Government of the Punjab
Punjab Pension Fund

Dated: 16 April 2013

MONTHLY REVIEW OF INVESTMENTS
March 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-March 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	1,512
Less: expenses during the period	(18)
Ending fund size	**17,099**

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 Mar 2013	
	Amount	%	Amount	%	Amount	%
PIBs	8,942	65.2	9,480	60.7	9,264	54.2
T-Bills	1,254	9.1	139	1.0	100	0.6
Short term bank deposits	3,002	21.9	5,349	34.3	6,130	35.9
National Saving Schemes	-	-	-	-	1,299	7.6
Corporate bonds/TFCs	501	3.7	501	3.2	238	1.4
Cash at bank	8	0.1	130	0.8	62	0.3
Other assets*	1	0.0	6	0.0	6	0.0
Total Fund Size	**13,708**	**100.0**	**15,605**	**100.0**	**17,099**	**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

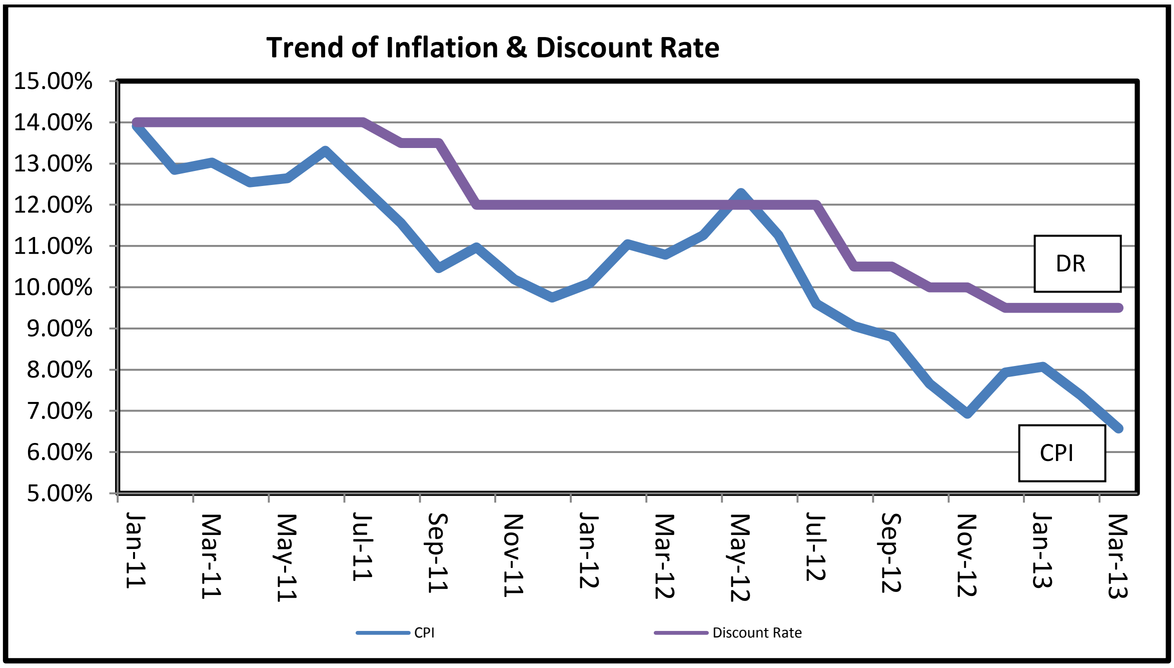
- Time Weighted Return (TWR) earned by PPF is summarized as under:

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 - February 2013	13.12%	12.95%			
February 2013	12.22%	12.07%			

*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.

