BANK OF PAPUA NEW GUINEA

MONETARY POLICY STATEMENT BY THE GOVERNOR OF THE BANK OF PAPUA NEW GUINEA, MR. L. WILSON KAMIT, CBE

PORT MORESBY
31 January 2003

OBJECTIVES OF THE CENTRAL BANK

"For the advantage of the people of Papua New Guinea, the objectives of the Central Bank are:

(a) to formulate and implement monetary policy with a view to achieving and maintaining price stability; and

(b) to formulate financial regulation and prudential standards to ensure stability of the financial system in Papua New Guinea; and

(c) to promote an efficient national and international payments system; and

(d) subject to the above, to promote macro-economic stability and economic growth in Papua New Guinea."

Central Banking Act (CBA) 2000, Section 7

POLICY STATEMENTS

"The Governor shall, within one month of the coming into operation of this Act, and every six months thereafter, issue a policy statement setting out the monetary policy of the Central Bank to achieve and maintain price stability for the following six months."

CBA 2000, Section 11, Sub-section 1

MONETARY POLICY STATEMENT
JANUARY 2003

INTRODUCTION

The Monetary Policy Statement (MPS) is published under the Central Banking Act 2000, and represents a key element of the transparency and accountability arrangements of the Act. The Policy Statement is presented in two parts. The first covers economic developments in 2002 and projections for 2003. The second sets out the rationale for the monetary policy stance for 2003 and the conduct of monetary policy.

1. DEVELOPMENTS IN 2002 AND PROJECTED DEVELOPMENTS FOR 2003

In designing monetary policy, the Central Bank considers actual and projected developments in seven main areas:

(a) The World Economy;
(b) Domestic Economic Activity;
(c) Balance of Payments (BOP);
(d) Fiscal Operations of the Government;
(e) Exchange Rate;
(f) Inflation; and
(g) Monetary and Financial Market Developments.

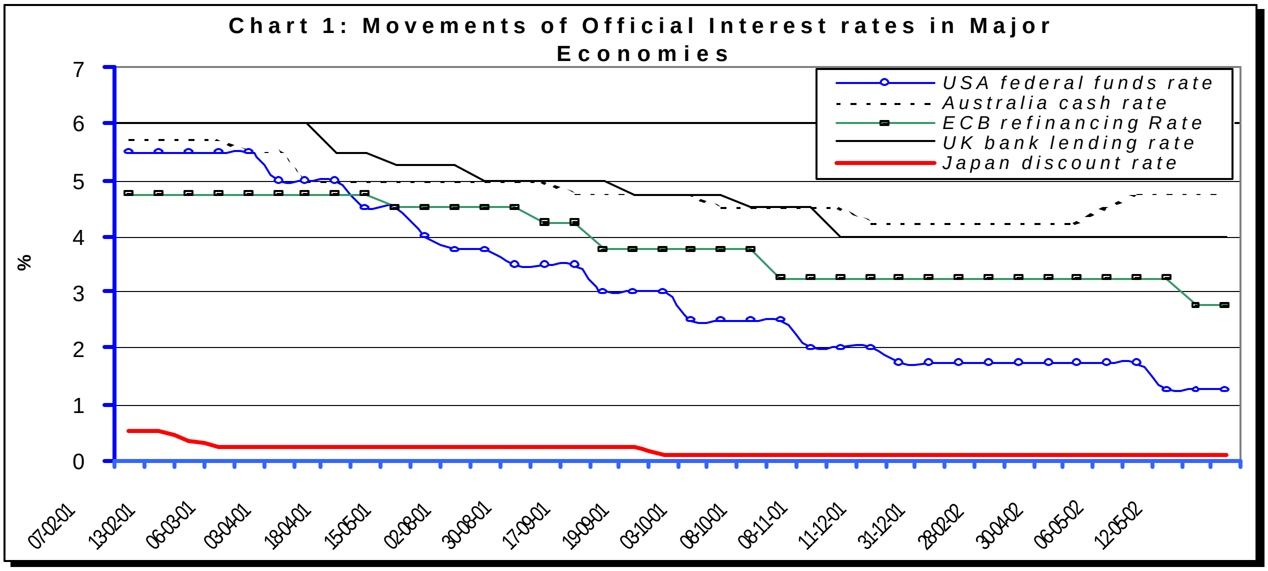
(a) The World Economy

World economic growth, as measured by Gross Domestic Product (GDP), is projected by the International Monetary Fund (IMF) to increase by 2.8 percent in 2002 and 3.7 percent in 2003, compared to an increase of 2.2 percent in 2001. Economic activity in 2003 is expected to increase following the global recovery in 2002, as a result of the growth in the United States (US), the turnaround in Japan, and the increase in global industrial production and trade. In September 2002, the IMF revised upwards their 2003 real growth projections made in April 2002 with major industrialised countries, as a group, expected to grow by 2.3 percent. Real GDP is projected to grow by 2.6 percent in the US, by 2.4 percent in the United Kingdom (UK), by 2.3 percent in the Euro Zone and by 1.1 percent in Japan. The emerging markets in Asia are expected to grow by 4.9 percent. Countries of the former centrally planned economies in Europe and the former Soviet Union are projected to grow by 4.5 percent. The developing countries are expected to grow by 5.2 percent, with higher growth expected in all regions.

