



**BANK OF PAPUA NEW GUINEA**

## **MEDIA RELEASE**

17<sup>th</sup> September, 2008

### **QUARTERLY ECONOMIC BULLETIN** **JUNE QUARTER OF 2008**

Mr. L. Wilson Kamit, CBE, Governor of the Bank of Papua New Guinea (Bank of PNG), today released the June 2008 Quarterly Economic Bulletin. This statement provides an overview of the financial and economic developments during the June quarter of 2008 as well as developments since June 2008.

#### **1. DEVELOPMENTS SINCE JUNE 2008**

The Governor noted that the annual headline inflation rate, as measured by the June quarter Consumer Price Index (CPI), released by the National Statistical Office (NSO), was 10.7 percent over the year to June 2008, compared to 7.5 percent over the year to March 2008. The significant increase was mainly driven by the soaring prices of international food and fuel over the year to June 2008. Inflationary pressures are expected to continue for the rest of this year. Given these outcomes and expectations on inflation, the Bank tightened monetary policy by increasing its policy signalling rate, the Kina Facility Rate, by 25 basis points to 6.50 percent in August and by a further 50 basis points to 7.00 percent in September 2008.

The Governor emphasized that the high annual rate of inflation to June 2008 is due to increased international prices for food and fuel, which is imported and is outside of Papua New Guinea's control. Inflation rates in major economies also continue to rise due to soaring food and energy (fuel) prices.

The financial market crisis that started in the United States (US) and United Kingdom continued to result in low levels of lending in the major industrialised economies, which added to expectations of a slowdown in global economic growth. Economic indicators released in August suggested that the US is better positioned to avoid a recession while some economies in the Euro area have shown signs of entering a recession. While many commodity prices retreated from their series of record highs, they still remain high by historical standards. Crude oil prices fell below US\$120 for the first time in three months on the 4<sup>th</sup> of August 2008. Lower demand from China and other slowing economies and increased supplies from the Organisation of Petroleum Exporting Countries (OPEC) contributed to the fall in oil prices. Other commodities, such as copper, also experienced decline in prices.

The kina has appreciated against the US dollar from US\$0.3760 at the end of June 2008 to US\$0.3860 as at 12<sup>th</sup> September 2008. The appreciation of the kina reflects the high inflows of export receipts, including mineral taxes and the Central Bank's intervention in the foreign exchange market. From the end of June to the 12<sup>th</sup> September 2008 the US dollar appreciated against the pound sterling, the Australian dollar and the euro. The kina appreciated against the Australian dollar from A\$0.3906 at the end of June 2008 to A\$0.4798 at 12<sup>th</sup> September 2008. As a result the level of foreign exchange reserves increased from K6,389.7 (US\$2,434.5) million at the end of June 2008 to K6,454.1 (US\$2,523.5) million on the 12<sup>th</sup> of September 2008.

The commercial bank's Indicator Lending Rate (ILR) spread increased from 8.95 - 9.50 percent at the end of June 2008 to 8.95-9.70 percent on the 1<sup>st</sup> September. Domestic interest rates, especially the 28 day Central Bank Bill (CBB) rate increased reflecting the tightening stance of monetary policy however, other domestic market interest rates continue to lag behind due to the high level of liquidity in the banking system. Lending to the private sector continued to increase due to the low interest rate environment.

## **2. OVERVIEW OF THE DEVELOPMENTS IN THE JUNE QUARTER OF 2008**

Economic indicators available to the Bank of Papua New Guinea (the Bank) show that economic activity continued to grow in the first half of 2008. This is evident in: growth in the level of employment, a large surplus in the trade account due to high international prices and increased production of most agricultural and mineral export commodities, higher lending to the private sector, increased Government spending and increased sales in the private sector. Inflation increased significantly in the June quarter of 2008 as a result of high international fuel and food prices and increased aggregate domestic demand. These, combined with high growth in monetary aggregates and expectations of continued inflationary pressures prompted the Bank to tighten monetary policy in June 2008. The kina appreciated against the US dollar and depreciated against the Australian dollar and resulted in the Trade Weighted Index (TWI) appreciating by 1.3 percent in the June quarter. Any favourable impact on inflation by this exchange rate movement was more than offset by high imported inflation. The Bank is concerned about the inflationary pressures and will take appropriate actions for its monetary policy.

Data obtained from the Bank of PNG's Business Liaison Survey (BLS) shows that the total nominal value of sales in the private sector increased by 15.0 percent in the March quarter of 2008, compared to a decline of 1.5 percent in the December quarter of 2007. Excluding the mineral sector, the total nominal value of sales increased by 6.6 percent in the March quarter of 2008. The increase was in all sectors, except the wholesale and transportation sectors. By region, increases in the total nominal value of sales were in the Southern, NCD, Momase and Islands regions, while the Morobe and Highlands regions recorded decreases. Over the twelve months to March 2008, the total nominal value of sales increased by 8.0 percent.

The Bank's Employment Index for the June quarter of 2008 indicated that the total level of employment in the formal private sector increased by 3.3 percent in the June quarter of 2008, compared to an increase of 2.0 percent in the previous quarter. Excluding the mineral sector, the level of employment increased by 3.4 percent in

the June quarter of 2008, compared to an increase of 2.9 percent in the previous quarter. All sectors recorded increases in employment levels, except the building and construction sector, which recorded a marginal decline. By region, all regions recorded increases. Over the year to the June 2008, the level of employment, excluding the mineral sector, increased by 8.2 percent.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), increased by 3.7 percent in the June quarter of 2008, compared to an increase of 3.1 percent in the previous quarter. This outcome was due to higher prices in all expenditure groups, except 'Clothing and footwear'. The annual headline inflation was 10.7 percent in the June quarter of 2008, compared to an increase of 7.5 percent in the previous quarter. The higher outcome was mainly attributed to higher international food and fuel prices as well as increases in the prices of seasonal produce. As a result, all expenditure groups indicated price increases, mainly in the 'Rents, council charges, fuel and power' and 'Food' expenditure groups. By region, all surveyed urban areas recorded higher prices in the June quarter and over the year to June 2008. The exclusion-based inflation was 3.7 percent in the June quarter of 2008, compared to 2.8 percent in the previous quarter. Trimmed mean inflation was 3.6 percent in the June quarter of 2008, compared to 3.9 percent in the March quarter of 2008.

