



**BANK OF PAPUA NEW GUINEA**

**MEDIA RELEASE**

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**QUARTERLY ECONOMIC BULLETIN**  
**DECEMBER QUARTER OF 2007**

Mr. L. Wilson Kamit, C.B.E., Governor of the Bank of Papua New Guinea (Bank of PNG), today released the December 2007 Quarterly Economic Bulletin (QEB). This statement presents an overview of financial and economic developments in 2007 as well as developments since December 2007.

**1. DEVELOPMENTS SINCE DECEMBER 2007**

The Governor reported that the annual headline inflation rate as measured by the Consumer Price Index (CPI), released by the National Statistical Office, was 3.2 percent in 2007, compared to negative 1.0 percent in 2006. The increase on the previous year's annual headline inflation was due to price increases in all expenditure groups in the CPI basket, except the 'Household equipment and operation' expenditure group in 2007. The annual inflation rate of 3.2 percent falls within the Bank's forecasts of 6.0 percent in its January 2007 and July 2007 Monetary Policy Statements (MPS) and estimate of 2.5 percent in its January 2008 MPS. The Governor stated that the outcome show that the annual headline inflation in PNG is low and comparable to PNG's key trading partners in the region.

Since the end of 2007, crisis in the credit markets in the United States (US) continue to be a major concern, triggering fears of a recession in the US and slowdown in the growth of the world economy. As a result, Central Banks in the major industrialised economies have continued to ease monetary policy in order to counter the adverse effects and stimulate their economies. This is despite increases in inflation in these economies, which have mainly been the result of higher prices for energy and food. Another major concern is the continued increase in international oil prices that reached a record high level of US\$111 per barrel in March 2008, and its impact on energy prices and global inflation.

The kina has appreciated against the US dollar from US\$0.3525 at the end of 2007 to US\$0.3565 as at 20<sup>th</sup> March 2008. The appreciation of the kina against the US dollar reflects the continued weakness of the US dollar against all major currencies, combined with the Bank's intervention to support the foreign exchange market with the supply of foreign currency. Aggressive interest rate cuts from the Federal Reserve led to the further weakening of the US dollar. The kina depreciated against the Australian dollar from A\$0.3999 at the beginning of 2008 to A\$0.3902 on the 20<sup>th</sup> March 2008. The depreciation of the kina against the Australian dollar stems from the weakening of the US dollar against the major currencies.

The commercial bank's Indicator Lending Rate (ILR) spread remained unchanged from the end of 2007. As of the 14<sup>th</sup> March 2008 the ILR spread was 8.95 percent to 9.45 percent. Domestic interest rates have remained low and stable up to March, consistent with the high levels of liquidity in the banking system. Lending to the private sector continued to

increase due to the low interest rate environment and the increase in economic activity.

The level of foreign exchange reserves decreased from K5,919.4 (US\$2,106.1) million at the end of December 2007 to K5,723.1 (US\$2,068.9) million as of the 20<sup>th</sup> March 2008. The decrease in the level of foreign exchange reserves was due to intervention by the Central Bank to support the foreign exchange market with the supply of foreign currency.

The Governor stated that the Papua New Guinea economy is experiencing strong economic growth. This is largely a result of the high international prices of Papua New Guinea's mineral and agricultural exports, prudent management of fiscal and monetary policies and business confidence in the economy. In light of the prospects for further high economic growth and the continued increase in fuel price, there are potential risks to price stability. The risks can come from: cost-side factors, which include a lagged effect of fuel price increases, recent increases in wages for the civil servants and tariffs on public utilities and the depreciation of the kina against the Australian dollar; demand side factors, which include the possibility of high private and public consumption and capital formation resulting from the high real GDP growth; and other factors such as declines in international commodity prices, increase in unplanned recurrent expenditure by the Government and a fast drawdown of trust account funds.

