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**PRESENTATION TO:**

**THE PNG INSTITUTE OF DIRECTORS**

**THE MARCH 2011 MONETARY POLICY STATEMENT**

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**THURSDAY 31<sup>ST</sup> MARCH 2011**

**VENUE: ROYAL PAPUA YACHT CLUB, PORT MORESBY**



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# Outline of Presentation

- Introduction
- Monetary Policy
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- Domestic Economy & Prospects
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- Risks & Issues for Price Stability
- Macroeconomic Management Agenda
- Outcomes of Macroeconomic Mgmt Measures
- Overall Macroeconomic Management - Summary
- Long Term Goal
- Monetary Policy Stance



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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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## International Developments

- Recovery in global economic growth continued during the second half of 2010, estimated at 5%.
- Slow recovery in industrialized economies, while emerging economies continued to expand at a rapid pace.
- Global economic growth projected to be 4.5 percent in 2011; industrialised economies by 2.5 percent, and emerging/developing countries by 6.5 percent (IMF).
- Threat to outlook: sovereign debt crises in European countries, disasters in Japan and recent political unrests in North Africa and Middle East.



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## International Developments

- Global inflation increased in 2010, driven mainly by higher commodity prices, as evident in the rising cost of food, minerals and energy products. Other factors: supply constraints associated with adverse weather conditions; increased demand due to global economic recovery; and weaker US dollar.
- Monetary policy was unchanged in the March quarter of 2011 to further stimulate economic growth, despite the inflation challenges.



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# Domestic Economy

- Strong growth of around 8.0% in 2010;
- Attributed to the construction of the LNG project and its spill-over effects to other sectors of the economy, higher Government funding on infrastructure, aggregate demand, capital formation and higher prices of export commodities.
- Projected growth of around 9.5% in 2011.
- Impact of LNG project and strong mineral sector
- Downside risks to growth prospects:
  - ✓ *any delays to the Ramu Nickel/Cobalt and the PNG LNG Projects;*
  - ✓ *a slowdown in the world economy resulting in lower commodity prices;*
  - ✓ *impact of the natural disaster in Japan on PNG's trade; and*
  - ✓ *adverse weather conditions (La Nina and El Nino).*



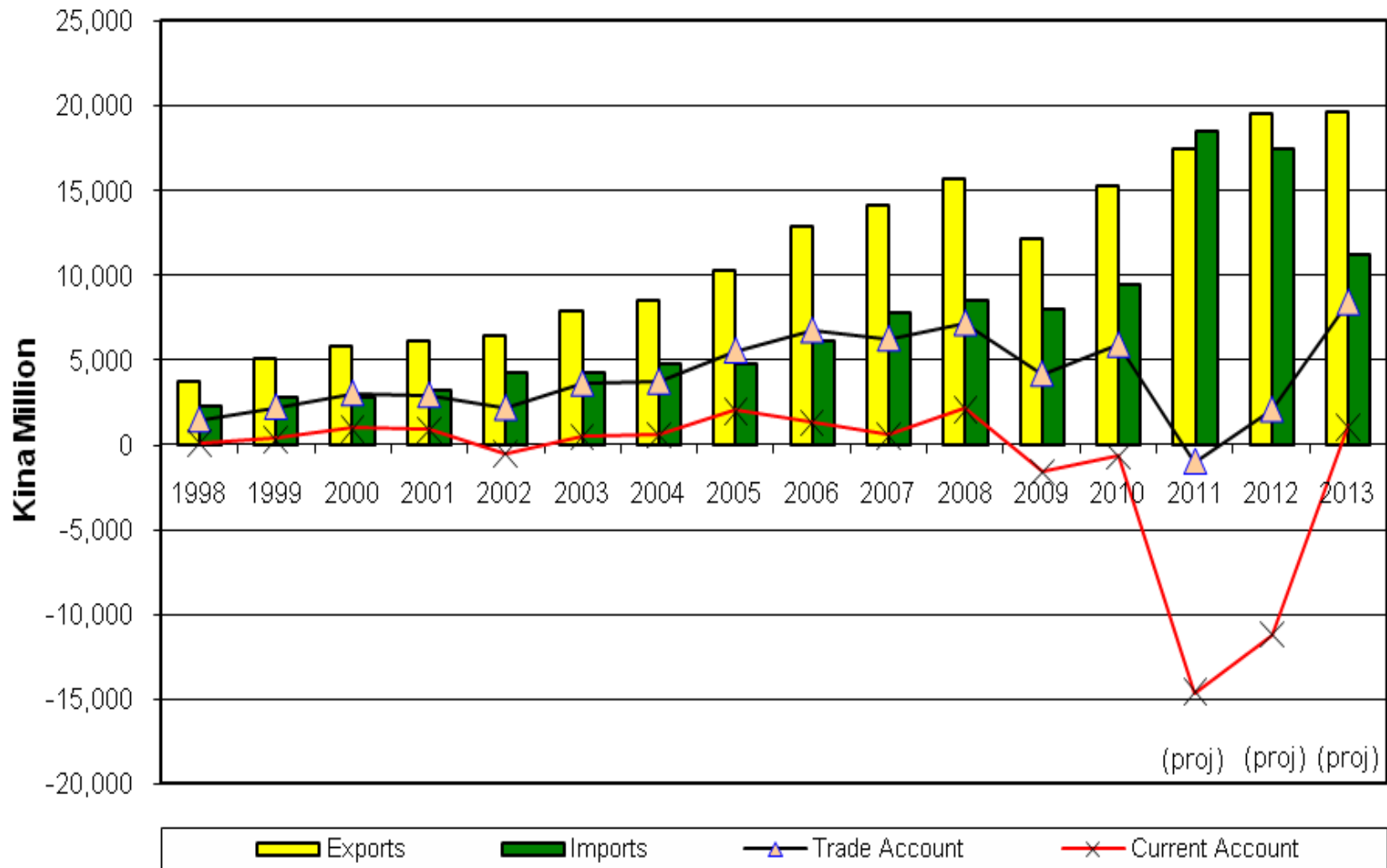
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# Key Macroeconomic Indicators

