



BANK OF PAPUA NEW GUINEA

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Economic Activity

In its latest World Economic Outlook (WEO) Update of 24 July 2014, the International Monetary Fund's (IMF) projects global economic activity to grow by 3.4 percent in 2014, a downward revision of 0.3 percent from its last Update. The downward revision was attributed to both the weaker first quarter performance, particularly the negative growth in the United States, and an expected slowdown in several emerging market economies. Global growth is expected to rebound in the second quarter of 2014, mainly driven by policies to support the recovery, including moderate fiscal consolidation and highly accommodative monetary policy in most advanced economies. The US economy is expected to grow by 1.7 percent in 2014, compared to an earlier forecast of 2.8 percent, with increases in personal consumption, private inventory investment, exports and Government spending among the contributing factors. The United Kingdom (UK) economy is projected to grow by 3.2 percent from an earlier projection of 2.8 percent. The Euro area is expected to grow by 1.1 percent but with uneven growth across the region, reflecting continued financial fragmentation, impaired private and public sector balance sheets, and high unemployment in some economies. In the emerging markets and developing economies, growth is projected to slow down to 4.6 percent from weaker external demand, notably from the United States and China, and weaker investment growth, and geo-political tension in Russia and Ukraine.

Growth in the domestic economy is expected to further increase in the second half of 2014, mainly reflecting the commencement of LNG exports, which are expected to be higher than initially projected. This would be one of the main sources of any revision to our earlier GDP forecast. The Government's fiscal stimulus budget is also another major source of economic growth. The high construction activity associated with major public infrastructure developments such as roads, and sea and air ports and the Pacific Games venues are contributing factors for this growth.

Balance of Payments

Preliminary balance of payments data for the five (5) months to May 2014 show an overall deficit of K487 million, compared to a deficit of K839 million in the corresponding period of 2013. There was a deficit in the current account, which more than offset a surplus in capital and financial accounts. The deficit in the current account was lower than in the corresponding

period in 2013 and was due to higher trade surplus and lower service, income and transfer payments. The surplus in the capital and financial account resulted from net inflows of equity from foreign direct investments by non-resident entities and portfolio investments, reflecting drawdown of investments in the short-term money market instruments by resident entities. As at 31st July 2014, the level of gross foreign exchange reserves was US\$2,615.8 (K6,4034) million.

Exchange Rate

The average inter-bank kina exchange rate against the US dollar depreciated from US\$0.4125 in June to US\$0.4104 in July 2014. During the same period, the average kina exchange rate against the Australian dollar depreciated from AU\$0.4402 to AU\$0.4372. This was due to cross currency movements as the Australian dollar appreciated against the US dollar. As a result, the average TWI¹ decreased by 0.1 percent to 34.65 at the end of July 2014.

Inflation

Annual headline Consumer Price Index (CPI) increased by 5.1 percent in the June quarter of 2014, compared to an increase of 3.8 percent in the March quarter.² This outcome resulted from price increases of: 5.5 percent in 'Food and non-alcoholic beverages'; 7.8 percent in 'Alcoholic beverages, tobacco and betelnut'; 12.0 percent in 'Housing'; 6.3 percent in 'Transport'; 8.1 percent in 'health'; and 8.2 percent in 'Restaurants and hotels' expenditure groups. The quarterly headline inflation increased by 1.5 percent.

The annual headline Retail Price Index (RPI)³ to July 2014 increased by 1.0 percent, compared to 4.0 percent in June 2014. The increase was due to higher prices in the 'Drinks, tobacco and betelnut' expenditure group, resulting from an increase in betel nut prices. The prices in the 'Rents, council charges fuel/power' and 'Food' expenditure groups also increased. RPI ex-seasonal increased by 3.4 percent while RPI ex-seasonal and fuel increased by 2.9 percent over the twelve months to July 2014. The monthly RPI for July increased by 1.7 percent, compared to a fall of 1.9 percent in June.

Fiscal Operations

Preliminary estimates of the fiscal operations of the National Government over the six months to June 2014 show an overall deficit of K563.6 million, compared to a deficit of K679.9 million

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

² Based on the new CPI basket.

³ The RPI survey covers the major supermarkets in Port Moresby and is compiled monthly.

in the corresponding period of 2013. This represents 1.4 percent of nominal GDP, and reflects higher expenditure, which more than offset an increase in revenue. The budget deficit of K563.6 million was financed through net domestic and external borrowing of K467.9 and K95.7 million, respectively.

Total revenue, including foreign grants, in the first half of 2014 was K4,723.0 million, 14.3 percent higher than the receipts collected in the corresponding period of 2013. This represents 37.2 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 K5,286.6 million, 9.9 percent higher than in the corresponding period of 2013 and represents 35.2 percent of the budgeted appropriation for 2014.

