



Government of the Punjab
Punjab Pension Fund



Dated: 07 November 2013

MONTHLY REVIEW OF INVESTMENTS

October 2013

FUND SIZE

- A summary of changes in fund size during FY14 is given in the following table:

Rs. millions (rounded to the nearest million)

	1ST July - 31ST October 2013
Beginning fund size (30 th June 2013)	17,585
Add: Contribution during the period	-
Less: Transfer to Reserve Pension Fund	-
Add: Gains during the period	675
Less: Expenses during the period	(7)
Ending fund size	18,253

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 2012		30 Jun 2013		31ST Oct 2013	
	Amount	%	Amount	%	Amount	%
PIBs	9,480	60.7	9,560	54.3	9,379	51.4
T-Bills	139	1.0	-	-	1,293	7.0
Short term bank deposits	5,349	34.3	5,928	33.7	-	0.0
National Saving Schemes	-	-	1,831	10.4	1,891	10.4
Corporate bonds/TFCs	501	3.2	246	1.4	599	3.3
Cash at bank	130	0.8	11	0.1	5,087	27.9
Other assets*	6	0.0	9	0.1	4	0.0
Total Fund Size	15,605	100.0	17,585	100.0	18,253	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.



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FUND'S PERFORMANCE

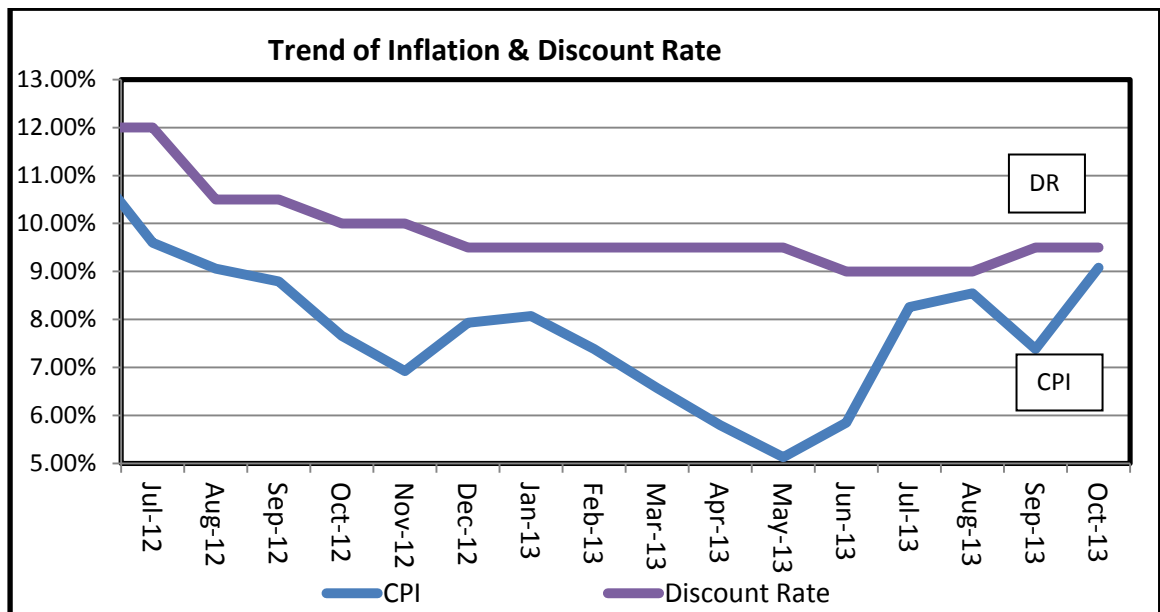
- Time Weighted Return (TWR) earned by PPF is summarized as under:

Period	Annualized Return for the period		Year End Discount Rate	CPI Inflation	Long-term Benchmark CPI Inflation + 3%
	Gross Return	Net Return*			
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%
FY 2012-13	12.85%	12.69%	9.00%	5.85%	8.85%
Jul 2008 - Jun 2013 (CAGR)**	13.85%	13.67%	12.14%	11.17%	14.17%
July-October 2013	11.82%	11.70%			
October 2013	11.79%	11.68%			

