

Bank of Papua New Guinea

**Presentation at the
CIMC National Development Forum**

***“Update on Current Monetary Conditions and
Future Prospects”***

**by
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Outline of presentation

1. Objectives of the Central Bank
2. Role and Function of Monetary Policy
3. Macroeconomic setting
4. Monetary Conditions
 - Monetary Indicators
5. Other BPNG Initiatives
 - Financial Inclusion
 - National Payments System

1. Objectives of the Central Bank

- Implementing monetary policy to achieve and maintain price stability,
- Supervising our financial system to ensure stability; and
- Promoting an efficient payments system.

(Central Banking Act 2000, section 7)

These objectives would promote macroeconomic stability and economic growth in the country. The challenge is to ensure the development is also responsible and sustainable.

2. Role and function of Monetary Policy

- Process by which the Central Bank controls (i) the supply of money, (ii) availability of money, and (iii) cost of money or rate of interest, in order to achieve price stability and promote economic growth.
- Monetary policy influences the decisions that we make about how much we save, borrow or invest and it can have a powerful impact on consumers and business entities.
- The Bank considers many indicators from both the demand and the supply-side of the economy and make a judgment about what this evidence says about inflationary pressures over a forecast horizon.

3. Macroeconomic setting

- 2015 – 14th year of successive GDP growth
- Real GDP growth of 15% in 2015 and 5% in 2016
- 2015 - full year production of LNG, full capacity production of nickel & cobalt and increased production in the non-mineral sector

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- Financial system is sound and prudently managed
- 4 banks, 8 financial institutions, 4 micro-banks, 22 S&L societies, 3 large super funds, several life and general insurance companies
- A stock exchange for equity fund raising
- Total assets of financial system is over K40 billion (end March 2015)
- Only 20% of population have access to the formal financial system

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- Expansionary fiscal policy for 3 successive years
- Support economic activity after LNG construction phase
- Increased spending to key priority areas of infrastructure, agriculture, education, health
- Financing budget mainly from domestic sources
- Temporary arrangement between BPNG and Gov't to take up 'slacks' & slow down rising interest rates

4. Monetary Conditions

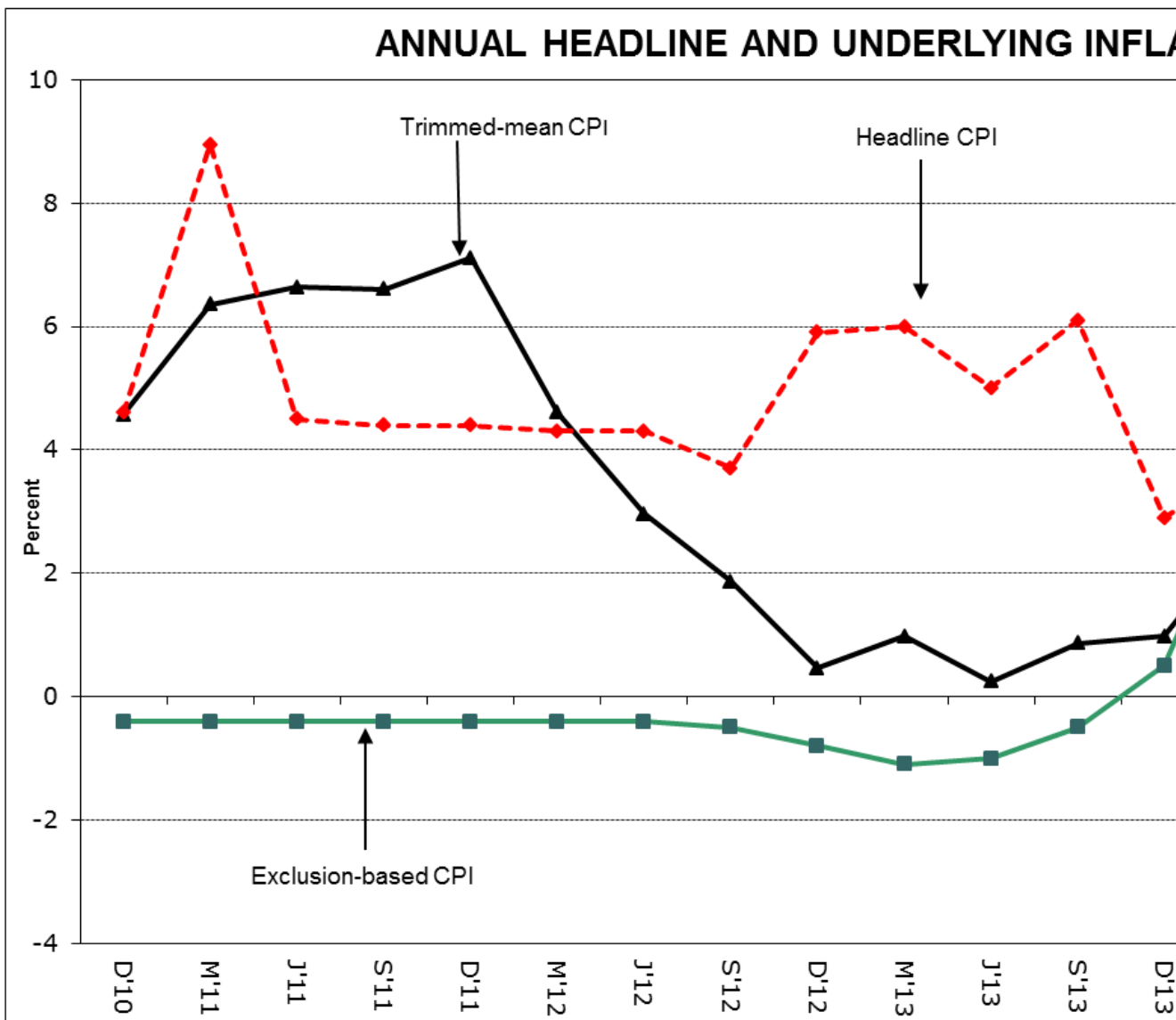
- Refers to the monetary policy settings, specifically to the effects of interest rates and the exchange rate on the economy.
- Monetary policy can be transmitted through these price variables to economic activity (real sector) and ultimately, inflation.

