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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 economic activity picked up in 2010, compared to 2009. As the world economy continued to slowly recover from the recession, global demand for raw materials increased, which led to higher international prices. Improved Government's fiscal position and increased spending, combined with continued lending by commercial banks and increased business activity in the private sector, as reflected by higher business revenue, and increased employment level are indicative of this growth. The increase in activity was largely due to the commencement of construction of the Liquefied Natural Gas (LNG) project. In the December quarter of 2010, the Trade Weighted Index (TWI) exchange rate depreciated as a result of a strengthening Australian dollar. The balance of payments recorded an overall surplus as a result of increased investment inflows and the Government recorded a budget surplus. With increased economic activity, inflation increased to 7.2 percent in 2010 compared to 5.7 percent in 2009. Due to inflationary pressures, the Bank kept the monthly Kina Facility Rate (KFR) at 7.0 percent throughout 2010.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the private sector increased by 8.8 percent in the September quarter of 2010, after increasing by 2.3 percent in the June quarter. Excluding the mineral sector, sales increased by 5.0 percent in the September quarter, compared to 16.1 percent in the previous quarter. By sector, there were increases in all sectors, except the building and construction, and financial/business and other services sectors. By region, sales picked up in all regions, except the Highlands region. Over the twelve months to September 2010, total sales increased by 20.4 percent.

The Bank's Employment Index shows that the level of employment in the formal private sector increased by 2.1 percent in the December quarter of 2010, following an increase of 0.4 percent in the previous quarter. Excluding the mineral sector, the level of employment increased by 1.2 percent in the December quarter of 2010, after a decline of 0.8 percent in the previous quarter. By sector, employment increased in the mineral, financial/business and other services, manufacturing, building and construction, wholesale and retail sectors while the agriculture/ forestry/fisheries and transportation sectors recorded decreases. By region, employment increased in the NCD, Southern, Morobe, Momase, and Islands regions, while it decreased in the Highlands region. In 2010, the total level of employment increased by 1.9 percent. Excluding the mineral sector, employment increased by 1.2 percent for the year.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 2.7 percent in the December quarter of 2010, compared to 1.3 percent in the September quarter. There were increases in all expenditure groups, mainly in the 'Drinks, Tobacco and Betelnut' expenditure group. Annual headline inflation was 7.2 percent in the December quarter, higher than the 5.6 percent in the previous quarter. By region, all urban areas recorded increases in the December quarter, with Rabaul having the highest increase and Madang the lowest.

In the December quarter of 2010, the daily average kina exchange rate appreciated against the US dollar, while it depreciated against the other major currencies. It appreciated against the US dollar by 3.3 percent to 0.3790, while it depreciated against the euro by 1.9 percent to 0.2789, pound sterling by 9.7 percent to 0.2398, Australian dollar by 5.7 percent to 0.3839 and the Japanese yen by 0.7 percent to 31.29. These movements resulted in the daily average TWI depreciating in the December quarter of 2010 to 30.96 from 31.80 in the September quarter.

The weighted average kina price of Papua New Guinea's exports increased by 28.5 percent in 2010, compared to 2009. There was an increase of 30.9 percent in the weighted average kina price of mineral exports, with higher prices of all mineral exports. For agricultural, logs and marine product exports, the weighted average kina price increased by 19.0 percent and was attributed to higher prices of coffee, copra, copra oil, palm oil, tea, rubber and logs, which more than offset the decline in prices of marine export products. The higher kina prices of all agricultural export commodities reflected increased demand associated with the recovery of the world economy from the global financial crisis. Excluding logs, the weighted average price of agricultural and marine product exports increased by 22.8 percent in 2010, compared to 2009.

There was an overall surplus in the balance of payments of K1,066 million in 2010, compared to a surplus of K1,725 million in 2009. A surplus in the capital and financial accounts more than offsetted a deficit in the current account.

The current account recorded a higher deficit of K1,762 million in 2010, compared to a deficit of K1,611 million in 2009. Higher net service and income payments more than offset the trade surplus and net transfer receipts.

The capital account recorded a net inflow of K101 million in 2010, compared to K74 million in 2009, reflecting higher transfers by donor agencies through direct project financing.

