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PORT MORESBY
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1. GENERAL OVERVIEW

Economic indicators available to the Bank of Papua New Guinea show that the domestic economy grew at a lower pace in 2009, compared to 2008. Lower global demand, as a result of the world recession, led to significant falls in the international prices of most primary commodities. This adversely affected exports of PNG's major commodities, with significant falls in both volumes and prices, resulting in lower export earnings for the mineral and the agriculture/forestry/fisheries sectors. Consequently, the current account recorded a large deficit. However, significant inflows in the capital and financial accounts more than offset the current account deficit, yielding an overall balance of payments surplus. After a low pace in the first half of the year, growth in the private sector activity picked up in the second half of 2009, with significant growth in the building and construction, financial/business and other services, retail and transportation sectors. This was also supported by the increase in private sector lending from the commercial banks, partly for capacity building associated with the LNG project. Increased spending by the Government, including drawdown of trust accounts, also contributed to the growth in the economy.

Evidence of growth also came from the increase in the quarterly aggregate employment and business sales for the December and September quarters of 2009, respectively. Annual headline inflation rate eased to 5.7 percent in 2009 from 11.2 percent in 2008, reflecting low foreign inflation, mainly associated with declines international prices of fuel and food and the appreciation of the kina exchange rate, especially against the Australian dollar. The Trade Weighted Exchange Rate Index (TWI) appreciated by 1.3 percent during the year. Given the high inflation in the first half of 2009, the Bank maintained a tight stance of monetary policy throughout the year until December when the policy signaling rate, the monthly Kina Facility Rate (KFR), was reduced from 8.0 percent to 7.0 percent. The reduction follows the easing in inflation rate.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the private sector increased by 3.4 percent in the September quarter of 2009, compared to an increase of 9.1 percent in the June quarter. Excluding the mineral sector, sales increased by 11.5 percent in the September quarter, following an increase of 4.9 percent in the previous quarter. By sector, all sectors recorded increases, except the mineral and transportation sectors. By region, all regions recorded increases, except the Islands and Highlands regions. Over the twelve months to September 2009, total sales declined by 15.8 percent.

The Bank's Employment Index show that the level of employment in the formal private sector increased by 0.7 percent in the December quarter of 2009, compared to an increase of 0.6 percent in the September quarter. The change in employment level in the mineral sector was negligible so that when excluding the mineral sector, the level of employment increased by 0.7 percent in the December quarter of 2009, compared to an increase of 0.6 percent in the previous quarter. By sector, the level of employment increased in all sectors, except the financial/business and other services sector. By region, all regions recorded increases, except the Momase and the Highlands regions. Over the year to December 2009, the level of employment increased by 4.2 percent, compared to 3.8 percent in September. Excluding the mineral sector, the level of employment increased by 5.0 percent over the year to December 2009, compared to 4.0 percent in September.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 1.2 percent in the December quarter of 2009, compared to 1.8 percent in the September quarter. There were increases in all expenditure groups, except the 'household equipment & operations expenditure' group, with the largest increases recorded in the 'Rents, council charges, fuel and power' and 'Transport and communication' expenditure groups, which mainly reflected an increase in fuel prices. By region, all urban areas recorded increases, except Lae. The quarterly exclusion-based and trimmed-mean inflation recorded increases of 0.8 percent and 1.2 percent, respectively, in the December quarter of 2009, compared to an increase of 0.9 and 1.4 percent, respectively, in the previous quarter.

In 2009, the daily average kina exchange rate appreciated against all major currencies, except the US dollar and Japanese yen. It appreciated against the Australian dollar by 4.54 percent to A$0.4652, pound sterling by 15.08 percent to 0.2331 sterling, euro by 3.25 percent to 0.2613 euro, while it depreciated against the US dollar by 1.9 percent to US$0.3639 and Japanese yen by 11.26 percent to 34.00 yen. These movements resulted in the daily average TWI appreciating by 1.3 percent for the year.

Lower kina prices of most of the mineral and agricultural export commodities, reflecting lower international prices, more than offset the depreciation of the kina against the US dollar in 2009. The weighted average kina price of Papua New Guinea's exports declined by 14.4 percent in 2009, relative to 2008. There was a decline of 14.5 percent in the weighted average kina price of mineral exports, with lower kina prices of copper and crude oil exports. For agricultural, logs and marine product exports, the weighted average kina price declined by 13.8 percent. This was accounted for by lower prices of coffee, cocoa, palm oil, copra, copra oil and rubber exports.

There was an overall surplus in the balance of payments of K1, 728 million in 2009, compared to a deficit of K598 million in 2008. This outcome was due to a surplus in the capital and financial account, more than offsetting a deficit in the current account.

The trade account recorded a surplus of K4,158 million in 2009, a decline of 42.2 per cent from 2008. The lower surplus was due to a significant decline in the value of merchandise exports, which more than offset a decline in the value of merchandise imports.

The capital account recorded a net inflow of K74 million in 2009, compared to K67 million in 2008, reflecting higher transfers by donor agencies through direct project financing for the acquisition of fixed assets.

The financial account recorded a net inflow of K2,989 million in 2009, compared to a net outflow of K2,863 million in 2008. This outcome was due to net inflows from direct investments, mainly from share placements by a resident mineral company to raise capital for on-going operation and capital related expenditure, drawdown from investments in short-term money market and financial derivative instruments, and from other investments.

The level of gross foreign exchange reserves at the end of December 2009 was K6, 553.1 (US$2,457.4) million, sufficient for 10.1 months of total and 15.3 months of non-mineral import covers.

The Bank of Papua New Guinea eased its monetary policy stance in the month of December 2009, based on moderation in inflation outcomes, by reducing the Kina Facility Rate (KFR) from 8.00 percent to 7.00 percent. The dealing margin for the Repurchase Agreements (Repos) was maintained at 100 basis points on both sides of the KFR. Domestic interest rates for short-term securities decreased across all maturities, reflecting excess liquidity in the banking system.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy in 2009. There was a decline in Treasury bill auction in 2009 due to the Government's positive cash flow position, prompting the Central Bank to diffuse excess liquidity mainly through issuance of additional CBBs and occasional use of Reverse Repos. Trading in the inter-bank market was low in 2009 due to the high level of liquidity in the banking system. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) of commercial banks were maintained at 3.0 percent and 25.0 percent, respectively, in 2009.

The average level of broad money supply (M3*) increased by 11.0 percent in 2009, compared to an increase of 26.4 percent in 2008. This outcome was due to an increase of 23.2 percent in average net private sector credit, an increase of 4.5 percent in average net foreign assets of depository corporations, and an increase of 20.8 percent in average net credit to public non financial corporations. Net domestic claims outstanding, excluding advances to the Central Government and outstanding loans under the Government's Agricultural export commodity support schemes increased by 17.5 percent in 2009, compared to an increase of 39.2 percent in 2008.

In 2009, total domestic credit extended by depository corporations to the private sector, public non-financial corporations, Provincial and Local Governments, and other financial corporations, increased by K946.0 million to K6,562.0 million, compared to an increase of K1,566.7 million in 2008. This was due to an increase in private sector credit of K954.4 million.

Fiscal operations of the National Government for 2009 show an overall deficit of K36.3 million in 2009, compared to a deficit of K478.5 million in 2008. This represents 0.2 percent of nominal GDP.

Total revenue, including foreign grants, was K6,651.3 million in 2009, 6.0 percent lower than in 2008. This represents 100.2 percent of the revised budget. The decline in revenue mainly reflected lower tax receipts, associated with lower international commodity prices, which more than offset an increase in non-tax revenue. Total expenditure in 2009 was K6,687.6 million, 11.4

percent lower than in 2008 and represented 99.4 percent of the revised budget. This outcome was mainly due to lower capital expenditure, which more than offset an increase in recurrent expenditure.

The deficit, combined with net external loan repayments totalling K110.1 million was financed domestically. Net external loan repayments comprised of K92.6 million to concessionary, K2.0 million to commercial and K15.5 million to extraordinary sources. Domestic financing totalled K146.4 million and comprised of K853.8 million in net financing by the financial corporations, which more than offset K707.4 million in settlement of presented cheques.

2. INTERNATIONAL DEVELOPMENTS

There were further evidence of world economic recovery from the recession in the December quarter of 2009. According to the IMF's January 2010 World Economic Outlook (WEO) Update, global economic growth in the second half of 2009 was stronger than anticipated but occured at different paces in various regions. The Update estimated that world economic activity declined by 0.8 percent in 2009, a lower decline than projected in the October 2009 WEO Update, reflecting huge support from the extraordinary fiscal policy stimulus. The January 2010 WEO Update revised upwards its projections of global economic growth to 3.9 percent in 2010 and 4.3 percent in 2011. The growth will be mainly driven by the emerging and developing economies. Advanced economies are expected to grow at a slower rate of 2.1 percent in 2010 and 2.4 percent in 2011, while emerging and developing economies are projected to grow by 6.0 percent in 2010 and 6.3 percent in 2011. Global inflation remained low in 2009 as a result of the economic recession and is expected to gradually pick up as economies recover.

In October 2009, at the 2009 IMF-World Bank meeting in Istanbul, Turkey, the World Bank President, Robert Zoellick, stated that the World Bank needs to be more efficient in order to best serve developing countries. The international system needs a World Bank group that represents the international economic realities of the 21st century and recognises the roles and responsibilities of growing stakeholders and provides a larger voice for developing countries. The President pledged to give developing countries a larger voice in the Bank's operations as they could become an important engine for growth that could create a more balanced global economy. He stressed that there is a need for a system of international political economy that reflects a new multi-collarity of growth and a need to integrate rising economic powers as responsible stakeholders.

Finance Ministers from the Group of 20 nations (G20) gathered in Scotland, in November 2009 to discuss exit strategies from economic stimulus packages by Governments in response to the global financial crisis. The Ministers pointed out that although the global economy is recovering, significant risks and uncertainty still persist and that support will still be in place until full recovery is realised. The IMF in support of this idea, noted that "the pace of recovery is uneven, particularly in advanced economies" and support is still required. The IMF warned that "withdrawing policy stimulus too early can be very costly". The British Prime Minister, Gordon Brown, proposed a financial rescue fund that is funded by imposition of a tax on financial institution around the world. This is to prepare for any possible future financial crisis.

Also in November 2009, the Asia Pacific Co-operation summit was held in Singapore. In support of the G20 Framework for Strong, Sustainable and Balanced Growth, the leaders agreed that global economic recovery requires a new growth model and an expanded trade and investment agenda that will strengthen regional economic integration in the Asia Pacific region. This includes pursuing a balanced, inclusive and sustainable growth supported by innovation and a knowledge based economy to ensure a stable recovery that will create employment opportunities and other benefits for member countries. Leaders warned that a world recovery still faces uncertainty and that reducing economic stimulus packages was a timing issue. If stimulus packages are withdrawn too early, the region's recovery could be derailed and if too late, deficits will be unsustainable.

International oil prices increased in December 2009 to around US$80 per barrel following further evidence of global economic recovery and cold weather in the Northern hemisphere. According to the US Energy Information Administration, the West Texas Intermediate crude oil price, which averaged US$62 per barrel in 2009, is projected to average at around US$80 and US$84 per barrel in 2010 and 2011, respectively, should economic recovery continues. Gold prices reached record levels of above US$1,000 per ounce in December 2009. Continued increase in global demand for gold is expected to put pressure on gold prices to further increase.

In the United States, real GDP increased by 0.1 percent in 2009, compared to a decline of 0.8 percent in 2008. The increase was mainly due to positive contributions from private inventory investments, exports, and personal consumption expenditures. The latest IMF forecast is for real GDP to grow by 2.7 percent in 2010.

Industrial production decreased by 2.0 percent in 2009, compared to a decrease of 7.8 percent in 2008. The Institute of Supply Management's Purchasing Managers Index was 55.2, 53.7 and 54.9 in October, November and December 2009, respectively. An index below 50 indicates contraction while an index above 50 indicates expansion in the manufacturing industry. Retail sales declined by 5.9 percent in 2009, compared to a decline of 6.4 percent in 2008, reflecting a slow pick up in consumer spending. The annual unemployment rate was 10.0 percent in December 2009, compared to 7.2 percent in December 2008.

Consumer prices increased by 2.7 percent in 2009, compared to an increase of 0.1 percent in 2008, reflecting increased domestic demand as the economy continues to recover. A surge in electric and gas utility prices, due to cold weather in the US, also contributed to the increase. Broad money supply increased by 3.4 percent in 2009, compared to an increase of 9.9 percent in 2008. The Federal Reserve will continue to employ a wide range of tools to promote economic growth and preserve price stability. It has maintained the target range for the federal funds rate at 0 to 0.25 percent. The Fed is of the view that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period.

The trade deficit was US$517.0 billion in December 2009, compared to a deficit of US$820.6 billion in December 2008. The lower deficit was attributed to the recovery in the US economy reflecting growth in exports and the Government's policy to reduce imports by encouraging domestic production of imported goods.

In Japan, real GDP declined by 0.4 percent in 2009, compared to a decline of 4.6 percent in 2008. This outcome was driven mainly by growth in domestic demand, in particular, private consumption. Exports also grew, mainly due to increased demand for Japanese automobiles and construction machinery, but at a slower pace. The January 2010 IMF forecast is for real GDP to grow by 1.7 percent in 2010.

Industrial production increased by 5.3 percent in 2009, compared to a decline of 20.8 percent in 2008. Retail sales declined by 0.2 percent in 2009, compared to an increase of 0.3 percent in 2008. The unemployment rate was 5.1 percent in December 2009, compared to 4.4 percent in December 2008.

Consumer prices decreased by 1.7 percent in 2009, compared to an increase of 0.4 percent in 2008, mainly reflecting weak consumer demand. Broad money supply grew by 3.1 percent in 2009, compared to an increase of 1.0 percent in 2008. The Bank of Japan maintained the uncollateralised overnight call rate at 0.1 percent during the December quarter of 2009.

The current account surplus was US$141.6 billion in 2009, compared to US$156.0 billion in 2008. Although lower, it reflects a gradual restoration of demand for Japanese exports.

In the Euro area, real GDP declined by 2.4 percent in 2009, compared to a growth of 0.8 percent in 2008. Production declined due to higher financial costs, and investment and exports growth slowed significantly due to reduced global demand. The January 2010 IMF forecast is for real GDP to grow by 1.0 percent in 2010.

Industrial production declined by 5.0 percent in 2009, compared to a decline of 12.0 percent in 2008. The decline was due to lower production of capital goods and durable consumer goods. Retail sales declined by 1.6 percent in 2009, the same as in 2008. The unemployment rate was 10.0 percent in December 2009, compared to 7.5 percent in December 2008. The economic downturn has severely affected business profitability and resulted in job losses.

Consumer prices in the Euro area increased by 0.9 percent in 2009, compared to a decline of 1.6 percent in 2008. The increase was mainly due to higher prices for alcohol and tobacco products. Broad money supply declined by 0.2 percent in 2009, compared to a decline of 7.3 percent in 2008. The European Central Bank (ECB) continued to pursue an accommodative monetary policy stance, maintaining the Euro Refinancing Rate at 1.00 percent in the December quarter.

The trade account of the Euro zone was in deficit by US$33.1 billion in 2009, compared to a deficit of US$46.4 billion in 2008. The deficit reflected the significant drop in exports.

In Germany, real GDP declined by 2.4 percent in 2009, compared to a decline of 1.7 percent in 2008. The decline was mainly driven by a significant slowdown in export growth owing to the economic recession. The country also breached the European Union's public deficit ceiling for the first time in four years. The January 2010 IMF forecast is for real GDP to grow by 1.5 percent in 2010.

Industrial production declined by 6.7 percent in 2009, compared to a decline of 12.0 percent in 2008. Retail sales declined by 2.5 percent in 2009, compared to a decline of 0.3 percent in 2008. The unemployment rate was 8.1 percent in December 2009, compared to 7.6 percent in December 2008. Consumer prices increased by 0.9 percent in 2009, compared to an increase of 1.1 percent in 2008.

The current account surplus was US$168.9 billion in 2009, compared to a surplus of US$237.0 billion in 2008, reflecting the drop in exports.

In the United Kingdom (UK), real GDP contracted by 3.2 percent in 2009, compared to a decline of 1.9 percent in 2008. This was mainly driven by declines in the manufacturing, construction and business services/ finance sectors. The January 2010 IMF forecast is for real GDP to grow by 1.3 percent in 2010.

Industrial production declined by 3.6 percent in 2009, compared to a decrease of 9.3 percent in 2008. Retail sales increased by 0.7 percent in 2009, compared to an increase of 1.8 percent in 2008. The unemployment rate was 7.8 percent in December 2009, compared to 6.3 percent in December 2008.

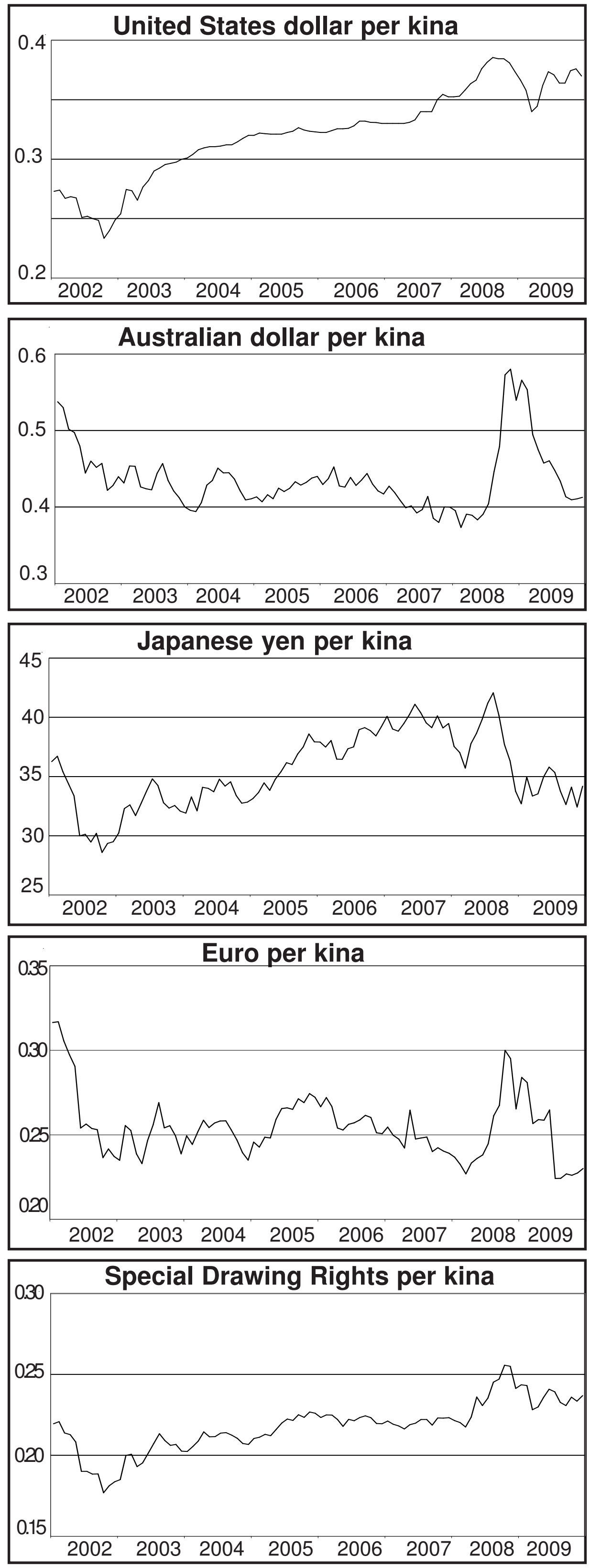
Consumer prices increased by 2.9 percent in 2009, compared to an increase of 3.1 percent in 2008. Broad money supply increased by 6.4 percent in 2009, compared to an increase of 16.6 percent in 2008. The Bank of England continued to maintain its official Bank Rate at 0.5 percent in the December quarter of 2009.

The trade deficit was US$128.1 billion in 2009, compared to US$173.0 billion deficit in 2008. The lower deficit was mainly due to fall in import demand.

In Australia, real GDP grew by 2.7 percent in 2009, compared to an increase of 0.3 percent in 2008. This growth mainly reflected a considerable rise in business investment and exports. The coordinated fiscal and monetary policy stimulus implemented during the height of the financial crisis, combined with the pick up in export demand from Asia, mainly China, supported the strong growth and prevented Australia from falling into recession. The latest IMF forecast is for real GDP to grow by 2.5 percent in 2010.

Industrial production declined by 2.6 percent in 2009, compared to an increase of 2.1 percent in 2008. Retail sales increased by 3.7 percent in 2009, compared to an increase of 1.0 percent in 2008. The unemployment rate was 5.5 percent in December 2009, compared to 4.5 percent in December 2008.

EXCHANGE RATES



Consumer prices rose by 2.1 percent in 2009, compared to an increase of 3.7 percent in 2008. Broad money supply increased by 5.8 percent in 2009, compared to 12.4 percent in 2008. The Reserve Bank of Australia raised its Cash Rate by 75 basis points to 3.75 percent in the December quarter of 2009, reflecting concerns about inflationary pressures following the strong growth of the Australian economy.

The trade deficit was US$7.1 billion in 2009, compared to a deficit of US$4.0 billion in 2008. The higher deficit was due to low export revenue associated with a decline in commodity prices.

In 2009, the daily average kina exchange rate appreciated against all major currencies, except the US dollar and Japanese yen. It appreciated against the Australian dollar by 4.54 percent to A$0.4652, pound sterling by 15.08 percent to 0.2331 sterling, euro by 3.25 percent to 0.2613 euro, while it depreciated against the US dollar by 1.9 percent to US$0.3639 and Japanese yen by 11.26 percent to 34.00 yen. These movements resulted in the daily average TWI appreciating by 1.3 percent for the year.

