BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

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QUARTERLY ECONOMIC BULLETIN
MARCH QUARTER 2009

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

1. UPDATE ON DEVELOPMENTS SINCE MARCH 2009

The economic recession in the major economies and the downturn in economic activity in other economies intensified in the first five months of 2009. In its April 2009 World Economic Outlook (WEO) the International Monetary Fund (IMF) revised downwards its world real Gross Domestic Product (GDP) to negative 1.3 percent for 2009. The concerns to stimulate employment and economic activity are still high on the agenda. Central banks and Governments in many countries are pursuing aggressive measures of easing monetary policy, through interest rate cuts, and large fiscal stimulus packages. However, the latest economic statistics for China show that its economic growth was higher than expected and could act as a catalyst for a global economic resurgence. In contrast, the IMF says an economic rebound will be slow in some parts of the world such as the euro zone, and has urged more aggressive efforts to rehabilitate the fragile banking sector. The price of oil has climbed past US$60.00 per barrel in May after declining to US$43.00 per barrel in March 2009.

For the Papua New Guinea economy, lower demand for its exports has translated to lower export prices and values and consequently, a lower trade account surplus. High inflation is still a concern as business houses have not fully passed on the benefit of lower import costs from the decline in food prices and appreciation of the kina against the key currencies in the second half of 2008.

The Governor noted that the annual headline inflation rate to March 2009, as measured by the Consumer Price Index (CPI), released by the National Statistical Office, was 10.2 percent. Higher prices were recorded in the 'Drinks, Tobacco and Betelnut', 'Miscellaneous', 'Household, equipment and operations' and 'Transport and communication' expenditure groups, with the largest increases coming from the first two groups. The Bank maintained its tight monetary policy stance by keeping its policy interest rate - the monthly Kina Facility Rate (KFR) at 8.0 percent in the first half of 2009.

Commercial banks' Indicator Lending Rates (ILR) spreads increased from 8.95-9.95 percent at the end of December 2008 to 10.95-11.95 percent at the end of March 2009, and remain unchanged to 18th June 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 growth for the private sector has eased slightly.

The level of gross foreign exchange reserves increased from US$1,950.1 (K5,644.3) million at the end of March 2009 to US$2,227.9 (K5981.0) million as at 17th June 2009.

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

Economic indicators available to the Bank of Papua New Guinea (The Bank) show that the domestic economy continued to grow in the first quarter of 2009 but some point to an easing in the growth. Increase in the level of aggregate employment is indicative of the continued economic growth, while declines in exports, resulting in a lower trade surplus, and a lower growth in credit to the private sector suggest an easing in the growth. Lower prices of export commodities, resulting from a fall in global demand, have started to have an impact on Papua New Guinea's exports. The Government recorded a fiscal deficit in the first quarter of the year. Although aggregate domestic demand may have eased somewhat it is still high. This, together with: a lower pass-through by businesses of lower import costs from the kina appreciation and decline in international food prices in the second half of 2008; and the depreciation of the kina in the first quarter, led to a higher than expected annual headline inflation of 10.2 percent in the first quarter of 2009. Considering the high inflation outcome in the December quarter 2008 and expectations of continued inflationary pressures, the Bank of PNG maintained its tight monetary policy stance by keeping the policy signaling rate – the Kina Facility Rate (KFR) at 8.0 percent over the first quarter of 2009.

Data obtained from the Bank's Business Liaison Survey (BLS) show that over the twelve months to December 2008, the total nominal value of sales in the non-mineral private sector, increased by 14.8 percent. However, in the December quarter 2008, the total sales in the non-mineral private sector declined by 9.4 percent compared to an increase of 8.8 percent in the previous quarter. The decrease was in the wholesale, manufacturing, building and construction, and agriculture/forestry/fisheries sectors. Including the mineral sector, total nominal sales declined by 15.3 percent in the December quarter 2008, compared to the previous quarter. By region, all regions recorded declines, except the Islands region, in the December quarter of 2008.

The Bank's Employment Index for the March quarter of 2009 show an increase in the level of employment in the formal private sector of 1.7 percent, compared to an increase of 0.3 percent in the December quarter of 2008. By industry, the level of employment increased in the agriculture/forestry/fisheries, manufacturing, transportation, wholesale and financial/business and other services sectors. By region, the National Capital District (NCD), Southern, Morobe and Islands regions recorded increases. Over the year to March 2009, the level of employment increased by 4.1 percent, compared to an increase of 6.3 percent over the year to December 2008. Excluding the mineral sector, it increased by 0.3 percent over the same period.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 2.1 percent in the March quarter of 2009, compared to 0.9 percent in the December quarter of 2008. Annual headline inflation was 10.2 percent in the March quarter of 2009, compared to 11.2 percent in the December quarter of 2008. The largest increases were recorded in the 'Food', 'Drinks, tobacco and betelnut' and 'Miscellaneous' expenditure groups, which reflected increases in the prices of soft drinks, fruits and vegetables, and school fees. Trimmed mean inflation was 0.5 percent in the March quarter of 2009, compared to 1.1 percent in the December quarter of 2008. Exclusion-based inflation was 2.5 percent in the March quarter of 2009, compared to 1.0 percent in the December quarter of 2008.

