



# Government of the Punjab

## Punjab Pension Fund



Dated: 11 January 2013

### MONTHLY REVIEW OF INVESTMENTS

December 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-December FY13
Beginning fund size (30 <sup>th</sup> June 2012)	15,605
Add: contribution during the period	-
Less: transfer to Reserve Pension Fund	-
Add: gain/(loss) during the period	1,026
Less: expenses during the period	(12)
<b>Ending fund size</b>	<b>16,619</b>

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		30 Jun 2012		31 Dec 2012	
	Amount	%	Amount	%	Amount	%
PIBs	8,942	65.2	9,480	60.7	9,550	57.5
T-Bills	1,254	9.1	139	1.0	-	-
Short term bank deposits	3,002	21.9	5,349	34.3	6,077	36.6
National Saving Schemes	-	-	-	-	650	3.9
Corporate bonds/TFCs	501	3.7	501	3.2	246	1.5
Cash at bank	8	0.1	130	0.8	89	0.5
Other assets*	1	0.0	6	0.0	1	0.0
<b>Total Fund Size</b>	<b>13,708</b>	<b>100.0</b>	<b>15,605</b>	<b>100.0</b>	<b>16,619</b>	<b>100.0</b>

\*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, National Saving Schemes and bank deposits.
- PPF keeps switching exposure between T-bills, National Saving Schemes & short-term bank placements in pursuit of higher rates of return.



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## FUND'S PERFORMANCE

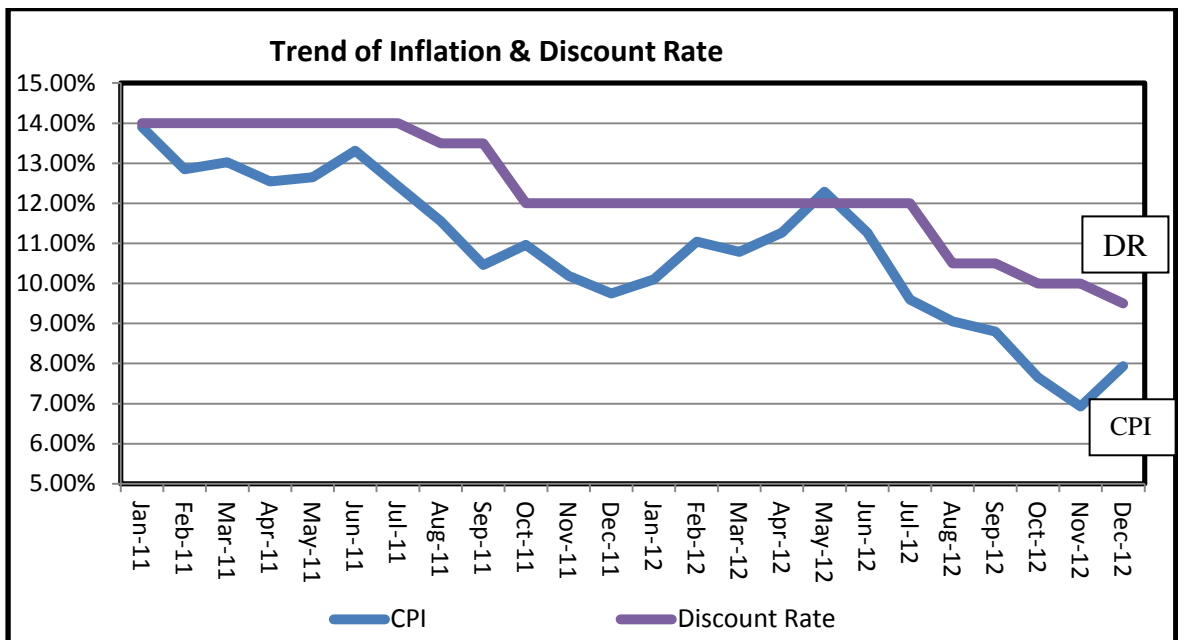
- Time Weighted Return (TWR) earned by PPF is summarized as under:

Period	Annualized Return for the period		Year End Discount Rate	CPI Inflation	Long-term Benchmark CPI Inflation + 3%
	Gross Return	Net Return*			
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%		12.54%	15.54%
July - December 2012	13.47%	13.30%			
December 2012	12.54%	12.39%			

\*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 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 57.5% of Fund size at the end of December 2012.
- CPI Inflation rate has declined sharply in FY13 and SBP has reduced discount rate by 2.5% cumulatively (from 12% to 9.5%) since June 2012. Despite lower interest rates, PPF continues to earn an attractive rate of return because of its high yielding portfolio of PIBs.





