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**“MARCH 2015 MONETARY POLICY STATEMENT” &
“FOREIGN EXCHANGE CONTROL DIRECTIVES”**

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**Lae Chamber of Commerce and Industry
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Presentation Outline

Part I: March 2015 Monetary Policy Statement

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3. International reserves
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6. Aim of directives
7. Way Forward
8. Conclusion

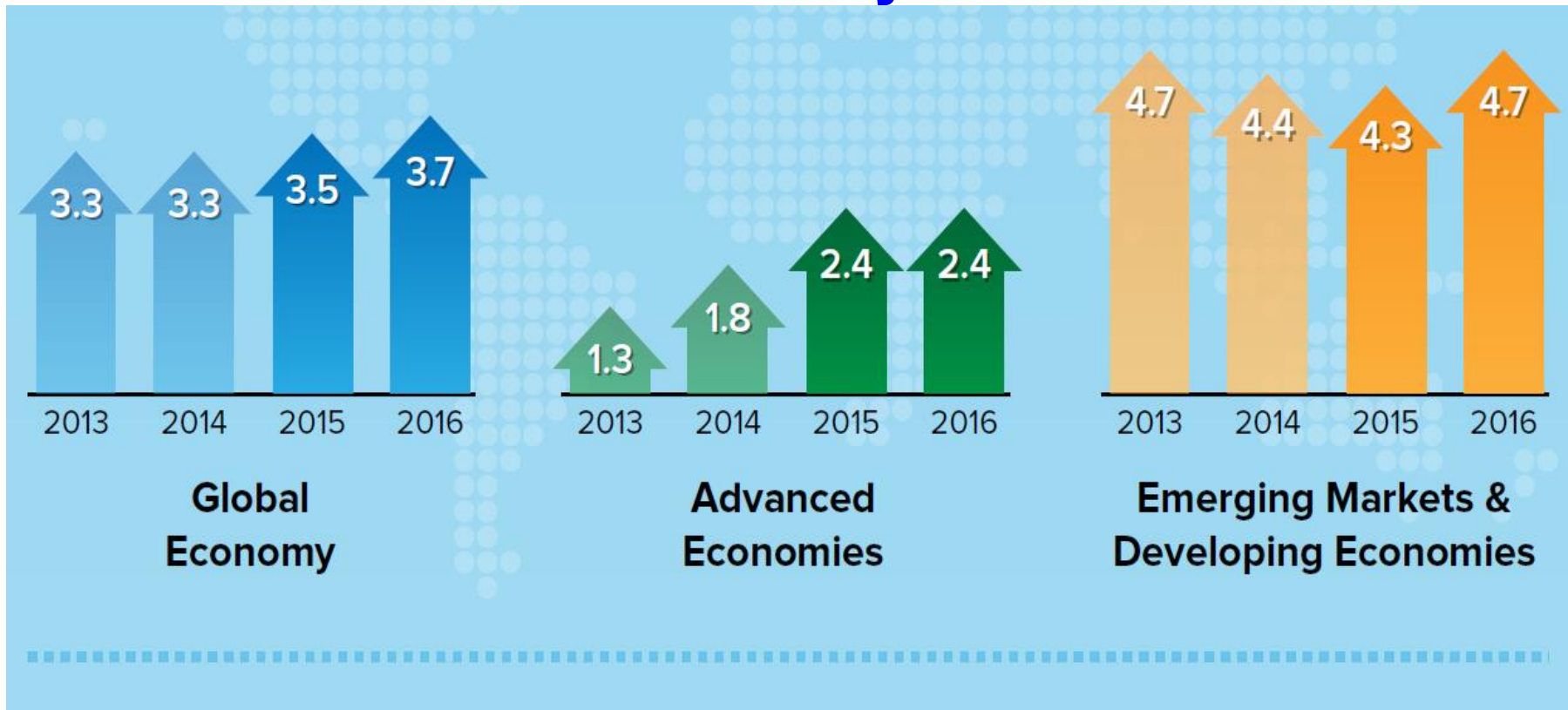


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Part I:
March 2015 Monetary policy
Statement



1. The Global Economy



- “ Global growth is expected to pick up slowly in 2015.
- “ Global inflation is also expected to pick-up slightly in 2015.
- “ Most Central Banks policy rates for Advanced Economies are expected to remain low, while US and UK are expected to increase.



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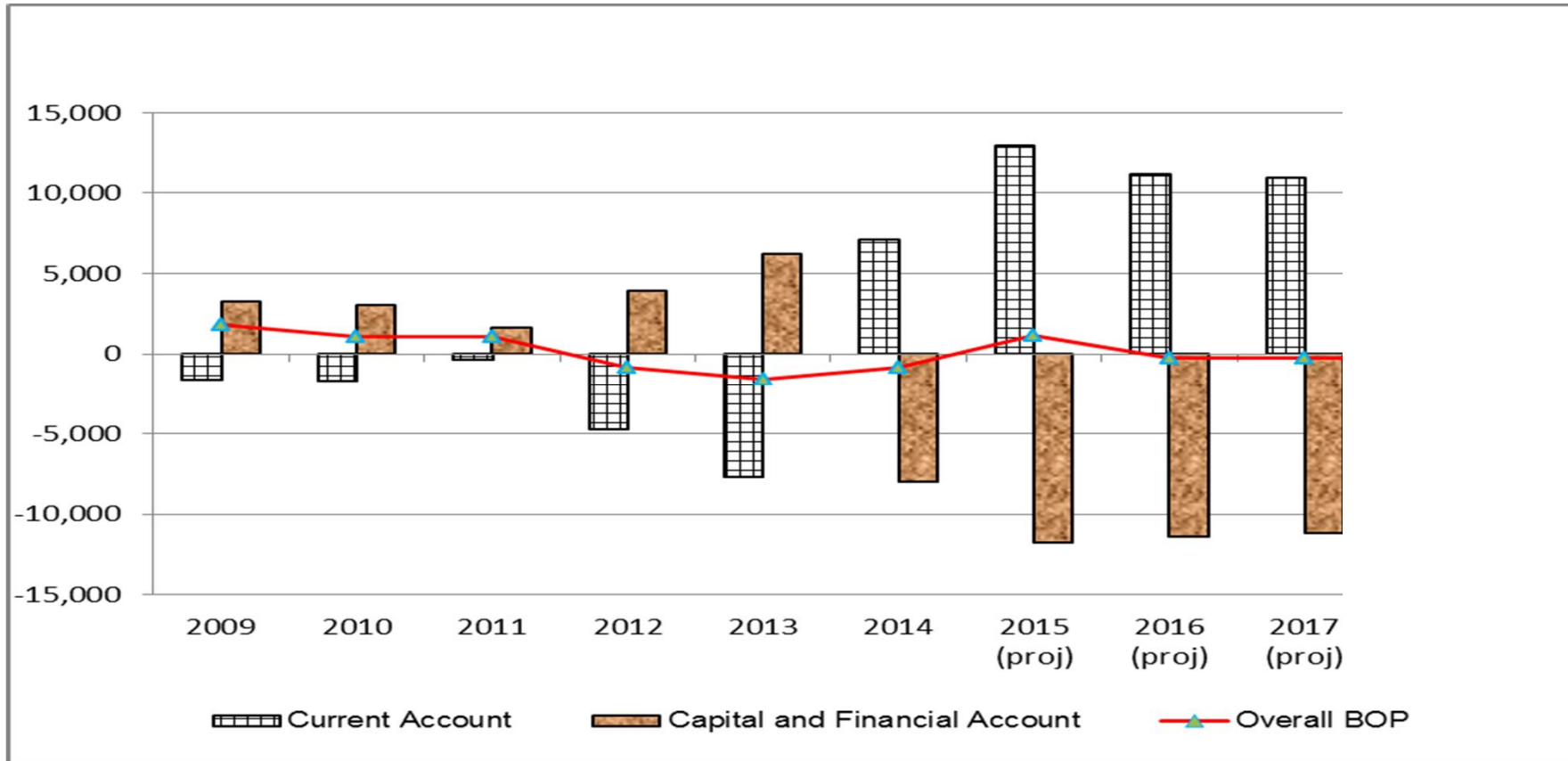
2. Monetary Policy Considerations & Issues

