



BANK OF PAPUA NEW GUINEA

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Quarterly Economic Bulletin

June Quarter 2017

Mr. Loi M. Bakani, Governor of the Bank of Papua New Guinea (Bank of PNG), today released the June 2017 Quarterly Economic Bulletin (QEB). This statement provides an overview of the economic and financial developments during the June quarter 2017 and some key developments since then.

1. UPDATE ON DEVELOPMENTS SINCE JUNE 2017

Global economic growth show further strengthening in 2017, mainly reflecting growth in the advanced economies and the emerging market economies. Eased monetary conditions, strong investment, increased public spending and rebound in commodity prices supported the growth. In the United State (US), growth was due to strong consumer spending and increased business investment although the economy was slightly affected by hurricanes Harvey and Irma during the second half of the year. In the United Kingdom (UK), growth was slow amid uncertainties over the complexity of Brexit negotiations and rising inflation. Growth in the Euro area continued its momentum mainly attributed to higher consumption spending and investment growth, supported by the accommodative stance of monetary policy and strong growth in exports. Growth in Japan continues to be supported by the resilience in

global growth and improvement in domestic demand. In the major emerging market economies, growth was supported by a rebound in commodity prices and substantial investments on public infrastructure especially in China. Lower growth in India reflected the effects of demonetisation and the implementation of the Goods and Services Tax (GST), whilst Russia showed signs of rebounding growth reflecting a pick-up in oil exports and lower interest rates. Based on these developments, the International Monetary Fund (IMF) in its October 2017 World Economic Outlook raised its global growth forecast to 3.6 percent from its earlier forecast of 3.2 percent.

Governor Bakani notes that despite the concerns of high global liquidity, global inflation remained low. In Papua New Guinea (PNG), the pass-through of foreign inflation to domestic prices has been low for quite some time now as indicated by the low underlying inflation. This was also supported by the general stability of the kina exchange rate. Over the four consecutive quarters to June 2017, annual headline inflation trended downward to 5.8 percent. This trend continued to September 2017 with annual inflation at 5.1 percent. The Governor reiterates that headline inflation in PNG was mainly driven by the domestic seasonal prices for items such as fruits, vegetables and betelnut. Prices for these seasonal items are volatile due to weather conditions and supply issues. With the kina exchange rate depreciating since September 2017, inflation may increase as domestic companies pass on the cost of imported goods to domestic prices. The Bank will continue to monitor this development and its impact on domestic prices.

During the September quarter of 2017, the average daily kina exchange rate depreciated against all major currencies, except the yen. It depreciated against the euro by 6.6 percent to €0.2674, the Australian dollar by 5.1 percent to A\$0.3968, the pound sterling by 2.0 percent to £0.2421, and the US dollar by 0.2 percent to US\$0.3139. Against the yen, it appreciated by 2.4 percent to ¥35.7993. These currency movements resulted in the Trade Weighted Index (TWI) depreciating by 2.85 percent to 29.99 in the September quarter of 2017. As at 22nd November, the kina exchange rate against the US dollar was \$0.3115 per kina, the Australian dollar was A\$0.4119 per kina, the pound sterling was £0.2350 per kina, the yen at ¥34.9500 per kina, and the euro at €0.2653 per kina.

The Governor stated that prices of some of PNG's export commodities, particularly for energy, metals and minerals have increased since June 2017. He noted the following prices increase in the September quarter: crude oil by 11.0 percent to US\$53.0 per barrel, nickel by 18.1 percent to US\$11,216.0 per metric tonnes, copper by 9.8 percent to US\$6,577.00 per metric tonnes, gold by 6.2 percent to US\$1,314.0 per ounce and Liquefied Natural Gas (LNG) by 0.72 percent to US\$8.35 per mmbtu.

Given the low revenue in 2017, the Government announced a Supplementary Budget in September 2017, with downward revisions in expenditure of K494.3 million and revenue of K494.1 million. The budget deficit was maintained at K1,876.2 million as projected in the original 2017 Budget. Among other initiatives proposed in the Government's 100 Day 25 Point Plan, the Central Bank implemented an intervention of US\$100 million to support the domestic foreign exchange market to meet some of the outstanding import orders. The level of foreign exchange reserves is currently at K5,318.1(US\$1,683.2) million.

