BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

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# QUARTERLY ECONOMIC BULLETIN SEPTEMBER QUARTER 2009

Mr. Loi M. Bakani, Governor of the Bank of Papua New Guinea (Bank of PNG), today released the September 2009 Quarterly Economic Bulletin (QEB). This statement provides an overview of the economic and financial developments for the September 2009 quarter as well as developments since September 2009.

## 1. UPDATE ON DEVELOPMENTS SINCE SEPTEMBER 2009

It appeared that the "great recession" may have come to an end in the third quarter of 2009 when key economies such as the United States and Germany experienced real GDP growth, after four consecutive quarters of decline.[1] Quarterly real GDP in the US and Germany increased by 2.8 percent 0.3 percent respectively in the third quarter of 2009. It is expected that growth in these economies will continue into the fourth quarter of the year. However, business uncertainty and low growth in consumer spending has had an adverse effect on employment growth, with the unemployment rate still high in the US (10 percent) and the Euro area (11 percent). Of the developed economies, Australia has performed well with growth in real GDP expected to continue in the fourth quarter

[1] . The National Bureau of Economic Research in the US will determine whether the recession ended or not once it has all the necessary data.

after the recovery in the third quarter, a small recovery in employment and growth in consumer spending. Emerging economies such as China and India have been performing remarkably well with real growth expected to be around 8.5 percent and 5.7 percent, respectively, for 2009. The growth in the emerging markets underlies the recovery in the developed nations and the world economy.

Mr. Bakani explained that the recovery in the world economy has to continue and become more pronounced before it can have a positive effect on the external sectors of developing countries. For the Papua New Guinea economy, the lower demand for its exports, induced by the global recession, translated to declines in export prices and values and consequently, a lower trade account surplus in the nine months to September 2009 compared to the corresponding nine months of 2008. On the other hand, low foreign inflation and lower international fuel and food prices compared to 2008, had led to a fall in the rate of inflation. The annual headline inflation rate has progressively declined over the quarters from the high of 13.5 percent in the September quarter of 2008 to 5.3 percent in the September quarter 2009. This was in part due to lag effect of the appreciation of the kina against the US and Australian dollars in late 2008 and the relative stability of the kina against these currencies in the first half of 2009.

The continued decline in inflation prompted the Bank of PNG to ease monetary policy in December 2009 by reducing its policy signaling interest rate, the Kina Facility Rate (KFR) by 1.0 percent to 7.0 percent. However, the Bank is mindful of the upside risks to inflation that could come from a weaker kina and excessive government spending, especially a fast drawdown of the trust account funds, and will closely monitor these developments.

Commercial banks' Indicator Lending Rates (ILR) spreads were at 10.95-11.95 percent at the end of September 2009, the same as at the end of June 2009, and remain unchanged to 18th November 2009. Domestic interest rates as reflected mainly by the 28 day Central Bank Bill (CBB) rate have declined to be in the range of 6.0 to 6.5 percent in the fourth quarter from the 6.5 and 7.0 percent in the September quarter, while credit to the private sector continued to grow but at a lower pace.

The level of gross foreign exchange reserves increased from US$2,349 (K6,155) million at the end of September to US$2,452 (K6,556) million as at 24th December 2009.

## 2. OVER VIEW OF THE DEVELOPMENTS IN THE SEPTEMBER QUARTER OF 2009

Economic indicators available to the Bank of Papua New Guinea (the Bank) show that low economic growth in the domestic economy, induced by the global recession, continued into the third quarter of 2009. Albeit an increase in business sales in the June quarter compared to the March quarter, lower employment growth in the private sector, lower credit growth, and continued deterioration of the current account in the September quarter 2009 are indicative of the low growth. The deficit in the current account was, however, more than offset by a surplus in the capital and financial accounts, yielding an overall balance of payments surplus. Annual headline inflation subsided to 5.3 percent in the twelve months to September 2009 from the 13.5 percent in the corresponding period of 2008, attributed to reduced international fuel and food prices, low imported inflation and low prices of domestic seasonal produces. With the economic recovery in Australia and the consequent appreciation of the Australian dollar against the US dollar, the kina depreciated against Australian dollar and other major trading partner currencies, while it appreciated against the US dollar. As a result, the Trade Weighted Exchange Rate Index (TWI) depreciated by 1.7 percent in the September quarter. Although the rate of inflation had come down, potential inflationary pressures can come from a weaker kina and excessive Government spending, especially a fast draw-down of trust funds. The Bank therefore maintained its tight monetary policy stance by keeping the policy signaling rate, the monthly Kina Facility Rate (KFR), unchanged at 8.0 percent throughout the September quarter 2009.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the private sector increased by 9.1 percent in the June quarter of 2009, compared to a decline of 12.0 percent in the March quarter. Excluding the mineral sector, sales increased by 4.9 percent in the June quarter, compared to a decline of 14.3 percent in the previous quarter. By sector, all sectors recorded increases, except the manufacturing. All regions recorded increases, except the Islands. Over the twelve months to June 2009, total sales declined by 20.9 percent.

