Government of the Punjab

Punjab Pension Fund

Dated: 16 February 2013

MONTHLY REVIEW OF INVESTMENTS

January 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-January FY13
Beginning fund size (30th June 2012)	15,605
Add: contribution during the period	-
Less: transfer to Reserve Pension Fund	-
Add: gain/(loss) during the period	1,194
Less: expenses during the period	(14)
Ending fund size	**16,785**

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 Jan 2013	
	Amount	%	Amount	%	Amount	%
PIBs	8,942	65.2	9,480	60.7	9,513	56.7
T-Bills	1,254	9.1	139	1.0	-	-
Short term bank deposits	3,002	21.9	5,349	34.3	6,073	36.2
National Saving Schemes	-	-	-	-	942	5.6
Corporate bonds/TFCs	501	3.7	501	3.2	249	1.5
Cash at bank	8	0.1	130	0.8	4	0.0
Other assets*	1	0.0	6	0.0	4	0.0
Total Fund Size	**13,708**	**100.0**	**15,605**	**100.0**	**16,785**	**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.

FUND'S PERFORMANCE

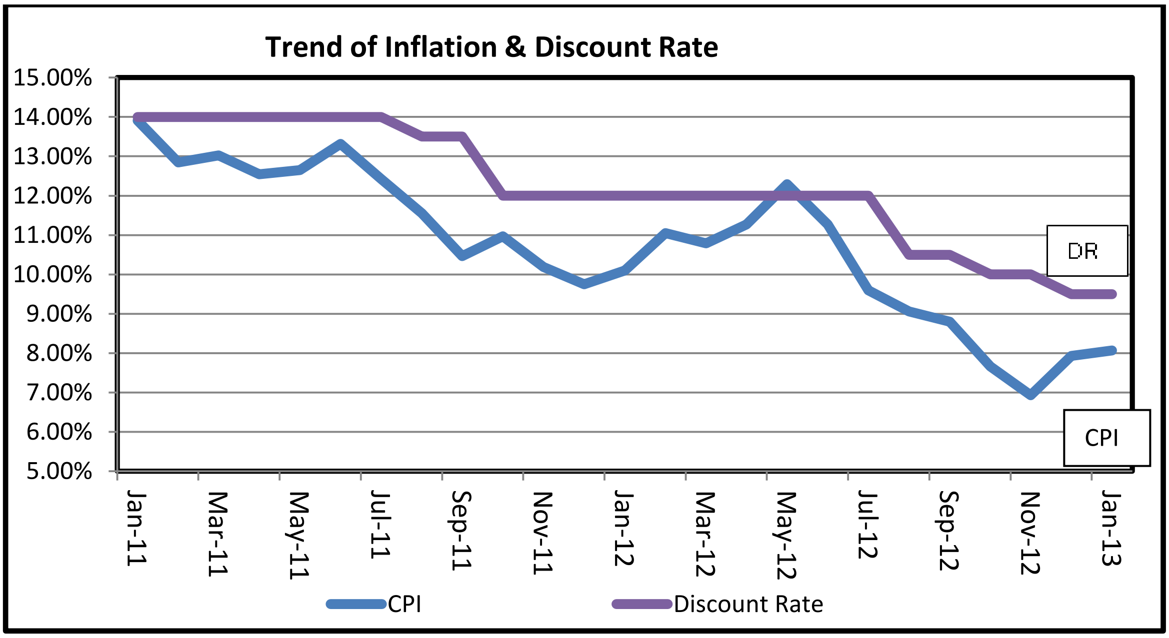
- Time Weighted Return (TWR) earned by PPF is summarized as under:

Period	Annualized Return for the period				Long-term Benchmark
	Gross Return	Net Return*	Year End Discount Rate	CPI Inflation	CPI Inflation + 3%
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 - January 2013	13.33%	13.17%			
January 2013	12.54%	12.38%			

*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 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.