The financial account recorded a net inflow of K2,794 million in 2010, compared to a net inflow of K3,220 million in 2009. This outcome was due to net inflows from foreign direct and other investments.

As a result of these developments, the capital and financial accounts recorded a lower surplus of K2,895 million in 2010, compared to a surplus of K3,294 million in 2009.

The level of gross foreign exchange reserves at the end of December 2010 was K8,169.6 (US$3,146.5) million, sufficient for 10.5 months of total and 14.4 months of non-mineral import covers.

The Bank of Papua New Guinea continued to maintain a cautious approach to its monetary policy stance by keeping the KFR at 7.00 percent in the December quarter of 2010. This was largely due to concerns regarding inflationary pressures reflecting high domestic demand associated with higher government spending, increased commodity prices and construction of the LNG project. The dealing margin for the Repurchase Agreements (Repos) was maintained at 100 basis points on both sides of the KFR.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy in 2010. There was limited Treasury bill auction in 2010 due to the Government's positive cash flow position, while Inscribe Stock auctions were conducted in line with the Government's debt strategy to shift debt to longer term. As a result, excess liquidity in the banking system was mainly diffused through issuance of additional Central Bank Bills (CBBs). Although the level of liquidity was high, the commercial banks were actively involved in the inter-bank market throughout the year due to the uneven distribution of liquidity in the system. As part of the strategy to mop up excess liquidity, the Bank increased the Cash Reserve Requirement (CRR) of the commercial banks by 1.0 percentage point to 4.0 percent, while the Minimum Liquid Assets Ratio (MLAR) of commercial banks was reduced from 25.0 percent to zero in October 2010.

The average level of broad money supply (M3*) increased by 17.0 percent in 2010, compared to an increase of 13.9 percent in 2009. This outcome was due to an increase of 17.4 percent in average net private sector credit and an increase of 16.0 percent in average net foreign assets of depository 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 16.5 percent in 2010, compared to an increase of 24.1 percent in 2009. The average level of monetary base (reserve money) grew by 20.4 percent in 2010, compared to an increase of 17.8 percent in 2009. The increase reflected higher deposits of Other Depository Corporations (ODCs) at the Central Bank and an increase in currency in circulation.

In 2010, 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 K1,093.4 million to K7,184.6 million, compared to an increase of K811.1 million in 2009. This was due to an increase in private sector credit of K1,058.4 million.

Preliminary estimates of the fiscal operations of the National Government in 2010 showed an overall surplus of K186.3 million, compared to a deficit of K36.3 million in 2009. This represents 0.7 percent of nominal GDP. Out of the surplus realised in 2010, the Government expended K653.3 million through a supplementary budget.

Total revenue, including foreign grants, in 2010 was K8,278.9 million, 24.5 percent higher than in 2009. This represents 100.4 percent of the revised budgeted revenue. The increase in revenue reflected an increase in all categories of tax revenue combined with higher foreign grants, which more than offset lower non-tax receipts.

Total expenditure in 2010 was K8,092.6 million, 21.0 percent higher than in 2009 and represents 98.2 percent of the 2010 revised budget appropriation. This outcome reflects higher capital expenditure, which more than offset a decline in recurrent expenditure.

As a result of these developments in revenue and expenditure, the Government recorded an overall surplus of K186.3 million in 2010. The surplus was used to make a net external loan repayment of K84.8 million and a net negative financing of K101.5 million to domestic sources. The net external loan repayment comprised of K27.6 million, K19.4 million and K37.8 million to concessionary, commercial and extraordinary sources, respectively. The net negative domestic financing comprised of K363.4 million in Government deposits placed at the Central Bank and K32.0 million repayment to ODCs. These more than offset a borrowing of K70.9 million by Other Financial Corporations (OFCs) and K223.0 million in cheque floats held by other resident sectors.

