



Government of the Punjab

Punjab Pension Fund



Dated: 16 March 2013

MONTHLY REVIEW OF INVESTMENTS

February 2013

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-February 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	1,346
Less: expenses during the period	(16)
Ending fund size	16,935

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		28 Feb 2013	
	Amount	%	Amount	%	Amount	%
PIBs	8,942	65.2	9,480	60.7	9,573	56.5
T-Bills	1,254	9.1	139	1.0	-	-
Short term bank deposits	3,002	21.9	5,349	34.3	6,122	36.2
National Saving Schemes	-	-	-	-	949	5.6
Corporate bonds/TFCs	501	3.7	501	3.2	250	1.5
Cash at bank	8	0.1	130	0.8	38	0.2
Other assets*	1	0.0	6	0.0	3	0.0
Total Fund Size	13,708	100.0	15,605	100.0	16,935	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, 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

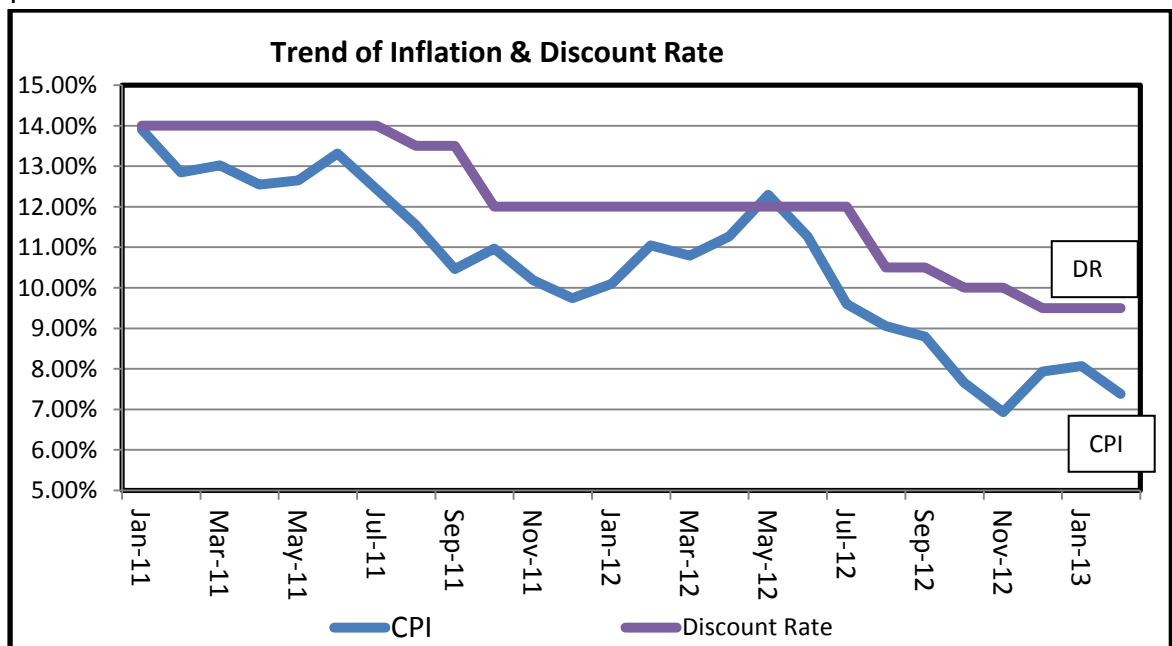
- Time Weighted Return (TWR) earned by PPF is summarized as under:

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 - February 2013	13.24%	13.07%			
February 2013	12.47%	12.30%			

