



BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

06th January 2016

Quarterly Economic Bulletin September Quarter 2015

The Governor of the Bank of Papua New Guinea (Bank of PNG), Mr Loi M. Bakani CMG, today released the September 2015 Quarterly Economic Bulletin (QEB). This statement provides an overview of the economic and financial developments during the September quarter of 2015 and some latest key developments.

1. UPDATE ON DEVELOPMENTS SINCE SEPTEMBER 2015

The International Monetary Fund (IMF) in its October *World Economic Outlook* (WEO) reported that growth prospects across different economies remain uneven as a result of continued low commodity prices, increased financial market volatility and weak global demand. In the United States (US), labour market conditions improved as there were strong growth in private consumption, residential investment and government spending. Exports in the US, however, grew moderately. Growth in the United Kingdom (UK) slowed down as a result of lower productivity in the manufacturing sector and a slowdown in the construction sector, which offset a modest growth in the services sector. The pound sterling continued to remain strong and gave rise to a wider trade deficit in the UK as imports of vehicles and consumer

goods increased. In Japan, growth was higher than expected as capital expenditure, domestic demand and residential investment increased, while growth in the euro area moderated, mainly as a result of weak international trade impacting the economies of Germany, Italy and France, despite strong consumption and household spending. Growth in the emerging market and developing market economies slowed as a result of prolonged low commodity prices and currency depreciations. As a result of these developments, the International Monetary Fund (IMF) revised downwards its 2015 growth forecast to 3.1 percent from its early forecast of 3.3 percent made in July.

Governor Bakani noted that prices for PNG's export commodities continue to remain low, while crude oil prices have dropped by more than 60.0 percent since June 2014. The weighted average kina prices of Papua New Guinea exports declined by 18.3 percent in the September quarter and partly resulted in a decline of 26.1 percent in the value of merchandise exports. The Governor reiterated that with the declining commodity prices and lower foreign exchange inflows, the kina continues to be under downward pressure. It is projected that commodity prices will remain depressed in 2016 and therefore the Government will have to exercise restraint and prudent management of its Budget to ensure that it will base its spending on actual or realised revenues and available financing. The Government's initiative to raise funds offshore by issuing a sovereign bond in 2016 will assist in providing some relief for foreign exchange liquidity to the market.

Lower oil and food prices and lack of demand from the emerging and developing economies associated with weak global economic activity is keeping global inflation flat. With an extended period of low commodity prices, the Governor mentioned that the feed through from lower international fuel and food prices should offset some of the pressures arising from the depreciation of kina. The Governor urges companies to pass on the benefits of lower prices to consumers.

In November 2015, the National Parliament passed the 2016 Budget with a planned total expenditure of K14.8 billion, which is 2.4 percent lower than the 2015 Budget estimate, and revenue of K12.7 billion. The budget deficit therefore is K2.1 billion or 3.3 percent of GDP. Some concerns about the 2016 Budget include the following.

- The K12.7 billion revenue is expected to be largely driven by the mineral and petroleum tax. Since the release of the 2016 Budget, international prices for mineral and petroleum has dropped further and are forecast to be even lower. The IMF forecast for the two commodities are US\$42.0 per barrel and US\$9.5 per million metric British thermal units (mmbtu) in 2016. The Governor is concerned that the Government's price forecast of US\$60.0 per barrel for oil and US\$12.0 per mmbtu for LNG are on the high side and that the revenue targets may not be achieved.
- Fiscal deficits have inflationary effects on the economy. In cases where there is revenue shortfall, it is crucial for the Government to cut and reprioritise its expenditure.
- With the accumulation of national debt to around K16.9 billion, the Governor stressed that money borrowed should be spent on productive and quality investments to grow the economy with more emphasis on the agriculture and the export sector as well as tourism. This should lessen the burden on future debt repayments and avoid more financial resources being diverted away from productive investments to debt repayments.

The level of gross foreign exchange reserves at the end of September 2015 was K5,586.8 (US\$1,972.6) million, sufficient for 10.5 months of total and 18.4 months of non-mineral import covers. The level of gross foreign exchange reserves as at 31st December 2015 was K5,526.2 (US\$1,865.1) million.

2. OVERVIEW OF THE DEVELOPMENTS IN THE SEPTEMBER QUARTER OF 2015

Economic indicators available to the Bank of Papua New Guinea (the Bank) point to a slowdown in economic activity in the September quarter of 2015. A decline in the total level of employment in the private sector, a lower growth in domestic credit by the banking system, and lower production and export values of most major export commodities are all indicative of the slowdown in economic activity. Annual headline

inflation was 5.8 percent in September 2015, mainly attributed to the depreciation of the kina. The Bank continued to take a cautious approach by maintaining the policy signalling rate, the Kina Facility Rate (KFR), at 6.25 percent throughout the quarter.

