



BANK OF PAPUA NEW GUINEA

MONTHLY ECONOMIC REVIEW

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Economic Activity

Global economic activity has broadly strengthened in the first four months of 2014, and is expected to improve further in the remaining months of 2014, with some of the improvement expected in advanced economies, including United States. The International Monetary Fund projects global growth to increase to 3.6 percent in 2014 from 3.0 percent in 2013. The Euro area is expected to return to positive growth in 2014, following the recession and is projected to grow by 1.2 percent. In China, growth is projected to remain at about 7.5 percent in 2014 as authorities seek to rein in credit and advance reforms, while ensuring a gradual transition to a more balanced and sustainable growth path. Although there has been a slowdown in key emerging market economies, economic growth in the group as a whole remains strong, despite a less favourable external financial environment, and will continue to constitute a significant share of global growth.

The domestic economy continues to experience a moderate growth for the first four months of the year in the face of low commodity prices, low production in mineral sector, and the winding down of the construction phase of the Liquefied Natural Gas project. The increased fiscal spending and increased private sector activity have sustained the economic growth. The Bank's forecast is for around 4.0 to 5.0 percent real GDP growth in 2014 as the construction phase of LNG project is completed and production commences.

Balance of Payments

Preliminary balance of payments data for the first two months to February 2014 show an overall deficit of K443.0 million, compared to a deficit of K247.1 million in the corresponding period of 2013. A deficit in the current account more than offset a surplus in the capital and financial account. The

deficit in the current account was due to lower trade surplus, and higher net service payments, which more than offset lower net income and transfer payments. The level of gross foreign exchange reserves at the end of February 2014 was US\$2,796.7 (K6,90.7) million, sufficient for 7.6 months of total and 11.5 months of non-mineral import covers. As at 29th April 2014, the level of gross foreign exchange reserves was US\$2,801.7 (K6,702.7) million.

Exchange Rate

The average inter-bank kina exchange rate against the US dollar continued to be at US\$0.4130 over the month to 28th April 2014, and has been since October 2013. During the same period, the average kina exchange rate depreciated against the Australian dollar by 132 basis points to AU\$0.4437. This was due to cross currency movements as the Australian dollar appreciated against the US dollar on the back of lower inflation in Australia. The Trade Weighted Index decreased by 1.0 percent to 37.58 between end of December 2013 and 28th April, mainly reflecting the depreciation of the kina against the Australian dollar. However, due to high sell kina (buy USD) orders in the FX market, commercial banks have been quoting rates well below the interbank rate and this tendency may add to inflationary pressures.

Inflation

The Bank's annual headline Retail Price Index (RPI) to March 2014 increased by 2.0 percent, compared to 2.8 percent in February 2014. This was due to price increases in the 'Drinks, tobacco and betelnut' and 'Rents, council charges fuel/power' expenditure groups and 'Motor vehicle operations (petrol only)' sub group. RPI ex-seasonal increased by 2.7 percent, while RPI ex-seasonal and fuel increased by 2.1 percent over the twelve months to March 2014. The monthly RPI for March increased by 2.0 percent, compared to a rise of 1.2 percent in the previous month. In 2014, inflationary pressures may arise from depreciation of the kina, mainly

¹ The Trade Weighted Index (TWI) measures the value of the kina against a basket of currencies of PNG's major trading partners.

² The RPI survey covers the major supermarkets in Port Moresby and is compiled monthly.

due to high import demand associated with high Government spending and private sector demand.

Fiscal Operation

Preliminary estimates of the fiscal operations of the National Government in January 2014 show an overall surplus of K195.5 million, compared to a surplus of K187.8 million in the corresponding month of 2013. This represents 0.5 percent of nominal GDP and reflects higher revenue, which more than offset an increase in expenditure. The budget surplus and external borrowing of K2.6 million from concessional sources were used to repay domestic borrowing of K198.1 million, mainly net retirement of Government securities and cheques presented for payment by other resident sectors. The Government's weekly cash flow for week-ending 25th April 2014 shows a closing position of K254.8 million. The Government expects around K200.0 million in mineral tax receipts in early May 2014. The domestic financing of the 2014 budget deficit by the Government through issuance of its securities would assist the Central Bank in absorbing some of the excess liquidity. However, the second round effect when the raised funds are disbursed through the commercial banks for spending will add to liquidity, and the Central Bank has to account for this in its liquidity management.

