Government of the Punjab

Punjab Pension Fund

Dated: 12 January 2011

MONTHLY REVIEW OF INVESTMENTS

December 2010

FUND SIZE

- A summary of changes in fund size during the current financial year is given in the following table:

Rs. millions (rounded to the nearest million)

	Jul-Dec 2010
Beginning fund size	12,097
Add: contribution during the period	-
Less: transfer to Reserve Pension Fund	-
Add: gain/(loss) during the period	776
Less: expenses during the period	(9)
Ending fund size	**12,864**

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		**31 Dec 2010**	
	Amount	**%**	**Amount**	**%**
PIBs	5,737	47.4	5,789	45.0
T-Bills	3,145	26.0	595	4.7
Short term bank deposits	3,015	24.9	6,000	46.6
Corporate bonds/TFCs	176	1.5	349	2.7
Cash at bank	21	0.2	130	1.0
Other assets*	3	0.0	1	0.0
Total Fund Size	**12,097**	**100.0**	**12,864**	**100.0**

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

- Long-term investments consist of PIBs and TFCs whereas short-term investments consist of T-bills and bank deposits.
- PPF has been switching exposure between T-bills & short-term bank placements in pursuit of higher rates of return.

FUND'S PERFORMANCE

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

Period	Annualized Return for the period			Long-term Benchmark
	Gross Return	Net Return*	CPI Inflation	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%
Jul-Dec 2010	13.13%	12.98%		
Dec 2010	13.45%	13.31%		

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

- Inflation rates over the last 2-3 years have been much higher than our long-term inflation expectations of 9%-10% p.a. Current interest rates are also higher than our long-term expectations. We consider this an opportunity to invest in long-term fixed rate instruments. As inflation and interest rates decline and revert to their long-term averages, the strategy to invest at fixed rates will pay off and the Fund will be able to earn an attractive real rate of return in accordance with its long-term objective.

REVIEW OF IMPORTANT ECONOMIC & FINANCIAL VARIABLES

GDP GROWTH

- For FY 2010-11, the government had originally set a GDP growth target of 4.5%. However, recent estimates by SBP project GDP growth in the range of 2.5%-3%.
- Reasons for the slowdown of the economy include:
    - Damage to crops, livestock, infrastructure, industry and economic activity in general, caused by floods;
    - Intensification of inflationary pressures due to
        - food shortages caused by floods
        - rising prices of petroleum products
        - rise in electricity tariffs
    - slowdown in borrowing and investment by the private sector due to a combination of slow economy, rising costs and high interest rates.

FISCAL MANAGEMENT

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

	Jul - Sep						
	Amount (Rs. bn)		As % of total exp.		As % of GDP		Growth (%)
	FY 10	FY 11	FY 10	FY 11	FY 10	FY 11	FY 11
(1)Total revenue	**427.3**	**400.1**	**66**	**59**	**2.9**	**2.3**	**(6.3)**
(1a) Tax	298.8	317.3	46	47	2.0	1.9	6.2
Direct Tax	84.1	94.4	13	14	0.6	0.6	12.3
Indirect Tax	214.7	222.9	33	33	1.4	1.3	3.8
(1b) Non-tax	128.5	82.9	20	12	0.9	0.5	(35.5)
Dividend	18.9	0.5	3	0.1	0.1	0.0	(97.6)
SBP Profit	70.0	40.0	11	6	0.5	0.2	(42.9)
(2) Total expenditure	**650.9**	**676.3**	**100**	**100**	**4.4**	**4.0**	**3.9**
(2a) Current	521	566.7	80	84	3.5	3.3	8.8
Domestic Debt Service	129.3	146.6	20	22	0.9	0.9	13.4
Foreign Debt Service	12.2	14.9	2	2	0.1	0.1	22.5
Defence	86.2	93.1	13	14	0.6	0.5	8.1
(2b) Development	109.0	59.4	17	9	0.7	0.3	(45.5)
Budget surplus / (deficit)	**(224)**	**(276)**	**(34)**	**(41)**	**(1.5)**	**(1.6)**	**23.5**
Financing	224	276	34	41	1.5	1.6	23.5
External	77.1	56.9	12	8	0.5	0.3	(26.2)
Domestic	146.6	219.3	23	32	1.0	1.3	49.6
Non-bank	107.6	98.4	17	15	0.7	0.6	(8.6)
Bank	39	121	6	18	0.3	0.7	210.0
Privatization	0	0	0	0	0	0	-
Full Year GDP	**14,838**	**17,106**					
Revenue surplus / (deficit)[1]	**(93.7)**	**(166.6)**			**(0.6)**	**(1.0)**	**77.8**