- “ GDP in 2014 is estimated to have grown by higher than the 8.4% reported in the 2015 Budget.
- “ In 2015, projected GDP growth reflects full year of LNG production and full capacity production for nickel & cobalt, as well as activity in the non-mineral sector.
- “ High economic growth & expansionary fiscal policy contributed to high import demand and depreciation of the Kina.
- “ Inflation is trending upwards.
- “ Financing of the Budget deficit will be a challenge.
- “ Declining oil and other commodity export prices have implications for Govt Budget and foreign exchange reserves.



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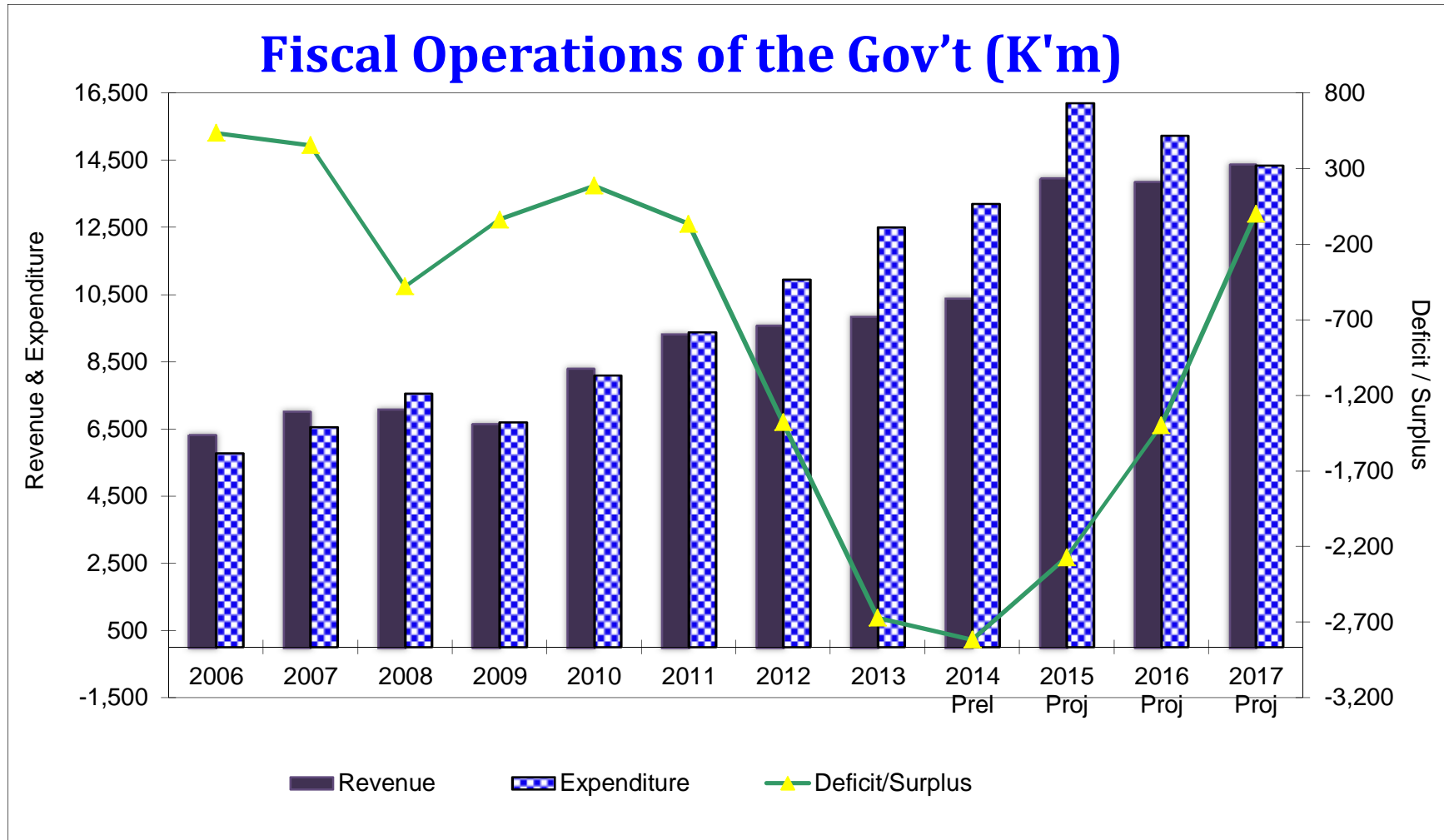
Balance of Payments (K'mn)



Source: Bank of PNG

Note: 2014 to 2017 includes flows related to the PNG LNG project, compared to the actuals, which do not include LNG figures.

“ Overall BOP projected to be in surplus in 2015 mainly due to LNG export inflows and higher holdings of foreign exchange by the Bank of PNG.

