



BANK OF PAPUA NEW GUINEA

Presentation

By

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Session 1 Topic: *Economic Outlook and Financial Sector Development*

The Prime Minister of Papua New Guinea, Hon. Peter O'Neill; Ministers of the State of Papua New Guinea; His Excellency Simon Tonge-High Commissioner to Papua New Guinea; Her Excellency Winnie Kiap-Papua New Guinea's High Commissioner to the United Kingdom; Colleagues and Distinguished guests.

On my way to this very important forum, I spent Thursday and Friday last week meeting with six large commercial and investment banks in Singapore to brief them on the Papua New Guinea economy. All of them are familiar with our economy. They are very impressed by its performance, especially with the smooth and early completion of the PNG LNG project. The investment in the PNG LNG project of US\$19 billion, some say US\$21 billion, let us take the lower number, equivalent to K52 billion, is higher than Papua New Guinea's total Gross Domestic Product (GDP). The consensus of all those attending the meetings in Singapore was that in spite of the lower oil and gas prices, the early commencement of

operation of the PNG LNG project, the commencement of full production at the Ramu Nickel and Cobalt project in 2014, will have a very positive impact on the Papua New Guinea economy. In 2015 the PNG economy will be the fastest growing economy in the world. GDP increase will be above ten percent, the current account will show a substantive positive balance, and government revenue will increase. The completion of the LNG project has already had very positive impact on investor confidence. In addition to Exxon Mobile which has a long time interest in our oil and gas industry, some very well known large corporation like Total and Rapsol have entered and are operating in the country. Added to this are companies operating in the other resource industries like Barrick, Newcrest, Harmony, PanAust and others. This is a clear vote of confidence in the Papua New Guinea economy.

The expected development of the Elk Antelope Gas Project by Total, the Wafi/Golpu Gold project by Newcrest and Harmony, the Frida River Copper and Gold project by PanAust, the first ever experiment by Nautilus Minerals to mine gold from the sea floor, are placing Papua New Guinea in the forefront of countries engaged in resource exploration and developments. The confidence of such a large number of developers in the country is enhancing the reputation of the country, as a safe and attractive place to invest in.

All the banks I met stressed that, it is crucial for the future development of the resource sectors to maintain, the strong commitment to the democratic principles Papua New Guinea is known to have, political stability, a transparent and stable taxation regime, and an independent legal system that protects the property rights of investors.

I want to add, the Bank of Papua New Guinea's very strong support of this government's increased spending on Health and Education, to improve on the very low social development indicators the country is ranked at the present. Spending on infrastructure is the other area this Government is concentrating on, and is very important to enable the development of the rural areas, where a great majority of the population of around 80% lives.

The source of economic development and growth is narrow. It does not cover the great majority of the rural population. The Bank of Papua New Guinea is advocating the development of the Agricultural Sector for many years. I stressed repeatedly the need to introduce Advanced Technologies and innovative systems in our agricultural sector. Just very recently, the introduction of modern technologies in the agriculture sector enabled Papua New Guinea to reduce the cost of production, and have its first ever export of vegetables.

I am sure that we will hear more about it from Hon. Tommy Tomscoll MP, the Minister for Agriculture and Livestock.

The Financial Sector is comprised of four banks, eight Financial Institutions, four Micro banks, twenty two Savings and Loan Societies, three large Superannuation funds and several life and general insurance companies.

The Port Moresby Stock Exchange (POMSE) is another institution in the Financial System. It has no "Width" with the number of traded companies are very few, and no "Depth" as the amounts of the daily trade is very low. Some of them are listed both on the Australian and the POMSE which clearly indicates that the listing requirements, trading rules and the regulations are adequate. The fast growth of the Papua New Guinean economy, the integration between the Melanesian countries in the Pacific, should enable a revisit of the POMSE, to see how its Width and Depth can be enhanced.

It is a very stable and prudently managed financial system. Let me inform you that there was a financial system, in a small developing country, down there in the South Pacific that was not affected by the 2008 Global Financial Crisis. There was only one small Lehman Brothers derivative sold, by one of the securities brokers of around US\$50 million, to some of our State Owned Enterprise. The parent company fully repaid the loss. This is the combined outcome of an advanced regulatory regime introduced in 2000, by the Central Bank and very prudent and responsible management by the Boards and Executive Management of the Banks and financial institutions. We have at the Forum two representatives of the

Banking Industry, Mr. Robin Fleming the CEO-MD of our largest bank and Mr. Mark Baker the CEO-MD of the second in size.

