



BANK OF PAPUA NEW GUINEA

MONTHLY ECONOMIC REVIEW

Vol. 1

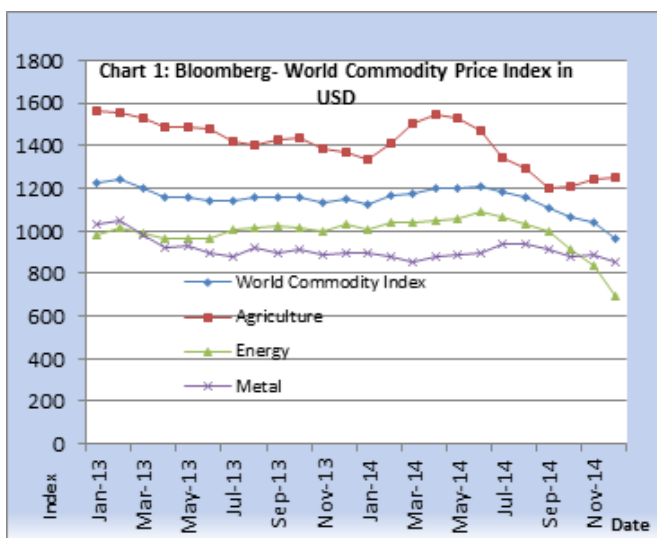
No. 12

Month Ended
December 2014

Economic Activity

There were signs that the fragile global economic recovery was slowing down towards the end of 2014 as a result of weak growth in the Euro area, Japan, and emerging markets. The United States (US) economy continues to improve on the back of increased confidence, rising employment numbers and low oil prices. While oil importing countries stand to benefit from lower oil price, oil exporting countries have started to experience downward pressure on their economic growth.

The latest Bloomberg data show that world commodity prices declined over the month of December 2014 by 7.8 percent, attributed to the ongoing slump in most key commodity prices (see chart 1). Energy prices declined by 16.9 percent primarily due to falling oil prices arising from surplus production from both OPEC and non-OPEC countries and insufficient demand from major oil importing countries. Oil prices dropped by 40 percent since June 2014. Metal prices fell by 5.4 percent. The decrease in energy and metal prices more than offset slight increase of 0.4 percent in agricultural commodity prices. Nonetheless, the IMF in its latest *Commodity Price Outlook and Risk* for December 2014 projects a rebound in oil prices but it will remain below recent past high levels due to a reduction of oil supply while metal price is expected to remain unchanged as metals market stabilise. Agricultural commodity prices have mixed projections for 2015.



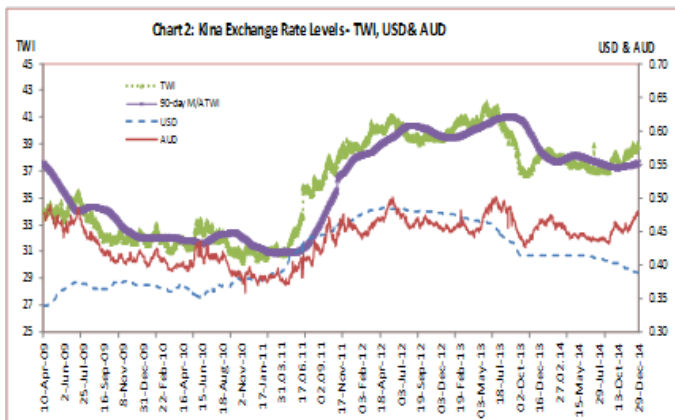
Balance of Payments

Preliminary balance of payments data for the eleven months to November 2014 show an overall deficit of K441.3 million, compared to a deficit of K1,327.8 million in the corresponding period of 2013. There was a lower deficit in the current account, which more than offset a lower surplus in capital and financial accounts. The lower deficit in the current account was due to lower service and income payments, combined with a higher trade surplus. The surplus in the capital and financial account was mainly due to net inflows from portfolio investments reflecting drawdown of investments in the short-term money markets instruments by resident entities. This more than offset net outflows in direct investments reflecting equity outflows and other investments.

