



Government of the Punjab
Punjab Pension Fund



Dated: 28 July 2011

MONTHLY REVIEW OF INVESTMENTS

June 2011

FUND SIZE

- A summary of changes in fund size during FY11 is given in the following table:

Rs. millions (rounded to the nearest million)

	FY11
Beginning fund size	12,097
Add: contribution during the period	-
Less: transfer to Reserve Pension Fund	-
Add: gain/(loss) during the period	1,630
Less: expenses during the period	(19)
Ending fund size	13,708

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 2010		31 Dec 2010		30 Jun 2011	
	Amount	%	Amount	%	Amount	%
PIBs	5,737	47.4	5,789	45.0	8,942	65.2
T-Bills	3,145	26.0	595	4.7	1,254	9.1
Short term bank deposits	3,015	24.9	6,000	46.6	3,002	21.9
Corporate bonds/TFCs	176	1.5	349	2.7	501	3.7
Cash at bank	21	0.2	130	1.0	8	0.1
Other assets*	3	0.0	1	0.0	1	0.0
Total Fund Size	12,097	100.0	12,864	100.0	13,708	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.
 - During the month of June 2011, PPF added a significant amount of long-term (10-yr, 15-yr, 20-yr & 30-yr) PIBs to its portfolio. PIBs having total face value of Rs. 1,850 m (10yr PIB - Rs. 1,175 m, 15-yr PIB - Rs. 225 m, 20-yr PIB - 225 m &

3/8/11



Government of the Punjab
Punjab Pension Fund



30-yr PIB - 225 m) having an average yield of 14.09% p.a. (the actual yield is even higher if reinvestment of 6-monthly coupons is taken into account) were purchased during the month. All of these PIBs were purchased in the PIB auction held on 22 June 2011.

- 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%
FY 2010-11	13.48%	13.32%	13.13%	16.13%
Jun 2011	13.71%	13.40%		

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

- Inflation rates over the last 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.

Handwritten mark resembling a checkmark or signature.

Handwritten mark resembling the number 34.



Government of the Punjab
Punjab Pension Fund



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 market value of the liabilities i.e. the present value of next 30-year liabilities computed at market rates of interest.
- The following table summarizes the amount & growth of Fund's assets vis-à-vis the amount & growth in 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	10.80%	-2.88%	13.4	608.9	2.19%
Jul 2008 - Jun 2011 (CAGR)*	12.99%	10.80%			

*CAGR means Compound Annualized Growth Rate

* June 2011 liabilities are updated based on new cash flows provided in actuarial assessment report 2010.

- 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.
- During FY 2008-09, interest rates for all maturities declined. Liability index grew by 28% during that period. The present value of liabilities increased sharply as the future liabilities were discounted at a lower rate.
- During FY 2009-10, interest rates increased for shorter maturities but declined for longer maturities. Liability index grew by a modest 9.41% during that period.
- During the current year i.e. FY 2010-11, interest rates for all maturities have increased. Liability index declined by 2.88% during this period. The present value of liabilities declined sharply as the future liabilities were discounted at a higher rate.
- The above analysis highlights that the biggest 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.
- The focus of the investment strategy of PPF is therefore on managing the interest rate risk by investing a large proportion of Fund size in long-term fixed-rate assets (mainly PIBs) which have a negative correlation with, and high sensitivity to, interest rates.

Handwritten signature

Handwritten signature



REVIEW OF IMPORTANT ECONOMIC & FINANCIAL VARIABLES

GDP GROWTH

- Ministry of Finance has released Pakistan Economic Survey 2010-11 which contains the figures of GDP growth for FY11 and the revised figures for FY10.
- Three major segments of the GDP are agriculture, industry and services. Their shares in GDP, growth rates and contributions to the GDP during the last two financial years are summarized in the following table:

	Growth rate (%)		Contribution to GDP growth (%)		Share in GDP (%)	
	FY10	FY11	FY10	FY11	FY10	FY11
Commodity producing sectors	4.7	0.5	2.22	0.24	47.6	46.7
Agriculture	0.6	1.2	0.13	0.26	21.2	20.9
Industry	8.3	(0.1)	2.09	(0.02)	26.4	25.8
Services sector	2.9	4.1	1.54	2.15	52.4	53.3
Overall GDP	3.8	2.4	3.76	2.39	100.0	100.0