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

**CAGR means Compound Annualized Growth Rate

- Inflation rates over the last few years (FY 09 to FY 12) 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.
- In FY 13, CPI Inflation rate has declined sharply and SBP has reduced the policy rate by 2.5% cumulatively (from 12% to 9.5%) so far.
- The investment strategy followed over the past few years i.e. investment in long-term fixed-rate instruments at attractive yields, is now paying off. 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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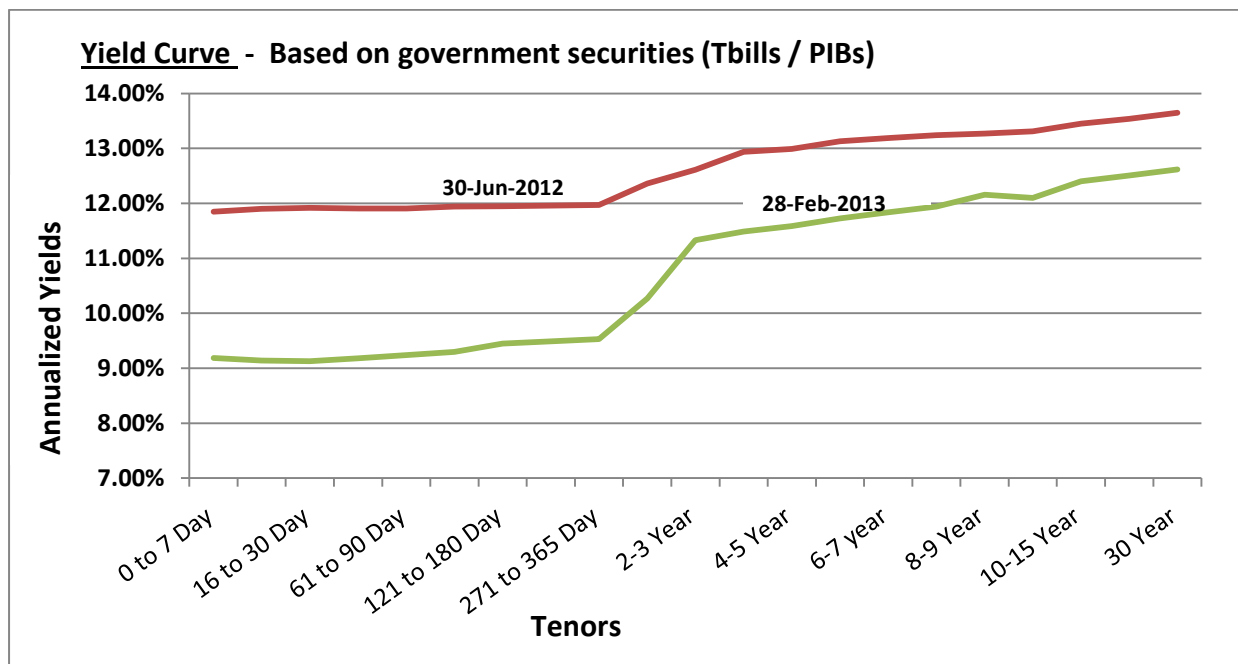


GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- We have constructed a liability index on the basis of next 30-year pension-related cash outflows 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-Feb 2013	12.36%	22.08%	17.5	924.4	1.90%
Jul 2008 - Feb2013 (CAGR)	14.66%	17.01%			

- 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-February FY13, short-term interest rates (yield on 1-yr T-bills) have declined by around 2.5% whereas long-term interest rates (yield on 10-yr PIBs) have declined by almost 1.25%. This has resulted in a sharp increase (22.08%) in present value of liabilities. Although Market value of Fund's assets also increased by 12.36% during the same period, the growth in market value of assets remained well short of the growth in present value of liabilities. This occurred 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

GDP GROWTH

- In FY12, Pakistan achieved GDP growth rate of 3.7% against the target of 4.2%. Compared with FY11 when services sector contributed around 80% of the total GDP growth of 3.0%, the growth in FY12 was evenly distributed across agriculture, industry and services sector.
- Analysis of the demand side shows that the Growth in FY12 was primarily driven by private consumption. Strong worker remittances, a vibrant informal economy and higher fiscal spending supported consumption growth during the year. On the other hand investment demand remained sluggish - a trend that has continued over the past several years. It is important to realize that over-dependence on consumption makes growth unsustainable, especially when a country's investment rate has been falling. During FY12, the investment-to-GDP reached a low of 12.5% which can be attributed to security concerns, energy constraints, excess capacity with the manufacturing sector and lower appetite of commercial banks to lend to private sector. Public investment has also been overshadowed by subsidies.
- On external front, slower global economic growth weighed on Pakistan's exports and financial inflows.
- For FY13, the government has set a GDP growth rate target of 4.3%.
- 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 about 3% p.a., and has projected an economic growth rate of 3.0-3.5% for FY13. The report emphasizes that Pakistan needs to accelerate its GDP growth rate by managing energy shortages, poor law & order situation and excessive fiscal deficit etc.
- SBP, in its recent review on economy, has observed that the 4.3% GDP growth rate target set by the government is over-optimistic and the economy is likely to grow at about the same rate as it did last year.



