Government of the Punjab

Punjab Pension Fund

Dated: 10 October 2012

MONTHLY REVIEW OF INVESTMENTS

September 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-September 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	531
Less: expenses during the period	(6)
Ending fund size	**16,130**

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		30 Sep 2012	
	Amount	%	Amount	%	Amount	%
PIBs	8,942	65.2	9,480	60.7	9,251	57.4
T-Bills	1,254	9.1	139	1.0	1,447	9.0
Short term bank deposits	3,002	21.9	5,349	34.3	2,154	13.3
Corporate bonds/TFCs	501	3.7	501	3.2	342	2.1
Cash at bank	8	0.1	130	0.8	2,935	18.2
Other assets*	1	0.0	6	0.0	1	0.0
Total Fund Size	**13,708**	**100.0**	**15,605**	**100.0**	**16,130**	**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 and bank deposits.
- PPF keeps switching exposure between T-bills & short-term bank placements in pursuit of higher rates of return.

FUND'S PERFORMANCE

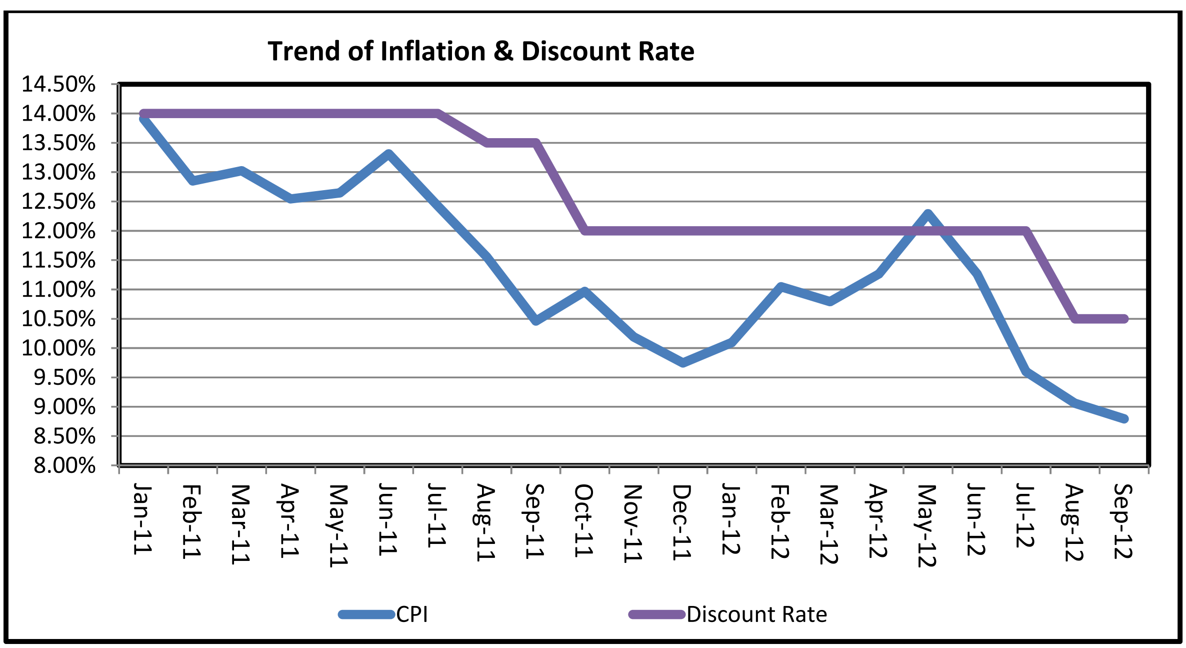
- Time Weighted Return (TWR) earned by PPF is summarized as under:

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 – September 2012	14.29%	14.12%		
September 2012	14.86%	14.68%		

*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 September 2012.
- CPI Inflation rate has declined sharply in FY13 and SBP has slashed discount rate by 200 basis points cumulatively since June 2012 from 12% to 10%. Despite lower interest rates, PPF continues to earn a handsome rate of return because of its high yielding portfolio of PIBs and TDRs.

