



Bank of Papua New Guinea

Presentation

By

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Bank of Papua New Guinea's Role in Managing the PNG Economy.

The Hon. Peter O'Neill CMG, Prime Minister of Papua New Guinea, Ministers from the Australian Government and Papua New Guinea, colleagues and distinguished guests.

In 2015 the PNG economy was planned to be the fastest growing economy in the world. While we might have lost this title, GDP is still projected to grow by 11%, and the current account is starting to show a substantive positive balance. The completion of the LNG project has already had positive impact on investor confidence. In addition to Exxon Mobil which has a long time interest in our oil and gas industry, some very well known large corporation like Total and Rapsol, have entered the oil and gas industry and are operating in the country. Added to this are companies operating in the other resource industries like Barrick, Newcrest, Harmony, PanAust, Anglo American and others. This is a clear vote of confidence in the Papua New Guinea economy.

The expected development of the Elk Antelope Gas Project by Total, the Wafi/Golpu Gold project by Newcrest and Harmony, the Frida River Copper and Gold project by PanAust, the Star Mountains Copper and Gold exploration by

Anglo American and Highlands Pacific, and the first ever experiment by Nautilus Minerals to mine gold from the sea floor, are placing Papua New Guinea in the forefront of countries engaged in resource exploration and developments. The confidence of such a large number of foreign investors in the country is enhancing the reputation of the country as a safe and attractive place to invest in.

In the last few months I met many investors, and all of them stressed that it is crucial for the future development of the resource sectors to maintain the strong commitment to the democratic principles Papua New Guinea is known to have, political stability, a transparent and stable taxation regime, and an independent legal system that protects the property rights of investors.

I want to add the Bank of Papua New Guinea's very strong support of this Government's increased spending and focus on Health and Education, to improve the very low social development indicators the country is ranked at the present. Spending on infrastructure is the other area this Government is concentrating on, and is very important to enable the development of the rural areas, where a great majority of the population of around 80% lives. As a developing economy, the development aspirations are huge. To achieve these development aspiration the 35% debt/GDP ratio need to be reviewed and adjusted.

The source of economic development and growth is narrow. It does not cover the great majority of the rural population. The Bank of Papua New Guinea is advocating the development of the agricultural sector, both farming and processing, for many years. I stressed repeatedly the need to introduce advanced technologies and innovative systems in our agricultural sector. Just very recently, the introduction of modern technologies in the agriculture sector enabled Papua New Guinea to reduce the cost of production, and have its first ever export of vegetables to overseas market.

We acknowledge the past contributions of our major development partners, specifically the Australian and the Japanese Governments, the Multinational Institutions like the Asian Development Bank, both the World Bank and the European Union and their subsidiaries, in our development effort, and urged

them to align their strategies to support this Government's development priorities.

One of the immediate needs of the country is project funding, especially in agriculture. As a result of very big losses incurred in the late 80th and early 90th of the previous century, banks are reluctant to advance loans to new project in the sector. The Bank of Papua New Guinea in close consultation and cooperation with the Government and the commercial banks will have to resolve it, to ensure that financial resources needed for the development of this very important sector are accommodated.

The liquidity in the banking system is very high. It is time to find ways to utilize it, for the development needs of the nation, both in the resource and non-resource industries. We look forward to implementation of the new legislation on Capital markets passed by Parliament, to develop the capital markets in PNG.

We have a very long way to go with Financial Inclusion of the great majority of the rural population. Like many other developing countries, the Bank of Papua New Guinea embarked on a very intensive financial education and awareness program. We aim to reach each and every one in the country and enable them to be included in the financial system. With today's technology of internet and mobile phone banking, it can be done at a reduced cost that even the low income earner's can afford.

The Bank of Papua New Guinea last year introduced an advanced Payments and Clearing System called Kina Automated Transfer System (KATS) to expedite the clearing of all transactions, and reduce the cost of all interbank activities. Since the introduction of KATS, we have seen reduction in fraudulent cheques, and increase in direct transfers between accounts. The next phase of our focus is on utilizing anti-money laundering module in KATS and development of a Central Switch.

Papua New Guinea is not an offshore center. It did not face problems with money laundering, from illegal flows of drugs and human trafficking. To ensure that we adhere to best International Standards and practices, the Department of Justice

and Attorney General, the Police and the Bank of Papua New Guinea, in very close cooperation with the financial system, introduced legislation and regulations, to ensure that we remain free of this vices as well as other money laundering players. One important component of this legislation is the establishment of Financial Analysis and Supervision Unit (FASU) in BPNG and separation of responsibilities between FASU and FIU (with Police). The FASU is now established at the BPNG.

Papua New Guinea has a floating exchange rate regime. As in many countries, the Bank of Papua New Guinea is intervening in the market to smooth uncalled sharp movements in the currency, without influencing the trend. Until mid 2012, the high International commodity prices of mineral and agriculture exports, combined with the large inflow of foreign currency for the construction of the PNG LNG project by Exxon Mobil, resulted in a continuous appreciation of the Kina. From mid 2012, the decline in commodity prices and the slowdown of expenditure on the construction of the LNG project, reduced the foreign currency inflows, and the exchange rate started to depreciate. The official exchange rate depreciated from US48 cents in 2012 to US43 Cents to the Kina, in mid 2014. In spite of BPNG's continuous intervention in the market, the banks decided to transact outside the official market, at exchange rates that ranged from US\$39 buy to US\$33 sell rate. It was clear that the BPNG could not agree to this margin of 600 basis points, and in June 2014, it used its regulatory powers to introduce a Trading Band of 150 basis points (75 above and 75 below) the official market rate.

In March 2015, the BPNG announced further measures relating to domestic and offshore foreign currency accounts, Vostro accounts for foreign banks and remittances. This follows our findings of unusual transactions conducted through these accounts. The exchange rate is continuing to devalue, and is at the present US35.95 cents to the Kina. It can be assumed that this trend might continue, at a much slower pace, until the end of this year, when we expect the exchange rate to stabilize. We are working with the Government to look at other sources of foreign currency to address the structural imbalance between supply and demand for foreign exchange

The level of foreign exchange reserves are at a comfortable level of US\$2.0 billion, sufficient to cover 7.0 months of total imports and 10.0 months of non mining and petroleum imports. Looking forward into the next five years, our projections show an increase in the foreign currency inflows, and increase in the reserves. We will deal with these inflows through the Sovereign Wealth Fund (SWF) which has been recently approved by Parliament.

The Sovereign Wealth Fund will have a positive effect of stabilizing the flows into the budget. Many see it as the solution to the Dutch Disease phenomena, of appreciation of the domestic currency and its impact on the traditional export sectors. While the SWF can be used as a stabilizer of the local currency, the best and most efficient solution is to develop the traditional domestic export industries, which in Papua New Guinea is the agriculture sector. Another area that should be supported consistent with Government policy is the SME sector dealing with light manufacturing of imported goods.

Once the education system will improve the technical and technological traits of the population, the development of other advanced industries will come on stream. The time will come when we will be in a state to diversify our rural based economy, to advanced industries.

Thank you all and God Bless