Governor Bakani noted that data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the private sector increased by 6.2 percent in the June quarter of 2015, compared to a decline of 8.1 percent in the March quarter. Excluding the mineral sector, sales increased by 5.3 percent, following a decline of 6.4 percent in the previous quarter. By sector, sales increased in the wholesale, agriculture/forestry/fisheries, mineral, retail, manufacturing, and finance/business and other services sectors, while it declined in the transportation and construction sectors. By region, the value of sales increased in the Southern, NCD, Islands and Momase while it declined in the Highlands and Morobe. Over the year to June 2015, the total value of sales declined by 5.1 percent, while excluding the mineral sector, sales declined by 7.5 percent.

The Bank's Employment Index shows that the level of employment in the formal private sector declined by 3.4 percent in the September quarter of 2015, compared to an increase of 2.6 percent in the June quarter of 2015. Excluding the mineral sector, the employment level decreased by 3.5 percent. There were declines in the construction, agriculture/forestry/fisheries, manufacturing, finance/business and other services sectors. By region, employment declined in the Southern, Highlands, National Capital District and New Guinea Islands while it increased in Morobe and Momase. Over the twelve months to September 2015, the total level of employment declined by 2.6 percent, while excluding the mineral sector, it declined by 2.8 percent.

The Governor noted that quarterly headline inflation, as measured by the Consumer Price Index (CPI), increased by 1.7 percent in the September quarter of 2015, compared to an increase of 1.1 percent in the June quarter. There were price increases in the Housing, Alcoholic beverages, tobacco, and betelnut, Clothing and footwear, Household Equipment, Food & Non-Alcoholic Beverages, and Restaurants & hotels' expenditure groups. The Transport, 'Miscellaneous, and Recreation expenditure groups recorded declines, while the Communications, Health, Education

recorded no price change. By urban centre, prices increased in all centres. The annual headline inflation was 5.8 percent in September 2015, compared to 5.7 percent in the June quarter.

During the September quarter of 2015, the average daily kina exchange rate depreciated against most major currencies. It depreciated against the pound sterling by 4.1 percent to 0.2311, euro by 3.6 percent to 0.3222, US dollar by 2.9 percent to 0.3583 and the yen by 2.2 percent to 43.8034. It appreciated against the Australian dollar by 4.0 percent to 0.4935. The appreciation against the Australian dollar resulted in the increase of the daily average trade weighted index by 0.4 percent to 35.80.

The Governor mentioned that the weighted average kina price of Papua New Guinea's exports was 18.3 percent lower in the September quarter of 2015, compared to the corresponding quarter of 2014. There was a 22.4 percent decline in the weighted average price of all mineral exports. This was due to lower prices for gold, copper, crude oil, nickel, and Liquefied Natural Gas (LNG) condensate. For the agricultural, logs and marine product exports, excluding refined petroleum product exports, the weighted average price declined by 4.0 percent due to lower kina export prices of all non-mineral exports, with the exception of cocoa, copra, tea and rubber. Excluding logs, the weighted average price of agricultural and marine product exports declined by 9.0 percent in the quarter, compared to the corresponding period of 2014. The lower export prices reflected weak international commodity prices and depressed global economy.

There was an overall deficit of K393 million for the nine months to September 2015, compared to a deficit of K755 million in the corresponding period of 2014. A higher deficit in the capital and financial account more than offset a surplus in the current account.

The surplus in the current account was due to a higher trade surplus and net transfer receipts. The deficit in capital and financial account mainly reflected a build-up in foreign currency account balances of mining, oil and LNG companies. These more than offset net inflows in direct and portfolio investments, reflecting sale of equity by

resident entities and drawdown from investments in short term money market instruments, respectively.

The level of gross foreign exchange reserves at the end of September 2015 was K5,586.8 (US\$1,972.6) million, sufficient for 10.5 months of total and 18.4 months of non-mineral import covers.

Governor Bakani explained that the inflation outcomes for the first three quarters of 4.8 percent, 5.7 percent and 5.8 percent, respectively, are considered to be manageable and within the Bank's inflation forecast for the year. Considering this and consistent with the National Government's fiscal policy intention to stimulate economic activity after the LNG construction phase, the Central Bank continued to be cautious by maintaining its neutral stance of monetary policy and keeping the Kina Facility Rate (KFR) at 6.25 percent during the September quarter of 2015.

