Government of the Punjab

Punjab Pension Fund

Dated:12 November 2012

MONTHLY REVIEW OF INVESTMENTS
October 2012

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-OctoberFY13
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	701
Less: expenses during the period	(8)
Ending fund size	**16,298**

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 Oct 2012**	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
PIBs	8,942	65.2	9,480	60.7	9,347	57.4
T-Bills	1,254	9.1	139	1.0	-	-
Short term bank deposits	3,002	21.9	5,349	34.3	6,072	37.3
Corporate bonds/TFCs	501	3.7	501	3.2	240	1.5
Cash at bank	8	0.1	130	0.8	635	3.9
Other assets*	1	0.0	6	0.0	4	0.0
Total Fund Size	**13,708**	**100.0**	**15,605**	**100.0**	**16,298**	**100.0**

*Other assets include prepaid expenses for management of PPF and bookvalue 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 and bank deposits.
- PPF keeps switching exposure between T-bills & short-term bank placements in pursuit of higher rates of return.

FUND'S PERFORMANCE

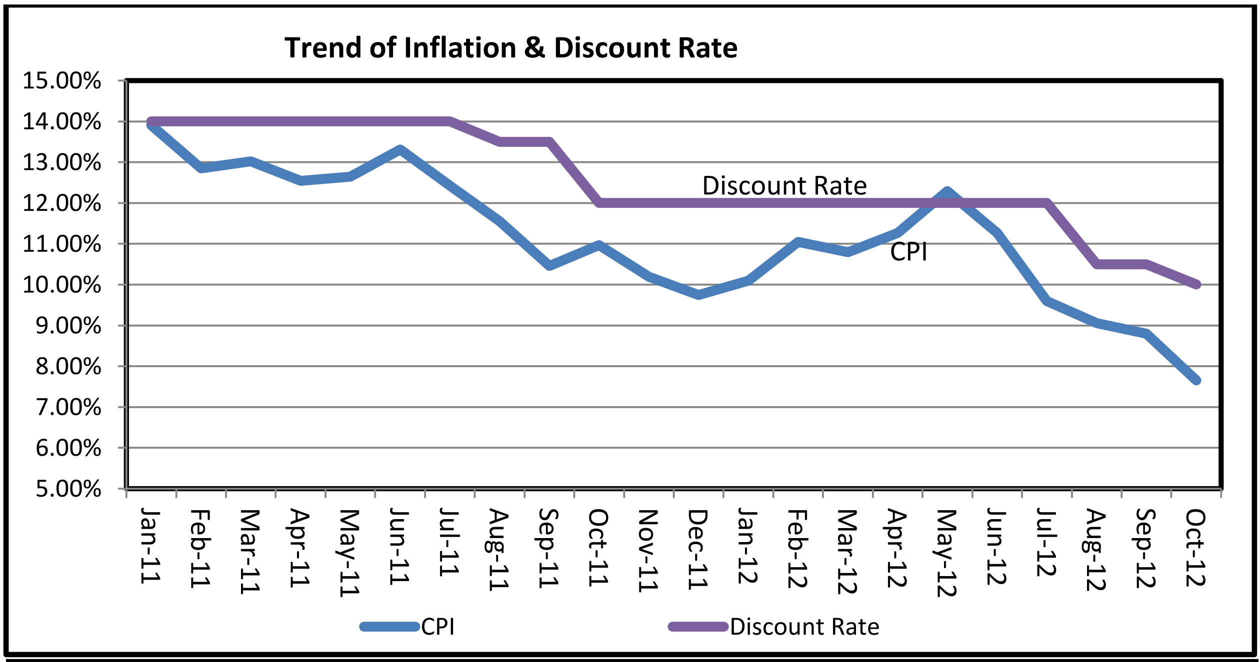
- Time Weighted Return (TWR) earned by PPF is summarized as under:

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%
FY 2011-12	13.96%	13.79%	11.26%	14.26%
Jul 2008 - Jun 2012 (CAGR)**	14.10%	13.92%	12.54%	15.54%
July - October 2012	13.93%	13.77%		
October 2012	12.88%	12.72%		

*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 has 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 October 2012.
- CPI Inflation rate has declined sharply in FY13 and SBP has reduced discount rate by 2% cumulatively since June 2012 from 12% to 10%. Despite lower interest rates, PPF continues to earn an attractive rate of return because of its high yielding portfolio of PIBs and TDRs.