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

**CAGR means Compound Annualized Growth Rate

- In order to lock-in high yields for a long period of time, the Fund has 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 3.0% cumulatively (from 12% to 9%). However, the government has recently announced considerable upward adjustments in electricity, gas and petroleum prices. Further sales tax also has been increased; all these steps are expected to increase inflation in coming months. The YoY inflation has already started to accelerate since May 2013. In its recent Monetary Policy Statement (MPS), the SPB has revised discount rate by 50 basis points to 9.5% from 9.0%. The next MPS is expected to be announced by end November 2013, and there are expectations of further increase in discount rate.





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- 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

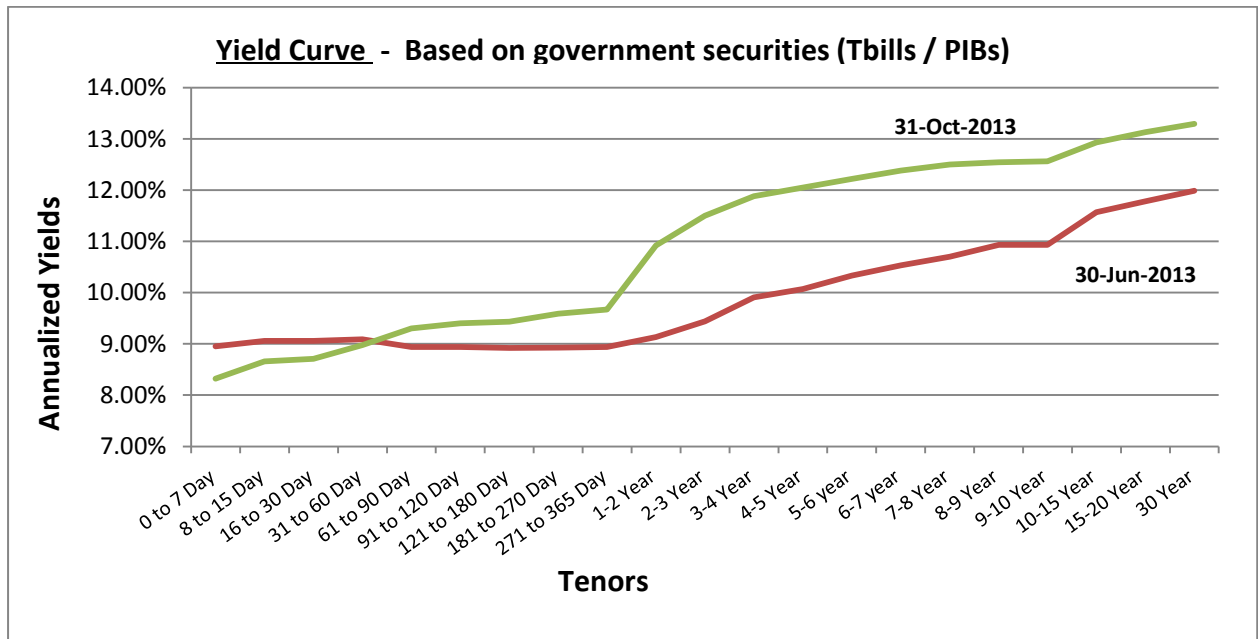
- We have constructed a liability index on the basis of next 30-year pension-related cash outflows projected by the Actuary of the Fund. The index captures the growth in the present value (computed at market rates of interest) of next 30-year liabilities.
- The following table summarizes the amount & growth of market value of Fund's assets vis-à-vis the amount & growth in present value of 30-year pension liabilities of GoPb:

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	10.81%	-2.88%	13.4	608.9	2.19%
FY 2011-12	16.86%	25.40%	15.6	757.1	2.06%
FY 2012-13	20.46%	38.96%	18.8	1052.1	1.79%
Jul-Oct FY14	-1.05%	-10.44%	18.6	942.3	1.98%
Jul 2008 - Oct 2013 (CAGR)	13.95%	17.54%			

- 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-October FY14, long term interest rates reversed with the expectations of resurgence in inflation. The long-term interest rates (yield on 10-yr PIBs) which were below 11% at the end of FY13 have touched 13%; the shift in yield curve is shown in graph below. This has resulted in a decrease of 10.44% in present value of liabilities. Although Market value of Fund's assets also declined by 1.05% during the same period, the decline in present value of liabilities is much higher than decline in market value of assets, which has resulted in a significant improvement in funding ratio. This occurred because there is a substantial Duration Gap 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.