During the first quarter of 2009, the daily average kina exchange rate depreciated by 5.3 percent against the US dollar to 34.00 cents, 4.5 percent against the Australian dollar to 49.46 cents, 8.0 percent against the yen to 33.75 yen, and 3.9 percent against the euro to 27.6 cents. However, the daily average kina exchange rate appreciated against the pound sterling by 3.6 percent to 25.18

pence. These movements resulted in the daily average Trade Weighted Index (TWI) depreciating by 4.9 percent in the March quarter of 2009.

Lower international prices of mineral and most agricultural exports resulted in a 29.7 percent decline in the weighted average price of Papua New Guinea's exports in the March quarter of 2009, compared to the corresponding quarter of 2008. There was a 31.9 percent decline in the weighted average price of mineral exports, with lower kina prices of all mineral products. For the agricultural, forestry and marine product exports, the weighted average price declined by 13.3 percent, which was due to lower kina prices of coffee, copra, copra oil, palm oil, rubber and marine exports.

The balance of payments recorded an overall surplus of K321 million in the March quarter of 2009, compared to a deficit of K114 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 K197 million in the March quarter of 2009, compared to a surplus of K438 million in the corresponding period of 2008. This outcome was mainly attributed to a lower trade surplus, inspite of lower net service and income payments.

The capital account recorded a net inflow of K8 million in the March quarter of 2009, compared to a net inflow of K14 million in the corresponding period of 2008, as a result of lower capital transfers by donor agencies for capital projects.

The financial account recorded a net inflow of K501 million in the March quarter of 2009, compared to a net outflow of K587 million in the corresponding period of 2008. This outcome was due to net inflows of direct investment, mainly from equity investments in a resident mineral company, combined with investments in financial derivative instruments reflecting currency hedge arrangements. This more than offset net outflows from portfolio investments in short-term money market instruments and other investments, combined with net loan repayments by the Government. The net outflow in other investments reflects a build-up in the net foreign assets of the commercial banks.

The level of gross foreign exchange reserves at the end of March 2009 was K5,644.3 (US$1,950.1) million, sufficient for 9.7 months of total and 13.9 months of non-mineral import covers.

The Bank of Papua New Guinea maintained a tight monetary policy stance during the March quarter of 2009, keeping the Kina Facility Rate (KFR) unchanged at 8.00 percent. The dealing margin for the Repurchase Agreements (Repos) was kept unchanged at 100 basis points on both sides of the KFR. As a result the interest rates on Central Bank Bills (CBB) maturities increased. Other domestic market interest rates also increased during the quarter.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy through the CBB, Treasury bill and Inscribed stock auctions, which helped diffuse liquidity during the quarter. The commercial banks mainly utilised 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 March quarter.

The average level of broad money supply (M3*) increased by 2.0 percent in the first quarter of 2009, compared to a decline of 3.6 percent in the December quarter of 2008. This outcome was mainly due to an increase of 3.1 percent in average net foreign assets of depository corporations and of 4.0 percent in average net private sector credit, which more than offset a decline of 76.7 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 4.7 percent in the first quarter of 2009, compared to an increase of 6.3 percent in the December quarter of 2008.

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 K139.2 million to K5,755.4 million, compared to an increase of K396.2 million in the December quarter of 2008. This was mainly due to an increase of K127.5 million in private sector credit and K12.4 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 38.2 percent in the first quarter of 2009.

Preliminary estimates of the fiscal operations of the National Government over the three months to March 2009 showed an overall deficit of K94.0 million, compared to a deficit of K116.8 million in the corresponding period of 2008. This represents 0.4 percent of nominal GDP. The outcome resulted from higher expenditure, which more than offset an increase in revenue.

Total revenue, including foreign grants, during the March quarter of 2009 was K869.0 million, 24.2 percent higher than the receipts collected in the corresponding period of 2008. This represents 13.0 percent of the budgeted revenue.

Total expenditure over the three months to March 2009 was K963.0 million, 18.0 percent higher than in the corresponding period of 2008, and represents 14.4 percent of the budgeted expenditure for 2009.

As a result of these developments in revenue and expenditure, the Government recorded an overall budget deficit of K94.0 million over the first three months of

2009. The deficit, combined with net overseas loan repayments of K30.7 million was financed domestically.