It is a small system, compared to the size of the economy and the population, total assets, of around US\$16 billion. The banking system inclusive of all institutions has an asset base of US\$11 billion, a loan portfolio of US\$5 billion. Only around 20% of the total population has access and use of the formal financial system.

One of the immediate needs of the country is project funding, especially in agriculture. As a result of very big losses incurred in the late 80th and early 90th of the previous century, banks are reluctant to advance loans to new project in the agriculture sector. The Bank of Papua New Guinea in close consultation and cooperation with the Government and the commercial banks, will have to resolve it, to ensure that all financial resources needed for the development of this very important sector are accommodated.

The liquidity in the banking system is very high. It is time to find ways to utilize it, for the development needs of the nation, both in the resource and non-resource industries.

We have a very long way to go with Financial Inclusion of the great majority of the rural population. As many other developing countries, the Bank of Papua New Guinea embarked on a very intensive Financial Education and Awareness program. We aim at reaching each and every one in the country and enable them to be included in the financial system. At today's technology of internet and mobile phone banking, it can be done at a reduced cost that even the low income earner's can afford.

The Bank of Papua New Guinea last year introduced an advanced Payments and Clearing System called Kina Automated Transfer System (KATS) to expedite the clearing of all transactions, and reduce the cost of all interbank activities.

Papua New Guinea is not an offshore center. It did not face problems with Money Laundering, from illegal flows of drugs and human trafficking. To ensure that we

adhere to best International Standards, and practices, the Department of Justice, the Office of the Attorney General, the Police and the Bank of Papua New Guinea, in very close cooperation with the financial system, plan to introduce legislation and regulations, to ensure that we remain free of these vices as well as other Money Laundering players.

Papua New Guinea has a floating exchange rate regime. As in many countries, the Bank of Papua New Guinea is intervening in the market to smooth uncalled for sharp up or down movements, without influencing the trend. Until mid 2012, the high International Commodity Prices of mineral and agriculture exports, combined with the large inflow of foreign currency, for the construction of the LNG project, resulted in a continuous appreciation of the Kina. From mid 2012, the decline in commodity prices and the slowdown of expenditure on the construction of the LNG project, reduced the foreign currency inflows, and the exchange rate started to depreciate. The Official Exchange Rate depreciated from US 48 cents to US 41 Cents to the Kina, until mid 2014. In spite of Bank of Papua New Guinea's continuous intervention in the market, the banks decided to transact outside the Official Market, at exchange rates that ranged from US\$ 39 buy to US\$ 33 sell rates. It was clear that the Bank of Papua New Guinea could not agree to this margin of 600 basis points, and the banks setting the exchange rate outside the formal market. In June 2014, it used its regulatory powers to introduce a Trading Band of 150 basis points, (75 above and 75 below) the daily set market rate. The exchange rate is continuing to devalue, and is at the present at a mid rate of US 36.65 cents to the Kina.

The level of foreign exchange reserves are at a very comfortable level of US\$ 2.1 billion, sufficient to cover 8.7 months of total imports and 13.5 months of non-mineral cover. The expected developments in the next five years indicate that, an increase in the foreign currency inflows, and increase in the foreign exchange reserves. We will deal with the economic impact of these flows, by the Sovereign Wealth Fund.

The recent introduction of the Organic Law on the Sovereign Wealth Fund (OLSWF) will have a very positive effect of stabilizing the flows into the budget. Many see it as the solution to the Dutch Disease phenomena, of appreciation of the domestic currency and its impact on the traditional export sectors. While the SWF can be used as a stabilizer of the local currency, the best solution and most efficient solution is, to develop the traditional domestic export industries, which in Papua New Guinea is at the present the Agriculture sector.

Once the education system will improve the technical and technological traits of the population, the development of other advanced industries will come on stream. The time will come when we will be in a state to diversify our rural based economy, to advanced industries.

Thank you all and God Bless