Global inflation is expected to edge higher from 1.4 percent in 2002 to 1.7 percent in 2003, partly reflecting the increase in commodity prices led by oil, due to increasing political tension in the Middle East and the recovery in global economic activity. The rate of inflation is expected to grow by 2.3 percent in the US, by 2.1 percent in the UK and by 1.8 percent in the Euro Zone. Japan remains in a deflationary environment with the inflation rate expected to decline by 0.6 percent in 2003.

All major central banks maintained accommodative monetary policy stances throughout 2002, though the Reserve Bank of Australia (RBA) marginally increased its cash rate in May and June 2002. The accommodative monetary policy of 2002 was motivated by the weakness in the global economy, volatility in the stock markets and political tension in the Middle East. In the second half of 2002, as shown in Chart 1, the US Federal Reserve Board reduced its federal funds rate by 0.5 percentage points to 1.25 percent. The Bank of Japan (BOJ) maintained its zero interest rate policy and concentrated on fiscal stimulus measures to revive economic activity. The European Central Bank (ECB) lowered its refinancing rate by 0.5 percentage points to 2.75 percent, while the Bank of England and the RBA maintained their cash rates at 4.0 percent and 4.25 percent, respectively.

In foreign exchange markets, trading conditions were volatile. Exchange rates were influenced by weak equity markets and predominantly accommodative monetary policies. Overall, the US dollar depreciated against all the major currencies in 2002, resulting from weak economic growth in the US, the deterioration in its current account to 4.6 percent of GDP in 2002 (from 3.9 percent in 2001), and the weakness in the equity market. The euro benefited most from the weakness of the US dollar and ended 2002 above par, while the Australian dollar recovered to end the year above US$0.55. The Japanese yen traded around the ¥120 level against the US dollar for most of the year.



Source: Various Central Banks' web-sites

(b) Domestic Economic Activity

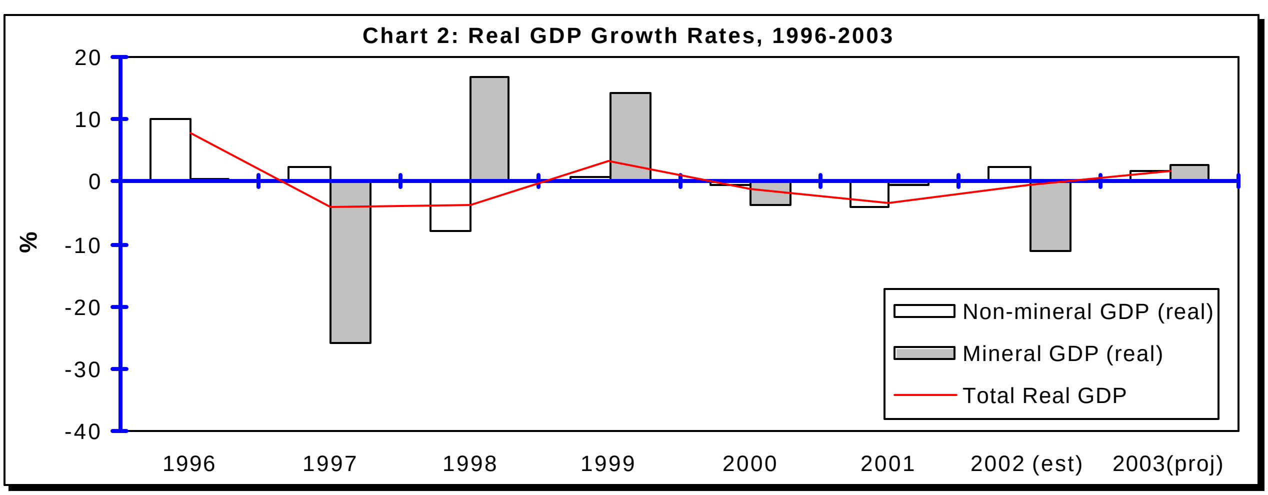
Preliminary estimates of economic activity in Papua New Guinea (PNG) indicate that total real GDP declined by 0.5 percent in 2002 (see Chart 2), following a revised decline of 3.4 percent in 2001. The decline in the growth rate was due to the continued depressed levels of activity in the mineral, building and construction, retail and wholesale, and electricity, gas and water sectors.

For 2003, real GDP is projected to increase by 1.8 percent with growth in both the mineral and non-mineral sectors. The agriculture/forestry/ fisheries sector is forecasted to grow by 2.9 percent in 2003, reflecting increased production of all agricultural export commodities. This is expected to more than offset lower log production. Activity is also expected to increase in the building and construction, wholesale and retail trade, and electricity, gas and water sectors. The petroleum and mining sectors are expected to grow by 4.8 and 2.1 percent, respectively, in 2003.