2. INTERNATIONAL DEVELOPMENTS

The two-speed nature of the global recovery continued in 2010. In advanced economies, growth in Gross Domestic Product (GDP) was slightly subdued, with unemployment high and on the rise, whilst in many emerging economies, economic activity remained high, with potential overheating being signalled by rising inflation and strong capital inflows. According to the International Monetary Fund's (IMF) October World Economic Outlook (WEO) update, global economic growth is projected to be around 4.5 percent in 2011, an upward revision of about a quarter percentage point relative to the October 2010 WEO. Downside risks to this forecast includes persistent pressure within the Euro zone, emanating from the debt crisis in peripheral countries.

In November 2010, the United Nations (UN) Climate Change Conference was held in Cancún, Mexico. The outcome of the summit was a non-committal agreement, which recognizes climate change as an urgent and potentially irreversible threat to human societies and the planet. The agreement includes a "Green Climate Fund," proposed to be worth US$100 billion a year by 2020, to assist poorer countries in financing emission reductions and adaptation. The conference was criticized in the media for not resulting in a binding agreement, although it did redress the faltering nature of international discussions regarding climate change in recent years.

The surge in international food prices continued in the December quarter of 2010, with the UN Food and Agriculture Organization's Food Price Index reaching its highest value since July 2008. There is no consensus currently regarding whether there will be a repeat of the 2007-2008 food crisis. However, food riots occurred in Mozambique in September 2010. In December 2010, the World Bank noted that food price volatility would last a further five years, and asked governments to contribute to a crisis fund after requests for more than US$1 billion from developing countries were made.

In the United States, real GDP increased by 2.7 percent in 2010, compared to a growth of 2.8 percent in 2009. The increase reflected positive contributions across all sectors, while there were negative contributions from low government spending and low inventory investment. Industrial production grew at 5.0 percent in 2010, compared to a growth of 6.1 percent in 2009. The Institute of Supply Management Purchasing Managers Index was at 60.8 in December 2010, having been at 58.5 the previous month. An index above 50 indicates expansion in the manufacturing industry. The unemployment rate in 2010 was 9.0 percent, down from 9.7 percent in 2009, with decreased unemployment in the construction, transport, finance and the government sectors. The January 2011 IMF forecast is for real GDP to grow by 3.0 percent in 2011.

Consumer prices increased by 1.6 percent in 2010, compared to a decline of 1.5 percent in 2009. Broad money supply increased by 3.4 percent in 2010, compared to 3.5 percent in 2009. Consumer confidence in 2010 was up from the previous year, according to the University of Michigan's Consumer Sentiment Index.

The trade balance was US$643.4 billion deficit in 2010, compared to US$571.0 billion deficit in 2009. An increase in exports of capital goods, industrial supply and petroleum, and a decline in imports of capital goods, computer accessories and telecommunication equipment contributed to this net increase in exports.

In Japan, real GDP increased by 2.2 percent in 2010, following a decline of 1.5 percent in 2009. Economic growth increased in the fourth quarter due to large increases in private sector inventories and net exports, which increased significantly by 260 percent. The January 2011 IMF forecast is for real GDP to grow by 1.6 percent in 2011.

Industrial production increased by 4.7 percent in 2010, compared to an increase of 18.9 percent in the previous year. Retail sales contracted by 2.1 percent in 2010, compared to an increase of 2.3 percent in 2009. The annual unemployment rate was 5.0 percent in 2010, compared to 4.9 percent in 2009.

Consumer prices were constant in 2010, compared to a decline of 1.7 percent in 2009. Broad money supply (M3) grew by 1.8 percent in 2010, compared to an increase of 2.2 percent in 2009. The Bank of Japan maintained the target rate at 0.1 percent.

The trade balance was in surplus of US$ 91.2 billion in 2010, which increased from US$43.5 billion in 2009. This surplus was due to higher exports, particularly in the automobile sector.

In the Euro area, real GDP increased by 2.0 percent in 2010, compared to a decline of 2.0 percent in 2009. Growth in the fourth quarter of 2010 was weaker than expected, due to the effect of cold weather conditions affecting Germany's output and an unexpected reduction of growth in French. Peripheral countries such as Ireland, Greece, Portugal as well as bigger players such as Spain are all the subject of continuing concern regarding their sovereign debt. The January 2011 IMF forecast is for real GDP to grow by 1.5 percent in 2011.