3. DOMESTIC ECONOMIC DEVELOPMENT

DOMESTIC ECONOMIC ACTIVITY

Data from the Bank's Business Liaison Survey (BLS) show an increase of 4.2 percent in the total nominal value of sales in the private sector in the September quarter of 2009, compared to an increase of 9.1 percent in the June quarter. Excluding the mineral sector, sales increased by 12.2 percent in the September quarter, following an increase of 4.9 percent in the previous quarter. By sector, all sectors recorded increases, except the mineral and transportation sectors. By region, all regions recorded increases, except the Islands and Highlands regions. Over the twelve months to September 2009, total sales declined by 15.2 percent.

In the building and construction sector, sales increased significantly by 24.1 percent in the September quarter, following an increase of 4.7 percent in the June quarter. Building and road projects in Morobe and NCD, and road maintenance work in the Highlands, Islands and Southern regions contributed to this strong growth. Over the twelve months to September 2009, sales increased by 43.5 percent.

In the wholesale sector, sales increased by 24.6 percent in the September quarter of 2009, compared to an increase of 2.1 percent in the previous quarter. The increase was attributed to opening of some new company branches, introduction of new products and higher activity associated with the mining and building projects. Over the twelve months to September 2009, sales declined by 18.3 percent.

In the financial/business and other services sector, sales increased by 26.2 percent in the September quarter of 2009, following an increase of 14.3 percent in the June quarter. The increase was mainly due to growth in banking activity, a pick up in guest turnover at hotels, higher demand for catering services, and increased real estate and security activities. Over the twelve months to September 2009, sales increased by 53.5 percent.

In the manufacturing sector, sales increased by 13.0 percent in the September quarter of 2009, compared to a decline of 6.9 percent in the previous quarter. The increase was mainly due to higher production of oil-based products by a major oil refinery, and a pick up in food processing from higher demand for consumables. Over the twelve months to September 2009, sales declined by 16.8 percent.

In the agriculture/forestry/fisheries sector, sales grew moderately by 2.9 percent in the September quarter of 2009, compared to an increase of 16.7 percent in the June quarter. The increase in the agriculture sub-sector was due to high palm oil and coffee exports as a result of improved production and international prices. In the forestry sub-sector, the increase was attributed to growth in log exports from a rebound in international prices and improved harvest of logs. The increase in the fisheries sub-sector was mainly due to high export of tuna and favorable international prices of marine products. Over the twelve months to September 2009, the value of sales declined by 36.8 percent.

In the retail sector, sales increased by 0.3 percent in the September quarter of 2009, compared to an increase of 14.3 percent in the June quarter. The increase was mainly associated with higher demand, especially for heavy duty machinery and vehicles by mining and construction projects and information technology consumables. Over the twelve months to September 2009, sales increased by 6.0 percent.

In the transportation sector, sales declined by 1.4 percent in the September quarter of 2009, after an increase of 24.3 percent in the June quarter. The decline was due to lower cargo haulage by sea transportation and decline in passenger travel by both air and land transportation. The deteriorating condition of the Highlands highway also contributed to lower revenue for some major trucking companies. Over the twelve months to September 2009, sales increased by 22.5 percent.

In the mineral sector, sales decreased by 6.0 percent in the September quarter of 2009, following a significant growth of 15.0 percent in the previous quarter. This was due to lower production and export of gold associated with the maintenance of the processing plant at the Lihir gold mine, unstable wall at the Porgera gold mine preventing access to the pit, and ongoing landowner issues at the Simberi gold mine. Over the twelve months to September 2009, sales declined by 30.8 percent.

By region, sales in the Momase region increased by 17.6 percent in the September quarter, compared to an increase of 22.4 percent in the previous quarter. The increase came from the manufacturing and wholesale sectors, and the fisheries sub-sector. The increase in the manufacturing sector was due to a pick up in food processing, associated with higher demand for consumables. In the wholesale sector, the increase reflected higher demand generated by mining and building projects, while the increase in fisheries sub-sector was attributed to increased exports of tuna and favorable international prices of marine products. The increase in the building and construction sector was mainly due to private sector funded building and road projects. Over the twelve months to September 2009, sales declined by 7.9 percent.

In NCD, sales rose by 12.3 percent in the September quarter, after increasing by 4.7 percent in the June quarter. The increase was in the manufacturing, wholesale, retail, building and construction, and the financial/business and other services sectors. The increase in the manufacturing sector was due to a higher throughput for oil-based products by a major oil refinery, and a pick up in food processing associated with higher demand for consumables. The growth in the retail and wholesale sectors reflected higher demand, especially for heavy duty machineries and information technology consumables, and expansion of business activity, while the increase in the financial/business and other services sector was mainly attributed to increased banking activity, a pick up in guest turnover at hotels, higher catering, real estate and security activities. Over the twelve months to September 2009, sales declined by 8.1 percent.

In the Southern region, sales increased by 10.3 percent in the September quarter, compared to an increase of 24.7 percent in the June quarter of 2009. The increase was mainly driven by the wholesale sector and agriculture and forestry sub-sectors. The increase in the wholesale sector reflected growth in demand, while the increase in the agriculture sub-sector was due to higher production and price of palm oil. The increase in the forestry sub-sector mainly reflected higher prices of forestry products. Over the twelve months to September 2009, sales declined by 63.3 percent.

In Morobe, sales grew by 7.7 percent in the September quarter, following an increase of 6.0 percent in the previous quarter. The growth was driven by the manufacturing, wholesale, retail, and building and construction sectors. In the manufacturing sector, the increase reflected a pick up in forestry products and food processing. The increases in the wholesale and retail sectors were due to higher demand stemming from increased activity in mining and construction projects. In the building and construction sector, the increase reflected the ongoing private sector building projects and road maintenance. Over the twelve months to September 2009, sales declined by 0.8 percent.

In the Highlands region, sales declined by 1.7 percent in the September quarter, after a solid growth of 22.0 percent in the June quarter of 2009. The fall was mainly in the mineral and wholesale sectors. The decrease in the mineral sector was driven by lower production of gold at Porgera mine, while the fall in the wholesale sector reflected lower demand, associated with the end of coffee season. Over the twelve months to September 2009, sales declined by 8.8 percent.

In the Islands region, sales fell markedly by 12.9 percent in the September quarter, following a 7.9 percent drop in the previous quarter. The decline was mainly in the mineral and wholesale sectors. The decrease in the mineral sector was due to lower production and export of gold at Lihir gold mine due to routine plant maintenance, while the decline in the wholesale sector was due to lower demand, reflecting a fall in income of cocoa farmers and lower prices of other agricultural commodities. Over the twelve months to September 2009, sales dropped by 6.8 percent.

EMPLOYMENT

The Bank's Employment Index shows that the level of employment in the formal private sector increased by 0.7 percent in the December quarter of 2009, compared to an increase of 0.6 percent in the September quarter. Excluding the mineral sector, the level of employment increased by 0.7 percent in the December quarter of 2009, as the change in mineral sector was negligible compared to an increase of 0.6 percent in the previous quarter. By industry, the level of employment increased in all sectors, except the financial/business and other services sector. By region, all regions recorded increases, except the Momase and Highlands regions. Over the year to December 2009, the level of employment increased by 4.2 percent, compared to 3.8 percent over the year to September. Excluding the mineral sector, the level of employment increased by 5.0 percent over the year to December 2009, compared to 4.0 percent over the year to September.

In the agriculture/forestry/fisheries sector, the level of employment increased by 1.3 percent in the December quarter of 2009, compared to a decline of 1.7 percent in the September quarter. There were increases in all the sub-sectors. The rise in the agriculture sub-sector was associated with increased harvesting and export of palm oil. The growth in the fisheries sub-sector was due to higher catch partly reflecting the addition of new fishing boats by a fishing company, while the increase in the forestry sub-sector was due to increased log harvest associated with favorable dry weather conditions. Over the year to December 2009, the level of employment increased by 9.2 percent.

In the building and construction sector, the level of employment increased by 5.6 percent in the December quarter of 2009, compared to a decline of 1.2 percent in the September quarter of 2009. The increase was attributed to a rise in building activities for both commercial and residential properties and maintenance of certain sections of the Highlands highway, and some roads in the Islands region. Over the year to December 2009, the level of employment declined by 2.0 percent.

In the mineral sector, employment rose by 0.4 percent in the December quarter of 2009, compared to an increase of 0.2 percent in the September quarter. The increase was due to more work load at a mining site and construction work associated with mineral activities. Over the year to December 2009, the level of employment declined by 3.3 percent.

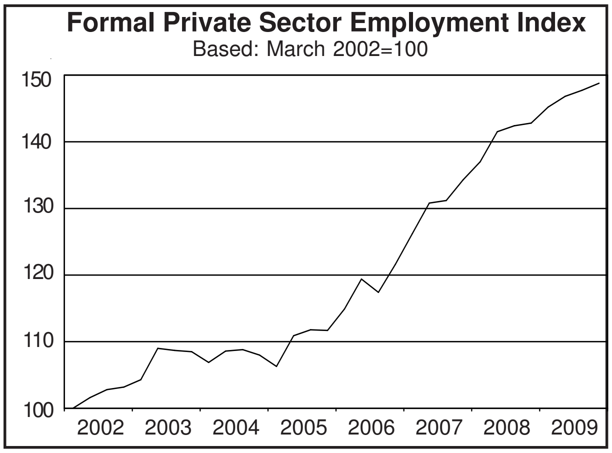
In the manufacturing sector, the level of employment increased by 1.5 percent in the December quarter of 2009, compared to 4.0 percent in the previous quarter. The increase was experienced by various companies involved in the manufacturing of goods ranging from dairy products and food to health care products. A general increase in demand for most of these products resulted in increased production and employment levels. Over the year to December 2009, the level of employment increased by 8.3 percent.

In the wholesale and retail sectors, the level of employment increased by 2.4 percent in the December quarter of 2009, compared to 1.7 percent in the previous quarter. The level of employment in the wholesale sector increased by 0.7 percent in the December quarter of 2009, compared to 1.0 percent in the previous quarter. In the retail sector, the level of employment increased by 3.1 percent in the December quarter of 2009, compared to an increase of 2.0 percent in the September quarter. The increases in both sectors were mainly associated with increased demand during the festive season. Over the year to December 2009, the level of employment in the wholesale and retail sectors increased by 3.9 percent and 0.2 percent, respectively.

In the transportation sector, the level of employment increased by 4.1 percent in the December quarter of 2009, compared to a decline of 1.5 percent in the September quarter. The increase was mainly due to higher cargo haulage to the Highlands region and increased demand for hire cars. A major airline company also recruited new staff under its graduate trainee scheme. Over the year to December 2009, the level of employment declined by 5.9 percent.

In the financial/business and other services sector, employment level declined by 3.9 percent in the December quarter of 2009, compared to an increase of 2.3 percent in the September quarter. The decline was mainly a result of the expiration of contracts by certain service providers and termination of employees. Over the year to December 2009, the level of employment grew by 7.1 percent.

By region, the level of employment increased in all regions, with the exception of the Highlands and Momase regions. In the Southern region, the level of



employment increased by 3.5 percent in the December quarter of 2009, compared to 2.1 percent in the September quarter. The increase was in the wholesale, retail, manufacturing and mineral sectors as well as the agriculture and fisheries sub-sectors. Over the year to December 2009, the level of employment increased by 11.1 percent.

In NCD, the employment level increased by 2.6 percent in the December quarter of 2009, compared to an increase of 1.8 percent in the September quarter. This was accounted for by increases in the building and construction, wholesale, retail, manufacturing and transportation sectors. Over the year to December 2009, the level of employment increased by 8.6 percent.

In the Islands region, the level of employment increased by 2.1 percent in the December quarter of 2009, compared to a decline of 2.3 percent in the September quarter. The increase was in the building and construction, wholesale, retail and mineral sectors and the agriculture and forestry sub-sectors. Over the year to December 2009, the employment level increased by 1.1 percent.

In Morobe, the level of employment increased by 1.5 percent in the December quarter of 2009, compared to a decline of 0.7 percent in the previous quarter. The increase was in the manufacturing, wholesale, retail and transportation sectors and the fisheries sub-sector. Over the year to December 2009, the level of employment increased by 8.2 percent.

In the Momase region, the level of employment declined by 2.6 percent in the December quarter of 2009, compared to an increase of 11.9 percent in the September quarter. The decline was in the building and construction sector and the fisheries sub -sector. Over the year to December 2009, the employment level increased by 13.2 percent.

In the Highlands region, the level of employment declined by 7.0 percent in the December quarter of 2009, compared to a decline of 5.5 percent in the September quarter. The decline was in the financial/ business and other services sector and the agriculture sub-sector. Over the year to December 2009, the level of employment declined by 16.1 percent

CONSUMER PRICE INDEX

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 1.2 percent in the December quarter of 2009, compared to 1.8 percent in the September quarter. There were increases in the 'Drinks, Tobacco and Betelnut', Food, 'Clothing and Footwear', 'Household equipment and operations', 'Transport and Communication', and 'Miscellaneous' expenditure groups. The largest increases were recorded in the 'Rents, council charges, fuel and power' and 'Transport and communication' expenditure groups. By region, all urban areas recorded increases, with the exception of Lae. The quarterly exclusion-based and trimmed-mean inflation recorded increases of 0.8 percent and 1.2 percent, respectively, in the December quarter of 2009, compared to an increase of 0.9 and 1.4 percent, respectively, in the previous quarter.

The CPI for the 'Food' expenditure group increased by 1.2 percent in the December quarter of 2009, compared to an increase of 1.5 percent in the September quarter. The increase was in all sub-groups, except cereals. This expenditure group contributed 0.5 percentage points to the overall movement in the CPI.

In the 'Drinks, Tobacco and Betelnut' expenditure group, prices increased by 1.1 percent in the December quarter of 2009, compared to an increase of 3.2 percent in the previous quarter. An increase in the cigarette and tobacco and betelnut subgroups offset a decline in other subgroups. This expenditure group contributed 0.2 percentage points to the overall movement in the CPI.

In the 'Clothing and Footwear' expenditure group, the CPI increased by 1.2 percent in the December quarter of 2009, compared to a decrease of 1.7 percent in the previous quarter. The increase was in the men and boys clothing, and other clothing and footwear, while prices for woman and girls clothing declined. This expenditure group contributed 0.1 percentage points to the overall movement in the CPI.

The CPI for the 'Rents, Council charges, Fuel and power' expenditure group increased by 1.8 percent in the December quarter of 2009, compared to an increase of 2.7 percent in the September quarter, accounted for by increases in all subgroups. This expenditure group contributed 0.1 percentage point to the overall movement in the CPI.

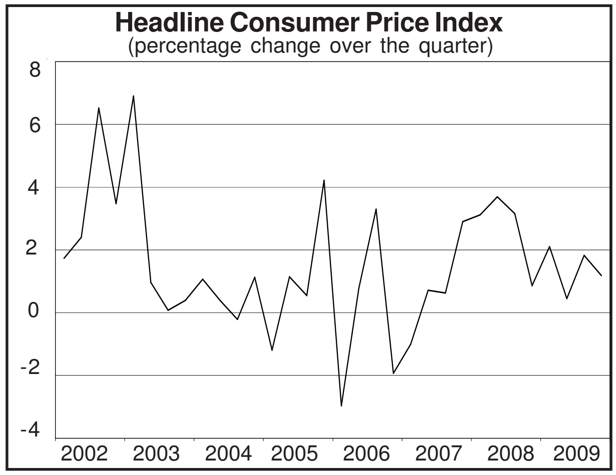
The CPI for the 'Household equipment and operations' expenditure group declined by 1.2 percent in the December quarter of 2009, compared to an increase of 2.5 percent in the previous quarter. The decrease was in all sub-groups, except for the durable goods. This expenditure group contributed negative 0.1 percentage point to the overall movement in the CPI.

In the 'Transport and Communication' expenditure group, prices increased by 1.8 percent in the December quarter of 2009, compared to an increase of 1.1 percent in the September quarter. The increase was in all sub-groups, with the largest price increase recorded in the motor vehicle operation. This expenditure group contributed 0.2 percentage points to the overall movement in the CPI.

In the 'Miscellaneous' expenditure group, prices increased by 0.2 percent in the December quarter of 2009, compared to no change in the previous quarter. The increase was mainly in the hospital and medical, and other goods subgroups. This expenditure group's contribution to the overall movement in the CPI was insignificant.

By urban areas, quarterly headline inflation increased in all the surveyed centers in the December quarter of 2009, except Lae. Port Moresby recorded the highest increase of 1.9 percent, followed by Madang with 1.6 percent. Goroka and Rabaul recorded 1.3 percent and 1.2 percent, respectively.

In Port Moresby, CPI increased by 1.9 percent in the December quarter of 2009, compared to an increase of 1.6 percent in the September quarter. All expenditure groups recorded increases, with the largest increase of 3.7 percent coming from the 'Drinks, tobacco and betelnut' expenditure group. 'Clothing and footwear' expenditure group increased by 2.2 percent, 'Transport and Communication' expenditure group by 1.7 percent,



'Food' expenditure group by 1.5 percent, and 'Rents, Council charges, Fuel and power' expenditure group by 1.5 percent. The 'Household equipment and operations' expenditure group recorded a marginal increase of 0.3 percent, while the 'Miscellaneous' expenditure group recorded a decline of 0.2 percent.

In Madang, prices increased by 1.6 percent in the December quarter of 2009, the same as in the September quarter. There were increases in all the expenditure groups. The 'Transport and communication' expenditure group recorded the highest increase of 2.4 percent followed by 'Rents, council charges, fuel & power' with 1.8 percent 'Household equipment and operations' and 'Food' expenditure groups both recorded 1.6 percent, while the 'Drinks, Tobacco and Betelnut' expenditure group recorded an increase of 1.5 percent. 'Clothing and footwear' and 'Miscellaneous' expenditure groups recorded small increases.

In Goroka, prices increased by 1.3 percent in the December quarter of 2009, compared to an increase of 1.2 percent in the previous quarter. All expenditure groups recorded price increases, except the 'Clothing and Footwear' and 'Household equipment & operation' expenditure groups. The 'Transport and communication' expenditure group recorded the highest increase of 2.4 percent followed by the 'Food' expenditure group with 2.1 percent. 'Rents, Council charges, Fuel and power', and 'Drinks, Tobacco and Betelnut' expenditure groups recorded an increase of 1.7 percent and 1.3 percent, respectively. The 'Miscellaneous' expenditure group recorded an increase of 0.4 percent.

In Rabaul, prices increased by 1.2 percent in the December quarter of 2009, compared to an increase of 1.5 percent in the previous quarter. All expenditure groups recorded increases, except the ‘Clothing and footwear’ and ‘Household equipment and operations’ groups. The highest increase of 3.2 percent came from the ‘Rents, Council charges, Fuel and power’ expenditure group, followed by the ‘Drinks, Tobacco and Betelnut’ expenditure group with 3.0 percent. The ‘Transport and Communication’ expenditure group recorded a 2.1 percent increase.

In Lae, prices declined by 0.4 percent in the December quarter of 2009, compared to an increase of 2.9 percent in the September quarter. Falls of 3.0 percent and 0.3 percent,respectively, in the ‘Drinks, Tobacco and Betelnut’ and ‘Household equipment and operation’ expenditure groups, more than offset the increases in the other expenditure groups.

Annual headline inflation was 5.7 percent in the December quarter of 2009, a drop from 11.2 percent in the December quarter of 2008. The lower inflation mainly reflected the decline in international food and fuel prices, low inflation in PNG’s main trading partners and fall in the prices of seasonal produce. Annual exclusion-based inflation was 5.0 percent in the December quarter of 2009, compared to 11.0 percent in the December quarter of 2008. Annual trimmed mean inflation was 3.8 percent in the December quarter of 2009, compared to 11.6 percent in the December quarter of 2008.

4. EXPORT COMMODITIES REVIEW

The total value of merchandise exports was K11,897.7 million in 2009, a decline of 24.0 percent from 2008. There were declines in the values of crude oil, copper, coffee, cocoa, copra, copra oil, palm oil, rubber, tea, logs, marine, refined petroleum product and other non-mineral exports, which more than offset an increase in the value of gold. The value of agricultural, marine products and other non-mineral exports, excluding forestry product and refined petroleum product exports was K2,052.3 million and accounted for 17.2 percent of total merchandise exports in 2009, compared to 17.6 percent in 2008. Forestry product exports were K409.9 million and accounted for 3.4 percent of total merchandise exports in 2009, same as in 2008. Refined petroleum product exports were K378.5 million and accounted for 3.2 percent of total merchandise exports in 2009, compared to 3.3 percent in 2008. Mineral export receipts, excluding crude oil, were K7,446.6 million and accounted for 62.6 percent of total merchandise exports in 2009, compared to 53.3 percent in 2008. Crude oil exports totalled K1,610.4 million and accounted for 13.5 percent of total merchandise exports in 2009, compared to 22.4 percent in 2008.

The weighted average kina price of Papua New Guinea’s exports declined by 14.4 percent in 2009, relative to 2008. There was a decline of 14.5 percent in the weighted average kina price of mineral exports, with lower kina prices of copper and crude oil exports. For agricultural, logs and marine product exports, the weighted average kina price declined by 13.8 percent, accounted for by lower prices of coffee, copra, copra oil, palm oil and rubber exports. The lower kina prices of most agricultural export commodities reflected lower international prices in 2009, compared to 2008 as a result of lower global demand induced by global financial crisis. Excluding logs, the weighted average price of agricultural and marine product exports declined by 15.1 percent in 2009, compared to 2008.

Mineral Exports

Total mineral export receipts were K9,057 million in 2009, a decline of 23.6 percent from 2008. The decline was due to lower kina prices of copper and crude oil, which more than offset an increase in the price of gold.

Gold export volumes were 63.3 tonnes in 2009, the same as in 2008. Higher production from the Lihir and Tolukuma mines were offset by lower production from the Ok Tedi, Porgera and Highlands Kainantu mines. The average free on board (f.o.b.) price received for Papua New Guinea’s gold exports was K84.8 million per tonne in 2009, an increase of 14.9 percent from 2008. The outcome is mainly attributed to higher international prices resulting from growing investment demand. The average gold price at the London Metal Exchange was US$970 per fine ounce in 2009, an increase of 13.5 percent from 2008. The increase was due to higher demand from investors for gold-based investments as a safe-haven investment after increased volatility of prices in the equity markets. The combined increase in export price and volume resulted in export receipts of K5,366.7 million in 2009, which is 14.9 percent higher than in 2008.

