



Government of the Punjab  
Punjab Pension Fund



Dated: 10 February 2010

MONTHLY REPORT ON INVESTMENTS

January 2010

FUND SIZE

- A summary of the fund size at the beginning, contributions during the period, transfers to Reserve Pension Fund during the period, profit earned during the period and the fund size at the end of the period is given in the following table:

Rs. millions (rounded to the nearest million)

|  | 1Q (Jul-Sep 09) | 2Q (Oct-Dec 09) | Jan 2010 |
|--|-----------------|-----------------|----------|
| Beginning fund size                    | 3,487           | 12,760          | 12,153   |
| Add: contribution during the period    | 9,000           | Nil             | Nil      |
| Less: transfer to Reserve Pension Fund | Nil             | 1,000           | Nil      |
| Add: gain/(loss) during the period     | 273             | 393             | 129      |
| Ending fund size                       | 12,760          | 12,153          | 12,282   |

FUND'S PORTFOLIO

- The Fund's exposure to different investment types is summarized as under:

Amounts: Rs. millions (rounded to the nearest million)

%: as percentage of Total Fund Size

|                          | 30 Sep 2009 |      | 31 Dec 2009 |      | 31 Jan 2010 |      |
|--------------------------|-------------|------|-------------|------|-------------|------|
|                          | Amount      | %    | Amount      | %    | Amount      | %    |
| Short term bank deposits | 12,670      | 99.3 | 7,814       | 64.3 | 7,900       | 64.3 |
| PIBs                     | Nil         | 0    | 4,115       | 33.9 | 4,116       | 33.5 |
| Accrued interest         | 41          | 0.3  | 202         | 1.6  | 245         | 2.0  |
| Cash at bank             | 49          | 0.4  | 22          | 0.2  | 21          | 0.2  |
| Total Fund Size          | 12,760      |      | 12,153      |      | 12,282      |      |



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- PPF is gradually shifting its focus to long term investments which are more consistent with the long term nature of the Fund's liabilities. At the end of January 2010, long term PIBs constitute 33.5% of the Fund size;

### FUND'S PERFORMANCE

- Time Weighted Return (TWR) earned by PPF until Jan 2010 is summarized as under:

| Period                                  | Return for the period |            |
|---|-----------------------|------------|
|   | Actual                | Annualized |
| 16 May 2008 (inception) to 30 June 2008 | 0.88%                 | 7.00%      |
| FY 2008-09                              | 15.21%                | 15.21%     |
| 1Q FY 2009-10 (Jul-Sep 09)              | 3.73%                 | 14.93%     |
| 2Q FY 2009-10 (Oct-Dec 09)              | 3.16%                 | 12.63%     |
| Jan 2010                                | 1.06%                 | 12.75%     |
| Jul 2009 - Jan 2010                     | 8.14%                 | 13.96%     |

- During FY 2008-09, a very large proportion of the Fund was placed in 1-yr Term Deposits with commercial banks at very attractive profit rates. These deposits matured at the beginning of Q2 of the current financial year. This explains the high return earned during Q1.
- Interest rates during the current financial year have been quite low compared with the peak witnessed during the last financial year (FY 2008-09).
- The Fund has been invested primarily in short term bank deposits during the current financial year therefore its return has been highly sensitive to market interest rates.
- The Fund's return has been falling in line with the decline in market interest rates since the first quarter of the current financial year.

### REVIEW OF IMPORTANT ECONOMIC & FINANCIAL VARIABLES

#### GDP GROWTH

- The economy of the country is still presenting a complicated picture;
- Lower inflation, lower current account deficit and revival of growth in large scale manufacturing as well as private sector credit are a few noticeable improvements that have occurred during the current financial year;
- Persistent power shortages, water shortages for agriculture sector, fiscal imbalances and poor law & order situation are the major factors dragging down economic growth;



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- In the 'Pakistan Economic Update' for first quarter FY 2009-10 issued by Finance Division, Government of Pakistan, real GDP growth for the current financial year i.e. FY 2009-10 has been estimated in the range of 2-3%.
- State Bank of Pakistan (SBP) expects GDP growth for the current financial year at 3%;
- IMF, in its country report for Jan 2010, has also estimated Pakistan's GDP growth for the current financial year at 3%.