Industrial production increased by 8.1 percent in 2010, after a fall of 9.9 percent in 2009. Retail sales decreased by 1.1 percent in 2010, compared to a 3.0 percent drop in 2009. The annual unemployment rate was 10.0 percent in 2010, up marginally from 9.9 percent in 2009.

Consumer prices in the Euro area, as measured by the Harmonised Index of Consumer Prices (HICP), increased by 2.2 percent in 2010, in contrast to an increase of 0.9 percent in 2009. The increase largely reflected crude oil and wheat price increases, the former impacting on transport costs. Broad money supply increase by 1.6 percent in 2010, compared to 0.3 percent contraction in 2009. The European Central Bank (ECB) continued to pursue an accommodative monetary policy stance, as it maintained the Euro Refinancing Rate at a record low of 1.0 percent for the 16th consecutive month to December 2010 to support the economic recovery across the 16-country region. There is, however, growing pressure to raise the rate, in the face of mounting inflationary pressure.

The trade account was in surplus of US$7.0 billion in 2010, compared to a surplus of US$33.1 billion in 2009.

In Germany, real GDP grew by 4.0 percent in 2010, following a decline of 2.0 percent in 2009. Strong export and industrial production, as well as large-scale investment in plant equipment contributed to the growth.The January 2011 IMF forecast is for real GDP to grow by 2.2 percent in 2011.

Industrial production grew by 10.0 percent in 2010, compared to a decline of 4.6 percent in 2009, due to strong growth in the mining and manufacturing sectors, following a surge in demand for intermediate goods and capital goods. Retail sales decreased by 0.5 percent in 2010, compared to a decline of 2.3 percent in 2009. The annual unemployment rate was 7.5 percent in 2010, lower than the 8.3 percent in 2009.

Consumer prices increased by 1.8 percent in 2010, compared to a rise of 0.8 percent in 2009. The trade surplus was US$205.4 billion in 2010, compared to US$191.2 billion surplus in 2009, reflecting an increase in exports.

In the United Kingdom (UK), real GDP increased by 1.4 percent in 2010, following a contraction of 2.8 percent in 2009. Growth in the fourth quarter of 2010 slowed to 0.5 percent, mainly due to the cold winter severely affecting retail sales around the Christmas period. Growth was led by increases in private consumption and corporate earnings. Industrial production grew by 3.6 percent in 2010, compared to a decline of 4.0 percent in 2009. The January 2011 IMF forecast is for real GDP to grow by 2.0 percent in 2011.

Retail sales increased by 0.3 percent in 2010, lower than a 2.3 percent increase in 2009, again due to the bad weather conditions. The annual unemployment rate was 7.9 percent in September 2010, slightly above the 7.8 percent recorded in September 2009.

Consumer prices increased by 3.7 percent in 2010, compared to an increase of 2.9 percent in 2009. This was attributed to escalating food prices, as well as less spare capacity in the economy. Inflation in 2010 was higher than expected, though core inflation remained at 2.7 percent. The Bank of England continued to maintain its official Bank Rate at 0.5 percent over the December quarter of 2010, for the 21st consecutive month. There is, however, increasing expectation that the rate will increase in response to increasing inflationary pressures.

The trade account deficit was US$150.4 billion in 2010, compared to US$128.1billion deficit in 2009.

In Australia, real GDP grew by 2.7 percent in 2010, compared to an increase of 2.6 percent in 2009. There was strong growth in capital equipment, inventory investment and agricultural income. Growth slowed on a quarterly basis as a result of a moderation in consumption and an appreciating Australian dollar. Industrial production increased by 5.0 percent in 2010, in contrast to a decline of 3.8 percent in 2009. Retail sales increased by 2.1 percent in 2010, the same as in 2009. The unemployment rate was 5.1 percent in 2010, compared to 5.6 percent in 2009. The January 2011 IMF forecast is for real GDP to grow by 3.5 percent in 2011.

Consumer prices increased by 2.7 percent in 2010, higher than 2.1 percent in 2009. Broad money supply increased by 10.2 percent in 2010, compared to 5.7 percent in 2009. The Reserve Bank of Australia (RBA) maintained its Cash Rate at 4.5 percent in the December quarter of 2010.