Copper export volumes were 153.7 thousand tonnes in 2009, a decline of 17.2 percent from 2008. The decline was due to lower production and shipment of copper ore from the Ok Tedi mine. The average f.o.b. price of

Papua New Guinea's copper exports was K13,181 per tonne in 2009, a decline of 32.3 percent from 2008. The decline was due to the collapse of copper price in the world market in the third quarter of 2009. The combined decline in export price and volume resulted in export receipts of K2,025.9 million in 2009, a decrease of 44.0 percent from 2008.

Crude oil export volumes were 9,972.5 thousand barrels in 2009, a decline of 18.2 percent from 2008. The decline reflected lower extraction rates and production due to natural decline from existing wells and shut down of facilities for maintenance at the Gobe Main, South East Gobe and Moran oil projects, which more than offset an increase in production at the Kutubu oil field. The average export price of crude oil in 2009 was K161 per barrel, a decline of 44.1 percent from 2008. The decline was due to lower international prices resulting from cuts to the production quota by OPEC. The combined decline in export price and volume resulted in export receipts of K1,610.4 million, 54.1 percent lower than in 2008.

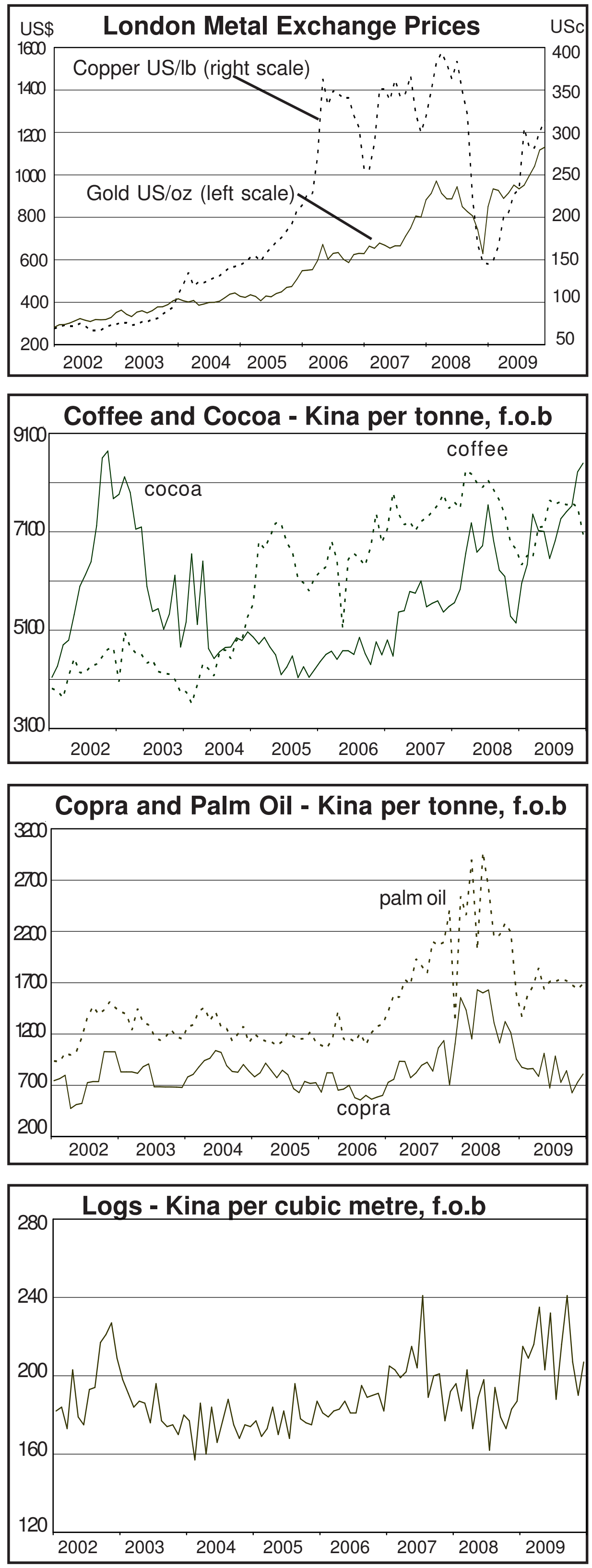
Export receipts of refined petroleum products from the Napanapa Oil Refinery in 2009 were K378.5 million, a decline of 25.9 percent from 2008. The decline was mainly due to lower export volumes attributed to low international prices.

Agriculture, Logs and Fisheries Exports

Export prices of most agricultural export commodities declined in 2009, compared to 2008. Coffee prices declined by 4.7 percent, copra by 41.0 percent, copra oil by 40.0 percent, palm oil by 26.5 percent and rubber by 27.6 percent. Cocoa and tea prices increased by 7.8 percent and 6.1 percent, respectively. The average export price of logs was K212 per cubic metre in 2009, an increase of 14.0 percent from 2008. The decline in export prices of coffee, copra, copra oil, palm oil, rubber and marine products, more than offset the increase in the price of cocoa, tea and logs resulting in a 13.8 percent decline in the weighted average price of agricultural, logs and marine exports. Excluding logs, the weighted average price of agricultural and marine product exports decreased by 17.9 percent in 2009, compared to 2008.

The volume of coffee exported was 62,200 tonnes in 2009, a decline of 7.2 percent from 2008. The decline was mainly attributed to replanting activities in most plantations in the major coffee producing areas under

EXPORT COMMODITY PRICES



the industry's rehabilitation program. The average export price of coffee was K7,400 per tonne in 2009, a decline of 4.7 percent from 2008, attributed mainly to lower international prices, reflecting a decline in global demand. The combined decline in export price and volume resulted in export receipts of K460.3 million in 2009, which is 11.5 percent lower than in 2008.

The volume of cocoa exported was 48,100 tonnes in 2009, a decline of 9.8 percent from 2008. The outcome was attributed to a significant decline in production by East New Britain, a major cocoa producing province, due to the cocoa pod borer disease. The lower production in East New Britain more than offset higher production in other cocoa growing areas, especially the Autonomous Region of Bougainville (ARB). The average export price of cocoa was K6,988 per tonne in 2009, an increase of 7.8 percent from 2008. The increase resulted from higher international prices due to lower production by Ivory Coast and Nigeria. The decline in export volume more than offset the increase in export price resulting in export receipts of K336.1 million in 2009, a decrease of 2.7 percent from 2008.

The volume of copra exported was 15,200 tonnes in 2009, a decline of 53.4 percent from 2008. The decline was mainly attributed to lower international prices, which prompted farmers to shift to producing alternative cash crops. The average export price of copra was K816 per tonne in 2009, a decline of 41.0 percent from 2008. The decline was due to lower international prices during the first three quarters of 2009 as a result of lower global demand. The combined decline in export price and volume resulted in export receipts of K12.4 million in 2009, a substantial decrease of 72.5 percent from 2008.

The volume of copra oil exported was 44,800 tonnes in 2009, a decline of 27.7 percent from 2008. The decline was mainly due to lower quantities of copra sold to two domestic mills for processing and export as a result of lower prices. The average export price of copra oil was K1,962 per tonne in 2009, a decline of 40.0 percent from 2008. The decline was due to lower international prices as a result of lower demand from Philippines and Indonesia, two of the world's major producers. The combined decline in export price and volume resulted in export receipts of K87.9 million in 2009, a decrease of 56.6 percent from 2008.

The volume of palm oil exported was 428,400 tonnes in 2009, a decline of 3.9 percent from 2008. This outcome was due to lower production as result of replanting by the estates to replace ageing palm trees, combined with lower shipment exporters. The average export price of palm oil was K1,667 per tonne in 2009, a decline of 26.5 percent from 2008. The decline reflected lower international prices associated with higher production from Malaysia and Indonesia, two of the world's major producers, combined with the lower global demand. The combined decline in export price and volume resulted in export receipts of K714.3 million in 2009, a decrease of 29.4 percent from 2008.

The volume of tea exported was 5,600 tonnes in 2009, a decline of 8.2 percent from 2008. The decline was a supply response to lower international prices, combined with major European importers preferring to source supplies from Sri Lanka and India, which attract lower sea freight charges. The average export price of tea was K3,286 per tonne in 2009, an increase of 6.1 percent from 2008. The increase reflected lower production and strong global demand. The decline in export volume more than offset the increase export price resulting in export receipts of K18.4 million in 2009, a decline of 2.6 percent from 2008.

The volume of rubber exported was 5,400 tonnes in 2009, an increase of 10.2 percent from 2008. The increase was attributed to the shipment of unsold stock by local producers, favourable weather conditions and improvements to road conditions in the rubber producing regions. The average export price was K4,815 per tonne in 2009, a decline of 27.6 percent from 2008. The decline was due to lower international prices resulting from high stock levels in the world market. The decline in export price more than offset an increase in export volume resulting in export receipts declining by 20.2 percent to K26.0 million in 2009.

The volume of logs exported was 1,809 thousand cubic metres in 2009, a decline of 28.0 percent from 2008. The decline was due to unfavourable weather conditions. The average export price of logs was K212 per cubic metre in 2009, an increase of 14.0 percent from 2008. The increase resulted from higher international prices due to increased demand from the Asian region, especially China. The decline in export volume more than offset the increase in export price resulting in export receipts of K383.1 million in 2009, a decline of 18.1 percent from 2008.

The value of marine product exports was K207.3 million in 2009, a decline of 29.3 percent from 2008. This outcome was due to declines in export price and volume.

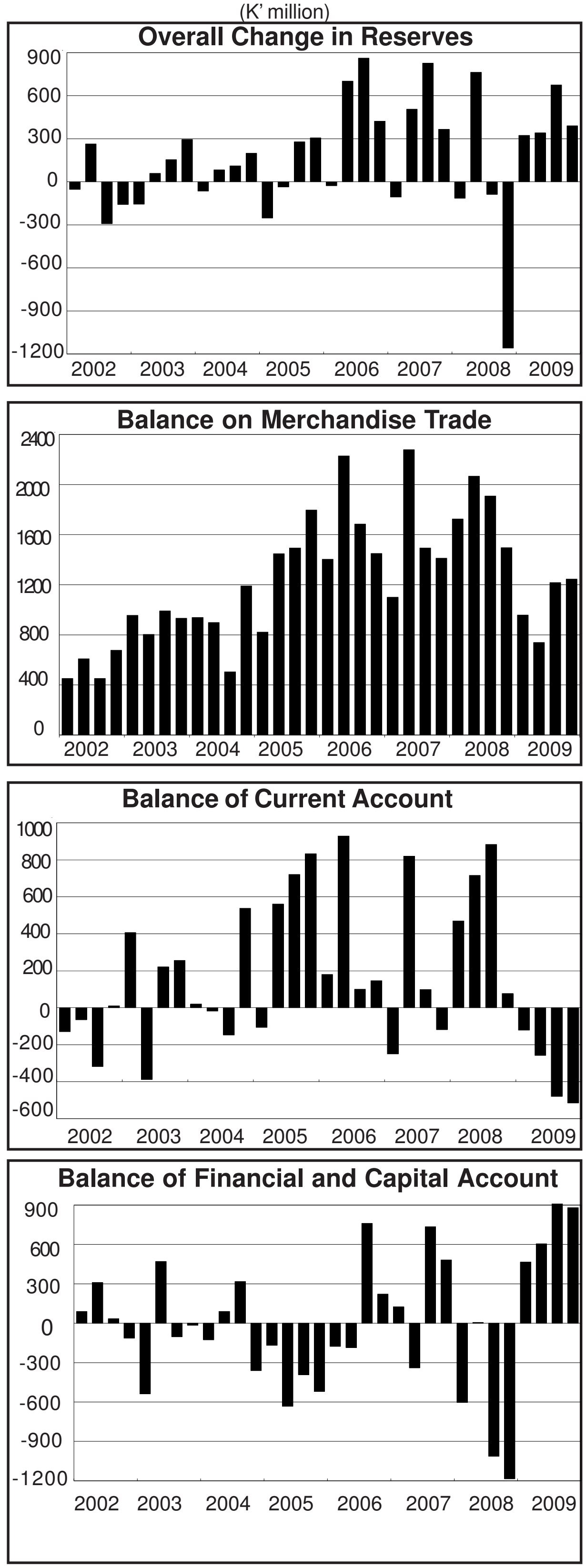
5. BALANCE OF PAYMENTS

There was an overall surplus in the balance of payments of K1,728 million in 2009, compared to a deficit of K598 million in 2008. This outcome was due to a significant surplus in the capital and financial accounts, which more than offset a deficit in the current account. The surplus in the capital and financial accounts reflected net inflows from capital transfers, foreign direct investments, portfolio investments, financial derivative instruments and other investments. The deficit in the current account was due to a lower trade surplus and higher net service payments and higher net transfer receipts. In 2009, the kina appreciated against most of the currencies of Papua New Guinea's major trading partner countries, with the exception of the US dollar and Japanese yen, compared to 2008. This resulted in a decline in the kina value of some balance of payments transactions.

The trade account recorded a surplus of K4,158 million in 2009, a decline of 42.1 percent from 2008. The lower surplus was due to a decline in the value of merchandise exports, which more than offset a decline in the value of merchandise imports. The value of merchandise exports in 2009 was K11,919 million, a decline of 24.0 percent from 2008. The decline was attributed to lower export values of crude oil, copper, coffee, cocoa, copra, copra oil, palm oil, tea, rubber, forestry, marine, refined petroleum and other non-mineral export products, which more than offset an increase in the export values of gold.

The value of merchandise imports was K7,761 million in 2009, a decline of 8.5 percent, compared to 2008. The decline was due to lower imports by all sectors. General imports declined by 4.9 percent to K5,655 million in 2009, compared to 2008, reflecting a slow down in demand in the domestic economy. Imports by the mining sector declined by 17.8 percent to K1,451 million in 2009, compared to 2008. The decline was mainly due to lower capital expenditure undertaken by the Ok Tedi mine. Petroleum sector imports declined by 19.0 percent to K655 million in 2009, compared to 2008. The outcome reflected d decline in exploration activities in response to lower international crude oil prices.

BALANCE OF PAYMENTS
(K' million)



The deficit in the services account was K4,310 million in 2009, an increase of 15.0 percent, compared to 2008. The higher deficit was due to increased payments for education, computer and information, other business, construction and refining and smelting services, combined with lower service receipts by resident companies.

The deficit in the income account was K1,714 million in 2009, a decline of 1.5 percent from 2008. The lower deficit was attributed to lower interest and dividend payments, combined with higher compensation of employees and dividend receipts.

The surplus in the transfers account was K491 million in 2009, an increase of 12.6 percent from 2008. The higher surplus was mainly due to increased receipts from gifts and grants, combined with lower transfer payments.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a deficit of K1,374 million in 2009, compared to a surplus of K2,145 million in 2008.

The capital account recorded a net inflow of K74 million in 2009, compared to K67 million in 2009, reflecting higher transfers by donor agencies for capital projects.

The financial account recorded a net inflow of K2,989 million in 2009, compared to a net outflow of K2,863 million in 2008. This outcome was due to net inflows from direct investments mainly from share placements by a resident mineral company to raise capital for on-going operating and capital related expenditure, drawdown from investments in short-term money market and financial derivative instruments, and from other investments. Net inflows from other investments reflect a drawdown in the net foreign assets of the banking system and foreign currency account balances of resident mineral companies. These more than offset net loan repayments by the Government.

As a result of these developments, the capital and financial accounts balance recorded a surplus of K3,063 million in 2009, compared to a deficit of K2,796 million in 2008.

In the December quarter of 2009, the balance of payments recorded an overall surplus of K390 million, compared to a deficit of K1,158 million in the corresponding quarter of 2008. This outcome was due to a surplus in the capital and financial accounts, which more than offset a deterioration in the current account.

The value of merchandise exports was K3,282 million in the December quarter of 2009, a decline of 4.0 percent from the corresponding quarter of 2008. The decline was due to lower export values of crude oil, cocoa, copra, copra oil, palm oil, rubber, forestry, marine and other non-mineral export products. Agricultural, forestry, marine products and other non-mineral exports, excluding refined petroleum product exports, were K582.1 million and comprised 17.7 percent of total merchandise exports in the December quarter of 2009, compared to 20.7 percent in the corresponding quarter of 2008. Refined petroleum product exports totalled K134.4 million in the December quarter of 2009 and accounted for 4.1 percent of total merchandise exports, compared to 3.0 percent in the corresponding quarter of 2008. Mineral exports totaled K2,560.4 million or 78.0 percent of total merchandise exports in the December quarter of 2009, compared to 76.1 percent in the corresponding quarter of 2008.

The value of merchandise imports was K2,037 million in the December quarter of 2009, an increase of 6.0 percent from the corresponding quarter of 2008. The outcome reflected higher general and mining imports, which more than offset lower petroleum imports. General imports increased by 8.5 percent to K1,480 million in the December quarter of 2009, compared to the corresponding quarter of 2008. Mining sector imports increased by 5.3 percent to K409.6 million in the December quarter of 2009, compared to the corresponding quarter of 2008. This outcome was due to higher capital expenditure by all mining projects. Imports by the petroleum sector declined by 29.8 percent to K147.1 million in the December quarter of 2009, compared to the corresponding quarter of 2008. This outcome was due to lower exploration activities.

The deficit in the services account was K1,186 million in the December quarter of 2009, an increase of 23.7 percent from the corresponding quarter of 2008. The higher deficit was attributed to an increase in payments for travel, education, computer and information, other business, construction, refining and smelting and other services, combined with lower service receipts by resident companies.

The deficit in the income account was K777 million in the December quarter of 2009, an increase of 39.5 percent, compared to the corresponding quarter of

2008. This outcome was due to higher compensation of employees and dividend payments, combined with lower interest receipts.

The surplus in the transfers account was K203 million in the December quarter of 2009, a significant increase of 109.3 percent, compared to the corresponding quarter of 2008. This outcome was mainly due to higher receipts from gifts and combined with lower transfer payments.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a deficit of K515 million in the December quarter of 2009, compared to a surplus of K77 million in the corresponding quarter of 2008.

The capital account recorded a net inflow of K16 million in the December Quarter of 2009, compared to K4 million in the corresponding quarter of 2008, reflecting higher capital transfers by donor agencies for capital projects. The financial account recorded a net inflow of K864 million in the December quarter of 2009, compared to a net outflow of K1,189 million in the corresponding period of 2008. This outcome was due to net inflows from foreign direct investments, drawdown from investments in short-term money market and financial derivative instruments, and from other investments. Net inflows from other investments reflect a drawdown in the net foreign assets of the banking system and foreign currency account balances of resident mineral companies. These more than offset net loan repayments by the Government.

As a result of these developments, the capital and financial accounts balance recorded a surplus of K880 million in the December quarter of 2009, compared to a deficit of K1,185 million in the corresponding quarter of 2008.

The level of gross foreign exchange reserves at the end of December 2009 was K6,553.1 (US$2,457.4) million, sufficient for 10.1 months of total and 15.3 months of non-mineral import covers.

6. MONETARY DEVELOPMENTS

INTEREST RATES AND LIQUIDITY

The Bank of Papua New Guinea eased its monetary policy in December 2009 by reducing the Kina Facility Rate (KFR) from 8.00 percent to 7.00 percent, following the slow down in inflation. The dealing margin for the Repurchase Agreements (Repos) was maintained at 100 basis points on both sides of the KFR.

Interest rates for short-term securities decreased across all maturities to December 2009. At the Central Bank Bill (CBB) market, the 28-day CBB rate decreased from 5.94 percent to 5.15 percent, the 63-day rate from 7.07 percent to 5.08 percent, and the 91-day CBB rate decreased from 7.35 percent to 6.01 percent, over the year to December 2009. The declining rates reflected excess liquidity in the banking system. Government Treasury bill rates decreased with the 182-day rate declining from 7.40 percent in December 2008 to 6.95 percent in November 2009 and the 364-day rate fell from 8.16 percent to 7.76 percent during the same period. The Government did not issue any bills under these terms in December 2009. There was no Treasury bills issued for 91-day maturity between April and December 2009.

The weighted average deposit rates quoted by commercial banks on wholesale deposits (K500,000 and above) decreased across all maturities in 2009, except the 60-day rate. The 30-day rate declined from 5.62 percent to 4.01 percent, 91-day rate from 4.83 percent to 4.09 percent and the 182-day rate from 5.32 percent to 4.35 percent, whilst the 60-day rate increased from 3.53 percent to 4.14 percent. The weighted average interest rate on total deposits paid by commercial banks increased from 1.6 percent to 2.2 percent over the year to December 2009, whilst the weighted average interest rate on total loans increased from 8.8 percent to 10.2 percent. The commercial banks' Indicator Lending Rates (ILR) spread increased from 8.95 - 9.95 percent to 10.95 – 11.95 percent during 2009.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy in 2009. There was a decline in Treasury bill auction in 2009 due to the Government's positive cash flow position. As a result, excess liquidity was diffused mainly through issuance of additional CBBs and occasional use of Reverse Repos. Trading in the inter-bank market was low in 2009 due to the high level of liquidity in the banking system. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) of commercial banks were maintained at 3.0 percent and 25.0 percent respectively, in 2009.

MONEY SUPPLY

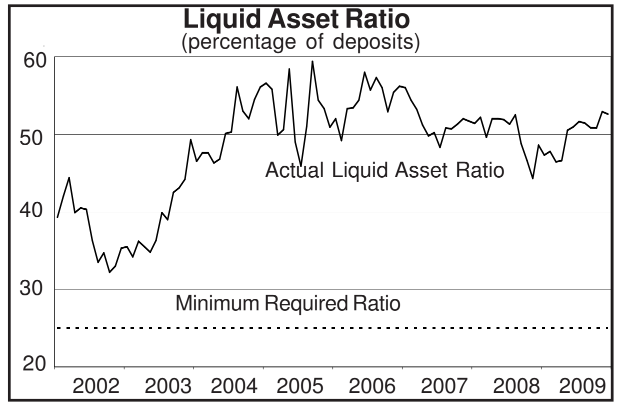
The average level of broad money supply (M3*) increased by 11.0 percent in 2009, compared to an increase of 26.4 percent in 2008. This was attributed to an increase of 23.2 percent in average net private sector credit and an increase of 4.5 percent in average net foreign assets of depository corporations, and an increase of 20.8 percent in average net credit to public non-financial corporations. Net domestic claims outstanding, excluding advances to the Central Government and outstanding loans under the Government's Agricultural export commodity price support schemes increased by 17.5 percent in 2009, compared to an increase of 39.2 percent in 2008. The average level of monetary base (reserve money) grew by 17.6 percent in 2009, compared to an increase of 16.1 percent in 2008. The increase reflected higher deposits of ODCs at the Central Bank and an increase in currency in circulation.