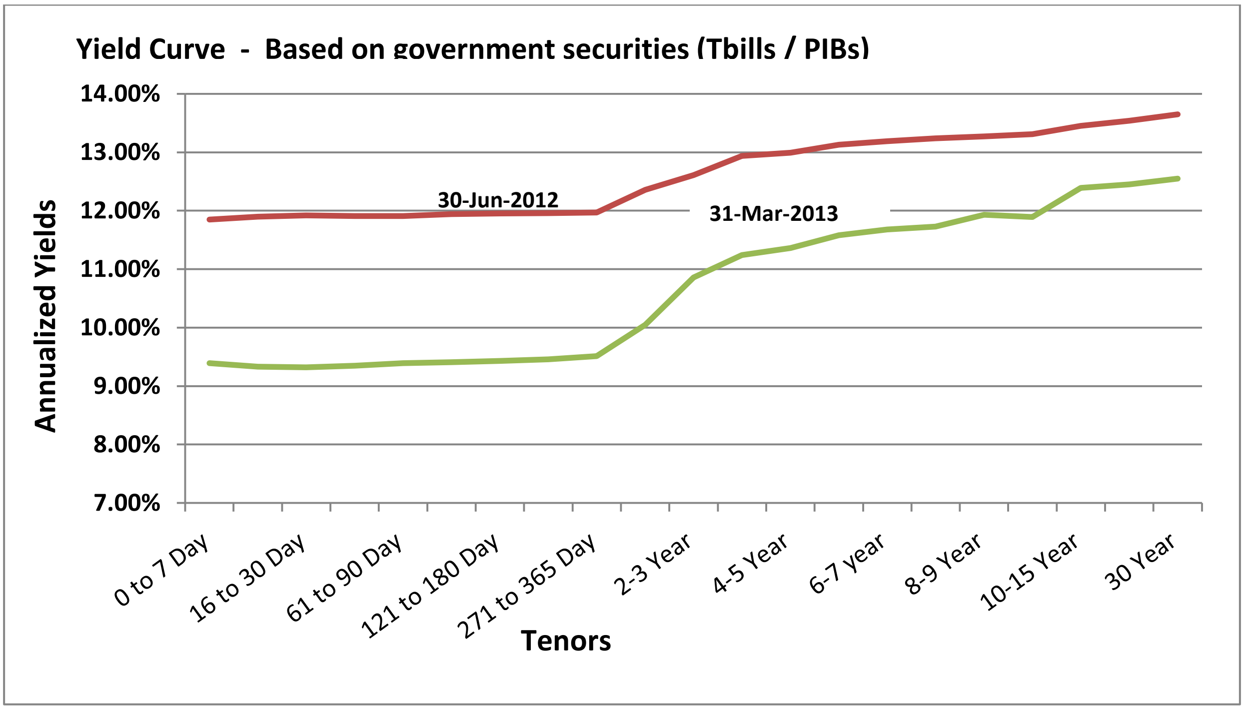


GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- 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-Mar 2013	13.74%	24.36%	17.8	941.6	1.89%
Jul 2008 – Feb2013 (CAGR)	14.68%	17.14%			

- 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-March 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 1.4%.This has resulted in a sharp increase (24.36%) in present value of liabilities. Although Market value of Fund's assets also increased by 13.74% 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 said that the real GDP growth Rate is likely to be below 4.0 percent, and projected the growth rate in the range of 3.5 to 4.0 percent. Here are some key points highlighted in the report;
    - Structural problems in the economy persist, and the growing issues like energy shortages, worsening law & order situation, sharply increasing debt, loss-making Public Sector Enterprises (PSEs) and a narrow tax base will continue to hamper the future economic outlook. Without addressing these main issues, the private sector will remain reluctant to take up the challenge of driving the country's economic growth.
    - The real sector is showing a mixed picture. Within agriculture, both cotton and rice crops remained below target, whereas sugarcane performed well. The wheat crop is likely to be below target despite the increase in support prices in November 2012.
    - Pakistan's manufacturing sector has posted an improvement, and is likely to continue with this trend. Heavyweights like POL and steel manufacturing have shown strong growth. In addition, allied sub-sectors that support construction activities have shown consistent growth.
    - The report also said that during the remaining period of FY 13, no major economic development can be expected and the investors are not likely to take long term view during the caretaker setup.

FISCAL MANAGEMENT

- 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.
- Fiscal Deficit during the 1st half FY 13 remained 2.6% of GDP which is same as it was last year, the USD 1.8 billion of CSF made it possible to control. With no further CSF inflows in the pipeline for the rest of the year, meeting the annual budget target of 4.7 percent seems very unlikely.
- This challenging fiscal situation can be traced to the following factors:
    - The sluggish growth in tax revenues, which grew by only 12.0 percent during the first half of the year, compared with 25.4 percent in H1-FY12.
    - Mounting interest payments on domestic public debt, which increased from Rs 363.5 billion in H1-FY12 to Rs 508.0 billion in H1-FY13; and
    - Inappropriate financing mix of the budget deficit with heavy reliance on expensive domestic sources due to drying up of external funds.
- During H1-FY13, the entire budget deficit was financed through domestic sources, particularly the banking system, which has implications for inflation and available funding for the private sector.
- 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 6.5 to 7.5% of GDP for FY13.

EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US $

	Jul-Feb FY12	Jul-Feb FY13	Growth %
Current Account	**(3.24)**	**(0.70)**	**78**
Trade balance(Goods)	(10.98)	(10.17)	7
Trade balance (Services)	(1.88)	(0.18)	91
Income transfers (net)	(1.94)	(2.31)	(19)
Remittances	8.59	9.24	7.5
Capital Account	**0.14**	**0.20**	**41**
Financial Account	**0.56**	**(0.17)**	**(130)**
Net Errors & Omissions	**(0.10)**	**(0.26)**	
Overall Balance of Payments	**(2.63)**	**(0.923)**	**65**