[1]Revenue surplus/(deficit) = Total revenue – Current expenditure

Source: Ministry of Finance

- Fiscal situation has been very difficult during the first quarter of the current fiscal year. As a percentage of GDP
  - Tax as well as non-tax revenues fell;
  - Expenses also fell but the brunt had to be borne by development expenditures which will have adverse consequences for long-term growth potential of the economy;

- Overall budget deficit increased;
- Revenue deficit increased significantly.

- It seems that the fiscal situation of the country will remain quite challenging in the near future.
    - Due to delays in introduction of tax reforms and weak industrial production, the target of 27% increase in tax revenues during FY 11 is unlikely to be achieved.
    - The Government continues to borrow heavily from the domestic economy which is contributing to high inflation, high interest rates and crowding out of the private sector.

DEBT

Domestic Debt:

- The domestic debt profile of Pakistan is summarized in the following table:

Domestic Debt	Amount (Rs. bn)		As % of Total Dom. Debt		As % of GDP		Growth (%)
	Jun-10	**Oct-10**	**Jun-10**	**Oct-10**	**Jun-10**	**Oct-10**	**FY 11**
I) Permanent	794	801	17.1	16.0	5.4	4.7	0.8
PIBs	505	508	10.9	10.1	3.4	3.0	0.6
Prize Bonds	236	246	5.1	4.9	1.6	1.4	4.3
II) Floating	2,399	2,703	51.6	54.0	16.4	15.8	12.7
III) Unfunded	1,456	1,502	31.3	30.0	9.9	8.8	3.1
Saving Schemes	1,350	1,395	29.0	27.9	9.2	8.2	3.4
IV) FC Instruments	3	2	0.1	0.0	0.0	0.0	(41.9)
Total Domestic Debt	**4,653**	**5,007**	**100.0**	**100.0**	**31.7**	**29.3**	**7.6**
GDP	**14,668**	**17,106**					

Source: SBP

- The government's dependence on short-term borrowing is quite high and has increased further during the current financial year. Floating debt, which consists of T-bills having maturities of 3, 6 and 12 months, constituted 54% of the total domestic debt at the end of Oct 2010.
- During the last quarter, most of the borrowing was made through the 3-month T-bills. This shows that, currently, the market is lending bigger amounts to the Government only in the shortest tenor (i.e. 3-month T-bill) because of the apprehension that continued high borrowing by the Government may lead to even higher inflation & interest rates in future.
- The result is that the Government has to roll over its debt after very short intervals. This, combined with the fresh borrowing needs of the Government, is putting further upward pressure on interest rates.

- During the current quarter (Jan-Mar 2011), T-bills worth Rs. 865 bn are maturing. In order to roll over this amount of Rs. 865 bn and also make fresh borrowing of Rs. 115 bn, the Government has set a target of Rs. 980 bn for issuance of T-bills during this quarter.

- Borrowing through PIBs and Sukuks during Jul-Dec 2010 was Rs. 30.3 bn and Rs. 89.0 bn respectively. The government has set a target of Rs. 35 bn and Rs. 45 bn for borrowing through PIBs and Sukuks during the current quarter i.e. Jan-Mar 2011.

External Debt:

- The external debt profile of Pakistan is summarized in the following table:

External Debt	Amount (USD billion)		Amount (Rs. billion)		As % of GDP		Growth[1] (%)
	June-10	**Sep-10**	**June-10**	**Sep-10**	**June-10**	**Sep-10**	**Jul-Sep10**
1) Public Debt	52.1	54.8	4,458	4,733	30.4	27.7	6.2
a) Govt Debt	42.9	44.8	3,671	3,869	25.0	22.6	5.4
i) Medium & long term	42.1	43.9	3,603	3,793	24.6	22.2	5.3
ii) Short term	0.8	0.9	68	76	0.5	0.4	12.0
b) From IMF	8.1	8.9	691	769	4.7	4.5	11.3
c) Foreign Ex Liabilities	1.1	1.1	96	95	0.7	0.6	(1.0)
2) PSE Guaranteed Debt	0.2	0.2	14	13	0.1	0.1	(4.1)
3) PSE Non-Guaranteed Debt	0.8	0.8	69	68	0.5	0.4	(2.1)
4) Schedule Bank Borrowings	0.2	0.2	17	21	0.1	0.1	28.7
5) Pvt. Guaranteed Debt	0.0	0.0	0	0	0	0	-
6) Pvt. Non-Guaranteed Debt	2.2	2.3	191	200	1.3	1.2	4.5
7) Pvt. Non-Guaranteed Bonds	0.1	0.1	11	11	0.1	0.1	1.0
Total External Debt	**55.6**	**58.4**	**4,459**	**5,046**	**32.4**	**29.5**	**6.0**
Exchange Rate (Rs./USD)			**85.56**	**86.38**			
GDP			**14,668**	**17,106**			

[1]Growth in rupee value
Source: SBP, MOF, Reuters

- Although interest rates on external debt are much lower than those on domestic debt, the depreciation of domestic currency leads to higher costs (interest as well as principal) in terms of domestic currency.

- Repayments of foreign loans becoming due combined with a weak external account position may put pressure on the exchange rate.

EXTERNAL ACCOUNT

- Balance of payments during the current financial year is compared with the balance of payment in the same period of last financial year in the following table:

Billion US $

	Jul-Nov 10	Jul-Nov 11	Growth* %
Current Account	(1.8)	(0.7)	72
Capital Account	0.1	0.0	(50)
Financial Account	2.2	0.5	(79)
Errors and Omissions	0.5	0.1	(80)
Overall Balance of Payments	**0.9**	**0.1**	(89)

Source: SBP

*Growth is positive where an account has shown improvement e.g. deficit has decreased or surplus has increased. Growth is negative where an account has worsened e.g. deficit has increased or surplus has decreased.

CURRENT ACCOUNT

- Composition of Current Account during the current financial year and its comparison with the same period of the last financial year is shown in the following table:

Billion US $

	Jul-Nov 10	Jul-Nov 11	Growth %
Current Account (1+2+3)	**(1.8)**	**(0.5)**	**72**
(1) Balance of trade in Goods & Services	**(6.0)**	**(5.6)**	**7**
Goods: Exports f.o.b	7.7	9.0	17
Goods: Imports f.o.b	12.4	16.6	9
Balance of trade in goods	(4.7)	(4.5)	4
Services: Credit (exports)	1.6	1.9	21
Services: Debit (imports)	2.8	2.9	3
Balance of trade in services	(1.3)	(1.0)	19
(2) Balance of Income Transfers	**(1.2)**	**(1.3)**	**(10)**
Income: Credit (inflows)	0.2	0.3	65
Income: Debit (outflows)	1.3	1.6	18
Interest Payments	0.4	0.7	62
Profit & Dividend	0.3	0.2	(9)
(3) Balance of Current Transfers	**5.3**	**6.3**	**19**
Current Transfers: Credit (inflows)	5.4	6.4	18
Workers' Remittances	3.8	4.4	16
FCA Residents	0.2	0.2	(14)
Current Transfers :Debit (outflows)	0.0	0.0	(48)

Source: SBP

- The Current Account Deficit (CAD) during Jul-Nov FY 11 is lower than the same period of last year.
  - Deficit on trade in goods & services is lower than the same period of last year. Exports of goods as well as services have grown faster than imports.
  - Workers' remittances have also shown a healthy growth over the same period of last year.
- SBP has projected that Current Account Deficit (CAD) in FY 11 is likely to be narrower than earlier projections of 3.5% of GDP as
  - the performance of exports and the trend in remittances are better than expectations so far; and
  - import demand remains contained due to weakening private sector demand.