Source: Pakistan Economic Survey 2010-11 (published by Ministry of Finance)

- Overall GDP growth rate for the year 2011 remained 2.4% which is lower than the growth rate of 3.8% in the previous year. The main reasons behind this slower growth were high inflation, unprecedented floods, power shortages and prevailing security concerns in the country.
- Growth rate of Agriculture sector has remained subdued over both the years. The sector is facing a long-term slow down in its growth potential. Over the last decade, this sector has grown at an average rate of 2.7% p.a. and its share in GDP has declined from 26% to 21%. During the year 2011, major crops showed negative growth (-4.0%), however healthy growth in livestock (3.7%) and minor crops (4.8%) kept the overall growth of Agriculture sector positive (1.2%).
- Growth rate of Industrial sector was very impressive (8.3% as per revised figures) during FY10 but the momentum did not sustain and the growth of the sector during FY11 has been close to zero. This slowdown is attributable primarily to 21.1% decline in Electricity & Gas Distribution subsector which contributed -0.6% in overall growth rate. However, Small Scale Manufacturing subsector posted a healthy 6.8% growth. Overall depressed performance of the industrial sector can be attributed to various factors including law & order situation, power shortages and rising costs of production.
- Growth rate of Services sector has been impressive (4.1%) during FY11 and accounts for 90% of the growth in overall GDP during the year. This sector has outperformed the



commodity producing sectors over the last decade which explains its rising share (53.3% at the end of FY11) in overall GDP. During FY11, the Wholesale & Trade, Public Administration & Defence and Social & Personal Services subsectors performed particularly well.

Future Growth Outlook:

- As far as future growth outlook is concerned, it will be shaped by policy responses to several key domestic challenges:
 - Energy shortages, which are restricting growth;
 - High fiscal deficit which is partially due to power sector subsidies of earlier years as reflected in the circular debt;
 - Build-up of domestic debt, raising concerns for macro stability and monetary management;
 - Inflationary pressure which require restrictions on government borrowings from SBP and fiscal discipline.
- Agriculture sector is likely to perform better in FY12 because (a) of low base due to floods during the year and more fertile post-flood land (b) there is a shift toward more productive and disease resistant BT cotton (c) water availability is expected to improve over the last year. However, rising fertilizer prices pose a downside risk (if farmers use less fertilizer because of high prices, the productivity of the Crops may be adversely affected).
- Industrial sector faces multiple challenges including (a) shortage of electricity and gas (b) law & order situation (c) competition for auto manufacturers from imported cars as the government has increased the age limit for used cars from 3 to 5 years.

38/1



Government of the Punjab
Punjab Pension Fund



FISCAL MANAGEMENT

- A summary of revenues and expenditures during Jul-Mar FY11 and their comparison with the same period of the previous financial year is shown in the following table:

	Jul - Mar						
	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	1,402	1,495	69.1	65.6	9.6	8.6	6.7
(1a) Tax	1,015	1,118	50.0	49.0	6.9	6.5	10.1
Direct Tax	342	374	16.9	16.4	2.3	2.2	9.3
Indirect Tax	672	743	33.2	32.6	4.6	4.3	10.6
(1b) Non-tax	387	378	19.1	16.6	2.6	2.2	(2.5)
Dividend	43	30	2.1	1.3	0.3	0.2	(31.4)
SBP Profit	183	125	9.0	5.5	1.2	0.7	(31.7)
(2) Total expenditure	2,028	2,279	100.0	100.0	13.8	13.2	12.4
(2a) Current	1,660	1,910	81.9	83.8	11.3	11.0	15.1
Domestic Debt Service	429	460	21.1	20.2	2.9	2.7	7.3
Foreign Debt Service	45	48	2.2	2.1	0.3	0.3	5.6
Defence	270	335	13.3	14.7	1.8	1.9	24.2
(2b) Development	347	282	17.1	12.4	2.4	1.6	(18.8)
Budget surplus / (deficit)	626	783	30.9	34.4	4.3	4.5	25.1
Financing							
External	93	83	4.6	3.6	0.6	0.5	(10.3)
Domestic	533	700	26.3	30.7	3.6	4.0	31.3
Non-bank	322	384	15.9	16.8	2.2	2.2	19.0
Bank	211	316	10.4	13.9	1.4	1.8	50.1
Privatization	-	-	-	-	-	-	-
GDP	14,668	17,304					
Revenue surplus/(deficit)¹	(258)	(415)			(1.8)	(2.4)	(60.6)

