



BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

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Quarterly Economic Bulletin December Quarter 2017

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

1. UPDATE ON DEVELOPMENTS SINCE DECEMBER 2017

Global economic growth is expected to continue to improve in 2018 mainly across advanced and emerging market economies, reflecting a rebound in investment, trade and manufacturing activity. During the first quarter of 2018, growth in the United States (US) remained strong mainly driven by private sector investment, industrial production, US tax policy reforms and the weak US dollar. In the euro area, growth slightly slowed due to lower retail trade and industrial output although, confidence remained broadly stable. In the United Kingdom (UK), activity slowed as a result of severe cold weather conditions in the months of February and March 2018. Japan's economy continues to expand as industrial and manufacturing output increased in the quarter. In emerging market and developing economies, China continues to drive growth reflecting strong consumer demand, and robust activity and investment in the real estate sector, while growth in India continues to stabilise. The International

Monetary Fund (IMF) in its April 2018 publication of World Economic Outlook (WEO) maintained its global growth forecast at 3.9 percent for 2018, from the last update made in January 2018.

Governor Bakani mentioned that international commodity price data from the World Bank published on the 04th of March 2018, showed mixed trends in the prices of major commodities. Price indices of energy and precious metals declined by 5.36 percent and 0.54 percent respectively, while the non-energy price index increased by 1.16 percent. The decline in energy prices reflected drop in crude oil and Liquefied Natural Gas (LNG) prices by 4.18 percent and 16.32 percent, respectively. The decline in the price index of precious metal was attributed to lower prices of gold and silver by 0.04 percent and 0.29 percent, respectively. The increase in the non-energy price index was driven by higher prices of agricultural commodities and metals by 1.67 percent and 0.04 percent, respectively. Oil prices averaged to US\$65.0 per barrel in the first quarter of 2018.

The Governor highlighted that the recent earthquake in the Southern Highlands in February 2018 was one of the biggest disasters ever experienced in the history of PNG causing some damages to the mining, oil and LNG project facilities, and road infrastructure as well as loss of lives. Temporary closure of these projects and loss of production and exports from the mineral sector has adversely affected activity in the March quarter and growth outlook for 2018. However, the earlier than expected resumption of production by the affected resource companies in less than two months and increase in production and export is expected to lessen the impact estimated initially. The assessment of the earthquake disaster is on-going due to information gaps and the full impact will be known in the near future.

Governor Bakani plans to introduce some changes to the use of Repurchase Agreement Facility (Repo), an instrument for Open Market Operations to facilitate liquidity management and achieve monetary policy objective of the Bank. Two changes to be introduced are: (1) Repo will be secured where the borrowing bank will pledge its holding of Government securities as collateral and, (2) Intra-day financing facility to be introduced for clearance of shortfalls in the exchange

settlement account balance of banks. On the other hand, the Central Bank can pledge its securities to diffuse liquidity (reverse repo) from the commercial banks for monetary policy purposes. The Repo or reverse repo will be priced at the Kina Facility Rate (KFR) and a margin.

He noted that the inflation outlook (April 2018 WEO) for the advanced economies is to pick up to about 2.0 percent in 2018, which implies that the impact of imported inflation to domestic prices in PNG is not of a grave concern. Domestic annual headline inflation has trended downward to 4.7 percent in the December quarter of 2017, mainly reflecting lower prices of seasonal items (fruits, vegetables and betelnut). The seasonal items continue to have a major impact on the overall movement of prices. However, he cautioned that whilst headline inflation is falling, the underlying inflation measures have increased during the same period. Bank of PNG's monthly Retail Price Index (RPI) for January and February of 2018 support this increasing trend in underlying measures and build-up in price pressures mainly reflecting the pass-through effect of the depreciation of the kina exchange rate. He reiterated that the Bank will continue to closely monitor this trend.

The Governor mentioned that from end of December 2017 to the 29th of March 2018, the average daily kina exchange rate depreciated against all major currencies. It depreciated against the euro by 6.1 percent to €0.2513, pound sterling by 5.3 percent to £0.2218, yen by 4.7 percent to ¥33.4613, Australian dollar by 3.0 percent to A\$0.3929, and the US dollar by 0.8 percent to US\$0.3088. As at 30th April 2018, the kina exchange rate against the US dollar was US\$0.3075, Australian dollar was A\$0.4065, euro was €0.2535, pound sterling was £0.2231 and the yen was ¥33.570. These currency movements resulted in the Trade Weighted Index (TWI) depreciating by 3.72 percent to 28.89 as at 30th March 2018 before further depreciating by 0.3 percent to 28.81 as at 30th April 2018.

