



BANK OF PAPUA NEW GUINEA

MONTHLY ECONOMIC REVIEW

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Economic Activity

The International Monetary Fund's September 2014 Quarterly Review of Commodity Markets reports that most commodity prices have fallen since May 2014. Oil and food prices have declined, due to sufficient global supply amid ongoing geopolitical tensions and favourable harvest prospects, respectively. In contrast, metal prices increased under expectation of tighter supplies.

The global economy growth continues to recover at a steady pace notwithstanding regional differences. This was mainly due to a relatively stronger performance in emerging economies, compared to a slow growth in advanced economies in the second quarter of 2014. Among the advanced economies; economic activity in the United States with a turnaround in business and consumer spending, following a weak first quarter.; the Euro area remained stagnant with the largest economy, Germany recording a quarterly decline in the second quarter, while an increase in the consumption tax resulted in a decline in Japan. In the emerging economies, growth in China show signs of slowdown, while in India growth picked up.

Growth in the PNG economy continued at a moderate pace in the third quarter of 2014 and is expected to continue throughout the remainder of the year. Real GDP growth for 2014 was revised upwards to 6.0 percent, stronger than earlier projected, in the Bank's Monetary Policy Statement of September 2014. This is attributed to the commencement of LNG production and exports ahead of schedule, and some growth in the non-mineral private sector activity, underpinned by the expansionary fiscal policy. Most sectors of the economy are expected to grow, except for the petroleum and construction sectors. The medium-term outlook for economic growth remains positive, with the mineral sector output expected to pick up significantly next year.

Balance of Payments

Preliminary balance of payments data for the eight months to August 2014 show an overall deficit of K459.1 million, compared to a large deficit of K1,344.4 million in the corresponding period of 2013. This outcome was due to a lower deficit in the current account, which more than offset a lower a surplus in capital

and financial accounts. The lower deficit in the current account was due to improvements in the trade, service and income accounts. The surplus in the capital and financial account was mainly due to net inflows from direct and portfolio investments. At the end of August 2014, the level of gross foreign exchange reserves was US\$2,614.2 million (K6,382.9) million, sufficient for 7.7 months of total import cover and 10.8 months of non-mineral import cover.

Exchange Rate

The average kina exchange rate depreciated against the US dollar by 0.9 percent to US\$0.4037 over the month to 30th September 2014, due to high import demand and a strengthening US dollar. Conversely, over the same period the average kina exchange rate appreciated against the Australian dollar by 2 percent to AU\$0.4462. This was due to cross currency movements as the Australian dollar recently depreciated against the US dollar. The appreciation of the US dollar reflected the announcement by the Federal Reserve Bank to taper its asset purchase program. The average TWI¹ increased by 1.3 percent to 37.58 over same period, reflecting the appreciation of the kina against the Australian dollar and other major currencies, which more than offset the kina depreciation against the US dollar. At the end of September 2014, the kina was trading at US\$ 0.4030.

Inflation

The annual headline Retail Price Index (RPI) to September 2014 increased by 3.0 percent, compared to an increase of 4.0 percent in the previous month. Higher prices were recorded for the 'Drinks, tobacco and betelnut' expenditure group, with increases in the prices of betelnut and alcoholic drinks, and the 'Food' expenditure group. The RPI excluding seasonal items increased by 2.1 percent, whilst the RPI excluding seasonal and fuel items increased by 2.4 percent over the twelve months to September 2014. The monthly RPI increased by 2.2 percent, compared to a decline of 3.9 percent in August.

The Bank revised its inflation forecast for 2014 upwards to 8.0 percent in September 2014, compared to the previous forecast of 6.5 percent, as import demand continues to be strong and export receipts are lower this year compared to last year, exerting down ward pressure on the kina exchange rate.

