



BANK OF PAPUA NEW GUINEA

MONTHLY ECONOMIC REVIEW

Vol. 1

No. 8

Month Ended
August 2014

Economic Activity

According to the IMF's latest *Commodity Price Outlook*, energy and metal commodity prices are expected to fall over the next 12 months, while most agricultural commodity prices are expected to increase. With increased supply expectations, oil prices are expected to decline through to 2015. Natural gas and gasoline price prospects are expected to follow seasonal demand patterns, rising in the winter and declining thereafter, while gold prices are expected to remain stable. With the on-going tensions in Eastern Europe, wheat prices are likely to increase for the rest of 2014 and next year and corn prices are also expected to increase over the next 12 months.

Developments in the global economy will continue to impact PNG, mainly through prices of imported goods and export commodities which depend on international price movements. The increases in the prices of food, especially cereals, are expected to impact domestic prices. On the other hand, the increase in prices of agricultural commodity exports should provide some relief to any possible falls in the prices of other mineral export commodities.

With the current lower international commodity prices and subsequent low export earnings, the revenue receipts for the Government as well as foreign exchange inflows have been low. Notwithstanding these, economic growth is expected to continue at a moderate pace or more for the rest of the 2014, attributable to the early commencement of LNG production and export, and growth in non-mineral private sector activity, supported by the Government's expansionary fiscal policy.

Balance of Payments

Preliminary balance of payments data for the six months to June 2014 showed an improvement in the overall deficit of K15.8 million, compared to a large deficit of K1,489.3 million in the corresponding period of 2013. This outcome was due to a deficit in the current account, which more than offset a surplus in the capital and financial account. The lower deficit in the current account was due to a higher trade surplus and lower net service payments. The outcome in the capital and financial account was mainly due to net inflows of equity from foreign direct investments by non-resident entities and portfolio investments reflecting drawdown

of investments from short term money market instruments by resident entities. At the end of August 2014, the level of gross foreign exchange reserves was US\$2,614.3 (K6,447.1) million, a decline from US\$2,615.9 (K6,880.3) million at end July 2014.

Exchange Rate

The average official inter-bank kina exchange rate against the US dollar trended downwards from US\$0.4104 at the end of July to US\$0.4073 at end of August 2014. Over the same period, the average kina exchange rate against the Australian dollar appreciated from AU\$0.4372 to AU\$0.4377. This was due to cross currency movements as the Australian dollar weakened against the US dollar. As a result, the average TWI¹ decreased by 0.7 percent to 34.42 at the end of August 2014. Since the introduction of the trading bank on June 4th and the subsequent alignment of the market rate to the official interbank rate, the official interbank mid-rate depreciated by 1.8 percent to US\$0.4055, whilst against the Australian dollar the kina fell by 2.6 percent to AU\$0.4337 at end of August.

Inflation

The annual headline Retail Price Index (RPI) to August 2014 increased by 4.0 percent, compared to a revised increase of 5.8 percent in the previous month. The increase was due to higher prices in the 'Drinks, tobacco and betelnut' expenditure group, resulting from an increase in the prices of betelnut and alcoholic drinks. The prices in the 'Rents, council charges, fuel/power' and 'Food' expenditure groups also increased. RPI ex-seasonal increased by 2.2 percent, while RPI ex-seasonal and fuel also increased by 2.2 percent over the twelve months to August 2014. The monthly RPI declined by 3.9 percent, compared to an increase of 3.5 percent in July.

Fiscal Operations

A higher budget deficit of K2,725.5 million or 6.9 percent of GDP was reported by the Treasury Department in the 2014 *Mid-Year Economic and Fiscal Outlook* Report. This was largely due to lower than the expected revenue from mining and petroleum taxes, while the total expenditure and net lending were unchanged from the 2014 original budget. With lower than budgeted revenue, it is important for the Government to manage its spending, even if it means to defer and reprioritise expenditure to manage its operations prudently and ensure that it does not exceed its budgeted debt ceiling.

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

In August, the Government raised K172 million in Treasury bills and K887 million in Inscribed stock. The need for the Government to raise the required finance to fund its expenditure has resulted in the increase in the Treasury bill interest rates. The Bank and the Treasury Department have agreed to have close consultation on the issuance of Treasury bills in order to stem any further increases in the rates.