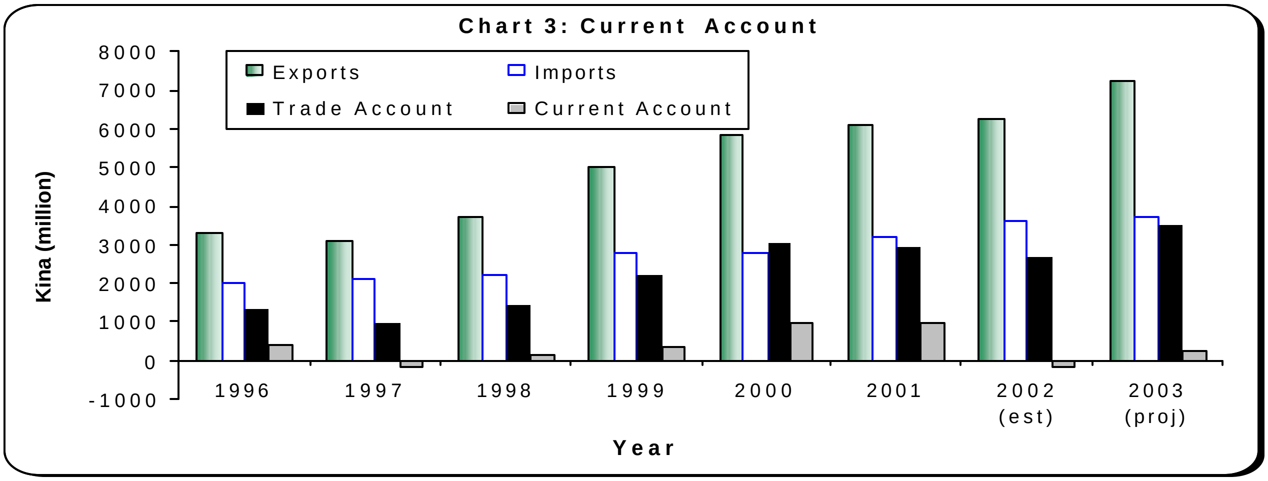
(c) Balance of Payments

i) Eleven months to November 2002

Preliminary balance of payments data for the eleven months to November 2002, showed an overall deficit of K176 million, compared to a surplus of K528 million in the corresponding period of 2001.The deficit in the current account



Source: 1996 to 1999 from NSO, and 2000 to 2003 from Volume 1 of the 2003 National Budget.



Source: Bank of PNG

was due to a decline in the trade surplus. The lower merchandise export values were attributed to declines in most agricultural commodities, gold, copper, crude oil, forestry and marine exports, combined with higher imports and net service payments. The capital account recorded a surplus due to net private capital inflows and draw-down from foreign currency accounts by the mineral companies.

The level of gross official reserves at the end of December 2002 was US$340.0 (K1,366.6) million, sufficient for around 4.6 months of total and 6.6 months of non-mineral import cover.

ii) 2003 Projections

The main assumptions underlying the balance of payments projections for 2003 are that:

- The Budget financing gap is partially met by financing under a structural adjustment program (SAP) in the second half of 2003;
- The Asian Development Bank (ADB) Public Sector Reform Program (PSRP) loan will be drawn down in the first half of 2003;
- The shift from project to budgetary grants from Australia is not included;
- There is no refinancing or rescheduling of external loans; and
- There is no foreign currency component of asset sale.

Accordingly, the balance of payments for 2003 is projected to show an overall deficit of K321 million, compared to the estimated deficit of K330 million in 2002. This outcome reflects a projected deficit of K494 million in the capital account and a surplus of K172 million in the current account. The projected surplus in the current account is attributed to increases in production and prices for the major agricultural and mineral exports.

The declining trend in the current account surplus, which commenced in 2000, reflects the continued excessive non-productive Government consumption, combined with a decline in investment over the years. This has contributed to a lower or negative real economic growth. In order to reverse this trend, the Government has undertaken to focus expenditure in productive areas, such as infrastructure and provision of extension services to promote export growth and sustainable economic development.

The level of gross foreign exchange reserves for 2003 is projected to average around US$260.0 (K1,040.0) million, sufficient for 3 months of total and 5 months of non-mineral import cover.

(d) Fiscal Operations of the Government

i) Eleven Months to November 2002

Preliminary estimates of the fiscal operations of the National Government over the eleven months to November 2002 showed an overall deficit of K246.3 million, compared to a surplus of K46.9 million in the corresponding period in 2001, and

Table 1: Fiscal Operations of the Government (K'million)

	2000	2001	2002 Supp Budget	2001 Jan-Nov	2002 Jan-Nov (prel)	2002 Est.	2003[a] Budget
Total Revenue & Grants	3,008.7	3,184.8	3,219.4	2,389.0	2,912.5	3,235.4	3,489.9
Total Expenditure	3,201.0	3,544.2	3,581.7	2,435.9	3,158.8	3,647.0	3,734.0
Deficit/Surplus	-192.3	-359.4	-362.3	-46.9	-246.3	-411.6	-244.1
Percentage of GDP (%)	-2.0	-3.7	-3.4	-0.5	-2.3	-3.8	-2.0
Financing	192.3	359.4	362.3	46.9	246.3	411.6	244.1
External	70.3	241.9	-62.7	-119.9	-147.2	-218.3	-78.1
Domestic	122.0	117.5	425.0	166.8	393.5	629.9	322.2
Of which							
BPNG	-361.6	-247.1		28.9	502.8		
Commercial Banks	256.0	-12.1		-86.3	-170.8		
Other Domestic Financing	227.6	376.6		224.2	-138.9		
Asset Sales	0.0	0.0	201.0	0.0	171.5	171.5	200.0

Source: Quarterly Economic Bulletin, Bank of PNG & National Budget 2003, Dep't of Treasury
[a] Adjusted for partial inflow of budgetary financing gap in 2003, and inclusion of K140 million ADB loan delayed from 2002.

represents 2.3 percent of nominal GDP. The deficit was the result of higher expenditure incurred by the Government, mainly due to increases in election-related expenses and payment of the unbudgeted expenditure.