- **Slides:**
  - Balance of Payments
  - Fiscal
  - Trust Account & Gov't deposits
  - Exchange rate
  - Inflation
  - Monetary aggregates



**Chart 3: Current Account**







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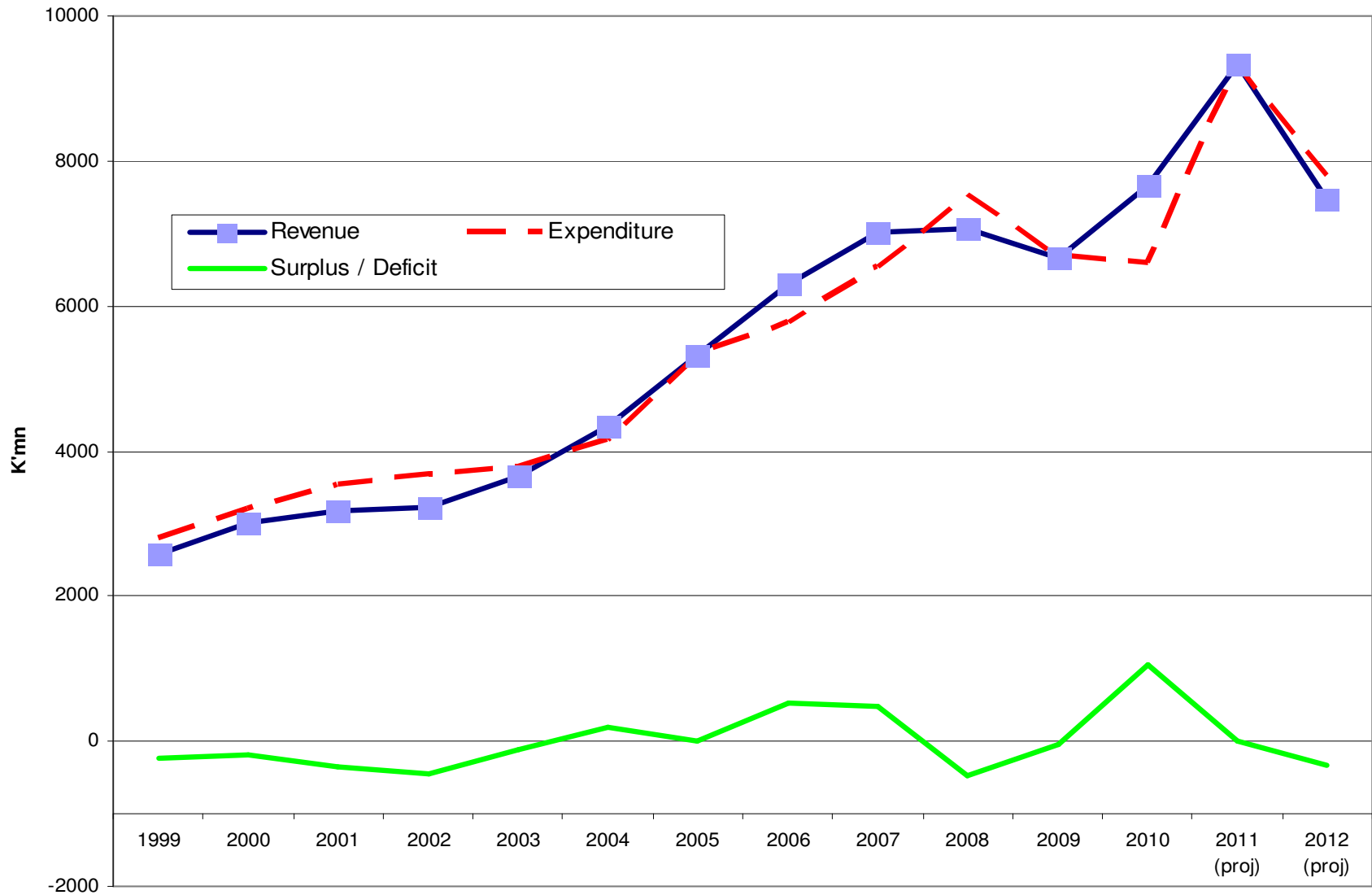
## International Reserves