The Governor re-iterated the Bank's stance in the January MPS that it will closely monitor these developments and their potential effects on the

maintenance of price stability and, if necessary, make adjustments to the stance of Monetary Policy in 2008.

## **2. OVERVIEW OF THE DEVELOPMENTS IN 2007**

Economic indicators available to the Bank of Papua New Guinea (Bank of PNG) showed that 2007 was another year of strong economic growth. In support of this growth were: increased annual business sales and employment growth in most sectors, mainly driven by higher international prices of export commodities; increased commercial bank lending to and investments by the private sector; and an increase in government spending that provided the stimulus for increased activity. The increase in lending to the private sector was due to the low interest rate environment. Also, the stability in the exchange rate and low inflation instilled continued business confidence that was conducive for growth. The balance of payments continued to be in surplus as well as the Government's fiscal position, which was mainly due to large mineral foreign exchange inflows. With these developments in 2007, the Bank is mindful of the liquidity impact of a large increase in Government spending, continued increase in lending to the private sector and the lag effects of fuel price increases in December 2007. The Bank of PNG will closely monitor these developments and assess their impacts on liquidity, the exchange rate and inflation to ensure that price stability is not threatened.

Data obtained from the Bank of PNG's Business Liaison Survey (BLS) showed that total nominal value of sales in the formal private sector, excluding the mineral sector, increased by 8.9 percent in the September quarter of 2007, compared to the June quarter. By sector, the increase

was in the transportation, retail, wholesale, manufacturing and financial/business and other services sector, while sales in the agriculture/forestry/fisheries, building and construction and mineral sectors declined. By region, all surveyed regions recorded increases, except the Southern and Morobe regions. Over the twelve months to September 2007, the total nominal value of sales in the formal private sector, excluding the mineral sector, increased by 41.2 percent.

The Bank's Employment Index indicated that over the year to December 2007, the level of employment in the formal private sector, excluding the mineral sector, increased by 9.6 percent. In the December quarter of 2007, the level of employment increased by 2.1 percent, compared to a decline of 0.5 percent in the September quarter. The increase in employment was in the transportation, agriculture/forestry/fisheries, retail, wholesale, manufacturing, financial/business and other services sectors, while the building and construction sector declined. By region, all surveyed regions recorded growth in employment, except the Highlands region.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 2.9 percent in the December quarter of 2007, compared to 0.6 percent in the September quarter. This outcome was due to higher betelnut prices, increase in fuel prices and higher inflation outcomes for PNG's major trading partners. Trimmed mean inflation was 2.3 percent in the December quarter of 2007, compared to 1.1 percent in the September quarter. Exclusion-based inflation was 2.1 percent in the December quarter of 2007, compared to 1.2 percent in the September quarter. Annual headline inflation was 3.2 percent in the December quarter of 2007, compared to negative 1.6 percent in the September

quarter. This outcome was due to higher prices in all expenditure groups, except the 'Household equipment and operations' group.

Over 2007, the kina appreciated against the US dollar and depreciated against the Australian dollar. The kina ended the year against the US dollar at 35.25 cents, from 33.00 cents at the end of 2006. Against the Australian dollar, the kina was worth 39.99 Australian cents at the end of 2007, compared to 41.71 cents at the end of 2006. During 2007, the daily average kina exchange rate appreciated by 1.0 percent against the US dollar to 33.75 cents and 4.3 percent against the Japanese yen to 39.71 yen. The daily average kina exchange rate depreciated by 7.7 percent against the Australian dollar to 40.3 cents, by 5.4 percent against the pound sterling to 16.86 pence and by 5.7 percent against the euro to 24.65 cents. These movements resulted in the daily average Trade Weighted Index (TWI) depreciating by 4.1 percent over the year.