The Government made net overseas loan repayments of K147.2 million, comprising of net concessional loan repayment of K181.9 million, which more than offset a net commercial loan draw-down of K34.7 million relating to the Yumi Yet Bridges Program. The deficit, combined with the net loan repayments to external sources resulted in a domestic financing requirement of K393.5 million. This comprised of an increase in net credit by the Bank of PNG reflecting the draw-down of Government deposits, increased holdings of Treasury bills and advances under the Temporary Advance Facility (TAF). The increase in the holdings of Treasury bills was due to the closure of the Tap facility and net maturity by the commercial banks and non-bank public in the last quarter of 2002. Other domestic sources recorded a net repayment due to the settlement of cheque floats issued in 2001, which more than offset the receipt of K171.5 million from the sale of assets.

Despite advice to the contrary from the Central Bank in May and July 2002 (refer July 2002 MPS), the Government continued to rely heavily on domestic borrowing to finance the Budget, without limiting its expenditure to the level of revenue collected during the year. The Government did not adjust its expenditure downwards, but resorted to the issuance of new Treasury bills to finance the unbudgeted expenditure. The Government's financing was further exacerbated by the continued delay in drawing down the US$35.0 million loan from the ADB for the PSRP. During 2002, the Government issued a net of K420.3 million in Treasury bills, which increased the total stock outstanding to K2,169.1 million at the end of the year. On the other hand, net Inscribed stock declined by K43.3 million to K261.4 million, as there was lack of demand for the new issues made in 2002. This level of domestic debt, which represents 22 percent of GDP is high and unsustainable, and has diverted resources from achieving the development objectives of the Budget and creates a debt burden for the future generation.

ii) 2002 Estimates and Supplementary Budget

The Government introduced a Supplementary Budget in August 2002, which was aimed at restoring macroeconomic and fiscal stability. Accordingly, substantial cuts were made on recurrent expenditure and the development budget was reprioritised to projects that would contribute positively to the Government's development objectives in promoting economic growth. Moreover, there was an upward revision of K81.6 million on expenditure to accommodate unbudgeted expenditures incurred in the first half of the year.

The 2002 Supplementary Budget aimed to achieve a deficit of K362.3 million, 3.4 percent of nominal GDP, compared to a deficit of 7.7 percent of GDP without adjustment. The deficit is now estimated to be 3.8 percent of GDP, due to payment of outstanding school fee subsidies, election-related expenses, and unbudgeted expenses.

iii) 2003 Budget

The 2003 National Budget, which was passed by Parliament in December 2002 aims to consolidate the fiscal adjustments introduced in the 2002 Supplementary Budget and restore it to a sustainable position. The adjustments would assist in achieving macroeconomic stability and provide the conditions necessary for sustainable economic growth. Growth may be achieved by redirecting expenditure towards productive areas that generate export revenue, create employment and maximise social welfare in the medium term. The budget deficit for 2003 is projected at 2.0 percent of GDP with reductions to 1.0 percent of GDP in the medium term.

The fiscal strategy for 2003 recognises the difficult economic environment that PNG confronts, in particular the decline in revenue from the mineral sector and therefore the need to adjust expenditure, and introduce new revenue measures (see 2003 Budget documents). The fiscal strategy encompasses the following adjustments to reduce expenditure. These are:

- The freeze on wages and new recruitment;
- The reduction in education subsidies; and
- Cuts to the recurrent and development budgets including the Electoral Development Fund.

The projected budget deficit of K244.1 million for 2003 is 2.0 percent of GDP, compared to an estimated deficit of 3.8 percent of GDP for 2002 (see Table 1). Net external loan repayments of K78.1 million are budgeted, comprising of K80.4 million in concessional and K15.2 million in commercial loans and a net draw-down in extraordinary sources of K17.5 million. The assumptions underlying the external financing of the 2003 Budget are consistent with the balance of payments mentioned on page 3. This leaves a net domestic financing of K322.2 million, to be financed from new issuance of Government securities and asset sales.