FINANCIAL ACCOUNT

- Composition of the Financial Account during the current financial year and its comparison with the same period of last financial year is shown in the following table:

Billion US $

	Jul-Nov 10	Jul-Nov 11	Growth %
Financial Account (1+2+3)	**2.2**	**0.5**	**(79)**
(1) Direct Investment	0.7	0.6	(17)
(2) Portfolio Investment	0.3	0.2	(43)
(2a) Equity	0.3	0.2	(42)
(2b) Debt	(0.0)	(0.0)	17
(3) Other Investment	1.2	(0.3)	(123)
Equity based flows (1+2a)	1.0	0.7	(25)
Debt based flows (2b+3)	1.2	(0.3)	(124)

Source: SBP

- Financial Account shows a significantly weak position compared with the same period of last year. Equity as well as Debt flows have been weaker than the same period of last year. This clearly indicates a weak capacity to finance the Current Account Deficit.

INFLATION

CONSUMER PRICES

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

	CPI Inflation								
Period	CPI Overall (%)			CPI Food (%)			CPI Non-food (%)		
	YOY	MOM	12mma[1]	YOY	MOM	12mma	YOY	MOM	12mma
Aug 2010	13.2	2.5	12.0	15.6	5.1	13.1	11.2	0.3	11.2
Sep 2010	15.7	2.7	12.5	21.2	5.3	14.0	11.0	0.3	11.2
Oct-2010	15.3	0.6	13.1	20.1	0.1	15.1	11.3	1.1	11.3
Nov-2010	15.5	1.5	13.5	20.5	2.2	15.9	11.1	0.9	11.4
12 month min.	10.5	-0.5	11.7	10.9	-1.7	11.9	10.2	0.1	11.1
12 month max.	15.7	2.7	15.0	21.2	5.3	15.1	12.2	2.8	13.9

[1]12 month moving average

Source: SBP

- High CPI inflation was recorded in Nov 2010 on both year-on-year and month-on-month basis.
- Food inflation has been the primary driver of overall CPI inflation during the current financial year. However, the month-on-month numbers for Oct and Nov 2010 suggest that Non-Food inflation is also picking up.
- The breakdown of CPI inflation into its various components is shown in the following table:

Index	Weightage % in CPI	Nov 2010 - CPI Inflation (%)		
		YOY	MOM	12mma
CPI	100	15.5	1.5	13.5
CPI food	40.34	20.5	2.2	15.9
Non-perishable food items	35.20	17.0	2.0	14.5
Perishable food items	5.14	42.1	3.5	24.5
CPI non-food	59.66	11.1	0.9	11.4
Apparel, textile & footwear	6.10	11.3	0.9	8.3
House rent	23.43	6.9	0.5	10.2
Fuel & lighting	7.29	21.1	0.8	18.0
Household, furniture & equipment etc.	3.29	9.7	1.1	7.1
Transport & communication	7.32	15.7	0.4	14.7
Recreation & entertainment	0.83	13.7	0.1	10.7
Education	3.45	6.0	0.3	9.4
Cleaning, laundry & personal appearance	5.88	11.3	2.3	10.2
Medicare	2.07	16.3	5.3	9.4

Source: SBP

CORE INFLATION

- A summary of measures of core inflation is given in the following table:

	Core Inflation					
Period	**NFNE[1] (%)**			**Trimmed[2] (%)**		
	YOY	**MOM**	**12mma**	**YOY**	**MOM**	**12mma**
Aug 2010	9.8	0.4	10.5	12.5	0.7	11.2
Sep 2010	9.4	0.4	10.3	12.8	0.9	11.5
Oct 2010	9.3	0.7	10.1	12.8	1.0	11.9
Nov 2010	9.5	1.0	10.1	13.4	1.2	12.1
12 month min.	9.3	0.4	10.1	10.4	0.4	11.2
12 month max.	10.7	1.7	15.3	13.4	1.3	16.0

[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 showing extreme changes in price

Source: SBP

- Year-on-year NFNE inflation has remained in single digits over the last few months indicating that inflationary pressures are concentrated in food & energy items. However, month-on-month NFNE inflation has picked up in Oct and Nov 2010 suggesting that inflation is beginning to spread to non-food non-energy items as well.
- Trimmed mean inflation has strengthened over the past few months which shows that within the food & energy categories, inflationary pressures are quite broad based.