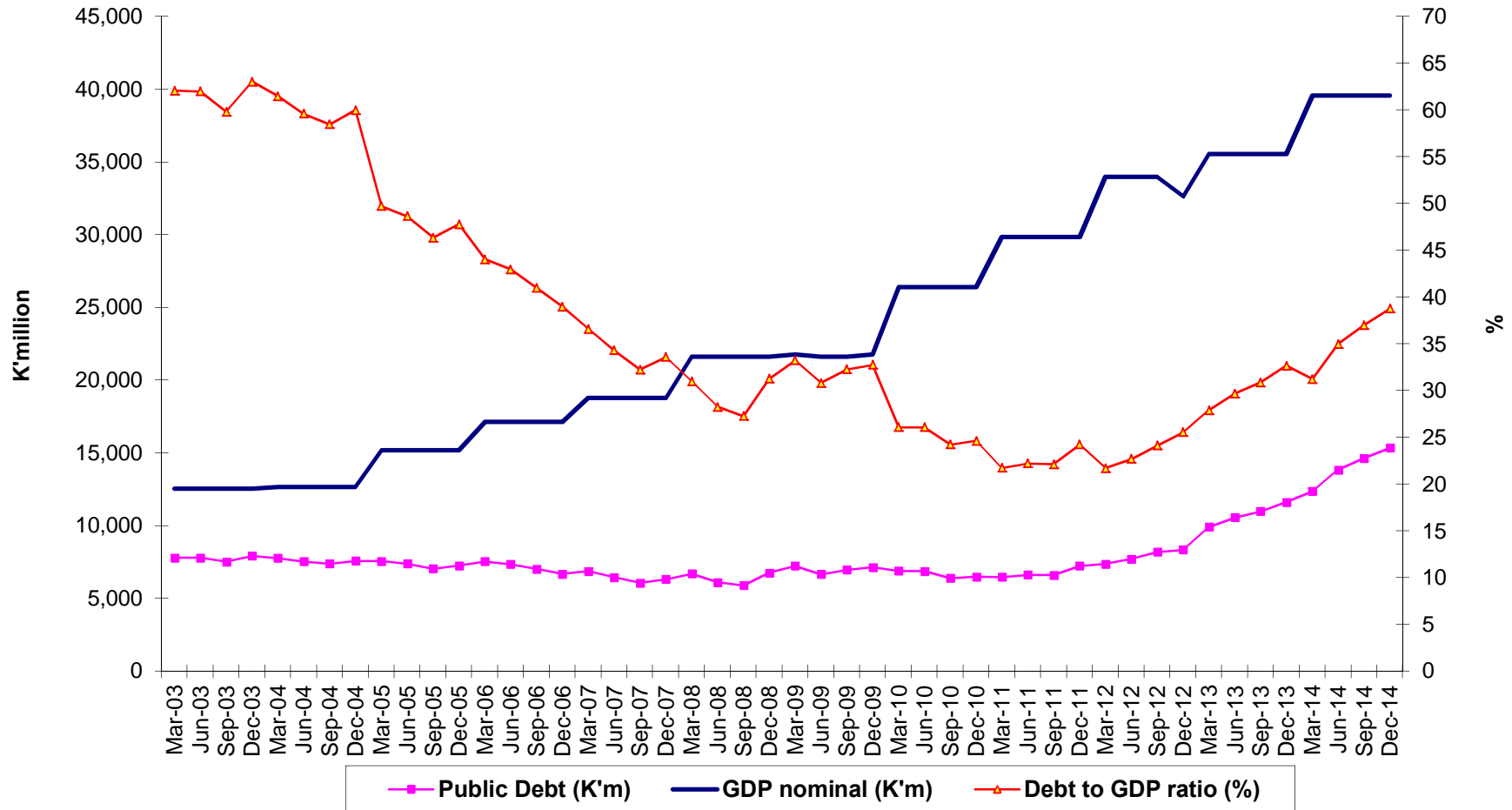


Source: 2015 National Budget. 2014 outcome is preliminary.

- “ Third expansionary fiscal budget with a deficit of K2.3 bn in 2015 or 4.4% of nominal GDP
- “ Expenditure to priority areas; transport infrastructure, agriculture, law and order, education and health services and increased funding to provincial, district and local level Governments (LLGs).



Public Debt to GDP

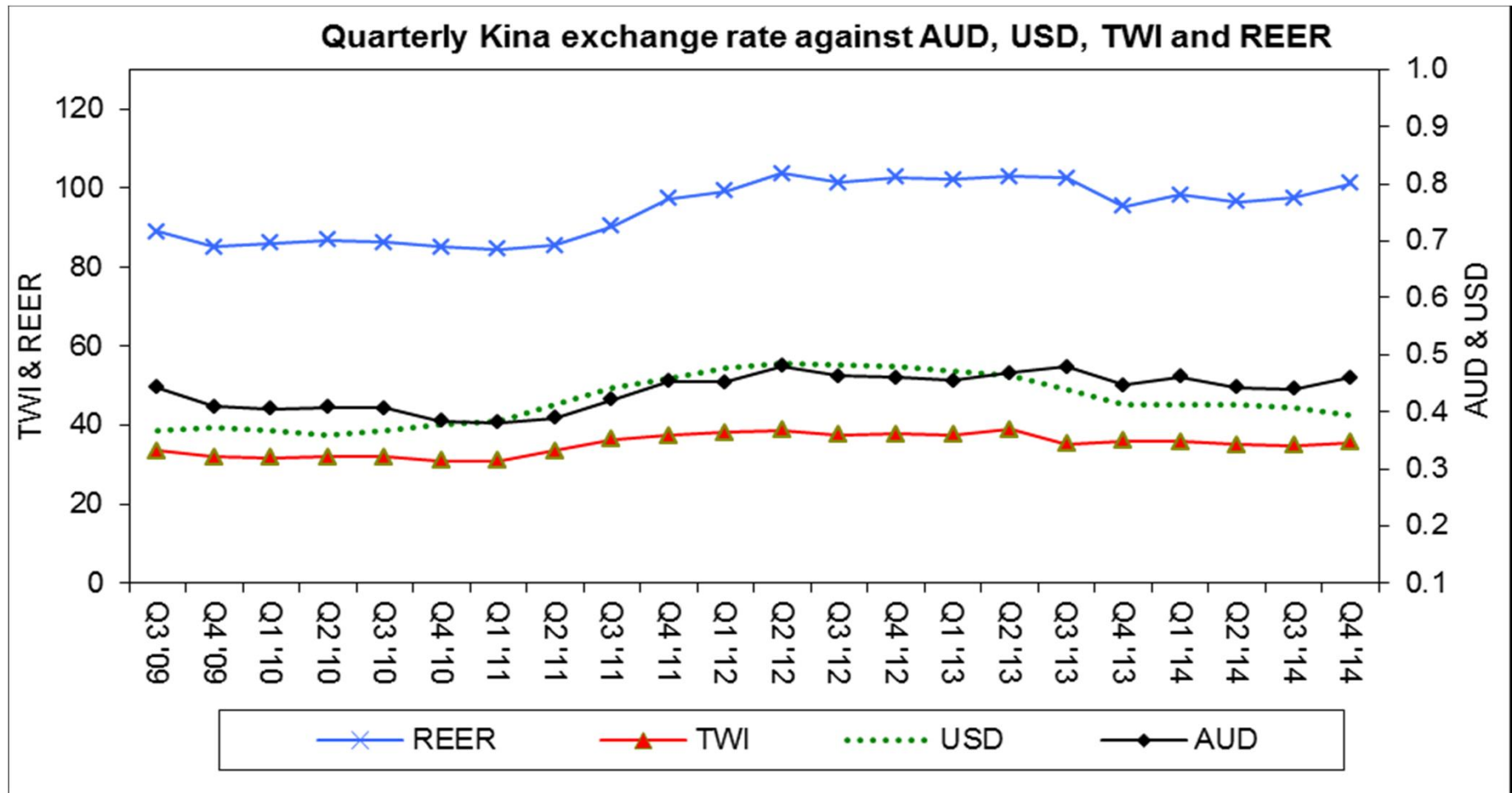


Source: 2015 National Budget & Bank of PNG

- “ Shortfall in revenue in 2014 resulted in high debt financing.
- “ Public debt is expected to decrease to 27.8% of GDP in 2015 from 35.5% in 2014.

