



Bank of Papua New Guinea

MARCH 2014 MONETARY POLICY STATEMENT

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BANK OF PAPUA NEW GUINEA

Port Moresby Chamber of Commerce & Industry

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Monetary Policy

The objective of monetary policy in PNG is to achieve and maintain price stability. This entails low inflation supported by stable interest and exchange rates. If achieved, price stability will lead to:

- Confidence in the kina exchange rate and management of the economy;
- A foundation for stable fiscal operations of the Government;
- Certainty for private sector businesses to plan for long-term investment and development; and
- A stable macroeconomic environment conducive to economic growth.



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Presentation Outline

- International Developments
- Domestic Economy & Prospects
 - Gross Domestic Product (GDP)
 - Inflation
 - Balance of Payments & Exchange Rate
 - Fiscal Operations
 - Monetary Aggregates
- Monetary Policy Stance
- Issues
- Financial Inclusion Initiatives



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International Developments

- The International Monetary Fund (IMF) projects global growth to be slightly higher, at around 3.7 percent in 2014.
- Growth in US is projected to increase in 2014, following a pickup in domestic demand, supported in part by a reduction in the fiscal cuts.
- The euro area is turning the corner from recession to recovery in 2014, due to easier credit conditions, increased confidence and high exports.
- In Asia, Japan is expected to slow more gradually reflecting the effects of the fiscal stimulus on confidence and private demand. China and India are projected to grow driven by domestic demand.
- Growth in Australia was supported by demand for minerals from China and India and is expected to slow down.



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International Developments

- Global inflation remained low in the first half of 2013.
- Most major central banks maintained an easy monetary policy stance (US, UK and Japan) while pursuing unconventional monetary actions – quantitative easing, extension of credit facilities, etc. – to stimulate economic activity.
- The European Central Bank and the Reserve Bank of Australia eased monetary policy in 2013.



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Gross Domestic Product

- The Bank projects Real GDP growth of 4.4 percent in 2014, lower than the budget forecast of 6.2 percent.
- This is attributed to the commencement of the Liquefied Natural Gas (LNG) production and implementation of Government's expansionary fiscal policy.
- The Government's expansionary fiscal policy is key to stimulating economic activity. It is important that it fully implements the 2014 Budget effectively and efficiently.



Inflation

- Annual headline inflation in December 2013 was 4.7%, lower than the Bank's forecast of 5.5% and higher than 3.5% recorded in September, reflecting higher import and excise duties, higher fuel and betelnut prices, and some pass-through of the exchange rate depreciation
- More competition, cheaper sources of imports and low domestic demand associated with winding down of the PNG LNG project construction mitigated the increase, resulting in the lower outcome.
- Underlying inflation measures were: trimmed-mean at 1.8% and exclusion-based at 5.9%
- Quarterly trend increased from 1.2% in September to 1.9% in December 2013.



