



BANK OF PAPUA NEW GUINEA

MONTHLY ECONOMIC REVIEW

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Economic Activity

Following the weakening in global economic growth in the first quarter of 2014, due largely to severe weather induced contraction in the US economy, the pace of global economic activity is expected to pick up as the year progresses. The forecast growth for 2014 is 2.8 percent according to the World Bank's latest Global Economic Prospects report, issued on June 10, 2014. High-income economies will contribute about half of the global growth in 2014 compared to less than 40 percent in 2013. Growth in the developing countries is expected to ease for a third consecutive year to below 5 percent, partly reflecting delays in pick-up in economic activity due to the weak performance in the first quarter of 2014. On the other hand, recovery in high-income countries is gaining momentum, despite the first quarter weakness in the United States (US). These economies are expected to grow by 1.9 percent in 2014. The Euro Area is on target and is projected to grow by 1.1 percent this year, while the US economy is expected to grow by 2.1 percent in 2014 compared to an earlier forecast of 2.8 percent.

Moderate growth is expected to continue in the second half of 2014 as the domestic economy embraces a milestone achievement with the early completion of the construction phase and the commencement of the Liquefied Natural Gas (LNG) production and export. This is a significant development by any standard in PNG. The effects of this transition is particularly evident in the domestic economy reflecting a lower activity and employment in the non-mineral sector as services rendered to the LNG project are scaled down or ceased in some sectors. Growth is expected to improve in the second half of the year due to the production and shipment of LNG and continued Government's fiscal stimulus support.

Balance of Payments

Preliminary balance of payments data for the four months to April 2014 show an overall deficit of K120 million, compared to a deficit of K554 million in the corresponding period of 2013. This outcome was due to a deficit in the current account more than offsetting a surplus in the capital and financial account. The deficit in the current account was lower than in the corresponding period in 2013, reflecting lower net service, income and transfer payments. The level of gross foreign exchange

reserves at the end of April 2014 was US\$2,819.1 (K6,772.2) million, sufficient for 7.2 months of total and 10.4 months of non-mineral import covers. As at 30th June 2014, the level of gross foreign exchange reserves was US\$2,593.4 (K6,219.1) million.

Exchange Rate

In June, the Bank of PNG introduced an exchange rate trading band within which authorised foreign exchange (FX) dealers are to trade currencies. The measure is to correct what was a 'market failure' with FX dealers quoting well away from the interbank market exchange rate. That is, to restore the price making mechanism in the FX market. FX dealers are to quote between the inter-bank exchange rate and 75 basis points above that for inflows (exporters) and between the inter-bank exchange rate and 75 basis points below it for outflows (importers). The floating exchange rate regime is still a floating one whereby the interbank exchange rate can move in line with market conditions of supply and demand of foreign currency. The trading band moves with the interbank market exchange rate. A new foreign exchange trading guideline has been worked on to accommodate this change for FX dealers to comply with. The FX dealers have adjusted to the new measure in the month.

The average kina exchange rate depreciated against the US dollar by 5 basis points to US\$0.4125 over the month to 30th June 2014, due to the persistence of high import demand. During the same period, the average kina exchange rate depreciated against the Australian dollar by 33 basis points to AU\$0.4406. This was due to cross currency movements as the Australian dollar appreciated against the US dollar on the back of positive manufacturing data from China and the Reserve Bank of Australia's (RBA) announcement to maintain the cash rate at 2.5 percent. As a result, the average TWI decreased by 0.3 percent to 37.36 over the month to 30th June 2014, reflecting the depreciation of the kina against the US dollar and the Australian dollar.

Inflation

Annual headline Retail Price Index (RPI) to June 2014 increased by 4.0 percent, compared to 2.3 percent in May 2014. The significant increase was due to price increases in the 'Motor vehicle operations (petrol only)' sub-group and the 'Drinks, tobacco and betelnut' expenditure group, driven mainly by a substantial increase in betel nut prices. The pric-

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.

es in the 'Rents, council charges fuel/power' and 'Food' expenditure groups also increased. RPI ex-seasonal increased by 3.7 percent while RPI ex-seasonal and fuel increased by 2.5 percent over the twelve months to June 2014. The monthly RPI for June fell by 1.9 percent, compared to a fall of 0.1 percent in the previous month.

Fiscal Operation

Preliminary estimates of the fiscal operations of the National Government over the six months to June 2014 show an overall deficit of K370.0 million, compared to a deficit of K679.9 million in the corresponding period of 2013. This represents 0.9 percent of nominal GDP, and reflected higher expenditure, which more than offset an increase in revenue. The budget deficit of K370.0 million was financed from net external borrowing of K95.7 million and net K274.3 million from the domestic sector.