2. OVERVIEW OF THE DEVELOPMENTS IN THE JUNE QUARTER OF 2017

Economic indicators available to the Bank show that domestic economic activity continued at a slow pace during the second quarter of 2017. The decline in private sector employment in the June quarter, drop in international commodity prices and a significant fall in imports were indicative of this slow growth. While global economic growth maintained its momentum in the second quarter of 2017, international prices of most PNG's export commodities declined in the June quarter, compared to the previous quarter. Production of most commodities increased however, this was not sufficient to offset the decline in prices and resulted in low export receipts. This, combined with large holdings of export earnings offshore by mineral companies, led to a deficit in the balance of payments. During the quarter, the kina exchange rate depreciated against all major currencies, except the Australian dollar. As a result, the TWI fell by 0.9 percent to 30.87. With the fall in prices of seasonal produce, the inflation rate dropped further to 5.8 percent in the June quarter, while underlying inflation remained relatively low around 2.0 percent. Given these developments, the

Central Bank maintained its neutral monetary policy stance by keeping the monthly Kina Facility Rate (KFR) at 6.25 percent over the June quarter of 2017.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the private sector declined by 4.2 percent in the March quarter of 2017, compared to an increase of 13.0 percent in the December quarter of 2016. Excluding the mineral sector, sales fell by 0.2 percent, following an increase of 9.2 percent in the previous quarter. By sector, sales declined in the construction, agriculture/forestry/fishing, retail, mineral, transportation, manufacturing and the financial/business and other services sectors, while it increased in the wholesale sector. By region, sales declined in all regions except the Momase (excluding Morobe) region. Over the year to March 2017, sales increased by 30.7 percent, compared to a decline of 11.1 percent in the corresponding quarter of 2016. Excluding the mineral sector, it increased by 34.9 percent in the quarter, compared to a decline of 5.5 percent in the March quarter of 2016.

The Bank's Employment Index shows that the level of employment in the formal private sector declined by 1.1 percent in the June quarter of 2017, compared to an increase of 1.1 percent in the March quarter of 2017. Excluding the mineral sector, the level of employment fell by 1.4 percent in the quarter. By sector, employment decreased in the construction, agriculture/forestry/fishing, retail and manufacturing sectors, which more than offset increases in the transportation, wholesale, financial/business and other services and mineral sectors. By region, the employment level declined in the Islands, National Capital District (NCD) and Morobe regions, while it increased in the Momase, Highlands and Southern regions. Over the year to June 2017, the total level of employment fell by 3.1 percent, compared to a decline of 4.0 percent over the corresponding period of 2016. Excluding the mineral sector, it declined by 4.0 percent, compared a decline of 4.5 percent in the corresponding period of 2016.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), increased by 1.2 percent in the June quarter of 2017, compared to an increase of 1.1 percent in the March quarter. All expenditure groups recorded price increases except for the 'Recreation' expenditure group. The 'Education' and 'Communication'

expenditure groups recorded no price changes. By urban centre, prices increased in all the surveyed centres. Annual headline inflation was 5.8 percent in the June quarter of 2017, compared to 6.0 percent in the March quarter of 2017.

In the June quarter of 2017, the US dollar depreciated against the yen by 9.8 percent and the euro and pound sterling by 2.2 percent respectively, while it appreciated against the Australian dollar by 1.9 percent. Most commodity currencies remained sluggish against the US dollar, while the yen and euro appreciated due to improved economic conditions. During the June quarter of 2017, the average daily kina exchange rate depreciated against all major currencies, except the Australian dollar. It depreciated against the euro by 2.8 percent to €0.2862, the sterling by 2.7 percent to £0.2471, the yen by 2.4 percent to ¥34.9529 and the US dollar by 0.1 percent to US\$0.3145. It appreciated against the Australian dollar by 0.8 percent to A\$0.4191. These currency movements resulted in the TWI depreciating by 0.9 percent to 30.87 in the June quarter of 2017.

The weighted average kina price of PNG's exports, excluding LNG, declined by 2.2 percent in the June quarter of 2017, compared to the corresponding quarter of 2016. There was a decline of 6.6 percent in the weighted average price of mineral exports, reflecting lower kina price for gold. For agricultural, logs and marine product exports, the weighted average kina price increased by 24.4 percent due to higher prices of all agricultural commodities, except for cocoa. Excluding log exports, the weighted average kina price of agricultural and marine product exports increased by 44.3 percent in the quarter, from the corresponding quarter of 2016. The increase in kina export prices reflected improved international prices for most of PNG's export commodities, combined with the price effect of the depreciation of the kina against the US dollar.

The balance of payments recorded an overall surplus of K141 million for the first six months of 2017, compared to a deficit of K73 million in the corresponding period of 2016. A surplus in the current account more than offset a deficit in the capital and financial account.

The current account recorded a surplus of K9,545.0 million in the first six months of 2017, compared to a surplus of K7,256.0 million in the corresponding period of 2016. The surplus in the current account was due to a higher trade surplus and net transfer receipts, combined with lower net service and income payments.