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- 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.

FISCAL MANAGEMENT

- A summary of revenues and expenditures during 1st Half FY13 and their comparison with the same period of the previous financial year is shown in the following table:

	Jul - Dec						
	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
(1) Total revenue	1,135.2	1,461.8	68.1	70.1	5.4	6.2	28.8
(1a) Tax	904.6	1012.7	54.2	48.5	4.3	4.3	12.0
(1b) Non-tax	230.6	449.1	13.8	21.5	1.1	1.9	94.7
(2) Total expenditure	1,667.8	2,086.5	100.0	100.0	7.9	8.8	25.1
(2a) Current	1,399.2	1,721.7	83.9	82.5	6.6	7.3	23.1
Debt Service	397.2	552.6	23.8	26.5	1.9	2.3	39.1
Defence	243.3	256.0	14.6	12.3	1.2	1.1	5.5
(2b) Development	227.7	272.1	13.7	13.0	1.1	1.2	19.5
Budget surplus / (deficit)	(532.5)	(624.7)	(31.9)	(29.9)	(2.5)	(2.6)	17.3
Financing							
External	(34.0)	(1.4)	(2.0)	0.1	(0.1)	(0.0)	(104.1)
Domestic	(498.5)	(626.1)	(29.9)	(30.0)	(2.4)	(2.6)	25.6

Source: Ministry of Finance

- As per the latest fiscal numbers released by the ministry of finance, fiscal deficit for the first half FY13 increased by 17.3% as compared with same period last year. However, in relative terms it remained 2.6% of GDP as compared to last year's 2.5% of GDP.
- Total revenue increased by 28.8% 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) receipts.
- Although, overall fiscal deficit did not deteriorate much when compared with last year, but some trends in expenditures are worrisome.
 - Overall debt servicing not only increased by 39% in absolute terms but also in relative terms as it increased from 23.8% of total expenses to 26.5%.
 - In the absence of any foreign inflows, government is bound to rely mainly on domestic short term borrowing.
- 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.
- International Monetary Fund estimates that Pakistan's budget deficit may touch 7.5% of GDP due to shortfall in tax and non-tax revenues.
- SBP also expects a fiscal deficit in the range of 6 to 7% of GDP for FY13.



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EXTERNAL ACCOUNT

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

	Jul-Jan FY12	Jul-Jan FY13	Growth %
Current Account	(2.79)	0.06	102
Trade balance(Goods)	(9.42)	(8.77)	7
Trade balance (Services)	(1.66)	0.08	105
Income transfers (net)	(1.72)	(1.97)	(14)
Remittances	7.44	8.21	10.4
Capital Account	0.09	0.18	101
Financial Account	0.33	(0.74)	(326)
Net Errors & Omissions	0.01	(0.24)	
Overall Balance of Payments	(2.37)	(0.73)	69

Source: SBP

- The Current Account posted a surplus of USD 62million in the period July - January FY13, compared with a huge deficit of USD 2.79 billion in the same period last year.
- Although the current account situation improved significantly on YoY basis, it is mainly due to Coalition Support Fund (CSF) receipts as Pakistan has received USD 1.8 billion since July 2012.
- Trade balance for the period improved by 7% due to 2% decline in imports and 1% growth in exports. Services balance turned into positive due to receipt of CSF payments.
- Current transfers continued to provide much needed support on the back of healthy remittances. Remittances were up by 10.4% during the period July-January FY13 compared with the same period of last year.
- During the period Jul-Jan FY13, Capital & Financial Accounts were unable to attract any inflows. There was actually a net outflow.
- The overall Balance of Payments remained negative USD 732 million.
- IMF, in its recent review, has projected the Current Account Deficit for FY13 at 0.7% of GDP and has cautioned that the pattern of inflows is insufficient even to finance this, relatively smaller, Current Account Deficit.

