BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

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QUARTERLY ECONOMIC BULLETIN
JUNE QUARTER 2009

Sir. Wilson L. Kamit, Kt, CBE, Governor of the Bank of Papua New Guinea (Bank of PNG), today released the June 2009 Quarterly Economic Bulletin (QEB). This statement provides an overview of the economic and financial developments for the June 2009 quarter as well as developments since June 2009.

1. UPDATE ON DEVELOPMENTS SINCE JUNE 2009

While economic activity in the advanced economies declined in the eight months to August 2009, there are some signs that the recession may have reached its trough and some signs of economic recovery have emerged. The significant pick-up in economic growth in China and India, and the recovery in Australia following one quarter of negative growth are positive indications. Also, there were some gains made in the manufacturing and industrial sectors in the USA, Japan and the Euro area for the first time since early 2008. The aggressive measures by central banks in easing monetary policy, through interest rate cuts, and large fiscal stimulus packages of Governments have helped to slow down the impact of the financial crisis and assist economies to recover.

For the Papua New Guinea economy, lower demand for its exports has translated to declines in export prices and values and consequently, a lower trade account surplus in the first six months of 2009 compared to the corresponding six months of 2008. The annual consumer price index headline inflation rate has progressively declined over the quarters from the high of 13.5 percent in the September quarter of 2008 to 6.7 percent in the June quarter 2009. While domestic demand contributed to the increase, the lower rate of increase can be attributed to lower fuel prices and foreign inflation, and, to an extent, aided by the lag effect of the appreciation of the Kina against the US and Australian dollars in late 2008.

Although the lower rate of inflation is a favourable development, the Bank is mindful of the upside risks to inflation that could come from a weaker kina, domestic demand, and increased government spending, especially a fast drawdown of the trust account funds and domestic demand. The Bank therefore continued to maintain the monthly Kina Facility Rate (KFR) at 8.0 percent in September 2009.

Commercial banks' Indicator Lending Rates (ILR) spreads are at 10.95-11.95 percent at the end of June 2009 the same as at the end of March 2009, and remain unchanged to 08th September 2009. Domestic interest rates as reflected mainly by the 28 day Central Bank Bill (CBB) rate stabilized between 6.5 and 7.0 percent, while credit to the private sector continued to grow but at a lower rate.

The level of gross foreign exchange reserves increased from US$2,263.7 (K6,118.1) million at the end of June 2009 to US$2,324.6 (K6,316.8) million as at 17th September 2009.

2. OVER VIEW OF THE DEVELOPMENTS IN THE JUNE QUARTER OF 2009

Economic indicators available to the Bank of Papua New Guinea (the Bank) show that growth in the domestic economy slowed down in the second quarter of 2009, mainly due to the impact of the global recession. Declines in export commodity prices and production resulted in lower mineral and agricultural exports and led to a significant current account deficit and lower government revenue. The deficit in the current account was, however, more than offset by a surplus in the capital and financial accounts to result in an overall balance of payments surplus. A lower increase in the total level of employment in the June quarter 2009 and a decline in total nominal value of sales in the private sector in the first quarter of 2009 are also indicative of the slowdown in economic activity. Growth in the economy was driven domestically by high Government expenditure and increase in lending to the private sector, although at a lower rate. Inflation slowed down to 6.7 percent in the June quarter of 2009 compared to 10.2 percent in the previous quarter. The average kina exchange rate continued its downward trend in the June quarter, depreciating against most major currencies. The Bank, therefore maintained a tight monetary policy stance in the first half of 2009 to consolidate its effort in stabilizing prices.

Data obtained from the Bank’s Business Liaison Survey (BLS) show that the total nominal value of sales in the private sector declined by 12.0 percent in the March quarter of 2009, compared to a decline of 15.3 percent in the December quarter of 2008. Excluding the mineral sector, sales declined by 14.3 percent in the March quarter, compared to a decline of 9.4 percent in the December quarter. By sector, all sectors recorded declines, except the building and construction and the financial/business and other services sectors. By region, all regions recorded declines, except the Islands region.

The Bank’s Employment Index shows that the aggregate level of employment in the formal private sector increased by 1.1 percent in the June quarter of 2009, compared to an increase of 1.7 percent in the March quarter. Excluding the mineral sector, the level of employment increased by 1.2 percent in the June quarter, compared to an increase of 2.4 percent in the previous quarter. By industry, the level of employment increased in the agriculture/forestry/fisheries, building and construction, wholesale, mineral and finance/businesses and others services sectors, which more than offset declines in the transportation, manufacturing and retail sectors. By region, all regions recorded increases, except the Southern and Islands regions. Over the twelve months to June quarter 2009, the level of employment increased by 3.8 percent, compared to an increase of 6.0 percent over the twelve months to March quarter. Excluding the mineral sector, the level of employment increased by 3.9 percent over twelve months to June 2009, compared to an increase of 6.1 percent over the twelve months to the March quarter.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 0.4 percent in the June quarter of 2009, compared to 2.1 percent in the March quarter. Higher prices in the ‘Rents, council charges & fuel/power’, ‘Transport and communication’, ‘Drinks, tobacco and betelnut’, Food, and Miscellaneous expenditure groups contributed to the increase. Annual headline inflation was 6.7 percent in the June quarter of 2009, compared to 10.2 percent in the March quarter of 2008. The largest increases were recorded in the ‘Miscellaneous’, ‘Drink, tobacco and betelnut’ and ‘Food’ expenditure groups. The lower rate of increase can be attributed to lower fuel prices and foreign inflation, and, to an extent, aided by the lag effect of the appreciation of the Kina against the US and Australian dollars in late 2008. By region, all urban areas recorded quarterly and annual price increases in the June quarter of 2009. Annual trimmed-mean inflation was 5.0 percent in the June quarter of 2009, compared to 7.9 percent in the March quarter.

