



Bank of Papua New Guinea

PRESENTATION - ON THE MARCH 2012

MONETARY POLICY STATEMENT BY MR. LOI M. BAKANI - GOVERNOR

BANK OF PAPUA NEW GUINEA

TUESDAY 3RD APRIL 2012

LAE INTERNATIONAL HOTEL, LAE

Monetary Policy

The objective of monetary policy in PNG is to achieve and maintain price stability. This entails low inflation supported by stable interest and exchange rates. If achieved, price stability will lead to:

- Confidence in the kina exchange rate and management of the economy;
- A foundation for stable fiscal operations of the Government;
- Certainty for private sector businesses to plan for long-term investment and development; and
- A stable macroeconomic environment conducive to economic growth.

International Developments

- Slow recovery in the global economy continued in the second half of 2011, revised global economic growth is 3.8%, down from an earlier estimate of 4% (IMF WEO).
- Slow recovery continued in both industrialized and emerging economies.
- Growth in Asia also slowed, but remained relatively high compared to the rest of the world;
- Major threats to outlook: continuing European sovereign debt crises and sustainability of US fiscal deficit.

- Global inflation eased in the fourth quarter of 2011 as a result of weak demand and easing in oil and food prices;
- Monetary policy in most major industrialised countries were kept unchanged in the second half of 2011 (except the European Central Bank and the Reserve Bank of Australia) to further stimulate economic growth.

