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BANK OF PAPUA NEW GUINEA



**MONETARY POLICY STATEMENT
BY THE GOVERNOR OF
THE BANK OF PAPUA NEW GUINEA,
MR. L. WILSON KAMIT, CBE**

PORT MORESBY

30th January 2009

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Queries on the contents of the Monetary Policy Statement (MPS) should be directed to the Manager, Economics Department on telephone number (675) 3227311 or Manager, Monetary Policy Unit on telephone number (675) 3227312, or both on fax number (675) 3200757. Copies of the Statement can be obtained from the Economics Department and is also available on the Bank's website: <http://www.bankpng.gov.pg>. It will be reproduced in the June 2008 issue of the Quarterly Economic Bulletin (QEB).

The Bank of PNG is changing the release cycle of the Monetary Policy Statement (MPS) from 31st January and 31st July to 31st March and 30th September. This is to allow for the first MPS of the year to be based on the year-end outcomes of macroeconomic indicators for the previous year and the second MPS to be based on the outcomes of the first six months of the year. Accordingly, this will be the last January MPS, covering only recent developments in 2008. A detailed MPS will be released in March 2009 covering 2009 and medium term projections based on the 2008 actual outcomes of macroeconomic indicators, including inflation, balance of payments and fiscal operations.

Objective of Monetary Policy

The objective of monetary policy in Papua New Guinea (PNG) is to achieve and maintain price stability. This entails low inflation supported by stable interest and exchange rates. The maintenance of price stability leads to:

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

2.0 Brief Overview

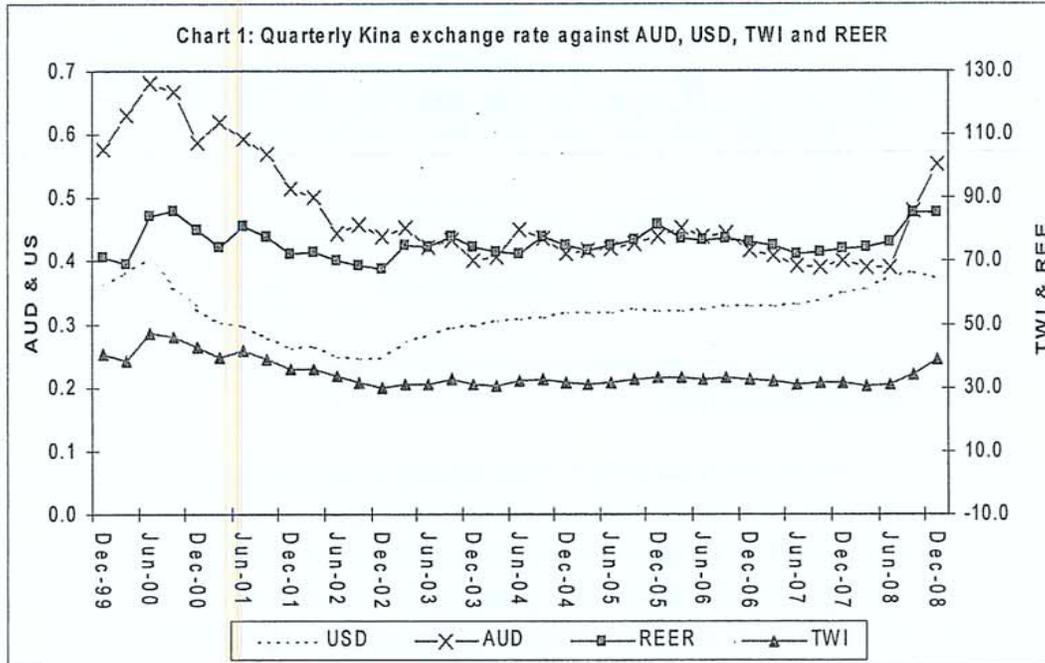
During the second half of 2008 the Central Bank's tightening of monetary policy was in response to the high inflation outcomes for the first three quarters of 2008 and expectations of continued inflationary pressures. This stance was signalled through the progressive increases in the Kina Facility Rate (KFR) from 6.0 percent in June 2008 to 8.0 percent by December 2008. However, recent declines in international oil and food prices and the appreciation of the kina exchange rate against all major partner countries' currencies provides an impetus for easing in inflationary pressures in the coming quarters.

The main factors that will mitigate the easing of inflationary pressures in the last quarter of 2008 and in 2009 will include; when businesses will pass on the declining import costs of goods and services; the continued high demand for credit and Government expenditures; ongoing capacity constraints in the domestic economy; and increasing wage demands. A fast drawdown of funds in the Government Trust Accounts can also contribute to further inflationary pressures.