- FX reserves were US\$3,146.5 (K8,169.60) million at end Dec 2010.
- Sufficient for 10.5 months of total and 14.4 months of non-mineral import covers.
- Today, around US\$3,174.2 (K 8,087.20) million.
- End 2011 to US\$3.6 billion.



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# Fiscal Operations of the Gov't

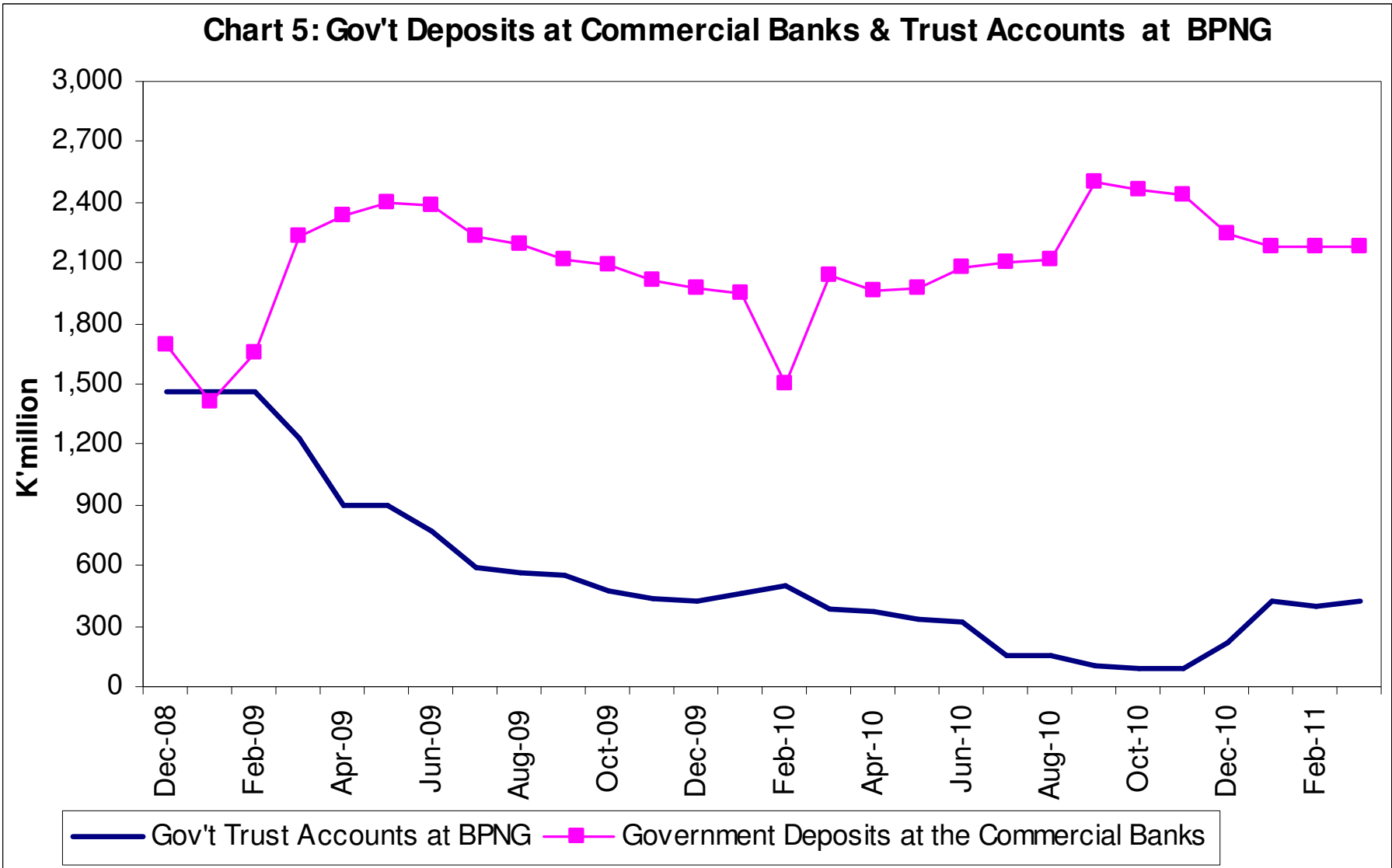




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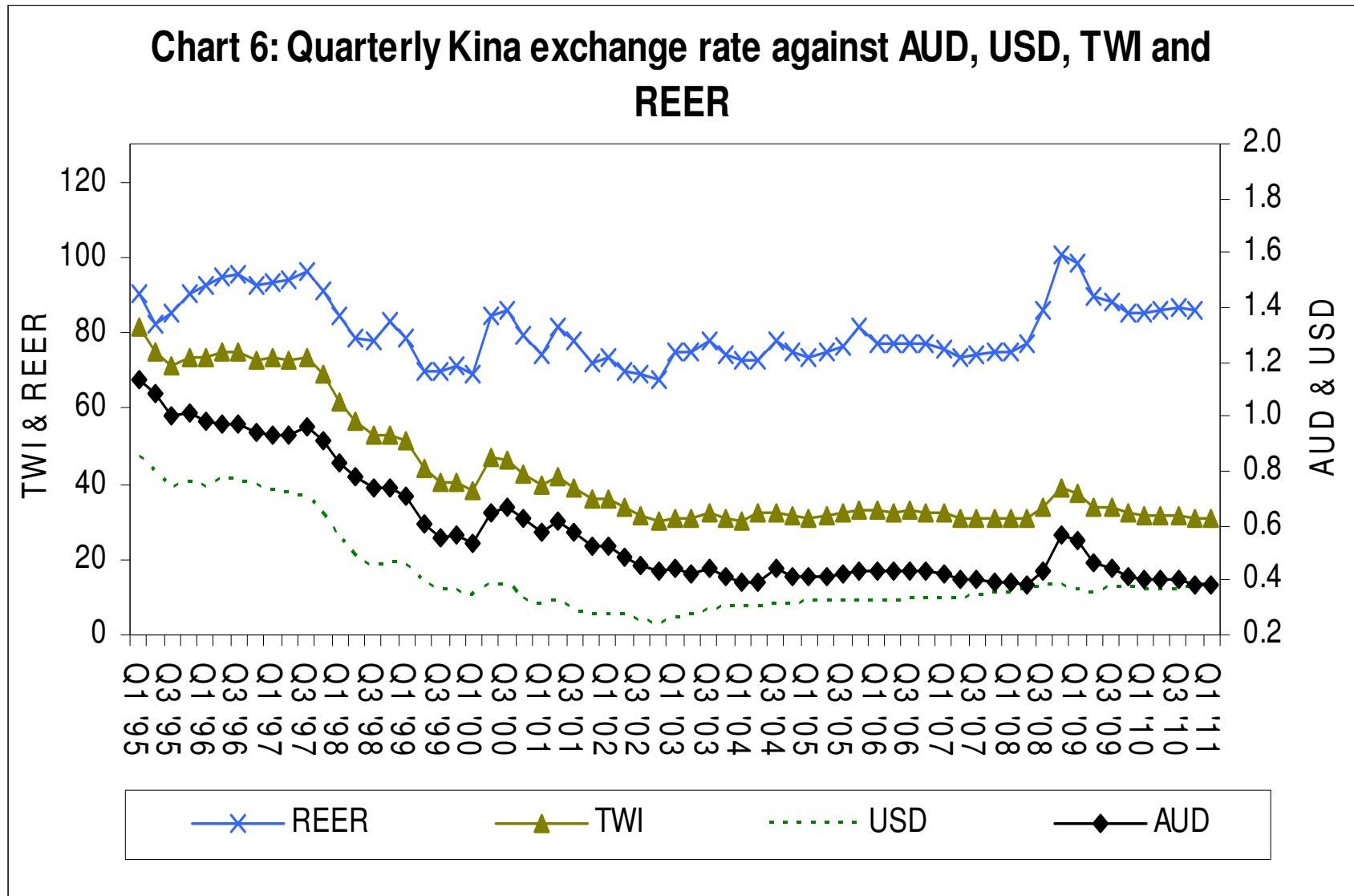
# Gov't Deposits, incl. Trust Accounts