4.1 Inflation

- High economic growth has not translated into high inflation
- Annual inflation was 6.1% to March quarter of 2015, compared to 6.6% in December 2014
- Increased aggregate demand, high Gov't spending and depreciation of the kina led to increases in the price of goods and services

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ANNUAL HEADLINE AND UNDERLYING INFLATION



4.2 Liquidity

- Liquidity over-hang in the banking system, currently K8 billion
- BPNG uses trade in Central Bank Bills (CBBs) and Gov't Treasury bills to diffuse some of the liquidity
- Currently over K2.5 billion CBBs on issue
- Set-up Sovereign Wealth Fund to manage any large inflows from export proceeds
- Using trust funds is not recommended

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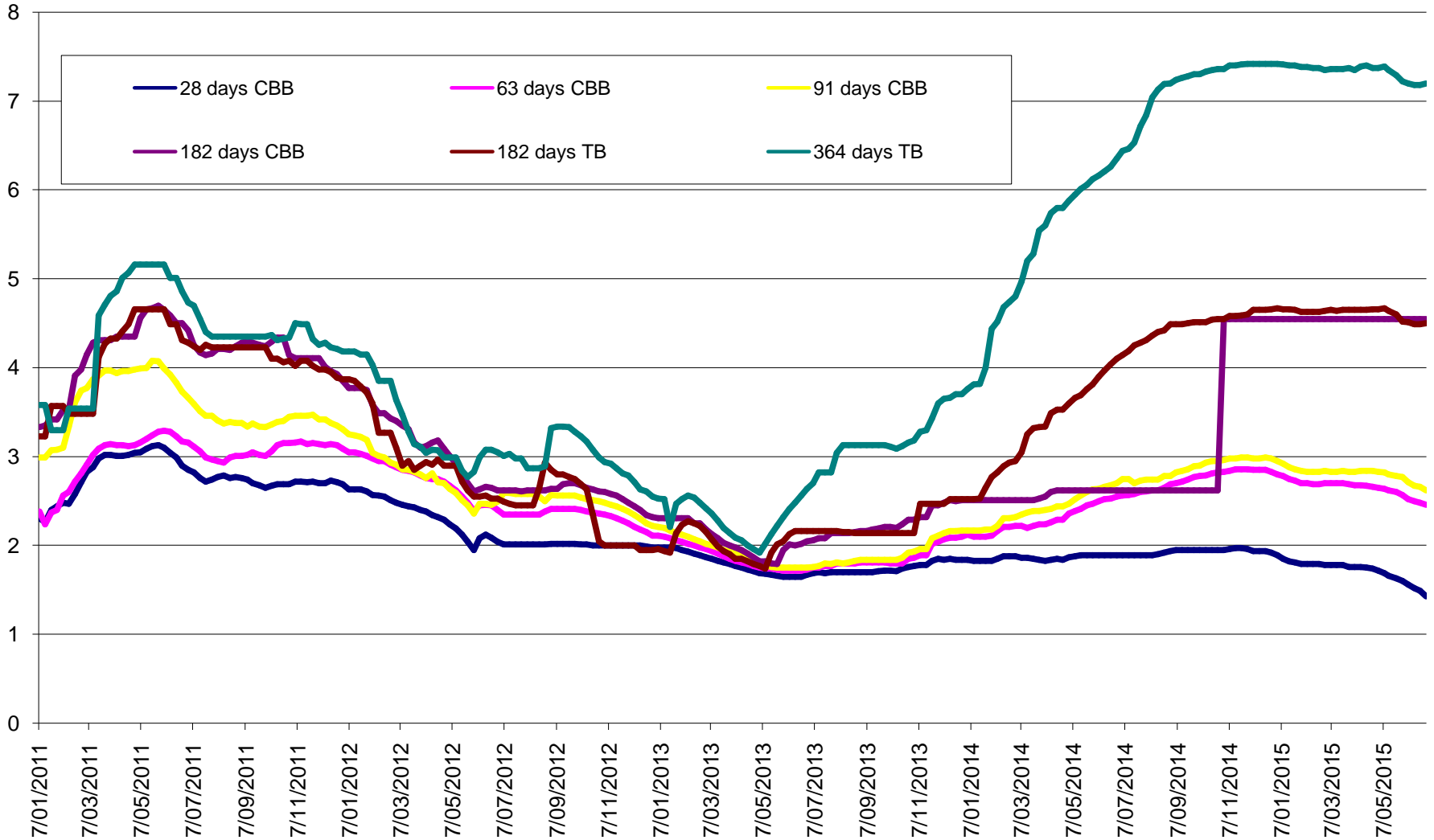
- Sufficient liquidity to support economic activity through bank lending
- Important to develop agriculture sector using advanced technologies and innovative systems
 - Majority of the population is engaged in this sector
 - Expand export base for the economy and revenue base for the Gov't
 - Help mitigate 'Dutch Disease' effects