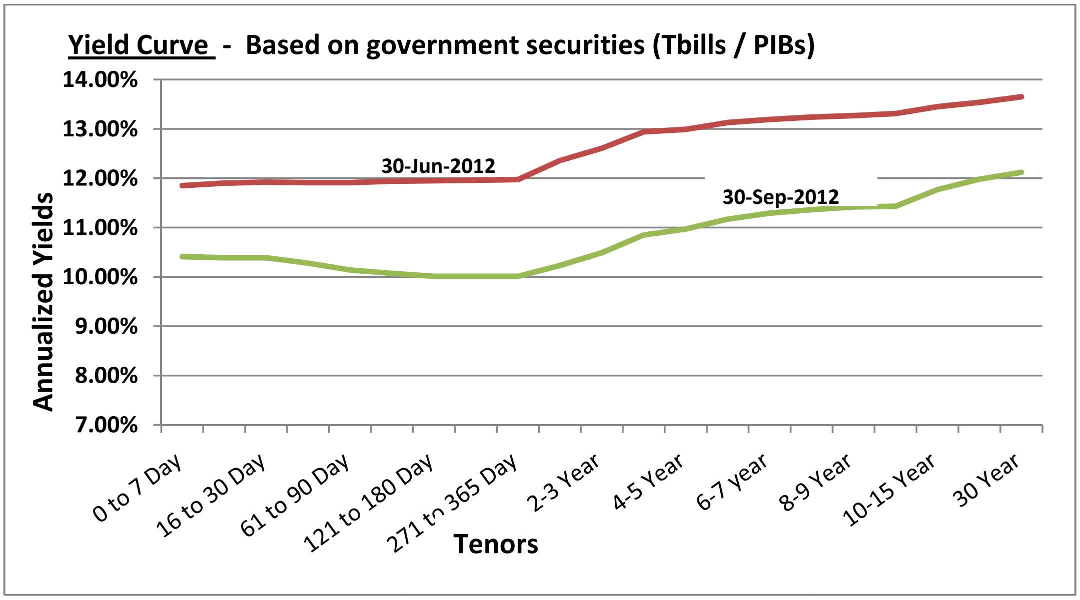


GROWTH IN ASSETS vs. LIABILITIES AND FUNDING RATIO

- 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%
July-September 2012	9.23%	24.63%	16.6	905.8	1.84%
Jul 2008 – Sep 2012 (CAGR)	15.43%	19.39%			

- 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 first quarter of FY13, interest rates declined by more than 1.5%, which resulted in a sharp increase in present value of liabilities (24.63%). Although Market value of Fund's assets also increased by 9.23% 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

1) 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 as well as 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 also 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 over a 4-year period during 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-Aug FY12	Jul-Aug FY13	Growth* %
Current Account	**(0.26)**	**0.92**	**452**
Trade balance(Goods)	(2.53)	(2.41)	5
Trade balance (Services)	(0.44)	0.66	251
Income transfers (net)	(0.35)	(0.39)	(11)
Remittances	2.41	2.46	2.4
Capital Account	**0.00**	**0.01**	**550**
Financial Account	**0.36**	**(0.58)**	**(263)**
Overall Balance of Payments	**(0.03)**	**0.02**	**171**

Source: SBP

- Current account posted a surplus in August 12 as the country received long awaited USD 1.12 billion of CSF (Collation support program).
- The current account surplus for the first two months of FY13 stood at USD 919 million as compared to deficit of USD 261 million during the same period of FY12.
- Although, both imports and exports declined by 5%, but the trade deficit improved by 5% as the quantum of imports is about ~1.6 time of exports.
- Current transfers continued to provide much needed support on the back of healthy remittances.
- During Jul-Aug FY13, capital & financial account were unable to attract any significant inflow rather there was a net outflow. However, the overall balance of payment 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**
Jul-2012	9.6	-0.2	10.8	9.1	1.8	10.4	10.0	-1.7	11.0
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
12 month high	12.3	1.8	12.8	11.7	2.2	16.2	13.0	1.9	11.0
12 month low	8.8	-0.7	10.4	7.6	-2.2	9.8	9.4	-1.7	10.2

[1]12 month moving average

Source: FBS, SBP.

- CPI for the month of September 2012 further eased to 8.8% which is significantly lower than market expectations and lowest since Dec 2009. The MoM inflation was up by 0.8%.

- On YoY basis, CPI inflation remained relatively lower than expectations largely because of lower food group inflation driven mainly by low growth in Housing & Fuel index which has 30% weightage in overall CPI and posted a growth of only 4.37%.

- 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**
Jul-2012	11.3	1.0	10.7	10.7	0.7	11.4
Aug-2012	10.8	0.3	10.8	10.6	0.4	11.1
Sep-2012	10.5	0.4	10.8	10.4	0.5	10.9
12 month high	11.5	1.4	10.8	11.7	1.3	12.1
12 month low	10.2	0.3	9.9	10.4	0.3	10.9

[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 the measures of core inflation remained in double digits on YoY basis which suggests that the lowering of headline CPI inflation does not reflect a broad-based decrease in 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
Jul-2012	11.87	12.11	13.06	12.95	11.99	12.18
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
12m high	12.07	13.49	13.34	13.77	12.06	13.51
12m low	10.01	11.61	11.43	12.69	10.22	11.69

Source: SBP, Reuters

- Market Interest rates have come down after State Bank's decision to lower the discount rate by 2% cumulative since June 2012, from 12% to 10%.
- 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.
- It its recent Monetary Policy Statement, SBP further reduced the discount rate by 50 basis point to 10% from 10.5%. The main points of the MPS are as under;
    - SBP re-emphasized its focus on spurring economic growth and job creation.
    - SBP referred to its policy stance as an incentive for private sector to borrow and invest, and also to influence the behavior of scheduled banks to improve their intermediary role and increase the supply of credit to private sector.
    - SBP clearly mentioned that the effectiveness of the monetary policy in reviving economic growth is contingent on 1) improvement in availability of energy 2) comprehensive tax reforms and efficient fiscal management and 3) consistent foreign financial inflows to alleviate the balance of payment concerns.
    - Although double digit core inflation is still persisting, but the likelihood of meeting the 9.5% inflation target for FY13 has increased.

INVESTMENT STRATEGY

- Current portfolio of the Fund is well positioned to earn a decent 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.

(Abdul Rehman Warraich)
Head of Investments
Punjab Pension Fund

(Aquil Raza Khoja)
General Manager
Punjab Pension Fund