¹Revenue surplus/(deficit) = Total revenue - Current expenditure

Source: Ministry of Finance

- Most of the components of the budget worsened during the first nine months of the current fiscal year.
 - Expenses grew faster than revenues. As a result, budget deficit grew sharply by 25.1% & stood at Rs. 783 bn (Rs. 626 bn in the same period last year);
 - Both revenues & expenses fell as a percentage of GDP. However, revenues showed a bigger decline. Budget deficit grew to 4.5% of GDP;



Government of the Punjab
Punjab Pension Fund



- Only 66% of the expenses were financed through revenues (49% through tax revenues & 17% through non-tax revenues). 31% of the expenses (amounting to Rs. 700 bn) were financed through domestic borrowing.
- Growth in expenses was attributable entirely to current expenditure. Development expenditure declined by 19% compared with the same period of last year. As a percentage of GDP, it fell from 2.4% of GDP last year to just 1.6% of GDP this year. Share of development expenditure in total expenditure declined from 17% last year to 12% this year. This has adverse consequences for long-term growth potential of the economy;
- Revenue deficit increased to Rs. 415 bn or 2.4% of GDP. Thus the Government had to finance its current expenditures to the extent of Rs. 415 bn from borrowing.
- High fiscal deficit combined with heavy borrowing is contributing to high inflation, high interest rates and crowding out of the private sector.
- Federal Government has announced the budget targets for FY12 which are summarized as under:

Rupees (Billions)	Budget FY 12
Gross Revenues	2,732
Net Revenues (excluding provincial shares)	1,529
Tax revenue	2,074
FBR taxes	1,952
Non-tax revenue	658
SBP Profit	200
Defence receipts	119
Total Expenditure	2,505
Current Expenditure	2,072
Debt Servicing	791
Defence	495
Subsidies	166
Development Expenditure	397
PSDP	300
Federal Budgetary Gap	(976)
<i>Provincial cash balances</i>	<i>125</i>
Overall Budget Deficit	(851)
as % of GDP	(4.0)
Financing	
External resources	64
Domestic	
Bank	304
Non-Bank	413
Privatization	70

3/1



Government of the Punjab
Punjab Pension Fund



DEBT

Total Debt:

- Total debt is summarized in the following table:

	Amount (USD bn)		Amount (Rs. bn)		As % of GDP		Growth ¹ (%)
	June-10	Mar-11	June-10	Mar-11	June-10	Mar-11	Jul-Mar 11
Domestic Debt & Liab.			4,895	5,594	33.4	32.3	14.3
External Debt	55.9	59.5	4,783	5,114	32.6	29.6	6.9
Total Debt			9,677	10,709	66.0	61.9	10.7
Exchange Rate (Rs./USD)			85.56	85.90			
GDP			14,668	17,304			

Source: SBP

Domestic Debt:

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

Domestic Debt & Liab.	Amount (Rs. bn)		As % of Total Dom. Debt		As % of GDP		Growth (%)
	Jun-10	Mar-11	Jun-10	Mar-11	Jun-10	Mar-11	Jul-Mar FY 11
I) Permanent	794	1,008	16.2	18.0	5.4	5.8	26.9
Ijara Sukuk	42	179	0.9	3.2	0.3	1.0	323.7
PIBs	505	561	10.3	10.0	3.4	3.2	11.1
Prize Bonds	236	263	4.8	4.7	1.6	1.5	11.5
II) Floating	2,399	2854	49.0	51.0	16.4	16.5	19.0
III) Unfunded	1,456	1,600	29.8	28.6	9.9	9.2	9.7
Saving Schemes	1350	1,492	27.6	26.7	9.2	8.6	10.5
IV) FC loans	3	2	0.1	0.0	0.0	0.0	(51.6)
Domestic Debt	4,653	5,463	95.1	97.6	31.7	31.6	17.4
Domestic Liab.	241	132	4.9	2.4	1.6	0.8	(45.2)
Total	4,895	5,594	100.0	100.0	33.4	32.3	14.3
GDP	14,668	17,304					

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 51% of the total domestic debt at the end of Mar 2011.
- 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.