As per the change in the release cycle of the MPS, after the actual outcomes of all macroeconomic indicators for 2008 become available, the Bank of PNG will revise its forecast of inflation and other indicators for 2009 and the medium term as published in the July 2008 MPS. These will be released in the detailed MPS in March 2009. **Until then, the Bank of PNG will continue its tight stance of monetary policy.**

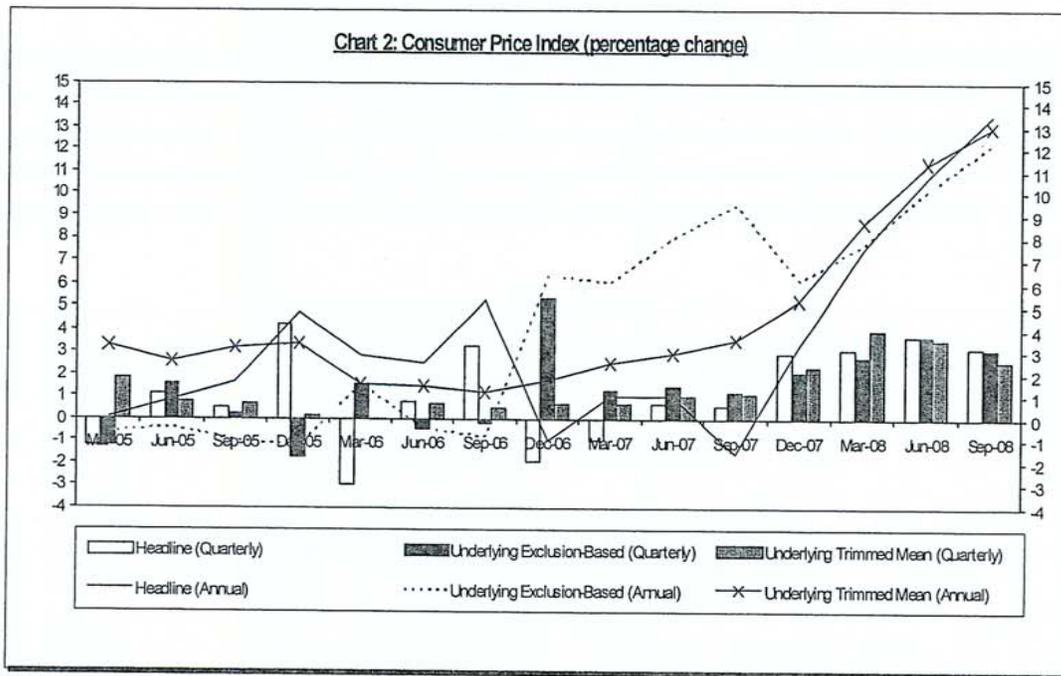
3.0 Developments

The kina strengthened against the US and Australian dollars by 6.4 percent and 28.8 percent on average to US\$0.3823 and A\$0.5003 respectively, during the second half of 2008. The significant appreciation of the kina against the Australian dollar, reflected cross currency movements as the US dollar strengthened against the Australian dollar due to uncertainties in the global financial markets. During the same period the Trade Weighted Index (TWI) appreciated by 12.2 percent. The Real Effective Exchange Rate (REER) appreciated by 15.1 percent to September 2008 from June 2008 (see Chart 1).