In the June quarter of 2008, the daily average kina exchange rate appreciated against the US dollar, pound sterling and Japanese yen, while it depreciated against the euro and Australian dollar. The kina appreciated by 3.1 percent against the US dollar, 3.6 percent against the pound sterling and 2.5 percent against the yen. The kina depreciated by 0.9 percent and 1.0 percent against the Australian dollar and euro, respectively during the June quarter. These movements resulted in the daily average Trade Weighted Index (TWI) appreciating by 1.3 percent during the June quarter.

Higher international prices for all mineral and most agricultural export commodities resulted in a 25.5 percent increase in the weighted average kina price of Papua New Guinea's exports in the June quarter of 2008, compared to the corresponding quarter of 2007. There was a 25.8 percent increase in the weighted average kina price of

mineral exports with higher kina prices of all minerals. For agricultural, log and marine product exports, the weighted average kina price increased by 23.7 percent and was accounted for by higher prices of coffee, cocoa, palm oil, copra, copra oil, rubber and marine products, which more than offset the decline in export prices of tea and logs.

The overall surplus in the balance of payments was K616 million in first six months to June 2008, compared to a lower surplus of K400 million in the corresponding period of 2007. This outcome was due to a higher surplus in the current account, which more than offset a deficit in the capital and financial accounts.

The current account recorded a surplus of K1,149 million in the first six months to June 2008, compared to a surplus of K570 million in the corresponding period of 2007. This outcome was the result of higher trade account surplus and lower net service payments, which more than offset higher net income payments and lower net transfer receipts.

The capital account recorded a net inflow of K18 million in the first six months to June 2008, a decline of 77.8 percent from the corresponding period of 2007, reflecting lower capital transfers.

The financial account recorded a net outflow of K607 million in first six months to June 2008, compared to a net outflow of K297 million in the corresponding period of 2007. This outcome was mainly due to higher net outflow from portfolio investments reflecting investments in short term money market instruments, financial derivative instruments and other investments. The net outflow in other investments is due to a build-up in the net foreign assets of the banking system and foreign currency account balances of resident mineral companies and higher net loan repayments by the Government. These more than offset net inflows from direct investments, reflecting the issuing of new shares abroad by a resident company to raise capital for further expansion.

The level of gross foreign exchange reserves at the end of June 2008 was K6,567.9 (US\$2,434.5) million, sufficient for 9.3 months of total and 13.5 months of non-mineral import covers.

The Bank of PNG tightened monetary policy in the June quarter of 2008. As a result the Kina Facility Rate (KFR) was increased by 25 basis points to 6.25 percent from 6.00 percent. The dealing margin for the Repurchase Agreements (Repos) was maintained at 100 basis points on both sides of the KFR during the same period. Domestic interest rates for short-term securities showed mixed trends over the quarter.

The Bank continued to utilise its Open Market Operation (OMO) instruments in the conduct of monetary policy over the June quarter of 2008, as both CBBs and Reverse Repos were used to diffuse excess liquidity. As a result, trading in the inter-bank market increased moderately during the same period. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) of commercial banks were maintained at 3.0 percent and 25.0 percent, respectively, over the June quarter of 2008.

The average level of broad money supply (M3\*) increased by 7.0 percent in the June quarter of 2008, compared to an increase of 10.2 percent in the March quarter of 2008. This outcome was due to an increase of 4.7 percent in average net foreign assets of the depository corporations and 11.0 percent increase in average private sector credit, which more than offset a decline of 13.5 percent in average net claims on the Government. Average 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 10.0 percent in the June quarter of 2008, compared to an increase of 11.3 percent in the previous quarter.

Total domestic credit extended by depository corporations to the private sector, public non-financial corporations, Provincial and Local Level Governments and other financial corporations increased by K393.2 million to K4,912.5 million in the June quarter of 2008. This was mainly due to an increase of K388.4 million in private

sector credit and K4.6 million in public non-financial corporations. The annualised growth in domestic credit, excluding the Central Government and advances under the price support schemes was 35.9 percent in the second quarter of 2008.

Preliminary estimates of the fiscal operations of the National Government over the six months to June 2008 showed an overall surplus of K304.4 million, compared to a surplus of K409.2 million in the corresponding period of 2007. This represents 1.5 percent of nominal GDP. The surplus resulted from higher revenue, which more than offset an increase in recurrent expenditure.

Total revenue, including foreign grants, during the first six months of 2008 was K2,502.5 million, K0.9 million higher than the receipts collected in the corresponding period of 2007. This represents 34.8 percent of the budgeted revenue for 2008.

Total expenditure over the six months to June 2008 was K2,198.1 million, 5.1 percent higher than in the corresponding period in 2007, and represents 31.4 percent of the budgeted expenditure for 2008.

As a result of these developments in revenue and expenditure, the Government recorded an overall budget surplus of K304.4 million over the first six months of 2008. The surplus was used to make overseas loan repayments totalling K108.8 million and net negative financing to domestic sources of K195.6 million. The overseas loan repayments comprised of K33.0 million to concessionary, K8.3 million to commercial and K67.5 million to extraordinary sources.