4.3 Interest Rates

- High liquidity contributed to low interest rate environment
- CBB rates ranged between 1.4% (28 days) to 2.6 (91 days)
- Treasury bills between 4.4% (182 days) and 7.1% (360 days)
- Commercial bank deposit rates are between 1.25% (30 days) and 1.5% (182 days)

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Interest rates - CBBs & Treasury Bills



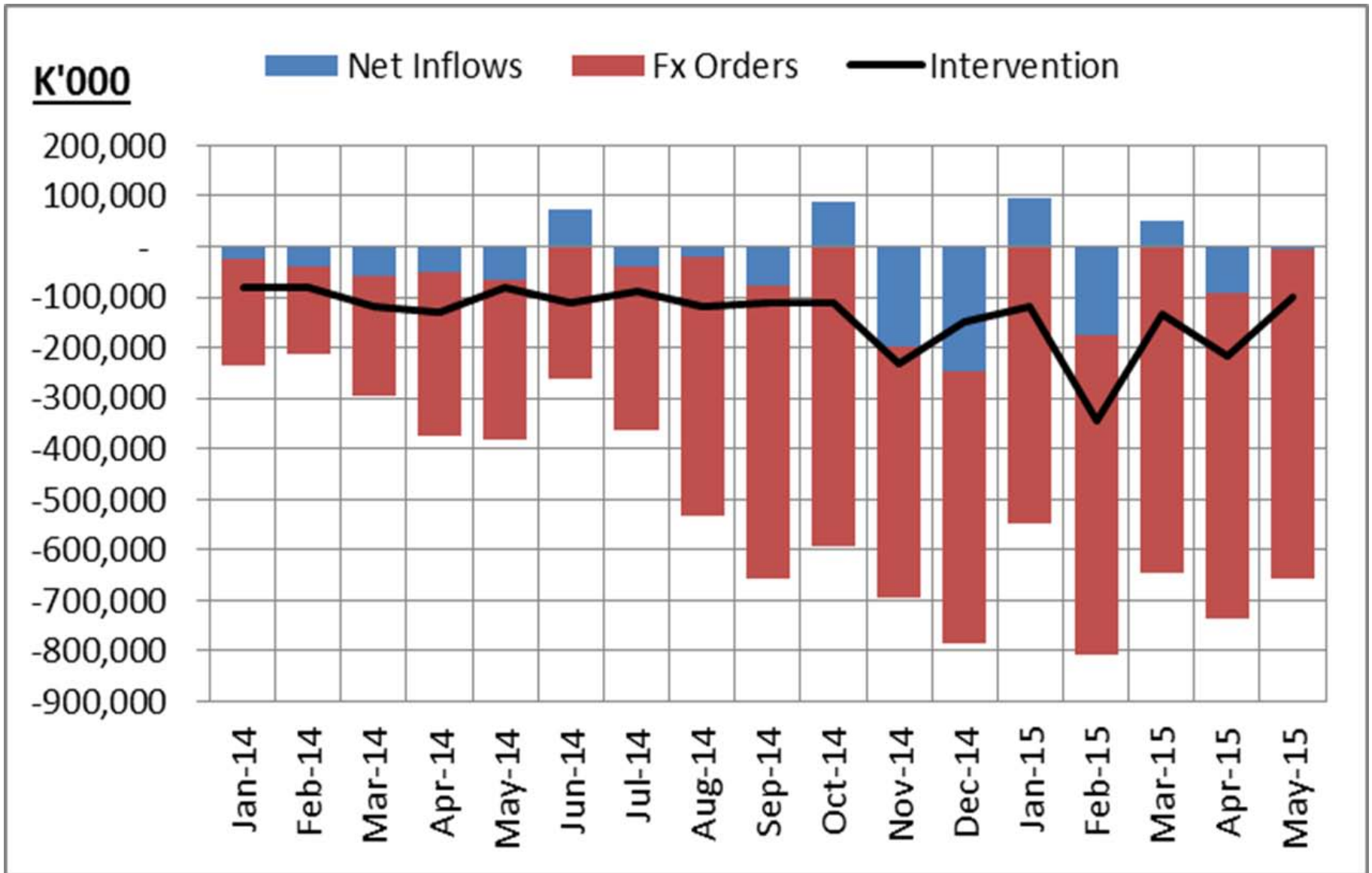
4.4 Exchange Rates

- High liquidity also contributed to high import demand, exerting downward pressure on exchange rate
 - Kina depreciated by 5% against US dollar between December 2014 and June 2015
 - Kina also depreciated by 0.4% against Australian dollar over the same time
 - Trend expected to continue for the remainder of 2015 and stabilise at year end

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- Several measures introduced to address high exchange rate margins (buy and sell rates) and between official and trading rates
 - Forward orders restricted from the inter-bank market in October and December 2013
 - Exchange rate trading band on June 2014 between buy and sell rates from inter-bank mid rate
 - Floating exchange rate regime maintained since the float in October 1994, where supply and demand of foreign currency determines the exchange rate