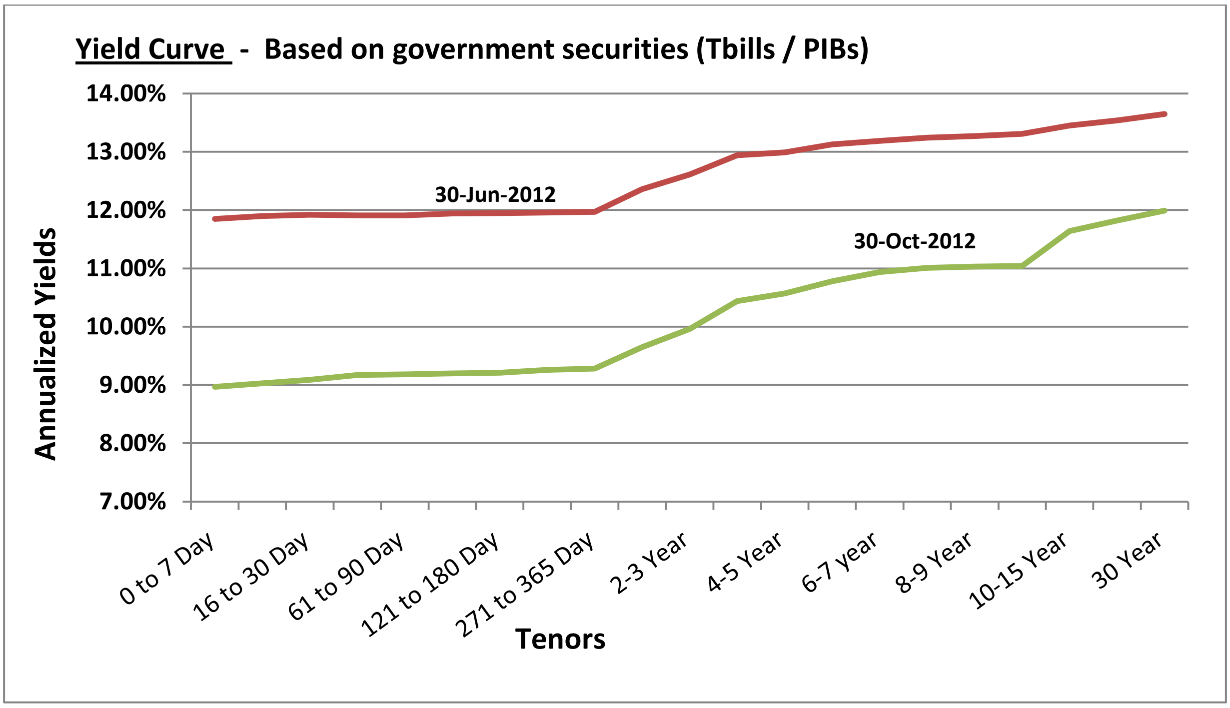


GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- 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-Oct 2012	11.23%	28.80%	17.4	975.2	1.78%
Jul 2008 – Oct2012 (CAGR)	15.59%	19.89%			

- 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 FY13, interest rates declined by more than 1.5%, which resulted in a sharp increase in present value of liabilities (28.80%). Although Market value of Fund's assets also increased by 11.23% during the same period, but growth in market value of assets fell 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 there is a difficult global economic environment which does not help the prospects of domestic economic growth.
- The average GDP growth rate of last four years is 2.87% which is the lowest growth achieved by Pakistan during a 4-year period over the last 5 decades.
- The economy needs a growth rate of 5-6% p.a. in coming years in order to meet the growing requirements of employment.
- IMF, in its recent report, showed serious concerns on economic performance of the country, and projected an economic growth rate of 3-3.5 percent for FY13.