Source: SBP

- The Current Account posted a deficit of USD 700 million in the period Jul – Feb FY13, compared with a huge deficit of USD 3.24 billion in the same period last year.
- The development in current account was due to a combination of CSF inflows, steady growth in worker remittances and a contraction in the trade deficit. Of these, the impact of CSF inflows was the largest.
- Trade balance for the period improved by 7% due to 4% decline in imports and 1% decline in exports. Services balance improved significantly due to receipt of CSF payments.
- Current transfers continued to provide much needed support on the back of healthy remittances. Remittances were up by 7.5% during the period Jul-Feb FY13 compared with the same period of last year.
- Capital and financial account almost dried during the period under review. Specifically, against a surplus of US$ 0.7 billion in Jul-Feb FY12, the financial and capital accounts recorded a surplus of only US$ 34 million in Jul-Feb FY13. Although net foreign investment improved somewhat compared to last year, it was the fall in foreign borrowings that led to the overall deterioration in the financial account.
- The overall Balance of Payments remained negative USD 923 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
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	9.2	7.4	-1.3	8.4	7.4	0.4	9.8
Mar-2013	6.6	0.4	8.9	6.3	0.5	8.1	6.7	0.3	9.4
12 month high	12.3	1.8	11.2	11.3	2.2	11.8	13.0	1.9	11.0
12 month low	6.6	-0.4	8.9	5.3	-1.3	8.1	6.7	-1.7	9.4

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

- YoY CPI declined to 6.6 percent in March 2013 which is lowest since the new index has been rebased. The cumulative increase in CPI index for the nine months of FY 13 is only 3.43%.
- Both Food and Non-Food segments are contributing towards lower inflation
    - Although perishable food items recorded a sharp increase of 7 percent during the March 2013, but due to a decline of 0.36% in Non-perishable food items, the overall food inflation remained on lower side.
    - 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.
    - Housing, water, gas &fuel index, having 29.4% weight in overall CPI, increased only by 3.56% on YoY basis.
- The cumulative increase of only 3.43% in CPI index for the first nine months of FY13 confirms the meeting the annual target of 9.5% for FY13 despite that high government borrowings and depreciation in rupee value.
- SBP in its recent review on economy projected CPI in the range of 8-9% forFY13. In actual, market is expecting that it will remain even below 8.0 percent for the full year FY 13.
- 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
Jan-2013	10.0	1.2	10.6	9.9	1.0	10.4
Feb-2013	9.6	0.4	10.5	9.2	0.2	10.2
Mar-2013	9.0	0.4	10.4	8.4	0.2	9.9
12 month high	11.5	1.4	10.8	11.7	1.3	11.5
12 month low	9.0	0.2	10.4	8.4	0.2	9.9

[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 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 also declined below 10% which shows that long-term inflationary trends are also softening.

- 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
Jan-2013	-0.6	2.7	-3.2	-2.7	3.2	-0.3	3.7	1.9	-7.8
Feb-2013	-2.9	1.6	-3.7	-5.0	2.3	-2.0	1.4	0.5	-6.5
Mar-2013	-9.0	-3.8	-4.6	-12.0	-4.1	-3.8	-2.8	-3.0	-5.7
12 month high	0.3	4.5	16.6	3.6	7.9	24.8	4.5	4.2	3.8
12 month low	-12.9	-8.1	-4.6	-12.0	-11.2	-3.8	-14.6	-3.4	-11.2

Source: IMF

- Due to continued slowdown in economic growth around the world, commodity prices show deflation of -9.0% on a YOY basis. The break-up shows that fuel/energy related commodities recorded deflation of -12.0% whereas non-fuel commodities recorded deflation of 2.8%.
- 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 9.0% in dollar terms may actually mean inflation of 1.0% in rupee terms. Further, the impact of currency depreciation on domestic prices is reflected with some time gap.

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
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
Mar-2013	9.51	10.37	11.89	12.15	9.58	10.47
12m high	11.98	12.59	13.34	13.16	12.06	12.62
12m low	9.19	10.37	11.04	12.15	9.34	10.47

Source: SBP, Reuters

- During FY13, short term interest rates are declining (yields on 1 year T-bills) have been declining in line with the reduction in discount rate but long term interest rates (yields on 10 year PIBs) have declined less than the reduction in discount rate despite lower inflation. This suggests that market is expecting higher inflation over the long-term.
- In its Monetary Policy Statement (MPS) announced on 12 April 2013, SPB kept the discount rate unchanged at 9.50%, by overweighting Balance of Payment situation and by not giving importance to declining inflation. Key points of MPS are summarized below;
  - SBP's foreign exchange reserves have declined by another $2 billion; from 8.7 billion at end-January 2013 to $6.7 billion as of 5th April 2013, mainly due to debt payments. Contrary to expectations, however, year-on-year inflation has come down by 1.5 percentage points; from 8.1 percent in January 2013 to 6.6 percent in March 2013. These developments pose divergent policy choices for the SBP. While the former calls for caution, the latter indicates a possible resumption of ease in the policy rate.
  - The balance of payments position continues to be driven by low financial inflows and high debt payments. While the external current account deficit is expected to widen further in the remaining months of FY13, the net capital and financial inflows are not likely to increase considerably.
  - The SBP has to retire another $838 million of IMF loans during the remaining period of FY13 after making payments of $2.2 billion during the first three quarters of the current fiscal year. The idea is to discourage speculative demand for dollars by keeping rupee denominated assets sufficiently lucrative.

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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