



**BANK OF PAPUA NEW GUINEA**

## **MEDIA RELEASE**

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**10<sup>th</sup> July 2014**

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### **Quarterly Economic Bulletin**

#### **March Quarter 2014**

Mr Loi M. Bakani, Governor of the Bank of Papua New Guinea (Bank of PNG), released the March 2014 Quarterly Economic Bulletin (QEB) today. This statement provides an overview of the economic and financial developments during the March quarter 2014 and some key developments since then.

#### **1. UPDATE ON DEVELOPMENTS SINCE MARCH 2014**

Global growth is currently subdued following the disappointing first quarter outcomes of the emerging market and developing economies. The main contributing factors affecting this growth are slow progress on structural reforms and capacity constraints in developing economies, the crisis in Ukraine, political strife in several middle-income economies, and China's economic rebalancing from credit-fuelled capital investment towards consumer demand. Notwithstanding this, global economy is expected to pick-up momentum as the year progresses. Growth in the United States and the Euro Area is expected to pick up in the second quarter once the transitory factors have waned. China's economy is expected to rebound due to its growth-supporting measures, whilst Japan's economic growth, which accelerated before the

tax increase in April, is expected to slow slightly as consumers adjust to the tax increase. The World Bank now projects the global economy to grow by 2.8 percent in 2014.

The key global commodity prices remained stable in the first quarter of 2014. Oil prices also remained stable despite the tensions between Russia and Ukraine and there are imminent risks arising from the conflict in Iraq. The World Bank is projecting oil prices to average US\$103/bbl in 2014, assuming no macroeconomic shocks. However, the natural gas prices in the US are expected to remain elevated in 2014 in response to stronger demand from energy intensive industries that are moving to the US. This will have an impact on the demand for natural gas from Europe, while Japan's LNG prices could moderate. The Governor mentioned that any decline in LNG prices in Japan could affect the current pricing of Papua New Guinea's LNG exports and, consequently, would affect the Government's LNG revenue forecast.

Stable commodity prices have eased global inflationary pressures, though recent exchange rate depreciations in some emerging market countries might put some upward pressure. Persistently low inflation in the Euro Area remains a concern, undermining the sluggish recovery and potentially affecting the effectiveness of macro-economic policies.

In May, the National Statistical Office released a new market basket for its Consumer Price Index (CPI) based on the Household Income & Expenditure Survey conducted in 2011 and 2012. The new basket has three new towns, namely Mt Hagen, Kimbe and Alotau, added to the existing five centres. Five new expenditure groups were also added resulting in a total of twelve expenditure groups. The Governor explained that the new CPI basket is much more comprehensive, being a better reflection of current consumption patterns in Papua New Guinea and of price movements in the economy. Based on the new CPI basket, the domestic headline inflation, as measured by the new CPI index, was 2.0 percent for the March quarter of 2014 and annual inflation over the year to March 2014 was 3.8 percent. The quarterly movements were mainly driven by price increases in the 'Housing', 'Alcoholic beverages, tobacco and betelnut', 'Health', 'Restaurants and hotels', 'Recreation',

‘Transport’ and ‘Food and Non-alcoholic beverages’. The Bank kept its policy rate at 6.25 percent up to June 2014, since the last reduction in March 2013.

In late May, the first LNG shipment from Papua New Guinea reached Japan, well-ahead of its original schedule. This is positive news though the Governor is concerned that the issue surrounding the SWF set-up has not been finalised and yet to go to Parliament for approval. He urged the Government to identify a solution that is in the best interests of Papua New Guinea and its citizens, and put to rest the uncertainty surrounding the SWF establishment.

On the 4<sup>th</sup> of June 2014, the Central Bank introduced a foreign exchange trading band of 150 basis points within which commercial banks can sell and buy kina in exchange for foreign currencies. This action was taken to correct the failure in the foreign exchange market and does not imply a change in the exchange rate regime. The Bank of PNG maintains that we still have a floating exchange rate regime as commercial banks can still move the official mid-rate in the interbank foreign exchange market. The Governor explained that commercial banks were trading well below the official (inter-bank) rate with very wide margins, resulting in the Bank intervening in the foreign exchange market, despite there being sufficient foreign currency in the market. Commercial banks are now required to trade between the interbank mid-rate and 75 basis points above it for exporters and between the interbank mid-rate and 75 basis points below it for importers.

The daily average kina exchange rate depreciated against the US dollar, Pound Sterling and Euro, while it appreciated against the Australian dollar and Japanese yen in the March quarter of 2014. As of 19<sup>th</sup> June, the kina depreciated against the Australian dollar by 3.9 percent, Pound Sterling by 1.6 percent, Euro by 0.3 percent and the Japanese yen by 0.7 percent, while the movement against the US dollar was negligible.

The level of gross foreign exchange reserves declined to K6, 217.6 (US\$2,589.6) million as of Friday the 04<sup>th</sup> July 2014, from K6, 645.9 (US\$2,778.0) million at the end of March 2013. The decline is due to intervention in the foreign exchange market by the Bank of PNG to ease the pace of the depreciation of the kina.