Government of the Punjab
Punjab Pension Fund



- Ijara Sukuk is a Shariah compliant floating-rate debt instrument with a maturity of 3 years. It is a relatively new instrument and Government borrowing through this instrument has grown quite rapidly over the current year. Total borrowing through Ijara Sukuk stood at Rs. 179 bn or 3.2% of total Domestic Debt & Liabilities of the Government as at end-March 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' (%)
	Jun-10	Mar-11	Jun-10	Mar-11	Jun-10	Mar-11	
1) Public Debt	52.1	55.6	4,458	4,777	30.4	27.6	7.1
a) Govt Debt	42.9	45.6	3,671	3,914	25.0	22.6	6.6
i) Medium & long term	42.1	44.6	3,603	3,835	24.6	22.2	6.4
ii) Short term	0.8	0.9	68	79	0.5	0.5	16.0
b) From IMF	8.1	8.9	691	768	4.7	4.4	11.1
c) Foreign Ex Liabilities	1.1	1.1	96	94	0.7	0.5	(1.6)
2) PSE Guaranteed Debt	0.2	0.1	14	9	0.1	0.1	(33.1)
3) PSE Non-Guaranteed Debt	1.1	1.0	93	88	0.6	0.5	(5.7)
4) Schedule Bank Borrowings	0.2	0.4	16	30	0.1	0.2	82.3
5) Pvt. Guaranteed Debt	0.0	0.0	0	0	0	-	-
6) Pvt. Non-Guaranteed Debt	2.2	2.3	191	200	1.3	1.2	5.0
7) Pvt. Non-Guaranteed Bonds	0.1	0.1	11	11	0.1	0.1	0.2
Total External Debt	55.9	59.5	4,783	5,114	32.6	29.6	6.9
Exchange Rate (Rs./USD)			85.56	85.90			
GDP			14,668	17,304			

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

- Helped by a stable exchange rate, the rupee value of the external debt has grown by a modest 6.9% during the first nine months of the financial year.
- The inter-relationship between external debt and exchange rate explains the major risk underlying foreign currency loans.
 - Depreciation of exchange rate leads to higher debt servicing cost (in terms of domestic currency) on external debt.
 - Repayment of external debt, especially in the backdrop of a weak external account position, can cause depreciation of the exchange rate.

Handwritten signature/initials



Government of the Punjab
Punjab Pension Fund



EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US \$

	FY 10	FY 11	Growth* %
Current Account	(3.9)	0.5	114
Capital Account	0.2	0.1	(32)
Financial Account	5.1	1.7	(66)
Errors and Omissions	(0.1)	0.1	281
Overall Balance of Payments	1.3	2.5	97

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

- Detailed position of Current Account is given in the following table:

Billion US \$

	Jul - Jun		Growth %
	FY 10	FY 11	
Current Account (1+2+3)	(3.9)	0.5	114
(1) Balance of trade in Goods & Services	(13.2)	(12.3)	7
Goods: Exports f.o.b	19.7	25.5	29
Goods: Imports f.o.b	31.2	35.6	14
Balance of trade in goods	(11.5)	(10.2)	12
Services: Credit (exports)	5.2	5.5	4
Services: Debit (imports)	6.9	7.6	10
Balance of trade in services	(1.7)	(2.1)	(26)
(2) Balance of Income Transfers	(3.3)	(3.0)	10
Income: Credit (inflows)	0.6	0.7	27
Income: Debit (outflows)	3.8	3.7	(5)
Interest Payments	1.5	1.5	1
Profit & Dividend	0.7	0.6	(9)
(3) Balance of Current Transfers	12.6	15.8	26
Current Transfers: Credit (inflows)	12.7	15.9	25
Workers' Remittances	8.9	11.2	26
FCA Residents	0.6	0.4	(42)
Current Transfers :Debit (outflows)	0.1	0.1	(25)

Source: SBP

3/1
↓



Government of the Punjab
Punjab Pension Fund



- After remaining in deficit for six consecutive years, Pakistan’s current account posted a surplus of US\$ 0.5 billion in FY11. The Current Account surplus is primarily a result of strong growth in exports (29%) and an increase in worker’s remittances (26%) during the year. Trade deficit declined by 12% as exports grew at a faster rate than imports.
- Although Current Account has recorded a surplus during FY11, the underlying fundamentals suggest that there is little room for complacency.
 - The increase in exports is attributable more to higher prices and less to higher volumes. Higher cotton prices have immensely helped the export performance. A moderation of cotton prices, which has already started to happen in the international markets, will adversely affect the export figures in future.
 - Recovery in global demand appears fragile which may impact exports;
 - Imports are expected to remain high in the near future because of high international commodity prices, especially oil;
 - Due to real appreciation in the exchange rate during FY11 there has been a shift in terms of trade in favor of higher imports and lower exports;
 - Domestic constraints to production i.e. energy shortages and a deteriorating law & order situation, are continuing.