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REVIEW OF IMPORTANT ECONOMIC & FINANCIAL VARIABLES

GDP GROWTH

- Pakistan's economy is facing a cycle of low growth and high inflation since last several years. GDP growth during FY13 fell to 3.6 percent from 4.4 percent in FY12. Fundamental issues like energy shortages and worsening law & order situation did not allow the country to achieve its economic potential.
- Prospectus of a sustainable global economic recovery also weakened in the wake of a likely slowdown in US and a protracted recession in the euro area. Even the emerging economies, led by China, Brazil, India and Russia, are expected to experience a relative slowdown. This weak global economic situation has implications for the domestic economy as it results a grim outlook of exports and lower investment related foreign inflows.
- The real investment to GDP ratio declined for the fifth consecutive year declined to 8.7% in FY13. A relentless increase in fiscal borrowings and a secular decline in both domestic and foreign investments, are not allowing the country to invest in order to increase its future productivity.
- IMF has projected that Pakistan's real GDP growth is estimated at 2.5 percent for the current financial year 2013-14. However, the government of Pakistan has projected 4.4 percent GDP growth rate for the same period.
- World Bank in its recent study warned that unemployment among the growing younger population is rapidly increasing and has become a most critical issue. In order to create sufficient number of job opportunities, Pakistan's GDP must growth 5 to 6 percent for a foreseeable future on consistent basis.



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EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US \$

	Jul-Sep FY13	Jul-Sep FY14	Growth %
Current Account	0.44	(1.23)	(381)
Trade balance(Goods)	(3.63)	(4.42)	(22)
Trade balance (Services)	0.11	(0.75)	(795)
Remittances	3.60	3.93	9.1
Capital Account	0.03	0.05	73
Financial Account	0.41	0.07	(83)
Overall Balance of Payments	0.78	(1.01)	

Source: SBP

- The Current Account posted a huge deficit of USD 1.23 billion during the first quarter of FY14 as compared to USD 440 million surplus during the same period last year. Last year's current account surplus was due to inflows of over USD 1 billion of Collation Support Fund (CSF) from the US.
- Although the trade balance on services worsened by 795%, but a 22% deterioration in trade deficit was main responsible for the situation due to its large quantum.
- Trade balance for the period deteriorated by 22% attributed to 9% surge in imports and a merely 1% increase in exports.
- Services balance worsened by a massive 795%, mainly because of absence of Collation Support Fund inflows; and a 10% increase in import bill of services.
- Current transfers continued to provide much needed support on the back of healthy remittances. Remittances were up by 9% during the July-September FY14 compared with the same period of last year.
- Capital and financial account continued to deplete in the absence of any significant capital and financial inflows and high loan repayments to IMF. However, the likelihood of receiving higher financial flows has increased given that a new IMF program has been approved for Pakistan in September 2013. This would not only ease pressure on foreign exchange reserves but also provide comfort to other international donors.
- The State Bank of Pakistan has projected that the external current account deficit is expected to remain USD 3 billion or 1.2% of GDP for FY14.



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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
Aug-2013	8.5	1.2	7.2	10.3	2.0	7.3	7.3	0.6	7.2
Sep-2013	7.4	-0.3	7.1	7.9	-1.5	7.3	7.0	0.6	7.0
Oct-2013	9.1	2.0	7.2	9.8	1.7	7.7	8.6	2.2	6.9
12 month high	9.1	2.0	9.8	10.3	3.0	8.9	8.6	2.2	10.5
12 month low	5.1	-0.4	7.1	5.3	-1.5	7.1	4.1	-0.4	6.9

¹12 month moving average Source: FBS, SBP.