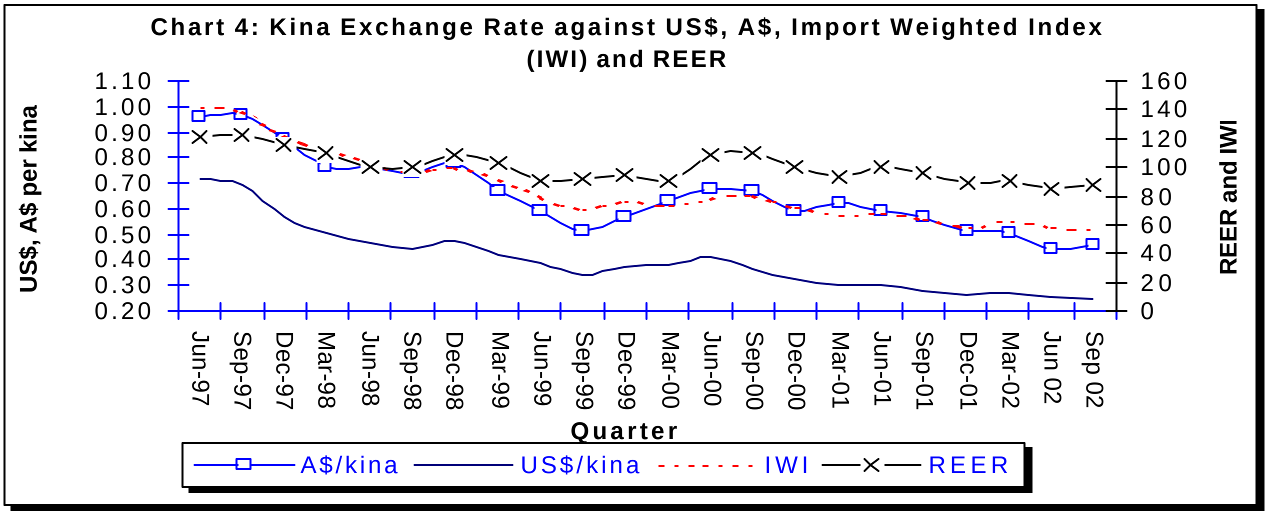
(e) Exchange Rate

In the first half of 2002, the kina depreciated by 4.4 percent and 13.5 percent against the US and Australian dollars, respectively. Although the trend continued in the second half of the year, the rate of depreciation slowed by 0.9 and 1.1 percent against the respective currencies. This was partly due to the tight monetary policy stance taken by the Central Bank and favourable inflows of foreign exchange.

The following factors impacted adversely on the foreign exchange market and the underlying pressure on the exchange rate during the second half of 2002:

- The effect of high Government expenditure in the first half of 2002, that led to an increase in liquidity;
- Persistent current account deficit in the non-mineral balance of payments during the year, due to sustained import demand mainly fuelled by fiscal expansion, low export receipts from the agriculture sector and high net overseas remittances by individuals and companies;
- Increased forward transactions by importers, while exporters delayed their inflow of funds anticipating further falls in the kina;
- Uncertainties created by the delay in formation of the Government, disruption to the Porgera and Kutubu projects by landowners and the controversy over the VAT court ruling;
- Increase in reserve money as a result of net maturity of Treasury bills by the commercial banks and non-bank public;
- Downgrading of PNG's credit rating by an international ratings firm;
- Further delay in draw-down of US$35.0 million loan from the ADB for the PSRP; and
- Negative real interest rates, which contributed to the high net remittances overseas.

The weakening of the kina means that goods abroad have become more expensive than local goods, thus having a positive effect on PNG's trade competitiveness relative to its trading partners. This is also measured by the depreciation of the real effective exchange rate (REER) as



Source: Bank of PNG

shown in Chart 4. PNG should take advantage of this trade competitiveness and increase exports, which would bring in foreign exchange and support the kina exchange rate. It is therefore important for agriculture producers to make use of this opportunity to improve their kina incomes by increasing production and exports of commodities such as copra, coffee, cocoa, oil palm and marine products.

(f) Inflation

i) Actual to September 2002

The annual headline and the two underlying measures of inflation to September 2002 are presented in Table 2.

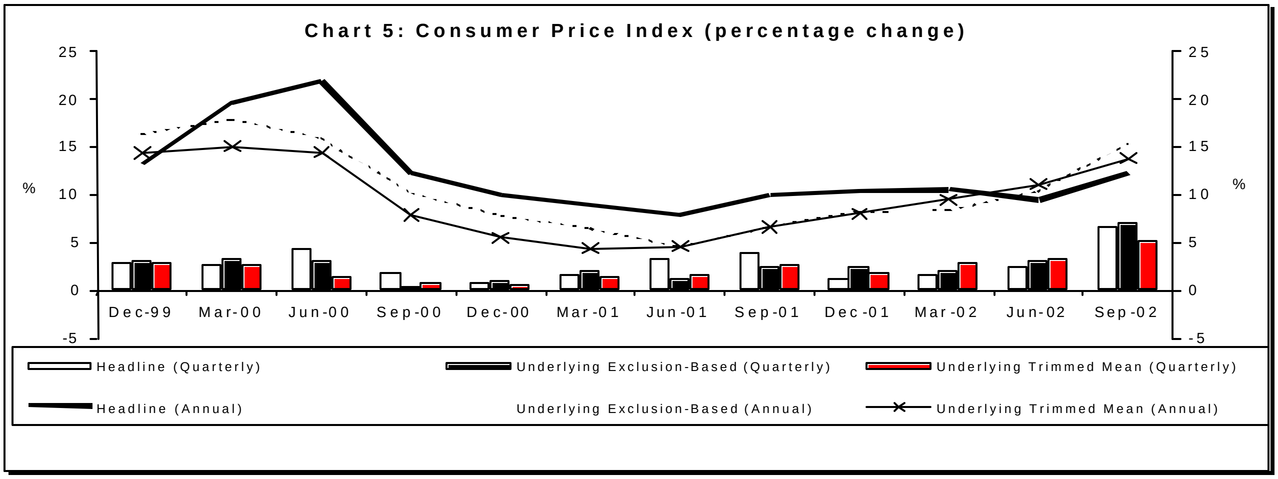
The upward trend in the rate of inflation that began in 2001 continued into the June and September quarters of 2002. This trend is clearly evident in Chart 5, which shows the CPI trimmed mean annual underlying inflation rate increasing for six consecutive quarters. Significant downward pressure on the kina contributed towards the upward movements in consumer prices [see Section (e) above]. Faced with rising import costs, businesses increased the price of consumer goods and services despite the depressed domestic economic conditions.