The trade surplus was US$18.1 billion in 2010, compared to US$7.1billion deficit in 2009.

In the December quarter of 2010, the US dollar depreciated against all the major currencies, reflecting ongoing concerns about the recovery in the US and continued low domestic interest rates. The US dollar depreciated by 5.4 percent against the euro, 2.1 percent against the British pound sterling, 4.1 percent against the Japanese yen, and 9.5 percent against the Australian dollar.

In the December quarter of 2010, the daily average kina exchange rate appreciated against the US dollar, but depreciated against the euro, pound sterling, Australian dollar and Japanese yen. It appreciated against the US dollar by 3.3 percent to 0.3790, while it depreciated against the euro by 1.9 percent to 0.2789, pound sterling by 9.7 percent to 0.2398, Australian dollar by 5.7 percent to 0.3839 and the Japanese yen by 0.7 percent to 31.29. These movements resulted in the daily average TWI depreciating in the December quarter of 2010 to 30.96 from 31.80 in the September quarter.

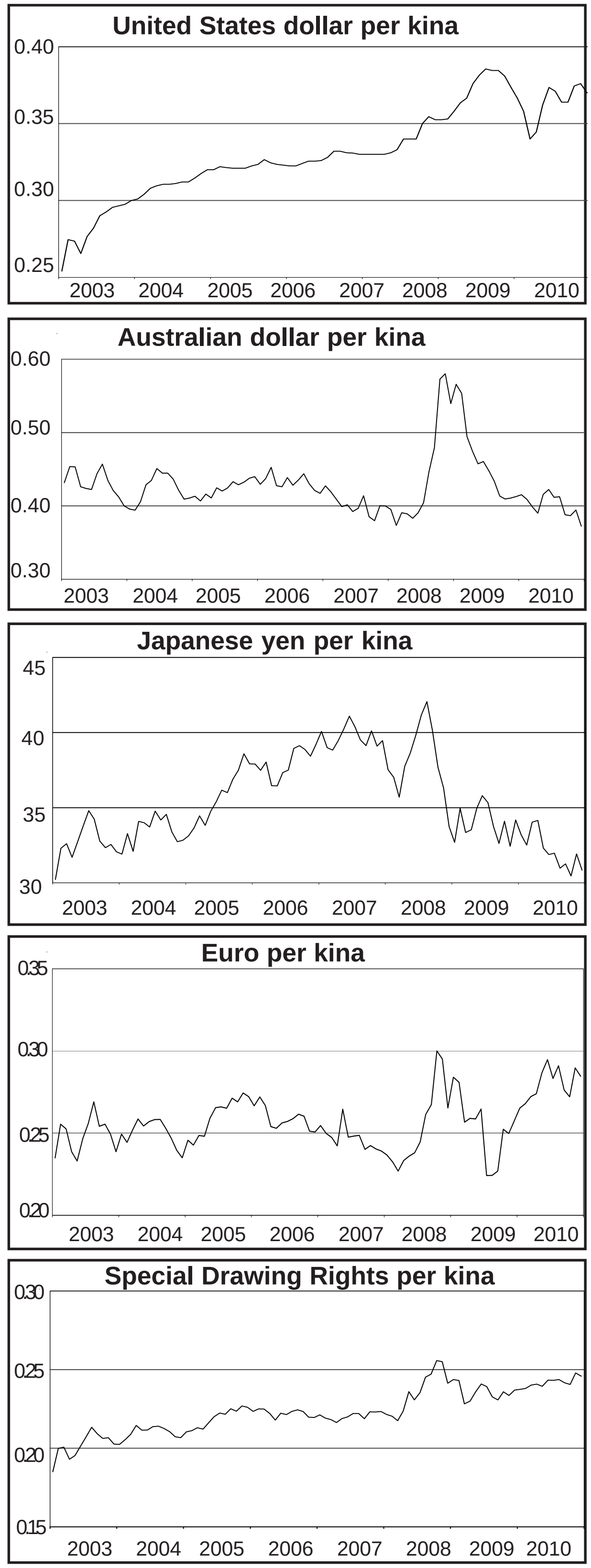
3. DOMESTIC ECONOMIC DEVELOPMENT[1]