FINANCIAL ACCOUNT

- Financial Account is summarized in the following table:

Billion US \$

	FY 10	FY 11	Growth %
Financial Account (1+2+3)	5.1	1.7	(66)
(1) Direct Investment	2.1	1.5	(26)
(2) Portfolio Investment	(0.1)	0.3	620
(2a) Equity	0.6	0.4	(39)
(2b) Debt	(0.7)	(0.0)	97
(3) Other Investment	3.1	(0.1)	(105)
Equity based flows (1+2a)	2.7	1.9	(29)
Debt based flows (2b+3)	2.4	(0.2)	(107)

Source: SBP

- Financial Account shows a significantly weak position compared with the same period of last year.
 - Equity flows have been weaker than the same period of last year mainly because of decline of investment in Telecommunication and Oil & Gas Exploration sector. The slowdown in Telecommunication related investments was expected because this



Government of the Punjab
Punjab Pension Fund



sector had been consistently receiving huge investment flows for many years. However, in case of Oil & Gas sector, growing circular debt and worsening law and order situation probably had a major adverse affect on the potential investment flows.

- Debt flows have been negative i.e. a net repayment of USD 0.2 bn has been made during the FY 11. The loan flows are mainly impacted by the suspension of IMF stand-by agreement which also caused decline in the ratio of “realized/pledged loans”.
- The Financial Account indicates a weak financing capacity in case of a Current Account Deficit.



INFLATION

CONSUMER PRICES

- 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
Apr-2011	13.0	1.6	13.9	17.2	1.4	17.8	9.5	1.8	10.6
May-2011	13.2	0.2	13.9	15.9	-1.1	17.9	11.0	1.4	10.5
Jun-2011	13.1	0.6	13.9	15.7	0.5	18.0	11.0	0.5	10.5
12 month high	15.7	2.7	13.9	21.2	5.3	18.0	12.0	1.8	11.5
12 month low	12.3	-0.7	11.8	12.8	-2.1	12.6	8.9	0.3	10.5

¹12 month moving average

Source: FBS, SBP.

- The breakdown of CPI inflation into its various components is shown in the following table:

Index	Weightage % in CPI	Jun 2011 - CPI Inflation (%)		
		YOY	MOM	12mma
CPI	100	13.1	0.6	13.9
CPI food	40.34	15.7	0.5	18.0
Non-perishable food items	35.20	16.6	1.1	16.0
Perishable food items	5.14	9.5	-3.3	30.9
CPI non-food	59.66	11.0	0.5	10.5
Apparel, textile & footwear	6.10	13.5	0.5	12.0
House rent	23.43	8.1	1.0	7.3
Fuel & lighting	7.29	10.8	-0.5	15.7
Household, furniture & equipment etc.	3.29	11.2	0.1	10.2
Transport & communication	7.32	14.8	-0.3	14.5
Recreation & entertainment	0.83	0.8	0.1	10.2
Education	3.45	7.4	1.6	6.1
Cleaning, laundry & personal appearance	5.88	17.6	1.7	12.5
Medicare	2.07	17.3	0.6	15.0

Source: SBP

- YOY CPI inflation settled at 13.13% for the year 2011.
- Although food segment is contributing more than the non-food segment to overall inflation, YOY inflation in the food segment declined from 17.2% in Apr to 15.7% in Jun.
- SBP has developed an Inflation Diffusion Index (IDI) which is based on the MOM changes in the prices of the commodities in CPI basket. It is calculated as the difference



between the proportion of items with increasing prices and the proportion of items with decreasing prices. IDI has been found to be a leading indicator of Pakistan's YOY inflation. It has fallen from 52.7% in Apr 2011 to 40.8% in June 2011.