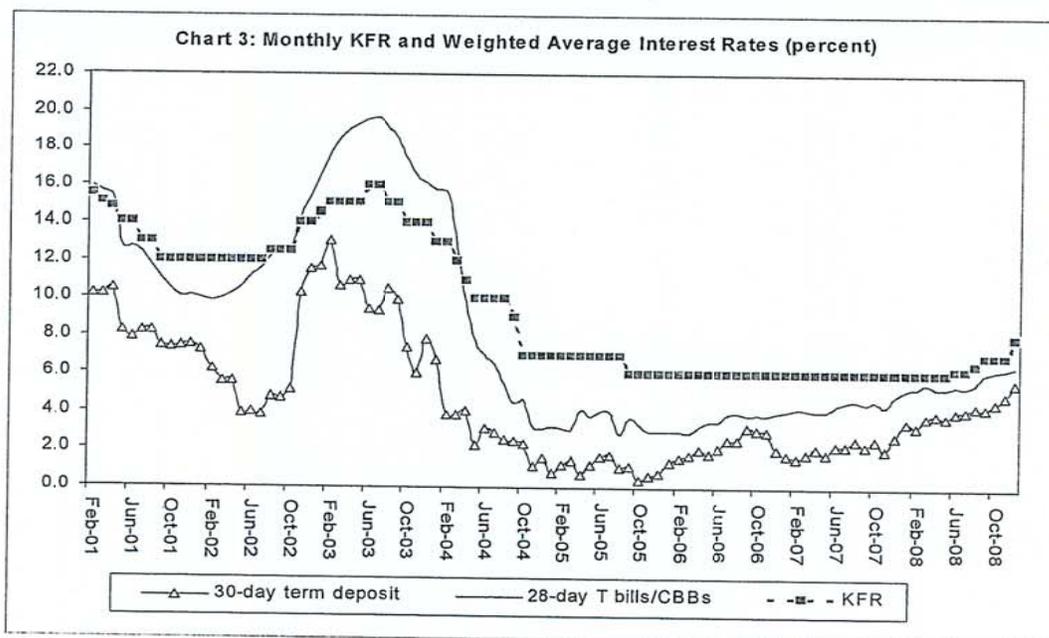
Source: Bank of PNG

The level of gross reserves was K5,812.6 (US\$2,092.6) million at the end of December 2008 compared to K5,919.4 (US\$2,109.0) million in 2007, sufficient for around 7.0 months of total and 13.7 months of non-mineral import covers. As at 26th January 2009, the level of gross foreign exchange reserves was K5,391.7 (US\$2,021.9) million.



Source: National Statistical Office

To support its tight monetary policy stance and diffuse excess liquidity in the banking system, the Bank issued Central Bank Bills (CBBs) totalling over K600 million in the second half of 2008. As a result, CBB rates increased from 5.0 percent to over 6.0 percent (see chart 3). Treasury bill rates also traded over 6.0 percent during the latter part of the second half of the year. The Indicator Lending Rates (ILR) spread increased from 8.95 - 9.45 percent to 8.95 - 9.95 percent during the second half of 2008. The weighted average interest rate on total deposits declined from 1.58 percent in December 2007 to 1.35 percent in December 2008, while the weighted average lending rate on total loans remained relatively stable at around 9.25 percent. As a result, the spread between the weighted average lending and deposit rates remained largely unchanged.



Source: Bank of PNG

Total liquidity of the banking system increased by 7.7 percent to K4,956.4 million between December 2007 and December 2008, mainly due to higher net Government expenditure and private sector credit. Lending extended mainly by commercial banks to the private sector increased by 41.0 percent in 2008. The growth in private sector credit was broad based across all sectors due to low interest rates and increased business activities.

4.0 Monetary Policy Stance

The Bank of Papua New Guinea will maintain its tight monetary policy stance.

5.0 Conduct of Monetary Policy

Monetary policy will be conducted within the reserve money framework. The MPS provides the overall monetary policy framework, while the monthly KFR remains the instrument for signalling the Bank's monetary policy stance through an announcement by the Governor. Following the announcement, Open Market Operations (OMOs) will be conducted to support the monetary policy stance. The OMOs involves Repurchase Agreement (Repo) transactions with commercial banks and the auction of CBBs to licensed financial institutions. The Bank also conducts auction of Government Treasury bills to the general public.

Appendix

Table 1: Monetary and Credit Aggregates (annual % changes)

INDICATOR	2005 (actual)	2006 (actual)	2007 (actual)	July 2008 MPS (proj)	2008 (prel)
Broad Money Supply	30.7	39.0	27.3	20.7	11.4
Monetary Base	3.0	21.7	61.8	16.3	-7.8
Claims on the Private Sector	25.2	36.8	30.8	28.5	41.0
Net Claims on Gov't	-24.7	-11.6	-83.5	-59.5	-153.9
Net Foreign Assets	33.5	58.2	51.7	17.2	-12.1

Source: Bank of PNG

Table 2: Summary of Other Macroeconomic Indicators

INDICATOR	2005 (actual)	2006 (actual)	2007 (actual)	July 2008 MPS (proj)	2008 (latest actual)
CONSUMER PRICE INDEX (annual % changes)*					
Headline	4.6	1.3	3.2	9.0	13.5
Trimmed-mean	3.3	0.4	6.0	8.0	13.0
Exclusion- based	-1.4	2.9	6.0	8.0	12.2
BALANCE OF PAYMENTS (kina millions)**					
Current account	1,987	1,255	366	338	2,030
Financial account	-1590	719	1,183	1,749	-2,190
Overall balance	296	1,958	1,592	2,087	-220
Gross Int. Reserves	2,368	4,326	5,919	7,386	5,813
IMPORT COVER (months)					
Total	6.0	8.5	9.1	9.8	7.0
Non-mineral	8.2	11.5	13.0	16.9	13.7
EXPORT PRICE					
Crude oil (US\$/barrel)	55	67	73	117	115
Gold (US\$/ounce)	403	555	671	890	941
Copper (US\$/pound)	162	296	320	323	350
FISCAL OPERATIONS OF THE GOVERNMENT*					
Surplus/Deficit (K'm)	7.6	535.8	454.5	202.3	1063.4
% of GDP	0.1	2.4	2.4	1.0	5.4
REAL GROSS DOMESTIC PRODUCT (annual % growth)					
Total GDP	3.4	2.6	6.5	7.6	7.2
Non-mineral GDP	3.1	3.7	7.3	7.1	7.9

Source: Bank of PNG, NSO and Department of Treasury

* CPI and fiscal operations actuals to September 2008

** BOP actuals are to October 2008, except for the reserve level and import covers which are end-December.