Towards the end of the year, seasonal demand for foreign currency contributed to import price pressure, as retail and wholesale companies accumulated inventories in anticipation of increased domestic demand during the festive season.

Table 2. Consumer Price Indices (annual percentage change [b])

	Actual				Forecast	
	1999	2000	2001	2002 1st – 3rd Qtr	2002	2003
HEADLINE	13.2	10.0	10.3	11.0	15.4	9.0
UNDERLYING						
CPI Exclusion-based	16.3	7.8	8.2	12.6	17.3	9.4
CPI Trimmed Mean	14.3	5.5	8.0	10.8	15.6	10.6

Source: National Statistical Office (NSO) and Bank of PNG
[b] December on December



Source: NSO and Bank of PNG (Refer Box 2 January 2002, MPS)

ii) Inflation Outcome for the Remainder of 2002 and Projections for 2003

The 2002 December quarter inflation outcome is expected to be high because of the negative developments of the kina outlined above and the increases in the price controlled items. As a result, the annual headline inflation outcome for 2002 is expected to be around 15 percent, significantly higher than the 10 percent outcomes of 2000 and 2001 (see Table 2).

The annual headline inflation rate for 2003 is expected to be an improvement on 2002, due to some of these influences:

- Reduced uncertainties regarding the Government's macroeconomic policies;
- The tight monetary policy stance adopted by the Bank of PNG to offset the monetary expansion during 2002;
- The Government's commitment to a responsible fiscal stance; and
- Indications of improvement in world commodity prices for PNG's major exports, particularly cocoa and copra with production expected to improve from the 2002 levels.

The above factors may significantly offset the effects of a reduction in education subsidies on inflation.

(g) Monetary and Financial Market Developments

As stated in the July 2002 MPS, the monetary policy stance would be influenced by factors that adversely affect prices and macroeconomic stability. Because of renewed fears for high inflation, the Central Bank tightened monetary policy during the second half of 2002. Accordingly, the Bank increased the Kina Facility Rate (KFR) by 2.0 percentage points in aggregate, from 12.0 percent in July to 12.5 percent in August and to 14.0 percent in November 2002.

Between July and December 2002, total liquid assets of the commercial banks decreased by 5.3 percent, although it increased significantly during the first half of the year. The decline in liquid assets of the commercial banks was attributed to:

- The maturing of Government securities by commercial banks to meet foreign exchange obligations;
- An increase in demand for Government securities by the non-bank private sector, which resulted in a shift from the commercial banks; and
- The tight monetary policy stance taken by the Central Bank.

Consistent with the increase in the KFR, and the subsequent decline in liquidity levels during the second half of the year, the weighted average total deposit rate increased from 2.1 percent in July to 5.6 percent in December 2002. Other market interest rates also increased, including the 182-day Treasury bill rate, which increased from 10.66 percent in July to 13.53 percent in December 2002. However, the weighted average lending rate on total loans declined, reflecting the lag associated with adjustments on earning assets by the commercial banks to the changes in the KFR. The minimum Indicator Lending Rate (ILR) declined from 13.75 percent at the end of July to 13.25 percent at the end of December 2002. Despite the decrease in the ILR, lending to the private sector declined, as overall economic activity remain depressed.

Following an increase in the KFR in November 2002, the Central Bank further tightened liquidity conditions through its open market operations. This resulted in substantial increases for wholesale deposit rates to around the Treasury bill rates (see Chart 6), creating competition for funds in the market. However, the continued reliance on new issuance of Treasury bills by the Government to finance the Budget crowded out the sale of securities to the public by the Central Bank for monetary policy management. Consequently, the commercial banks and non-banks matured their holdings of securities issued by the Bank of PNG. This led to an increase in the net holdings of Treasury bills by the Bank of PNG from K34.0 million at the end of June, to K475.0 million at the end of the year. This injected liquidity into the banking system, and partly reduced the effectiveness of the Central Bank's open market operations as reserve money increased significantly during the last two months of 2002.