Domestic Interest Rates & Monetary Aggregates

Over the month to 28th April 2014, Central Bank Bill (CBB) rates increased for all maturities, except for the 28-day rate. The 63-day, 91-day and 182-day rates increased to 2.29, 2.44 and 2.62 percent, respectively from 2.24, 2.39 and 2.53 percent, while the 28-day rate remained at 1.84 percent. Treasury

bill rates also increased. The 182 and 365 days rates increased to 3.53 percent and 5.80 percent from 3.33 percent and 5.54 percent, respectively. The wholesale deposit rates decreased across all terms.

Broad money supply (M3*) increased by 4.3 percent over the year to March 2014, compared to an increase of 8.9 percent in the corresponding period in 2013. The lower growth was mainly driven by increases in net claims on Government and private sector credit, which more than offset a decline in net foreign assets. Monetary base increased by 3.6 percent in March 2014, compared to an increase of 12.7 percent in the corresponding period in 2013. This was due to increases in deposits of commercial banks at the Central Bank and currency in circulation.

Over the year to 25th April 2014, average lending by banks increased by 16.4 percent to K8,864.0 million. The commercial bank deposits decreased by K255.5 million to K18,116.0 million between December 2013 and week-ending 25th April 2014, reflecting net deposits by the mining, petroleum, government, finance, construction, manufacturing, communication and other business sectors.

Monetary Policy

With the expected depreciation of the kina, especially in the first half of 2014, associated with high import demand and low export receipts, inflationary pressures may persists. The Bank is therefore taking a cautious approach by maintaining its neutral stance of monetary policy. The policy signalling rate, the Kina Facility Rate, is maintained at 6.25 percent for the month of April 2014.

Papua New Guinea Key Economic Indicators								
		Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	
1. Consumer (YOY % Change)	Headline Food	- -	4.7 1.0	- -	- -	- -	- -	
2. Retail Price Index (YOY % Change)	Headline Ex-seasonal	1.7 3.1	-0.3 0.9	0.1 1.4	2.8 3.1	2.0 2.7	- -	
3. Exchange Rates (mid rate, eop)	USD AUD GBP JPY NZD	0.4130 0.4538 0.2525 42.23 0.5091	0.4130 0.4622 0.2506 43.38 0.5024	0.4130 0.4710 0.2507 42.36 0.5074	0.4130 0.4610 0.2475 42.02 0.4922	0.4130 0.4475 0.2483 42.490 0.4769	0.4130 0.4448 0.2457 42.260 0.4824	
4. Foreign Exchange Reserve (eop US\$ mill)		2,944	2,855	2,811.3	2,796.7	2,781.3	2,801.7	
5. Liquidity (eop)	Liquid Assets Margin to Deposit Ratio (%) Banks Demand Deposits (K'bn)	41.9 10.6	44.6 10.7	44.9 13.4	46.2 13.4	45.9 13.5	45.5 13.9	
6. Money and Credit (YOY % change)	Broad Money Monetary Base Private Sector Credit	11.0 -0.4 16.1	6.5 -0.5 17.5	9.5 10.5 4.0	5.9 4.0 10.6	4.3 3.6 9.3	- - -	
7. Interest Rates (% pa) (monthly weighted average)	Kina Facility Rate Central Bank Bill Rate (28 day) Commercial bank Term Deposit (30 day) Government Treasury bill (364 day) 3-year Inscribed stock Rate 16-year Inscribed stock Rate (>10 years)	6.25 1.85 0.61 3.60 4.66 0.11	6.25 1.84 0.35 3.72 4.52 -	6.25 1.83 0.82 4.44 6.02 10.1	6.25 1.88 0.81 4.80 6.49 10.45	6.25 1.84 1.13 5.54 6.67 11.59	6.25 1.87 0.64 5.88 6.88 13.21	
8. Commodity Prices (monthly average)	Oil (\$/bbl) Gold (\$/troy oz) Copper (\$/mt) Coffee (cents/kg) Cocoa (cents/kg)	102.6 1280.8 7096.3 123.1 276.0	105.5 1223.7 7193.6 127.0 279.1	102.1 1246.3 7285.0 134.4 171.0	104.8 1301.0 7151.6 104.8 180.0	104.0 1338.3 6669.1 216.2 183.3	104.9 1299.1 6655.5 223.4 182.5	

Authorised for release by Mr. Loi M. Bakani, Governor