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### GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

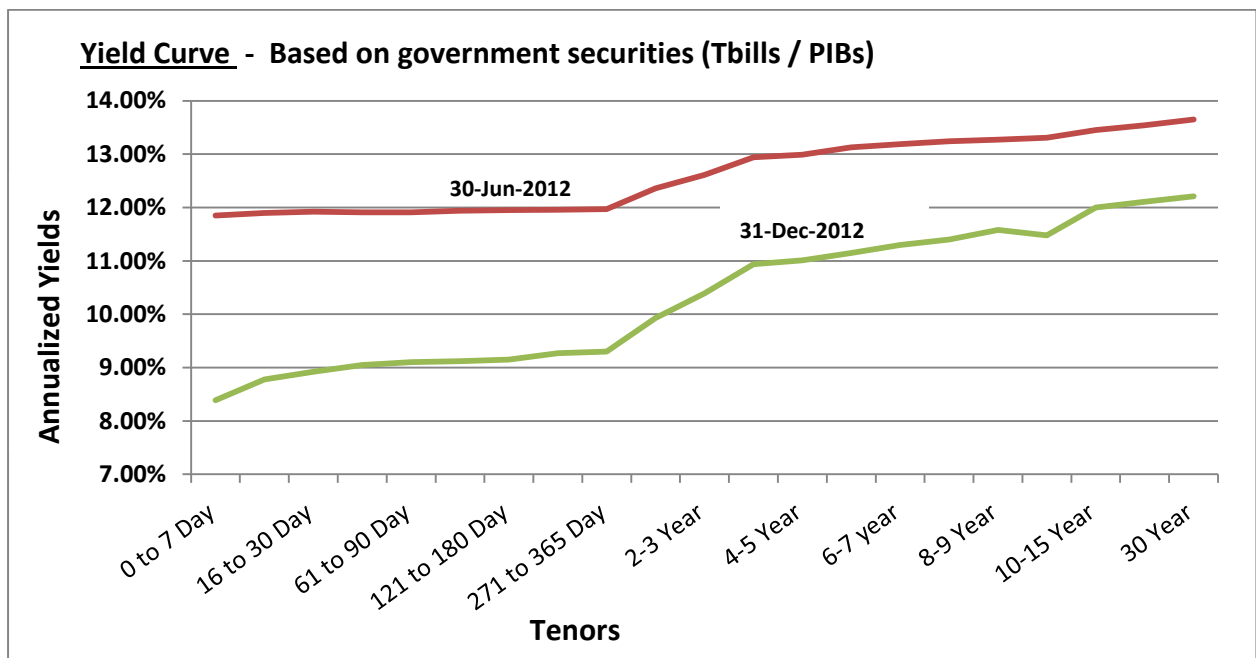
- We have constructed a liability index on the basis of next 30-year pension-related cash outflows as projected by the Actuary of the Fund. The index captures the growth in the present value (computed at market rates of interest) of next 30-year liabilities.
- The following table summarizes the amount & 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%
Jul-Dec 2012	12.07%	26.25%	17.5	955.9	1.83%
Jul 2008 - Dec2012 (CAGR)	15.34%	18.55%			

- 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 period July-December FY13, interest rates have declined by more than 1.5%, which resulted in a sharp increase in present value of liabilities (26.25%). Although Market value of Fund's assets also increased by ~12% during the same period, but growth in market value of assets remained 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.



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## REVIEW OF IMPORTANT ECONOMIC & FINANCIAL VARIABLES

### 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 and 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 the difficult global economic environment does not help the prospects of domestic economic growth.
- IMF, in its recent report, showed serious concerns regarding economic performance of the country. The report says that Pakistan's real GDP growth rate over the past four years has averaged merely about 3% annually, and projected an economic growth rate of 3.25% for FY13.
- If the real GDP growth rate is netted with population growth rate (which is close to 2% p.a.), there is almost no improvement in overall standards of living in the country.
- The current growth rate is insufficient to absorb the rapidly rising working-age population of the country. The economy needs a sustainable growth rate of 5-6% p.a. in coming years in order to meet the growing requirements of employment.