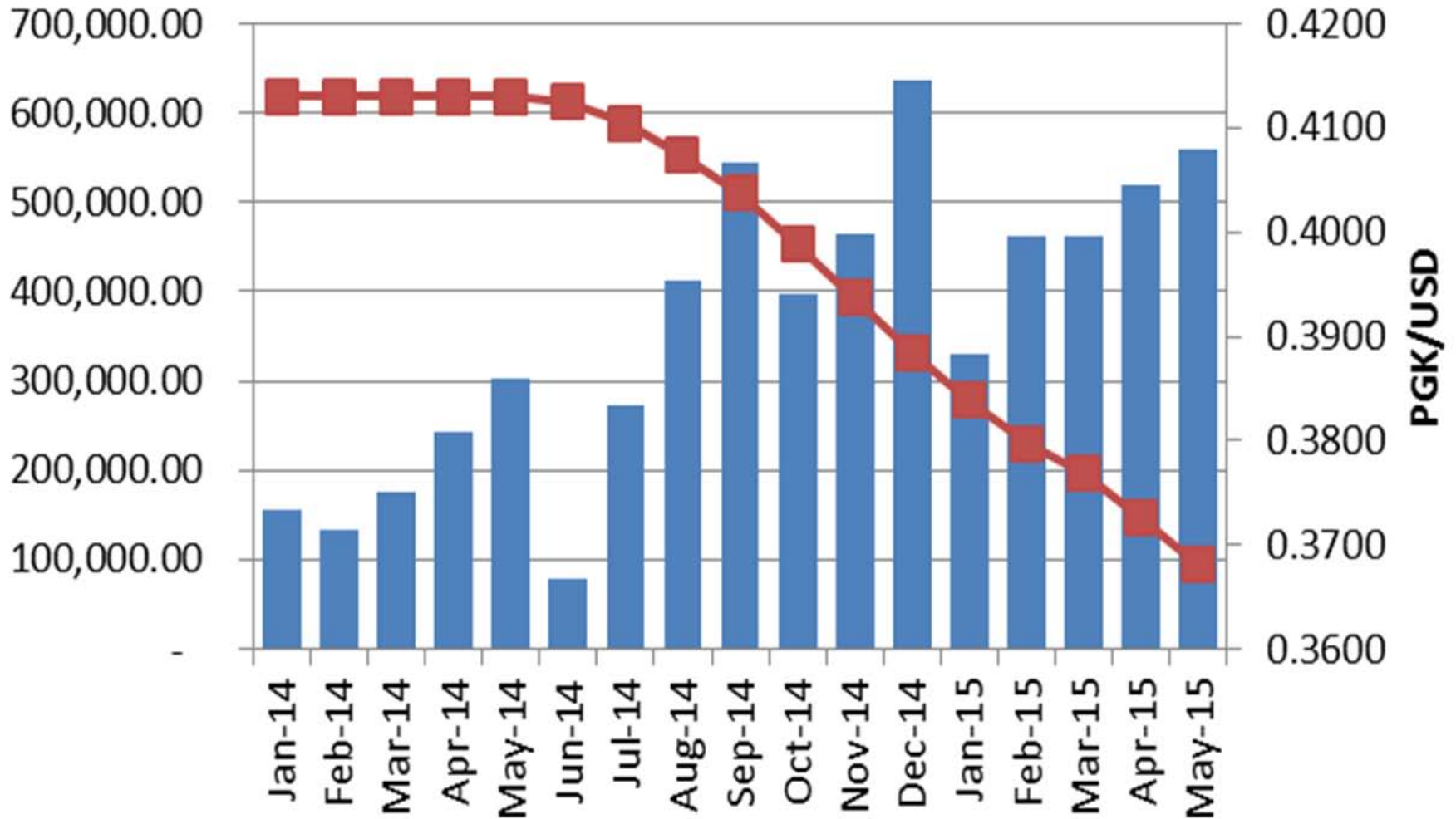
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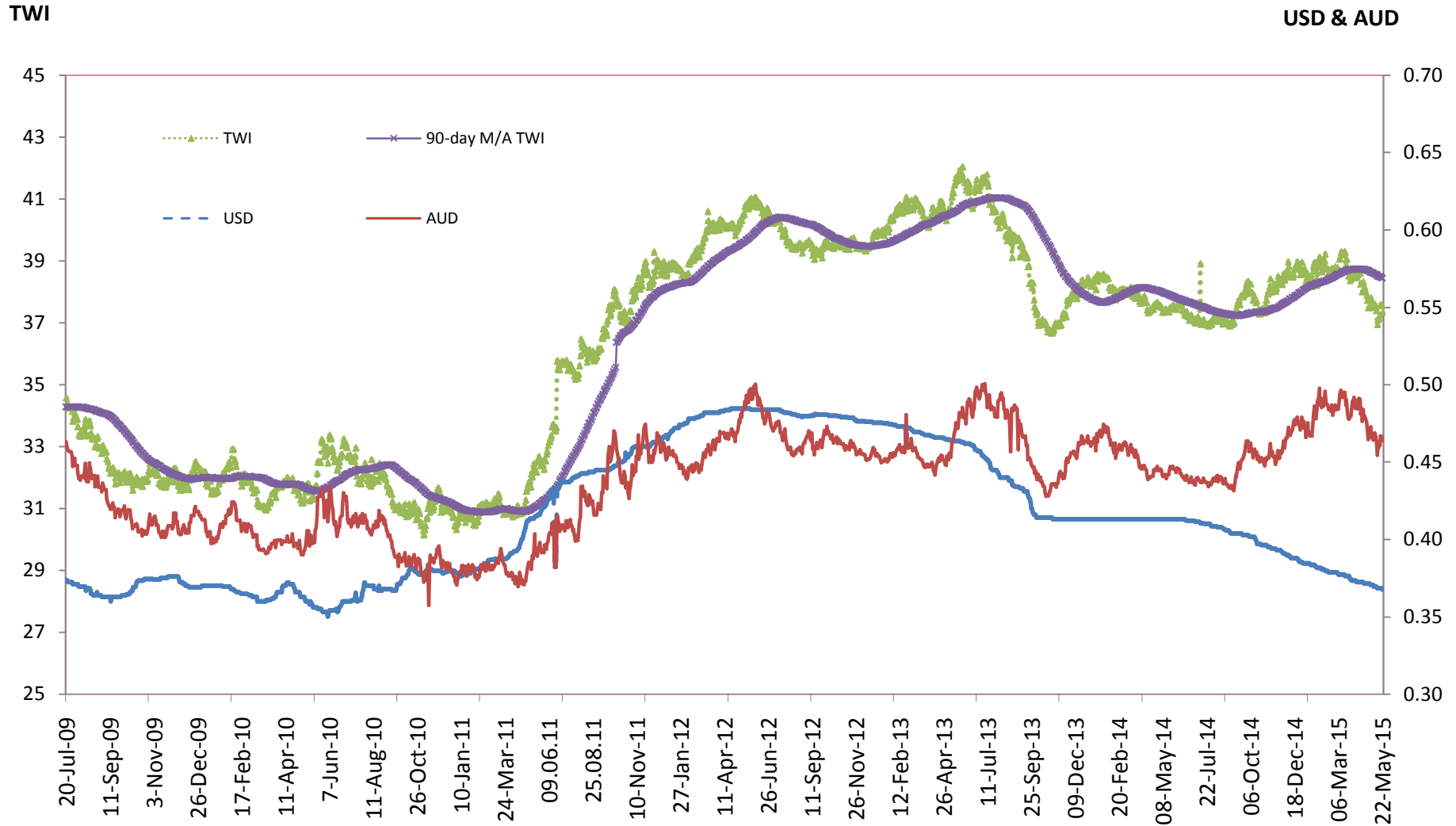
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Foreign Exchange Market - Excess Demand