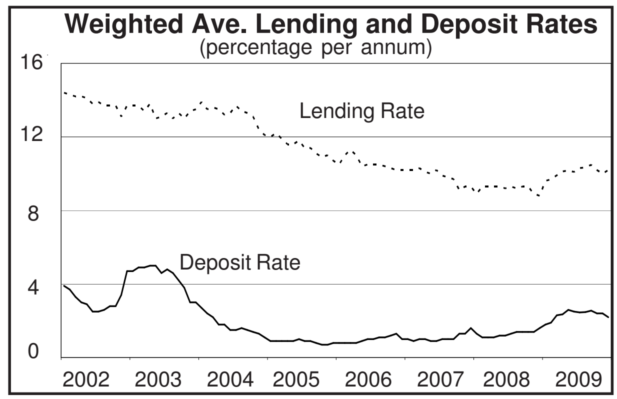
The average level of narrow money supply (M1*) decreased by 0.4 percent in 2009, compared to an increase of 29.2 percent in 2008. This was due to a decline in average transferable deposits, which more than offset an increase in average currency held outside depository corporations. The average level of quasi money increased by 25.8 percent in 2009, compared to an increase of 22.9 percent in 2008, resulting from an increase in average term deposits.

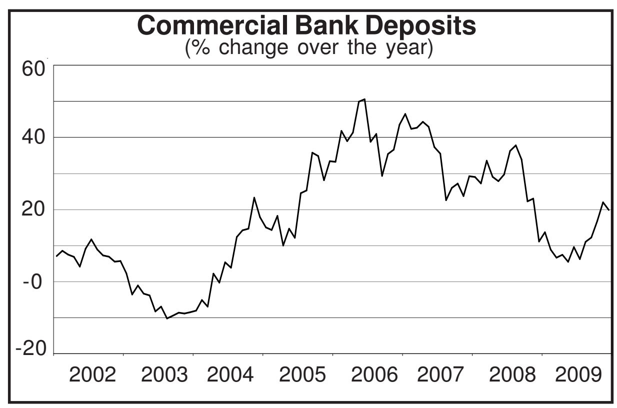
The average level of deposits of the ODCs increased by 11.1 percent to K10,182.5 million in 2009 from K9,162.3 million in 2008, due to increases in other deposits including Central Government deposits.

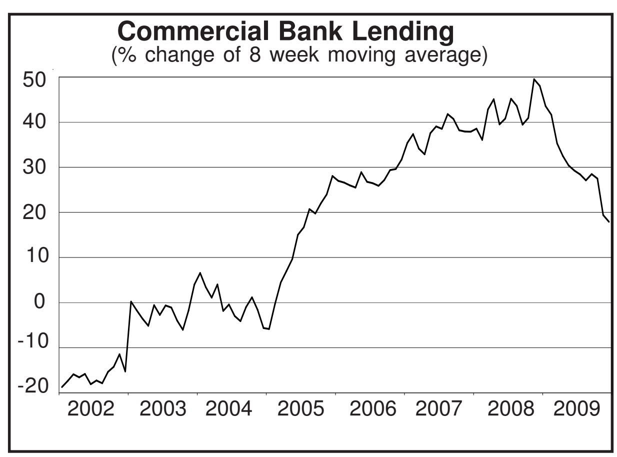
LENDING

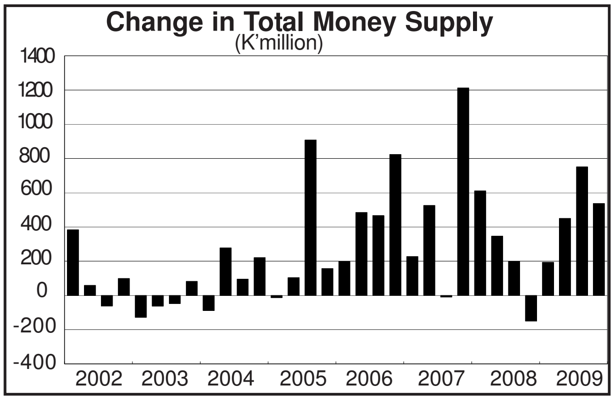
In 2009, total domestic credit extended by depository corporations to the private sector, public non-financial corporations, Provincial and Local Governments, and other financial corporations, increased by K948.3 million to K6,564.3 million, compared to an increase of K1,566.7 million in 2008. This was due to an increase in private sector credit of K956.8 million. The growth in private sector credit was broad based reflecting lending

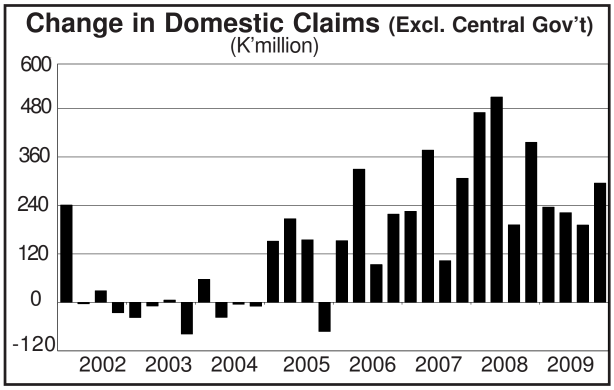


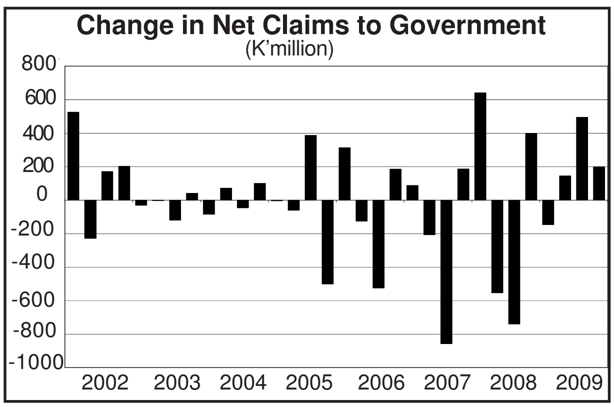


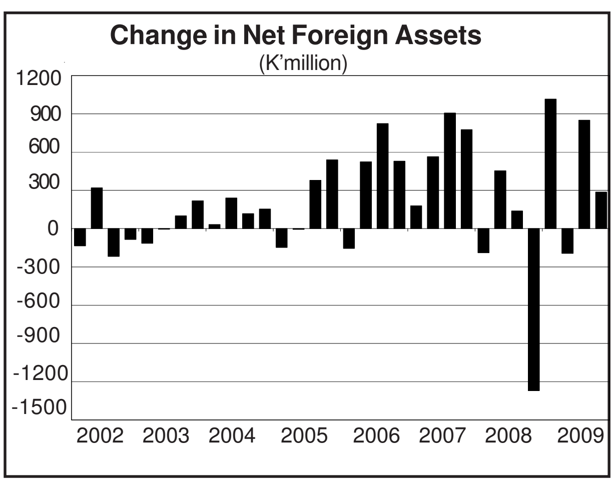












to the building and construction, transport and communication, commerce, hotels and restaurants, real estate, renting and other business services sectors, as well as for personal and housing loans. Whilst there were no repayments under the agriculture price support schemes, a Government write-off of K26.2 million for cocoa price support loan was effected in December 2009. The annual growth in domestic credit, excluding Central Government and advances under the price support schemes, was 17.5 percent in 2009.

7. PUBLIC FINANCE

Fiscal operations of the National Government show an overall deficit of K36.3 million in 2009, compared to a deficit of K478.5 million in 2008. This represents 0.2 percent of nominal GDP.

Total revenue, including foreign grants, was K6,651.3 million in 2009, 6.0 percent lower than in 2008. This represents 100.2 percent of the revised budget. The decline in revenue mainly reflected lower tax receipts, associated with lower international commodity prices, which more than offset an increase in non-tax revenue.

Total tax revenue amounted to K4,974.5 million, 13.6 percent lower than the receipts collected in 2008, and represents 103.2 percent of the revised budget for 2009. Direct tax receipts totalled K3,519.7 million, 19.1 percent lower than the receipts collected in 2008, and represents 105.4 percent of the revised budget. This outcome reflected a decline in company tax receipts, which more than offset an increases in personal income and other direct tax receipts. The decline in company tax receipts reflected lower mining and petroleum taxes associated with lower international commodity prices due to the global financial crisis. The increase in personal income tax was due to higher remuneration and employment resulting from increased domestic economic activities, while the increase in other direct tax was mainly due to injection from trust accounts.

Indirect tax receipts were K1,454.8 million, 3.7 percent higher than in 2008, and represents 97.7 percent of the revised budget for 2009. The increase reflected higher collections in goods and services tax (GST) and excise duties, which more than offset declines in most indirect tax receipts. The increase in GST was attributed to higher collections in the main contributing provinces resulting from higher economic activity. The increase in excise duties reflected increased consumption of domestically produced and imported items. The decline in import duties was due to lower volume of imports, while the decline in export tax was related to lower log exports.

Total non-tax revenue amounted to K765.8 million, K483.2 million higher than in 2008. The increase was mainly attributed to an injection from the trust accounts, which more than offset a decline in dividend payments by statutory bodies. Foreign grants amounted to K877.5 million, 12.4 percent lower than in 2008, mainly due to delay in reporting by donor agencies. Infrastructure tax credits amounted to K33.5 million, compared to K32.6 million in 2008 as approval for undertaking projects mainly by mineral companies were granted.

Total expenditure in 2009 was K6,687.6 million, 11.4 percent lower than in 2008 and represented 99.4 percent of the revised budget. This outcome was mainly due to lower capital expenditure, which more than offset an increase in recurrent expenditure.

Recurrent expenditure in 2009 was K4,166.5 million, 10.6 percent higher than in 2008, and represents 105.4 percent of the revised appropriation for 2009. The increase mainly resulted from higher spending by National Departments and Provincial Governments combined with higher interest payments. National Departmental expenditure totalled K2,403.4 million, 5.6 percent higher than the amount spent in 2008, and represents 101.7 percent of the revised budget appropriation. The increase mainly reflected higher payments for departmental goods and services and an increase in disbursement of personnel emoluments. Provincial Government expenditure was K1,046.6 million, 30.4 percent higher than in 2008, and represents 116.7 percent of the 2009 revised budget. This resulted from increases in the disbursement of personal emoluments, payments for goods and services and allocation to the Autonomous Bougainville Government. Interest payments totalled K449.2 million, 17.9 percent higher than in the corresponding period of 2008, and represents 101.8 percent of the revised budget for 2009. The increase reflected higher interest payments on Inscribed stocks and Treasury bills associated with the increase in domestic debt issuance.

Total capital expenditure, including reappropriation to trust accounts, was K2,521.2 million, 33.4 percent lower than in 2008, and represents 90.9 percent of the revised budget for 2009. The additional priority expenditure and reappropriation to trust accounts comprise of both recurrent and development expenditure and their separation is difficult. Excluding the additional priority expenditure and re-appropriation to trust accounts, the Development expenditure in 2009 was K2,348.7 million, 44.1 percent higher than in 2008 and represents 90.5 percent of the revised budget. The higher development outlay mainly reflected the implementation of the Development Budget for 2009 with an increase in funding by the Government.

As a result of these developments in revenue and expenditure, the Government recorded an overall budget deficit of K36.3 million. The deficit, combined with net external loan repayments totalling K110.1 million was financed domestically. Net external loan repayments comprised of K92.6 million to concessionary, K2.0 million to commercial and K15.5 million to extraordinary sources. Domestic financing totalled K146.4 million and comprised of K853.8 million in net financing by the financial corporations, which more than offset K707.4 million in settlement of presented cheques. Of the K853.8 million by financial corporations, K1,498.3 million mainly reflected the drawdown of Government deposits at the Central Bank and K115.0 million reflected borrowing from other financial corporations, which more than offset K759.5 million mainly relating to Government deposits placed at the commercial banks.

THE 2010 NATIONAL BUDGET

The National Budget is the principal tool for fiscal policy; one component of a set of policy tools employed to meet multiple objectives of macroeconomic management. At the macroeconomic level, the importance of the budget lies in its immediate impact on the level of aggregate demand and hence, on the whole economy.

This article reviews the 2010 National Budget, which was presented in Parliament on 17th November 2009. The 2010 Budget focuses on promoting sustained economic growth through empowering and transforming the rural economy. The implementation of the budget will be guided by the Medium Term Fiscal Strategy (MTFS) 2008-2012, Medium Term Development Strategy (MTDS) 2005-2010 and the Medium Term Debt Strategy (Debt Strategy). As with previous budget articles the detailed budget data has been rearranged and aggregated. Some misclassification of data may occur as a result of this process, but the primary focus here is the broad aggregates and trends.

The fiscal strategy for 2010 is framed on the back of the global economic recovery and strong domestic economic growth expected from the commencement of construction on the PNG Liquefied Natural Gas (LNG) project. The MTFS aims for a balanced budget for 2010 in order to provide a stable macroeconomic environment conducive to private sector investment in line with the existing overarching frameworks - the MTFS, MTDS, Debt Strategy and the *Fiscal Responsibility Act 2006*. The MTFS contains three fiscal rules to ensure macroeconomic stability is maintained and guide the use of any additional revenue which include: keeping on-going expenditure in line with normal revenue defined as all non-mineral revenues plus mineral revenue equal to 4 percent of GDP; using additional revenue to pre-fund public investment projects and repay debts and other liabilities using a 70:30 ratio; and limiting the amount of public investment expenditure sourced from additional revenues to 4 percent of GDP. The MTFS also recognizes the inherent risks to the 2010 Budget, which include: the delay in the commencement of the LNG project, unforeseen shutdowns in the mineral sector, falls in the international commodity prices, and an unforeseen stalling in global economic recovery.

Consistent with the MTDS, which is based on export-driven growth, rural development and poverty reduction, the Government continues to focus on the seven Expenditure Priority Areas (EPAs). These are: Transport Rehabilitation and Maintenance; Promotion of Income Earning Opportunities; Primary and Preventive Health; Basic Education; HIV/AIDS Prevention; Law and Justice; and Development Oriented Adult Education. The Development Budget strategy aims to target public investment mostly in the non-mineral sector of the economy and allow participation by the rural population in economic activity. The effective implementation of the MTDS requires the Government to align both the Recurrent and Development Budget with it through increased allocations, which would reach 55.0 percent by 2010 from 48.0 percent in 2005.

The 2010 Budget was based on the existing tax structure with no new tax measures introduced. The tax policy continues to focus on tax concessions all sectors to support private sector investment and employment, while it defers the Tariff Reduction Program to 2011.

The expenditure allocations for 2010 continue to focus on the broad goals of increased appropriations for MTDS priority areas, continued public sector reforms and removal of impediments to business and investment. The Government's on-going public sector reforms are vital in building the capacity of the institutions of public service delivery and creating a conducive environment for macroeconomic stability and economic growth.

Project grants from donor countries are an important component in the development process, which the Government would not otherwise undertake. In 2010, project support grants are expected to increase by K261.8 million to K1,293.9 million from the 2009 revised budget estimate, mainly attributed to the depreciation of the kina against the Australian dollar. In seeking to promote sustained economic growth the Government has substantially increased its budgetary support for the Development Budget by K385.1 million to K2,099.9 million. The Governments contribution to the Development Budget comes in three forms: Direct Financing, Tax Credit Scheme and Loans. Of a total of K3,393.8 million, 62.0 percent (K2,099.9 million) comes from the Government sources, while 38.0 percent (K1,293.9 million) comes from donors in the form of grants. The project support grants from donor countries continue to play an important role in the development of the country.

The formulation of the Budget was based on the expectations of global economic recovery and the commencement of construction of the LNG project. Real GDP is projected to grow at 8.5 percent in 2010 following an expected growth of 4.5 percent in 2009 mainly boosted by the construction phase of the LNG project. The higher growth also reflects commencement of production at the new Ramu Nickel and Hidden Valley gold mines and the expected expansion at Lihir gold mine. Growth is also expected from all sectors of the economy except the oil and gas extraction sector mainly due to the natural decline of reserves in existing oil fields. The non-mining sectors including the 'transport, storage and communication', manufacturing, construction, 'wholesale and retail' are expected to continue to grow reflecting the increased domestic demand as the construction of the LNG project starts and the Government increases expenditure on infrastructure projects. The 'agriculture, forestry and fisheries' sector will also contribute to the growth in 2010 with higher coffee and cocoa production expected.

Table 1 summarises fiscal developments from 2006 to 2009 and the Budget indicators for 2010. In 2010, the fiscal burden on the economy as represented by the appropriations/nominal GDP ratio and net external borrowing, is expected to be minimal. This is due to the growth in nominal GDP outweighing the planned increase in expenditure and the Government borrowing from concessional sources. The lower burden also reflects a projected balanced budget in 2010.

The 2010 Budget is considered to be a balanced budget when measured against GDP. Financing of the Budget is comprised of an expected net external borrowing of K85.1 million and an offsetting reduction in domestic debt by the same amount. The external borrowing will be mainly from concessional sources totaling K140.5 million, while external loan repayments will comprise of K17.8 million to commercial and K37.6 million to extraordinary sources. The external borrowing is consistent with the Debt Strategy, as the Government tries to reduce its financial and exchange rate risks.

The overall primary balance measures the effects of discretionary budgetary policy by adding net interest

Table 1: Budgetary Indicators (K'million)

	2006	2007	2008	2009			2010
	Actuals			Original Budget	Revised Budget	December Outcome	Budget
1. Total Internal Revenue & Grants	6,312	7,029	7,073	6,666	6,640	6,651	7,490
2. Appropriations	5,776	6,552	7,552	6,677	6,726	6,688	7,490
3. *of which:* Additional Priority Expenditure	1,207	1,727	2,155	0	0	0	0
4. Surplus/(Deficit) =1-2	536	476	-479	-10	-86	-36	0
5. Primary Balance	843	846	-97	383	355	413	467
6. *FINANCING*	***-536***	***-476***	***479***	***10***	***86***	***36***	***0***
External	-219	-397	-456	-61	-31	-110	85
Domestic	-317	-79	935	71	117	146	-85
Memorandum Items:							
7. Borrowed Funds	1,268	4,797	2,769	1,692	2,371	1,094	2,147
8. GDP (Nominal)	16,897	18,798	21,626	21,782	21,782	21,782	24,890
(Ratios to Nominal GDP in %)							
9. Appropriations/GDP	34.2	34.9	34.9	30.7	30.9	30.7	30.1
10. Total Internal Revenue & Grants/GDP	37.4	37.4	32.7	30.6	30.5	30.5	30.1
11. Surplus or Deficit/GDP	3.2	2.5	-2.2	0.0	-0.4	-0.2	0.0
12. Borrowed Funds/GDP	7.5	25.5	12.8	7.8	10.9	5.0	8.6
(Growth rates in %, year on year)							
13. Appropriations	39.2	13.4	15.3	1.9	2.6	2.1	11.4
14. GDP (Nominal)	33.5	11.3	15.0	15.9	15.9	15.9	14.3
15. Headline Inflation (Over the Year) (a)	1.3	3.2	11.2	7.0	7.4	5.7	9.9

The above figures may not correspond to Table 7.1in the QEB due to some reclassification.

(a) Actual inflation figures are from the September 2009 QEB, while inflation figures for 2009 and 2010 is from the National Statistical Office and the 2010 Budget document, respectively. Inflation figures from the QEB are annual while those from the Budget documents are projections.

Source: Bank of Papua New Guinea and 2010 Budget Papers, Volume 1, Department of Treasury and Finance.

expenses on the conventional measure of overall fiscal balance (Table 1). This balance indicates how the fiscal actions of the Government affect its net debt position. A surplus in the primary balance in 2010 indicates that the Government's public debt is expected to decline resulting in lower financial and foreign currency risks.

Table 2 depicts the revenue components of the 2010 Budget as a percentage of total revenue, which are projected to increase for all revenue measures. The total budgeted revenue and grants for 2010 is projected to be 12.6 percent higher than the actual outcome for 2009.

In 2010, total direct taxes are projected to increase by 14.5 percent and account for 53.8 percent of total revenue, compared to the actual 2009 outcome. The increase is due to higher personal, company and other direct tax receipts.

Indirect taxes are expected to increase by 17.3 percent in 2010 and increase as a ratio of total revenue to 22.8 percent, compared to the 2009 actual outcome. This mainly reflects higher collections in all categories of indirect tax receipts. Non-tax revenue is expected to decrease by 42.4 percent, compared to the 2009 outcome mainly due to the non-recording of injections from trust accounts.

Total project grants are estimated to increase by 47.5 percent in 2010, compared to the 2009 outcome. The increase is mainly accounted for by the depreciation of the kina exchange rate against the Australian dollar as more than 50 percent of donor funding is from the AusAID combined with additional funding by the United Nations on projects.

The 2010 Budget shows that total expenditure is 12.0 percent higher than the actual outcome for 2009. National recurrent expenditure is projected to decline by 0.2 percent and recurrent Provincial Government spending by 6.1 percent, while Development expenditure is projected to increase by 44.5 percent.