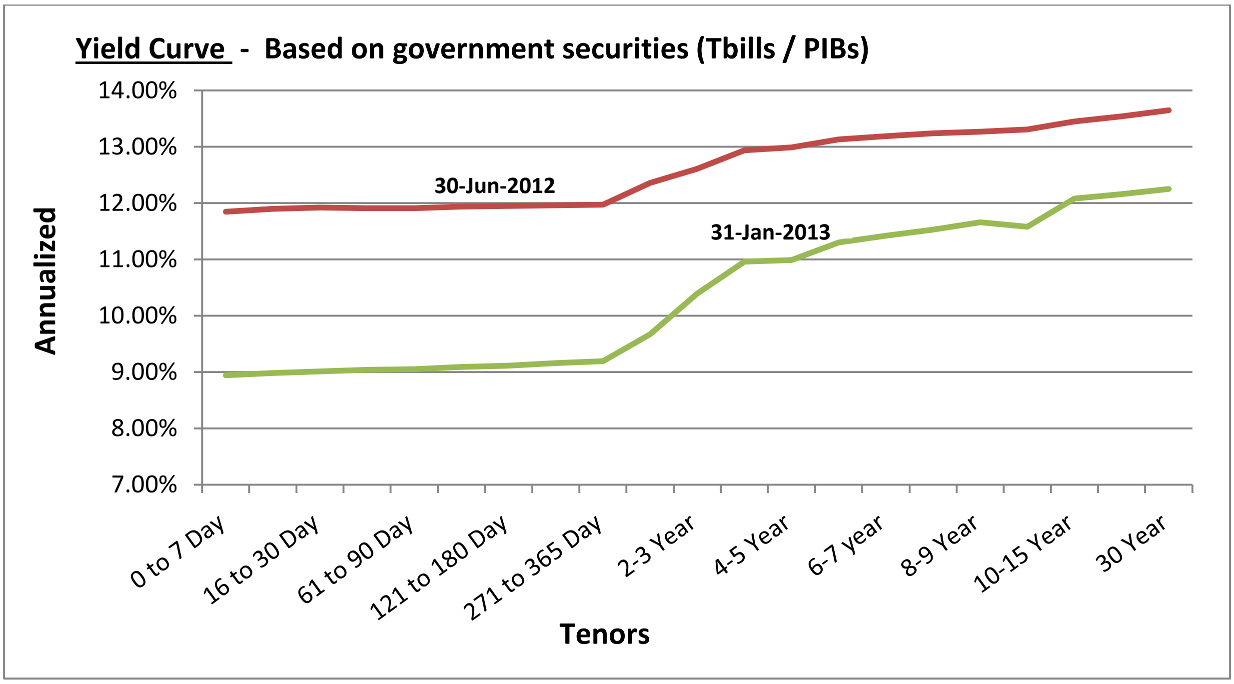


GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- 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:

	During the period		End of period		
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-Jan 2013	12.74%	26.47%	17.6	957.6	1.84%
Jul 2008 – Jan 2013 (CAGR)	15.01%	18.23%			

- 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-January FY13, short-term interest rates (yield on 1-yr T-bills) have declined by more than 2.5% whereas long-term interest rates (yield on 10-yr PIBs) have declined by almost 1.75%. This has resulted in a sharp increase (26.47%) in present value of liabilities. Although Market value of Fund's assets also increased by 12.74% 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.



REVIEW OF IMPORTANT ECONOMIC & FINANCIAL VARIABLES

GDP GROWTH

- In FY12, Pakistan achieved GDP growth rate of 3.7% against the target of 4.2%.
- For FY13, the government has set a GDP growth rate target of 4.3%.
- The economic performance of the country has weakened as a result of both domestic and external factors. Domestically, continuing energy sector crises, poor law and order situation, inability of the Government in implementing tax reforms and high government borrowings remained hurdles in the way of economic growth. On external front, slower global economic growth weighed on Pakistan's exports and financial inflows.
- 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% 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.
- 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 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
(1)Total revenue	**533.6**	**692.1**	**67.5**	**70.9**	**2.5**	**2.9**	**29.7**
(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
(2) Total expenditure	**790.9**	**975.9**	**100.0**	**100.0**	**3.8**	**4.1**	**23.4**
(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)
Budget surplus / (deficit)	**(257.2)**	**(283.8)**	**(32.5)**	**(29.1)**	**(1.2)**	**(1.2)**	**10.4**
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 7.5% of GDP in FY13.
- SBP also confirmed it expects a fiscal deficit in the range of 6 to 7% of GDP for FY13.

EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US $

	Jul-Dec FY12	Jul-Dec FY13	Growth %
Current Account	**(2.43)**	**0.25**	**110**
Trade balance(Goods)	(7.90)	(7.61)	4
Trade balance (Services)	(1.34)	0.26	119
Income transfers (net)	(1.28)	(1.57)	(23)
Remittances	6.33	7.12	12.5
Capital Account	**0.10**	**0.14**	**45**
Financial Account	**0.52**	**(0.68)**	**(231)**
Net Errors & Omissions	**0.02**	**(0.25)**	
Overall Balance of Payments	**(1.79)**	**(0.54)**	**70**

Source: SBP

- The Current Account posted a surplus of USD 0.25 billion in the period July – December FY13, compared with a huge deficit of USD 2.43 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 during the first half of FY13.
- Trade balance for the period improved by 4% due to 2% decline in imports while there was no 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 12.5% during the period July-December FY13 compared with the same period of last year.
- During the period Jul-Dec FY13, Capital & Financial Accounts were unable to attract any inflows. There was actually a net outflow.
- The overall Balance of Payments remained negative USD 541 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:

	CPI Inflation								
Period	CPI Overall (%)			CPI Food (%)			CPI Non-food (%)		
	YOY	MOM	12mma[1]	YOY	MOM	12mma	YOY	MOM	12mma
Nov-2012	6.9	-0.4	9.8	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
Jan-2013	8.1	1.7	9.5	8.1	1.9	8.7	8.1	1.5	10.1
12 month high	12.3	1.8	11.5	11.3	2.2	12.9	13.0	1.9	11.0
12 month low	6.9	-0.4	9.5	5.3	-0.7	8.7	8.1	-1.7	10.1

[1]12 month moving average
Source: FBS, SBP.

- On MoM basis, the CPI registered a 1.67% increase in the month of January 2013; mainly contributed by non-perishable food group, transport and communication.
    - The prices of non-perishable food group, having 30% weight in overall CPI, increased by more than 2% on MoM basis. The prices of wheat related goods, rice, chicken and tomatoes increased sharply on MoM basis.
    - Transport group, having 7% weight in CPI, saw a 3.15% rise on MoM basis, which is mainly due to increase in CNG price.
    - For the first time since the start of FY13, housing, water, gas & fuel index has increased sharply (1.75%) on MoM basis.

  The cumulative increase in CPI index for the first seven months of FY13 is only 3.36% which suggests that the likelihood of meeting the annual target of 9.5% for FY13 has increased despite that high government borrowings and depreciation in rupee value 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:

	Core Inflation					
Period	NFNE[1] (%)			Trimmed[2] (%)		
	YOY	MOM	12mma	YOY	MOM	12mma
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
Jan-2013	10.0	1.2	10.6	9.9	1.0	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

[1]NFNE stands for non-food non-energy measure of core inflation Source: SBP
[2]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 higher 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.

- The following table summarizes international commodity price inflation rates:

	Inflation Rates (%) as per the indices maintained by IMF								
Period	(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
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
Dec-2012	-1.2	0.7	-2.9	-4.0	0.0	1.2	4.5	2.2	-9.3
12 month high	3.6	4.5	25.5	15.3	7.9	31.4	4.5	4.2	16.6
12 month low	-12.9	-8.1	-2.9	-11.9	-11.2	1.2	-14.7	-3.4	-11.2

Source: IMF

- Due to continued slowdown in economic growth around the world, commodity prices show deflation of -1.2% on a YOY basis. The break-up shows that fuel/energy related commodities recorded deflation of -4.0% whereas non-fuel commodities recorded inflation of 4.5%.
- 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 -1.2% in dollar terms may actually mean inflation of 8.8% 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
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
Jan-2013	9.19	10.77	11.58	12.35	9.34	10.87
12m high	11.98	12.89	13.34	13.29	12.06	12.91
12m low	9.19	10.77	11.04	12.35	9.34	10.87

Source: SBP, Reuters

- During FY13, short-term interest rates (yield on 1-yr T-bills) have been declining in line with the reduction in discount rate but long-term interest rates (yield on 10-yr PIBs) have declined less than the reduction in discount rate. This suggests that market is expecting higher inflation over the long-term.

- In its Monetary Policy Decision dated 08 February 2013, SBP kept the discount rate unchanged at 9.50%. Key points of Monetary Policy Statement are summarized below:
    - Fiscal deficit is expected to be higher than the budgeted target.
    - In the wake of rising risks to macroeconomic stability and in the absence of structural reforms that could have supported permanent price stability and consistent growth, it may be difficult for SBP to continue with the current Monetary Policy stance.
    - Two major macroeconomic challenges include managing the balance of payment position and containing the resurgence of inflationary pressures.
    - Current Account Surplus during H1-FY13 is primarily due to the receipt of $1.8 billion in the CSF. However, after repayment of $1.4 billion to IMF, foreign exchange reserves of SBP declined to $8.7 billion as on 31st January 2013 from $10.8 billion at 30th June 2012. Declining trend in reserves not only puts pressure on the currency but also creates inflationary pressures in medium to 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.

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