### FISCAL MANAGEMENT

- Despite government's efforts to rationalize expenditures (by phasing out subsidies and adjusting energy prices) and reform the tax administration, fiscal management remains challenging. Increasing revenue collection and curtailing expenditures in a time of economic slowdown and worsening law & order situation is an uphill task.
- Government has issued revised projections for the budget of FY 2009-10 setting the total fiscal deficit target for FY 2009-10 at Rs. 740 billion or 4.9% of GDP. The revised projections and government's plan to finance the deficit for FY 2009-10 and the actual results for Q1 FY 2009-10 are shown in the following table:

Billion rupees

|                          | FY 2009-10<br>Projected | Q1 FY 2009-10<br>(Jul-Sep 2009) |
|--------------------------|-------------------------|---------------------------------|
| <b>Total revenue</b>     | <b>2,187</b>            | <b>427</b>                      |
| Tax                      | 1,600                   | 299                             |
| Non-tax                  | 587                     | 128                             |
| <b>Total expenditure</b> | <b>2,927</b>            | <b>651</b>                      |
| Current                  | 2,403                   | 521                             |
| Development              | 510                     | 116                             |
| Unidentified             | 14                      | 14                              |
| <b>Budget deficit</b>    | <b>-740</b>             | <b>-224</b>                     |
| <b>Financing</b>         | <b>740</b>              | <b>224</b>                      |
| External                 | 301                     | 77                              |
| Domestic                 | 415                     | 147                             |
| Non-bank                 | 240                     | 108                             |
| Bank                     | 175                     | 39                              |
| Privatization            | 23                      | 0                               |



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- Fiscal deficit of Rs. 224 billion incurred during Q1 (Jul-Sep 09) FY 2009-10 was higher than the deficit target of Rs. 194 billion for that quarter. Under the current scenario, meeting the fiscal deficit target of Rs. 740 seems unlikely.
- Higher deficit during the first quarter was attributable to lower-than-expected revenues and was financed primarily by higher domestic non-bank borrowings (Saving Schemes, T-bills, PIBs, Prize bonds).
- Shortfall or delay in budgeted external (foreign) financing and non-tax revenues on account of foreign reimbursements may lead to even higher domestic borrowing by the government in order to finance the fiscal deficit. This may put pressure on domestic liquidity and interest rates.

### EXTERNAL ACCOUNT

- Balance of payments has shown considerable improvement which is evident from the following table:

Billion US \$

|                                      | FY 09       | H1 FY 10    | FY 10<br>SBP's Projection |
|--------------------------------------|-------------|-------------|---------------------------|
| <b>Current Account</b>               | <b>-9.3</b> | <b>-2.0</b> | <b>-6.1</b>               |
| Trade balance                        | -12.6       | -5.8        |                           |
| Imports                              | 31.7        | 15.1        |                           |
| Exports                              | 19.1        | 9.3         |                           |
| Services net                         | -3.4        | -1.6        |                           |
| Income net                           | -4.4        | -1.5        |                           |
| Current transfers                    | 11.2        | 6.8         |                           |
| Remittances                          | 7.8         | 4.5         |                           |
| <b>Capital and Financial Account</b> | <b>6.1</b>  | <b>3.8</b>  |                           |
| Direct Investment                    | 3.7         | 1.0         |                           |
| Portfolio Investment                 | -1.1        | 0.3         |                           |
| Long term Loans                      | 1.5         | 1.8         |                           |
| Errors & Omissions                   | 0.2         | -0.4        |                           |
| <b>Overall balance</b>               | <b>-3.1</b> | <b>1.4</b>  |                           |