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Inflation

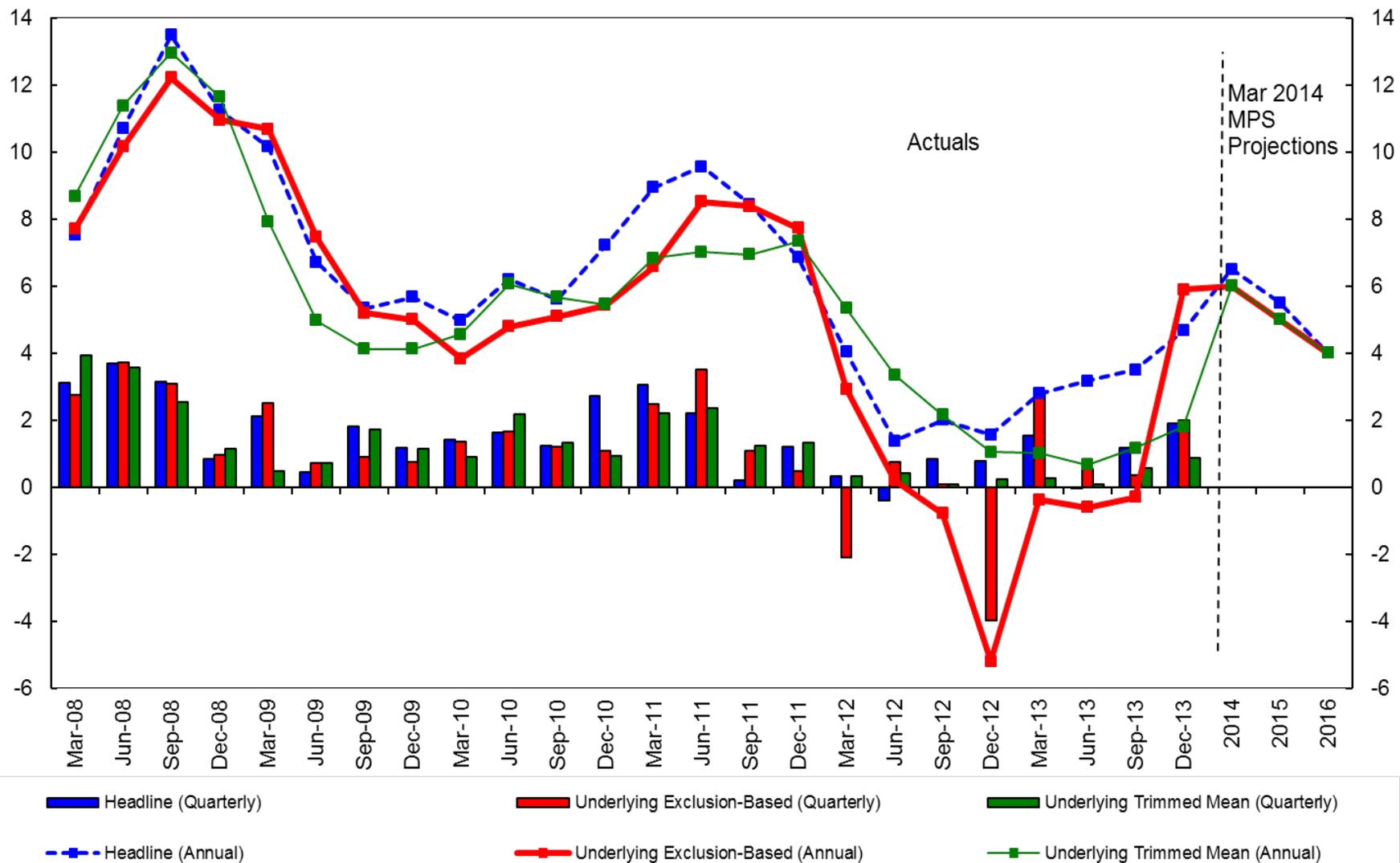
- The Bank maintains its annual headline inflation projection for 2014 to be around 6.5%.
- This is based on the assumptions of:
 - some imported inflation as the global economy improves; and
 - high domestic import demand

Upside risks: Any major Supply side shocks (bad weather conditions), further depreciation of the kina and higher than expected imported inflation from our trading partners.



Inflation

Chart 1: Consumer Price Index (percentage change)





