



Government of the Punjab
Punjab Pension Fund



Dated: 7 September 2012

MONTHLY REVIEW OF INVESTMENTS

August 2012

FUND SIZE

- A summary of changes in fund size during FY13 is given in the following table:

Rs. millions (rounded to the nearest million)

	July-August FY13
Beginning fund size (30 th June 2012)	15,605
Add: contribution during the period	-
Less: transfer to Reserve Pension Fund	-
Add: gain/(loss) during the period	352
Less: expenses during the period	(4)
Ending fund size	15,953

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 Jun 2011		30Jun 2012		31 Aug 2012	
	Amount	%	Amount	%	Amount	%
PIBs	8,942	65.2	9,480	60.7	9,338	58.5
T-Bills	1,254	9.1	139	1.0	-	-
Short term bank deposits	3,002	21.9	5,349	34.3	5,015	31.4
Corporate bonds/TFCs	501	3.7	501	3.2	512	3.2
Cash at bank	8	0.1	130	0.8	1,085	6.9
Other assets*	1	0.0	6	0.0	3	0.0
Total Fund Size	13,708	100.0	15,605	100.0	15,953	100.0

*Other assets include prepaid expenses for management of PPF and book value of fixed assets (motor cycles, computers etc.) 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.



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FUND'S PERFORMANCE

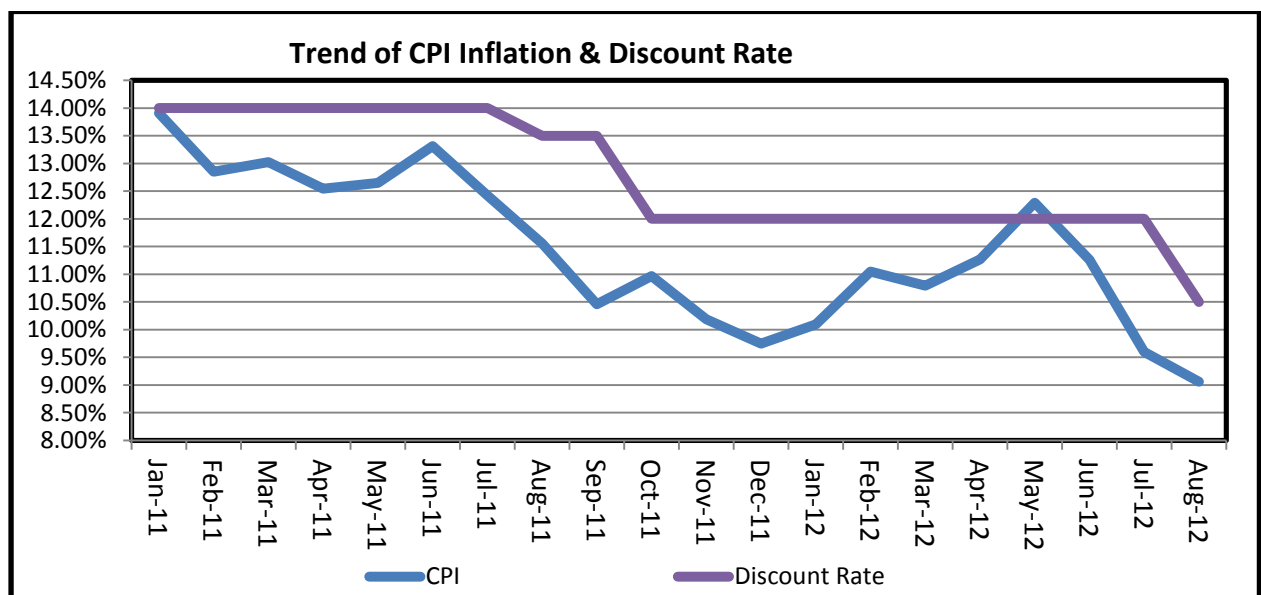
- Time Weighted Return (TWR) earned by PPF is summarized as under:

Period	Annualized Return for the period		CPI Inflation	Long-term Benchmark
	Gross Return	Net Return*		CPI Inflation + 3%
FY 2008-09	15.21%	15.00%	13.14%	16.14%
FY 2009-10	13.79%	13.61%	12.69%	15.69%
FY 2010-11	13.48%	13.32%	13.13%	16.13%
FY 2011-12	13.96%	13.79%	11.26%	14.26%
Jul 2008 - Jun 2012 (CAGR)**	14.10%	13.92%	12.54%	15.54%
July - August 2012	14.02%	13.85%		
August 2012	14.14%	13.97%		

*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 58.5% of Fund size at the end of August 2012.
- CPI Inflation rate has declined sharply in FY13 and SBP has already slashed discount rate by 150 basis points on 10th August 2012 from 12% to 10.50%. Despite lower interest rates, PPF continues to earn a handsome rate of return because of its high yielding portfolio of PIBs and TDRs.