The level of gross foreign exchange reserves at the end of November 2014 was K6,083.8 (US\$2,422.6) million, sufficient for 8.5 months of total and 12.1 months of non-mineral import covers. As at 19th January 2015, the level of gross foreign exchange reserves was US\$2,296.0 (K5,910.1) million.

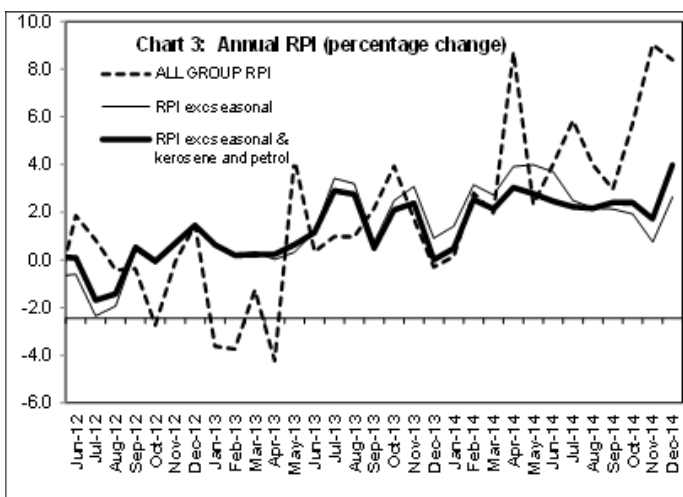
Exchange Rate

The average kina exchange rate depreciated against the US dollar by 54 basis points to US\$0.3893 over the month to 29th December 2014, reflecting high import demand combined with low export receipts. Over the same period the average kina exchange rate appreciated by 150 basis points against the Australian dollar to AU\$0.4683. This was a result of cross currency movements with the AUD depreciating against the USD on the back of improved employment data for the US economy and Federal Reserve's indication to raise interest rate in early 2015. The average trade weighted index (TWI¹) increased by 1.7 percent to 38.63 over the month to 29th December 2014, mainly reflecting the appreciation of the kina against the Australian dollar. The kina exchange rate continued to remain under pressure due to persistently high-unfilled kina sell orders in the market.



Inflation

The annual headline Retail Price Index (RPI)² increased by 8.4 percent over the twelve months to December 2014, compared to an increase of 9.0 percent in November. There were price increases in the ‘Drinks, Tobacco & Betelnut’ expenditure group, driven mainly by a substantial rise in the prices of betel nut and alcoholic drinks of 187.8 percent and 19.0 percent, respectively. Prices in ‘Fruits and Vegetables’ sub-group increased by 13.3 percent. These more than offset the decline in the prices of fuel. Over the twelve months to December 2014, RPI ex-seasonal and fuel increased by 2.6 percent and 4.0 percent, respectively. The monthly RPI for December declined by 1.0 percent, compared to an increase of 1.6 percent in the previous month. It is important to note that while seasonal items are very volatile in nature partly due to betelnut ban in Port Moresby, the underlying trend in price increases is significantly lower and therefore does not threaten price stability.



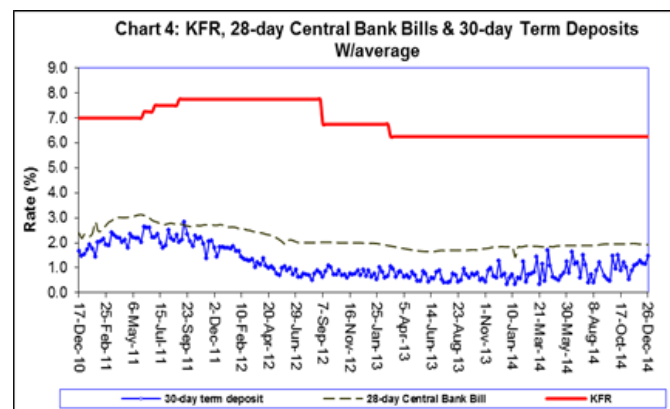
Fiscal Operations

The National Government’s cash flow has come under pressure in recent months, with high expenditure and low revenue, prompting the Government to borrow from domestic sources to fund its expenditure. The high priority expenditure items featured in the 2014 Supplementary Budget, were re-appropriated and K879.3 million from trust funds was expected to be used by the end of 2014