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

Fiscal Operations

Preliminary estimates of the fiscal operations of the National Government over the seven months to July 2014 show an overall deficit of K695.8 million, compared to a deficit of K629.7 million in the corresponding period of 2013. This represents 1.8 percent of nominal GDP, and reflected higher expenditure, which more than offset an increase in revenue. The budget deficit of K695.8 million was financed from domestic and external sources of K587.6 million and K108.3 million, respectively.

Total revenue, including foreign grants, over the seven months to July 2014 was K5,210.1 million, 6.0 percent higher than the receipts collected in the corresponding period of 2013. This represents 41.1 percent of the budgeted revenue for 2014. The increase in revenue reflected higher collections in tax and non-tax receipts, which more than offset lower foreign grants. Total expenditure over the seven months to July 2014 was K5,905.9 million, 6.5 percent higher than in the corresponding period of 2013 and represents 39.3 percent of the budgeted appropriation for 2014.

Domestic Interest Rates & Monetary Aggregates

Over the month to 26th September 2014, Central Bank

Bill (CBB) rates increased across all maturities except the 182-day term which had no CBB allocation since August 2014. The 28-day, 63-day and 91-day rates increased to 1.95 percent, 2.77 percent and 2.89 percent, respectively, from 1.94 percent, 2.69 percent and 2.81 percent. At the Treasury bill auction, the 182 and 365 days rates increased from 4.49 percent and 7.20 percent to 4.51 percent and 7.30 percent, respectively, at the end of the month. The Kina Facility Rate (KFR) was maintained at 6.25 percent in September 2014, while the Cash Reserve Requirement (CRR) was increased by 1.0 percent to 10.0 percent in view of the persistent high liquidity level.

Over the year to 26th September 2014, average lending by banks increased by 16.2 percent to K9,456.2 million. The commercial bank deposits increased by K386.8 million to K18,758.3 million between December 2013 and week-ending 26th September 2014. Over the year to 26th September 2014, average deposits increased by 6.0 percent to K18,634.9 million.

Monetary Policy

The Bank continues to take a cautious approach by maintaining the policy signalling rate, the Kina Facility Rate, at 6.25 percent for the month of September 2014.

Papua New Guinea Key Economic Indicators

			Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14
1	Consumer Price Index (CPI)	Healine	-	-	5.1	-	-	-
		Food	-	-	5.5	-	-	-
2	Retail Price Index (RPI) (YOY % Change)(a)	Healine	8.7	2.3	4.0	5.8 r	4.0	3.00
		Ex-seasonal	3.9	4.0	3.7	2.5 r	2.2	2.10
3	Exchange Rates (mid-rate)	USD	0.4130	0.4130	0.4120	0.4085	0.4055	0.4030
		AUD	0.4432	0.4432	0.4373	0.4382	0.4337	0.4605
		GBP	0.2468	0.2468	0.2420	0.2415	0.2445	0.2479
		JPY	41.950	41.950	41.470	41.970	42.100	44.0600
		NZD	0.4855	0.4855	0.4706	0.4799	0.4843	0.5164
4	Foreign Exchange Reserve (eop, US\$ mill)		2,644.4	2,644.4	2,593.4	2,615.8	2,614.2	2489.3
5	Liquidity	Liquid Assets Margin to Deposit Ratio (%)	45.5	42.9	43.8	44.7	45.6	45.5
		Banks' Demand Deposits (K'bn)	13.9	14.3	14.2	14.2	14.4	14.2
6	Money and Credit (YOY % Change)	Broad Money	0.8	6.7	3.7	-0.6	2.8	-
		Monetary Base	5.3	20.0	31.8	19.0	31.0	-
		Private Sector Credit	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)	1.87	1.89	1.89	1.89	1.94	1.95
		Commercial bank Term Deposit (30 day)	0.64	1.24	1.22	0.39	1.19	1.46
		Government Treasury Bill (364 day)	5.88	6.12	6.35	6.84 r	7.20	7.30
		3-year Inscribed stock Rate	6.88	7.64	7.69	7.94	7.98	8.03
		16-year Inscribed stock Rate (> 10 years)	13.21	14.65	15.18	15.40	15.45	15.40

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