Source: SBP



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- Major factors behind improvement in Current Account Deficit are
  - Decline in imports; and
  - Rise in workers' remittances
- Decline in imports has been due to a combination of
  - Moderation in aggregate demand; and
  - Lower international commodity prices
- Despite the improvement, it is evident that the Balance of Payments situation is quite fragile. Recovery in domestic aggregate demand and a rise in commodity prices may lead to renewed pressures on Current Account, exchange rate and domestic inflation.
- Mix of inflows related to Capital & Financial Account is also shifting towards lesser investment-related and higher debt-creating inflows which will put more pressure on country's resources for debt repayments in future.
- The timing and scale of foreign flows pledged by Friends of Democratic Pakistan (FoDP) will also have a significant influence over the Balance of Payments position in the medium term. Actual disbursements in this regards are behind schedule and the original \$25 billion disbursements projected for FY 10 have been revised to \$1.5 billion.

### INFLATION

- A summary of inflation rates for the period Jul-Dec 09 is given in the following table:

| End of month   | CPI Inflation (YOY) |
|----------------|---------------------|
| July 2009      | 11.17%              |
| August 2009    | 10.69%              |
| September 2009 | 10.12%              |
| October 2009   | 8.87%               |
| November 2009  | 10.51%              |
| December 2009  | 10.52%              |

- Average CPI Inflation has been 10.31% during first half (Jul-Dec 09) of the current financial year (FY 2009-10). Higher electricity & gas prices w.e.f. Jan 2010, rising international commodity prices, poor law & order situation and power shortages



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suggest that inflation will be higher during the second half of the financial year. SBP expects average CPI Inflation for FY 2009-10 to remain between 11 and 12%.

### INTEREST RATES

- A summary of interest rates for the period Jul-Dec 09 is given in the following table:

| End of month   | Yield on 1-yr T-bill (p.a.) | Yield on 10-yr PIB (p.a.) | 6-month KIBOR (p.a.) |
|----------------|-----------------------------|---------------------------|----------------------|
| July 2009      | 11.83%                      | 11.84%                    | 11.99%               |
| August 2009    | 12.35%                      | 12.36%                    | 12.56%               |
| September 2009 | 12.46%                      | 12.47%                    | 12.65%               |
| October 2009   | 12.57%                      | 12.76%                    | 12.84%               |
| November 2009  | 12.07%                      | 12.40%                    | 12.41%               |
| December 2009  | 12.10%                      | 12.62%                    | 12.43%               |

- Inflation outlook and financing mix of the budget deficit will be the major determinants of future direction of interest rates.
- The current situation on both of these fronts is not very promising.
  - Inflation is expected to rise in the remaining half of the current fiscal year; and
  - High borrowing needs of the government and gradually reviving private sector demand for loans also suggest that, during the rest of FY 2009-10, competition for borrowing will remain high.
- Considering the above situation, we think that, in the near term, risk free rates as well as KIBOR are unlikely to fall from their current levels.

### FUTURE STRATEGY

- PPF can benefit from high interest rates by making further long term placements at fixed rates. This will enable the Fund to maintain a high return on its investments for a long time to come without worrying about a fall in interest rates in the market;



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- The Investment Sub-Committee (ISC) has approved the following asset allocation for PPF:

| Investment Category                          | Allocation (% of fund size) | Decision        |
|--|-----------------------------|-----------------|
| Pakistan Investment Bonds (PIBs)             | 65%                         | Approved        |
| Long term placement(s) with Commercial Banks | 20%                         | Approved        |
| Term Finance Certificates (TFCs)             | 5%                          | Approved        |
| Equity Investments                           | 10%                         | To be discussed |

- We plan to further build the PIB portfolio over the next few months. PPF has a preference for longer tenor (15-yr, 20-yr & 30-yr) PIBs. However, due to limited supply of these instruments, a significant portion will be invested in 10-yr PIBs.
- We also plan to build the TFC portfolio over the next few months.
- We are also negotiating with commercial banks for long term placement of funds preferably at fixed rates.
- Proposal for investment in stocks will be debated in the next Investment Sub-Committee (ISC) meeting.

(Aquil Raza Khoja)  
General Manager  
Punjab Pension Fund