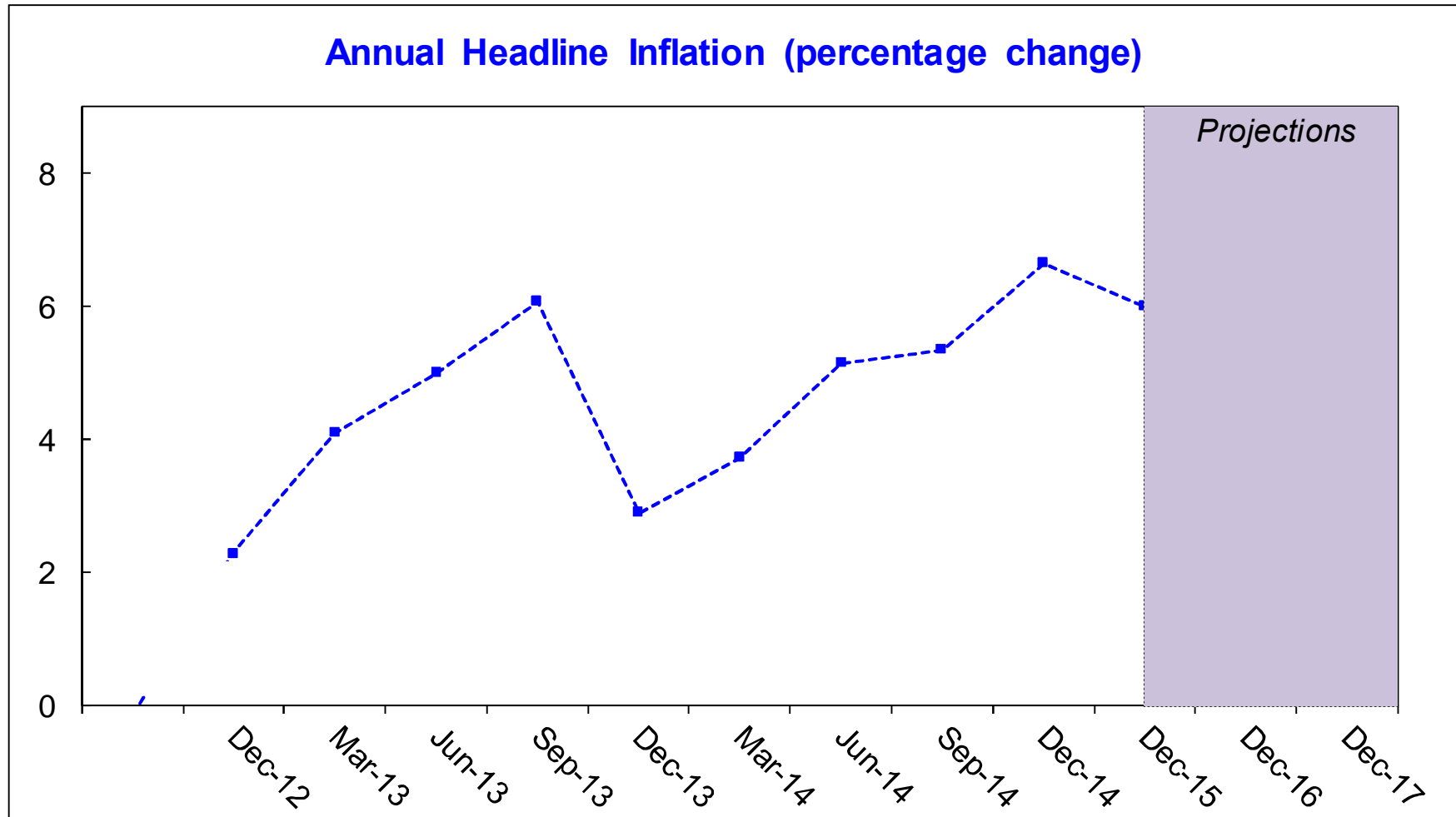


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Source: Bank of PNG

- “ The exchange rate has depreciated by 9.3% since the banding, from US\$0.4130 to US\$0.3745 as at 27th March 2015.
- “ The continued depreciation was due to high economic growth that led to increased import demand, while foreign exchange inflows were lower.



Source: BPNG and NSO.

- “ Inflation is expected to be around 6.0% in 2015.
- “ Inflationary pressures are expected mainly due to continued economic growth that led to high import demand.



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3. Summary

- “ Economic growth was boosted during the construction phase of the LNG project but inflation remained low
- “ Growth continued, supported by the expansionary fiscal policy of the Govt with spending in priority areas
- “ High growth contributed to increased import demand which led to the depreciation of the Kina
- “ BPNG intervened to support the foreign exchange market
- “ Despite the growth and depreciation, inflation has been manageable



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Summary (cont'd)

- “ Monetary policy management was aimed at finding a balance between high liquidity levels, rising interest rates from budget financing, and high import demand resulting in the depreciation of the Kina
- “ Advised caution in the 2014 September MPS on the high expectation of LNG revenue
- “ In March 2015, LNG revenue were much lower, further aggravated by low oil and other commodity export prices



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4. Monetary Policy Stance

- “ Given the projected revenue shortfalls, the Govd will have to make adjustments to its 2015 Budget
- “ Ongoing close coordination between Fiscal and Monetary Policies is important
- “ Coordination is enhanced by operation of new payments system-Kina Automated Transfers System (KATS)
- “ Also further progress on establishment of SWF
- “ ***BPNG will maintain its stance of Monetary Policy***



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Part II: **Foreign Exchange Control Directives**



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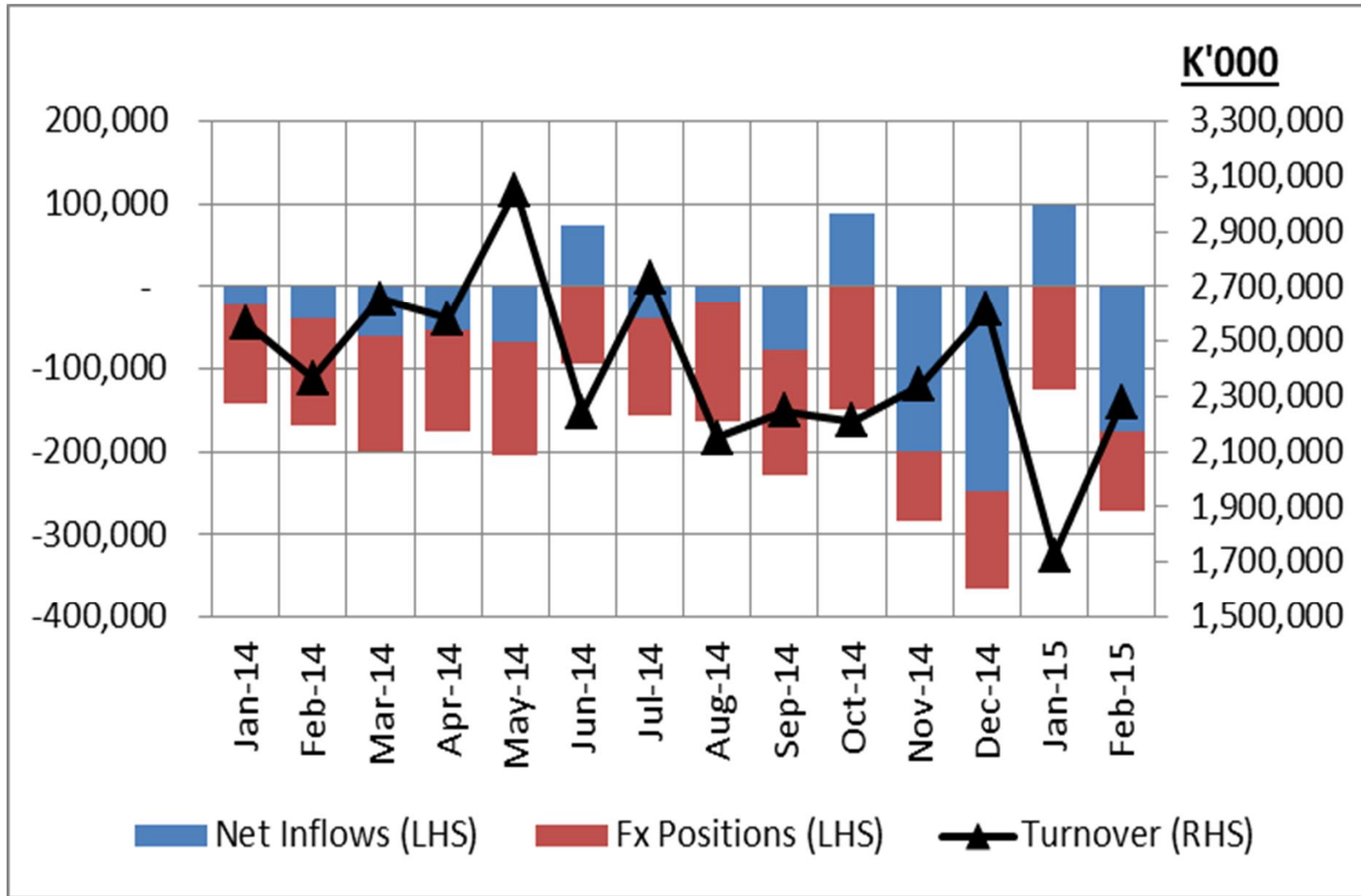
5. Observations in Forex Market

