



Government of the Punjab
Punjab Pension Fund



Dated: 10 December 2010

MONTHLY REVIEW OF INVESTMENTS

November 2010

FUND SIZE

- A summary of changes in fund size during the current financial year is given in the following table:

Rs. millions (rounded to the nearest million)

	Jul-Nov 2010
Beginning fund size	12,097
Add: contribution during the period	-
Less: transfer to Reserve Pension Fund	-
Add: gain/(loss) during the period	639
Less: expenses during the period	7
Ending fund size	12,729

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 June 2010		30 Sep 2010		30 Nov 2010	
	Amount	%	Amount	%	Amount	%
PIBs	5,737	47.4	5,570	44.7	5,729	45.0
T-Bills	3,145	26.0	4,503	36.1	4,508	35.4
Short term bank deposits	3,015	24.9	-	-	2,017	15.9
Corporate bonds/TFCs	176	1.5	300	2.4	330	2.6
Cash at bank	21	0.2	2,092	16.8	142	1.1
Other assets*	3	0.0	5	0.0	3	0.0
Total Fund Size	12,097	100.0	12,470	100.0	12,729	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.
- 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%
Jul-Nov 2010	13.07%	12.91%		
Nov 2010	13.27%	13.11%		

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

- Inflation rates over the last 2-3 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.

REVIEW OF IMPORTANT ECONOMIC & FINANCIAL VARIABLES

GDP GROWTH

- For FY 2010-11, the government had originally set a GDP growth target of 4.5%. However, recent estimates by SBP project GDP growth in the range of 2.5%-3%.
- Reasons for the slowdown of the economy include:
 - Damage to crops, livestock, infrastructure, industry and economic activity in general, caused by floods;
 - Intensification of inflationary pressures due to
 - food shortages caused by floods
 - rising prices of petroleum products
 - rise in electricity tariffs
 - slowdown in borrowing and investment by the private sector due to a combination of slow economy, rising costs and high interest rates.



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FISCAL MANAGEMENT

- A summary of revenues and expenditures during the current financial year 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 10	FY 11	FY 10	FY 11	FY 10	FY 11	FY 11
(1) Total revenue	427.3	400.1	66	59	2.9	2.3	(6.3)
(1a) Tax	298.8	317.3	46	47	2.0	1.9	6.2
Direct Tax	84.1	94.4	13	14	0.6	0.6	12.3
Indirect Tax	214.7	222.9	33	33	1.4	1.3	3.8
(1b) Non-tax	128.5	82.9	20	12	0.9	0.5	(35.5)
Dividend	18.9	0.5	3	0.1	0.1	0.0	(97.6)
SBP Profit	70.0	40.0	11	6	0.5	0.2	(42.9)
(2) Total expenditure	650.9	676.3	100	100	4.4	4.0	3.9
(2a) Current	521	566.7	80	84	3.5	3.3	8.8
Domestic Debt Service	129.3	146.6	20	22	0.9	0.9	13.4
Foreign Debt Service	12.2	14.9	2	2	0.1	0.1	22.5
Defence	86.2	93.1	13	14	0.6	0.5	8.1
(2b) Development	109.0	59.4	17	9	0.7	0.3	(45.5)
Budget surplus / (deficit)	(224)	(276)	(34)	(41)	(1.5)	(1.6)	23.5
Financing	224	276	34	41	1.5	1.6	23.5
External	77.1	56.9	12	8	0.5	0.3	(26.2)
Domestic	146.6	219.3	23	32	1.0	1.3	49.6
Non-bank	107.6	98.4	17	15	0.7	0.6	(8.6)
Bank	39	121	6	18	0.3	0.7	210.0
Privatization	0	0	0	0	0	0	-
Full Year GDP - Sept.	14,838	17,106					
	(93.7)	(166.6)			(0.6)	(1.0)	77.8

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

Source: Ministry of Finance

- Fiscal situation has been very difficult during the first quarter of the current fiscal year. As a percentage of GDP



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- Tax as well as non-tax revenues fell;
- Expenses also fell but the brunt had to be borne by development expenditures which will have adverse consequences for long-term growth potential of the economy;
- Overall budget deficit increased;
- Revenue deficit increased significantly.
- In the monetary policy decision dated 29 Nov 2010, SBP has noted that the fiscal situation continues to be highly vulnerable. Due to delays in introduction of tax reforms and weak industrial production, the target of 27% increase in tax revenues during FY 11 looks quite ambitious.