Domestic Interest Rates & Monetary Aggregates

During the month of July 2014, Central Bank Bill (CBB) rates showed mixed trends, with the 28-day rate remaining constant at 1.89 percent, the 63-day rate increasing from 2.56 percent to 2.61 percent and the 91-day rate declining from 2.75 percent to 2.74 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 4.14 percent and 6.44 percent to 4.31 percent and 6.84 percent, respectively, at the end the month.

Broad money supply (M3*) increased by 0.6 percent over the year to June 2014, compared to an increase of 7.7 percent in the corresponding period in 2013. The growth was due to increases in private sector credit and net credit to the Government. Over the year to 25th July 2014, average lending by banks increased by 18.0 percent to K9,507.1

million. The commercial bank deposits increased by K503.6 million to K18,875.2 million between December 2013 and week-ending 25th July 2014, reflecting net deposits by the mining, petroleum, government, transport, finance and other business sectors. Over the year to 25th July 2014, average deposits increased by 7.5 percent to K18,610.2 million.

Monetary Policy

The Bank continued to take a cautious approach by maintaining the Kina Facility Rate (KFR) at 6.25 percent for July. This was based on stable June RPI outcome, improvements in the overall fiscal and balance of payments positions.

Financial System Stability

As at the end of June 2014, total assets of the banking sector stood at K29.8 billion, of which the amount for the commercial banks is 91.8 percent, licensed financial institutions 4.3 percent, micro banks 0.7 percent and savings & loan societies 3.2 percent. Total deposits were K22.8 billion. Commercial banks accounted for 93.7 percent while licensed financial institutions, microfinance institutions and savings & loan societies accounted for 3.5 percent, 0.7 percent, and 2.1 percent, respectively. Total loans were K12.5 billion. The ratio of non-performing loans to total loans was 2.4 percent, whilst the ratio of non-performing loans to total assets was 1.0 percent.

The capital adequacy ratio for the banking sector was 29.7 percent, well above the minimum requirement of 12.0 percent. The return on assets was 2.9 percent and return on equity was 28.3 percent. These indicators show that the financial system in PNG is very sound.

Papua New Guinea Key Economic Indicators								
		Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14
1 Consumer Price Index (CPI)	Headline	-	-	3.8	-	-	5.1	-
	Food	-	-	2.7	-	-	5.5	-
2 Retail Price Index (RPI) (YOY %)	Headline	0.1	2.8	2.0	8.7	2.3	4.0	1.0
	Ex-seasonal	1.4	3.1	2.7	3.9	4.0	3.7	0.9
3 Exchange Rates (mid-rate, eop)	USD	0.4130	0.4130	0.4130	0.4130	0.4130	0.4120	0.4085
	AUD	0.4610	0.4610	0.4475	0.4432	0.4432	0.4373	0.4382
	GBP	0.2475	0.2475	0.2483	0.2468	0.2468	0.2420	0.2415
	JPY	42.050	42.020	42.490	41.950	41.950	41.470	41.970
	NZD	0.4922	0.4922	0.4769	0.4855	0.4855	0.4706	0.4799
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	2,615.8
5 Liquidity (eop)	Liquid Assets Margin to Deposit Ratio (%)	44.9	46.2	45.9	45.5	42.9	43.8	44.7
	Banks' Demand Deposits (K'bn)	13.4	13.4	13.5	13.9	14.3	14.2	14.2
6 Money and Credit (YOY % Change)	Broad Money	9.5	5.9	4.3	0.8	6.7	3.7	-
	Monetary Base	10.5	4.0	3.6	5.3	20.0	31.8	-
	Private Sector Credit	4.0	10.6	9.3	7.6	9.2	3.8	-
7 Interest Rates (%) (monthly weighted average)	Kila Facility Rate	6.25	6.25	6.25	6.25	6.25	6.25	6.25
	Central Bank Bill (28 day)	1.83	1.88	1.84	1.87	1.89	1.89	1.89
	Commercial bank Term Deposit (30 day)	0.52	0.81	1.13	0.64	1.24	1.22	0.39
	Government Treasury Bill (364 day)	4.44	4.80	5.54	5.88	6.12	6.35	6.70
	3-year Inscribed stock Rate	6.02	6.49	6.67	6.88	7.64	7.69	7.94
	16-year Inscribed stock Rate (> 10 years)	10.10	10.45	11.59	13.21	14.65	15.18	15.40
8 Commodity Prices (monthly average)	Oil (\$/bbl)	102.1	104.8	104.0	104.9	105.7	108.4	105.2
	Gold (\$/troy oz)	1,246.3	1,301.0	1,338.3	1,299.1	1,285.9	1,277.3	1,312.4
	Copper (\$/mt)	7,285.0	7,151.6	6,669.1	6,655.5	6,857.7	6,798.4	7,098.1
	Coffee (cents/kg)	134.4	172.3	216.2	223.4	218.6	198.5	198.6
	Cocoa (cents/kg)	171.0	180.0	183.3	182.5	180.1	187.0	187.2