- “ Over the last 2 years, undesirable activities in the foreign exchange market were observed, which led to the introduction of the trading band in June 2014
- “ In 2014, BPNG observed:
 - . ***Increased volume of activities conducted through Vostro accounts of foreign banks***
 - . ***Increased transactions in onshore and offshore Foreign Currency Accounts (FCAs)***
 - . ***Led to reduced foreign currency liquidity in market***
 - . ***Affected businesses and kina depreciated.***



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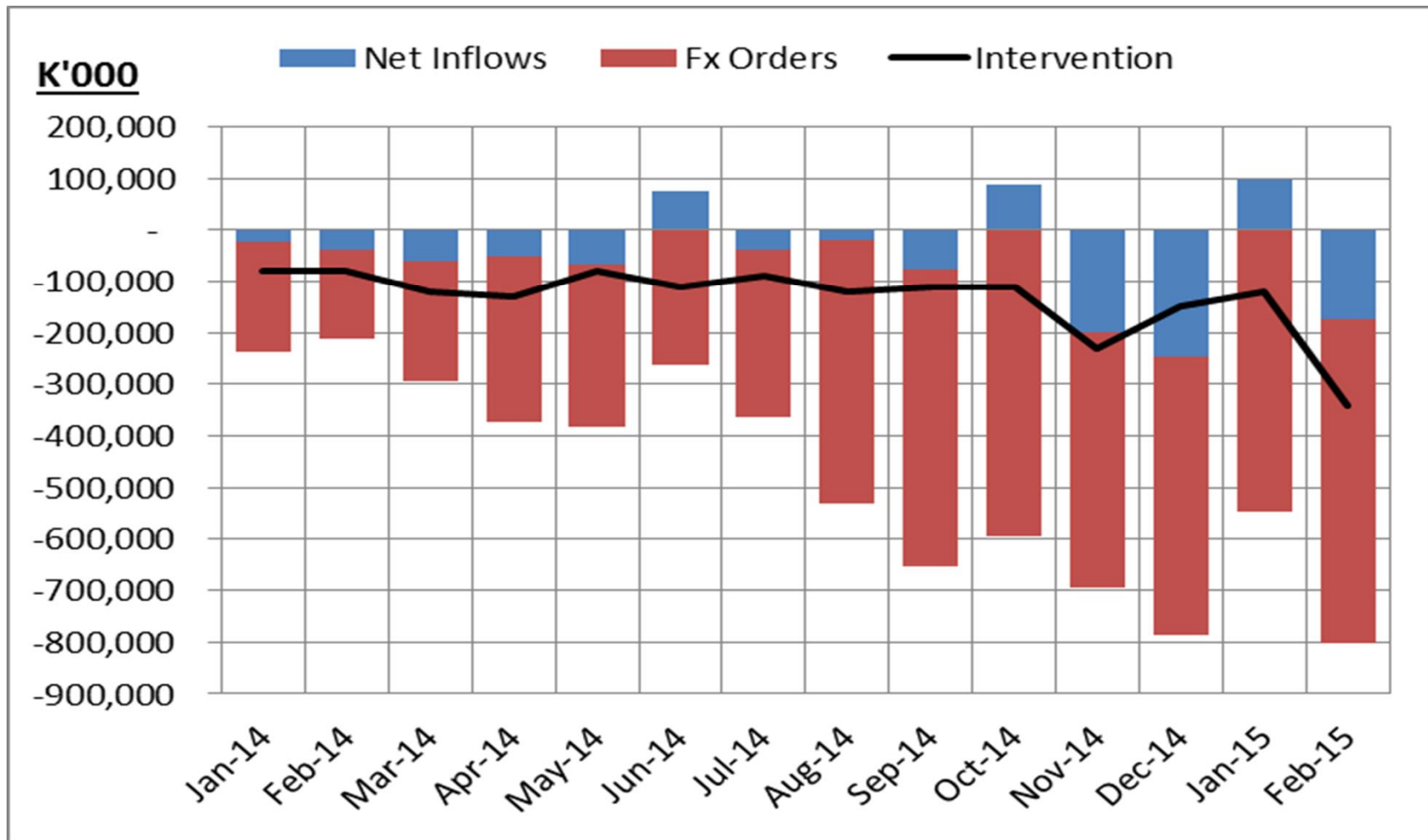
Domestic Foreign Exchange Market



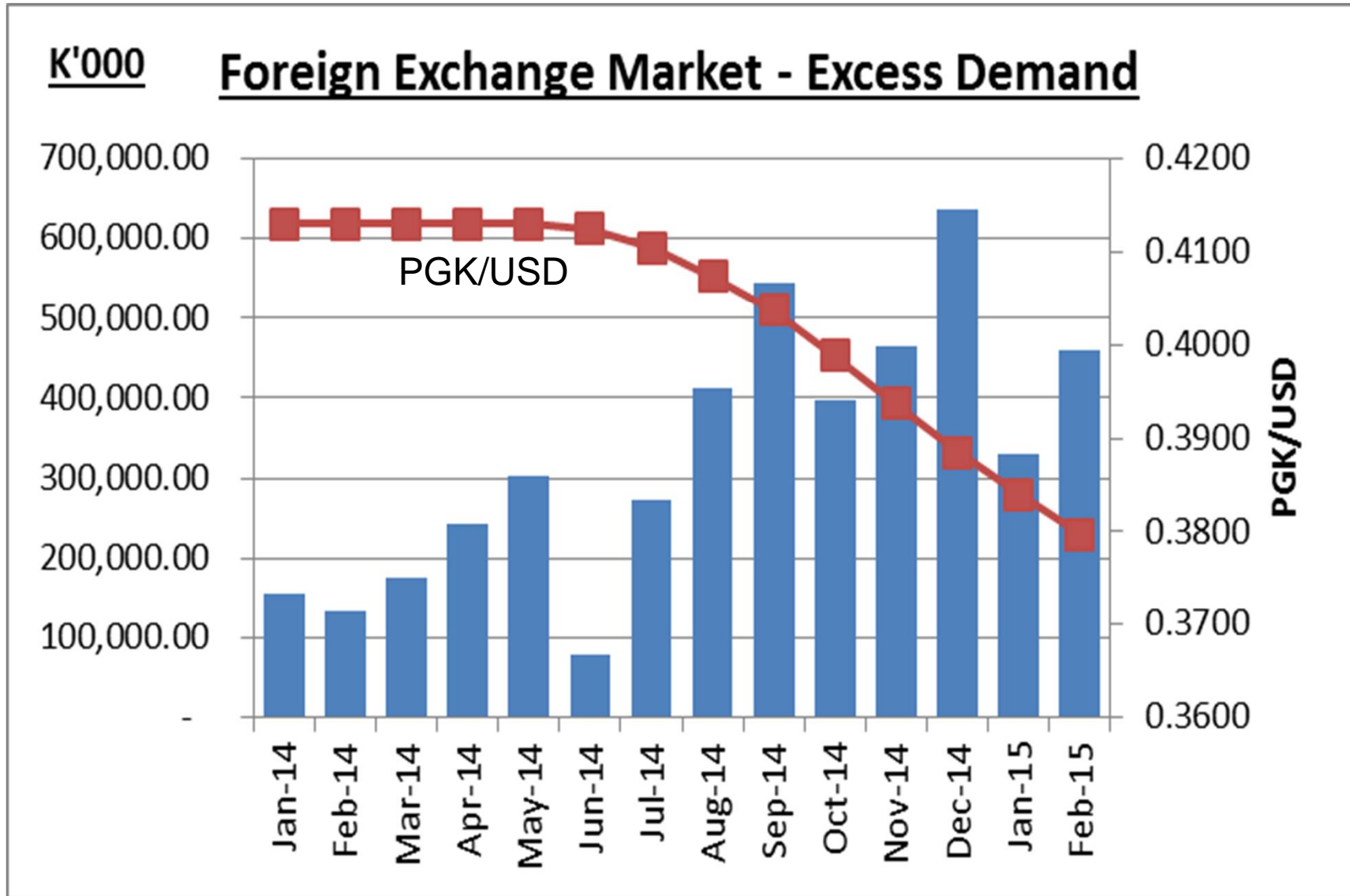


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Domestic Foreign Exchange Market