DEBT

Domestic Debt:

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

Domestic Debt	Amount (Rs. bn)		As % of Total Dom. Debt		As % of GDP		Growth (%)
	Jun-10	Aug-10	Jun-10	Aug-10	Jun-10	Aug-10	FY 11
A) Permanent	794	787	17.1	16.2	5.4	4.6	(0.9)
PIBs	505	500	10.9	10.3	3.4	2.9	(1.0)
Prize Bonds	236	240	5.1	4.9	1.6	1.4	1.8
B) Floating	2,399	2,593	51.6	53.3	16.4	15.2	8.1
C) Unfunded	1,456	1,480	31.3	30.4	9.9	8.7	1.6
DSCs	225	226	4.8	4.6	1.5	1.3	0.4
SSCs	351	357	7.5	7.3	2.4	2.1	1.8
BSCs	367	377	7.9	7.7	2.5	2.2	2.7
D) FC Instruments	3	3	0.1	0.1	0.1	0.0	-
Total Domestic Debt	4,653	4,863	100.0	100.0	31.7	28.4	4.5
GDP	14,668	17,106					

Source: SBP

- The proportion of long-term borrowing (represented by PIBs, DSCs and BSCs) in total domestic debt is quite modest.
- The government's dependence on short-term borrowing is quite high. This implies that the government must overcome its fiscal problems sooner rather than later otherwise rising yields on short-term debt may become increasingly unaffordable.



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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 ¹ (%)
	June-10	Sep-10	June-10	Sep-10	June-10	Sep-10	Jul-Sep10
1) Public Debt	52.1	54.8	4,458	4,733	30.4	27.7	6.2
a) Govt Debt	42.9	44.8	3,671	3,869	25.0	22.6	5.4
i) Medium & long term	42.1	43.9	3,603	3,793	24.6	22.2	5.3
ii) Short term	0.8	0.9	68	76	0.5	0.4	12.0
b) From IMF	8.1	8.9	691	769	4.7	4.5	11.3
c) Foreign Ex Liabilities	1.1	1.1	96	95	0.7	0.6	(1.0)
2) PSE Guaranteed Debt	0.2	0.2	14	13	0.1	0.1	(4.1)
3) PSE Non-Guaranteed Debt	0.8	0.8	69	68	0.5	0.4	(2.1)
4) Schedule Bank Borrowings	0.2	0.2	17	21	0.1	0.1	28.7
5) Pvt. Guaranteed Debt	0.0	0.0	0	0	0	0	-
6) Pvt. Non-Guaranteed Debt	2.2	2.3	191	200	1.3	1.2	4.5
7) Pvt. Non-Guaranteed Bonds	0.1	0.1	11	11	0.1	0.1	1.0
Total External Debt	55.6	58.4	4,459	5,046	32.4	29.5	6.0
Exchange Rate (Rs./USD)			85.56	86.38			
GDP			14,668	17,106			

¹Growth in rupee value

²Ministry of Finance has projected nominal GDP as on 30 Jun 2011 at Rs. 17,106 bn.

Source: SBP, MOF, Reuters

- The interest cost of external debt is much lower than that of domestic debt.
- However, the major risk in relation to external debt lies in the exchange rate.
 - Depreciation of domestic currency leads to higher costs (interest as well as principal) in terms of domestic currency.
 - Repayments of foreign loans becoming due combined with a weak external account position can exacerbate the decline of domestic currency.