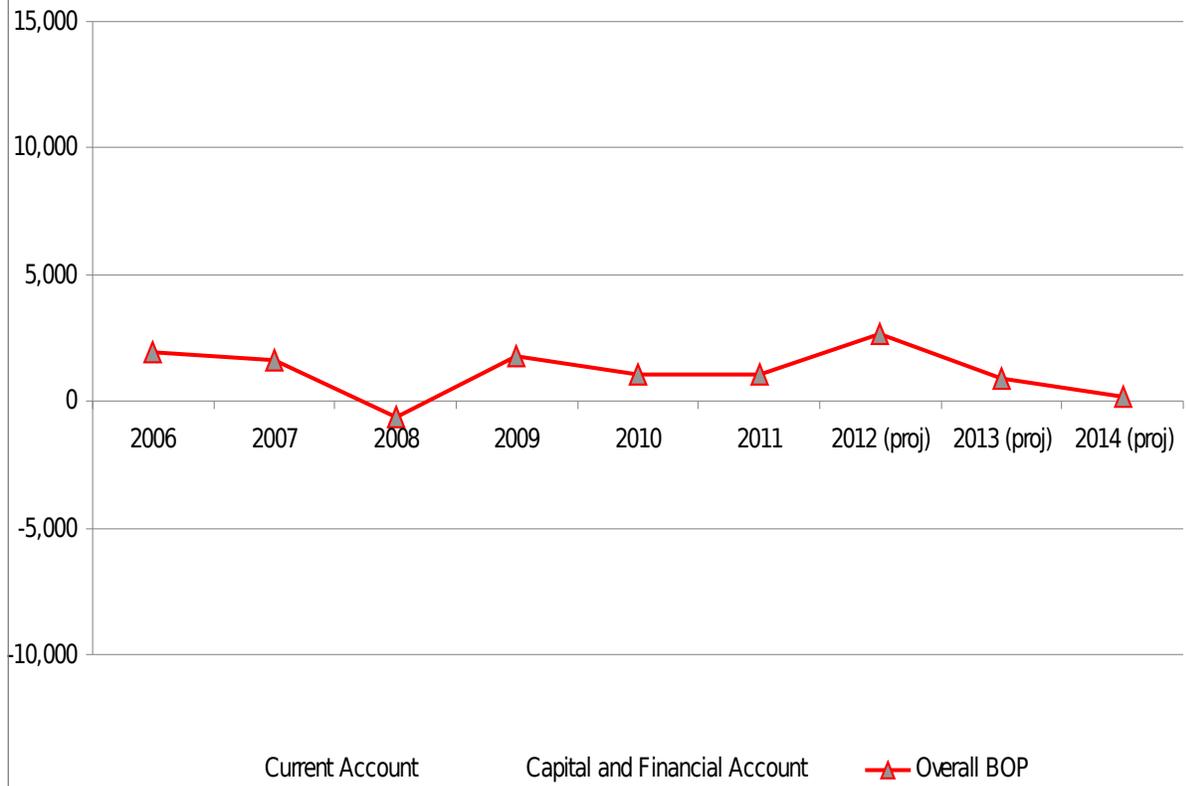
Domestic Economy

- Stronger real GDP growth estimated by BPNG for 2011 than the earlier projection of 9.5% and Treasury's estimate of 8.9% in the 2012 Budget
- Strong growth (7.8%) is expected to continue in 2012
- Attributed to the construction of the LNG project which peaks in 2012, commencement of production at the Ramu Nickel/Cobalt mine, higher Government expenditure in relation to the national elections, high international commodity prices and private sector activity

Key Macroeconomic Indicators

- International reserves of US\$4,340.1 (K9,226.4) million at end December 2011. Sufficient for 11.5 months of total and 16.7 months of non-mineral import covers
- As at 28th March, 2012, reserves of US\$4,318.6.9 (K8,867.9) million
- Slides:
 - BOP
 - Fiscal
 - Exchange rate
 - Monetary aggregates

Chart 1: Balance of Payments in K' Million



Exchange Rate

Monetary Aggregates

Liquidity & Price Stability

- The main issue that the Central Bank is confronted with is the increasing level of liquidity in the banking system in recent years, caused by the foreign exchange reserve build-up related largely to dollar-denominated mineral tax earnings, high export earnings and inflows related to the PNG Liquefied Natural Gas (LNG) project and other private foreign direct investments.
- Whilst the high liquidity levels do not appear to influence inflation via credit to private sector despite strong economic growth, it is still a threat to price stability and soundness of the financial system.

Upside risks to liquidity would come from:

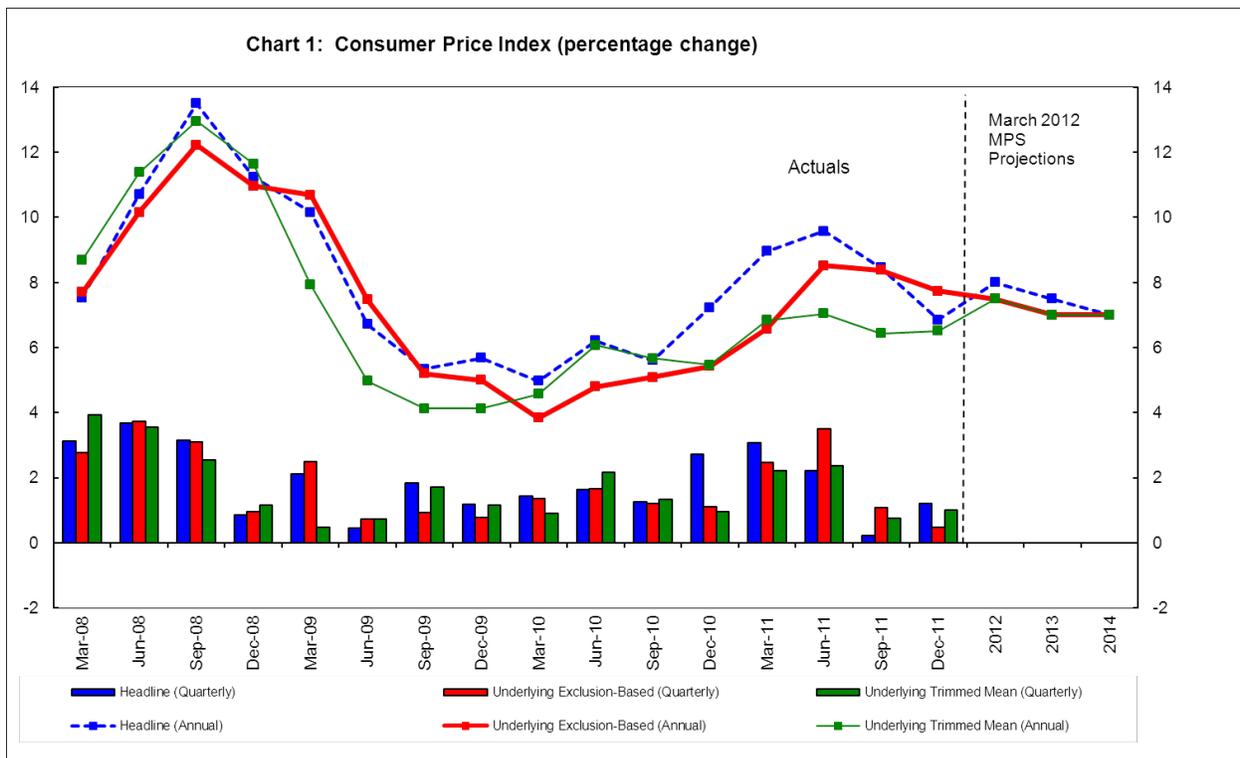
- faster drawdown of trust accounts from the Central Bank;
- higher than budgeted overall expenditure by Government;
- higher transactions demand for money during the national elections; and
- continued high inflows of foreign exchange.