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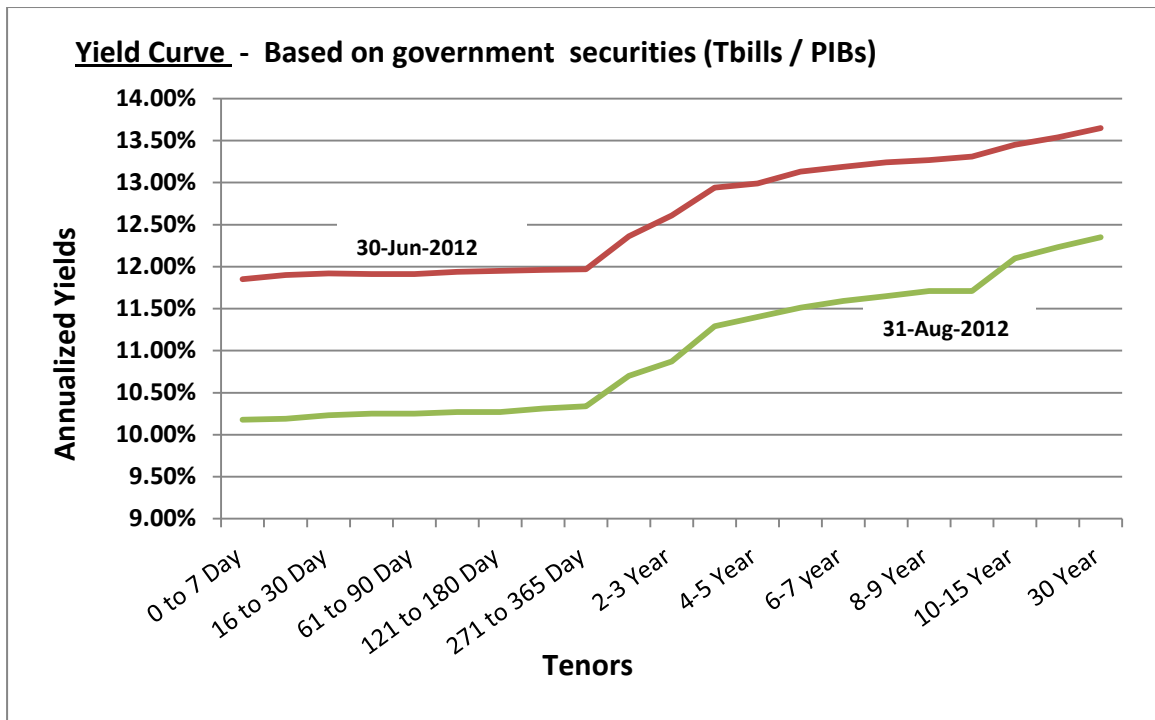


GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- We have constructed a liability index on the basis of next 30-year pension-related cash outflows as projected by the Actuary of the Fund. The index captures the growth in the present value (computed at market rates of interest) of next 30-year liabilities.
- The following table summarizes the amount & growth of market value of Fund's assets vis-à-vis the amount & growth in present value of 30-year Pension liabilities of GoPb:

Period	During the period		End of period		
	Growth		Market Value (Rs. billions)		Funding Ratio
	Fund's Assets	Liability Index	Fund's Assets (a)	30-yr Pension Liabilities (b)	(a)/(b)
FY 2008-09	15.00%	28.01%	3.5	575.9	0.60%
FY 2009-10	13.21%	9.41%	12.1	621.7	1.94%
FY 2010-11	10.81%	-2.88%	13.4	608.9	2.19%
FY 2011-12	16.86%	25.40%	15.6	757.1	2.06%
July-August 2012	6.46%	19.63%	16.6	905.8	1.84%
Jul 2008 - Aug2012 (CAGR)	15.23%	18.64%			

- Since the pension liabilities have very long maturities, their present value is highly sensitive to changes in interest rates.
- The present value of liabilities has a negative correlation with interest rates - it increases sharply when interest rates decrease and vice versa.
- The biggest market risk exposure of the pension liabilities is a decline in interest rates. It can sharply increase the requirement of funds to meet the same liabilities and thus lower the Funding Ratio of the pension plan.
- During the first two months of FY13, interest rates declined by more than 1%, which resulted in a sharp increase in present value of liabilities (19.63%). Although Market value of Fund's assets also increased by 6.46% during the same period, but growth in market value of assets fell well short of the growth in present value of liabilities because a substantial Duration Gap still remains between the Fund's assets and its liabilities.
- Duration measures the sensitivity of present value of a series of cash flows to changes in interest rates. Despite investing a large proportion of Fund's assets in long-term fixed-rate bonds which have higher Durations, the overall Duration of Fund's assets is still much lower than the overall Duration of Fund's liabilities.