The Bank's Employment Index shows that the level of employment in the formal private sector increased by 0.6 percent in the September quarter of 2009, compared to an increase of 1.1 percent in the June quarter. Excluding the mineral sector, employment increased by 0.6 percent in the September quarter of 2009, compared to an increase of 1.2 percent in the previous quarter. By industry, employment increased in the manufacturing, mineral, wholesale, and retail sectors, which more than offset decclines in agriculture/forestry/fisheries, building and construction, transportation, financial/business and other services sectors. By region, NCD, Southern, and Momase recorded increases. Over the twelve months to September 2009, total employment increased by 3.6 percent while excluding the mineral sector it increased by 3.8 percent.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 1.8 percent in the September quarter of 2009, compared to 0.4 percent in the June quarter. The increase was in the 'Drinks, Tobacco and Betelnut', Food, 'Clothing and Footwear', 'Household equipment and operations', 'Transport and Communication', and Miscellaneous expenditure groups. Annual headline inflation was 5.3 percent in the September quarter of 2009, compared to 6.7

percent in the previous quarter. The lower inflation outcome was mainly attributed to low imported inflation and prices of seasonal produce. By region, all urban areas recorded both quarterly and annual price increases in the September quarter.

In the September quarter of 2009, the daily average kina exchange rate depreciated against all major trading currencies except the US dollar compared to the June quarter. While the kina appreciated against the US dollar by 4.0 percent to US$0.3680, it depreciated against the Australian dollar by 5.1 percent to A$0.4428, pound sterling by 2.0 percent to 0.2242 sterling, euro by 0.8 percent to 0.2576 euro and Japanese yen by 0.02 percent to 34.4473 yen. These movements resulted in the daily average TWI depreciating by 1.7 percent during the September quarter of 2009 compared to the June quarter.

Lower international prices for most mineral and agricultural exports resulted in a 17.4 percent decline in the weighted average kina price of exports in the September quarter of 2009, compared to the corresponding quarter of 2008. There was an 18.8 percent decline in the weighted average price of mineral exports, with lower kina prices of copper and crude oil. The weighted average price of agricultural, logs and marine product exports declined by 11.1 percent and was accounted for by lower kina prices of coffee, palm oil, copra, copra oil, tea, rubber and marine product exports.

The overall surplus in the balance of payments for the nine months to September 2009 was K833 million, compared to a surplus of K560 million in the corresponding period of 2008. This outcome was due to a surplus in the capital and financial accounts, which more than offset a deficit in the current account.

The current account recorded a deficit of K905 million in the nine months to September 2009, compared to a surplus of K2,068 million in the corresponding period of 2008. The outcome in the current account was attributed to a lower trade surplus, higher net service payments and lower net transfer receipts.

The capital and financial account recorded a net inflow of K1,783 million in the nine months to September 2009, compared to a net outflow of K1,674 million in the corresponding period of 2008.

The capital account recorded a lower net inflow of K58 million in the nine months to September 2009, compared to the corresponding period of 2008. The decline reflected lower capital inflows by donor agencies for project financing.

The financial account recorded a net inflow of K1,725 million in the nine months to September 2009, compared to a net outflow of K1,674 million in the corresponding period of 2008. This outcome reflected a higher net inflow from direct investments due to equity investments into a mineral company and liquidation of investments in financial derivative instruments and draw down of foreign currency account balances of mineral companies.

The level of gross foreign exchange reserves at the end of September 2009 was K6,155.0 (US$2,349) million, sufficient for 9.8 months of total and 13.5 months of non-mineral import covers.

The Bank of Papua New Guinea maintained a tight monetary policy stance during the September quarter of 2009 as stated in the September Monetary Policy Statement (MPS). The Kina Facility Rate (KFR) was kept unchanged at 8.00 percent with the dealing margin for the Repurchase Agreements (Repos) kept unchanged at 100 basis points on both sides of the KFR. Domestic interest rates for short-term securities and deposits showed declining trends across most maturities during the September quarter.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy over the September quarter of 2009. The commercial banks also used the interbank market to meet their daily liquidity needs. 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 September quarter 2009.

The average level of broad money supply (M3*) increased by 7.0 percent in the September quarter of 2009, compared to an increase of 4.1 percent in the June quarter. This outcome was mainly due to a substantial increase by 209.6 percent in average net claims on the Central Government following higher issuance of Treasury bills and withdrawal of Government deposits, 4.4 percent increase in average net private sector credit and an increase of 1.0 percent in average net foreign assets of depository corporations. 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 4.1 percent in the September quarter of 2009, compared to an increase of 2.9 percent in the June quarter of 2009.

During the September quarter of 2009, 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 K192.9 million to K6,264.9 million, compared to an increase of K220.5 million in the June quarter of 2009. This was mainly due to an increase of K196.8 million in private sector credit. The annualised growth in domestic credit, excluding Central Government and advances under the price support schemes was 29.7 percent during the quarter.

Preliminary estimates of the fiscal operations of the National Government over the nine months to September 2009 showed an overall surplus of K541.3 million, compared to a surplus of K885.8 million in the corresponding period of 2008. This represents 2.6 percent of nominal GDP.

Total revenue, including foreign grants, during the nine months to September 2009 was K4, 063.8 million, 11.6 percent lower than the receipts collected in the corresponding period of 2008. This represents 55.9 percent of the budgeted revenue. The decline reflected low tax receipts during the period, which more than offset  increases in non-tax revenue and foreign grants.

Total expenditure over the nine months to September 2009 was K3,522.5 million, 5.1 percent lower than in the corresponding period of 2008, and represents 52.8 percent of the budgeted expenditure for 2009. This was due to lower development expenditure, which more than offset an increase in recurrent expenditure.

The surplus was used to make net external loan repayments of K125.8 million and net negative financing to domestic sources of K415.5 million. The net overseas loan repayments comprised of K85.7 million, K9.8 million and K30.2 million to concessionary, commercial and extraordinary sources, respectively. The net negative financing to domestic sources comprised of K1, 019.3 million in cheque floats that were settled, which more than offset a net draw down of K603.8 million from Government deposits at the Central Bank.