In the June quarter of 2009, the daily average kina exchange rate depreciated against the US dollar by 2.0 percent to 0.354, the Australian dollar by 14.3

percent to 0.466, pound sterling by 9.2 percent to 0.229, and the euro by 6.0 percent to 0.260. The kina appreciated against the Japanese yen by 2.2 percent to 34.455. These movements resulted in the daily average Trade Weighted Index (TWI) depreciating by 8.4 percent during the June quarter.

Lower international prices for most mineral and agricultural export commodities resulted in the weighted average kina price of Papua New Guinea's exports declining by 23.2 percent in the June quarter of 2009, compared to the corresponding quarter of 2008. There was a 23.6 percent decline in the weighted average kina price of mineral exports, with lower prices for crude oil and copper. For the agricultural, forestry and marine product exports, the weighted average kina price declined by 21.5 percent, due to lower prices of coffee, cocoa, palm oil, copra oil, copra and rubber.

There was an overall surplus of K664 million in the balance of payments for the first six months of 2009, compared to a lower surplus of K648 million in the corresponding period of 2008. This was the result of a surplus in the capital and financial accounts more than offsetting a deficit in the current account.

The current account recorded a deficit of K361 million in the first six months of 2009, compared to a surplus of K1,185 million in the corresponding period of 2008. This outcome was the result of a significantly lower trade account surplus and net transfer receipts which was more than offset by a deficit in the service and income accounts.

The capital account recorded a net inflow of K48 million in the first six months of 2009, an increase of 29.7 percent from the corresponding period of 2008. This reflected higher capital transfers by donor agencies for project financing.

The financial account recorded a net inflow of K928 million in the first six months of 2009, compared to a net outflow of K635 million in the corresponding period of

2008. This outcome reflected a higher net inflow from direct investments mainly due to share placements by a resident mineral company to raise capital for ongoing capital and operating expenditure, and investments in financial derivative instruments through hedge arrangements. These more than offset net outflows from portfolio investments reflecting investments in short-term money market instruments and other investments, combined with lower net loan repayments by the Government. The net outflow from 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.

The level of gross foreign exchange reserves at the end of June quarter 2009 was K5,985.2 (US$2,263.7) million, sufficient for 10.3 months of total and 14.1 months of non-mineral import covers.

The Bank of Papua New Guinea maintained a tight monetary policy stance during the June quarter of 2009 with the Kina Facility Rate (KFR) kept unchanged at 8.00 percent. The dealing margin for the Repurchase Agreements (Repos) was maintained at 100 basis points on both sides of the KFR. Domestic interest rates for short-term securities, particularly Central Bank Bill (CBB) and commercial bank lending and deposit rates increased during the June quarter of 2009.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy over the June quarter of 2009. The CBB auction was utilised to diffuse excess liquidity from the banking system together with the issuance of the Government Treasury bills. 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 June quarter.

The average level of broad money supply (M3*) increased by 4.1 percent in the June quarter of 2009, compared to an increase of 2.3 percent in the March quarter. This outcome was mainly due to an increase of 8.1 percent in average net foreign assets of depository corporations and an increase of 3.6 percent in average net private sector credit, which more than offset a decline of 60.2 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 2.9 percent in the June quarter of 2009, compared to an increase of 5.3 percent in the March quarter of 2009.

During the June 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 K229.6 million to K6,034.6 million, compared to an increase of K222.4 million in the March quarter of 2009. This was mainly due to an increase of K224.7 million in private sector credit and K7.3 million in claims on public non-financial corporations. The annualised growth in domestic credit, excluding Central Government and advances under the price support schemes was 34.8 percent in the second quarter of 2009.

Preliminary estimates of the fiscal operations of the National Government over the six months to June 2009 showed an overall surplus of K302.2 million, compared to a surplus of K304.4 million in the corresponding period of 2008. This represents 1.4 percent of nominal GDP. The surplus resulted from higher revenue, which more than offset an increase in expenditure.

Total revenue, including foreign grants, during the June quarter of 2009 was K2,626.7 million, 5.4 percent higher than the receipts collected in the corresponding period of 2008. This represents 39.4 percent of the budgeted revenue for 2009.

Total expenditure over the first six months to June 2009 was K2,324.5 million, 5.8 percent higher than in the corresponding period of 2008, and represents 34.8 percent of the budgeted expenditure for 2009. This was due to higher recurrent and development expenditures.

As a result of these developments in revenue and expenditure, the Government recorded an overall budget surplus of K302.2 million in the first six months of June 2009. The surplus was used to make net external loan repayments of K86.3 million and net negative financing to domestic sources of K276.7 million. The net overseas loan repayments comprised K59.2 million, K9.1 million and K18.0 million to concessionary, commercial and extraordinary sources, respectively. The net domestic financing comprised of K276.7 million in cheque floats presented for settlement, which more than offset K60.8 million in net drawdown of Government deposits held at the Central Bank.