Table 2: Distribution between Revenue and Financing items in the 2010 Budget (K' million)

	2006	2007	2008	2009			2010
	Actuals			Original Budget	Revised Budget	December Outcome	Budget
1. Total Internal Revenue & Grants	6,312	7,029	7,073	6,666	6,640	6,651	7,490
2. Direct Taxes	3,824	4,491	4,353	3,044	3,339	3,520	4,029
3. Indirect Taxes	1,121	1,363	1,404	1,570	1,489	1,455	1,706
4. Department Rev. & Services	89	120	95	115	93	100	115
5. Revenue from Assets	363	334	221	363	186	178	345
6. Trust Account Injection				600	500	521	
7. Grants	915	721	1,002	974	1,032	878	1,294
Memorandum Item:							
8. Borrowings	1,268	4,797	2,769	1,692	2,371	1,094	2,147
Ratios (%)							
9. Direct Taxes/Total Revenue	60.6	63.9	61.5	45.7	50.3	52.9	53.8
10. Indirect Taxes/Total Revenue	17.8	19.4	19.8	23.6	22.4	21.9	22.8
11. Dept. Revenue/Total Revenue	1.4	1.7	1.3	1.7	1.4	1.5	1.5
12. Revenue from Assets/Total Revenue	5.8	4.7	3.1	5.4	2.8	2.7	4.6
13. Grants/Total Revenue	14.5	10.3	14.2	14.6	15.5	13.2	17.3
Memorandum Item:							
14. Borrowings/Total Revenue	20.1	68.3	39.1	25.4	35.7	16.5	28.7

Source: Table 1

Table 3 shows that the share of recurrent expenditure to total appropriation will reduce to 41.6 percent in 2010, compared to 46.7 percent in 2009. This is consistent with the planned balanced budget for 2010 and in line with the fiscal strategy of spending additional revenue equal to 4.0 percent of GDP. The share of development expenditure to total appropriation is 45.3 percent in 2010, compared to 35.1 percent in 2009. The increase reflects the alignment of funding for the Development Budget with the MTDS priority areas through increased funding allocation by the Government in the 2010 Budget.

Achieving the 2010 Budget revenue and expenditure targets is important because of its implications on financing and the level of public debt. The threat to monetary conditions, exchange rate and inflation remains any fiscal slippages in the 2010 Budget in light of a build up of unfunded commitments from past Supplementary Budgets. Therefore, adherence to the MTFS, MTDS, and debt strategy are important to ensure prudent management of public finances will help to maintain balanced budget projected in 2010 and sustainable debt levels in the medium term and sustain economic growth.

The Central Bank will pursue a tight monetary policy stance, despite easing it in December 2009, in light of expectations of high inflationary pressures emanating from the domestic sector through increased Government expenditure and high credit growth to the private sector combined with the improvement in the global economy.

This policy stance is expected to be complemented by the Government's sound fiscal management through the restraint on recurrent expenditure and the increase in development expenditure in the priority areas of health, education, law and order and physical infrastructure. The continuation of public sector reforms and removal of impediments to trade and investment will assist the efforts to sustain and enhance economic growth in the medium term. Given the anticipated decline in revenue, the Government should spend within the parameters set out in the 2010 Budget without resorting to domestic financing to meet budgeted and unbudgeted expenditure levels. Any increase in domestic financing to cover shortfalls in revenue could undermine the macroeconomic stability gained over the last seven years. In this context, it is important that the Government continue with the structural reforms and expenditure priorities are implemented in order to achieve long-term sustainable growth.

Table 3: Appropriation (K' million)

	2006	2007	2008	2009			2010
	Actuals			Original Budget	Revised Budget	December Outcome (p)	Budget
1. Total Appropriation	5,776	6,552	7,552	6,677	6,726	6,688	7,490
2. Current Expend. National Level (a)	2,203	2,703	2,964	3,007	3,056	3,120	3,113
3. Development Expenditure (b)	1,554	1,328	1,630	2,595	2,596	2,349	3,394
4. Provincial Governments (c)	812	795	803	897	897	1,047	983
5. Additional Priority Expenditure/Reappropriation to Trust Acco	1,207	1,727	2,155	177	177	173	
6. Supplementary Budget							
Ratios (%)							
7. Current Expenditure/Total Appropriation	38.1	41.3	39.2	45.0	45.4	46.7	41.6
8. Dev. Expenditure/Total Appropriation	26.9	20.3	21.6	38.9	38.6	35.1	45.3
9. Provincial Govts/Total Appropriation	14.1	12.1	10.6	13.4	13.3	15.6	13.1

Source: Table 1

Notes:

(a) Current Expenditure, National Level includes interest payments and transfers to Statutory Authorities.

(b) Development expenditure includes Australian project grants

(c) Provincial Government's is recurrent expenditure only.

Objective of Monetary Policy

The objective of monetary policy in Papua New Guinea (PNG) is to achieve and maintain price stability. This entails low inflation supported by stable interest and exchange rates. The maintenance of price stability leads to:

- Confidence in the kina exchange rate and management of the economy;
- A foundation for stable fiscal operations of the Government;
- Certainty for businesses to plan for long-term investment; and
- A stable macroeconomic environment conducive to economic growth.

Executive Summary

The PNG economy will experience a period of significant economic growth following the commencement of the PNG Liquefied Natural Gas (LNG) project in 2010. During the construction phase, Gross Domestic Product (GDP) is expected to increase significantly, especially in 2010 and 2011. The global economic recovery is also expected to contribute to the growth.

Inflationary pressures are expected to increase through activities related to the LNG project and the global economic recovery. The Bank will carefully assess and evaluate the trade-off between higher economic growth and inflation so as not to discourage domestic economic activity and ensure inflation does not spiral out of control.

Inflation declined from a high of 13.5 percent in the September quarter of 2008 to a low of 5.3 percent in the September quarter of 2009, before increasing slightly to 5.7 percent in the December quarter. The easing in inflation prompted the Bank to reduce the Kina Facility Rate (KFR) from 8.00 percent to 7.00 percent in December 2009 where it was maintained up to March 2010.

For 2010, the Bank projects annual headline inflation to be around 8.0 percent. This projection is based on the following factors: domestic demand pressures resulting from the commencement of construction for the LNG project starting in 2010; implementation of the minimum wage increases in late 2009 and early 2010; slightly higher imported inflation from PNG's major trading partners; and stability in the kina exchange rate for the rest of 2010.

Broad money supply grew by 19.3 percent in 2009 mainly due to increases in net foreign assets of depository corporations and private sector credit. A growth of 11.9 percent in monetary base was associated with drawdown of Government trust account funds. In 2010, the Bank projects growth of 21.3 percent in broad money supply, influenced mainly by higher growth in credit to the private sector to cater for a projected increase in domestic economic activity, and 15.3 percent in monetary base. Whilst the Bank is mindful of the inflationary impact of growth in private sector credit, the projected growth in monetary aggregates is considered sufficient to support economic growth.

Preliminary estimates of the fiscal operations of the Government for 2009 show a deficit of 0.2 percent of nominal GDP, which included the K521 million drawdowns from the trust accounts that were already recorded as revenue. Despite an initial understanding, the failure by the Government to move trust account funds from commercial banks to the Bank of PNG has substantially increased the cost of monetary policy management, with the Central Bank issuing net K1,567 million in Central Bank Bills (CBBs) in 2009, at a cost of around K90 million, to diffuse the excess liquidity. The Bank reiterates that only closer coordination and cooperation between fiscal and monetary management can help mitigate inflationary pressures.

Only prudent fiscal management of the windfall revenue from the LNG project and close cooperation and coordination between the Central Bank and the Government will make it possible for monetary policy to address inflationary concerns. The decision by Government to establish a Sovereign Wealth Fund (SWF) is a positive move and part of a responsible Government fiscal strategy, which would help limit exchange rate pressures while also regulating the Government's drawdown of the revenues from the project. Until the establishment of the SWF, the Government should allow the Bank of PNG to keep windfall mineral tax income, not budgeted for immediate use, in offshore foreign currency accounts, instead of depositing them in trust accounts. This would reduce the impact of these inflows on domestic liquidity, the exchange rate and inflation.

The Bank will review its monetary policy management and operations and adopt appropriate strategies to contain inflation and support economic growth.

1.0 Monetary Policy Discussions

1.1 Monetary Policy Assessment and Issues

In PNG inflation declined from a high of 13.5 percent in the September quarter of 2008 to a low of 5.3 percent in the September quarter of 2009, before increasing slightly to 5.7 percent in the December quarter. Low global demand and imported inflation, resulting mainly from lower international food and fuel prices, the lag effect of the kina's appreciation in the latter part of 2008 and first half of 2009, and the tight monetary policy stance in 2009 contributed to the favourable inflation outcomes. The easing in inflation prompted the Bank to reduce the KFR from 8.00 percent to 7.00 percent in December 2009.

Annual growth in broad money supply (M3*) and the monetary base were 19.3 percent and 11.9 percent, respectively, in 2009. The high growth in broad money supply relative to 2008 was mainly due to an increase in net foreign assets of depository corporations, while private sector growth moderated to 17.3 percent in 2009. The growth in monetary base was associated with drawdown of trust account funds, which resulted in high exchange settlement account balances of commercial banks and currency outside depository corporations, in spite of the tight stance of monetary policy. To diffuse excess liquidity from the banking system and counter domestic inflationary pressures, the Bank issued net new CBBs of K1,567 million in 2009.

In spite of the understanding between the Bank and the Government to move the trust account funds from commercial banks to the Bank of PNG, most of the funds still remain at the commercial banks, making monetary policy management more difficult and expensive. Additionally, the fast drawdown of these funds—which breached the 4 percent of GDP limit in the Medium Term Fiscal Strategy—is highly inflationary. More stringent measures must be put in place to control spending in the future, especially in the lead up to the National Elections in 2012. Under these circumstances, the Bank reiterates that only closer coordination and cooperation between fiscal and monetary management can help mitigate inflationary pressures. This includes keeping trust accounts at the Central Bank and offshore management of any windfall revenues from mineral taxes before the establishment of a SWF for LNG taxes and dividends.

Preliminary estimates of the Government's fiscal operation show a deficit of K36.3 million in 2009, or 0.2 percent of nominal GDP, which included the K521 million drawdowns from the trust accounts that were already recorded as revenue. Recurrent expenditure was 105.4 percent of the revised budget, while development expenditure was 90.4 percent. The deficit combined with the net external loan repayment of K110.1 million was financed from domestic sources totalling K146.4 million.

In 2010, broad money supply is expected to grow by 21.3 percent, influenced mainly by higher growth in credit to the private sector to cater for a projected increase in domestic economic activity. Monetary base is expected to grow by 15.3 percent in 2010. While the Bank is mindful of the inflationary impact of growth in private sector credit associated with the LNG project, the projected growth in monetary aggregates is considered sufficient to support economic growth.

The recovery in the global economy that began in the second half of 2009, which has been particularly strong in Australia, China and India, could also fuel foreign inflation leading to higher imported inflation in PNG. This could also be exacerbated by inflationary pressures emanating from the LNG project. Stronger global demand could also impact positively on PNG's export revenues, which would lead to further increases in domestic demand.

Looking ahead, the LNG project will generate a lot of business activity in the private sector, mainly in the building and construction, transport and communication, manufacturing, commerce and financial/business and other services sectors as indicated from both the Bank's Business Liaison Survey (BLS) and the study on the impact of the LNG project (refer to Box 1). According to the BLS conducted in February 2010, firms are streamlining their operations and building their capacity to meet demand arising from the LNG project. While the project is expected to fuel higher growth it can also generate higher inflation in 2010 and the medium term. With the private sector expecting higher growth, it is therefore important that the Government conforms to its budget framework to avoid over-expenditure that would only add to the inflationary environment.

In the short term, foreign exchange inflows for the domestic component of the construction phase may exert an upward bias on the exchange rate. However, this could be offset by firms importing materials to expand their operations. After the project begins exporting, the significant tax revenues and any export proceeds would lead to an appreciation of the kina. Although this would help to reduce imported inflation, the appreciation would adversely affect the traditional export sector - a condition referred to as the *Dutch Disease*. Establishing an offshore managed SWF would help limit these exchange rate volatilities while also regulating the Government's drawdown of the income from the project. The real benefit of the project to the rest of PNG will depend on how the Government manages and spends this windfall revenue. An appropriate fiscal framework that involves the Government saving some of this revenue under the SWF will make it easier for the management of monetary policy in addressing inflationary concerns and minimise the effects of *Dutch Disease*. This fiscal strategy is referred to as the conservative policy in the study (see Box 1). Under the strategy, living standards of the people can be improved through spending on priority areas while at the same time there is some saving for future generation, in contrast to an aggressive (overspending) or passive (balanced budget) fiscal policy. It is through this kind of prudent fiscal management that the rest of PNG can benefit from the LNG project.

Until the establishment of the SWF, the Government should allow the Bank of PNG to keep windfall mineral tax income, not budgeted for immediate use, in offshore foreign currency accounts, instead of depositing them in trust accounts. This would reduce the impact of these inflows on domestic liquidity, the exchange rate and inflation.

With the expected high economic growth and inflation environment, the Bank will carefully assess and evaluate the trade-off between higher economic growth and inflation so as not to discourage domestic economic activity and ensure inflation does not spiral out of control. In light of this, the Bank will re-assess its monetary policy instruments and prudential measures.

1.2 Monetary Policy Stance

Inflation continued to ease in the second half of 2009. As a result, the KFR was reduced from 8.00 percent to 7.00 percent in December 2009. With the pick up in domestic demand and the global recovery, the Bank kept the KFR unchanged at 7.00 percent over the three months to March 2010.

The projected growth of the economy and a high inflation environment mainly as a result of the LNG project presents a significant challenge for the Bank and the Government. In order to contain inflation in 2010 and the medium term when the private sector is driving economic growth, coordination between fiscal and monetary policies is essential. This will entail the Government managing fiscal policy prudently in line with the budget framework and its medium to long term policies. The Bank will take necessary measures to limit inflationary pressures.

The Bank projects broad money supply to grow by 21.3 percent and the monetary base by 15.3 percent in 2010. Private sector credit growth is expected to be around 23.0 percent in 2010, which is considered sufficient to cater for an increase in economic activity associated with the LNG project.

The Bank projects headline inflation to be around 8.00 percent in 2010. Upside risks to this projection could arise from:

- Higher than expected domestic demand pressures resulting from the commencement of construction for the LNG project;
- Excessive Government expenditure;
- Higher imported inflation from PNG's major trading partners; and
- Depreciation in the kina exchange rate due to high demand for foreign exchange resulting from increased economic activity.

The Bank will assess these developments and, if necessary, make appropriate adjustments to the stance of monetary policy in the coming six months.

1.3 Conduct of Monetary Policy

Monetary policy will be conducted within the reserve money framework. The Monetary Policy Statement (MPS) provides the overall monetary policy stance, while the monthly KFR remains the instrument for signalling this stance or any changes through an announcement by the Governor. Following the announcement, Open Market Operations (OMOs) will be conducted to support the Bank's monetary policy stance. The OMOs involve Repurchase Agreement (Repo) transactions with commercial banks and the auction of CBBs to licensed Other Depository Corporations (ODCs) and Treasury bills to the general public.

In light of the high inflationary environment, the Bank will also re-assess its monetary policy instruments and prudential measures.

2.0 Developments and Expectations

2.1 International Developments

There were indications of economic recovery in the second half of 2009, with a turnaround in economic activity in some major economies. According to the January 2010 *World Economic Outlook* (WEO) Update by the International Monetary Fund (IMF), the advanced economies bounced back in the second half of 2009. The recovery was supported by improved confidence in global financial markets and a rebound in global trade on the back of coordinated fiscal stimulus and highly expansionary monetary policies. As a result, real GDP in the advanced economies is expected to grow by 2.1 percent in 2010 and by 2.4 percent in 2011, after a decline of 3.2 percent in 2009. However, major challenges still lie ahead as countries deal with high unemployment rates, high public debt and low net household assets. The IMF projects emerging and developing economies to grow by 6.0 percent in 2010, compared to 2.1 percent in 2009. China is expected to take the lead followed by India and Latin American countries.

Real GDP increased in the United States (US) at an annualized rate of 5.9 percent in the fourth quarter of 2009, compared to 2.2 percent in the third quarter of 2009. The acceleration in the US was mainly due to strong growth in inventories, non-residential fixed investments, exports and personal consumption expenditures. Japan's GDP also increased in the fourth quarter by 1.1 percent supported by strong domestic demand, whilst the United Kingdom (UK) experienced its first positive growth of 0.3 percent in the December quarter after six quarters of consecutive negative growth. The expansion in the Eurozone economies slowed to a meager 0.1 percent in the fourth quarter as the region reeled under the weight of high public debt, especially in Greece, Ireland, Portugal and Spain.

The global labour market remained weak as countries dealt with the aftermath of the financial crisis. In the US, the rate of unemployment declined slightly to 9.7 percent in January 2010 after peaking at 10.0 percent in December 2009. In the Eurozone, the unemployment rate in January 2010 stands at 9.9 percent with the total number of unemployed people increasing to a record 15.7 million. In the UK, the unemployment rate remained unchanged at 7.8 percent in January 2010 but the number of people claiming unemployment benefits increased to 1.64 million. Australia was an exception, where the unemployment rate continued to trend lower on the back of a strong recovery in the domestic economy. Australia's unemployment rate declined to 5.3 percent in January 2010 from 5.5 percent in December 2009.

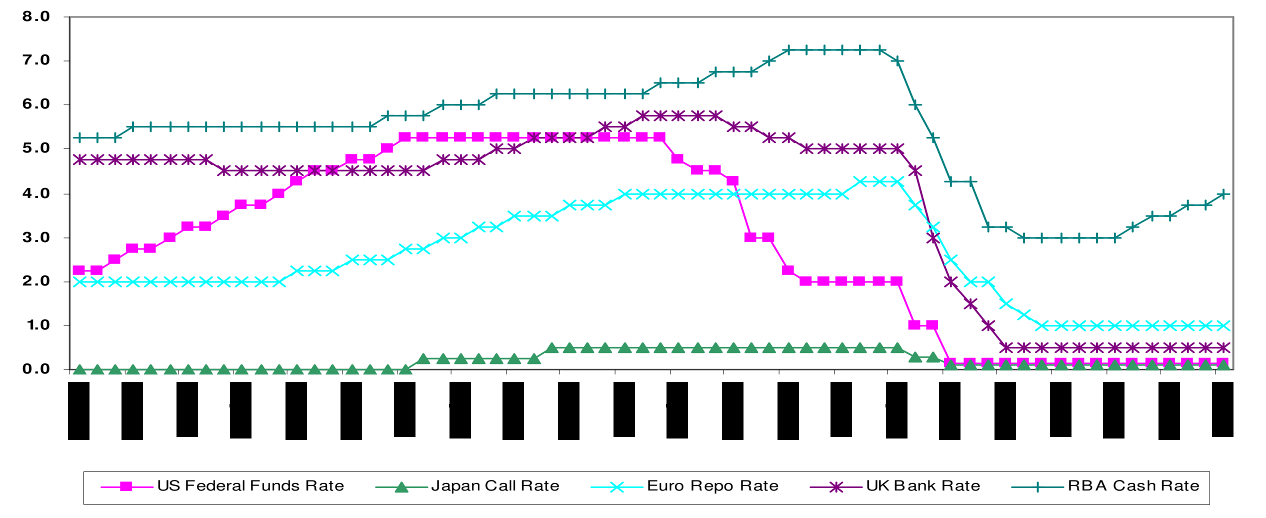
Inflation remained low in the advanced economies in 2009 reflecting weak consumer demand. However, the projected increase in most commodity and energy prices would pose a risk to future inflation. In January 2010, the inflation rate was 2.7 percent in the US, 1.0 percent in the Eurozone, 3.5 percent in the UK, and negative 1.3 percent in Japan.

Most major central banks maintained an accommodative monetary policy stance up to March 2010. The US Federal Reserve kept their policy rate at 0.25 percent and the Bank of Japan at 0.10 percent. The European Central Bank and the Bank of England have reduced their official rates by 150 basis points each to 1.00 percent and 0.50 percent, respectively. Since September 2009, the Reserve Bank of Australia has gradually increased its overnight cash rate from 3.00 percent to 4.00 percent (see Chart 1).

Globally, financial markets have improved as governments and central banks restored liquidity in their respective markets. Confidence has returned to the money markets as banks gradually moved back to the inter-bank market instead of relying on credit from central banks. However, bank lending is expected to remain moderate as banks rebuild their balance sheets. Equity markets have strengthened and bond markets have improved as more issuers enter the market, buoyed by investors' appetite for high yields. Sovereign debt however, has come under pressure due to rising fiscal deficits amongst some Eurozone countries.

In the foreign exchange market, the US dollar strengthened against the euro and pound sterling but weakened against the Australian dollar and the Japanese yen over the six months to February 2010. The US dollar strengthened against the euro as a result of high public debt of some of the member countries and the slowdown in the Eurozone area. Sterling's

Chart 1: Monthly Movements in Official Interest Rates (Percent)



Source: Various Central Banks' websites

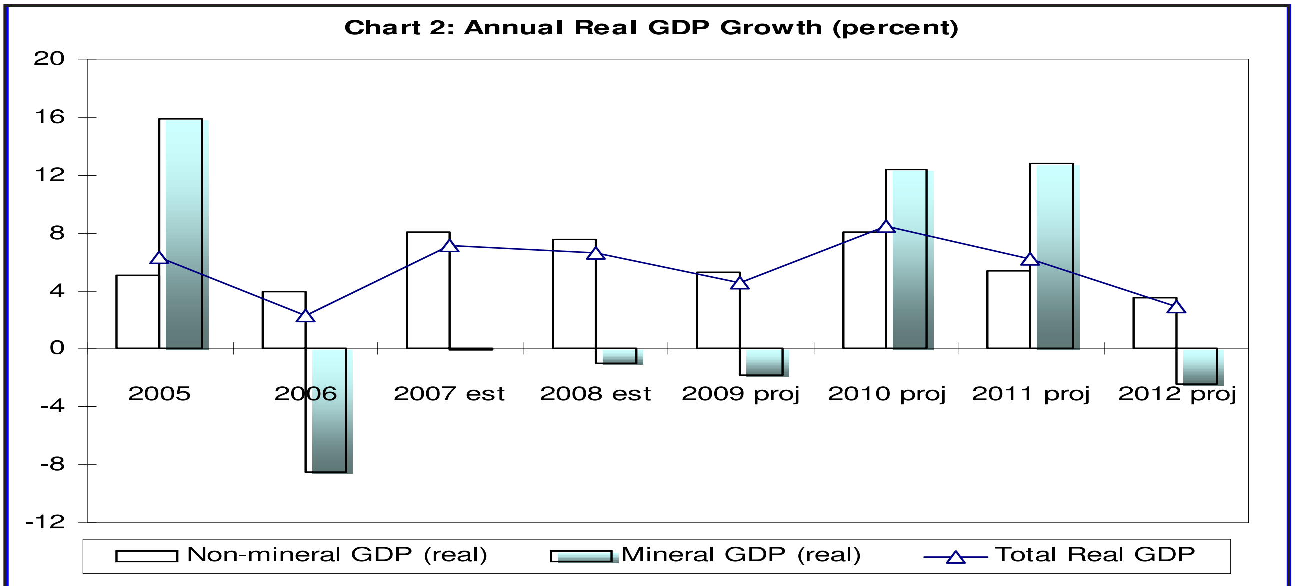
weakness against the US dollar was mainly on the back of a plunge in equity markets. The Australian dollar strengthened against the US dollar as a result of rising domestic interest rates in Australia and improved commodity prices. The yen appreciated against the US dollar due to the weak US economic growth.