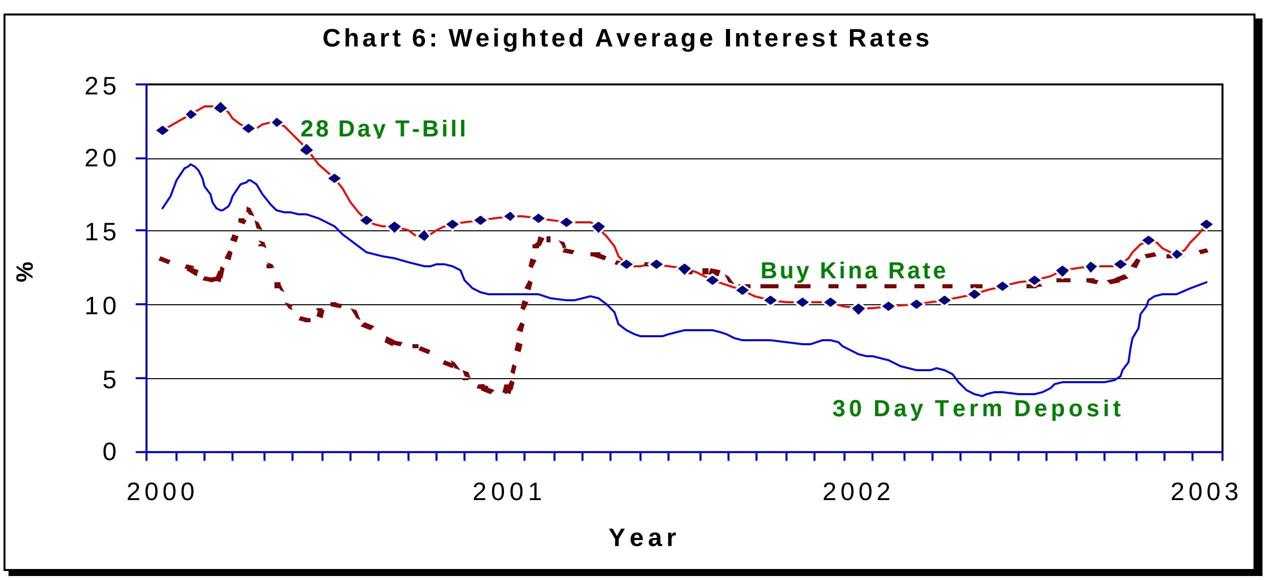
The level of broad money supply (M3*) increased by 4.2 percent in 2002, influenced mainly by the growth in net credit to the Government, official entities and non-monetary financial institutions (see Chart 7).

2. MONETARY POLICY

a) Monetary Policy Stance

Persistent growth in underlying and headline inflation arising from high Government expenditure and continued pressure on the exchange rate, combined with increased prospects for higher inflationary outcome in the December quarter of 2002 and first half of 2003 were the immediate factors that influenced the Bank's decision to significantly tighten monetary policy. Other factors that influenced the Central Bank's decision to maintain the tight stance in the second half of 2002 were:

- Pressure on the exchange rate emanating from a combination of sentiments related to the National Elections, a persistent deficit in the current account of the non-mineral sector and increased Government expenditure;
- The consecutive increase in underlying inflation and the large increase in the September quarter headline inflation,



Source: Bank of PNG

with further expectations of a higher inflation outcome in the December quarter of 2002;

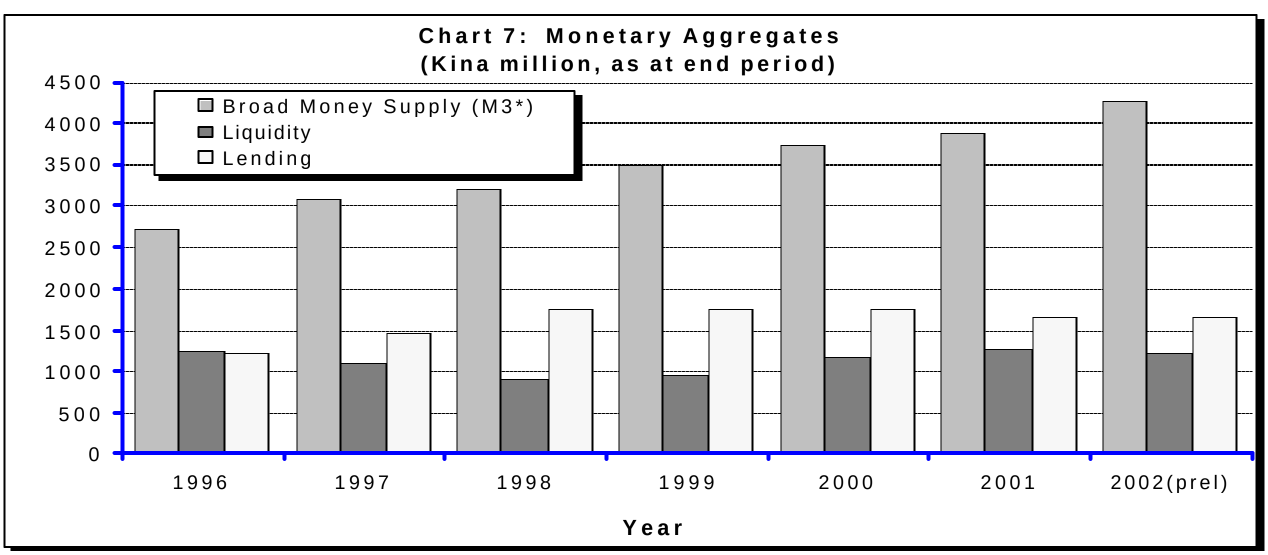
- New issuance of Government securities for financing of the high Government expenditure;
- The increase in liquidity following excessive Government expenditure;
- Uncertainty arising from the election-related problems and the delay in the formation of the Government;
- The controversy over the VAT, which caused major uncertainty in the Government's ability to finance the Budget;
- The declining level of foreign exchange reserves as the magnitude of intervention by the Central Bank to smooth out fluctuations in the exchange rate became unsustainable; and
- Further delay in the draw-down of the PSRP loan from the ADB.