Chart 5: Gov't Deposits at Commercial Banks & Trust Accounts at BPNG





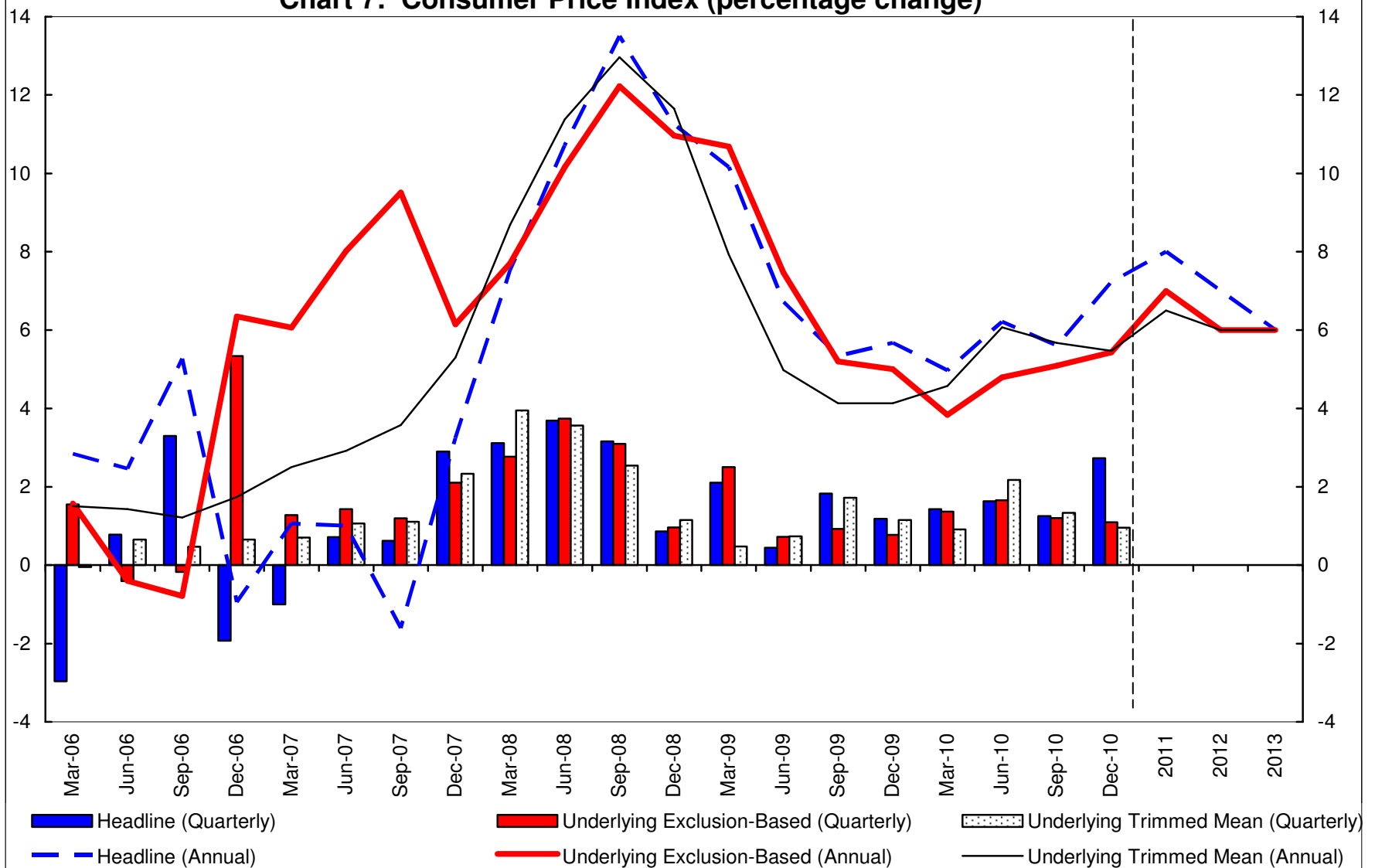
# Exchange Rate





# Inflation

Chart 7: Consumer Price Index (percentage change)





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# Inflationary Pressures

## Sources:

- Domestic demand pressures arising from capacity constraints to meet demand from LNG project & increased business activity, high commodity export prices and disposable incomes, high Government expenditures including trust accounts & LNG landowner payouts and wage increases.
- Growth in monetary aggregates non-inflationary.
- These can be managed by domestic policies



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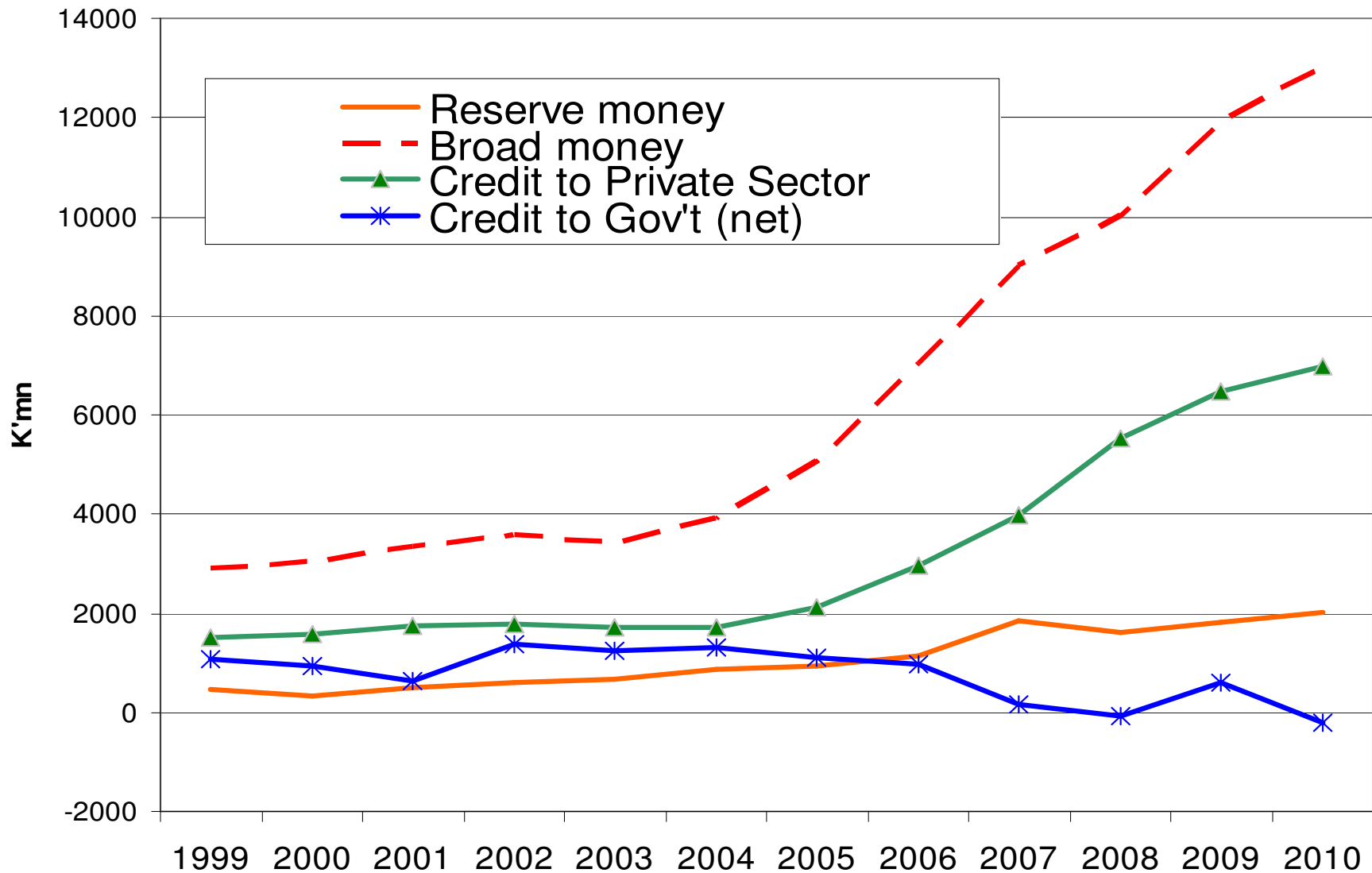
# Inflationary Pressures