As at 30th April 2018, the level of foreign exchange reserves was K 5,339.32 (US\$ 1,668.54) million, compared to K5,461.2 (US\$1,717.5) million at the end of December 2017.

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

Governor Bakani mentioned that economic indicators available to the Bank of PNG point to a higher growth in 2017, compared to 2016, mainly driven by the mineral sector. Improvement in the international commodity prices and higher production of most of Papua New Guinea's major exports contributed to this growth. Consequently, the balance of payments recorded a higher surplus in 2017, compared to 2016. Increased foreign exchange inflows combined with the intervention from the Central Bank, assisted in improving the availability of foreign currency in the domestic market. A decline in the employment level in 2017 and lower sales by the non-mineral private sector for the nine months to September were indicative of low activity in the non-mineral sector. The stability of the kina against the US dollar over the year to September before depreciating in the December quarter contained the effect of the exchange rate pass-through to domestic inflation. This, combined with lower prices of seasonal items resulted in easing of the annual headline inflation to 4.7 percent in the December quarter of 2017. Taking into consideration the macroeconomic conditions and movement in prices, the Bank maintained a neutral monetary policy stance by keeping the monthly Kina Facility Rate (KFR) at 6.25 percent throughout 2017.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the private sector declined by 2.6 percent in the September quarter of 2017, compared to a decline of 12.9 percent in the previous quarter. Excluding the mineral sector, sales declined by 3.0 percent, compared to a decline of 7.8 percent in the previous quarter. By sector, sales declined in the construction, wholesale, financial/business/other services, manufacturing, mineral and agriculture/forestry/fishery sectors, while sales in the retail and transportation sectors increased. By region, sales declined in the Islands, Highlands and Morobe, while it increased in the National Capital District (NCD), Momase (excluding Morobe) and the Southern (excluding NCD) regions. Over the year to September 2017, total sales declined by 6.1 percent, compared to an increase of 12.5 percent in the corresponding period of 2016, while in the non-mineral sector, sales declined by 0.9

percent, compared to an increase of 14.6 percent in the corresponding period of 2016.

The Bank's Employment Index shows that the level of employment in the formal private sector declined by 2.3 percent in the December quarter of 2017, compared to a decline of 1.4 percent in the September quarter of 2017. The level of employment fell by 2.2 percent in the non-mineral sector. By sector, employment decreased in the construction, mineral, wholesale, agriculture/forestry/fisheries, transportation and financial/business and other services, which more than offset increases in the manufacturing and retail sectors. By region, employment declined in the Highlands, Southern, Morobe and Islands regions, while it increased in the Momase and NCD regions. In 2017, the total level of employment declined by 3.9 percent, compared to a marginal increase of 0.3 percent in 2016. In the non-mineral sector, it declined by 4.8 percent in 2017.

The Governor noted that quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 1.3 percent in the December quarter of 2017, compared to 1.0 percent in the September quarter. All expenditure groups recorded price increases except for the 'Communication' and 'Education' expenditure groups which recorded no price change. By urban centre, prices increased in all the surveyed centres. Annual headline inflation was 4.7 percent in the December quarter of 2017, compared to 5.1 percent in the September quarter of 2017. Annual underlying inflation, measured as trimmed mean and exclusion-based, were 2.3 percent and 4.4 percent, respectively in 2017.

In the December quarter of 2017, the average daily kina exchange rate depreciated against the pound sterling by 3.3 percent to £0.2341, the yen by 1.9 percent to ¥35.1235 and the US dollar by 0.8 percent to US\$0.3113. The kina appreciated against the Australian dollar by 1.8 percent to A\$0.4050 and the euro by 0.1 percent to €0.2676. These currency movements resulted in the Trade Weighted Index (TWI) appreciating by 0.04 percent to 30.00 in the December quarter of 2017.

The Governor mentioned that the weighted average kina price of Papua New Guinea's exports, excluding Liquefied Natural Gas (LNG) increased by 14.0 percent

in 2017, from 2016. There was an increase of 14.4 percent in the weighted average kina price of mineral exports reflecting higher kina prices for all mineral commodities. For agricultural, logs and marine product exports, the weighted average kina price increased by 12.6 percent, due to higher kina prices of all agricultural commodities, except for cocoa and coffee. Excluding log exports, the weighted average kina price of agricultural and marine product exports increased by 16.8 percent in 2017, from 2016. The higher kina export price reflected improved international prices for most of PNG's export commodities, combined with the effect of the depreciation of the kina against the US dollar.