WHOLESALE PRICES

- A summary of inflation rates based on WPI (Wholesale Price Index) is given below:

	WPI Inflation								
Period	**WPI Overall (%)**			**WPI Food (%)**			**WPI Non-food (%)**		
	YOY	**MOM**	**12mma**	**YOY**	**MOM**	**12mma**	**YOY**	**MOM**	**12mma**
Aug 2010	19.2	2.6	16.0	16.4	4.2	13.1	21.6	1.4	18.2
Sep 2010	21.5	2.1	17.7	21.1	4.5	14.2	21.8	0.2	20.6
Oct 2010	23.8	3.1	19.4	22.2	1.8	15.6	25.1	4.2	22.6
Nov 2010	24.7	3.5	20.4	22.7	2.3	16.8	26.2	4.4	23.5
12 month min.	15.0	-0.6	7.3	11.5	-0.7	11.4	17.9	-2.0	3.4
12 month max.	24.7	4.2	20.4	22.7	4.5	16.8	27.7	5.5	23.5

Source: SBP

- A breakdown of WPI inflation into its various components is shown in the following table:

Index	**Weightage (%) in WPI**	**Nov 2010 - WPI Inflation (%)**		
		YOY	**MOM**	**12mma**
WPI	100	24.7	3.5	20.4
WPI food	42.1	22.7	2.3	16.8
WPI non-food	57.9	26.2	4.4	23.5
Raw materials	8.0	70.7	8.9	49.8
Fuel, lighting & lubricants	19.3	12.8	2.0	22.2
Manufactures	25.9	28.4	5.9	19.4
Building materials	4.7	18.9	1.4	6.1

Source: SBP

- YOY inflation is very high in both food and non-food segments of wholesale prices.
- MOM inflation captures the recent trend in wholesale prices. Food as well as Non-Food inflation has recorded a high MOM increase which reflects the strengthening of international commodity prices during the month.

INTERNATIONAL COMMODITY PRICES

- 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
Aug 2010	12.3	3.3	22.5	8.7	0.9	26.5	18.3	7.4	17.3
Sep 2010	17.6	1.3	26.4	14.1	0.4	30.6	23.5	2.7	20.5
Oct 2010	17.7	5.6	28.2	12.3	6.3	32.3	27.5	4.6	22.6
Nov 2010	16.5	3.1	27.9	11.3	3.6	31.3	25.8	2.3	23.5
12 month high	48.3	5.7	28.2	60.0	6.3	32.3	31.3	7.4	23.5
12 month low	9.9	-7.5	-25.7	8.7	-8.8	-29.7	10.3	-5.1	-16.2

Source: IMF

- A breakdown of the Commodity index into its various components is given below:

Index	**Weightage (%) in Commodity Index**	**Nov 2010 Inflation (%)**		
		YOY	**MOM**	**12mma**
Fuel & Non-fuel Commodities	**100**	**16.5**	**3.1**	**27.9**
Fuel Commodities (Energy)	**63.1**	**11.3**	**3.6**	**31.3**
Petroleum	53.6	9.3	3.5	38.6
Natural Gas	6.9	3.4	0.0	28.7
Coal	2.6	30.4	6.2	34.8
Non-Fuel Commodities	**36.9**	**25.8**	**2.3**	**23.5**
Industrial inputs	18.4	32.8	2.6	39.6
Agricultural Raw Mat.	7.7	35.6	6.5	34.6
Metals	10.7	31.2	0.6	42.7
Edibles	18.5	19.5	2.0	11.5
Food	16.7	21.0	1.9	11.0
Beverages	1.8	8.7	2.8	16.2

Source: IMF

- International commodity prices exhibited high YOY as well as MOM inflation during Nov 2010 driven mainly by petroleum, coal and agricultural raw materials.

MONEY SUPPLY & INTEREST RATES

- A summary of the total stock of money supply (M2) and the changes in it during the current financial year is given in the following table:

Rs. billions

			Change (1 Jul – 24 Dec 2010)	
		End Jun 2010	Absolute	%
	Broad Money (M 2)	5,777	456	7.9
	LIABILITY SIDE (A+B)			
A	Currency in circulation	1,295	262	20.2
B	Demand & Time deposits	4,482	194	4.3
	ASSET SIDE (C+D)			
C	Net Foreign Assets (NFA) of banking system	545	69	12.7
D	Net Domestic Assets (NDA) of banking system (a+b+c)	5,232	387	7.4
a	Net Govt. Sector borrowings	2,441	416	17.0
b	Credit to Non Govt. Sectors	3,389	129	3.8
c	Other items (net)	(598)	(158)	