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EXTERNAL ACCOUNT

- Balance of payments during the current financial year is compared with the balance of payment in the same period of last financial year in the following table:

Billion US \$

	Jul-Oct 10	Jul-Oct 11
Current Account	(1.2)	(0.5)
Capital Account	0.0	0.0
Financial Account	2.8	0.6
Errors and Omissions	(0.3)	0.1
Overall Balance of Payments	1.3	0.2

Source: SBP

CURRENT ACCOUNT

- Composition of Current Account during the current financial year and its comparison with the same period of the last financial year is shown in the following table:

Billion US \$

	Jul-Oct 10	Jul-Oct 11
Current Account (1+2+3)	(1.2)	(0.5)
(1) Balance of trade in Goods & Services	(5.0)	(4.7)
Goods: Exports f.o.b	6.2	7.1
Goods: Imports f.o.b	10.2	10.8
Balance of trade in goods	(3.9)	(3.7)
Services: Credit (exports)	1.2	1.4
Services: Debit (imports)	2.2	2.3
Balance of trade in services	(1.1)	(1.0)
(2) Balance of Income Transfers	(0.9)	(0.8)
Income: Credit (inflows)	0.2	0.2
Income: Debit (outflows)	1.0	1.1
Interest Payments	0.3	0.4
Profit & Dividend	0.2	0.2
(3) Balance of Current Transfers	4.7	5.0
Current Transfers: Credit (inflows)	4.7	5.0
Workers' Remittances	3.1	3.5
FCA Residents	0.2	0.1
Current Transfers :Debit (outflows)	0.0	0.0

Source: SBP



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- The Current Account Deficit (CAD) during Jul-Oct FY 11 is lower than the same period of last year.
 - All components of the Current Account including trade in goods & services, income transfers and current transfers showed improved during this period.
 - Export of goods grew by an impressive 13% over the same period of last year driven by food and textile categories. Imports of goods, on the other hand, grew by 6% over the same period of last year.
 - Workers' remittances also showed a healthy growth of 13% over the same period of last year.
- In its monetary policy decision dated 29 Nov 2010, SBP has projected that External Current Account Deficit (CAD) is likely to be narrower in FY 11 than earlier projections of 3.5% of GDP as
 - the performance of exports and the trend in remittances are better than expectations so far; and
 - import demand remains contained due to weakening private sector demand.

FINANCIAL ACCOUNT

- Composition of the Financial Account during the current financial year and its comparison with the same period of last financial year is shown in the following table:
Billion US \$

	Jul-Oct 10	Jul-Oct 11
Financial Account (1+2+3)	2.8	0.6
(1) Direct Investment	0.7	0.5
(2) Portfolio Investment	0.3	0.1
(2a) Equity	0.3	0.1
(2b) Debt	(0.0)	(0.0)
(3) Other Investment	1.9	0.0
Equity based flows (1+2a)	1.0	0.6
Debt based flows (2b+3)	1.8	0.0

Source: SBP

- Total inflows on account of direct investment and portfolio investment are \$ 0.5 bn and \$ 0.1 bn during the first four months of the financial year. This clearly indicates a weak capacity to finance a high Current Account Deficit.



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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
July 2010	12.3	1.2	11.8	12.8	1.5	12.6	12.0	1.0	11.1
Aug 2010	13.2	2.5	12.0	15.6	5.1	13.1	11.2	0.3	11.2
Sep 2010	15.7	2.7	12.5	21.2	5.3	14.0	11.0	0.3	11.2
Oct-2010	15.3	0.6	13.0	20.1	0.1	15.1	11.3	1.1	11.3
12 month min.	10.5	-0.5	11.7	7.5	-1.7	11.9	10.0	0.1	11.1
12 month max.	15.7	2.7	15.0	21.2	5.3	15.1	12.2	2.8	14.7

¹12 month moving average

Source: SBP

- Although YOY CPI inflation (15.3%) was quite high in Oct 2010, the MOM CPI inflation came at 0.6% suggesting that the inflationary forces have lost some momentum.
- Food inflation has been the primary driver of overall CPI inflation.
- The breakdown of CPI inflation into its various components is shown in the following table:

Index	Weightage % in CPI	Oct 2010 - CPI Inflation (%)		
		YOY	MOM	12mma
CPI	100	15.3	0.6	13.0
CPI food	40.34	20.1	0.1	15.0
Non-perishable food items	35.20	16.9	1.5	13.9
Perishable food items	5.14	39.4	-6.6	22.5
CPI non-food	59.66	11.3	1.1	11.3
Apparel, textile & footwear	6.10	10.8	0.9	7.8
House rent	23.43	7.1	0.4	10.9
Fuel & lighting	7.29	21.1	1.7	16.6
Household, furniture & equipment etc.	3.29	9.4	1.0	6.8
Transport & communication	7.32	18.5	2.7	13.8
Recreation & entertainment	0.83	14.5	0.0	9.8
Education	3.45	6.3	0.3	10.0
Cleaning, laundry & personal appearance	5.88	10.5	2.0	10.2
Medicare	2.07	10.5	0.2	8.5

Source: SBP



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
Jul 2010	10.3	0.5	10.7	12.0	0.7	11.4
Aug 2010	9.8	0.4	10.5	12.5	0.7	11.2
Sep 2010	9.4	0.4	10.3	12.8	0.9	11.5
Oct 2010	9.3	0.7	10.1	12.8	1.0	11.9
12 month min.	9.3	0.4	10.1	10.4	0.4	11.2
12 month max.	10.7	1.7	15.3	12.8	1.3	16.0

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

- NFNE inflation has been declining over the past few months indicating that inflationary pressures are concentrated in food & energy items.
- Trimmed mean inflation, on the other hand, has strengthened over the past few months which shows that within the food & energy categories, inflationary pressures are quite broad based. MOM inflation at 1% is particularly worrisome and suggests that inflation is accelerating.



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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
Jul 2010	18.7	1.7	14.4	14.3	1.9	12.4	22.5	1.5	15.7
Aug 2010	19.2	2.6	16.0	16.4	4.2	13.1	21.6	1.4	18.2
Sep 2010	21.5	2.1	17.7	21.1	4.5	14.2	21.8	0.2	20.6
Oct 2010	23.8	3.1	19.4	22.2	1.8	15.6	25.1	4.2	22.6
12 month min.	12.5	-0.6	7.3	9.6	-0.7	11.4	14.9	-2.0	2.8
12 month max.	23.8	4.2	19.4	22.2	4.5	15.6	27.7	5.5	22.6

Source: SBP

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

Index	Weightage in overall WPI	Oct 2010 - WPI Inflation (%)		
		YOY	MOM	12mma
WPI	100	23.8	3.1	19.4
WPI food	42.1	22.2	1.8	15.6
WPI non-food	57.9	25.1	4.2	22.6
Raw materials	8.0	65.8	5.6	45.6
Fuel, lighting & lubricants	19.3	14.7	4.0	23.4
Manufactures	25.9	25.7	4.1	17.7
Building materials	4.7	15.5	2.0	3.2

Source: SBP

- YOY inflation is very high in both food and non-food segments of wholesale prices.
- MOM inflation captures the recent trend in wholesale prices. Non-food inflation has recorded a very high MOM increase of 4.2% which reflects the strengthening of international commodity prices during the month.



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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
Jul 2010	16.4	1.5	18.7	17.4	0.3	22.4	14.9	3.7	14.3
Aug 2010	12.3	3.3	22.5	8.7	0.9	26.5	18.3	7.4	17.3
Sep 2010	17.6	1.3	26.4	14.1	0.4	30.6	23.5	2.7	20.5
Oct 2010	17.7	5.6	28.2	12.3	6.3	32.3	27.5	4.6	22.6
12 month high	48.3	5.7	28.2	60.0	6.3	32.3	31.3	7.4	22.6
12 month low	9.9	-7.5	-32.2	9.6	-8.8	-37.6	10.3	-5.1	-20.4