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Kina Exchange Rate Levels - TWI, USD & AUD

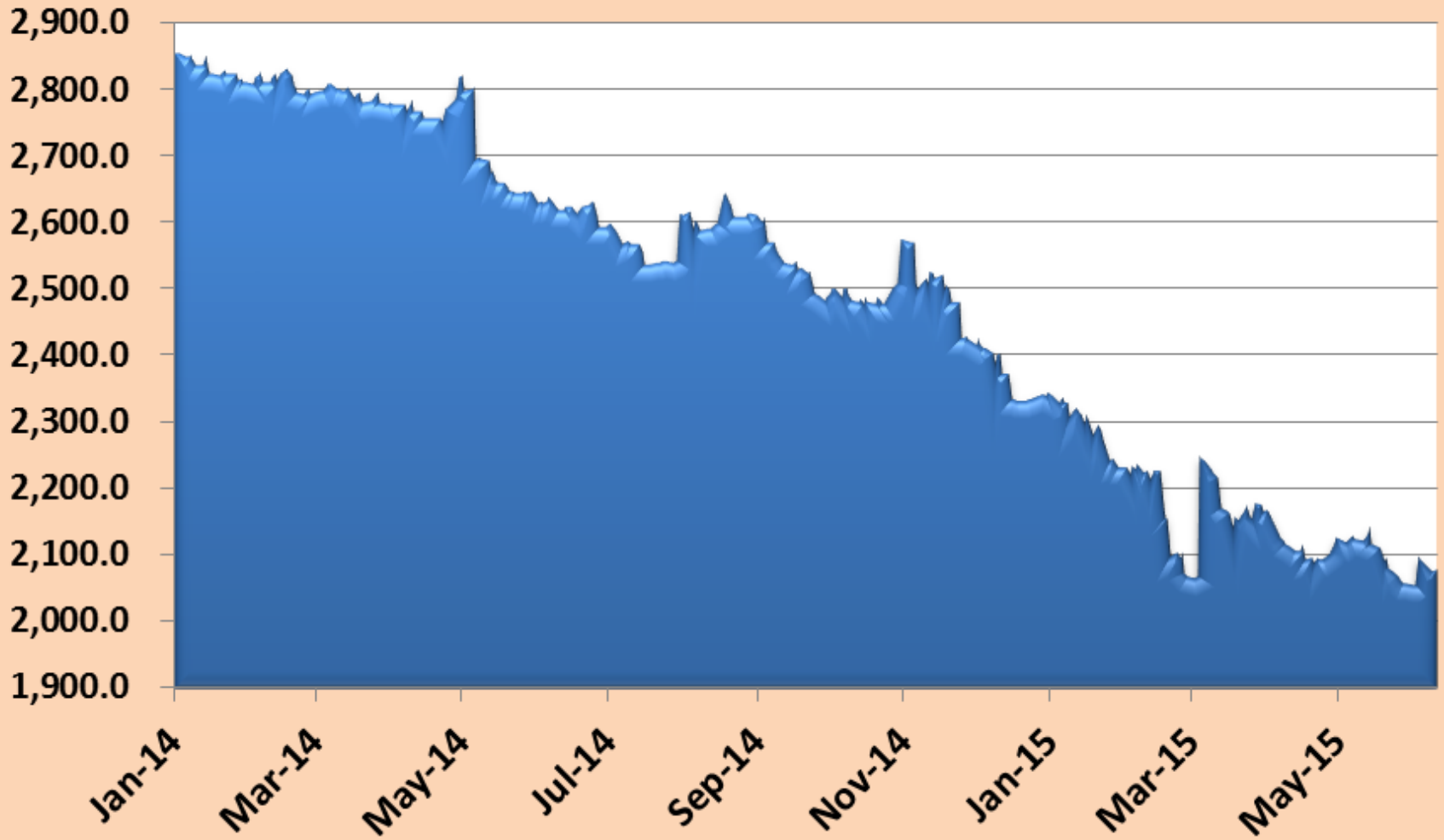


4.5 Foreign Exchange Reserves

- BPNG intervenes to support FX market and smooth the exchange rate depreciation
- BPNG intervention amounts to US\$382 million (K1,011 million) in first six months of 2015
- Current international reserves around US\$2 billion (K5.5 billion)
- Sufficient for 8 months of total and 12 months of non-mineral import cover

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FX Reserves (US\$m)



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- Various practises in the FX market led to several Foreign Exchange Control Directives issued in March 2015
 - To restrict unauthorised foreign banks conducting bank business through Vostro accounts
 - Assess the use of foreign currency accounts through an audit
 - Introduce 3 months retention period for exporters to bring back export proceeds