## **2. OVERVIEW OF THE DEVELOPMENTS IN THE MARCH QUARTER OF 2014**

Economic indicators available to the Bank of Papua New Guinea (the Bank) show a slowdown in domestic economic growth in the first quarter of 2014, in light of the near completion of the construction phase of the PNG LNG project. Increased Government spending on major infrastructure and social services projects, and growth in the non-mineral private sector activity, including the construction of sporting facilities for the 2015 Pacific Games are behind the growth. International prices, production and export of some commodities increased in the March quarter of 2014. This has resulted in a higher trade surplus and contributed to a lower deficit in the balance of payments in the March quarter of 2014, compared to the corresponding quarter of 2013. The kina depreciated against the US dollar, pound sterling and euro compared to the previous quarter, while it appreciated against the Australian dollar and Japanese yen. As a result, the Trade Weighted Index (TWI) appreciated by 2.0 percent. Based on the new Consumer Price Index (CPI), the annual headline inflation was 3.8 percent in the March quarter of 2014, compared to 2.9 percent in the previous quarter. The Bank maintained a neutral stance of monetary policy by keeping the KFR at 6.25 percent throughout the quarter.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the private sector increased by 12.8 percent in the December quarter of 2013, compared to an increase of 0.3 percent in the September quarter. Excluding the mineral sector, sales increased by 11.5 percent in the quarter, following an increase of 4.6 percent in the September quarter. Sales increased in all sectors, except for the transport and retail sectors. By region, sales increased for all regions, except for the Southern region. In 2013, the total value of sales increased by 13.7 percent while, excluding the mineral sector, sales increased by 11.8 percent.

The Bank's Employment Index shows that the total level of employment in the private sector declined by 0.2 percent in the March quarter of 2014, compared to an increase of 1.5 percent in the December quarter of 2013. Excluding the mineral sector, the level of employment increased by 0.4 percent, mainly driven by the building and construction sector. By region, employment declined in the Highlands, Morobe and Southern regions, while it increased in the Momase, NCD and Islands

regions. Over the year to March 2014, the total level of employment increased by 0.5 percent, whilst the non-mineral private sector employment level declined by 0.2 percent.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 2.0 percent in the March quarter of 2014, compared to an increase of 0.1 percent (revised from 1.9 percent) in the December quarter of 2013. There were increases in the 'Housing', 'Health', 'Miscellaneous', 'Recreation', 'Transport' 'Restaurants & Hotels', 'Food and Non-Alcoholic Beverages', expenditure groups which more than offset declines in the 'Alcoholic Beverages, Tobacco & Betelnut', 'Clothing & Footwear', 'Household Equipment', 'Communications' and 'Education' expenditure groups. By urban centres, prices increased in Port Moresby, Lae, Alotau/Rabaul/Kimbe while there were declines in Goroka/Hagen/Madang. The annual headline inflation rate was 3.8 percent in the March quarter of 2014, compared to 2.9 percent in the previous quarter.

The daily average kina exchange rate depreciated against the US dollar, pound sterling and euro, while it appreciated against the Australian dollar and Japanese yen in the March quarter of 2014. The kina depreciated against the US dollar by 0.1 percent to 0.4130, pound sterling by 2.2 percent to 0.2496 and euro by 0.7 percent to 0.3015. It appreciated against the Australian dollar by 3.3 percent to 0.4610 and the Japanese yen by 2.3 percent to 42.4724. These movements resulted in the appreciation of the daily average trade weighted Index (TWI) by 2.0 percent.

The weighted average kina price of Papua New Guinea's exports increased by 0.9 percent in the March quarter of 2014, compared to the corresponding quarter of 2013. There was a 2.0 percent decline in the weighted average price of mineral exports, excluding nickel and cobalt. This was due to lower gold prices. For the agricultural, logs and marine product exports, and excluding refined petroleum product exports, the weighted average kina price increased by 13.2 percent. This was due to higher kina export prices of all agricultural exports, with the exception of coffee and rubber. Excluding logs, the weighted average price of agricultural and marine product exports increased by 15.3 percent in the March quarter of 2014, compared to the corresponding quarter in 2013. The higher kina export prices are

attributed to the depreciation of the kina and improvement in the international prices of most of the commodities.

The balance of payments recorded an overall deficit of K182 million in the March quarter of 2014, compared to a deficit of K430 million in the corresponding quarter of 2013, with a deficit in the current account, more than offsetting a surplus in the financial and capital account. The lower deficit in the current account was due to a higher trade surplus, and lower net service payments.

The net inflow in the capital and financial account was mainly due to equity inflows for foreign direct investments and portfolio investments, reflecting drawdown from investments in short term money market instruments, combined with drawdown in the net foreign assets of the domestic banking system.

