Government of the Punjab

Punjab Pension Fund

Dated:17 December 2012

MONTHLY REVIEW OF INVESTMENTS
November2012

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-NovemberFY13
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	860
Less: expenses during the period	(10)
Ending fund size	**16,455**

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		30Nov 2012	
	Amount	%	Amount	%	Amount	%
PIBs	8,942	65.2	9,480	60.7	9,446	57.4
T-Bills	1,254	9.1	139	1.0	-	-
Short term bank deposits	3,002	21.9	5,349	34.3	6,124	37.2
National Saving Schemes	-	-	-	-	600	3.6
Corporate bonds/TFCs	501	3.7	501	3.2	243	1.5
Cash at bank	8	0.1	130	0.8	39	0.2
Other assets*	1	0.0	6	0.0	3	0.0
Total Fund Size	**13,708**	**100.0**	**15,605**	**100.0**	**16,455**	**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

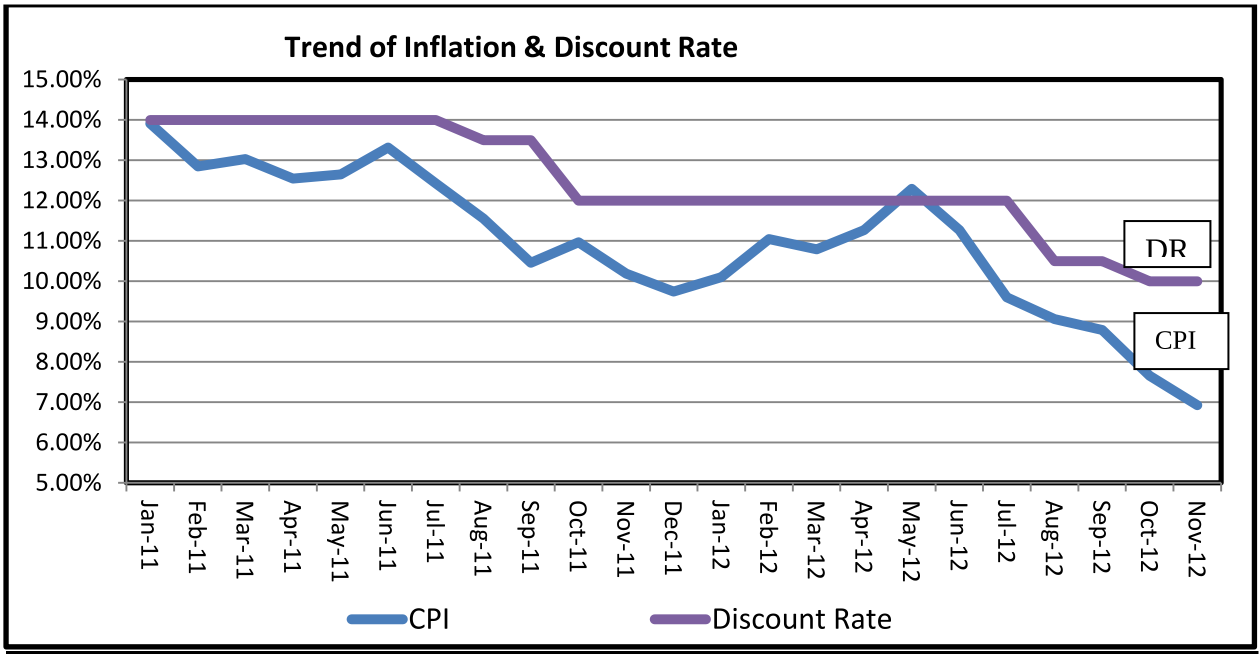
- Time Weighted Return (TWR) earned by PPF is summarized as under:

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%	13.00%	13.14%	16.14%
FY 2009-10	13.79%	13.61%	12.50%	12.69%	15.69%
FY 2010-11	13.48%	13.32%	13.00%	13.13%	16.13%
FY 2011-12	13.96%	13.79%	13.50%	11.26%	14.26%
Jul 2008 – Jun 2012 (CAGR)**	14.10%	13.92%	13.00%	12.54%	15.54%
July – November 2012	13.66%	13.49%			
November 2012	12.53%	12.36%			

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

**CAGR means Compound Annualized Growth Rate

- Inflation rates over the last 3-4 years 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 had invested a large proportion of its assets in long-term fixed-rate instruments consisting mainly of PIBs. The Fund's exposure to long-term PIBs stands at 57.4% of Fund size at the end of November 2012.
- CPI Inflation rate has declined sharply in FY13 and SBP has reduced discount rate by 2.5% cumulatively since June 2012from 12% to 9.5%. Despite lower interest rates, PPF continues to earn an attractive rate of return because of its high yielding portfolio of PIBs.