Domestic Interest Rates & Monetary Aggregates

During the month of August 2014, CBB rates trended upwards with the 28-day rate increasing from 1.89 percent to 1.94 percent, the 63-day rate from 2.61 percent to 2.69 percent and the 91-day rate increasing from 2.74 percent to 2.81 percent at the end of the month. The 182-day term had no allocation during the month. At the Treasury bill auction, the 182 and 365 days rates increased from 4.31 percent and 6.84 percent to 4.49 percent and 7.20 percent, respectively, at the end the month.

Broad money supply (M3*) increased by 2.8 percent over the year to August 2014, compared to an increase of 9.8 percent in the corresponding period in 2013.

The growth in broad money was due to increases in private sector credit and net credit to the Government, which more than offset the decline in net foreign assets. Monetary base increased by 31.0 percent in August 2014 due to increases in deposits of commercial banks at the Central Bank and currency in circulation. Over the year to 29th August 2014, lending by banks increased by 5.2 percent to K9,889.9 million. The commercial bank deposits increased by K531.0.2 million to K18,888.3 million between December 2013 and week-ending 29th August 2014. Over the year to 29th August 2014, average deposits increased by 2.0 percent to K18,852.9 million.

Monetary Policy

The Bank maintained its neutral monetary policy stance and kept the KFR unchanged at 6.25 percent in August 2014. This was based on a decline in the monthly RPI outcome for July, improvements in the overall fiscal and BOP positions and lower rate of depreciation in the kina against the US dollar.

Papua New Guinea Key Economic Indicators

		Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14
1. Consumer Price Index (CPI)	Headline	3.8	-	-	5.1	-	-
	Food	2.7	-	-	5.5	-	-
2. Retail Price Index (RPI) (YOY % Change)(a)	Headline	2.0	8.7	2.3	4.0	5.8 r	4.0
	Ex-seasonal	2.7	3.9	4.0	3.7	2.5 r	2.2
3. Exchange Rates (mid-rate, eop)	USD	0.4130	0.4130	0.4130	0.4120	0.4085	0.4055
	AUD	0.4475	0.4432	0.4432	0.4373	0.4382	0.4337
	GBP	0.2483	0.2468	0.2468	0.2420	0.2415	0.2445
	JPY	42.490	41.950	41.950	41.470	41.970	42.100
	NZD	0.4769	0.4855	0.4855	0.4706	0.4799	0.4843
4. Foreign Exchange Reserves (eop, US\$ mill)		2,778.0	2,819.1	2,649.5	2,593.4	2,615.9	2,614.3
5. Liquidity (eop)	Liquid Assets to Deposit Ratio (%)	45.9	45.5	42.9	43.8	44.7	45.6
	Banks' Demand Deposits (K'bn)	13.5	13.9	14.3	14.2	14.2	14.4
6. Money and Credit (YOY % Change)	Broad Money	4.3	0.8	6.7	3.7	-0.6	2.8
	Monetary Base	3.6	5.3	20.0	31.8	19.0	31.0
	Private Sector Credit	9.3	7.6	9.2	3.8	-2.9	5.2
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 (28 day)	1.84	1.87	1.89	1.89	1.89	1.94
	Commercial bank Term Deposit (30 day)	1.13	0.64	1.24	1.22	0.39	1.19
	Government Treasury Bill (364 day)	5.54	5.88	6.12	6.35	6.70	7.20
	3-year Inscribed stock Rate	6.67	6.88	7.64	7.69	7.94	7.98
	16-year Inscribed stock Rate (> 10 years)	11.59	13.21	14.65	15.18	15.40	15.45
8. Commodity Prices (monthly average)	Oil (\$/bbl)	104.0	104.9	105.7	108.4	105.2	100.1
	Gold (\$/troy oz)	1,338.3	1,299.1	1,285.9	1,277.3	1,312.4	1,295.8
	Copper (\$/mt)	6,669.1	6,655.5	6,857.7	6,798.4	7,098.1	6,998.5
	Coffee (cents/kg)	216.2	223.4	218.6	198.5	198.6	213.7
	Cocoa (cents/kg)	183.3	182.5	180.1	187.0	187.2	195.5