Some or all of these, if realized, could potentially lead to price instability and adversely affect business confidence.

The Bank projects headline inflation for 2012 to be around 8%. The upside risks to this projection include:

- significantly higher domestic demand pressures and inflation expectations;
- any substantial increase in food and fuel prices;
- higher than expected inflation in PNG's major trading partners;
- any supply-side shocks associated with bad weather; and
- impact of the European debt crisis and oil export embargo on Iran.

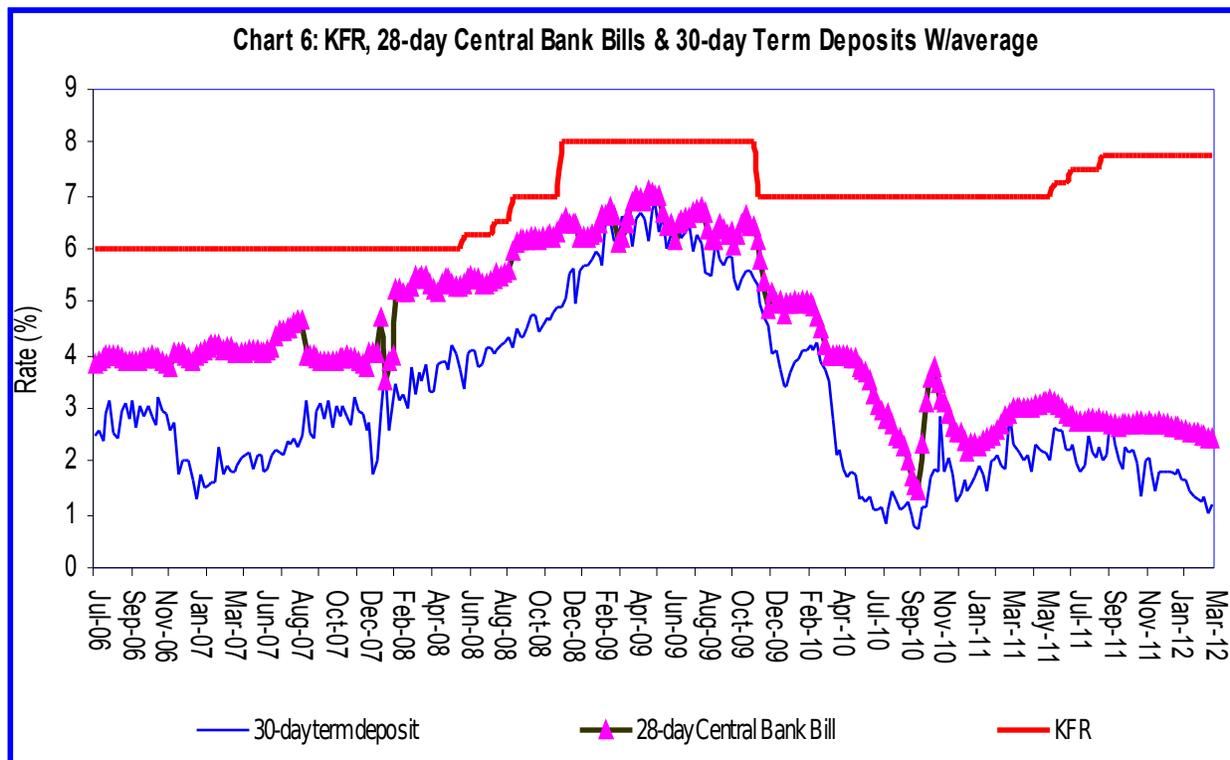
Inflation



Monetary Policy Stance

- **Given the concern on high level of liquidity and inflationary pressures, the Bank maintained a tight monetary policy stance by leaving the KFR unchanged at 7.75 percent in the December quarter of 2011 and March quarter of 2012.**
- **To support the tight stance, the CRR was increased from 6.0 percent to 7.0 percent in March 2012.**