2.2 Domestic Economic Conditions

The Bank revised downwards its GDP growth (from the September 2009 MPS) estimate for 2009, reflecting weak demand, decline in business sales and lower employment growth. The revision was largely due to lower export commodity prices associated with the downturn in global economy. Over the twelve months to September 2009, the Bank's BLS show that total sales declined by 15.8 percent, while excluding the mineral sector, it fell by 9.2 percent. The significant decline in 2009 was mainly associated with low commodity prices for most of PNG's major exports. The Bank's Employment Index show that the total level of employment in the formal private sector increased by 4.2 percent over the year to December 2009, compared to 6.7 percent in 2008. The increase was broad-based across all sectors except the financial/ business and other services sector. All regions recorded higher employment levels except the Momase region. Excluding the mineral sector, the employment index increased by 5.0 percent over the year to December 2009.

The Bank's GDP projection for 2010 is broadly in line with the Government's projection of around 8.0 percent. Exceptional growth is projected in the building and construction, mining and quarrying, manufacturing and commerce sectors, and the transport and communication sub-sectors, while the petroleum sector is expected to decline. The increase in the construction sector and its spill-over effects to the other sectors is attributed to the remaining construction works at the Ramu Nickel/Cobalt mine and commencement of construction works for the LNG project and related activities, as well as major transport infrastructure and building projects undertaken by the Government and private sector. The growth in the mining and quarrying sector reflects the commencement of production at the Ramu Nickel/Cobalt mine and first full year of production at the Simberi and Hidden Valley mines. There will also be increased production of gold at existing mines. The significant increase in the commerce and manufacturing sectors are driven by strong domestic demand and growth in construction activity. The increase in the transport sub-sector reflects an increase in shipping activity, combined with high passenger travel and cargo haulage by air and land transportation companies. Growth in the communication sub-sector is mainly the result of expansion of networks by the two mobile phone companies.

For the medium term, the Bank expects the economy to continue to grow. Growth in the building and construction sector is associated with construction work for the LNG project, together with ongoing Government, donor and private sector funded projects.



Source: 2010 National Budget

The increase in the mining sector reflects production by the Ramu Nickel/Cobalt, Lihir, Hidden Valley, and Simberi mines. Other sectors are also expected to grow and contribute to the overall growth in GDP.

2.3 Balance of Payments

Preliminary balance of payments data for 2009 showed an overall surplus of K1,724 million, compared to a deficit of K598 million in 2008. This outcome was due to a surplus in the capital and financial accounts, which more than offset a deficit in the current account (see Chart 3). The surplus in the capital account was the result of higher transfers by donor agencies through direct project financing.

The surplus in the financial account reflected higher net inflow from direct investments associated with share placements by a resident mineral company to raise capital for on-going operating and capital-related expenditure, combined with drawdown of investments in short-term money market instruments. The inflows from other investments were due to a drawdown in the net foreign assets of the banking system and foreign currency account balances of resident mineral companies. These more than offset net loan repayments by the Government. The deficit in the current account resulted from lower trade surplus and higher net service payments, which more than offset lower income payments and higher net transfer receipts.

The level of gross foreign exchange reserves at the end of December 2009 was US$2,610.5 (K7,045.9) million, sufficient for 10.9 months of total and 15.0 months of non-mineral import covers. As at 30th March 2010, the level of gross foreign exchange reserves was US$2,329.8 (K6,330.9) million.

The IMF's February 2010 price forecasts suggest that international prices for most of PNG's non-mineral export commodities will be higher in 2010, compared to 2009. According to the mineral companies, prices of all mineral exports are also expected to increase in 2010.

Price forecasts for nickel and cobalt, PNG's new export commodities, are projected to be higher during the same period.

The export volumes of all of PNG's major non-mineral commodities are projected to increase in 2010 compared to 2009, with the exception of tea, rubber and logs. The projected higher production in 2010 and over the medium term is associated with increased international prices attributed to growth in global demand. Mineral commodity export volumes are projected to increase in 2010 compared to 2009, with the exception of crude oil. The increase in gold production is due to the on going expansion at the Lihir mine, first full year production from the Simberi and Hidden Valley mines and the mining of higher ore grades from existing mines. Copper export volumes are expected to increase due to export of stock piles accumulated from 2009. In the petroleum sector, the decline in production is associated with the natural decline in the existing oilfields. The Ramu Nickel/ Cobalt project is expected to commence production in the second half of 2010.

The main assumptions underlying the balance of payments projections for 2010 and the medium term are:

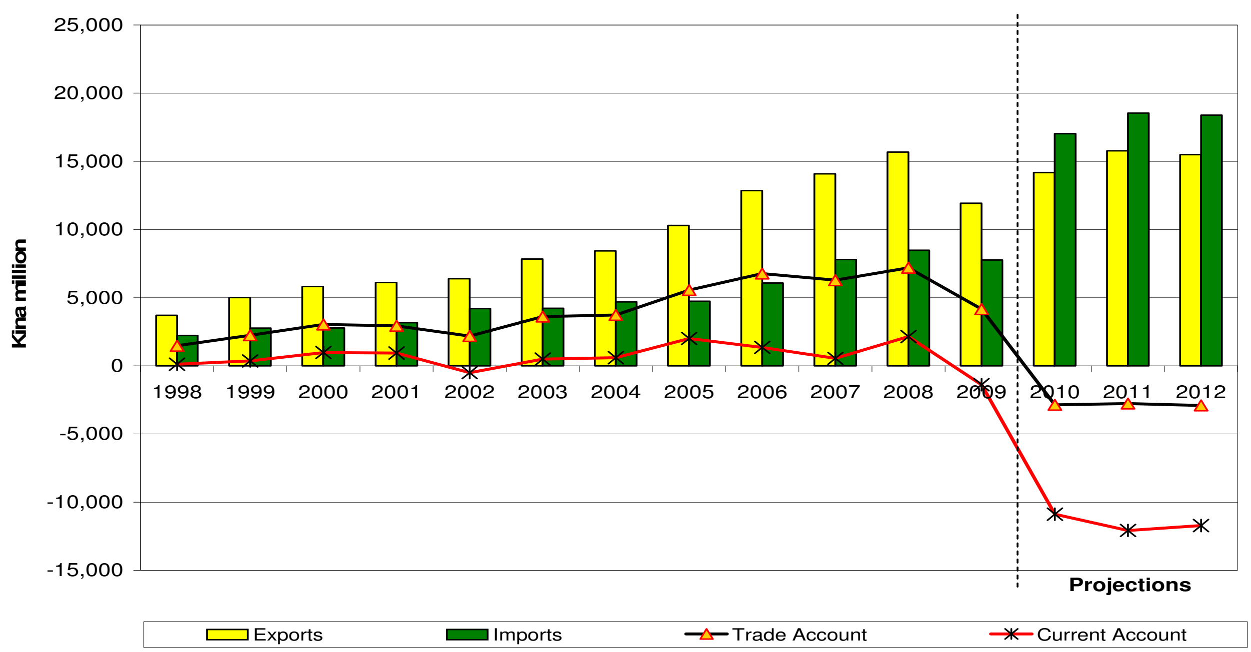
- Stability in the kina exchange rate;
- The commencement of production at Ramu Nickel/Cobalt mine in the second half of 2010;
- The commencement of construction of the LNG project; and
- Higher export prices and volumes, stemming from increased global demand as world economic recovery continues.

The current account is projected to record a significantly higher deficit in 2010 mainly due to increase in import and service payments associated with the LNG project. This will be partially offset by a surplus in the financial account reflecting inflows mainly associated with the drawdown of equity and loan funds for financing of the LNG project. As a result, the overall balance of payments is projected to be in deficit by K759 million in 2010, compared to a surplus of K1,724 million in 2009. At the end of 2010, the gross foreign exchange reserves are projected to be around US$2,284.0 (K6,202.0) million, sufficient for 4.4 months of total and 11.2 months of non-mineral import covers. Despite the inflows associated with LNG project during the construction phase, gross reserves are projected to decline due to higher demand for foreign reserves to finance the balance of payments transactions (see Appendix – Table 2). Most of the flows associated with the LNG project will be conducted through offshore accounts and will have a minimum impact on the level of foreign exchange reserves. Foreign exchange inflows for the domestic component of the construction phase may exert an upward bias on the exchange rate. However, this could be offset by increased demand for imports.

2.4 Fiscal Operations of the National Government

Preliminary estimates of the Government's fiscal operation show a deficit of K36.3 million in 2009, which is 0.2 percent of nominal GDP, which included the K521 million drawdowns from the trust accounts that were already recorded as revenue. Total revenue, including foreign grants, declined by 6.0 percent in

Chart 3 - Current Account



Source: Bank of PNG

2009, compared to 2008 and represented 100.2 percent of the revised budget. The decrease in revenue mainly reflected lower tax receipts, which more than offset an increase in non-tax revenue. Total expenditure declined by 11.4 percent over the same period and represented 99.4 percent of the revised budget. The increase in recurrent expenditure resulted mainly from higher National Department, provincial government spending and interest payments. Development expenditure increased reflecting the implementation of the 2009 Development Budget combined with projects funded by international donors.

The total amount of government deposits in the depository corporations decreased by K649.6 million from K3,339.4 million in 2008 to K2,689.8 million in 2009. At the Central Bank, the amount of trust account funds has declined from K1,460 million in December 2008 to K389 million in March 2010 (see Chart 5).

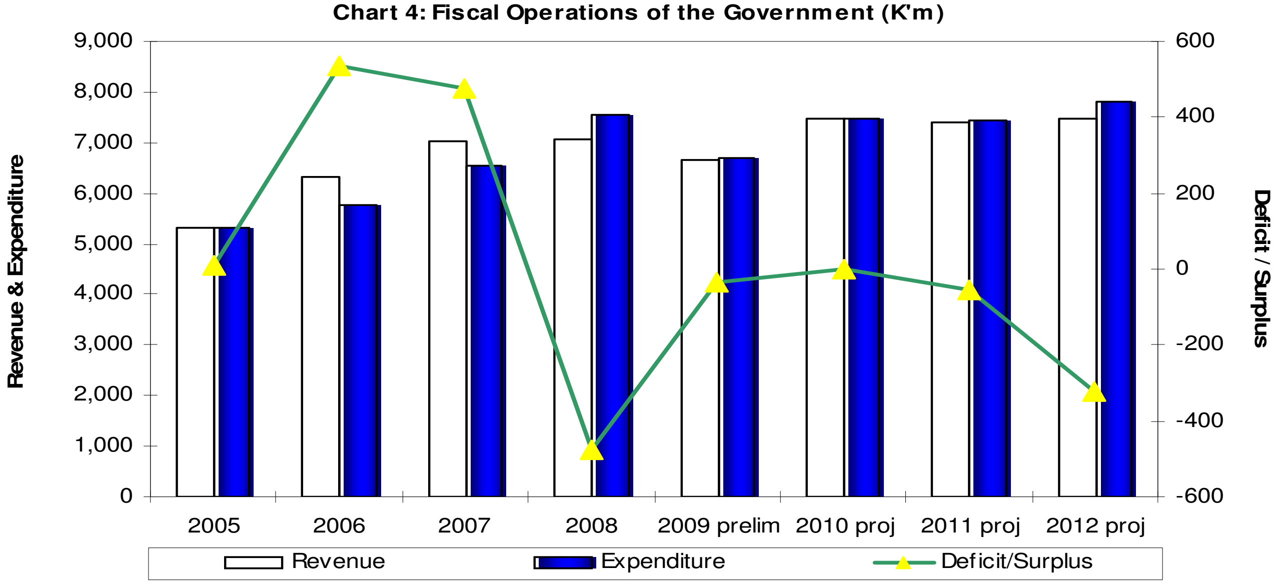
In spite of the understanding between the Bank and the Government to move the trust account funds from commercial banks to the Bank of PNG, most of the funds still remain at the commercial banks, making monetary policy management more difficult and expensive. Additionally, the fast drawdown of these funds—which breached the 4 percent of GDP limit in the Medium Term Fiscal Strategy—is highly inflationary. More stringent measures must be put in place to control spending in the future, especially in the lead up to the National Elections in 2012. Under these circumstances, the Bank reiterates that only closer coordination and cooperation between fiscal and monetary management can help mitigate inflationary pressures. This includes keeping trust accounts at the Central Bank and offshore management of any windfall revenues from mineral taxes before the establishment of a SWF for LNG taxes and dividends.

The Government should allow the Bank of PNG to keep windfall mineral tax income, not budgeted for immediate use, in offshore foreign currency accounts, instead of depositing them in trust accounts. This would reduce the impact of these inflows on domestic liquidity, the exchange rate and inflation.

Total debt to nominal GDP ratio increased to 32.6 percent from 31.3 percent between 2009 and 2008, reflecting the net issuance of domestic securities to finance the deficit. Total domestic debt increased by 7.1 percent to K4,228.3 million, mainly due to increased issuance of Inscribed stocks and Treasury bills. Foreign debt increased by 0.3 percent to K2,827.9 million, mainly reflecting the depreciation of the kina against most of the major currencies combined with lower net loan repayments during the year.

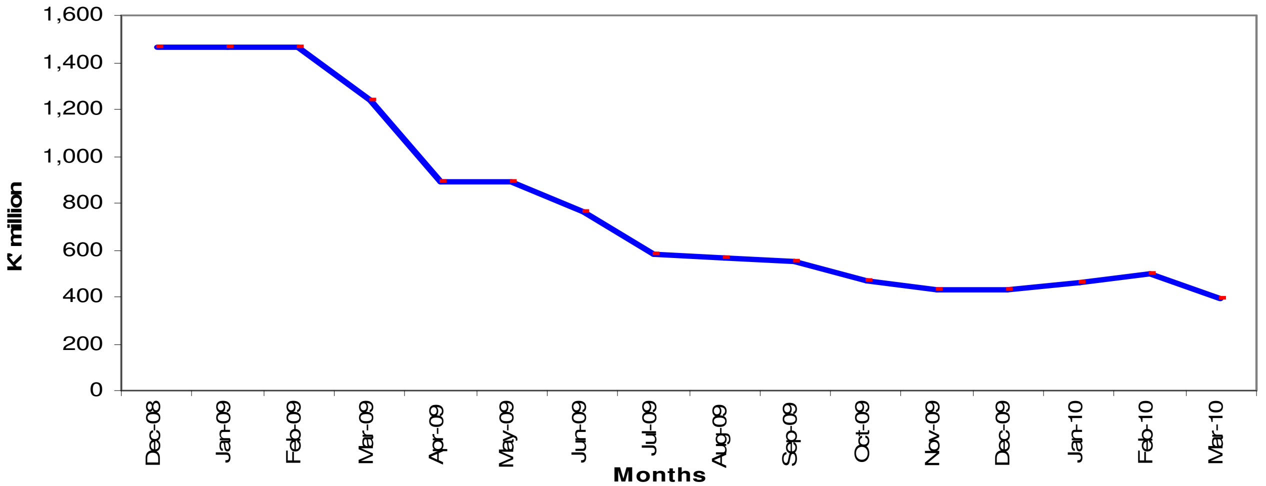
The 2010 National Budget was framed against a background of global economic recovery and strong domestic growth, mainly driven by activities associated with the commencement of the LNG project. The Government projected a balanced budget for 2010,

Chart 4: Fiscal Operations of the Government (K'm)



Source: Dep't of Treasury

Chart 5: Government Trust Account Funds at the Central Bank



Source: Bank of PNG

reflecting higher revenue mainly due to increase in commodity prices and tax revenue from increased business activity associated with the LNG project. The financing of the 2010 Budget reflects a net borrowing of K85.1 million from external sources and net repayment to domestic sources of the same amount. Public debt is projected to be 28.7 percent of GDP in 2010. The Government projects budget deficits for 2011 and 2012.

2.5 Exchange Rate

Between December quarter 2009 and 26th March 2010, the daily average kina exchange rate depreciated against the US dollar by 1.7 percent to US$0.3658 and against the Australian dollar by 1.1 percent to AU$0.4049. The depreciation of the kina against the US dollar reflected lower export receipts, whilst the depreciation against the Australian dollar was attributed to cross currency movements, as the Australian dollar strengthened against most major currencies due to increased demand for its exports coupled with the rise in its interest rates. As a result, the Trade Weighted Index (TWI) depreciated by 2.2 percent during the same period. The Real Effective Exchange Rate (REER) depreciated by 3.9 percent during the December quarter of 2009 (see Chart 6).

2.6 Inflation

Annual headline inflation was 5.7 percent in the December quarter of 2009, coming down from 11.2 percent in the December quarter of 2008. The easing in inflation was mainly due to lower international food and fuel prices and low inflation in PNG's main trading partners. All expenditure groups and urban areas recorded lower inflation rates in 2009.

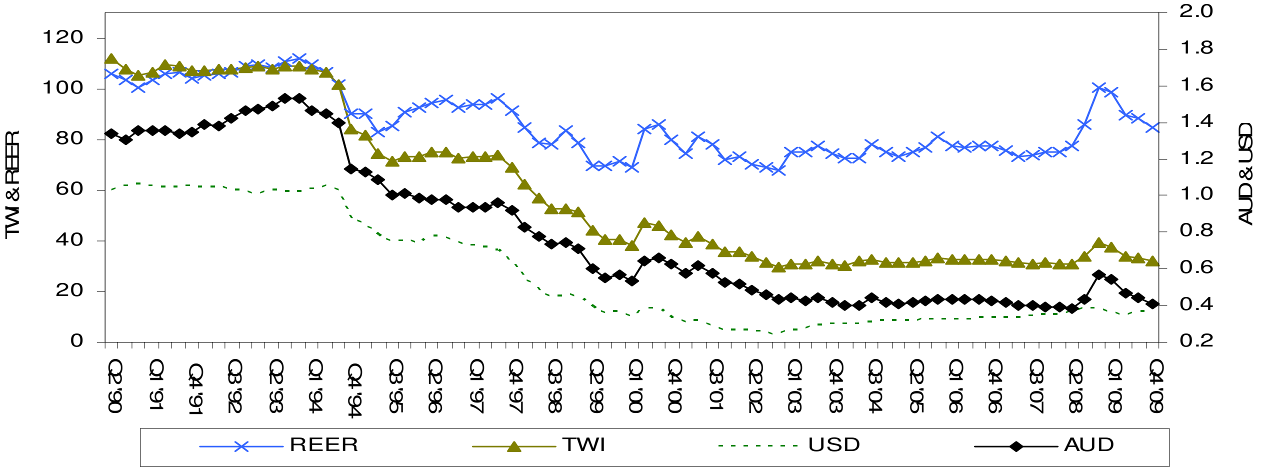
The underlying inflation measures also decreased in the December quarter of 2009. Annual exclusion-based inflation was 5.0 percent in the December quarter of 2009, falling from 11.0 percent in December 2008, while annual trimmed mean inflation declined to 3.8 percent from 11.7 percent over the same period (see Chart 7).

The Bank projects the annual headline inflation for 2010 to be around 8.0 percent, while trimmed-mean inflation and the exclusion-based measure are projected to be around 7.5 and 9.0 percent, respectively. These projections are based on the following factors:

- Domestic demand pressures resulting from the commencement of construction for the LNG project in 2010;
- Implementation of the minimum wage increases in late 2009 and early 2010;
- Slightly higher imported inflation from PNG's major trading partners; and
- Stability in the kina exchange rate for the rest of 2010.

Additional assumptions used for these projections are that the currencies of most of PNG's major trading partners are expected to depreciate slightly against the US dollar, fuel prices are expected to increase

Chart 6: Quarterly Kina exchange rate against AUD, USD, TWI and REER



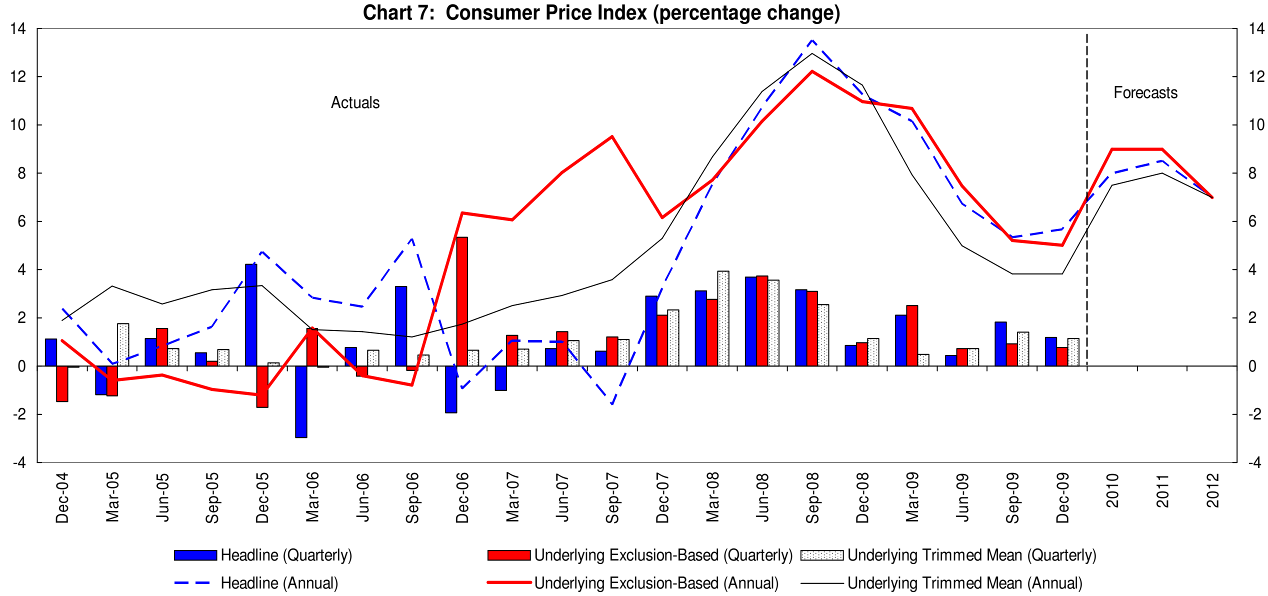
Source: Bank of PNG

gradually.and the Government is expected to run a balanced budget. For the medium term, headline inflation is projected to be around 8.5 percent in 2011 and 7.0 percent in 2012.

