



BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

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Quarterly Economic Bulletin June Quarter 2019

Mr. Loi M. Bakani CMG, Governor of the Bank of Papua New Guinea (Bank of PNG), today released the June 2019 Quarterly Economic Bulletin (QEB). This statement provides an overview of the economic and financial developments during the June quarter of 2019 and some key developments since then.

1. UPDATE ON DEVELOPMENTS SINCE June 2019

The growth outlook for the world economy for 2019 remained sluggish reflecting the slowdown in global trade and subdued activity in the manufacturing sector. This is reflective of the continued trade tensions between China and US as well as between South Korea and Japan, prolonged Brexit uncertainties and the geo-political tensions in the Middle-East. In the US, growth is expected to continue at a moderate pace mainly supported by the fiscal stimulus and net exports resulting from tariffs on Chinese goods. Growth prospect in the euro area remain low, mainly reflecting weak exports from Germany. Growth in emerging market economies continues to be weak, as growth in China slowed down and expected to continue, mainly reflecting weak exports due to the escalating trade tensions with the US.

The latest international commodity price data published by the World Bank in September 2019 show that prices of most agriculture commodities declined except for palm oil, while the price of LNG declined. For the mineral commodities, prices increased except for copper. The increase in gold prices have resulted from higher demand for gold denominated assets as safe haven investments due to increasing global uncertainties and risks. Energy prices fell by 11.8 percent reflecting lower prices of oil and natural gas, while international prices for agricultural commodities declined by 2.3 percent due to subdued global demand.

Global inflation is expected to remain low reflecting the slowdown in global growth and partly due to lower energy prices especially in the advanced economies. In response to lower inflation, major central banks have either lowered their monetary policy rates or left them unchanged. Governor Bakani mentioned that these developments have helped dampen the impact of foreign inflation on domestic prices partly resulted in lower domestic inflation outcomes. As a result, the Bank of PNG eased monetary policy by reducing the policy rate, the Kina Facility Rate (KFR) by 25 basis points from 6.25 percent to 6.00 percent in July, and again by 50 basis points to 5.50 percent in August 2019.

As at the 20th September 2019, the average daily kina exchange rate depreciated against all currencies except the pound sterling. The kina depreciated against the Japanese yen by 2.0 percent to ¥31.8626, US dollar by 0.4 percent to US\$0.2945, euro dollar by 0.4 percent to €0.2623, and the Australian dollar by 0.3 percent to A\$0.4212. Against the pound sterling, it appreciated by 2.4 percent to 0.2358. These currency movements resulted in the Trade Weighted Index (TWI) depreciating by 0.6 percent to 29.4.

Governor Bakani stated that the level of foreign exchange reserves as at the end of June 2019 fell to K6,830.3 (US\$2,045.7) million, from K6,899.7 (US\$2,080.3) million at the end of March 2019. As of the 20th September 2019, the level of foreign exchange reserves declined further to K6460.4 (US\$1931.7) million reflecting continued intervention by the Central Bank to support the foreign exchange market.

2. OVERVIEW OF THE DEVELOPMENTS IN THE JUNE QUARTER OF 2019

Economic indicators available to the Bank of Papua New Guinea (the Bank) point to a higher annual growth in the June quarter of 2019, reflecting the post-earthquake rebound in production of gas and petroleum, combined with higher production in the mining sector, which more than offset declines in international commodity prices. Activity in the non-mineral private sector was supported by increase in credit to private sector and higher government expenditure. The annual increase in employment in the June quarter and high annual sales by the private sector in the March quarter of 2019 were indicative of the growth. During the June quarter, the kina appreciated against most trading currencies except the US dollar and the Japanese yen. These movements resulted in the Trade Weighted Index (TWI) appreciating slightly by 0.62 percent to 29.577 in the quarter. With the relative stability in the exchange rate, and lower annual headline inflation outcome and inflationary expectations, the Bank maintained its monthly Kina Facility Rate (KFR) at 6.25 percent in the June quarter of 2019.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the formal private sector declined by 13.6 percent in the March quarter of 2019, compared to an increase of 15.6 percent in the December quarter of 2018. Excluding the mineral sector, sales declined by 16.9 percent in the March quarter, compared to an increase of 22.3 percent in the previous quarter. By sector, sales declined in all sectors except in the construction and agriculture/forestry/fishing sectors. By region, sales declined in all the regions except the Southern (excluding NCD) region. Over the year to March 2019, total sales increased by 7.9 percent, compared to a decline of 18.2 percent in the corresponding period of 2018. Excluding the mineral sector, sales increased by 9.5 percent, compared to a decline of 12.8 percent in the corresponding period of 2018.

