



# BANK OF PAPUA NEW GUINEA

## MONTHLY ECONOMIC REVIEW

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### Economic Activity

In its December 2014 *Commodity Market Monthly*, the International Monetary Fund (IMF) reported a fall in world commodity prices by 5.9 percent in November, as a result of a sharp drop in oil prices. Crude oil prices plunged by 10.7 percent, reflecting increased market supply and expectation of continued surplus supply by Organization of the Petroleum Exporting Countries (OPEC), following a decision by OPEC to maintain the 30 million barrels per day production target. Metal prices fell by 0.3 percent due to reduced global demand as a result of slowdown in demand from China and other emerging market economies. On the other hand, agriculture prices rose by 0.4 percent for the first time in seven months, mainly influenced by price increases in vegetable oils/meals and cereals, which offset price declines in meat and beverages. In its October 2014 *World Economic Outlook World Economic Outlook* (WEO), the IMF revised slightly downwards the global economic growth for 2014 to 3.3 percent from 3.4 percent made in its April WEO. The revision reflects the geo-political tension in Middle East and the ongoing crisis between Russia and Ukraine.

The decline in international prices for some of PNG's main export commodities could reduce the country's export earnings. If this happens and import demand continues to be strong, it will exert downward pressure on the kina exchange rate. In the domestic economy, there was continued growth in economic activity with the continuation of construction of infrastructure projects, including the sporting facilities in Port Moresby for the 2015 Pacific Games, and construction and maintenance of roads, health and education facilities. The forecast by the Bank is for a real GDP growth of 6.0 percent in 2014. Employment growth and business sales in the September quarter of the year are consistent for overall growth in 2014.

### Balance of Payments

Balance of Payments data for the ten months to October 2014 show an overall deficit of K233 million, compared to a deficit of K1,254 million in the corresponding period of 2013. There was a lower deficit in the current account, which more than offset a lower surplus in the capital and financial account. The lower deficit in the current account reflects a higher trade surplus and

lower net service and income payments. The lower surplus in the capital and financial account was mainly due to net inflows from portfolio investments. The level of gross foreign exchange reserves at the end of November 2014 was K6,125.2 (US\$2,425.6) million, sufficient for 8.2 months of total and 11.3 months of non-mineral import covers.

### Exchange Rate

The average kina exchange rate depreciated against the US dollar by 52 basis points to US\$0.3937 over the month of November 2014, reflecting high import demand. Over the same period, the average kina exchange rate appreciated against the Australian dollar by 9 basis points to AU\$0.4554, as a result of cross currency movements, with the Australian dollar weakening against the US dollar as key commodity prices declined due to a slowdown in activity in China and the Euro zone. The average Trade Weighted Index (TWI) decreased by 1.4 percent to 38.2 over the month to 28<sup>th</sup> November 2014, as a result of the depreciation of the kina against the US dollar. At the end of November 2014, kina traded at US\$0.3910.

### Inflation

The annual headline Retail Price Index (RPI<sup>1</sup>) increased by 9.0 percent over the twelve months to November 2014, compared to an increase of 5.7 percent in October. There were price increases in the 'Drinks, Tobacco & Betelnut' expenditure group, driven mainly by a substantial rise in the price of 'betel nut' and 'cigarette and tobacco' sub-groups of 124.1 percent and 39.8 percent, respectively. Prices in 'Fruits and Vegetables' sub-group increased by 52.5 percent. Over the twelve months to November 2014, RPI ex-seasonal and fuel increased by 0.7 percent and 1.7 percent respectively. The monthly RPI for November increased by 1.6 percent compared to an increase of 1.3 percent in the previous month.

### Fiscal Operations

Preliminary estimates of the fiscal operations of the National Government over the nine months to September 2014 show an overall deficit of K1, 510.1 million, compared to a deficit of K495.5 million in the corresponding period of 2013. This represents 3.8 percent of nominal GDP, and reflected higher Government expenditure, which more

<sup>1</sup> The 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.

than offset an increase in revenue. The budget deficit and a net external loan repayment of K146.0 million was financed with K1, 656.1 million from domestic sources.