There are significant upside risks to these projections. These include the potential for higher than expected domestic demand pressures due to the LNG project, depreciation of the kina due to higher imports, higher inflation expectations reflecting the LNG project, increased government spending especially from trust account funds outside of the budget, and a faster than expected global economic recovery which could push up fuel and commodity prices as well as inflation in the major advanced economies.

The Bank will carefully assess and evaluate the trade-off between higher economic growth and inflation so as not to discourage domestic economic activity and ensure inflation does not spiral out of control.

Chart 7: Consumer Price Index (percentage change)



Source: Bank of PNG & National Statistical Office

2.7 Monetary and Financial Market Developments

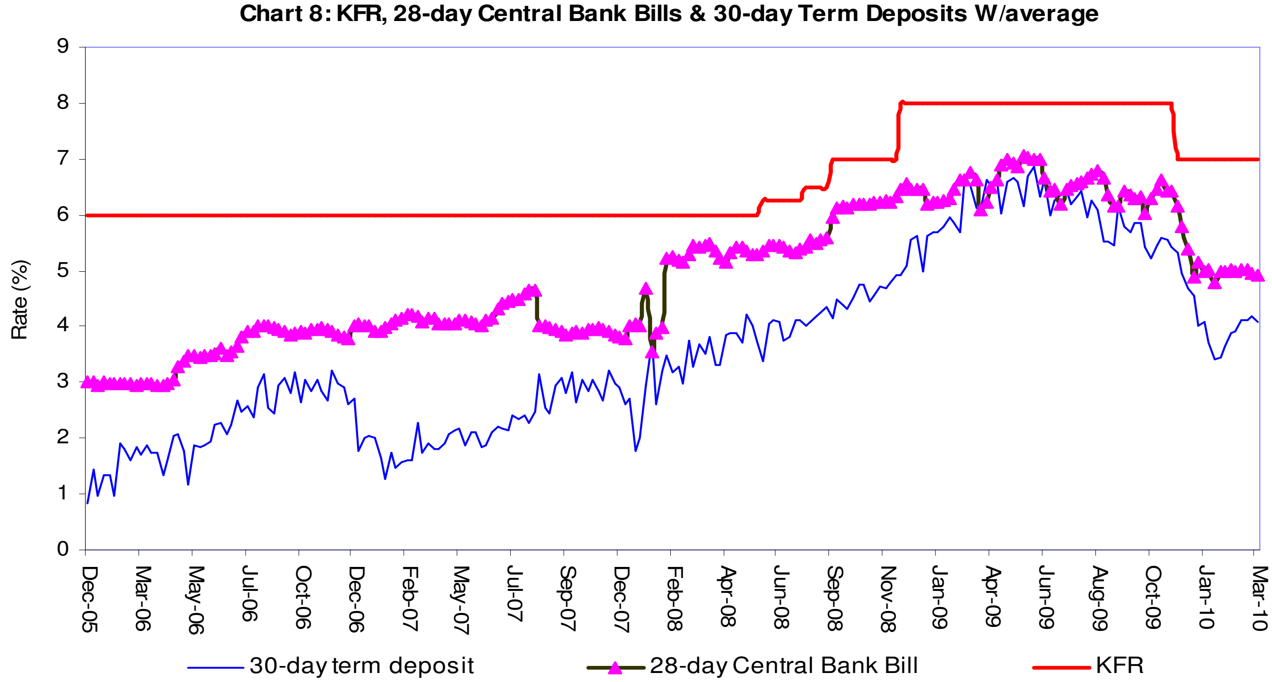
In view of the moderation in headline inflation from a high of 13.5 percent in the September quarter of 2008 to 5.3 percent in the September quarter of 2009, the Bank reduced the KFR from 8.00 percent to 7.00 percent in December 2009, after maintaining it at 8.00 percent since December 2008 (see Chart 8). The trading margin for the Repo was maintained at 100 basis points on both sides of the KFR. Annual headline inflation was 5.7 percent in the December quarter of 2009. Although inflation eased over the year, the Bank was mindful of inflationary pressures arising from various economic developments including strong domestic demand associated with the LNG project, drawdown of trust account funds and foreign inflation given the recovery in the global economy. The KFR was therefore maintained at 7.00 percent over the three months to March 2010.

The Bank issued net new CBBs totalling over K1,567 million in 2009 to diffuse excess liquidity in the banking system in 2009. As a result, CBB rates decreased from over 7.0 percent to 5.0 percent in 2009. Treasury bill rates also decreased from 8.0 percent to over 7.0 percent during the same period. Indicator Lending Rates (ILR) of commercial banks remain unchanged at 10.95 – 11.95 percent as at December 2009, following the increase from 9.95 – 10.95 percent in March 2009. The weighted average interest rate on total deposits increased from 1.62 percent in December 2008 to 2.16 percent in December 2009, while the weighted average lending rate on total loans increased from 8.79 percent to 10.19 percent. As a result, the spread between the weighted average lending and deposit rates remained largely unchanged (see Chart 9).

Total liquidity of the banking system increased by 32.2 percent to K6,557.7 million in 2009, influenced mainly by draw downs in the trust account funds. Lending extended by ODCs to the private sector increased by 15.7 percent in 2009. The growth in private sector credit was broad based across all sectors, with notable increase to the building and construction, hotels and restaurants and real estate and business services sectors, as well as personal loans. Net claims on the Government increased by K690.9 million in 2009, mainly due to the utilisation of trust account funds in ODCs.

The level of broad money supply (M3*) increased by 19.3 percent in 2009 as a result of growth in private sector credit, increases in net foreign assets of ODCs and net credit to Government. The monetary base increased by 11.9 percent during the same period,

Chart 8: KFR, 28-day Central Bank Bills & 30-day Term Deposits W/average

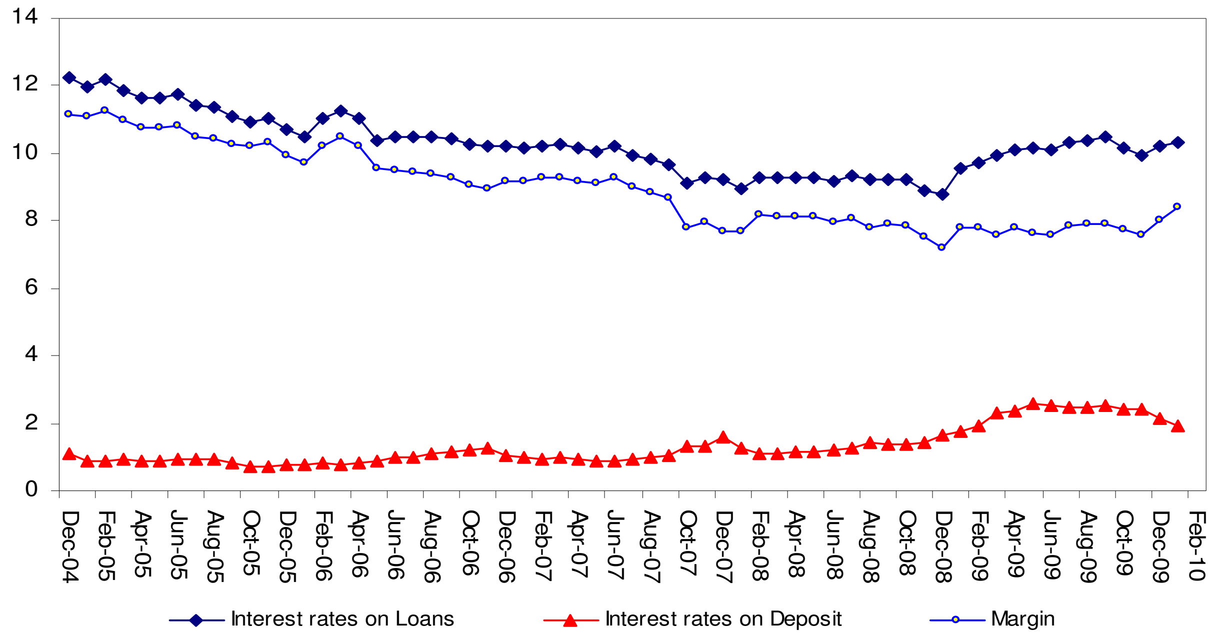


Source: Bank of PNG

mainly reflecting the increases in the Exchange Settlement Accounts of the commercial banks held at the Central Bank and currency outside depository corporations.

In 2010, broad money supply is expected to grow by 21.3 percent, influenced mainly by higher growth in credit to the private sector to cater for the projected increase in domestic economic activity. Monetary base is expected to grow by 15.3 percent and private sector credit by 23.0 percent in 2010. While the Bank is mindful of the inflationary impact of growth in private sector credit associated with the LNG project, the projected growth in monetary aggregates is considered sufficient to support economic growth (see Appendix-Table 1).

Chart 9: Monthly Weighted Average Lending & Deposit rates and Margins (percent)



Source: Bank of PNG

Box 1: Effects on the PNG economy of a major LNG project[1]

1. Introduction

Work has commenced on a LNG project in PNG led by Exxon Mobil, generating a lot of hype and expectations about the benefits of the project. The project is important for the economy but a study[1] warned that the benefits can be exaggerated. It is important to identify and distinguish the benefits that really matters for the domestic economy. In the construction phase, what matters for the domestic economy are the expenditures on PNG factors of production and not the bulk of around K30 billion for setup expenditure over the first three years that will be spent on imported material and short-term foreign labour (paid for by non-residents). Similarly, in the production phase, exports from PNG will have an enormous effect on Gross Domestic Product (GDP) but from the point of view of the PNG economy, this is largely irrelevant as the LNG exports are owned by foreigners. What is of relevant for PNG are the taxes, royalties and dividends paid to the Government and how that money is managed and spent for the benefit of all Papua New Guineans. That is, the welfare of a country depends on its Gross National Product (GNP - a measure of its income), and not the GDP (a measure of output produced within its borders).

2. Macroeconomic management of the LNG generated Government revenue: three scenarios

The means through which to spread the benefits of the LNG project throughout PNG through time is the Government's fiscal policy. The Government can use the LNG revenues to allow real public and private consumption to move steadily above their baseline forecast paths (paths without the project) while at the same time save some of the funds for future use under a ***conservative policy***. A quicker increase in standards of living in PNG can be achieved under an ***aggressive policy***, where more than what is received from the project is spent, thus incurring debt. Or under a ***passive policy***, the LNG revenues are spent on public and private consumption as they accrue and neither incurs debt nor make savings.

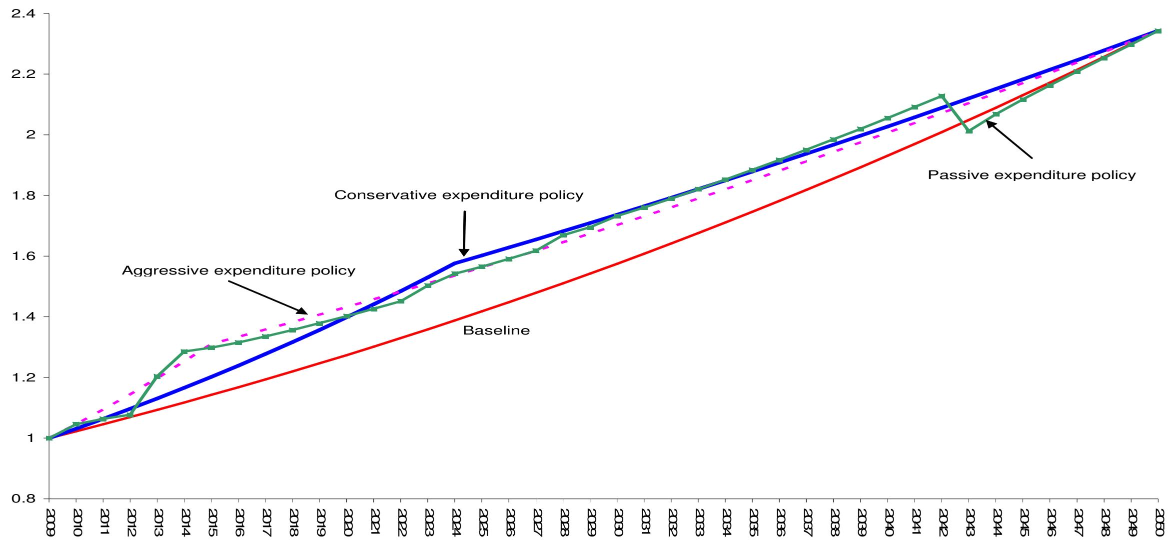
3. Economic effects of the LNG project

3.1 Consumption

Figure 1 shows the results of real public and private consumption under the three policies. Under the conservative policy, the consumption deviation peaks in 2024. This gives a slow build up in PNG's standard of living, with the LNG revenue being allowed to increase the rate of growth in consumption by a little less than 1 percentage point a year (14 percent deviation after 15 years). Under the aggressive policy, the consumption build-up is much more rapid. The consumption deviation peaks in 2015 (can be interpreted as a few years later given the late start of the project) at about 14.5 percent, implying that the LNG revenue is allowed to increase the rate of growth of consumption between 2009 and 2015 by about 2.4 percentage points (14.5 percent deviation after 6 years). The passive policy gives a similar increase in consumption for the period 2009 to 2015 to that in the aggressive policy.

[1] A study on the impact of the project on the PNG economy, using computable general equilibrium modelling analysis, was carried out jointly by the Bank of PNG and the Centre of Policy Studies, Monash University, early this year. A detailed report of the study will be released by the Governor of the Bank later this year.

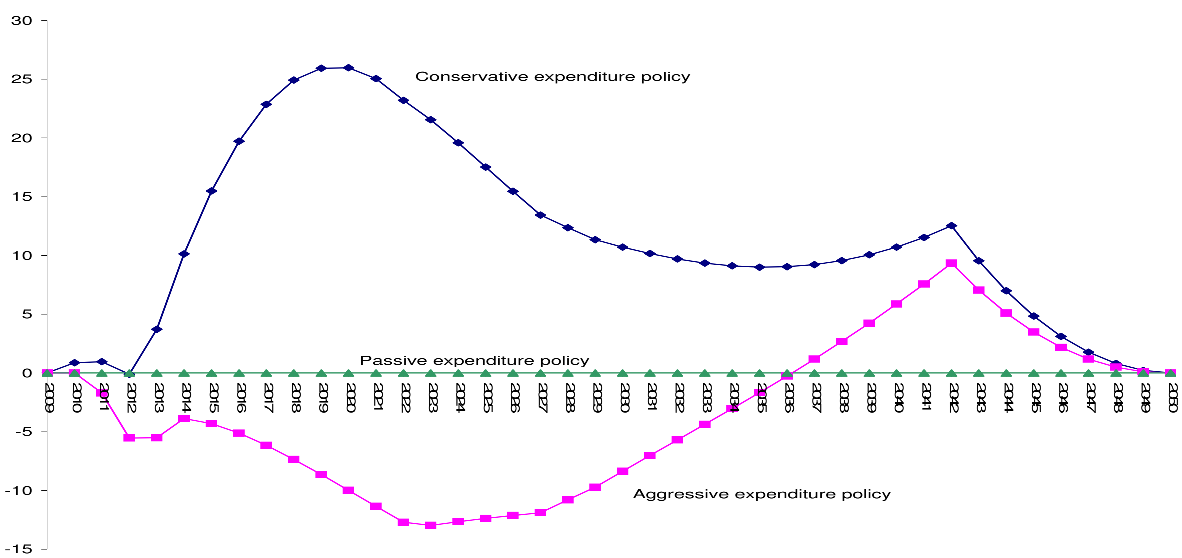
Figure 1. Index of private and public consumption per capita: Baseline and paths with alternative Government expenditure policies



3.2 Assets and Debt

Under the conservative policy, PNG accumulates assets during the early years of the LNG project. During these years, PNG makes considerable savings: the boost in consumption does not absorb all of the LNG-related revenue. As seen in figure 2, the Government uses savings of LNG related revenue to accumulate assets, e.g., US bonds, worth about 25 percent of baseline GNP in 2020. These assets are gradually run down and reach zero by 2050. By contrast, under the aggressive policy, PNG accumulates debt during the early years of the LNG project. The rapid increase in consumption under this policy more than absorbs LNG-related revenue. Debt peaks at about 14 percent of GNP in 2023. Under the passive scenario, PNG accumulates neither assets nor debt.

Figure 2. Assets accumulated by PNG government from LNG project: percent of baseline GNP



3.3 Trade and Real Exchange Rate

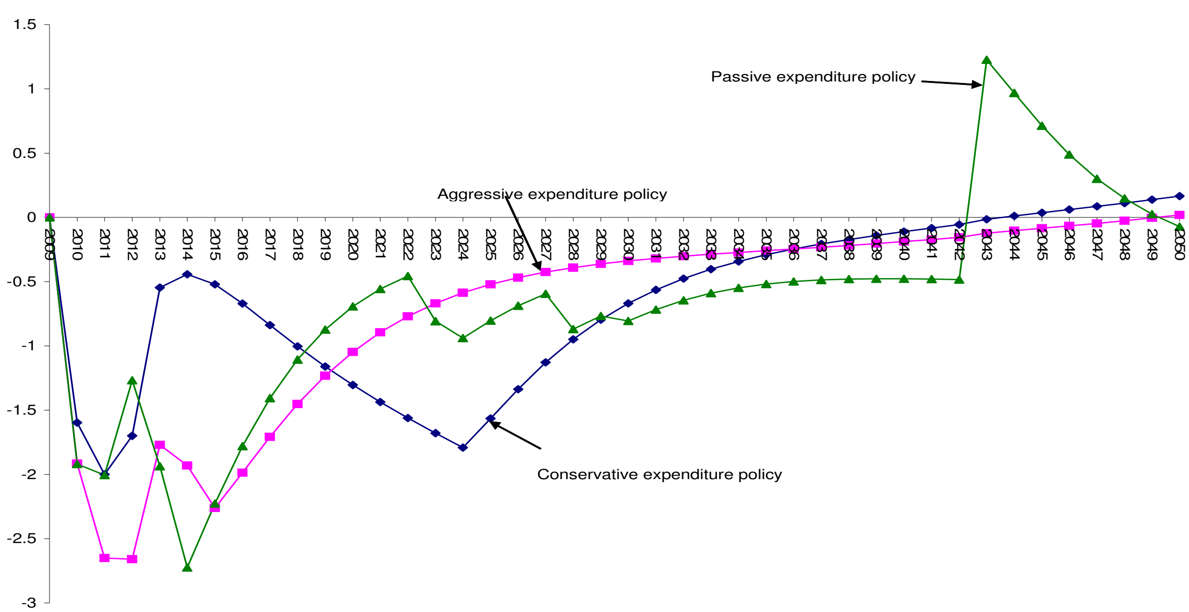
The study shows that the LNG project under all three scenarios has a negative effect on the traditional non-LNG exports and a positive effect on non-LNG imports for the entire period up to 2050. This was to be expected. The project provides PNG with extra foreign currency income, allowing it to increase its consumption by importing more and exporting less. The reduction in exports and increase in imports are realised via changes in the real exchange rate. The study found that with the project the real exchange rate appreciates in all three scenarios for almost all years out to 2050. The only exceptions are the years beyond 2043 when the project ends. From the point of view of current exchange rate policy, the important years are at the beginning of the project where PNG cannot avoid significant real appreciation during the construction phase. During these years, under any of the policy scenarios, the real exchange rate is forced up by the project's demand for labour and for domestic material inputs.

3.4 Sectoral Implications

Only some sectors will benefit from the LNG project, especially in the short run. These are the building and construction, transportation, manufacturing, services, and domestically oriented agriculture sectors. The short-run effect on construction, manufacturing and transportation are particularly pronounced, reflecting inputs from these sectors to the construction phase of the project. While the manufacturing and transportation sectors gain in the short run from the provision of inputs during the construction phase, in the operational phase, both these sectors show predominantly negative output deviations. Manufacturing faces considerable competition from imports and is harmed by LNG-induced appreciation of the real exchange rate. The negative effects on transport are associated with the overall contraction of traditional exports. These exports are heavy users of internal transport services (facilitating flows from points of production to ports of exit).

The sector that will particularly be affected by the LNG project is the export agriculture sector (an aggregation of coffee, cocoa, palm oil, copra and forestry). This sector is harmed by real appreciation, the *Dutch Disease*. The downward adjustment in output is noticeably more rapid under the passive and aggressive scenarios than under the conservative scenario.

Figure 3. Output of the Export agriculture sector (percentage deviation from baseline)



4. Recurring Theme

A recurring theme in the study is that economic adjustment problems associated with the LNG project will be easier to handle if the conservative pattern of consumption increases is adopted. Under the conservative scenario there will be less strain on monetary policy than under the other two scenarios. In addition, adjustment in the industrial composition of economic activity in PNG will be more gradual, in other words, the *Dutch Disease* will be less under the conservative policy scenario.