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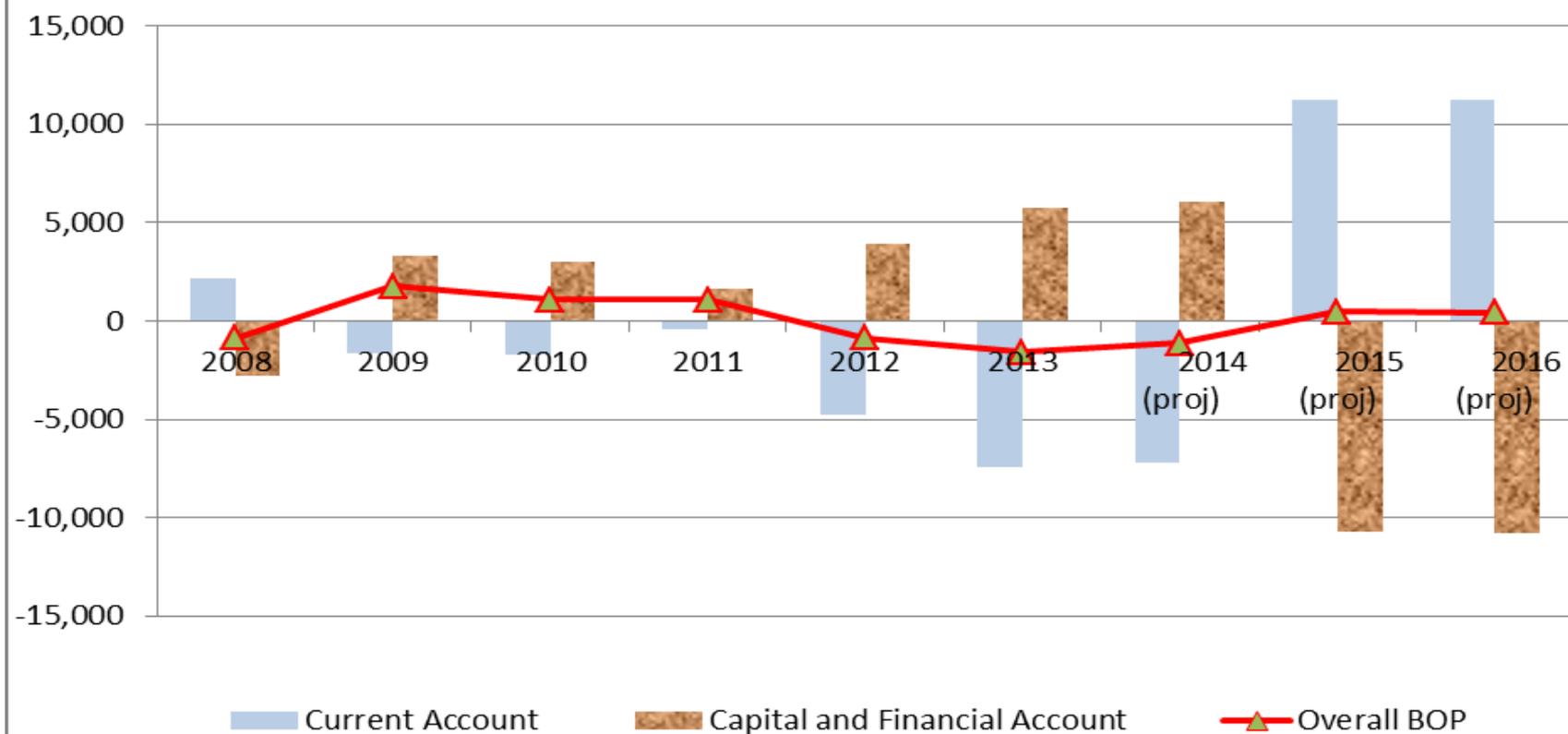
BOP & Exchange Rate

- The average kina exchange rate depreciated against the USD by 12.6% but appreciated against the AUD by 0.3% between December quarter of 2013 and 27th March 2014.
- In the interbank market, the kina stabilised at US\$0.4130 since the last quarter of 2013, after the Central Bank excluded forward orders from the interbank market.
- The overall balance of payments is projected to be a deficit of K1,143 million in 2014.
- As at 31st December 2013, the level of gross foreign exchange reserves was US\$2,854.7 (K6,912.1) million.
- By the end of 2014, the gross foreign exchange reserves are projected to be US\$2,785.5 (K6,744.6) million, sufficient for 5.3 months of total and 9.7 months of non-mineral import covers