and early part of 2015. The priority expenditures include the 2015 Pacific Games facilities, road infrastructures, and final quarter payment for the DSIP/PSIP. As at 30th December 2014, around K300 million from trust accounts from commercial banks was transferred to the Central Bank to fund some of the re-appropriation. In assisting the Government to meet its financing requirements for the major development projects, the National Petroleum Company PNG Limited (NPCP) paid K400 million in dividend to the Government, while Bank of PNG paid K102 million. While high expenditure on developmental projects is good for nation building to underpin long term economic growth, its short term adverse effects of significantly increasing liquidity in the banking system is a cause of concern as it increases demand for imports, exerts pressure on the exchange rate and increases inflationary pressure.

Domestic Interest Rates & Monetary Aggregates

Over the month to weekending 24th December 2014, Central Bank Bill (CBB) rates declined while Treasury bill rates increased. The CBB rates declined for all maturities except the 182-day term which had no allocation for auction. The 28-day, 63-day and 91-day rates decreased to 1.92 percent, 2.83 percent and 2.98 percent from 1.96 percent, 2.86 percent and 2.99 percent, respectively. At the Treasury bill auction, the 182-day rate increased to 4.66 percent from 4.60 percent while the rate for 364 days remained at 7.42 percent. The KFR was kept unchanged at 6.25 percent in December 2014, with the trading margins for the Repos remaining at 100 basis points from the KFR (Chart 6). The Central Bank utilised its weekly Open Market Operation (OMO) instruments to manage liquidity during the month. To meet its financing requirements, the Government also issued new Treasury bills and Inscribed stock, which also supported the Bank’s effort in diffusing excess liquidity in the banking system. The Cash Reserve Requirement (CRR) was maintained at 10.0 percent.



Broad money supply (M3*) increased by 1.7 percent over the year to November 2014, compared an increase of 11.2 percent in the corresponding period of 2013. This was due to increases in private sector credit and net claims

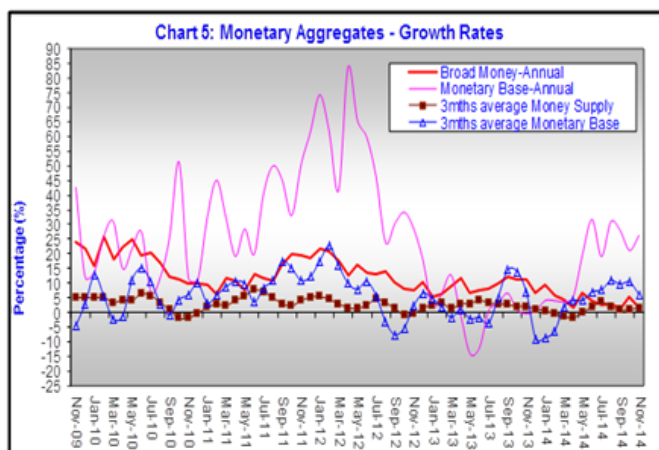
¹ The Trade Weighted Index (TWI) measures the value of the kina against a basket of currencies of PNG’s major trading partners.

² The RPI only covers Port Moresby and not other urban centres in the CPI basket so it may not be comparable to the overall CPI movements

on the Government, which more than offset a decline in net foreign assets. Monetary base grew significantly by 26.3 percent in November 2014, compared to a decline of 0.4 percent in the corresponding period of 2013. This reflected increases in deposits of commercial banks at the Central Bank and currency in circulation. Over the year to 24th December 2014, average lending by banks increased by 13.4 percent to K9,820.6 million. The commercial bank deposits increased by K932.9 million to K19,304.5 million between December 2013 and week-ending 24th December 2014. Over the year to 24th December 2014, average deposits increased by 3.3 percent to K18,780.0 million.