CORE INFLATION

- 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
Apr-2011	9.4	1.6	9.7	11.6	1.2	12.4
May-2011	10.2	0.2	9.7	12.1	0.9	12.4
Jun-2011	10.4	0.9	9.7	12.0	0.7	13.0
12 month high	10.4	1.6	10.7	13.6	1.2	13.0
12 month low	9.2	0.4	9.7	11.6	0.4	11.2

¹NFNE stands for non-food non-energy measure of core inflation

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

Source: SBP

- YOY NFNE inflation picked up in May & Jun and recorded double digit increase after remaining in single digits for a few months. The diffusion of NFNE inflation declined from 62.3% in Apr to 60.2% in May and to 43.6% in Jun indicating that inflationary pressures within non-food & non-energy items are easing.

WHOLESALE PRICES

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

Period	WPI Inflation								
	WPI Overall (%)			WPI Food (%)			WPI Non-food (%)		
	YOY	MOM	12mma	YOY	MOM	12mma	YOY	MOM	12mma
Apr 2011	25.9	2.3	22.6	19.4	0.8	18.9	30.9	3.3	25.8
May 2011	22.9	-1.6	22.8	19.0	-0.2	19.3	25.8	-2.5	25.7
Jun 2011	24.4	0.6	23.4	19.4	1.5	19.6	28.3	-0.1	26.3
12 month high	25.9	3.5	22.8	22.7	4.5	19.6	30.9	4.5	25.8
12 month low	18.7	-1.6	14.2	14.3	-1.5	12.4	21.6	-2.5	15.7

Source: SBP



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

Index	Weightage (%) in WPI	Jun 2011 - WPI Inflation (%)		
		YOY	MOM	12mma
WPI	100	24.4	0.6	23.4
WPI food	42.1	19.4	1.5	19.6
WPI non-food	57.9	28.3	-0.1	26.3
Raw materials	8.0	29.3	0.1	58.4
Fuel, lighting & lubricants	19.3	31.7	0.2	17.3
Manufactures	25.9	24.8	-2.8	27.2
Building materials	4.7	19.1	8.2	13.3

Source: SBP

- WPI showed a modest growth of 0.6% on MOM basis. Food segment showed MOM growth of 1.5% but the Non-Food segment recorded negative growth of -0.1% on MOM basis.
- YOY inflation and its 12-month moving average are still quite high in case of overall WPI.

3/1



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
Apr 2011	31.9	4.6	24.5	35.8	6.1	20.7	25.7	2.0	31.2
May 2011	35.2	-5.0	25.0	40.3	-5.7	21.6	27.3	-3.7	31.2
Jun 2011	36.1	-1.5	27.0	39.7	-1.5	24.1	30.3	-1.5	32.1
12 month high	37.6	6.1	30.0	40.3	9.4	32.4	46.2	6.1	32.6
12 month low	14.2	-5.0	19.9	8.7	-5.7	20.7	21.5	-3.7	17.3

Source: IMF

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

Index	Weightage (%) in Commodity Index	Jun 2011 Inflation (%)		
		YOY	MOM	12mma
Fuel & Non-fuel Commodities	100	36.1%	-1.5%	27.0%
Fuel Commodities (Energy)	63.1	39.7%	-1.5%	24.1%
Petroleum	53.6	41.9%	-2.1%	23.9%
Natural Gas	6.9	55.3%	18.3%	19.3%
Coal	2.6	21.5%	-2.9%	31.9%
Non-Fuel Commodities	36.9	30.3%	-1.5%	32.1%
Industrial inputs	18.4	29.3%	-0.2%	41.0%
Agricultural Raw Mat.	7.7	30.3%	2.8%	30.7%
Metals	10.7	28.9%	-1.6%	47.0%
Edibles	18.5	31.3%	-3.0%	24.4%
Food	16.7	32.9%	-3.0%	25.1%
Beverages	1.8	20.0%	-2.9%	19.0%

Source: IMF

- International commodity prices exhibited another month of deflation as overall price index declined by 1.5% on MOM basis in June over 5.0% fall in previous month. All major sub-indexes showed declining trend except one or two during June 2011.
- YOY overall inflation stood at 36.1% mainly because of low base of index in last year
- The major reasons behind recent softening in international commodity prices include:
 - Recovery outlook among the developed world not seeing very promising.
 - Concerns over Greece debt, and "US debt ceiling issue" as US debt can't legally exceed a debt ceiling of US\$ 14.29 trillion which was reached in May 2011.
 - Improved supply prospectus of agricultural goods.