Balance of Payments

Chart 2: Balance of Payments in K' Million

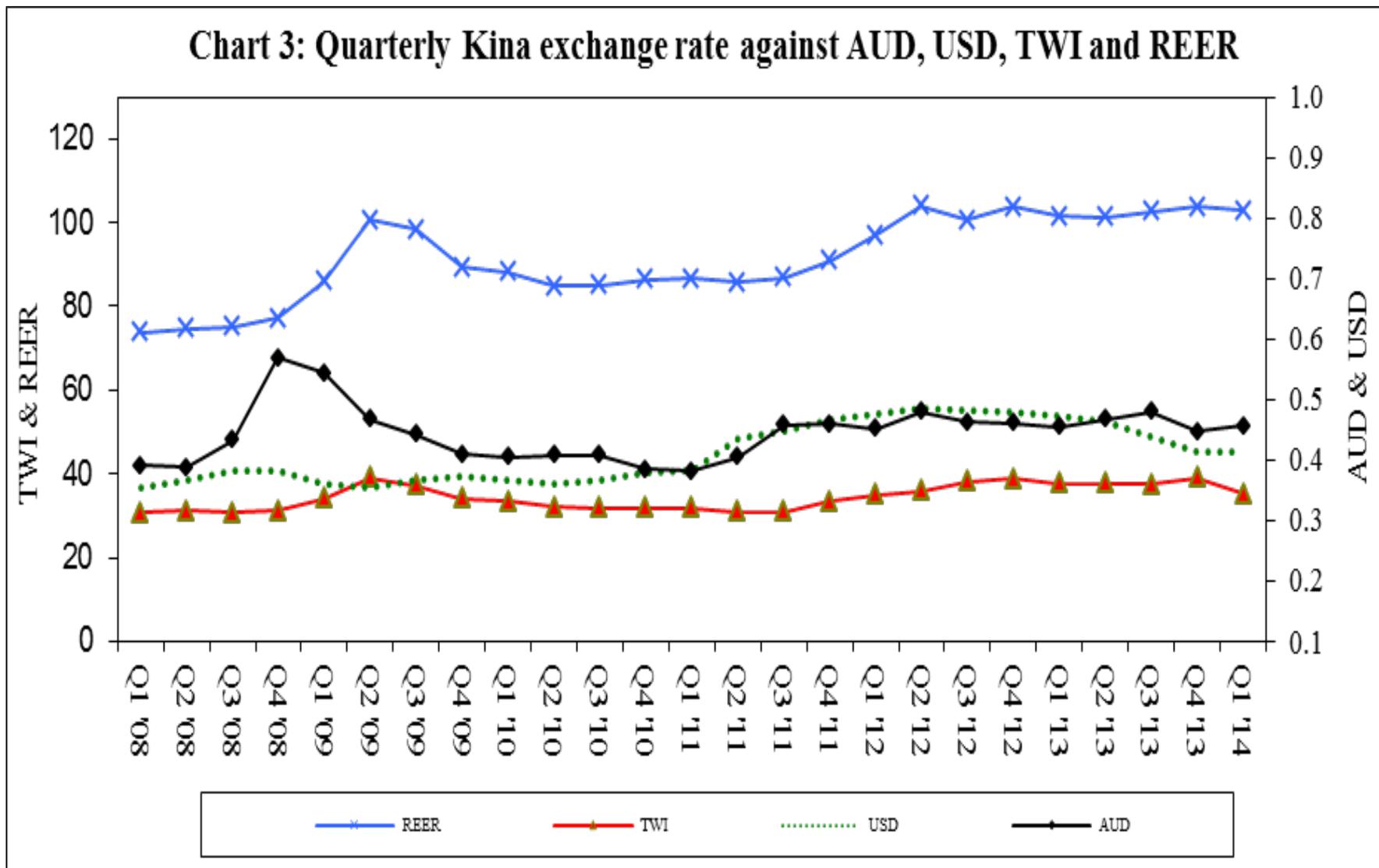


Source: Bank of PNG

Note: 2013 to 2015 includes flows related to the PNG LNG project, compared to the actuals, which do not include LNG figures.