FISCAL MANAGEMENT

- As per the latest fiscal numbers released by ministry of finance, total deficit of Pakistan for the full year- FY12 stood at 6.6% of GDP which excludes the payment of Rs. 391 billion made to settle a portion of the circular debt.If that amount is included, the budget deficit climbs to 8.5% of GDP.
- 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 IMF estimates, fiscal deficit will remain 5.5 to 6% of GDP in FY13.

EXTERNAL ACCOUNT

- Balance of payments is summarized in the following table:

Billion US $

	Jul-Sep FY12	Jul-Sep FY13	Growth %
Current Account	**(1.34)**	**0.43**	**132**
Trade balance(Goods)	(4.16)	(3.63)	13
Trade balance (Services)	(0.75)	0.30	140
Income transfers (net)	(0.65)	(0.75)	(17)
Remittances	3.30	3.60	9.2
Capital Account	**0.03**	**0.02**	**(32)**
Financial Account	**0.54**	**(0.01)**	**(102)**
Net Errors & Omissions	**0.01**	**(0.46)**	**(3407)**
Overall Balance of Payments	**(0.76)**	**(0.02)**	**97**

Source: SBP

- Although the Current Account posted a deficit of USD 331 million in September 12; but during the first quarter Jul-Sep of FY13, it recorded a surplus mainly on the back of USD 1.12 billion received on account of CSF (Collation Support Fund).
- Although, both imports and exports declined but the overall trade deficit improved by 13% as the imports declined by 7% as compared with only 2% decline in exports.
- Current transfers continued to provide much needed support on the back of healthy remittances. Remittances were up by 9.2% during the 1st quarter of FY13 compared with the same period of last year.
- During Jul-Sep FY13, Capital & Financial Accounts were unable to attract any significant inflows.
- The overall Balance of Payments remained flat on the back of Current Account surplus.

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**
Aug-2012	9.1	0.9	10.6	8.5	0.9	10.0	9.4	0.9	10.9
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	9.0	0.7	10.7
12 month high	12.3	1.8	12.4	11.3	2.2	15.3	13.0	1.9	11.0
12 month low	7.7	-0.7	10.1	5.8	-2.2	9.3	9.0	-1.7	10.2

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

- YOY CPI for the month of October 2012 further eased to 7.7% which was significantly lower than market expectations. This was mainly due to lower food group inflation which was 5.8% on YoY basis.
- Another major driver of lower inflation is Housing & Fuel index which has 30% weight in overall CPI and posted a growth of only 4.17% on YoY basis.
- 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**
Aug-2012	10.8	0.3	10.8	10.6	0.4	11.1
Sep-2012	10.4	0.4	10.8	10.4	0.5	10.9
Oct-2012	10.8	1.8	10.8	10.0	0.8	10.8
12 month high	11.5	1.8	10.8	11.7	1.3	12.1
12 month low	10.2	0.3	9.9	10.0	0.3	10.8

[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

- NFNE inflation recorded increase both on YOY and MOM basis. The 1.8% MOM increase in non-food non-energy prices is the highest MOM increase over the last 12 months. This indicates that inflationary pressures are widespread in the non-food non-energy items.
- Trimmed Mean inflation decreased slightly on YOY basis but increased on MOM basis.
- 12-month moving average, which reflects the long-term trend, stands at 10.8% in case of both the core inflation measures. This also suggests persistence of inflationary pressures in both the core measures of inflation.
- 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**
Jul-2012	-10.7	4.5	4.9	-10.0	4.7	12.5	-11.8	4.2	-6.9
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
12 month high	14.8	4.5	29.7	25.5	7.9	32.2	-0.7	4.2	28.2
12 month low	-12.9	-8.1	0.2	-11.9	-11.2	7.4	-14.7	-7.4	-11.2

Source: IMF

- On MoM basis the commodity prices have been increasing with fuel commodities leading the price increase.
- The inflation outlook in international market is still unclear as the developed world is struggling with recession while geo-political situation is pushing up energy prices.

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-2012	10.34	11.86	11.71	12.82	10.51	11.94
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
12m high	12.07	13.36	13.34	13.62	12.06	13.36
12m low	9.28	11.41	11.04	12.61	9.51	11.49

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 are set to rise within a few months.

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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