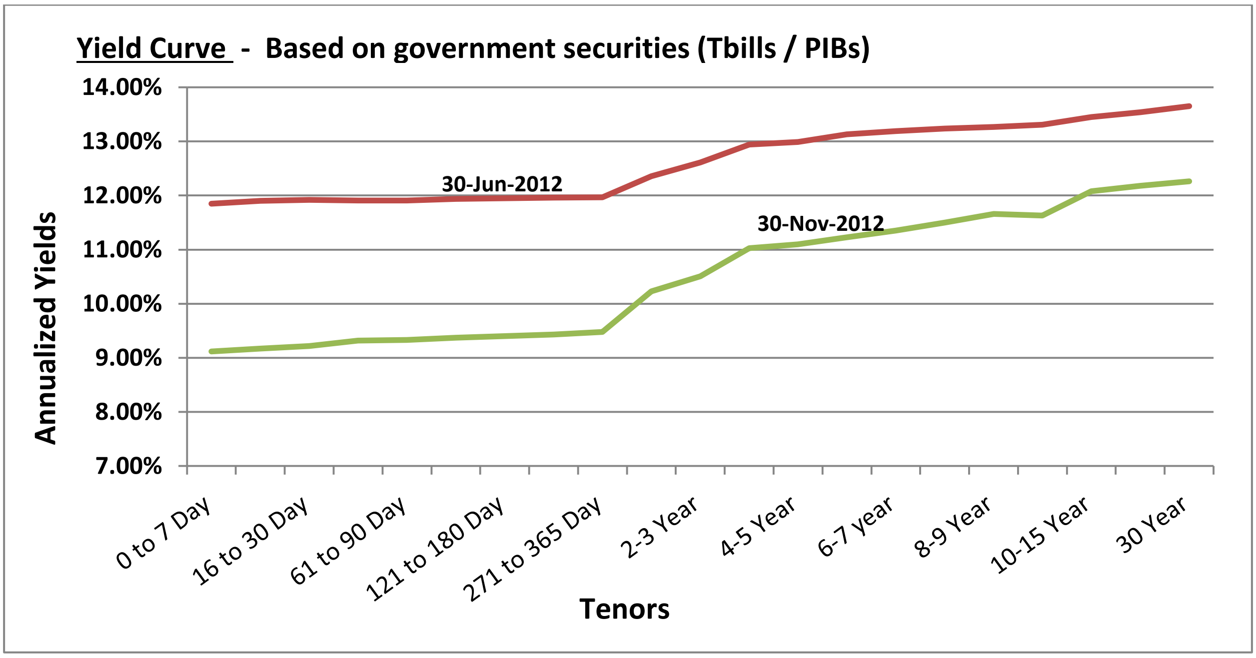
GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- We have constructed a liability index on the basis of next 30-year pension-related cash outflows as 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-Nov 2012	10.98%	23.97%	17.3	938.6	1.85%
Jul 2008 – Nov 2012 (CAGR)	15.22%	18.45%			

- 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-November FY13, interest rates declined by more than 1.5%, which resulted in a sharp increase in present value of liabilities (24%). Although Market value of Fund's assets also increased by 11% 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

- The country achieved GDP growth rate of 3.7% for FY12 which indicates that the economic growth improved over last year's revised growth rate of 3.0%, but still missed the target of 4.2%.
- The economic performance of the country has weakened as a result of both domestic and external factors. As far as domestic factors are concerned, the continuing energy sector crises, poor law and order situation, inability of the Government in implementing tax reforms and high government borrowings all remained hurdles in the way of economic growth. On external front the difficult

global economic environment does not help the prospects of domestic economic growth.

- 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 percent annually, and projected an economic growth rate of 3.25 percent for FY13.
- If the real GDP growth rate is netted with population growth rate (2), there is almost no improvement in overall standards of living in the country.
- 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. Only domestic debt servicing increased by a whopping 82% when 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 6.4% of GDP in FY13.

EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US $

	Jul-Oct FY12	Jul-OctFY13	Growth %
Current Account	**(1.66)**	**0.26**	**116**
Trade balance(Goods)	(5.40)	(5.00)	7
Trade balance (Services)	(0.95)	0.04	105
Income transfers (net)	(0.87)	(1.09)	(25)
Remittances	4.32	4.96	15
Capital Account	**0.03**	**0.04**	**38**
Financial Account	**0.12**	**(0.34)**	**(397)**
Net Errors & Omissions	**0.12**	**(0.42)**	**(466)**
Overall Balance of Payments	**(1.39)**	**(0.47)**	**66**

Source: SBP

- Although the Current Account posted a deficit of USD 177 million in October 12; but on cumulative basis, during the period July-October 2012, it recorded a surplus mainly on the back of USD 1.12 billion received on account of CSF (Collation Support Fund) and a healthy growth in remittances.
- Trade balance improved by 7% on the back of 1% increase in exports and a decline of 2% in imports. Services balance also turned into positive due to receipt of long awaited CSF payments.
- Current transfers continued to provide much needed support on the back of healthy remittances. Remittances were up by 15% during the period July-Oct FY12compared with the same period of last year.
- During Jul-SepFY13, Capital & Financial Accounts were unable to attract any inflows. There was actually a net outflow.
- The overall Balance of Payments remained negative USD 470 million .