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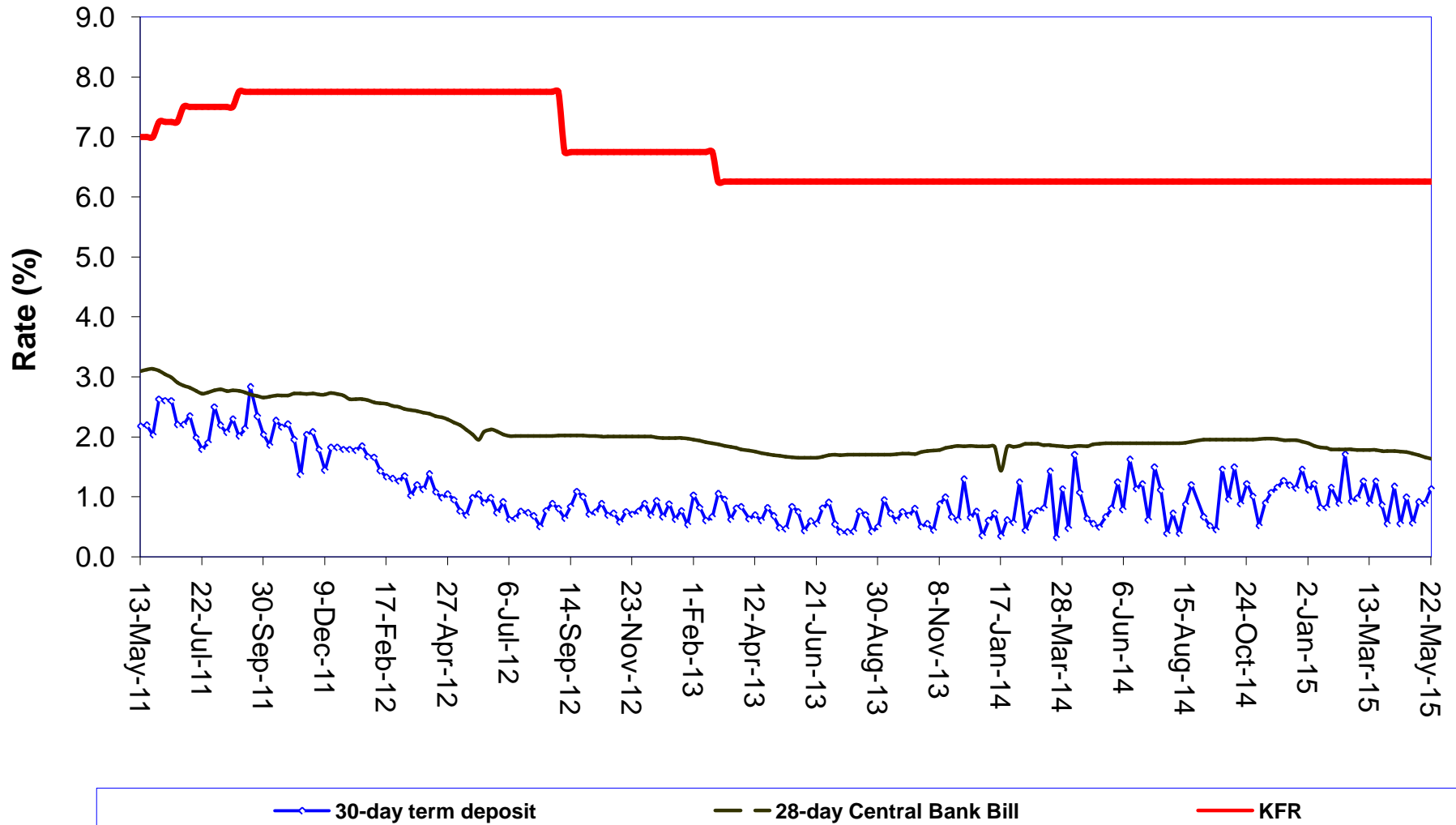
- Directives do not mean a change in the Foreign Exchange (FE) Control regime. Done through the FE manual
- Not meant to create fear or panic
- All the measures since 2013 are to restore order and ensure a smooth functioning of the FX market, with transparent price setting

4.6 Monetary Policy Stance

- Low inflation outcomes and favourable macroeconomic conditions resulted in BPNG maintaining an accommodative (neutral) monetary policy stance
- To also support economic activity in line with the Gov't fiscal stance after LNG construction ended
- Policy signalling rate, Kina Facility Rate maintained at 6.25% since March 2013

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KFR, 28-day Central Bank Bills & 30-day Term Deposits W/average