Section 13 (b) of the CBA 2000 requires the Governor to report to the Minister any developments that may threaten monetary stability, implementation of monetary policy, and achievement of financial and economic policies of the Government. Accordingly, in addition to previous advices mentioned in the July 2002 MPS, the Central Bank made a presentation to the National Executive Council (NEC) in October 2002. The presentation stressed the need for a coordinated approach between fiscal and monetary policies towards achieving price stability. On 21 January 2003, the Bank further advised the Government to exercise restraint in its expenditure in the first quarter of 2003 through warrant issuance and not to resort to high domestic financing. This is because tax revenue is expected to be lower, the draw-down of the ADB loan for PSRP is being delayed, the TAF has to be fully repaid on 20 February and financing has to be provided for cheque floats from 2002.

It is critical that the Government exercise restraint and prudent management of the Budget without incurring large budget deficits that is financed by new domestic debt. It should prioritise its expenditure to areas that can generate revenue, create employment, maximise welfare and promote sustainable economic growth in the medium term, consistent with its broad macroeconomic policy framework.

The tight monetary policy stance is expected to be maintained in the first half of 2003, due largely to the following factors:

- The high underlying inflation outcomes expected for the December quarter of 2002, and the first half of 2003;
- The sustainability of the exchange rate remaining stable in view of the declining level of foreign exchange reserves;
- The ability of the Government to prioritise expenditures, implement and achieve the



Source: Bank of PNG

Budget objectives within the parameters of the 2003 Budget;

- The uncertainties relating to the financing sources for the 2003 Budget, including a SAP supported by the international financial institutions;
- The continued recovery of the world economy and its effect on the international prices and demand for PNG's exports;
- The timing of the draw-down of the delayed PSRP loan from the ADB; and
- Uncertainties relating to the continuation of the structural reform program by the Government.

If the Government remains within the parameters of the 2003 Budget including its financing assumptions, the expected growth in monetary aggregates is as shown in Table 3. Broad money is expected to grow in line with the developments in the real sector of the economy, the foreign exchange market and net credit to Government. The 2003 monetary program takes into account the Budget assumptions with a deficit of 2.0 percent of nominal GDP financed partly by the ADB loan for PSRP and draw-down relating to the SAP, supported by the international financial institutions and other donor partners. These foreign financing are expected to reduce the level of financing from domestic sources. Consistent with these assumptions, the Central Bank expects to counteract the growth in monetary aggregates using open market operations and the Tap facility to mitigate the inflationary impulse that would otherwise arise. The Central Bank will maintain a cautious approach in allowing growth in reserve money. This is due to the high level of underlying liquidity and excess capacity that the commercial banks currently have to increase lending and demand for foreign exchange, which may exert pressure on the exchange rate. Accordingly, the annual percentage change in underlying inflation for trimmed mean and headline inflation are expected to be 10.6 and 9.0 percent in 2003, respectively.

If the assumptions in the Budget hold and the economy achieves a real growth rate of 1.8 percent, the Government may be able to fund its expenses through increased revenues. However, if the economy remains depressed and revenue declines, it is prudent for the Government to cut expenditure and not to resort to increased domestic financing, as the level of domestic debt is becoming unsustainable for the budget over the medium term.

In the second half of 2003, the expected inflow of revenue from asset sales and financing from external sources under a SAP, combined with prudent fiscal management and their impact on macroeconomic and price stability should restore public confidence and form the basis for adjustment to the monetary policy stance. However, the Central Bank will maintain a cautious approach to any adjustment that may jeopardise the achievement of price stability. It is therefore crucial that the Government commences negotiations for a SAP with the international financial institutions early in 2003, with a view to draw-down the funding in the

Table 3: Growth in Monetary and Credit Aggregates
(percentages)

	2000 (Actual)	**2001** (Actual)	**Jul MPS** 2002	**2002** (prel)	**2003** (proj)
Broad money supply	7.7	1.8	5.7	4.2	9.3
Reserve money	3.5	4.6	7.7	16.3	-5.7
Private sector credit	0.5	-1.2	-0.7	-4.1	4.8
Net credit to Government	10.8	-27.5	2.7	80.6	-13.7

Source: Bank of PNG

second half of the year.

b) Conduct of Monetary Policy

Consistent with the monetary policy objectives stated above, the KFR will remain as the main instrument for signaling the Central Bank's policy stance on a monthly basis. The KFR will be reinforced through the reserve money framework, which is defined as currency in circulation, deposits of commercial banks with the Central Bank and the level of liquid assets in relation to statutory requirements. During 2003 reserve money is expected to decline by 5.7 percent, following an increase of 16.3 percent in 2002 (see Table 3). The Central Bank expects to contain any growth in reserve money due to the increase in underlying liquidity and capacitiy of the banking system to increase lending and demand for foreign exchange, which is detrimental to price stability. The projected decline in reserve money is likely to have a positive impact on inflation.

To enhance the competition for funds and influence market interest rates, the Central Bank reintroduced the Tap facility on 16 January 2003 to encourage individuals to invest in Government Treasury bills.The Central Bank will retain the daily repurchase agreement facility (RAF) and supplement it with the term RAF of 2-7 day maturities introduced in January 2003. The MLAR and CRR will be retained and continued to be assessed based on the developments in liquidity and its impact on the foreign exchange and domestic prices.

Queries on the contents of the Monetary Policy Statement should be directed to the Manager, Economics Department on telephone number (675) 3227311 or Manager, Monetary Policy Unit on telephone number (675) 3227312, or both on fax number (675) 3200757. Copies of the Statement can be obtained from the Economics Department and is also available on the Bank's website: http://www.bankpng.gov.pg