“ High intervention by BPNG in February 2015 of around K300 mn



“ Exchange rate depreciated by 9.3% since the banding



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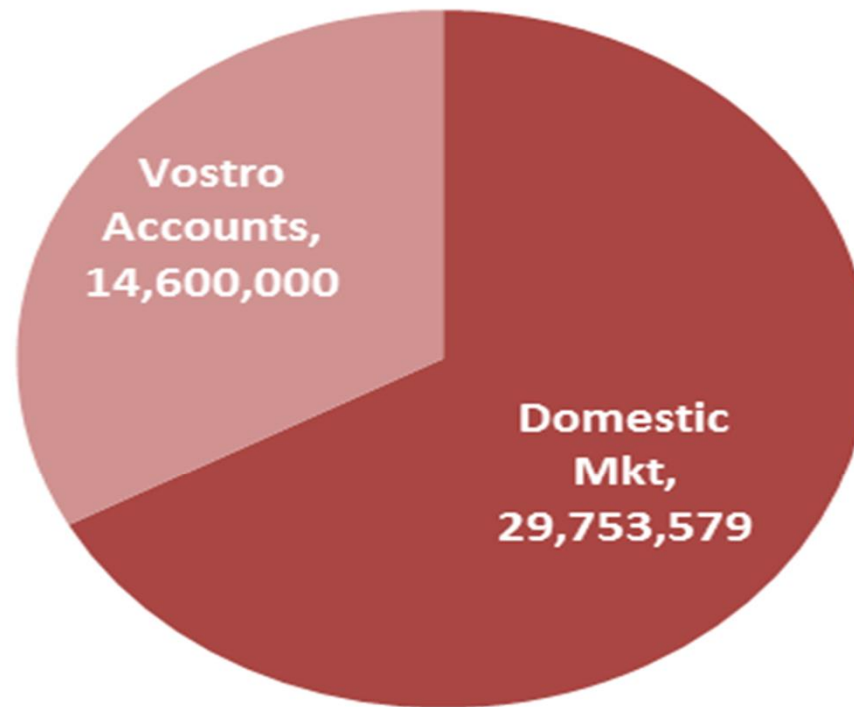
5.1 Kina Vostro Accounts

- “ Kina Vostro accounts of foreign banks were used for unauthorised banking business by:
 - . Not using authorised foreign exchange dealers to convert kina for foreign currency, in breach of Regulation 6 of the *Central Banking (Foreign Exchange and Gold) Regulation 2000*.
 - . Taking deposits from PNG resident entities
- “ In 2014 the volume of kina transacted via the Vostro accounts was approximately 50 percent of the turnover in the domestic foreign exchange market
- “ The large kina payments and receipts are not reported to BPNG because the foreign currency leg is done by foreign banks
- “ The transactions that involved the use of Vostro accounts were not subject to the exchange rate trading band
- “ Exchange rate spreads offered by foreign banks to PNG residents were much wider than 150 point spread in the domestic market



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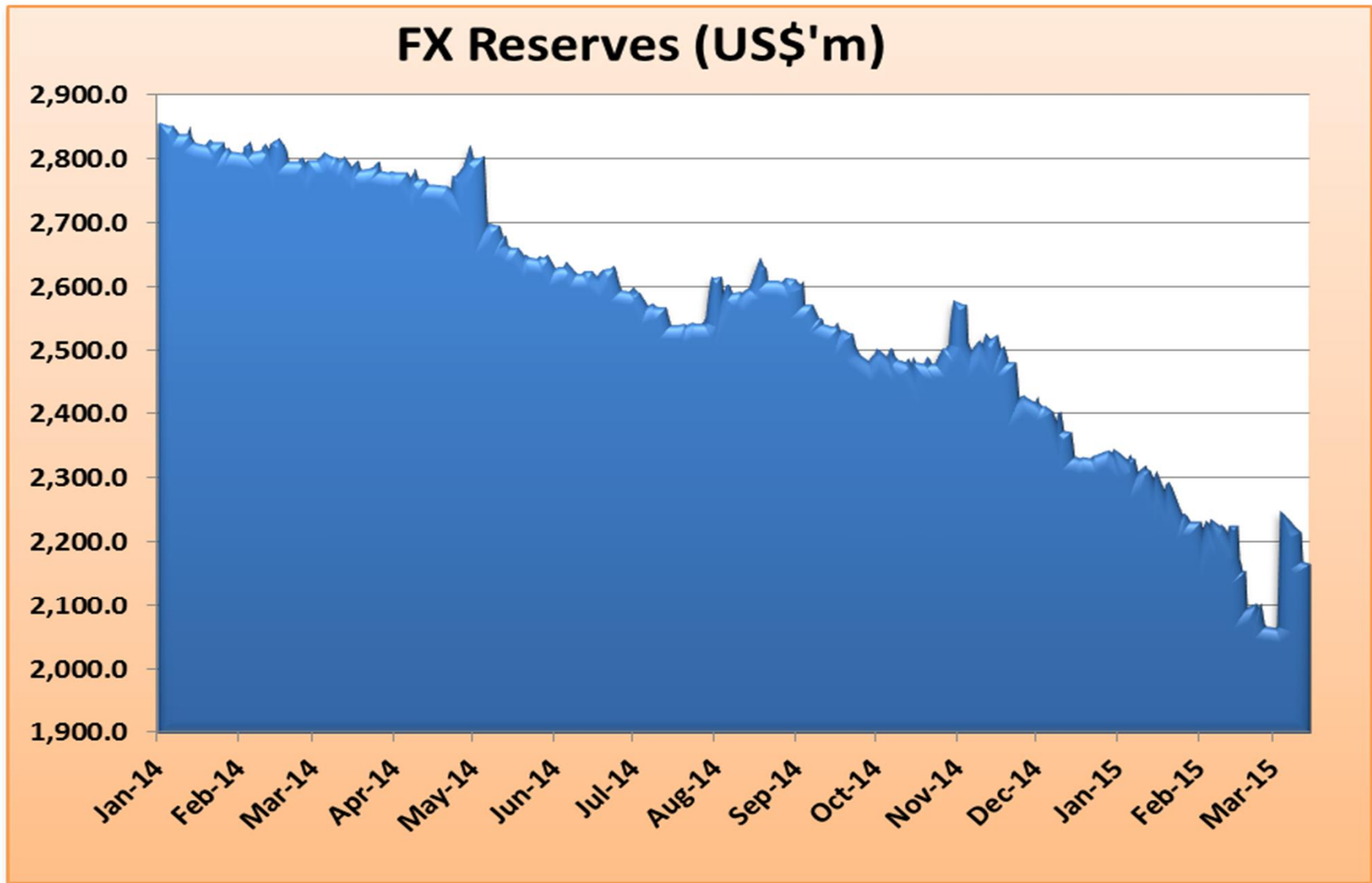
2014 Foreign Exchange Turnover (K'000)