Source: SBP

- A summary of the total stock of Reserve Money (RM) and the changes in it during the current financial year is given in the following table:

Rs. billions

			Change (1 Jul – 24 Dec 2010)	
		End Jun 2010	Absolute	%
	Broad Money (M 2)	1,679	267	15.9
	LIABILITY SIDE (A+B)			
A	Currency in circulation	1,295	262	20.2
B	Others (Cash in tills & Deposits)	384	5	1.3
	ASSET SIDE (C+D)			
C	Net Foreign Assets (NFA)	379	40	10.6
D	Net Domestic Assets (NDA) (a+b+c)	1,301	227	17.4
a	Govt. Sector	1,225	274	22.4
b	Non Govt. Sector	330	20	6.1
c	Others	(254)	(67)	

Source: SBP

- It is evident that, during the current financial year, the Monetary Base (Reserve Money RM) has grown much faster than the Monetary Aggregate (Broad Money M2). Government borrowing from SBP has been the major cause of high growth in Reserve Money.
- Since the Monetary Base is ultimately converted to Monetary Aggregate through the multiplier effect (repeated cycles of deposits and loans), the risk of high growth in M2 in future has increased. And high growth in M2 accompanied by slow growth in Real GDP will lead to higher inflation. This explains why SBP is so apprehensive of the current fiscal management by the government.
- A summary of interest rates for the last few months 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
Sep 2010	12.97	12.36	13.75	12.79	13.27	12.52
Oct 2010	13.17	12.41	13.83	12.88	13.23	12.56
Nov 2010	13.38	12.52	13.88	13.01	13.60	12.66
Dec 2010	13.65	12.65	14.24	13.14	13.62	12.75
12m high	13.65	12.65	14.24	13.14	13.62	13.62
12m low	11.95	12.21	12.47	12.42	12.23	12.23

Source: SBP, Reuters

- We think that the way out of the current problems lies in fiscal reform (higher tax collection) and better management (improving the efficiency of public sector entities) and not in further monetary tightening. Private Sector has already slowed down considerably (low capacity utilization in many sectors, low borrowing and/or investment, rising unemployment etc.) and further tightening will only worsen that trend.
- However, we expect that SBP will increase the discount rate by 0.5% in its next monetary policy decision which is due at the end of January 2011. Our expectation is based on the following reasons:
    - High growth in Reserve Money (RM) due to continued government borrowing has raised the risk of high growth in Broad Money (M2) in future which, given the expectation of slow growth in Real GDP, will have adverse implications for inflation;
    - Measures of Core Inflation i.e. NFNE and Trimmed Mean Inflation are accelerating on month-on-month basis which suggest that the second round of

inflation (where other prices follow the path of rising food & energy prices) is strengthening.

INVESTMENT STRATEGY

- Average inflation (CAGR) over the 19 year period from Jul 1991 to Jun 2010 has been 8.8% p.a. Our long-term inflation expectation for the future is in the range of 9-10% p.a. We think that a fixed rate of return of 12.5% p.a. or above on our investments is consistent with our long-term return objective of 'inflation + 3%'.
- We think that the current inflation rate is too high and will gradually revert to its long-term average. Since above-average inflation has led to above-average interest rates also, our strategy is to invest at fixed rates of return for longer periods.
- Considering the attractive yields on a few highly rated TFCs, the ISC may consider increasing the allocation to corporate bonds/TFCs which currently stands a maximum of 5% of Fund size.
- A major limitation of investments in floating-rate TFCs is that their yields are vulnerable to a decline in interest rates. In order to manage the interest rate risk underlying the floating-rate investments, the ISC will consider entering into fixed-for-floating Interest Rate Swaps so that PPF can convert its floating-rate investments into fixed-rate investments.
- The ISC is yet to make a decision on our recommendation to allocate 10% of Fund size to equity investments. This will also be discussed in the next ISC meeting.
- There has been no breakthrough in negotiations with commercial banks for long term placement of funds. The banks are generally reluctant to take fixed deposits for periods longer than one year. The matter will be discussed in the next ISC meeting. The ISC may consider revising the asset allocation and reallocating this portion to other avenues such as corporate bonds/TFCs, T-bills, Short-term TDRs, PIBs, Saving Schemes or Stocks etc.

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