The Bank's Employment Index show that the total level of employment in the formal private sector increased by 0.4 percent in the June quarter of 2019, compared to an increase of 2.0 percent in the March quarter of 2019. Excluding the mineral sector, the level of employment also increased by 0.4 percent. By sector, the level of employment increased in the retail, transportation, wholesale, mineral and the

financial/business and other services sectors, while it declined in the construction, agriculture/forestry/fishing and manufacturing sectors. By region, the level of employment increased in the NCD, Highlands and Morobe regions while it fell in the Islands, Momase and Southern regions. Over the year to June 2019, the total level of employment increased by 4.2 percent, compared to a decline of 3.2 percent in the corresponding period of 2018. Excluding the mineral sector, employment increased by 2.1 percent over the year to June 2019, compared to a decline of 4.1 percent in the corresponding period of 2018.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), increased by 0.8 percent in the June quarter of 2019, compared to an increase of 0.7 percent in the March quarter. By expenditure group, consumer prices increased in the 'Transport', 'Recreation', 'Restaurants and Hotels' 'Alcoholic Beverages, Tobacco and Betelnut', 'Household Equipment', 'Miscellaneous', 'Food and Non-alcoholic Beverages' and 'Housing' expenditure groups. The 'Communication', 'Health' and 'Clothing and Footwear' expenditure groups recorded declines. The 'Education' expenditure group recorded no price change during the quarter. By urban centre, prices increased in all the surveyed centres. Annual headline inflation was 4.0 percent in the June quarter of 2019, compared to an increase of 4.5 percent in the previous quarter.

In the June quarter of 2019, the average daily kina exchange rate appreciated against the Australian dollar by 1.3 percent to 0.4226, the pound sterling by 0.9 percent to 0.2301 and the euro by 0.7 percent to 0.2633, while it depreciated against the US dollar by 0.3 percent to 0.2958 and the Japanese yen by 0.5 percent to 32.5192. These currency movements resulted in the appreciation of the TWI by 0.62 percent to 29.5771 in the June quarter of 2019.

The weighted average kina price of Papua New Guinea's exports, excluding LNG, decreased by 7.8 percent in the June quarter of 2019, compared to the corresponding quarter of 2018. The weighted average kina price of mineral exports was 6.7 percent lower, reflecting lower kina prices for all mineral commodities, except for gold. For agricultural, logs and marine product exports, the weighted average kina price decreased by 13.7 percent, due to lower kina prices for coffee,

tea, copra oil and marine products. Excluding logs, the weighted average kina price of agricultural and marine product exports decreased by 18.5 percent in the June quarter of 2019, compared to the corresponding quarter of 2018. Lower international prices accounted for the decline.

The balance of payments recorded an overall deficit of K388 million for the first six months of 2019, compared to a surplus of K98 million in the corresponding period of 2018. A 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 higher trade surplus and net income receipts, combined with lower net service payments. This more than offset lower net transfer receipts.

The deficit in the capital and financial account was contributed by net outflows from direct investment and other investments reflecting intercompany equity withdrawal and build up in offshore foreign currency accounts of mineral companies including the LNG companies covered under the Project Development Agreements, respectively. These combined with net outflows in Government loan repayments.

The level of gross foreign exchange reserves was K6,460.4 (US\$1,931.7) million at the end of June 2019, equivalent to 5.3 months of total and 11.3 months of non-mineral import covers.

Taking into consideration lower inflationary expectations and general stability in other key macroeconomic indicators, the Bank maintained the monthly Kina Facility Rate (KFR) at 6.25 percent in the second quarter of 2019. The dealing margin for the Repurchase Agreement (Repos) Facility was reduced to 75 basis points from 100 basis points, following the securitization of borrowing under the Repo Facility in April 2019.