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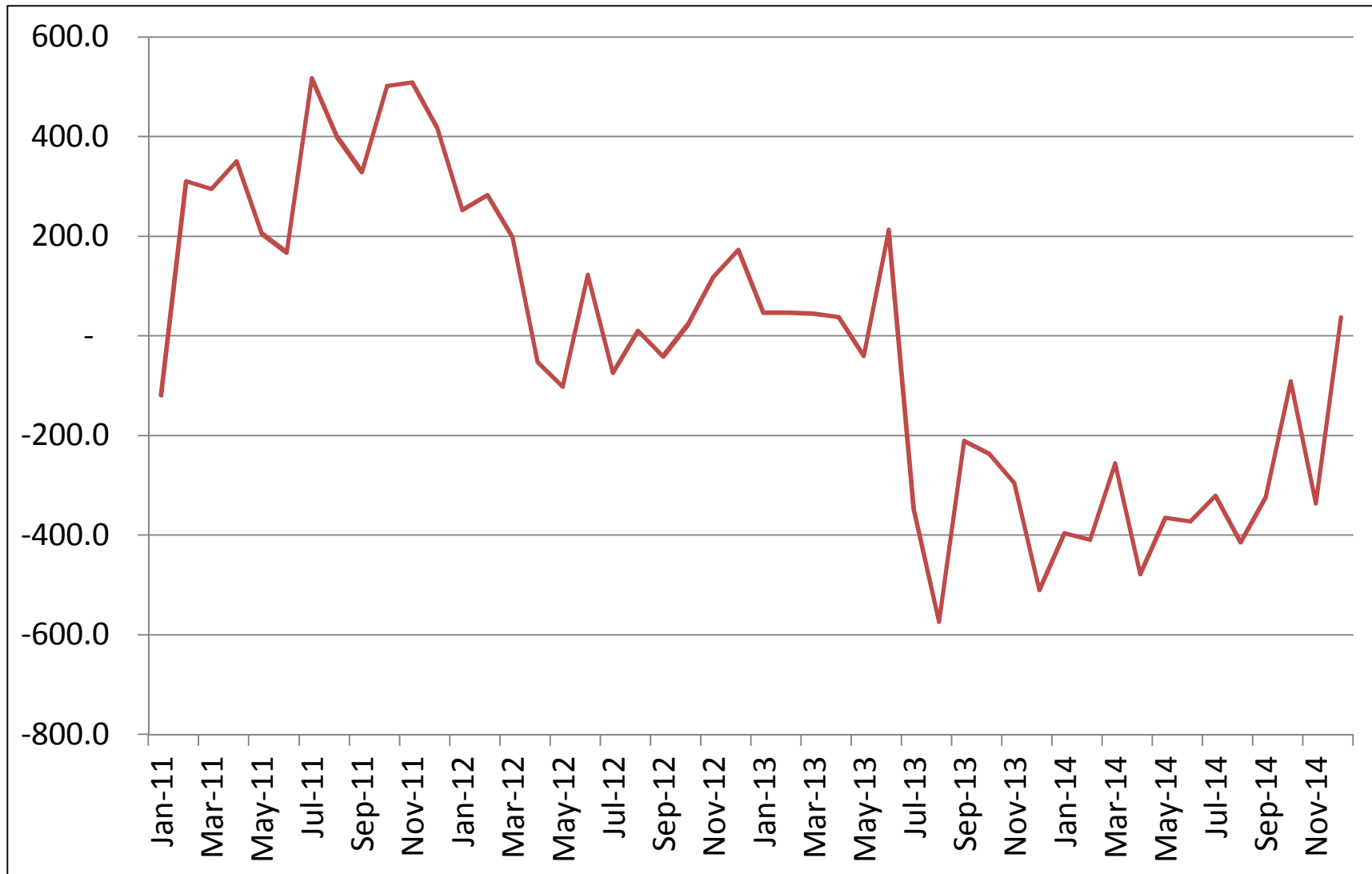
5.2 International Reserves (BPNG)





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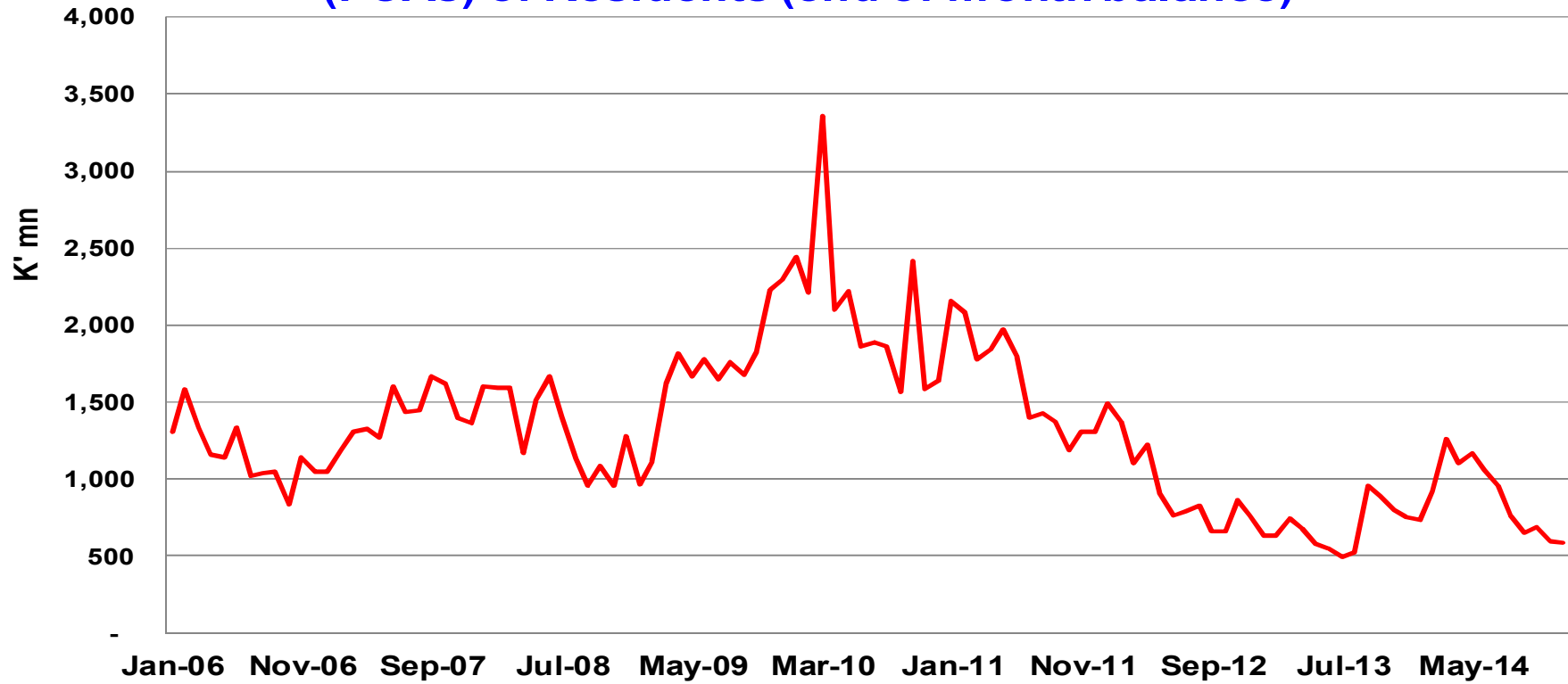
Commercial Banks – Net Foreign Currency Deposits (K'mn)