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### FISCAL MANAGEMENT

- A summary of revenues and expenditures during 1<sup>st</sup> Quarter FY13 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 12	FY 13	FY 12	FY 13	FY 12	FY 13	FY 13
<b>(1) Total revenue</b>	<b>533.6</b>	<b>692.1</b>	<b>67.5</b>	<b>70.9</b>	<b>2.5</b>	<b>2.9</b>	<b>29.7</b>
(1a) Tax	409.0	451.3	51.7	46.2	1.9	1.9	10.3
(1b) Non-tax	124.7	240.8	15.8	24.7	0.6	1.0	93.2
<b>(2) Total expenditure</b>	<b>790.9</b>	<b>975.9</b>	<b>100.0</b>	<b>100.0</b>	<b>3.8</b>	<b>4.1</b>	<b>23.4</b>
(2a) Current	656.6	812.4	83.0	83.2	3.1	3.4	23.7
Debt Service	177.3	312.8	22.4	25.1	0.8	1.3	76.5
Defence	107.3	117.4	13.6	12.0	0.5	0.5	9.5
(2b) Development	88.9	74.1	11.2	7.6	0.4	0.3	(16.7)
<b>Budget surplus / (deficit)</b>	<b>(257.2)</b>	<b>(283.8)</b>	<b>(32.5)</b>	<b>(29.1)</b>	<b>(1.2)</b>	<b>(1.2)</b>	<b>10.4</b>
Financing							
External	(4.4)	(1.6)	(0.6)	(0.2)	0.0	0.0	(64.4)
Domestic	261.6	285.4	33.1	29.2	1.2	1.2	9.1

Source: Ministry of Finance

- As per the latest fiscal numbers released by the ministry of finance, fiscal deficit for the first quarter FY13 increased by 10.4% as compared with same period last year. However, in relative terms it remained 1.2% of GDP, same as it was last year.
- Total revenue increased by 29.7% which is mainly supported by non-tax revenues, while there was no noticeable improvement in tax revenues. Non-tax revenues increased mainly on the back of receipt of CSF (Collation Support Fund) payments.
- Although, overall fiscal deficit did not deteriorate compared with last year and remained 1.2% of GDP, but the trends in expenditures are worrisome.
  - Overall debt servicing not only increased by 76% in absolute terms but also in relative terms as it increased from 22.4% of total expenses to 25.1%.
  - In the absence of any tax reforms, country doesn't have resources to spend on infrastructure and development which is critical to spur future economic growth. Development spending declined from 11.2% of total expenses to merely 7.6% and declined even in absolute terms by 17%.
  - In the absence of any major foreign inflows, government is bound to rely on domestic short term borrowing which increased by a whopping 82% compared with last year.
- The government has fixed the fiscal deficit target of 4.7% for FY13 which is unlikely to be achieved due to higher than budgeted power subsidies and ambitious revenue targets.
- As per a recent review of IMF on Pakistan economy, fiscal deficit will remain around 6.4% of GDP in FY13.



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### EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:  
Billion US \$

	Jul-Nov FY12	Jul-Nov FY13	Growth %
<b>Current Account</b>	<b>(2.34)</b>	<b>(0.37)</b>	<b>84</b>
Trade balance(Goods)	(6.66)	(6.40)	4
Trade balance (Services)	(1.18)	(0.25)	79
Income transfers (net)	(1.28)	(1.57)	(23)
Remittances	5.24	5.98	14
<b>Capital Account</b>	<b>0.06</b>	<b>0.04</b>	<b>(35)</b>
<b>Financial Account</b>	<b>0.54</b>	<b>(0.11)</b>	<b>(120)</b>
<b>Net Errors &amp; Omissions</b>	<b>0.03</b>	<b>(0.46)</b>	
<b>Overall Balance of Payments</b>	<b>(1.72)</b>	<b>(0.89)</b>	<b>48</b>

Source: SBP

- The Current Account posted a deficit of USD 365 million in the period July - November FY13, compared with a deficit of USD 2.341 billion in the same period last year.
- Although the current account situation improved significantly on YoY basis, but the monthly trend is not encouraging as the current account deficit only for the month of November stood at USD 638 million.
- Trade balance improved by 4% on the back of 2% increase in exports and almost zero growth in imports. Services balance also turned into positive due to receipt of long awaited CSF payments.
- Current transfers continued to provide much needed support on the back of healthy remittances. Remittances were up by 14% during the period July-November FY13 compared with the same period of last year.
- During the period Jul-Nov FY13, Capital & Financial Accounts were unable to attract any inflows. There was actually a net outflow.
- The overall Balance of Payments remained negative USD 893 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 <sup>1</sup>	YOY	MOM	12mma	YOY	MOM	12mma
Oct-2012	7.7	0.4	10.1	5.8	-0.1	9.3	9.1	0.7	10.7
Nov-2012	6.9	-0.4	9.9	5.3	-0.3	8.9	8.1	-0.4	10.5
Dec-2012	7.9	0.2	9.7	7.7	0.0	8.8	8.1	0.4	10.4
12 month high	12.3	1.8	11.6	11.3	2.2	13.5	13.0	1.9	11.0
12 month low	6.9	-0.7	9.7	5.3	-0.7	8.8	8.1	-1.7	10.3

<sup>1</sup>12 month moving average



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Source: FBS, SBP.