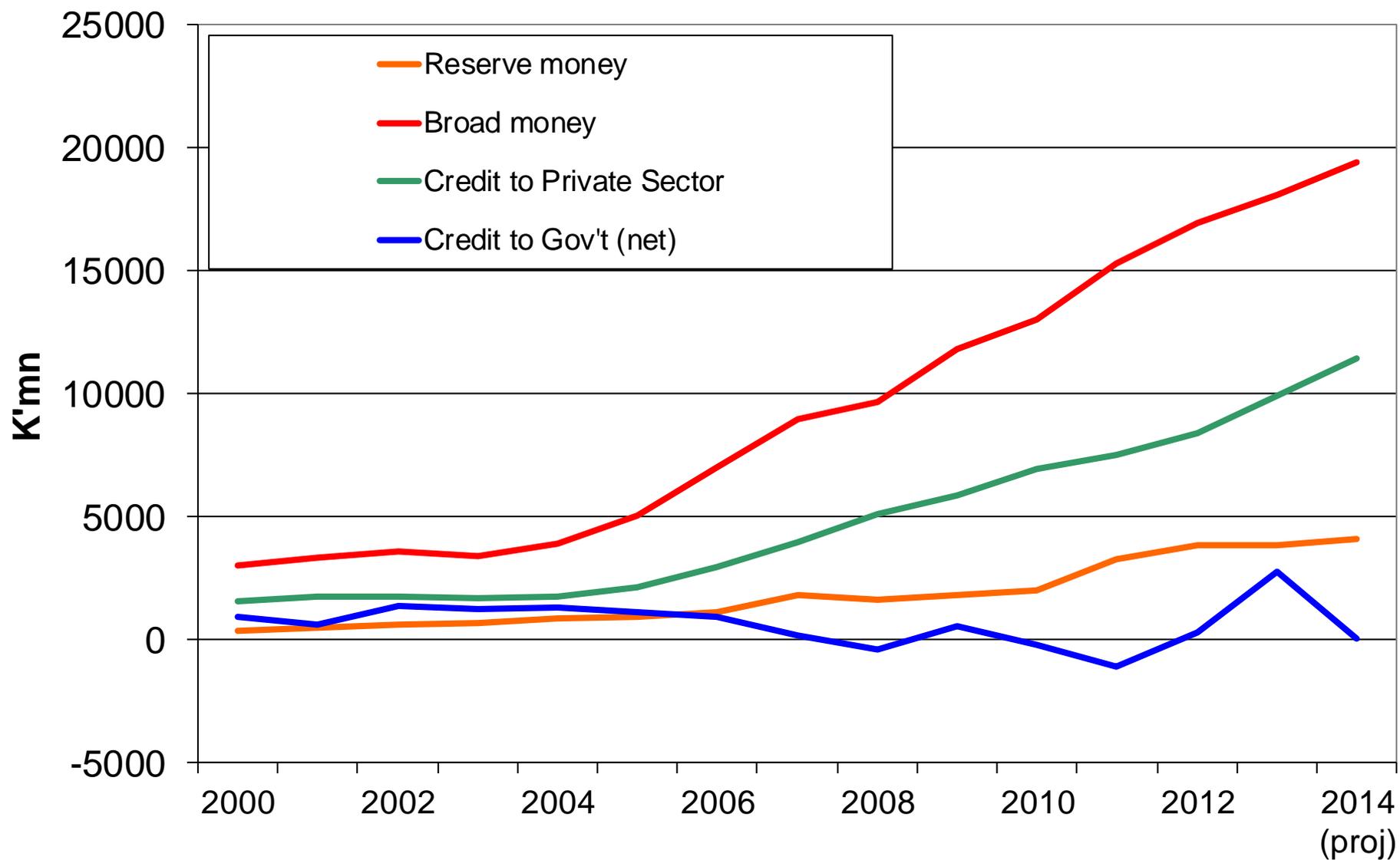
Exchange Rate





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Monetary Aggregates





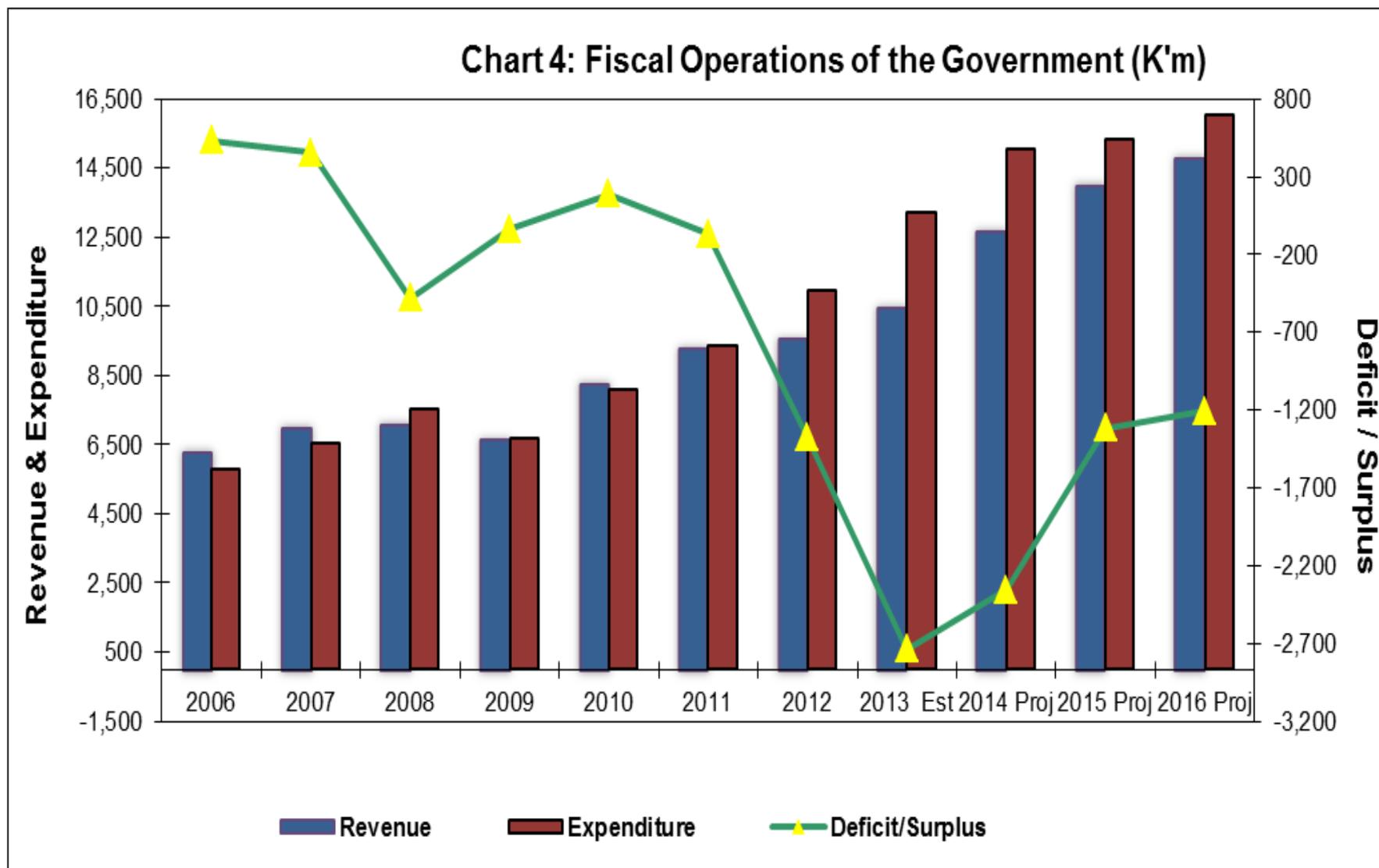
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Fiscal Operations

- The preliminary fiscal outcome for 2013 shows a deficit of K2,555.1 million.
- For 2014, the Government passed a K15,041.5 million budget with a deficit of K2,353.0 million or 5.9 percent of nominal GDP.
- The continued expansionary fiscal policy is intended to stimulate domestic economic activity in light of winding down of the construction phase of the PNG LNG project.
- As such, the Budget increased funding to Medium Term Development Plan enablers such as infrastructure, law and order, health and education services, including free education and free public health services.