- Now external pressures due to recovery of global economy, increasing food & oil prices, exacerbated by political unrests in North Africa & Middle East & disasters in Japan.
- PNG is price taker and will import these price increases. Difficult to avoid/manage.



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# Monetary Aggregates







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# Risks and Issues for Price Stability

- **Government to adhere to 2011 Budget and medium term fiscal plan:**
  - avoid further appropriation of windfall tax revenue to increase expenditures
  - avoid further use of trust accounts
  - allow BPNG to open account overseas to manage windfall mineral tax revenue prior to establishment of SWF
- **Trust Accounts:**
  - maintained at BPNG;
  - transfer some existing balances from commercial banks to BPNG for liquidity management
  - close monitoring to control draw down and management
- **Placement of securities on tap for public with interest costs to be appropriated and paid for by Government in 2012 Budget.**



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# Macroeconomic Management Agenda

- Government to refrain from competing with the private sector on the limited production resources (crowding out) engaged in LNG project as it may lead to:
  - *Increase costs*
  - *Lower quality of work output*
  - *Increase potential for mismanagement of funds*
- Government to concentrate on improving the social indicators (health, education, law and order) and encourage local business.
- Focus on development of the traditional industries esp., agriculture sector, which can mitigate the Dutch Disease.
- Build up capacities and improve performance of implementing agencies.



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# Macroeconomic Management Agenda

- Gov't should give priority to maintenance to deteriorating physical infrastructures.
- prepare for the utilization of the expertise (physical and human resources) that are built up by the LNG project development, to be efficiently and productively used as and when they are released from the project.
- private sector to behave prudently and responsibly in passing on the lower import good prices sourced from lower cost countries like China, India and other developing nations to consumers.
- Responsible Gov't agencies to tighten up on monitoring of price movements.



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## Other Reforms

- Other necessary reforms necessary for transmission of benefits of development to population:
  - *Revamp the national payments and settlement system*
  - *Financial Inclusion and education programs*
- BPNG ready to lead these reforms with support from stakeholders
- Other reforms to public institutions to enhance competition & service delivery



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## Expected outcomes of macroeconomic management measures

- Acceptance and implementation of macroeconomic management agenda can help to minimise incidence of Dutch Disease.
- Inflation contained below double digit level during LNG construction phase
- Prudent management of revenue from LNG project through SWF will ensure sustainable, efficient, and productive use that can benefit the majority of the population.
- SWF can secure the orderly development of the traditional industries that do not benefit directly from LNG project, and enable the introduction of more sophisticated industries, & care for future generation.



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# Overall Macroeconomic Management

## Summary:

- Prudent macroeconomic management is necessary
- Has to be integrated and coordinated with National Development Plans and Vision 2050
- Will contain inflation at an acceptable or tolerable level
- Minimise effects of Dutch Disease on industries that will not directly benefit from the LNG project



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## Long Term Goal

- If above is achieved, Price Stability can be sustained over medium to long term
- Sustained macroeconomic stability can lead to high non-inflationary economic growth
- Will move PNG from a developing to an emerging market economy, and improve the standard of living of population (Vision 2050 objective).



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## Monetary Policy Stance

- In view of the expected strong economic growth and associated demand pressures in 2011, combined with high international food and fuel prices, the Bank will continue to assess the trade-off between high economic growth and inflation, and will consider tightening monetary policy as necessary to contain inflation under the double digit level.





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**THANK YOU**

**QUESTIONS???**