REVIEW OF IMPORTANT ECONOMIC & FINANCIAL VARIABLES

1) GDP GROWTH

- The country achieved GDP growth rate of 3.7% for FY12 which indicates that the economic growth improved over last year's revised growth rate of 3.0%, but still missed the target of 4.2%.
- The economic performance of the country has weakened as a result of both domestic as well as external factors. As far as domestic factors are concerned, the continuing energy sector crises, poor law and order situation, inability of the Government in implementing tax reforms and high government borrowings all remained hurdles in the way of economic growth. On external front there is also a difficult global economic environment which does not help the prospects of domestic economic growth.
- The average GDP growth rate of last four years is 2.87% which is the lowest over a 4-year period during the last 5 decades.
- The economy needs a growth rate of 5-6% p.a. in coming years in order to meet the growing requirements of employment.



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2) Fiscal Management

- A summary of revenues and expenditures during FY12 and their comparison with the same period of the previous financial year is shown in the following table:

	Jul - Jun						
	Amount (Rs. bn)		As % of total exp.		As % of GDP		Growth (%)
	FY 11	FY 12	FY 11	FY 12	FY 11	FY 12	FY 12
(1) Total revenue	2,253	2,567	65.4	65.2	12.5	12.4	13.9
(1a) Tax	1,699	2,053	49.3	52.2	9.4	9.9	20.8
(1b) Non-tax	554	514	17.3	18.6	3.1	2.5	(7.2)
(2) Total expenditure	3,447	3,936	100.0	100.0	19.1	19.1	14.2
(2a) Current	2,901	3,123	84.1	79.3	16.1	15.1	7.6
Debt Service	698	889	20.3	22.6	3.9	4.3	27.3
Defence	450	507	13.1	12.9	2.5	2.5	12.5
(2b) Development	506	732	14.7	18.6	2.8	3.5	44.6
Budget surplus / (deficit)	(1,194)	(1,370)	(34.6)	(34.8)	(6.6)	(6.6)	14.7
Financing							
External	108	129	3.1	3.3	0.6	0.6	19.4
Domestic	1,087	1,241	31.5	31.5	6.0	6.0	14.2

Source: Ministry of Finance

- As per the latest fiscal numbers released by ministry of finance, total deficit of Pakistan for the full year- FY12 stood at 6.6% of GDP which excludes the payment of Rs. 391 billion made to settle a portion of the circular debt. If that amount is included, the budget deficit climbs to 8.5% of GDP.
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- Tax revenues increased by a healthy rate of ~21%, however, the overall performance of revenues was harmed by a decline of 7.2% in non-tax revenues.
- Debt servicing expenditures (excluding the payment of Rs. 391 billion on account of circular debt) grew at a worryingly high rate of 27.3%
- Foreign inflows remained small as around 91% of deficit had to be financed with domestic sources.



3) EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US \$

	July FY12	July FY13	Growth* %
Current Account	(0.08)	(0.30)	(262)
Trade balance(Goods)	(1.03)	(1.32)	(29)
Trade balance (Services)	(0.26)	(0.26)	3
Income transfers (net)	(0.21)	(0.18)	18
Remittances	1.10	1.21	9.8
Capital Account	0.00	0.01	300
Financial Account	0.16	(0.11)	(167)
Overall Balance of Payments	0.07	(0.61)	(933)

Source: SBP

- During first month of FY13, current account deficit increased sharply by 262% and stood at USD 297 million as compared to deficit of only USD 82 million during the same period of FY12.
- Trade deficit deteriorated the most and reached at USD 1.32 billion as compared to USD 1.03 billion during the same period last year. This was primarily due to an increase in imports of 6% and decline in exports of 5%.
- Current transfers continued to provide much needed support on the back of 9.8% growth in remittances.
- During July FY13, capital & financial account were unable to provide support to current account deficit and resultantly overall balance of payment remained in deficit of USD 608 million.

INFLATION

- A summary of consumer price inflation rates is given in the following table:

Period	CPI Inflation								
	CPI Overall (%)			CPI Food (%)			CPI Non-food (%)		
	YOY	MOM	12mma ¹	YOY	MOM	12mma	YOY	MOM	12mma
Jun-2012	11.3	0.0	11.0	10.3	-0.2	11.0	12.0	0.2	11.0
Jul-2012	9.6	-0.2	10.8	9.1	1.8	10.4	10.0	-1.7	11.0
Aug-2012	9.1	0.9	10.6	8.5	0.9	10.0	9.4	0.9	10.9
12 month high	12.3	1.8	13.2	11.7	2.2	16.9	13.0	1.9	11.0
12 month low	9.1	-0.7	10.6	8.5	-2.2	10.0	9.4	-1.7	10.2

¹12 month moving average

Source: FBS, SBP.

