



Summary Discussions of Investor Meetings Between Department of Treasury and Investors of Government Securities **September - October 2011**

The Department of Treasury (DoT), through its Financial Management Division, held its second round of semi-annual investor meetings throughout September and early October. Staff of FMD met with senior management of various domestic investors, as well as stakeholders, to update them on the 2011 Debt Issuance Plan, and other budgetary updates. The meetings also provided opportunity for investors to provide their feedback on the Issuance Plan as well as to raise issues of concern.

Presented below is a summary of the discussions and issues or views raised.

1. Government Securities

Investors continue to have strong appetite for Treasury Bills and Inscribed Stock. Strong demand has seen oversubscription of most tenders. Regular participants include the major commercial banks, pension funds, private fund managers, small financial institutions and non-government organisations. Most investors assured that current holdings would be rolled over upon maturity. Preferences on maturity terms would be client driven or on cash flow positions.

Despite the growing demand for Government securities, investors raised concerns that returns on their investments were low. Large liquidity holdings combined with limited options to invest domestically results in aggressive bidding which is significantly reducing yields on Government securities. Furthermore inflation at 9% is yielding negative real interest rates especially on Treasury Bills, and some investors have asked for returns on Inscribed Stock to be increased.

The current liquidity situation has caused the Bank of PNG to increase the Kina Facility Rate (KFR) by 75 basis points from a year start of 7% to the current 7.75%. However, the market rates have not moved in line with the KFR movement, instead they have moved downward.

The investors would like the Government to intervene via policies to curb inflation from increasing to double digits, increase issuance on Treasury Bills and Inscribed Stock to meet excess liquidity demand and possibly drive up yields.

DoT advised that the State does not want inflation to hit double digits. The passing of the 2011 Supplementary Budget can trigger inflation by means of increased government spending however it is anticipated that sectors which have received bulk funding can absorb the impact. These sectors include education and health.

The State is also addressing excess liquidity, by transferring, to BPNG, all new Trust Accounts and its Trust Accounts that are held with commercial banks. These will reduce the amount of liquidity in the banking sector.

2. Market Developments

2.a Domestic Debt Market Project

ADB Technical Assistance

In trying to develop PNG's domestic debt market, ADB provided to DoT, Technical Assistance (TA) to conduct a feasibility study on current market regulatory systems and infrastructure, procedures, legal aspects, etc. One bond expert and a legal

expert were recruited under this ADB TA to perform this study over a three month period beginning in January 2011.

The study, amongst other, things looked into the possibility of issuing a Kina Denominated ADB Bond in PNG, the listing of Inscribed Stock on the Port Moresby Stock Exchange (POMSOX) and provide a roadmap to address issues related for the development of domestic debt market including the issuance of ADB Kina denominated bond. Recommendations from the Report will be reviewed by Treasury and relevant stakeholders so that a work plan can be prepared to start implementation in 2012. Although work will commence in 2012, there are many issues (legal, procedural, regulatory, system) to address in order to progress the development of domestic debt market. The process is estimated to take 3 to 5 years to implement to advance current market standards to meet international requirements.

The ADB TA report has been finalized and will be released to relevant stakeholders soon.

2.b Repurchase Agreement Facility

Some investors expressed their desire for a Repurchase Agreement facility to liquidate long-term securities (Inscribed Stock). These investors stated that because of the absence of a formal secondary market, the facility would allow them to liquidate long term maturing stock quicker as and when liquidity needs arose. Having this facility could also increase greater participation in the Inscribed Stock market. The concerned investors informed that discussions have been held with the BPNG, since 2009, and that they would like DoT to progress work on establishing the facility, and further, develop the secondary market.

2.c Dissemination of Government Securities Information

Treasury Bills Monthly Issuance Plan

DoT, in May this year, started issuing a monthly Treasury Bill issuance notice, to provide to investors, an estimation of how much the State would offer in a particular month. This hopefully would give investors ample time to plan their investment portfolios. The monthly notice only provides an indication and not an exact amount of Treasury Bills to be issued.

Investors welcomed this new initiative, but raised concerns that BPNG was not communicating this information to all of them. In this connection DoT will be talking to BPNG to ensure this important information is disseminated promptly to all investors as soon as DoT provides it to BPNG. This information will also be made available on DoT's website (www.treasury.gov.pg/public debt).

3. Policy Issues

2011 Supplementary Budget

The Government passed the 2011 Supplementary Budget of K781.8 million. Much of this budget will be financed by surplus commodity revenue of about K606 million. Almost fifty percent of the budget will be allocated to the education sector to provide free tuition fees for primary to secondary level education.

DoT advised in its 2011 Debt Issuance update that it had, in Treasury Bills, only K173 million remaining to issue, however in the event of a shortfall in projected surplus revenue, financing will be required mainly from Treasury Bill issuance, therefore, there is a likelihood of issuance of more than K173 million.

Transfer of State Trust Accounts to BPNG

The State has commenced transferring Trust Accounts held in commercial banks to BPNG. All new Trust Accounts are also being created at BPNG. This exercise will help reduce the level of liquidity in the banking sector, and further assist in combating inflation from reaching a double digit figure.

4. Other Discussions

4. a Sovereign Community Infrastructure Treasury Bill for Kokopo (SCITB)

Enquiries were made about the status of the SCITB scheme. DoT advised that the scheme did not follow proper legal and budgetary processes, and therefore the State Solicitor advised that it was illegal. Investigations are currently being undertaken by authorities to establish what has happened and take necessary remedial actions.