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
Sep-2012	8.8	0.8	10.4	7.6	0.7	9.8	9.7	0.9	10.8
Oct-2012	7.7	0.4	10.1	5.8	-0.1	9.3	9.1	0.7	10.7
Nov-2012	6.9	-0.4	9.9	5.3	-0.3	8.9	8.1	-0.4	10.5
12 month high	12.3	1.8	12.0	11.3	2.2	14.4	13.1	1.9	11.0
12 month low	6.9	-0.7	9.9	5.3	-2.2	8.9	8.1	-1.7	10.2

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

- YOY CPI declined to 6.9% in November 2012, which is not only significantly lower than market expectations but also lowest since the CPI index has been rebased. The cumulative increase in CPI index for the first five months of FY13 was only 1.43%.
- This was mainly due to lower food group inflation which was 4.7% on YoY basis. Perishable food items were mainly responsible for MoM and YoY decrease in food inflation and overall CPI.
- The transport sub index contributing 7.2 percent to the CPI basket is down by 5.5% on MoM basis which also caused lower overall CPI. Decrease in CNG prices could be the main reason behind this decrease.
- Another major driver of lower inflation is Housing & Fuel index which has30% weight in overall CPI and posted a growth of only 4.15% on YoY basis.
- As far as future outlook in concerned, the likelihood of meeting of annual target of 9.5 percent set by government has increased.
- IMF in its recent review on Pakistan economy projected CPI in the range of 10% 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
Sep-2012	10.4	0.4	10.8	10.4	0.5	10.9
Oct-2012	10.1	1.2	10.7	9.7	0.7	10.7
Nov-2012	9.7	0.2	10.7	8.8	0.2	10.5
12 month high	11.4	1.4	10.8	11.7	1.3	11.7
12 month low	9.7	0.2	10.0	8.8	0.2	10.5

[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 are lower on both YoY & MoM basis. However, the 12 month moving average of both measures remains above 10% which indicates that the longer term trend in core inflation is still intact.

- 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
Aug-2012	-2.3	4.4	2.4	3.1	7.9	9.9	-11.4	-2.0	-9.4
Sep-2012	-0.7	0.9	0.2	3.6	0.9	7.4	-8.2	0.7	-11.2
Oct-2012	0.3	-1.9	-1.0	1.2	-2.7	5.4	-1.3	-0.4	-11.2
12 month high	13.1	4.5	29.2	25.5	7.9	32.2	-1.3	4.2	25.0
12 month low	-12.9	-8.1	-1.0	-11.9	-11.2	5.4	-14.7	-3.4	-11.2

Source: IMF

- The MOM inflation numbers for September and October 2012 suggest a softening of commodity prices as the global economy continues to falter.

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
Sep-2012	10.01	11.61	11.43	12.69	10.22	11.69
Oct-2012	9.28	11.41	11.04	12.61	9.51	11.49
Nov-2012	9.48	11.21	11.63	12.57	9.54	11.30
12m high	12.07	13.22	13.34	13.52	12.06	13.23
12m low	9.28	11.21	11.04	12.57	9.51	11.30

Source: SBP, Reuters

- Market Interest rates have been decreasing since June 2012, in line with the reduction in discount rate.
- Future course of interest rates remains quite uncertain.
    - Recent decrease in headline inflation and SBP's renewed emphasis on reviving private sector credit suggests that interest rates may remain at these levels or even decline further in the near future.
    - The underlying fundamentals of the economy, including high fiscal deficit, power shortages, rising oil prices and fragile external account position & exchange rate, suggest that inflation and interest rates may rise within a few months.
- Despite lower inflation numbers, the long-term bond yields are rising again which is evident from the yield of 11.63% at the end of November compared with the yield

of 11.04% at the end of October. This suggests that market is expecting higher inflation over the long-term.

- In its Monetary Policy Decision dated 14 December 2012, SBP reduced the discount rate by another 0.5% from 10% to 9.5%. Key points of the Monetary Policy Statement are summarized below:
    - External Account Deficit until October 2012 is small. However, the stress on the External Account is increasing due to smaller financial inflows and substantial debt repayments.
    - Exchange rate has come under pressure. Rupee has depreciated by 3.3% during the current financial year. Continuation of this trend has adverse implications for domestic inflation. In order to stabilize the exchange rate, it is important that the return on rupee denominated assets is attractive relative to foreign currency assets.
    - YOY growth in money supply stands at 17.8% which is a cause of concern and may lead to inflationary pressures in future.
    - During second quarter of FY13, government has again resorted to borrowing from SBP which is inflationary in nature. Tax collection must increase in order to enable the government to lower its deficit and borrowing.
    - Private sector credit remains muted. This is a major concern because the future productivity of the economy is dependent on private sector investment.
    - CPI is declining faster than the earlier projections. This is attributable mainly to lower food prices.
    - Lower inflation and weak private sector credit have created justification for a reduction of 0.5% in discount rate.

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.
- In its next meeting, the Investment Sub-Committee will debate a few more amendments to the governing documents. The amendments are aimed at expanding the investment options, improving the investment process and providing more flexibility in pursuing investment strategies according to the prevailing economic environment.

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