The capital and financial account recorded a deficit of K9,425.0 million in the first six months of 2017, compared to K7333 million in the corresponding period of 2016. This outcome was attributed to outflows in portfolio and other investments reflecting investments in short-term money market and a build-up in offshore foreign currency account balances of mineral companies, mainly the PNG LNG project.

The level of gross foreign exchange reserves at the end of June 2017 was K5,398.4 (US\$1,697.8) million, sufficient for 6.2 months of total and 9.9 months of non-mineral import covers.

Annual headline inflation continued on a downward trend to 5.8 percent in the June quarter of 2017. The Central Bank also considered the relatively stable outcomes in other key macroeconomic indicators and therefore maintained its neutral stance of monetary policy by keeping the KFR at 6.25 percent during the June quarter of 2017. The dealing margin of the Repurchase Agreement (Repos) was maintained at 100 basis points on both sides of the KFR. The Bank utilised its Open Market Operation (OMO) instruments in the conduct of monetary policy to manage liquidity. There was a net Central Bank Bill (CBB) issuance of K197.5 million during the quarter. The Government also made a net issuance of K161.2 million in Treasury bills, and K190.8 million in Treasury bonds during the period. The Cash Reserve Requirement (CRR) for the commercial banks was maintained at 10.0 percent during the quarter.

The average level of broad money supply (M3*) decreased marginally in the June quarter of 2017, compared to an increase of 1.9 percent in the March quarter. This outcome was mainly due to decreases in average net foreign assets (NFA), net claims on Central Government and credit to the private sector. The average net domestic claims outstanding, excluding net claims on the Central Government, decreased by 0.4 percent in the June quarter of 2017, compared to a decrease of 1.7 percent in the previous quarter.

The NFA of the financial corporations, comprising depository corporations (DCs) and other financial corporations (OFCs), decreased by 6.5 percent to K6,932.2 million in the June quarter of 2017, compared to an increase of 15.9 percent in the previous quarter. There were decreases in the NFA of both the Central Bank and ODCs. The decrease in NFA of the Central Bank reflected foreign exchange intervention and repayment of external debt whilst the decline for ODCs reflected lower foreign exchange inflows during the period.

In the June quarter of 2017, total domestic credit extended by financial corporations to the private sector, public non-financial corporations and Provincial and Local level Governments increased by K98.7 million to K16,408.8 million, compared to a decrease of K570.7 million in the previous quarter. This was influenced by increases of K65.8 million and K32.9 million in credit to the public non-financial corporations and private sector, respectively. The increase in credit to the public non-financial corporations was due to advances to State Owned Enterprises (SOEs), while the increase in private sector credit was mainly to the 'agriculture, forestry and fisheries', 'finance', 'building and construction' and 'household' sectors.

Preliminary estimates of the fiscal operations of the National Government over the six months to June 2017 show a deficit of K784.4 million, compared to the deficit of K704.3 million in the corresponding period of 2016. This represents 1.1 percent of nominal Gross Domestic Product (GDP).

Total revenue, including foreign grants, over the six months to June 2017 was K4,441.4 million, 8.8 percent higher than in the corresponding period of 2016. This represents 38.7 percent of the total budgeted revenue for 2017. The increase in revenue reflects higher tax receipts and foreign grants, which more than offset a decline in non-tax receipts.

Total expenditure over the six months to June 2017 was K5,225.8 million, 9.2 percent higher than in the corresponding period of 2016 and represents 39.1 percent of the 2017 budgeted expenditure. This outcome was driven by higher recurrent expenditure, which offset lower development expenditure.

The deficit of K784.4 million was financed from external sources totalling K422.4 million, and domestic sources totalling K362.0 million. External financing comprised net concessional borrowing of K91.9 million and commercial loans of K330.5 million. Net domestic borrowing comprised of net purchase of Government securities by the ODCs and OFCs of K925.8 million and K375.3 million, respectively. These more than offset net retirement of Government securities by the Central Bank and public non-financial corporations of K84.6 million and K25.2 million, respectively, and the encashment of presented cheques from the previous year, totalling K829.4 million.

Total public (Government) debt outstanding as at June 2017 was K24,061.8 million, an increase of K1,609.7 million from March 2017. Both the external and domestic debt levels increased. The increase in external debt reflected loan drawdowns on concessional and commercial loans. The increase in domestic debt was attributed to net issuance of Government securities.

The total amount of Government deposits at depository corporations decreased by K394.9 million to K2,242.3 million in June 2017, compared to March 2017.