Total revenue, including foreign grants, in the first half of 2014 was K4,680.2 million, 13.3 percent higher than the receipts collected in the corresponding period of 2013. This represents 36.9 percent of the budgeted revenue for 2014. The increase in revenue mainly reflected higher collections in tax receipts which more than offset lower non-tax receipts and foreign grants. Total expenditure for the first six months to June 2014 was K5,050.2 million, 4.9 percent higher than in the corresponding period of 2013 and represents 33.6 percent of the budgeted appropriation for 2014.

Domestic Interest Rates & Monetary Aggregates

Interest rates for Central Bank Bills increased for half of the maturity terms over the month to 27th June 2014. There was no auction for the 182-day term during the month to allow

the Government to raise its required funds under this term for T-bills. The 63-day and 91-day rates increased to 2.55 and 2.70 percent from 2.47 and 2.63 percent, respectively, while the 28-day rate remained at 1.89 percent. At the Treasury bill auction, the 182 and 365 days rates increased to 4.10 percent and 6.35 percent from 3.81 percent and 6.12 percent, respectively. Over the same period the weighted average interest rates on wholesale deposits above K500,000 depicted mixed movements in all maturity terms.

Broad money supply (M3*) increased by 6.7 percent over the year to May 2014, compared to an increase of 6.6 percent in the corresponding period of 2013. This was mainly driven by increases in private sector credit and net credit to the Government, which more than offset a decline in net foreign assets. Over the year to 27th June 2014, average lending by banks increased by 18.4 percent to K9,200.7 million. Deposits at the commercial bank increased by K533.1 million to K18,904.6 million between December 2013 and week-ending 27th June 2014, reflecting net deposits by industries and government sectors. Over the year to 27th June 2014, average deposits increased by 7.8 percent to K18,550.8 million.

Monetary Policy

With the expectation of inflationary pressures coming from high import demand and high Government expenditure, the Bank continues to take a cautious approach by maintaining the policy rate, the Kina Facility Rate, at 6.25 percent for the month of June 2014.

Papua New Guinea Key Economic Indicators							
		Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14
1. Consumer Price Index (CPI) (YOY % Change)	Headline	-	-	3.8	-	-	-
	Food	-	-	2.7	-	-	-
2. Retail Price Index (RPI) (YOY % Change) (a)	Headline	0.1	2.8	2.0	8.7	2.3	4.0
	Ex-seasonal	1.4	3.1	2.7	3.9	4.0	3.7
3. Exchange Rates (mid-rate, eop)	USD	0.4130	0.4130	0.4130	0.4130	0.4130	0.4120
	AUD	0.4610	0.4610	0.4475	0.4432	0.4432	0.4373
	GBP	0.2475	0.2475	0.2483	0.2468	0.2468	0.2420
	JPY	42.02	42.02	42.490	41.950	41.950	41.470
	NZD	0.4922	0.4922	0.4769	0.4855	0.4855	0.4706
4. Foreign Exchange Reserve (eop US\$ mill)		2,796.7	2,796.7	2,781.3	2,644.4	2,644.4	2,593.4
5. Liquidity (eop)	Liquid Assets Margin to Deposit Ratio (%)	44.9	46.2	45.9	45.5	42.9	43.8
	Banks Demand Deposits (K'bn)	13.4	13.4	13.5	13.9	14.3	14.2
6. Money and Credit (YOY % change)	Broad Money	9.5	5.9	4.3	0.8	6.7	-
	Monetary Base	10.5	4.0	3.6	5.3	20.0	-
	Private Sector Credit	4.0	10.6	9.3	7.6	9.2	-
7. Interest Rates (% pa) (monthly weighted average)	Kina Facility Rate	6.25	6.25	6.25	6.25	6.25	6.25
	Central Bank Bill Rate (28 day)	1.83	1.88	1.84	1.87	1.89	1.89
	Commercial bank Term Deposit (30 day)	0.82	0.81	1.13	0.64	1.24	1.22
	Government Treasury bill (364 day)	4.44	4.80	5.54	5.88	6.12	6.35
	3-year Inscribed stock Rate	6.02	6.49	6.67	6.88	7.64	7.69
	16-year Inscribed stock Rate (>10 years)	10.1	10.45	11.59	13.21	14.65	15.18
8. Commodity Prices (monthly average)	Oil (\$/bbl)	102.1	104.8	104.0	104.9	105.7	108.4
	Gold (\$/troy oz)	1246.3	1301.0	1338.3	1299.1	1285.9	1277.3
	Copper (\$/mt)	7285.0	7151.6	6669.1	6655.5	6857.7	6798.4
	Coffee (cents/kg)	134.4	172.3	216.2	223.4	218.6	198.5
	Cocoa (cents/kg)	171.0	180.0	183.3	182.5	180.1	187.0

(a) Retail Price Index (RPI) only covers Port Moresby and not other urban centres in the CPI basket so it may not be comparable to the overall CPI movements.