- CPI for the month of August 2012 further eased to 9.1% which is not only significantly lower than market expectations but also lowest since Dec 2009. The MoM inflation was up by 0.9%.



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- On YoY basis, CPI inflation remained relatively lower than expectations mainly because of lower food group inflation driven mainly by low growth in Housing & Fuel index which has 30% weightage in overall CPI and posted a growth of only 4.42%.
- We expect a relative higher MoM inflation in Sep-12, as the government has increased the oil prices twice during last month which are to be reflected in next month's CPI numbers.
- In the Budget of FY13, government has set the inflation target at 9.5% which seems ambitious considering that the economy continues to grapple with multiple challenges including the energy crisis which creates supply side constraints, high government borrowing and spending which create aggregate demand pressures and worsening external account situation which puts downward pressure on exchange rate.
- A summary of measures of core inflation is given in the following table:

Period	Core Inflation					
	NFNE ¹ (%)			Trimmed ² (%)		
	YOY	MOM	12mma	YOY	MOM	12mma
Jun-2012	11.5	0.7	10.6	11.1	0.5	11.5
Jul-2012	11.3	1.0	10.7	10.7	0.7	11.4
Aug-2012	10.8	0.3	10.8	10.6	0.4	11.1
12 month high	11.5	1.4	10.8	11.7	1.3	12.4
12 month low	10.2	0.3	9.8	10.4	0.3	11.1

¹NFNE stands for non-food non-energy measure of core inflation Source: SBP

²Trimmed Mean measure of core inflation excludes 20% of the items in the CPI basket showing extreme changes in price

- Both the measures of core inflation remained in double digits on YoY basis which suggests that the lowering of headline CPI inflation does not reflect a broad-based decrease in inflation.

The following table summarizes international commodity price inflation rates:

Period	Inflation Rates (%) as per the indices maintained by IMF								
	(Overall) Index of Fuel & Non-fuel Commodities			Commodity Fuel (Energy) Index			Index of Non-fuel Primary Commodities		
	YOY	MOM	12mma	YOY	MOM	12mma	YOY	MOM	12mma
May-2012	-6.7	-6.0	13.1	-2.3	-7.2	21.3	-14.2	-3.4	0.3
Jun-2012	-12.9	-8.1	9.0	-11.9	-11.2	17.0	-14.6	-2.0	-3.4
Jul-2012	-10.7	4.5	4.9	-10.0	4.7	12.5	-11.8	4.2	-6.9
12 month high	27.9	4.5	30.2	33.7	4.7	32.2	19.1	4.2	32.4
12 month low	-12.9	-8.1	4.9	-11.9	-11.2	12.5	-14.7	-7.4	-6.9

Source: IMF



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- In July 2012, inflation in both Fuel & Non-Fuel commodities showed highest MoM increase over the last 12 months.
- Prices of agricultural commodities have started to rise partly because of draught and extreme weather conditions in major producing countries of the world (e.g. USA, India, Russia etc.)
- The increase in Fuel index is solely contributed by Oil prices which are increasing mainly due to growing geo-political tension in Middle East.

INTEREST RATES

- A summary of important interest rates is given below:

Period	Yield on 1-yr T-bill (% p.a.)		Yield on 10-yr PIB (% p.a.)		6-month KIBOR (% p.a.)	
	Month end	12mma	Month end	12mma	Month end	12mma
Jun-2012	11.97	12.28	13.31	13.03	12.06	12.33
Jul-2012	11.87	12.11	13.06	12.95	11.99	12.18
Aug-2012	10.34	11.86	11.71	12.82	10.51	11.94
12m high	12.97	13.61	13.24	13.92	13.25	13.62
12m low	10.34	11.86	11.71	12.82	10.51	11.94

Source: SBP, Reuters

- Market Interest rates have come down after State Bank's decision to lower the discount rate by 1.5% from 12% to 10.5% during August 2012.
- Future course of interest rates remains quite uncertain.
 - 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.
 - 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.



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INVESTMENT STRATEGY

- Current portfolio of the Fund is well positioned to earn a decent inflation-adjusted rate of return during FY13. If inflation & interest rates remain low, the high yielding PIB portfolio will provide an attractive spread above inflation. If inflation and interest rates increase, the Fund will have the opportunity to further build its high-yielding long-term bond portfolio by diverting part of its short-term liquid investments.
- In its next meeting, the Investment Sub-Committee will debate a few more amendments to the governing documents. 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.

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