.

Place: Lahore
Dated: 05 December 2012

Chairman