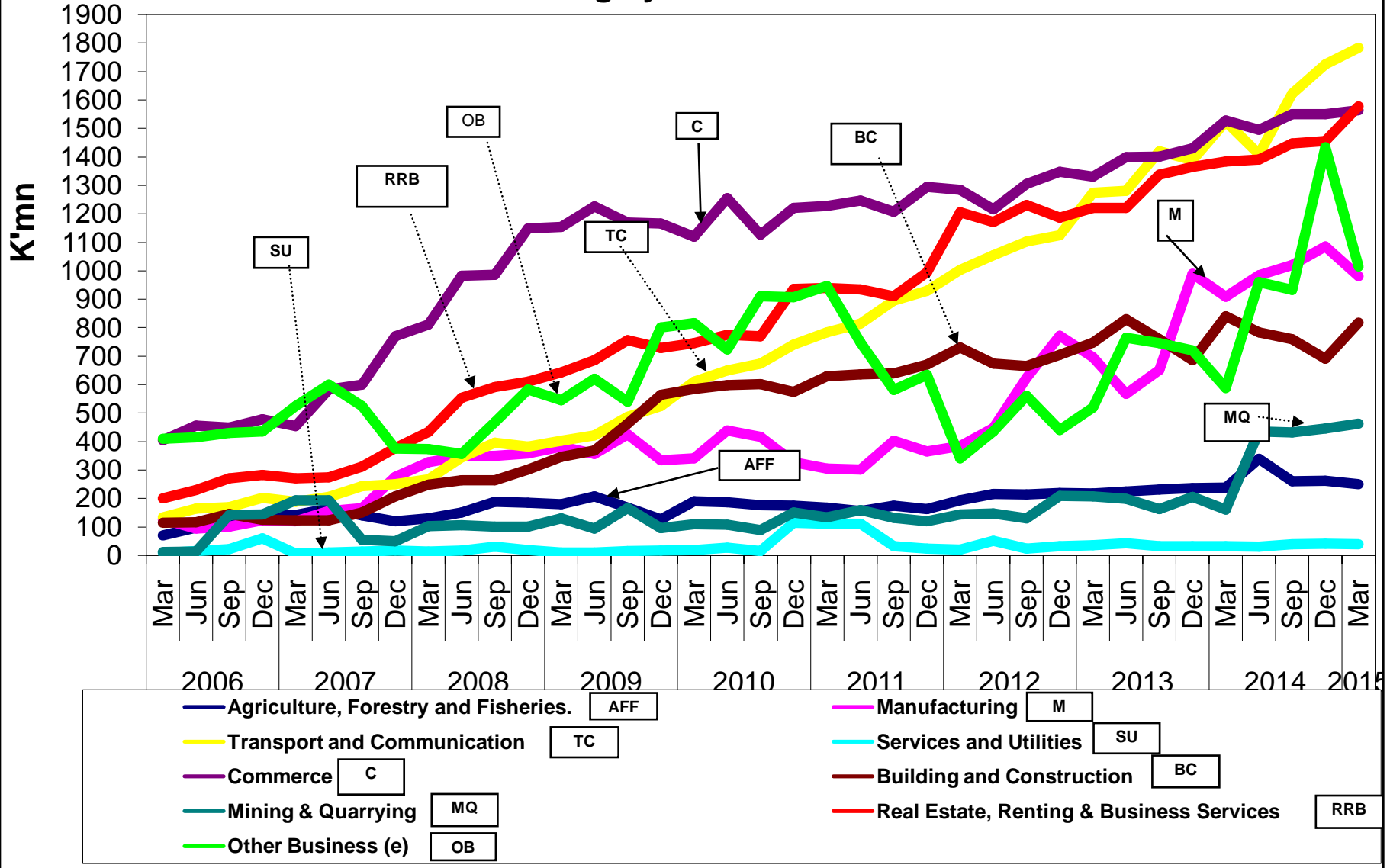


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- Sufficient lending to fund Gov't financing needs and lend to private sector
- Increased lending by banks, mainly to commerce, transportation, manufacturing and real estate/housing
- Monetary policy management aimed at finding a balance between high liquidity levels, rising interest rates and high import demand resulting in depreciation

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Commercial Bank Lending by Sector



5. Other BPNG Initiatives

5.1 Promoting Financial Inclusion

- To empower our people financially to fight poverty
- Various financial inclusion initiatives - a program of getting every Papua New Guineans access to banking and financial services.
- Licensed financial institutions have rolled out various products and services, so as telephony companies
- Financial inclusion Expos – Lae, Port Moresby & Kokopo, next for Mt. Hagen for Highlands region

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- Launched PNG National Financial Inclusion & Financial Literacy Strategy 2014-2015
- Targets opening of 1 million bank accounts over the next 2 years
- Of which 50% will be women

5.2 National Payments System Project

- Launched in March 2014
- Has real time gross settlement for inter-bank payments
- Also introduced automated cheque clearing, known as cheque truncation. All cheques to be compliant with the new system, that is, MICR Encoded format
- Direct credits was launched this year
- We now have a safe, cost effective and reliable domestic payment system, bringing it up to par with the international payment system

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Thank you