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
Dec-2012	7.9	0.2	9.7	7.7	0.0	8.8	8.1	0.4	10.4
Jan-2013	8.1	1.7	9.5	8.1	1.9	8.7	8.1	1.5	10.1
Feb-2013	7.4	-0.3	9.3	7.4	-1.3	8.5	7.4	0.3	9.3
12 month high	12.3	1.8	11.3	11.3	2.2	12.9	13.0	1.9	10.7
12 month low	6.9	-0.4	9.3	5.3	-1.3	8.5	7.4	-1.7	9.3

¹12 month moving average

Source: FBS, SBP.



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- February 2013 was another month with negative CPI on MoM basis, the CPI registered a 0.38% decrease driven mainly by food group. On YoY basis CPI registered 7.4% increase which is well below market expectations.
 - Both perishable and non-perishable food commodities declined on MoM basis, but the fall was more pronounced in perishable food items. The overall food prices declined by 1.43% on MoM basis; the prices of non-perishable food group decreased by 0.71% while perishable food items declined by 6.1% on MoM basis. The prices of chicken, eggs, potatoes, tomatoes, and fresh vegetables fell in a range of 5-28% on MoM basis in February 2013.
 - On YoY basis, some small sub-groups - Health, Recreation & Culture, Clothing & Footwear, and Beverages & Tobacco - registered a sharp increase in prices but due to their lower weight in overall CPI they could not impact the overall index.
 - Transport group, having 7% weight in CPI, saw a 3.15% rise on MoM basis, which is mainly due to increase in CNG price.
 - Housing, water, gas & fuel index, having 29.4% weight in overall CPI, increased only by 3.5% on YoY basis.

The cumulative increase in CPI index for the first eight months of FY13 is only 3% which suggests there is a high likelihood of meeting the annual target of 9.5% for FY13 despite that high government borrowings and depreciation in rupee value which may lead to higher inflation in remaining months of FY13.

- SBP in its recent review on economy projected CPI in the range of 8-9% for FY13.
- 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
Dec-2012	9.8	0.5	10.6	9.2	0.3	10.4
Jan-2013	9.9	1.2	10.6	9.9	1.0	10.4
Feb-2013	9.6	0.4	10.5	9.2	0.2	10.2
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	10.2

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 measures of core inflation have also recorded lower inflation on YOY as well as MOM basis. 12-month moving average of YOY inflation in both measures of core inflation is above 10% which shows that long-term inflationary trends are 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
Nov-2012	-2.8	-1.3	-2.3	-4.4	-1.6	2.9	0.5	-0.7	-10.7
Dec-2012	-1.2	0.7	-2.9	-4.0	0.0	1.2	4.5	2.2	-9.3
Jan-2013	-0.7	2.6	-3.2	-2.9	3.0	-0.3	3.8	2.0	-7.8
12 month high	3.3	4.5	22.7	15.2	7.9	30.1	4.5	4.2	11.5
12 month low	-12.9	-8.1	-3.2	-11.9	-11.2	-0.3	-14.7	-3.4	-11.2

Source: IMF

- Due to continued slowdown in economic growth around the world, commodity prices show deflation of -0.7% on a YOY basis. The break-up shows that fuel/energy related commodities recorded deflation of -2.9% whereas non-fuel commodities recorded inflation of 3.8%.
- The inflation figures are based on US dollar (and not Pak rupee) prices of commodities, therefore these figures need to be interpreted carefully. For instance, assuming a 10% depreciation of rupee against dollar, a deflation of -0.7% in dollar terms may actually mean inflation of 9.3% in rupee terms.

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
Dec-2012	9.30	10.98	11.48	12.44	9.38	11.08
Jan-2013	9.19	10.77	11.58	12.35	9.34	10.87
Feb-2013	9.53	10.57	12.10	12.27	9.49	10.67
12m high	11.98	12.74	13.34	13.22	12.06	12.76
12m low	9.19	10.57	11.04	12.27	9.34	10.67

Source: SBP, Reuters

- During Feb 2013, interest rates increased across the board which suggests that market expects resurgence in inflationary pressures. .
- Although inflation for the month of Feb 2013 came in lower than expectations, concerns regarding foreign exchange reserves, exchange rate & high government borrowing are intensifying and expectations of higher inflation and higher interest rates are building up.



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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.

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