DOMESTIC ECONOMIC ACTIVITY

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the private sector increased by 8.8 percent in the September quarter of 2010, after increasing by 2.3 percent in the June quarter. Excluding the mineral sector, sales were higher by 5.0 percent in the September quarter, compared to an increase of 16.1 percent in the previous quarter. By sector, there were increases in all sectors, except the building and construction, and financial/business and other services sectors. By region, sales picked up in all the regions, except the Highlands. Over the twelve

[1]Some companies engaged in the LNG project are not covered in the BLS and Employment Surveys and therefore some of the growth figures may not be reflective of actual industry trends.

EXCHANGE RATES



months to September 2010, total sales increased by 20.4 percent.

In the mineral sector, sales increased by 17.5 percent in the September quarter of 2010, following a decline of 19.2 percent in the previous quarter. The increase was due to higher international prices of gold, copper and crude oil, combined with increased production at the Tolukuma, Ok Tedi and Simberi mines. Over the twelve months to September 2010, sales increased by 8.4 percent.

In the retail sector, sales increased by 17.0 percent in the September quarter of 2010, compared to an increase of 22.6 percent in the June quarter. The increase was mainly associated with high demand for vehicles, heavy machinery and equipment, furniture and white goods.The increase was also due to expansion of operations by major retail stores. Over the twelve months to September 2010, sales increased by 52.3 percent.

In the transportation sector, sales increased by 11.0 percent in the September quarter of 2010, after an increase of 8.6 percent in the June quarter. The increase was in all transportation sub-sectors, mainly attributed to higher passenger travel and cargo haulage. Over the twelve months to September 2010, sales increased by 48.1 percent.

In the wholesale sector, sales picked up by 11.0 percent in the September quarter of 2010, following an increase of 9.5 percent in the previous quarter. The increase mainly reflected strong demand for fuel-based products and grocery items supported by a pick up in commodity prices, especially for coffee, palm oil and cocoa. Over the twelve months to September 2010, sales increased by 16.6 percent.

In the agriculture/forestry/fisheries sector, sales increased by 2.4 percent in the September quarter of 2010, following a decline of 4.2 percent in the June quarter.The increase was in the agriculture and forestry sub-sectors. The increase in the agriculture sub-sector was attributed to a pick up in palm oil and coffee production and exports, combined with higher prices of both commodities. The increase in the forestry sub-sector was due to higher prices and export of logs. Over the twelve months to September 2010, the value of sales increased by 18.6 percent.

In the manufacturing sector, sales increased slightly by 1.1 percent in the September quarter of 2010, after increasing significantly by 27.0 percent in the previous quarter. The increase was mainly associated with high demand for industrial goods, steel fabrication, fuel lubricants and alcoholic drinks, combined with increased production due to the expansion of an alcohol and beverage plant. Over the twelve months to September 2010, sales increased by 34.0 percent.

In the financial/business and other services sector, sales dropped by 4.4 percent in the September quarter of 2010, following an increase of 9.3 percent in the June quarter. The decrease was mainly due to lower investment and foreign exchange incomes in the financial sub-sector, combined with lower catering activity. These more than offset the increases in sales by hotels, real estate and security companies. Over the twelve months to September 2010, sales declined by 10.6 percent.

In the building and construction sector, sales decreased by 11.7 percent in the September quarter of 2010, in contrast to an increase of 25.2 percent in the previous quarter. The decline was mainly driven by lower contract payments, and completion of building and road maintenance projects. Over the twelve months to September 2010, sales increased by 34.2 percent.

By region, sales increased in all regions except the Highlands. In the Southern region, sales picked up significantly by 45.3 percent in the September quarter of 2010, compared to a decline of 34.0 percent in the previous quarter.The increase was mainly in the mineral and wholesale sectors. In the mineral sector, the increase was attributed to higher international prices of gold and copper and increased production at the Tolokuma and Ok Tedi mines. The increase in the wholesale sector was due to high demand. Over the twelve months to September 2010, sales increased by 17.9 percent.