Higher international prices for most of Papua New Guinea's exports more than offset the appreciation of the kina against the US dollar, resulted in a 11.0 percent increase in the weighted average kina price of exports in 2007, compared to 2006. There was a 8.7 percent increase in the weighted average price of mineral exports, with higher kina prices of gold, copper and crude oil. For agricultural, logs and marine product exports, the weighted average kina price increased by 24.4 percent. This was accounted for by higher kina prices of coffee, cocoa, copra, copra oil, palm oil, rubber and log exports.

The overall surplus in the balance of payments was K1,592 million in 2007, compared to a surplus of K1,958 million in 2006. This outcome was mainly due to a lower surplus in the current account.

The current account recorded a lower surplus of K555 million in 2007, compared to a surplus of K1,255 million in 2006. This outcome was the result of a lower trade surplus and higher net service payments.

The capital account recorded a net inflow of K113 million in 2007, compared to a surplus of K135 million in 2006, reflecting lower transfers by donor agencies through direct project financing.

The financial account recorded a higher net inflow of K924 million in 2007, compared to a net inflow of K584 million in 2006. This outcome was due to higher net inflows of foreign direct investments. These more than offset net outflows from investments in financial derivative instruments and other investments.

The level of gross foreign exchange reserves at the end of December 2007 was K5,919.4 (US\$2,106.1) million, sufficient for 9.3 months of total and 13.4 months of non-mineral import covers.

The Bank of Papua New Guinea maintained a neutral monetary policy stance based on low quarterly inflation outcomes in 2007. This was consistent with the Bank's expectations, as stated in the January and July 2007 Monetary Policy Statements (MPS) with the Kina Facility Rate (KFR) maintained at 6.00 percent throughout 2007.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy over the year to December 2007. Between June and November 2007, there were no Treasury bill auctions as the Government retired its maturing bills. The liquidity impact

of the maturities was sterilised through the additional issuance of Central Bank Bills (CBBs) and use of Reverse Repos.

The average level of broad money supply (M3\*) increased by 32.0 percent in 2007, compared to an increase of 35.4 percent in 2006. This outcome was due to increases of 57.7 percent in average net foreign assets of the depository corporations and 35.8 percent in average net private sector credit, which more than offset a decline of 52.0 percent in average net claims on the Central Government. Net domestic claims outstanding, excluding advances to the Central Government and outstanding loans under the Government's Agricultural export commodity price support schemes increased by 33.5 percent in 2007, compared to an increase of 26.7 percent in 2006. The average level of the monetary base (reserve money) grew by 19.0 percent in 2007, compared to an increase of 10.5 percent in 2006. This was due to increases in deposits from Other Deposit Corporations (ODCs) at the Central Bank and currency in circulation.

In 2007, total domestic credit extended by depository corporations to the private sector, public non-financial corporations, Provincial and Local Governments, and other financial corporations, increased by K1,007.3 million to K4,043.8 million, compared to an increase of K795.3 million in 2006, mainly due to the growth in private sector credit of K1,006.7 million.

Preliminary estimates of the fiscal operations of the National Government for 2007 showed an overall surplus of K575.5 million, compared to a surplus of K535.8 million in 2006. This represents 3.1 percent of the revised nominal GDP and was mainly due to higher than



expected mineral tax revenue, which more than offset an increase in expenditure.

Total revenue, including foreign grants, during 2007 was K6,960.3 million, 10.3 percent higher than the receipts collected in 2006, and represents 96.7 percent of the revised budgeted revenue for 2007. The increase was attributed to higher tax revenue, which more than offset declines in non-tax revenue, infrastructure tax credits and foreign grants.

Total expenditure during 2007 was K6,384.8 million, 10.6 percent higher than in 2006, and represents 92.8 percent of the revised budgeted expenditure for 2007. The increase reflected higher recurrent and capital expenditure.

The budget surplus was partly used to make net overseas loan repayments totalling K427.3 million, while a net negative financing of K148.2 million reflected deposits held with the domestic banking system. The net external loan repayments comprised of K324.6 million to concessionary, K15.6 million to commercial and K87.1 million to extraordinary sources.