The Bank utilised its Open Market Operation (OMO) instruments in the conduct of monetary policy to manage liquidity. Central Bank intervention in the foreign exchange market also continues to play a major role in diffusing kina liquidity during

the period. Nevertheless, system liquidity remained high and unevenly distributed among the banks, resulting in the on-going borrowing in the inter-bank market and under the Repo Facility during the quarter. There was a net issuance in Central Bank Bill (CBB) of K43.2 million, and a net retirement in Treasury bills of K116.5 million in the June quarter of 2019, while there was a net issuance in Treasury bonds of K169.0 million. The Cash Reserve Requirement (CRR) for the commercial banks was maintained at 10.0 percent during the quarter.

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The average level of broad money supply (M3*) decreased by 0.9 percent in the June quarter, following a decrease of 0.4 percent in the March quarter of 2019. This outcome was due to a decline in the average net foreign assets (NFA), which more than offset an increase in average net domestic assets of the banking system. Average net domestic claims outstanding, excluding net claims on the Central Government, increased by 1.8 percent in the June quarter of 2019, following a decline of 0.6 percent in the previous quarter.

The average level of monetary base (reserve money) decreased by 5.6 percent during the June quarter of 2019, compared to an increase of 2.2 percent in the previous quarter. This reflected decreases in the average level of both the deposits of commercial banks held at the Central Bank and currency in circulation

The NFA of the FCs, comprising DCs and OFCs, increased by 2.4 percent to K8,363.1 million in the June quarter of 2019, compared to a decrease of 6.0 percent

in the previous quarter. This reflected an increase in NFA of the OFCs stemming mainly from increase in holdings of foreign assets, which more than offset decreases in NFA of the Central Bank and ODCs.

Net claims on the Central Government by FCs increased by K152.7 million to K12,576.3 million in the June quarter of 2019, following an increase of K845.3 million in the previous quarter. This was mainly due to a decline in Government deposits held at depository corporations.

In the June quarter of 2019, total domestic credit extended by FCs to the private sector, public non-financial corporations and 'Provincial and Local level Governments' increased by K130.8 million to K17,673.5 million, following an increase of K107.0 million in the previous quarter. This was attributed to increases of K107.2 million and K23.6 million in lending to the public non-financial corporation and private sector, respectively. The increase in private sector credit was broad based across sectors, with notable increase in advances to the manufacturing, wholesale/retail, finance, construction, real estate, service and the household sectors.

The fiscal operations of the National Government over the six months to June 2019 show a higher deficit of K1,667.4 million, compared to a deficit of K324.9 million in the corresponding period of 2018. The deficit represents 1.9 percent of nominal GDP.

Total revenue and grants, over the six months to June was K5,810.6 million, 4.6 percent higher than in the same period of 2018 and represents 40.7 percent of the 2019 Budget. This reflected increases in taxes and project grants which more than offset the decline in non-tax revenues. Total expenditure for the period was K7,478.0 million, 27.2 percent higher than in the corresponding period of 2018 and represents 46.7 percent of the 2019 Budget. Both the development and recurrent expenditures increased.

The developments in revenue and expenditure resulted in the Government recording a budget deficit of K1,667.4 million in the first half of the year. Of the deficit, K1,464.1

million was financed domestically while K203.3 million was from external sources, mainly concessional loans. Net domestic financing comprised of K3,161.0 million (of which K1,276.1 million was from trust account balances), K132.6 million and K50.5 million from the other resident sectors, OFCs and public non-financial corporations, respectively. There were net retirements of K1,045.4 million and K834.6 million in Government securities by Bank of PNG and Other Depository Corporations, respectively.

Total public (Government) debt outstanding as at the end of June 2019 was K 27,522.4 million, a decline of K43.9 million from the March quarter, reflecting net repayment of domestic debt during the quarter.

Total Government deposits at depository corporations declined by K317.1 million to K2,932.0 million at the end of June compared to the level at the end March, 2019.