The level of gross foreign exchange reserves at the end of March 2014 was US\$2,778.0 (6, 645.9) million, sufficient for 6.9 months of total and 9.9 months of non-mineral import covers.

The Central Bank continued to take a cautious approach and maintained a neutral stance of monetary policy by keeping the KFR at 6.25 percent throughout the March quarter of 2014, in consideration of the inflation outcome for the last quarter, underlying inflationary pressures that persists, and to support lending and economic activity, as the PNG LNG construction phase nears completion, consistent with the objectives of the National Budget. The dealing margin for the Repurchase Agreements (Repos) was maintained at 100 basis points from the KFR. Domestic interest rates continued to trend upwards between the end of December 2013 to end of March 2014. There was a net retirement of CBBs by the market totalling K235.3 million in the quarter. To finance the budget deficit, the Government made a net issuance of K53.9 million in Treasury bills and issued K325.7 million in Inscribed stock, which assisted in diffusing some of the excess liquidity in the banking system.

The average level of broad money supply (M3\*) decreased by 1.4 percent in the March quarter of 2014, compared to an increase of 1.2 percent in the December quarter of 2013. This outcome was influenced by declines in average net foreign

assets and private sector credit, which more than offset an increase in average net claims on the Central Government. The average net domestic claims outstanding, excluding net claims on the Central Government, slightly increased by 0.8 percent in the March quarter of 2014, following an increase of 2.5 percent in the December quarter of 2013.

The average level of monetary base (reserve money) increased by 1.7 percent in the March quarter of 2014, following an increase of 3.4 percent in the previous quarter. There was an increase in commercial banks' deposits at the Central Bank, which more than offset a decline in currency in circulation.

The average level of deposits in other depository corporations (ODCs) decreased by 1.7 percent to K18,727.6 million in the March quarter of 2014, from K19,058.4 million in the previous quarter. This mainly reflected a decline in deposits by the Central Government and 'public non-financial corporations'.

The net foreign assets of financial corporations (FCs), comprising depository corporations (DCs) and other financial corporations (OFCs), decreased by 0.7 percent to K9,359.3 million in the March quarter of 2014, compared to a decline of 12.4 percent in the December quarter of 2013. This resulted from decreases in net foreign asset of the Central Bank and ODCs, which more than offset an increase at OFCs. Net claims on the Central Government increased by K329.6 million to K5,065.9 million in the March quarter of 2014, compared to an increase of K811.5 million in the previous quarter. This resulted from an increase in issuance of Government securities for financing of the Budget deficit.

In the March quarter of 2014, total domestic credit extended by financial corporations to the private sector, public non-financial corporations, Provincial and Local level Governments, and other financial corporations, increased by K303.4 million to K12,551.7 million, compared to an increase of K287.4 million in the December quarter of 2013. This was mainly due to an increase of K367.7 million in credit to the public non-financial corporations. Credit to the private sector declined. The annualized growth in domestic credit, excluding Central Government, was 11.9

percent in the March quarter of 2014, compared to 18.0 percent in the previous quarter.

Preliminary estimates of the fiscal operations of the National Government over the three months to March 2014 show an overall surplus of K105.2 million, compared to a deficit of K403.9 million in the corresponding quarter of 2013. This represents 0.3 percent of nominal GDP, and reflected higher revenue and lower expenditure.

Total revenue, including foreign grants, during the March quarter of 2014 was K2,004.3 million, 12.2 percent higher than the receipts collected in the corresponding quarter of 2013. This represents 15.8 percent of the budgeted revenue for 2014. The increase in revenue came from higher collections in direct, indirect and non-tax receipts, which more than offset lower foreign grants.

Total expenditure for the first three months to March 2014 was K1,899.1 million, 13.3 percent lower than in the corresponding period of 2013 and represents 12.6 percent of the budget appropriation for 2014. This outcome reflected lower development expenditure, which more than offset an increase in recurrent expenditures.

The budget surplus of K105.2 million and net external borrowing of K420.4 million were used to repay net domestic borrowing totalling K525.6 million. The external borrowing of K450.8 million was from concessional sources, while repayments of K16.3 million and K14.1 million were made to commercial and extraordinary sources, respectively. The net payments to domestic sources mainly comprised of K1,856.4 million worth of cheques presented for payment by other resident sectors and K40.8 million to ODCs. These more than offset Government deposits placed at the Central Bank totalling K229.2 million and purchase of Government securities totalling K1142.4 million by OFCs.

Total public (Government) debt outstanding in the March quarter of 2014 was K12,369.3 million, K749.4 million higher than in the December quarter of 2013, with an increase in both domestic and external loans. The increase in domestic debt came from new issuance of Treasury bills and Inscribed stocks, while the increase in external debt mainly reflected drawdown of concessional loans.

The total amount of Government deposits in the depository corporations increased by K117.7 million to K4,069.8 million in March 2014, compared to K3,952.1 million in December 2013. Government trust accounts held at the Central Bank increased by K43.0 million to K337.0 million in the March quarter of 2014.