Fiscal Operations





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Fiscal Operations

- Capacity constraints should be addressed to minimize the risk of inefficient spending and to avoid a build-up of deposits in the Government's accounts with the commercial banks.
- The Bank re-emphasises the need to transfer all budget-funded trust accounts of the Gov't to the Central Bank.



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Fiscal Operations

- To finance the budget deficit, the Government should continue to use domestic sources and concessionary foreign borrowing.
- Using domestic financing will generate benefits reflected in lower cost in real terms, fewer risks and the opportunity to develop the domestic financial market.
- There is sufficient liquidity in the banking system to finance the deficit as well as meeting private sector borrowing needs. However, there are exposure limits on government securities by major participants which may constrain domestic financing, as well as increase interest cost for the government.
- The Government can also resort to other ways of raising funds from domestic sources like listing its securities on in the stock market and private placement for targeted infrastructure funding.



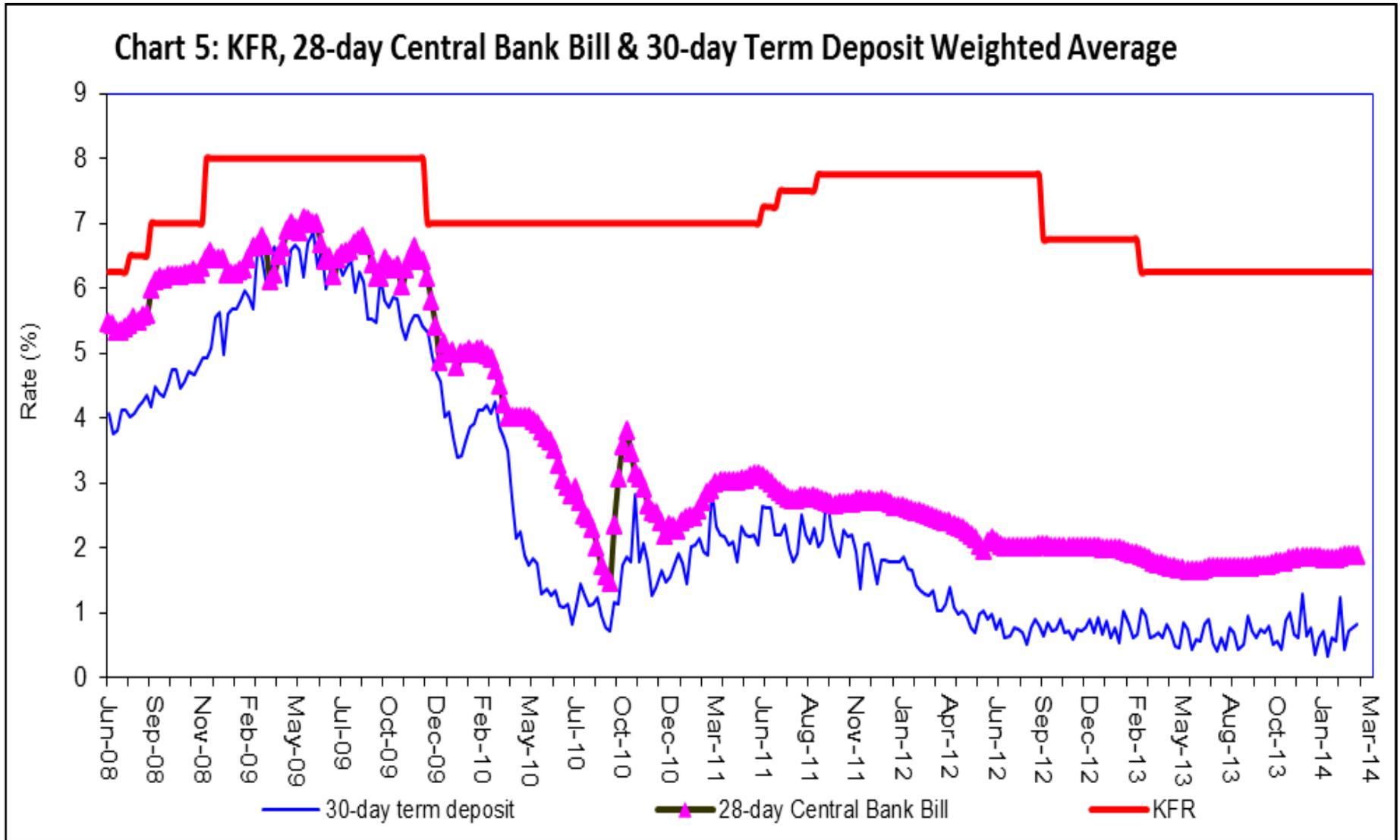
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Monetary Policy Stance