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

		End Jun 2010	Change (1 Jul - 25 Jun FY11)	
			Absolute	%
	Broad Money (M 2)	5,777	824	14.3
LIABILITY SIDE (A+B)				
A	Currency in circulation	1,295	246	19.0
B	Demand, Time & other deposits	4,482	578	12.90
ASSET SIDE (C+D)				
C	Net Foreign Assets (NFA) of banking system	545	181	33.2
D	Net Domestic Assets (NDA) of banking system (a+b+c)	5,232	643	12.3
a	Net Govt. Sector borrowings	2,441	703	28.8
b	Credit to Non Govt. Sectors	3,389	108	3.2
c	Other items (net)	(598)	(168)	

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

		End Jun 2010	Change (1 Jul - 25 Jun FY11)	
			Absolute	%
	Reserve Money (RM)	1,679	297	17.7
LIABILITY SIDE (A+B)				
A	Currency in circulation	1,295	246	19.0
B	Others (Cash in tills & Deposits)	384	51	13.3
ASSET SIDE (C+D)				
C	Net Foreign Assets (NFA)	379	167	44.1
D	Net Domestic Assets (NDA) (a+b+c)	1,301	131	10.1
a	Govt. Sector	1,225	122	14.0
b	Non Govt. Sector	330	5.5	1.7
c	Others	(254)	5	

Source: SBP



**Government of the Punjab
Punjab Pension Fund**



- It is evident that, during the current financial year, the Monetary Base (Reserve Money RM) has grown faster than the Monetary Aggregate (Broad Money M2). The major causes of high growth in Reserve Money include
 - growth in NFA; and
 - government borrowing from SBP
- Since the Monetary Base is ultimately converted to Monetary Aggregates through the multiplier effect (repeated cycles of deposits and loans), high growth in RM usually leads to high growth in M2 and higher inflation (especially when Real GDP is growing at a slower rate).
- 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
Apr 2011	13.80	13.18	14.10	13.66	13.67	13.22
May 2011	13.82	13.31	14.09	13.78	13.74	13.34
Jun 2011	13.85	13.44	14.09	13.79	13.78	13.46
12m high	13.85	13.44	14.25	13.79	13.83	13.46
12m low	12.42	12.28	12.95	12.61	12.42	12.45

Source: SBP, Reuters

- Two major reasons behind the persistence in high interest rates include high inflation and high budget deficit & borrowing by the government.
- Continued spending by the government in excess of its resources pushes up aggregate demand despite a tight monetary policy and slowdown in private sector spending. Supply constraints due to energy shortages and scarcity of credit are preventing a similar growth in aggregate supply. The resulting demand-supply gap leads to higher inflation (despite slower economic growth).
- The most crucial adjustment that the economy needs is a lowering of budget deficit and borrowing by the government. This will narrow the demand-supply gap, lower the inflationary pressures and pave the way for lower interest rates and revival of credit flow to the private sector.
- Currently YOY inflation stands approximately 1% lower than the discount rate. If the trend of softening of inflationary pressures continues, we expect that SBP may consider lowering the discount rates later during the current financial year. Our view is based on the following reasons:
 - Inflationary pressures have been easing over the last two months.
 - Inflation Diffusion Index has fallen during May and June for CPI as well as NFNE inflation measures.

3

4



- YOY CPI Inflation is expected to decline further over the next few months due to high base effect.
- The Current Account Surplus during FY11 has eased near-term pressures on the external account and the exchange rate.
- However, we expect that SBP will maintain the discount rate at 14% in its monetary policy decision due in Jul 2011 and will wait until confirmation of lower inflation numbers before considering a lowering of discount rate.

INVESTMENT STRATEGY

- Our long-term inflation expectation for the future is in the range of 9-10% p.a. and a fixed rate of return of 12.5% p.a. or above on the investments is consistent with PPF's long-term return objective of 'inflation + 3%'.
- 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, this is an opportunity 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 at 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 the 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 offer term deposits for periods longer than one year. 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.

(Abdul Rehman Warraich)
Head of Investments
Punjab Pension Fund

(Aquil Raza Khoja)
General Manager
Punjab Pension Fund