Total revenue, including foreign grants, over the nine months to September 2014 was K6, 675.9 million, 2.0 percent higher than the receipts collected in the corresponding period of 2013. This represents 52.6 percent of the budgeted revenue for 2014. The increase in revenue was largely attributed to higher collections in direct receipts, which more than offset lower non-tax receipts and foreign grants. Total expenditure for the nine months to September 2014 was K8, 186.0 million, 16.3 percent higher than the corresponding period of 2013 and represents 54.4 percent of the budgeted appropriation for 2014. This outcome reflected higher recurrent and development expenditures.

In November 2014, the government passed a 2014 Supplementary Budget to reallocate expenditure to major projects, notably infrastructure spending for the Pacific Games and other recurrent expenditures. The Government also handed down the 2015 National Budget with total expenditure and net lending projected at K16.2 billion and total revenue and grants at K13.9 billion, hence a deficit of K2.3 billion or 4.4% of nominal GDP.

### **Domestic Interest Rates & Monetary Aggregates**

Over the month to 26<sup>th</sup> 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 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 26<sup>th</sup> 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 26<sup>th</sup> September 2014. Over the year to 26<sup>th</sup> September 2014, average deposits increased by 6.0 percent to K18,634.9 million.

### **Monetary Policy**

The headline CPI inflation up to the September quarter and the annual RPI up to November 2014 show an upward trend for inflation. The outcomes are however, considered manageable in light of economic activity, and therefore, 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 November 2014.

**Papua New Guinea Key Economic Indicators**

		Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14
<b>1. Consumer Price Index (CPI)</b>	Healine	5.1	-	-	5.3	-	-
	Food	5.5	-	-	5.1	-	-
<b>2. Retail Price Index (RPI) (YOY % Change)</b>	Healine	4.0	5.8	4.0	3.00	5.7	9.0
	Ex-seasonal	3.7	2.5	2.2	2.10	1.9	0.7
<b>3. Exchange Rates</b> (mid-rate, eop)	USD	0.4120	0.4085	0.4055	0.4030	0.3965	0.3910
	AUD	0.4373	0.4382	0.4337	0.4605	0.4511	0.4600
	GBP	0.2420	0.2415	0.2445	0.2479	0.2483	0.2489
	JPY	41.47	41.97	42.10	44.06	43.99	46.23
	NZD	0.4706	0.4799	0.4843	0.5164	0.5066	0.4988
<b>4. Foreign Exchange Reserve</b> (eop, US\$ mill)		2,593.4	2,615.8	2,614.2	2,489.3	2,577.8	2,422.6
<b>5. Liquidity</b> (eop)	Liquid Assets Margin to Deposit Ratio (%)	43.8	44.7	45.6	45.5	44.0	46.3
	Banks' Demand Deposits (K'bn)	14.2	14.2	14.4	14.2	14.7	14.4
<b>6. Money and Credit</b> (YOY % Change)	Broad Money	3.7	-0.6	2.8	2.8	5.5	-
	Monetary Base	31.8	19.0	31.0	27.9	21.1	-
	Private Sector Credit	3.8	-2.9	5.2	3.2	4.3	-
<b>7. Interest Rates</b> (% pa) (monthly weighted average)	Kina Facility Rate	6.25	6.25	6.25	6.25	6.25	6.25
	Central Bank Bill (28 day)	1.89	1.89	1.94	1.95	1.95	1.96
	Commercial bank Term Deposit (30 day)	1.22	0.39	1.19	1.46	1.01	1.16
	Government Treasury Bill (364 day)	6.35	6.84	7.20	7.30	7.36	7.42
	3-year Inscribed stock Rate	7.69	7.94	7.98	8.03	8.06	8.01
	16-year Inscribed stock Rate (> 10 years)	15.18	15.40	15.45	15.40	15.3	14.49
<b>8. Commodity Prices</b> (monthly average)	Oil (\$/bbl)	108.4	105.2	100.1	95.9	86.1	77.0
	Gold (\$/troy oz)	1,277.3	1,312.4	1,295.8	1,240.9	1,221.3	1,176.3
	Copper (\$/mt)	6,798.4	7,098.1	6,998.5	6,885.5	6,735.9	6,700.7
	Coffee (cents/kg)	198.5	198.6	213.7	215.3	226.5	213.9
	Cocoa (cents/kg)	187.0	187.2	195.5	195.7	195.0	184.6

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