Source: IMF

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

Index	Weightage (%) in Commodity Index	Oct 2010 Inflation (%)		
		YOY	MOM	12mma
Fuel & Non-fuel Commodities	100	17.7	5.6	28.2
Fuel Commodities (Energy)	63.1	12.3	6.3	32.3
Petroleum	53.6	10.6	7.3	41.4
Natural Gas	6.9	1.1	-2.6	27.9
Coal	2.6	36.1	1.9	31.1
Non-Fuel Commodities	36.9	27.5	4.6	22.6
Industrial inputs	18.4	34.8	4.5	38.1
Agricultural Raw Mat.	7.7	36.4	6.6	32.0
Metals	10.7	34.0	3.4	42.0
Edibles	18.5	21.0	4.6	11.0
Food	16.7	23.1	5.2	10.3
Beverages	1.8	5.6	0.6	18.2

Source: IMF

- International commodity prices exhibited very high MOM inflation during Oct 2010 driven mainly by petroleum and raw material prices.



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INTEREST RATES

- 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
Aug 2010	12.75	12.32	13.19	12.68	12.87	12.47
Sep 2010	12.97	12.36	13.75	12.79	13.27	12.52
Oct 2010	13.17	12.41	13.83	12.88	13.23	12.56
Nov 2010	13.38	12.52	13.88	13.01	13.60	12.66
12m high	13.38	12.52	13.88	13.01	13.60	12.98
12m low	11.95	12.21	12.47	12.42	12.23	12.41

Source: SBP, Reuters

- 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

			Change (1 Jul - 19 Nov 2010)	
		End Jun 2010	Absolute	%
	Broad Money (M 2)	5,777	279	4.8
	LIABILITY SIDE (A+B)			
A	Currency in circulation	1,295	269	20.8
B	Demand & Time deposits	4,482	9	0.2
	ASSET SIDE (C+D)			
C	Net Foreign Assets (NFA) of banking system	545	70	12.9
D	Net Domestic Assets (NDA) of banking system (a+b+c)	5,232	209	4.0
a	Net Govt. Sector borrowings	2,441	318	13.0
b	Credit to Non Govt. Sectors	3,389	9	0.3
c	Other items (net)	(598)	(118)	

Source: SBP

- In its Monetary Policy Decision dated 29 Nov 2010, SBP raised the discount rate by 50 basis points from 13.5% to 14%. The salient features of the SBP's decision are summarized as under:
 - Increase in electricity and petroleum prices and impact of floods on food prices have played a part in creating CPI inflation but do not fully explain the persistence in inflation.



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- High inflation occurs because of money creation in excess of productive activity in the economy. A large increase of Rs. 308 bn in reserve money during the current financial year is attributable primarily to government borrowing of Rs. 266 bn from SBP. This is leading to expectations of high inflation and is resulting in high interest rates. It would be difficult to bring inflation down unless government borrowing from SBP is curtailed substantially and kept under control on a sustained basis.
- Rising NDA to NFA ratio of SBP balance sheet and its strong association with CPI inflation suggest that inflation is likely to persist at double digit levels during much of FY 11 and possibly in FY 12.
- It has been decided to strictly implement the revised limits on borrowings of provinces from SBP.
- The burden of monetary tightening is being borne largely by private sector which gets crowded out by the excesses of government borrowing with adverse implications for sustainable economic growth.
- We think that the combination of higher tax collection (after RGST) and lower expenditures (by phasing out subsidies) should gradually result in improvement in the fiscal and hence the macroeconomic situation. In the very short-term, however, the high-inflation-high-interest-rate scenario is expected to continue.

INVESTMENT STRATEGY

- Average inflation (CAGR) over the 19 year period from Jul 1991 to Jun 2010 has been 8.8% p.a. Our long-term inflation expectation for the future is in the range of 9-10% p.a. We think that a fixed rate of return of 12.5% p.a. or above on our investments is consistent with our long-term return objective of 'inflation + 3%'.
- We think that 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, our strategy is 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 a maximum of 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.



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- The ISC is yet to make a decision on our 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 take fixed deposits for periods longer than one year. The matter will be discussed in the next ISC meeting. 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