- The Bank took a cautious approach by maintaining the policy rate at 6.25 percent for most of 2013 in light of inflationary pressures, and to support economic activity.
- In light of the present economic circumstances as well as the future outlook, the current policy stance will be maintained for the next six months, but may be adjusted if developments in the economy and/or financial markets warrant it.
- The Bank is taking a cautious approach, mindful of the Gov't spending and potential inflationary pressure that this could cause.
- This stance also aims to encourage economic activity by supporting lending to the private sector, which has continued to grow steadily over 2013.



Key Interest Rates





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Review of Policy Signalling Rate

- BPNG have issue of transmission of policy intentions via KFR to market interest rates.
- Partly due to high liquidity overhang



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Issues

- Effective and efficient implementation of major infrastructure developments is key to ensuring the fiscal stimulus achieves its desired development outcomes.
- For this to happen, the Government must address capacity constraints faced by implementing agencies, which are still a major concern.
- The 2014 Budget increased funding to Medium Term Development Plan enablers such as infrastructure, law and order, health and education services, including free education and free public health service.
- These priority areas are expected to increase the future capacity of the country in sustaining economic growth and improvements in the welfare of its population.



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Issues

- The Government should not be constrained by the limits on its total debt, as long as this debt-financing is strategically targeted to developments and activities that increase the income generating capacity of the economy in the long term.
- This revenue generating capacity can then sustain future economic growth and repayment of debt.
- With the completion of the construction phase of the LNG project, the Government should coordinate its efforts and priorities towards utilizing the labour and capital that are released from the project.



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Issues

- In addition, the Government should continue to develop the agriculture sector and invest in vital infrastructure projects in order to enhance the productive capacity of the economy.
- A diversified agriculture sector, including downstream processing, can broaden the export base and build PNG's resilience to withstand external shocks by lowering instability in export earnings.
- Production and export of LNG will start in the second half of 2014.
- However, export receipts and revenue for the Government would be minimal and therefore expectations of windfall revenue and any associated kina appreciation might not materialize in the near term.



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Issues

- It is important that the Sovereign Wealth Fund becomes operational before LNG proceeds start to flow to the Government.
- This would assist in managing the LNG and other mineral revenues in a sustainable manner to help mitigate any *Dutch Disease* effects in years of significant foreign exchange inflows.



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Issues...contd

- Addressing issues relating to provision, reliability and costs of public utilities....open up sector.
- Addressing access to financial services through technology and innovation
- Enhancing competition in financial services
- Promoting good governance in boards and mgmt of financial institutions...PS
- Anti money laundering issues
- Financial Literacy and Education



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BPNG and Financial Inclusion

- The Bank continued with several initiatives on financial system and inclusive economic growth such as:
 - National Financial Inclusion and Literacy Strategy
 - Maya Declaration...1m new accounts..50% women.
 - Microfinance Expansion project and various surveys and studies
 - Youth savings campaign
 - Financial literacy
 - Financial Education
 - Mobile phone banking
 - Agent banking
- Facilitate reforms in financial sector
- Encouraging competition in provision of financial services
- New Savings and Loan Societies Act



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New Payment System

- The Kina Automated Transfer System (KATS) will facilitate real time settlement of transactions.
- Thereby improving efficiency and make payments safer and improve Government's cash flow management, reducing leakages and overhead costs and improve revenue collection and monitoring of expenditures.



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Thank You

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