- **Given the projected strong domestic economic growth and associated demand pressures in 2012, the Bank will continue to assess the trade-off between high economic growth and inflation.**
- **The Bank will therefore maintain this policy stance and may adjust it to ensure the high level of liquidity is managed appropriately so that inflation remains at an acceptable level.**



Macroeconomic Management Issues

- Increased Gov't expenditure contributed to increased liquidity in the banking system, through increased deposits, including trust accounts, and increased the cost for monetary policy management
- Responsible fiscal and monetary policies are needed to ensure macroeconomic stability

Need for greater co-ordination between fiscal and monetary policies

- *Dutch Disease*
 - *Appreciation of kina exchange rate from resource boom*
 - *Pull resources away from other sectors to the booming sector*

- *Makes traditional exports uncompetitive-eg agricultural products*
- *Makes non-tradable goods and services more expensive*
- Gov't has agreed to open all new Trust accounts at BPNG
- Gov't enacted the Sovereign Wealth Fund (SWF) Act in February 2012 to manage revenues from LNG and other mineral projects;
- Until the SWF comes into operation, the Gov't should deposit revenue inflows from mineral taxes in an offshore account to be managed by BPNG.
- This will minimise large foreign exchange inflows and reduce upward pressure on the exchange rate, and assist in liquidity management, thereby mitigating the effect of *Dutch Disease*.
- Gov't has to invest in developing a competitive and advanced agriculture sector. Alternate source of income generation for majority of population.
- Gov't not to compete with private sector and LNG developer for limited production resources during the construction phase of the PNG LNG project
- Private sector should act responsibly in passing on the benefit of the appreciation of the kina exchange rate through lower prices for consumers.
- Responsible Govt agencies to tighten up on monitoring of price movements and ensuring competitive markets prevail.

Other Macroeconomic Issues...

- BPNG will undertake financial inclusion initiatives to ensure that the majority of the population participates in the financial system and enhance competition.
- Financial Inclusion in PNG
 - Vision 2050 encourages wealth creation, poverty reduction and promotion of economic growth
 - Role of Central Bank to ensure financial stability, and create an enabling environment for expanding financial services in the country
 - The Bank has made financial inclusion as one of its key objectives in 2012-2014 strategic plan, which includes the promotion and development of financial institutions and products to enable expansion of financial services to majority of population.
- Financial Inclusion Initiatives

- Payment and Settlement System
 - National Payment System Act
 - Real Time Gross Payment & Settlement
- Microfinance development
- Financial Education
 - Include in primary/secondary curriculum
 - Banking products for school children
- Mobile Phone Banking

A. Microfinance Development

- The Microfinance Expansion Project – US\$24.1mn project co-funded by ADB, Ausaid, Govt of PNG and participating financial institutions. It will focus on:
 - Financial literacy to encourage the unbanked population to manage their financial wealth, and integrate into the monetized sector;
 - Develop an appropriate and balanced regulation for supervision of MFIs ; and
 - Increase **lending to small and medium enterprises (SMEs) through a risk sharing facility**

B. Financial Education

- Project Working Group set up between BPNG and Dept of Education to introduce financial education in primary and secondary schools
- Objective is to create a culture of savings
- Develop a National Strategy for Financial Inclusion to properly coordinate financial inclusion initiatives

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Some developments in mobile banking include:

- Digicel CellMoni trial nationwide
- Bemobile trial in Lae and Port Moresby
- BSP mobile banking and BSP Rural Banking using wireless EFTPOS
- Westpac Mobile Banking
- Post PNG's Mobile SMK
- Nationwide Microbank's MiCash trial in WNB
- Balance checking with Teachers' and Nasfund S&L