The average level of broad money supply (M3*) increased by 0.3 percent in the September quarter of 2015, compared to an increase of 1.2 percent in the June quarter of 2015. This outcome was mainly influenced by increases in average net credit to the other financial corporations (OFCs) and public non-financial corporations, with the latter reflecting increased lending to state owned enterprises. The average net domestic claims outstanding, excluding net claims on the Central Government, increased by 4.0 percent in the September quarter of 2015, following an increase of 0.6 percent in the June quarter of 2015. The average level of monetary base (reserve money) increased by 0.1 percent in the September quarter of 2015, from a decline of 1.7 percent in the previous quarter. This was mainly influenced by the increase in currency in circulation, which more than offset a decline in commercial banks' deposits at the Central Bank.

The average level of deposits in other depository corporations (ODCs) declined by 0.1 percent to K20,257.5 million in the September quarter of 2015, from K20,271.0 million in the previous quarter. This reflected decreases in deposits of the Government, financial corporation and public nonfinancial corporations.

The net foreign assets (NFA) of the financial corporations, comprising depository corporations (DCs) and other financial corporations (OFCs), declined by 10.2 percent to K7,585.5 million in the September quarter of 2015, compared to an increase of 2.3 percent in the June quarter. This resulted from declines in the NFA of both the Central Bank and ODCs. The decline in NFA of the Central Bank reflected its interventions to supply foreign currency in the foreign exchange market. The decline in NFA of ODCs was mainly due to decreases in their foreign assets, including investments abroad. Net claims on the Central Government decreased by K256.4 million to K7,685.6 million in the September quarter of 2015, compared to an increase of K648.9 million in the previous quarter. This resulted from the retirement of Government securities, reflecting a lack of demand.

In the September quarter of 2015, total domestic credit extended by financial corporations to the private sector, public non-financial corporations and 'Provincial and Local level Governments' increased by K669.4 million to K15,369.3 million, compared to an increase of K263.7 million in the previous quarter. This was mainly due to an increase of K702.2 million in credit to the public non-financial corporations, while credit to the private sector declined by K32.7 million. The increase in credit to the public non-financial corporations reflected advances by the ODCs to the State Owned Enterprises, especially for financing various infrastructure projects. The annualised growth in domestic credit, excluding Central Government, was 8.8 percent in the September quarter of 2015, lower than 12.0 percent recorded in the June quarter.

The Governor noted that the preliminary estimates of the fiscal operations of the National Government over the nine months to September 2015 show an overall deficit of K1,940.1 million, compared to a deficit of K1,510.1 million in the corresponding period of 2014. This represents 3.8 percent of nominal GDP, and reflected higher expenditure, which more than an increase in revenue.

Total tax revenue amounted to K6,207.1 million, 10.7 percent higher than the receipts collected during the same period in 2014, and represents 61.5 percent of the revised budgeted amount for 2015. Direct tax receipts totalled K3,974.5 million, 1.5 percent lower than the receipts collected during the corresponding period in

2014, and represents 60.9 percent of the revised budgeted amount. This outcome was mainly attributed to lower company taxes, which more than offset increases in personal and other direct tax receipts. The decrease in company taxes was mainly due to lower mining and petroleum taxes associated with lower international commodity prices and lower growth in the non-resource sector. The increase in personal income tax was due to higher tax collections as a result of increased enforcement and compliance measures by IRC. The higher collections in other direct taxes were mainly reflective of higher dividend withholding tax, gaming machine turnover and interest withholding tax receipts.

Total expenditure over the nine months to September 2015 was K9,395.9 million, 14.8 percent higher than in the corresponding period of 2014 and represents 62.1 percent of the revised budgeted appropriation for 2015. This outcome reflected higher recurrent and development expenditures.

Recurrent expenditure over the nine months to September 2015 was K5,395.9 million, 7.2 percent higher than in the corresponding period of 2014 and represents 54.9 percent of the revised budgeted appropriation for 2015. The increase was mainly due to higher spending by National Departments, high interest payments and grants to statutory bodies.

The Governor explained that the budget deficit of K1,940.1 million was financed from domestic sources totalling K2,076.0 million. External loan repayments comprised of K114.9 million and K21.0 million from concessional and extra ordinary sources, respectively. The domestic financing comprised net holdings of Government securities of K438.8 million by the Central Bank, K532.8 million by the ODCs, K489.6 million by OFCs and K200.0 million by Public Non-Financial Corporations, combined with K414.8 million in cheques yet to be settled.

Total public (Government) debt outstanding in the September quarter of 2015 was K17,515.1 million, K2,859.5 million higher than in the December quarter of 2014. Both domestic and external loans increased. The increase in domestic debt resulted from net new issuance of Treasury bills and Inscribed stocks, while the increase in

external debt mainly reflected exchange rate revaluation losses due to the depreciation of the kina, combined with drawdown of concessional loans.

The total amount of Government deposits in the depository corporations decreased by K352.1 million to K3,986.2 million in September 2015, compared to K4,338.3 million in the December quarter of 2014.

.