- CPI for the month of October 2013 recorded at 9.1% on YoY basis, which is its 15 month high, as compared to the same period of last year. On MoM basis overall CPI surges by 2%, on the back of sharp rise in both food and non-food prices.
- A key driver towards the high MoM Non-Food inflation is revision in Housing, Water, Electricity, Gas & Other Fuel Index which has a significant share of 29.4% in overall CPI basket, and increased by 4.07% on MoM basis.
- As far as higher Food group MoM rise is concerned, Perishable food items were solely responsible for this, although they have only 5% weightage in overall CPI but surged by 8.82% on MoM basis.
- This upward pressure in prices was expected because the government had increased electricity and fuel prices recently. Further, there is another phase of passing on electricity & Gas prices on consumers as government agreed with IMF. Currency depreciation will also cause increase in domestic prices despite no significant increase in commodity prices globally.
- The Government has set an inflation target of 8 percent for FY14. However, State Bank of Pakistan, in its recent Monetary Policy Statement, projected inflation 11 to 12 percent for FY14.

- 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
Aug-2013	8.5	0.6	9.2	7.9	0.6	8.6
Sep-2013	8.7	0.6	9.0	7.6	0.6	8.3
Oct-2013	8.4	0.9	8.9	9.0	0.8	8.2
12 month high	10.0	1.5	10.7	9.9	1.2	10.5
12 month low	7.8	0.2	8.9	6.7	0.2	8.2

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

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



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- NFNE inflation recoded 8.4% on YoY and 0.9% on MoM basis, which states that general CPI is higher due to food and energy prices. Otherwise inflation is not as much higher in ex-food & energy items.
- Trimmed inflation also increased by 9% on YoY and 0.8% on MoM basis; it is also due to non-inclusion of outliers which is again food & energy items.
- 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-2013	3.3	2.6	-1.9	6.4	4.2	-1.9	-2.3	-0.3	-1.5
Aug-2013	0.1	1.2	-1.7	1.0	2.4	-2.1	-1.5	-1.2	-0.6
Sep -2013	-1.0	-0.3	-1.7	0.7	0.6	-2.4	-4.3	-2.2	-0.3
12 month high	5.2	2.7	-1.0	7.0	4.2	5.4	4.5	2.2	-0.3
12 month low	-9.1	-3.8	-4.9	-12.0	-4.1	-4.9	-4.3	-3.0	-11.2

Source: IMF

- Due to continued slowdown in economic growth around the world, commodity prices showed a nominal decline both on YoY & MoM basis in September 2013. The break-up shows that on MoM basis, fuel/energy related commodities recorded an increase of 0.6% whereas non-fuel commodities recorded deflation of 2.2%.
- 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% in dollar terms may actually mean inflation of 9% in rupee terms. However, the impact of currency depreciation on domestic prices is reflected with some time lag.

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
Aug-2013	9.30	9.38	12.02	11.54	9.15	9.46
Sep-2013	9.71	9.35	12.96	11.66	9.51	9.40
Oct-2013	9.67	9.39	12.56	11.79	9.57	9.41
12m high	9.71	11.21	12.96	12.57	9.58	11.30
12m low	8.94	9.35	10.80	11.51	9.08	9.40

Source: SBP, Reuters



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- In its last Monetary Policy Statement dated 13 September 2013, the State Bank of Pakistan (SBP) increased the Discount Rate by 50 basis points to 9.5% from 9.0%.
- The inflation for the month of August was 8.5% which has increased to 9.1% by October end. SBP also predicted in September's MPS that inflation for FY14 will remain 11 to 12 percent. Due to higher inflation projection, expectations of further rate increase have been built in secondary market yields. We expected another 50 to 100 basis points increase in discount rate in coming MPS which is going to be announced by end of November 2013.

INVESTMENT STRATEGY

- Current portfolio of the Fund is based on the expectations that inflation and interest rates will increase. Our expectations of reversal in inflation have also started realizing as CPI reversed since start of FY14. We expect this trend to persist in coming months. The liquid portion of Fund's portfolio will be used to capitalize on any opportunity to lock in securities at higher returns as rates go up; however, in an upward interest rates scenario, the Fund may not be able to post a decent real return over inflation.

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