The balance of payments position recorded a surplus of K350 million in 2017, compared to a surplus of K30 million in 2016. This outcome was a result of higher surplus in the current account, which more than offset a deficit in the capital and financial account.

The current account recorded a surplus of K19,860 million in 2017, compared to a surplus of K16,240 million in 2016. This was due to a higher trade surplus and net transfer receipts, which more than offset net service and income payments.

The capital and financial account recorded a deficit of K19,506 million in 2017, compared to a deficit of K16,203 million in 2016. The outcome was due to outflows in direct, portfolio and other investments reflecting equity outflow from liquidation of investments, short term money market investments offshore and build-up in foreign currency accounts of mineral companies, respectively.

The level of gross foreign exchange reserves at the end of December 2017 was K5,461.2 (US\$1,717.5) million, sufficient to cover 5.9 months of total and 9.7 months of non-mineral imports.

Governor Bakani noted that taking into consideration the easing of inflation, stability in the exchange rate and lower imported inflation from PNG's trading partners, the Central Bank maintained a neutral monetary policy stance by keeping the Kina Facility Rate unchanged at 6.25 percent over the December quarter of 2017. The

dealing margins for the Repurchase Agreement (Repos) were 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, which continued to remain high but unevenly distributed among banks. As a result, borrowing in the inter-bank market increased, as well as lending from the Central Bank through the Repurchase Agreement (Repo). There was a net retirement of K45.7 million of Central Bank Bills (CBBs), while there was a net issuance of K23.2 million in Government Treasury bills and K28.1 million in Treasury bonds during the quarter. The Cash Reserve Requirement for the commercial banks was maintained at 10.0 percent during the quarter.

The average level of broad money supply (M3*) decreased by 1.8 percent in the December quarter of 2017, compared to an increase of 1.3 percent in the previous quarter. This outcome was influenced by decreases in average net foreign assets (NFA) and net domestic claims of 2.9 percent and 1.0 percent, respectively. The average net domestic claims outstanding, excluding net claims on the Central Government, increased by 0.1 percent in the quarter, compared to an increase of 0.9 percent in the September quarter. The average level of monetary base (reserve money) decreased by 6.2 percent during the December quarter of 2017, following an increase of 0.4 percent in the previous quarter. This reflected a decrease in commercial banks' deposits at the Central Bank.

The NFA of the financial corporations, comprising depository corporations (DCs) and other financial corporations (OFCs), decreased by 3.4 percent to K7,266.7 million in the December quarter of 2017, compared to an increase of 8.5 percent in the previous quarter. There were decreases in the NFA of both the Central Bank and other depository corporations (ODCs).

Net claims on the Central Government by financial corporations increased by K27.9 million to K13,142.1 million in the December quarter of 2017, compared to an increase of K212.2 million in the previous quarter. This resulted from issuance of Government securities, both Treasury bills and Treasury bonds for budget financing.

In the December 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 K149.8 million to K16,652.3 million, compared to an increase of K93.7 million in the previous quarter. This reflected an increase of K104.0 million in credit to the private sector and K45.8 million to public non-financial corporation sector.

The Governor mentioned that the fiscal position of the National Government in 2017 shows an overall deficit of K1,794.7 million, compared to a deficit of K3,086.9 million in 2016. This represents 2.4 percent of nominal GDP.

Total revenue, including foreign grants, in 2017 was K11,525.0 million, 9.9 percent higher than in 2016. This represents 105.0 percent of the total revised revenue for 2017. The increase reflects higher tax and non-tax receipts, and foreign grants.

Total expenditure in 2017 was K13,319.7 million, 1.9 percent lower than in 2016 and represents 103.6 percent of the 2017 revised expenditure. This outcome was driven by higher recurrent expenditure, which offset lower development expenditure.

The deficit of K1,794.7 million was financed from both the domestic and external sources of K916.6 million and K878.1 million, respectively. Net domestic borrowing comprised net purchases of Government securities by the OFCs and ODCs of K980.3 million and K889.9 million, respectively. These, more than offset net retirement of Government securities by the Central Bank of K430.3 million and by the public non-financial corporations of K30.9 million, while presented cheque floats from the previous year was K492.4 million. Net external borrowing comprised net borrowings in concessional and commercial loans of K576.1 million and K346.9 million, respectively, which more than offset a net repayment of K44.9 million under extraordinary financing.

Total public (Government) debt outstanding in 2017 was K23,558.2 million, compared to K21,943.9 million in 2016, reflecting increases in both the external and domestic debt levels.

The total amount of Government deposits at depository corporations increased by K10.3 million to K2,184.7 million in December 2017, compared to September 2017.