While the project is highly significant for the PNG economy, care must be taken not to exaggerate its effects and create false expectations. In popular discussions, emphasis is often placed on GDP effects. This study asserts that GDP will increase by about 50 percent. But as emphasised earlier, the increase in GDP is not relevant. Attention should be concentrated on the effects on GNP and the consequent potential for increases in public and private consumption. The increase in public and private consumption, and the overall standard of living can be greatly enhanced by the appropriate expenditures by the Government on infrastructure, including transport, health and education. The LNG project on its own will not do that.

Appendix

Table 1: Monetary and Credit Aggregates (annual % changes)

INDICATOR	2006 (actual)	2007 (actual)	2008 (actual)	Sep 2009 MPS	2009 (actual)	2010 (proj)	2011 (proj)	2012 (proj)
Broad Money Supply	39.0	27.3	11.2	7.4	19.3	21.3	16.5	9.9
Monetary Base	21.7	61.8	-12.0	4.1	11.9	15.3	16.6	16.9
Claims on the Private Sector	36.8	30.8	39.4	15.0	17.3	23.0	18.0	15.0
Net Claims on Gov't	-11.6	-83.5	-174.3	122.1	-568.8	99.8	5.9	21.0
Net Foreign Assets	58.2	51.7	-9.4	13.4	20.0	-2.5	-6.6	-2.0

Source: Bank of PNG

Table 2: Summary of Other Macroeconomic Indicators

INDICATOR	2006 (actual)	2007 (actual)	2008 (actual)	Sep 2009 MPS	2009 (actual)	2010 (proj)	2011 (proj)	2012 (proj)
CONSUMER PRICE INDEX (annual % changes)								
Headline	-0.9	3.2	11.2	6.5	5.7	8.0	8.5	7.0
Trimmed-mean	1.5	5.5	11.7	4.0	3.8	7.5	8.0	7.0
Exclusion- based	6.0	5.7	11.0	7.5	5.0	9.0	9.0	7.0
BALANCE OF PAYMENTS (kina millions)								
Current account	1,354	550	2,145	-1,269	-1,374	-10,872	-12,079	-11,708
Financial account	485	888	-2,861	1,808	2,989	10,021	11,376	11,341
Overall balance	1,958	1,592	-598	538	1,724	-759	-605	-272
Gross Int. Reserves	4,326	5,919	5,322	6,305	7,046	6,202	5,598	5,326
IMPORT COVER (months)								
Total	8.5	9.1	7.9	7.8	10.1	4.4	3.6	3.5
Non-mineral	11.5	13.0	11.4	12.4	15.3	11.2	9.3	8.2
EXPORT PRICE								
Crude oil (US$/barrel)*	67.3	73.0	106.7	52.1	58.7	60.0	70.0	70.4
Gold (US$/ounce)	554.7	671.0	850.9	865.7	959.2	999.4	995.1	994.6
Copper (US$/pound)	296.6	320.0	327.8	168.0	217.6	275.0	275.0	275.0
FISCAL OPERATIONS OF THE GOVERNMENT* **								
Surplus/Deficit (K'm)	535.8	476.2	-478.5	-249.6	-36.3	0.0	-54	-322.8
% of GDP	3.1	2.5	2.2	1.2	0.2	0.0	0.2	1.2
REAL GROSS DOMESTIC PRODUCT (annual % growth) **								
Total GDP	2.3	7.2	6.7	6.2	4.5	8.5	6.2	2.9
Non-mineral GDP	3.9	8.1	7.6	5.6	5.2	8.1	5.4	3.5

* Prices take into account, company hedging and differ from market prices.
** Preliminary fiscal operations for 2009; 2010 - 2012 projections are from the 2010 National Budget
*** GDP figures are from the 2010 National Budget
Source: Bank of PNG, NSO and Department of Treasury

FOR THE RECORD

Revisions to Monetary and Financial Statistics tables in the December 2009 quarterly economic bulletin

Revised treatment of SDR Allocations in Monetary Statistics

In August 2009 there was a revision in the treatment of the IMF Special Drawing Rights (SDR) Allocations in the compilation of Monetary Statistics. Hence, the increase in Central Bank 'liabilities to nonresidents' was due to the reclassification of the SDR Allocations as 'liabilities to nonresidents' previously recorded as a component of 'shares and other equity'. This alignment is consistent with the methodology in the System of National Accounts (SNA 2008) and the Balance of Payments Manual, 6th edition (BPM 6). The IMF member countries pay interest on the SDR allocations and as such are considered as debt holdings and not equity. Historical data have been revised accordingly.

Increase in SDR Allocations

Also in August 2009, the IMF agreed to increase SDR Allocations and Holdings to all member countries after the 2008 global financial crisis and economic slowdown. Papua New Guinea was allocated its share of over US$150 million. This is recorded in the respective central bank (Bank of PNG) sectoral balance sheet and survey contained in the monetary statistics tables.

Corrections to data sources.

The changes also reflect corrections done to previous data sources as revisions are done and data were updated. This also accounts for errors done when data was recorded. Hence, historical data have been revised accordingly.

FOR THE RECORD

Reporting of Detail Current Account Transactions

In spite of data availability, the Bank did not publish the details of import transactions, classified under standard international trade classification (SITC) and the details of services, income and current transfer's transactions, classified in various Balance of Payment's Manual in the Quarterly Economic Bulletin (QEB). The data were published in a summarized form. Since the disaggregate transactions data on merchandise imports, services, income and transfers accounts are captured by Balance of Payments Reporting System, but not published, expert from Pacific Financial and Technical Assistance Centre (PFTAC) recommended that the detail data can be published for serious research and analysis purposes. As a result, detail data from 2005-2009 annual and 2008-2009 quarterly data on imports, services, income and transfers accounts were published in December Quarter Issue of the QEB respectively. The incorporated changes are in line with the fifth edition of the International Monetary Fund's Balance of Payments Manual (BPM5). *(Refer to the table that follows on page 28)*

FOR THE RECORD

The following table depicts various changes to page numbers, titles and contents of the BOP tables due to the inclusion of the imports, services, income and current transfers account tables in the QEB.

OLD PAGE	OLD TABLE	OLD TITLE	NEW PAGE	NEW TABLE	NEW TITLE	COMMENTS
S39	8.1	Balance of Payments	S39	8.1	Balance of Payments	No Change
S40	8.2	Net Foreign Assets	S40	8.2 8.3	Exports by Commodity Group (Values) Agriculture and Other Exports (Values)	Changes in Page, Table # but NOT content Changes in Page, Table # but NOT content
S41	8.3	Exchange Rates	S41	8.4 8.5	Agriculture Export by Qty Non Agriculture Export by Qty	Changes in Page, Table # but NOT content Changes in Page, Table # but NOT content
S42	8.4 8.5	Export by Commodity Group (Values) Agriculture Exports (Values)	S42	8.6 8.7	Imports Service Account	New New
S43	8.6 8.7	Agriculture Exports by Quantity Non-Agriculture Exports by Qty	S43	8.8 8.9	Income Account Current Transfers Account	New New
S44	8.8	Export Prices, Non-Mineral Commodity	S44	8.10	Net Foreign Assets	Changes in Page, Table # but NOT content
S45	8.9	International Commodity Prices	S45	8.11	Exchange Rates	Changes in Page, Table # but NOT content
S46	8.10	Economist Price Indices	S46	8.12	Export Prices, Non-Mineral Commodity	Changes in Page, Table # but NOT content
S47	8.11	Export Price Indices	S47	8.13	International Commodity Prices	Changes in Page, Table # but NOT content
S48	8.12	Export Volume Indices	S48	8.14	Economist Price Indices	Changes in Page, Table # but NOT content
S49	8.13 8.14	Origin of Imports Destination of Exports	S49	8.15	Export Price Indices	Changes in Page, Table # but NOT content
S50	9.1	Prices and Wages	S50	8.16	Export Volume Indices	Changes in Page, Table # but NOT content
S51	9.2 9.3	CPI – Classified by Expenditure Group CPI – Classified by Urban Areas	S51	8.17 8.18	Origin of Imports Destination of Exports	Changes in Page, Table # but NOT content Changes in Page, Table # but NOT content
S52	9.4	Employment Classified by Region	S52	9.1	Prices and Wages	Changes in Page, but NOT Table # and content
S53	9.5	Employment Classified by Industry	S53	9.2 9.3	Consumer Price Index – Classified by Expenditure Group Consumer Price Index – Classified by Urban Areas	Changes in Page, but NOT Table # and content Changes in Page, but NOT Table # and content
S54	9.6 9.7 9.8	Expenditure on GDP – Current Prices Expenditure on GDP – Constant Prices Income Component of GDP – Current Prices	S54	9.4	Employment Classified by Region	Changes in Page, but NOT Table # and content
			S55	9.5	Employment Classified by Industry	Changes in Page, but NOT Table # and content
			S56	9.6 9.7 9.8	Expenditure on GDP – Current Prices Expenditure on GDP – Constant Prices Income Components of GDP – Current Prices	Changes in Page, but NOT Table # and content Changes in Page, but NOT Table # and content Changes in Page, but NOT Table # and content

FOR THE RECORD

MONTHLY KINA FACILITY RATE ANNOUNCEMENTS

The Central Bank introduced the Kina Facility Rate (KFR) in February 2001 as the official rate to indicate its stance of monetary policy. The KFR is a monthly rate and any changes to it should translate to changes in market interest rates. Changes to the KFR is based on assessment of economic fundamentals consistent with the overall objective of monetary policy of price stability in the economy. From January 2008, the KFR announcements by the Bank were;

2008	07 January	Maintained at 6.00 %
	04 February	Maintained at 6.00 %
	03 March	Maintained at 6.00 %
	07 April	Maintained at 6.00 %
	05 May	Maintained at 6.00 %
	02 June	Maintained at 6.00 %
	10 June	Raised to 6.25 %
	07 July	Maintained at 6.25 %
	04 August	Raised to 6.50 %
	01 September	Raised to 7.00 %
	06 October	Maintained at 7.00 %
	03 November	Maintained at 7.00 %
	01 December	Raised to 8.00 %
2009	05 January	Maintained at 8.00 %
	02 February	Maintained at 8.00 %
	02 March	Maintained at 8.00 %
	06 April	Maintained at 8.00 %
	04 May	Maintained at 8.00 %
	01 June	Maintained at 8.00 %
	06 July	Maintained at 8.00 %
	03 August	Maintained at 8.00 %
	07 September	Maintained at 8.00 %
	05 October	Maintained at 8.00 %
	02 November	Maintained at 8.00 %
	07 December	Reduced to 7.00 %
2010	04 January	Maintained at 7.00 %
	01 February	Maintained at 7.00 %
	01 March	Maintained at 7.00 %
	06 April	Maintained at 7.00 %

For details of the KFR, see Table 6.3 (S34) of the QEB.
KFR announcements prior to January 2007 are reported in various bulletins starting with the March 2001 QEB.

GLOSSARY OF TERMS AND ACRONYMS

Balance of Payments
A statistical statement that systematically summarises a country's economic transactions with the rest of the world, over a specific time period. It comprises the Current and Capital and Financial Accounts.

Broad Money Supply (M3*)
Total volume of money comprising narrow money (M1*) and quasi money in the economy at a point in time. See 'narrow' and 'quasi' money.

Cash Reserve Requirement (CRR)
A requirement imposed on commercial banks to hold cash as a percentage of total deposits and other prescribed liabilities at all times.

Capital Account
Records all transactions that involves the receipts or transfers of capital and acquisitions/disposal of non-produced, non-financial assets such as purchase of production facilities, i.e. plants and machinery, etc.

Central Bank Bill (CBB) [1]
A monetary policy instrument of the Bank of PNG used to manage liquidity in the banking system by either injecting or defusing it in order to achieve a desired level of interest rate.

Current Transfers Account
Records all foreign transactions that are not transfers of capital and cannot be repaid. These includes donations, gifts and grants, superannuation funds and licensing fees.

Exchange Settlement Account (ESA)
Accounts of the commercial banks with the Bank of PNG for settlement transactions with each other.

Exclusion-based CPI measure
An underlying inflation measure which involves zero weighting of volatile sub-groups or items such as fruit & vegetables, betelnut and prices that are largely determined by non-market (seasonal) forces, as well as alcoholic drinks, cigarettes & tobacco, etc. See 'Underlying CPI'.

Financial Account
Records all transactions associated with changes of ownership of foreign financial assets such as holdings of monetary gold, special drawing rights (SDR), claims on non-residents and foreign liabilities.

Headline Consumer Price Index (CPI)
A measure of inflation as calculated and published quarterly by the National Statistical Office (NSO), which measures the total price movements in goods and services in the basket.

[1] See 'For the Record' on page 34 in the 2004 September QEB.

Income Account	Records transactions such as compensation of employees, which cover wages, salaries, and other benefits in cash and kind, dividends and interest earned on investments between PNG and the other countries.
Inscribed Stock (bond)	A Government debt instrument sold to the public for a maturity term of one year or longer for Budget financing.
Kina Facility Rate (KFR)	Official benchmark rate used by the Bank of PNG to signal its monetary policy stance. The KFR is announced monthly by the Governor and published in the newspapers and on the Bank's website.
Liquid Assets	Assets of the commercial banks, which are in near liquid form, comprising cash, ESA balances, CBBs, Treasury bills and Inscribed stocks less than 3 years to maturity.
Minimum Liquid Asset Ratio (MLAR)	A prudential requirement imposed by the Bank of PNG on commercial banks to hold liquid assets as a percentage of total deposits and other prescribed liabilities at all times.
Monetary Base (or Reserve Money)	Comprised of currency held by the public and liquid assets of the commercial banks, including deposits held with the Bank of PNG under the Repurchase Agreement Facility (RAF) or Repos.
Narrow Money	A component of total money supply that is considered liquid or can be converted easily to cash on demand, and comprises of currency in circulation (held outside the banking system) and demand deposits.
Open Market Operations (OMO)	Operations of liquidity management conducted by the Bank of PNG with commercial banks and other financial intermediaries involving Government securities, CBB, Repos and foreign exchange trading to influence short-term interest rates.
Over the year CPI	Percentage change in the CPI of a quarter compared to the corresponding quarter of the previous year (Also called 'annual' CPI).
Portfolio Investment	Investments, mainly in equity and debt securities such as bonds and notes, money market debt instruments and financial derivatives, as well as long-term debt, equity and securities.
Quasi Money	A component of total money supply that is not easily convertible to cash on demand and comprises of savings and term deposits.

Repurchase Agreement Facility (RAF)

A money market instrument used by Bank of PNG to lend to or borrow from the commercial banks, for liquidity management, and is unwound on maturity. The terms range from overnight to 14 days and can be collateralised, for instance, using Treasury bills.

Tap Facility

A facility conducted by the Bank of PNG for sale of Treasury bills and Inscribed stocks to the public.

Temporary Advance Facility

A statutory mechanism stipulated under Section 54 of the Central Banking Act 2000, that provides the National Government with access to short-term financing to meet mismatches in revenue.

Trade Account

Records all economic transactions associated with merchandise exports and imports of physical goods.

Trade Weighted Index [2]

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

Treasury Bill

Government security or debt instrument sold at a discount value, but redeemed at face value on maturity for purposes of Budget financing. In PNG, Treasury bills are issued for 28, 61, 91, 182 and 364 day maturities.

Trimmed-mean CPI measure

A fixed proportion of prices at each end of the distribution of price changes are zero weighted and the mean of the remaining price changes recomputed. See also 'Underlying CPI'.

Underlying CPI (exclusion-based and trimmed-mean CPI measures)

A measure of inflation that excludes short-term volatile movements in prices, such as seasonal factors, Government policy decisions and price controlled items.

[2] See 'For the Record' p.24 in the 2005 September QEB.

REFERENCE "FOR THE RECORD"

Some issues of the Quarterly Economic Bulletin (QEB) have 'For the Record' as additional information relating to changes introduced to various statistical tables. The following 'For the Record' have appeared in the QEB since March 2000.

Issue		For the Record
Mar 2000	-	Removal of QEB Table 3.8
Jun 2000	-	Inflation - Consumer Price Index (CPI)
	-	Changes to Table 7.2: Other Domestic Interest Rates
Mar 2001	-	Introduction of Monthly Kina Facility Rate
Jun 2001	-	Changes to Table 10.2: Prices and Wages
Dec 2001	-	Measures of Inflation
	-	Changes to Table 7.1: Commercial Banks Interest Rates
	-	Changes to Table 7.2: Other Domestic Interest Rates
	-	Changes to Table 10.2 Prices and Wages
Jun 2002	-	Exclusion of QEB Tables 4.2: Rural Development Bank of PNG and Table 10.1: Indicators of Economic Activity
Mar 2003	-	Changes to Balance of Payments Tables
	-	Bank of PNG Employment Index: Changes to Table 10.4 and Table 10.5
	-	Regional and Industrial Classifications and Abbreviations
Jun 2003	-	Changes to Open Market Operations Instruments
	-	Directions of Merchandise Trade
Sep 2003	-	Changes to the Treasury Bills Auction Allocation Process
Dec 2003	-	Further Change to the Treasury Bills Auction Allocation Process
	-	Bank of PNG Employment Survey
Sep 2004	-	Introduction of Central Bank Bill (CBB)
Mar 2005	-	Changes to Table 9.5 to include Exports from Napanapa Oil Refinery
	-	Changes to Tables 1.2 and 1.3 'Other Items (Net)'
June 2005	-	Changes to Tables 8.2 and 8.5 'External Public Debt'
Sep 2005	-	Trade Weighted Exchange Rate Index
	-	Employment Index - Changes to Tables 10.4 and 10.5
	-	Central Bank Bill (CBB) Auction - Changes to Tables 3.8 and 7.2
Mar 2006	-	Updated Weights for the Trade Weighted Index (TWI)
June 2006	-	Expansion of Monetary and Financial Data Coverage
	-	Upgrade of PNG's Private Debt and Equity Recording System
Dec 2006	-	Changes to Table 8.1 - Capital Transfers
Jun 2007	-	Revisions to the March Quarter 2007 and December Quarter 2006 Consumer Price Index
Jun 2007	-	Debt Ratios
Sep 2007	-	Revisions to the Consumer Price Indices in June Quarter 2007 back to September Quarter 2005.
Mar 2008	-	Updated Weights for the Trade Weighted Index (TWI)
Mar 2009	-	Changed Monetary Policy Statement release month from January to March
Mar 2009	-	Updated Weights for the Trade Weighted Index (TWI)
Dec 2009	-	New Tables; 8.7, 8.8, 8.9 and 8.10 were included in the December Quarterly Economic Bulletin, resulting in subsequent renumbering of all other tables that follow.
Dec 2009	-	Revisions to Monetary and Financial Statistics tables in the December 2009 Quarterly Economic Bulletin

REFERENCE

Each issue of the Quarterly Economic Bulletin contains a review of economic conditions for the past quarter and a comprehensive set of updated statistical tables. Articles of special interest to current economic policy are also prepared by Bank staff for inclusion in the Bulletin. The following articles have appeared in the Quarterly Economic Bulletin since December 1998.

Issue	Title
Dec 1998	Monetary Policy for 1999
Mar 1999	Papua New Guinea's Total External Exposure
Sep 1999	The 1999 Supplementary Budget
Dec 1999	The 2000 National Budget
Jun 2000	Semi-annual Monetary Policy Statement, July 2000
Dec 2000	The 2001 National Budget
Dec 2000	Semi-annual Monetary Policy Statement, January 2001
Jun 2001	Semi-annual Monetary Policy Statement, July 2001
Dec 2001	Semi-annual Monetary Policy Statement, January 2002
Dec 2001	The 2002 National Budget
Jun 2002	Semi-annual Monetary Policy Statement, July 2002
Sep 2002	The 2002 Supplementary Budget
Dec 2002	Semi-annual Monetary Policy Statement, January 2003
Dec 2002	The 2003 National Budget
Mar 2003	Special article: Export Price Index, Volume Index and Weights Calculations Methodology
Jun 2003	Semi-annual Monetary Policy Statement, July 2003
Dec 2003	The 2004 National Budget
Dec 2003	Semi-annual Monetary Policy Statement, January 2004
Sep 2004	Semi-annual Monetary Policy Statement, July 2004
Dec 2004	Semi-annual Monetary Policy Statement, January 2005
Dec 2004	The 2005 National Budget
Jun 2005	Papua New Guinea's Total External Exposure
Jun 2005	Semi-annual Monetary Policy Statement, July 2005
Dec 2005	The 2006 National Budget
Dec 2005	Semi-annual Monetary Policy Statement, January 2006
Jun 2006	Papua New Guinea's Total External Exposure
Jun 2006	Semi-annual Monetary Policy Statement, July 2006
Dec 2006	The 2007 National Budget
Dec 2006	Semi-annual Monetary Policy Statement, January 2007
Jun 2007	Papua New Guinea's Total External Exposure
Jun 2007	Semi-annual Monetary Policy Statement, July 2007
Jun 2007	Supplement to the July 2007 Monetary Policy Statement
Dec 2007	The 2008 National Budget
Dec 2007	Semi-annual Monetary Policy Statement, January 2008
Jun 2008	Papua New Guinea’s Total External Exposure
Jun 2008	Semi-annual Monetary Policy Statement, July 2008
Dec 2008	The 2009 National Budget Document
Dec 2008	Monetary Policy Statement, January 2009 Update
Mar 2009	Monetary Policy Statement, March 2009
Jun 2009	Papua New Guinea’s Total External Exposure
Sep 2009	Monetary Policy Statement, September 2009
Dec 2009	The 2010 National Budget Document
Mar 2010	Monetary Policy Statement, March 2010

STATISTICAL SECTION

Sources

Statistics for the commercial banks have been derived from returns submitted to the Bank. Statistics on Savings and Loan Societies and Papua New Guinea Government securities are derived from sources within the Bank.

Government financial statistics are supplied by the Department of Finance and Treasury.

Information on prices of Papua New Guinea exports are gathered from marketing boards or export producers; world indicator prices are reproduced from the Public Ledger published in London. Tea prices are from the Tea Market Report, London. The general indices of commodity prices are constructed from data published in The Economist, London.

Most other statistics are published initially by the National Statistical Office.

Symbols used

n.a	not available
..	figure less than half the digit shown
-	nil
e	estimate
f	forecast
p	provisional
r	revised
n.i.e	not included elsewhere