Monetary Policy

The price changes in recent months, as shown in the annual headline RPI indicate an upward trend for inflation but the outcomes are considered manageable. In consideration also for the recent significant declines in oil prices, the Bank continued to take a cautious approach by maintaining the policy-signalling rate (KFR) at 6.25 percent for the month of December.



| Papua New Guinea Key Economic Indicators | | Jul-14 | Aug-14 | Sep-14 | Oct-14 | Nov-14 | Dec-14 |
|---|---|---------|---------|---------|---------|---------|---------|
| 1. Consumer Price Index (CPI) | Headline | - | - | 5.3 | - | - | - |
| | Food | - | - | 5.1 | - | - | - |
| 2. Retail Price Index (RPI) (YOY % Change)(a) | Headline | 5.8 | 4.0 | 3.00 | 5.7 | 9.0 | 8.4 |
| | Ex-seasonal | 2.5 | 2.2 | 2.10 | 1.9 | 0.7 | 2.6 |
| 3. Exchange Rates (mid-rate, eop) | USD | 0.4085 | 0.4055 | 0.4030 | 0.3965 | 0.3910 | 0.3855 |
| | AUD | 0.4382 | 0.4337 | 0.4605 | 0.4511 | 0.4600 | 0.4708 |
| | GBP | 0.2415 | 0.2445 | 0.2479 | 0.2483 | 0.2489 | 0.2477 |
| | JPY | 41.97 | 42.10 | 44.06 | 43.99 | 46.23 | 46.17 |
| | NZD | 0.4799 | 0.4843 | 0.5164 | 0.5066 | 0.4988 | 0.4921 |
| 4. Foreign Exchange Reserve (eop, US\$ mill) | | 2,615.8 | 2,614.2 | 2,489.3 | 2,577.8 | 2,422.6 | 2,347.3 |
| 5. Liquidity (eop) | Liquid Assets Margin to Deposit Ratio (%) | 44.7 | 45.6 | 45.5 | 44.0 | 46.3 | 46.1 |
| | Banks' Demand Deposits (K'bn) | 14.2 | 14.4 | 14.2 | 14.7 | 14.4 | 15.1 |
| 6. Money and Credit (YOY % Change) | Broad Money | -0.6 | 2.8 | 2.8 | 5.5 | 1.7 | - |
| | Monetary Base | 19.0 | 31.0 | 27.9 | 21.1 | 26.3 | - |
| | Private Sector Credit | -2.9 | 5.2 | 3.2 | 4.3 | 4.4 | - |
| 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) | 1.89 | 1.94 | 1.95 | 1.95 | 1.96 | 1.92 |
| | Commercial bank Term Deposit (30 day) | 0.39 | 1.19 | 1.46 | 1.01 | 1.16 | 1.46 |
| | Government Treasury Bill (364 day) | 6.84 | 7.20 | 7.30 | 7.36 | 7.42 | 7.42 |
| | 3-year Inscribed stock Rate | 7.94 | 7.98 | 8.03 | 8.06 | 8.01 | 7.95 |
| | 16-year Inscribed stock Rate (> 10 years) | 15.40 | 15.45 | 15.40 | 15.3 | 14.49 | 13.74 |
| 8. Commodity Prices (monthly average) | Oil (\$/bbl) | 105.2 | 100.1 | 95.9 | 86.1 | 77.0 | 60.7 |
| | Gold (\$/troy oz) | 1,312.4 | 1,295.8 | 1240.9 | 1221.3 | 1176.3 | 1200.4 |
| | Copper (\$/mt) | 7,098.1 | 6,998.5 | 6885.5 | 6735.9 | 6700.7 | 6430.8 |
| | Coffee (cents/kg) | 198.6 | 213.7 | 215.3 | 226.5 | 213.9 | 202.4 |
| | Cocoa (cents/kg) | 187.2 | 195.5 | 195.7 | 195.0 | 184.6 | 188.6 |