- YOY CPI in December 2012 reversed after touching its lowest of 6.9% in November, since the index has been rebased in July 2008, and stood at 7.9%.
- Increase in YOY CPI inflation is due to lower base impact as the index grew only 0.23% on MoM basis.
- The cumulative increase in CPI index for the first six months of FY13 is just 1.66%.
- Apparently both food & non-food groups are contributing towards softening prices, but actually a few outliers are driving the lower CPI.
  - In food group there is a 7% decline on YoY basis in perishable food items, having 5% overall weightage in overall CPI basket. Excluding the impact of this small sub-group, the food inflation stands at 9.4% on YoY basis.
  - In non-food group, Housing & Fuel index which has 30% weight in overall CPI with only 4.12% YoY increase is solely impacting the group; otherwise the inflation for the remaining items of non-food group is 12% on YoY basis.
- As far as future outlook in concerned, the likelihood of meeting of annual target of 9.5 percent set by government has increased; however, the revision in CNG prices (20% proposed), increase in wheat support price (14%), high government borrowings and depreciation in rupee value may lead to higher inflation in remaining months of FY13.
- IMF in its recent review on Pakistan economy projected CPI in the range of 10% for FY13.
- A summary of measures of core inflation is given in the following table:

Period	Core Inflation					
	NFNE <sup>1</sup> (%)			Trimmed <sup>2</sup> (%)		
	YOY	MOM	12mma	YOY	MOM	12mma
Oct-2012	10.1	1.2	10.7	9.7	0.7	10.7
Nov-2012	9.8	0.2	10.7	8.8	0.2	10.5
Dec-2012	9.8	0.5	10.6	9.2	0.3	10.4
12 month high	11.5	1.4	10.8	11.7	1.3	11.7
12 month low	9.8	0.2	10.0	8.8	0.2	10.4

<sup>1</sup>NFNE stands for non-food non-energy measure of core inflation Source: SBP

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

- Both measures of core inflation have recorded lower MOM inflation during Nov and Dec 2012. However, the 12 month moving average of both measures remains above 10% which indicates that the longer term trend in core inflation is still intact.



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- 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
Sep-2012	-0.7	0.9	0.2	3.6	0.9	7.4	-8.2	0.7	-11.2
Oct-2012	0.3	-1.9	-1.0	1.2	-2.7	5.4	-1.3	-0.4	-11.2
Nov-2012	-2.8	-1.3	-2.3	-4.4	-1.6	2.9	0.5	-0.7	-10.7
12 month high	5.7	4.5	27.5	17.4	7.9	31.8	0.5	4.2	21.0
12 month low	-12.9	-8.1	-1.0	-11.9	-11.2	2.9	-14.7	-3.4	-11.2

Source: IMF

- The MOM inflation numbers for October and November 2012 suggest a softening of commodity prices as the global economy continues to falter.

### 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
Oct-2012	9.28	11.41	11.04	12.61	9.51	11.49
Nov-2012	9.48	11.21	11.63	12.57	9.54	11.30
Dec-2012	9.30	10.98	11.48	12.44	9.38	11.08
12m high	11.98	13.04	13.34	13.38	12.06	13.06
12m low	9.28	10.98	11.04	12.44	9.38	11.08

Source: SBP, Reuters

- Market Interest rates have been decreasing since June 2012, in line with the reduction in discount rate.
- 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 may rise within a few months.
- Despite lower inflation numbers and reduction in discount rate by the SBP, the long-term bond yields are not declining in line with inflation or discount rate. The 10 year PIB yield was at 11.04% at the end of October 2012 when the discount rate





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was 10%. At the end of December 2012 the 10 year PIB yield increased to 11.48%, although the discount rate has been further reduced to 9.5%. This suggests that market is expecting higher inflation over the long-term.

### INVESTMENT STRATEGY

- Current portfolio of the Fund is well positioned to earn a decent real (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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