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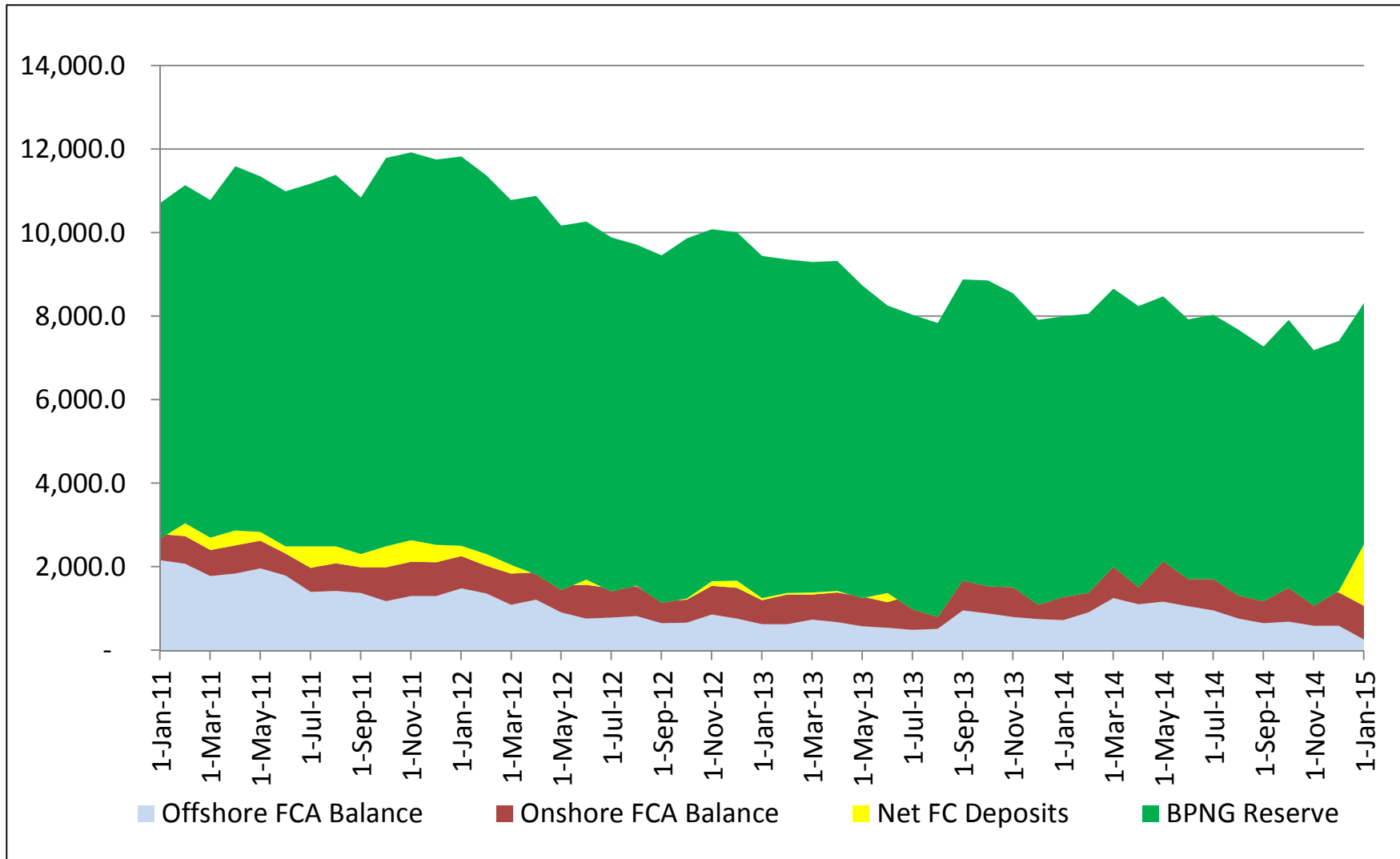
5. Approved Offshore Foreign Currency Accounts (FCAs) of Residents (end of month balance)





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Distribution of Foreign Currency Holdings



“ In aggregate, around K8bn forex reserves for PNG. Likely import cover of 11.8 months for total and 16.6 months for non-mineral, as at January 2015



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6. Exchange Control Directives

- “ On the 5th of March 2015, the following Foreign Exchange Control Directives were issued on:
 - . Use of Vostro accounts by foreign banks
 - “ Unauthorised banking business conducted by foreign banks
 - . Onshore foreign currency accounts
 - “ Cease the opening up of new accounts until an audit is complete
 - . Offshore foreign currency accounts
 - “ Cease the opening up of new accounts until an audit is complete
 - . Export proceeds
 - “ 3 months retention period to repatriate export proceeds onshore



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Aim of the Directives

- “ The Exchange Control Directives were issued under the *Foreign Exchange Manual*
- “ They are not a re-introduction of foreign exchange controls or removal of exemption notices
- “ Not meant to frighten or scare anyone but restore order in the foreign exchange market
- “ Help address the imbalance in the foreign exchange market



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Planned Implementation

- “ Authorised Foreign exchange dealers to enforce directives with their customers
- “ External audit conducted on onshore and offshore foreign currency accounts (FCAs)
- “ Pending the findings of the audit, a ban is imposed on opening of new onshore and offshore FCAs
- “ Offshore Kina or foreign currency accounts for trade purposes are opened with the prior approval of BPNG



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Implementation

- “ BPNG approves 2 types of offshore FCAs opened for trade-related purposes
 - . Those under Project Development Agreements
 - . Those not under Project Development Agreements
- “ Holders of offshore FCAs are to use them for the sole purpose of meeting their offshore liabilities and repatriate surplus funds to PNG
- “ Introduce 3 months repatriation requirement from date of shipment of export



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Implementation

- “ Holders of offshore FCA opened for trade purposes without BPNG’s prior approval have 2 months (until 6th May) to close them down and convert the funds into Kina
- “ They can then apply to BPNG should they want an offshore FCA
- “ Breaches of the Directives will be dealt with in accordance with the *Central Banking (Foreign Exchange & Gold) Regulation*.
- “ Revised *Foreign Exchange Manual* will be issued with the new Directives



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8. Conclusion

These Directives are aimed at stopping the use of Vostro accounts for unauthorised banking business

- “ Restore order and help to address imbalance in the foreign exchange market
- “ It is not a crisis situation
- “ Vostro accounts to be used only for authorised purposes and resident entities (importers/exporters) should deal only with authorised dealers
- “ Authorised dealers or banks have to report transactions through Vostro accounts on the BOP forms



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Conclusion (cont'd)

- “ Offshore FCAs should be used only to pay for foreign liabilities of the holders
- “ Offshore FCAs for trade purposes are not exempted and requires BPNGs prior approval to open
- “ All offshore FCAs that are not for trade related purposes will be addressed by BPNG later
- “ Onshore FCAs should not be held for speculative purposes and any demand for foreign currency should be brought to the spot market



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Conclusion (cont'd)

- “ BPNG will make further decisions based on the findings of the audits on FCAs
- “ Any breaches of these Directives will be dealt with by the *Central Banking (Foreign Exchange & Gold) Regulation*



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Conclusion (cont'd)

” Penalties:

- . Fine of K100,000; or
- . Amount equal 25% of the total value of funds or property involved, whichever is greater; or
- . Imprisonment for a term not exceeding five years.
- . In addition, a court may order forfeiture of an asset or order its sale to BPNG



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Thank You

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