In Morobe, sales grew by 8.6 percent in the September quarter of 2010, following an increase of 9.2 percent in the previous quarter. The increase was mainly in the wholesale, retail, transportation and manufacturing sectors. In the retail and wholesale sectors, the increase was due to higher demand for consumer goods, and increased sales of fuel-based products, vehicles and spare part. In the manufacturing sector, the pick up was due to higher production and sales of consumable and industrial products. In the transportation sector, the increase reflected higher cargo haulage and passenger travel by the sea and land transportation . Over the twelve months to September 2010, sales increased by 34.5 percent.

In the Momase region, sales increased by 5.2 percent in the September quarter of 2010, compared to an increase of 14.6 percent in the previous quarter. The increase was mainly in the manufacturing, wholesale and retail sectors. The increase in the manufacturing sector reflected higher production and sales of tobacco and sugar products. The increases in the wholesale and retail sectors were due to higher demand from mining projects. Over the twelve months to September 2010, sales increased by 26.4 percent.

In the Islands region, sales increased by 4.3 percent in the September quarter of 2010, following an increase of 9.2 percent in the previous quarter. The growth was mainly in the wholesale and mineral sectors. The increase in the wholesale sector was associated with increased demand reflecting high cocoa and copra prices, and increase in sales of fuel-based products. The increase in the mineral sector was due to higher prices and production of gold. Over the twelve months to September 2010, sales increased by 48.6 percent.

In NCD, sales increased by 2.9 percent in the September quarter of 2010, after increasing by 21.4 percent in the previous quarter. The increase was in the manufacturing, transportation, wholesale and retail sectors. The increases in the manufacturing, wholesale and retail sectors were due to higher consumer demand, while the increase in the transportation sector was associated with higher passenger travel and cargo haulage by the air and sea transportation sub-sectors. Over the twelve months to September 2010, sales increased by 29.7 percent.

In the Highlands region, sales dropped by 5.6 percent in the September quarter of 2010, following an increase of 11.9 percent in the June quarter. The decline was in the mineral sector attributed to a fall in gold production at the Porgera gold mine. This more than offset the increases in the other sectors. Over the twelve months to September 2010, sales increased by 3.4 percent.

EMPLOYMENT

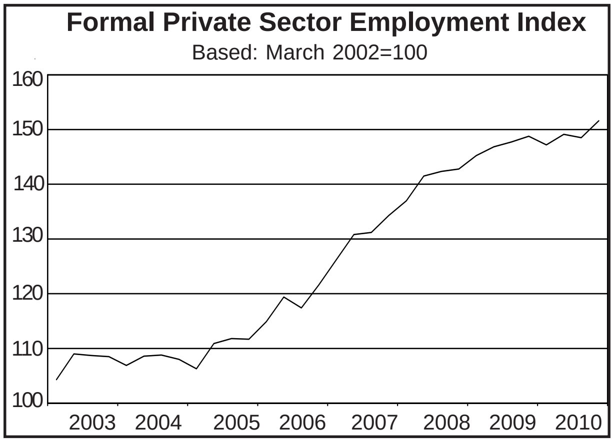
The Bank's Employment Index indicate that the level of employment in the formal private sector increased by 2.1 percent in the December quarter of 2010, following a decline of 0.5 percent in the previous quarter.Excluding the mineral sector, the level of employment increased by 2.0 percent in the December quarter of 2010, after a decline of 0.8 percent in the previous quarter.By sector, employment increased in the manufacturing, building and construction, wholesale, retail, mineral and the financial/business and other services sector, while the agriculture/forestry/ fisheries and transportation sectors recorded declines. By region, employment increased in all the regions, except the Highlands. In 2010, the total level of employment increased by 1.9 percent. Excluding the mineral sector, employment increased by 1.2 percent in the year.

In the transportation sector, the level of employment declined by 5.7 percent in the December quarter of 2010, compared to a decrease of 6.6 percent in the previous quarter. The decline was mainly due to an airline company letting go of its employees as their contracts expired and less stevedoring activities at sea ports. In 2010, employment decreased by 8.4 percent, compared to 2009.

In the agriculture/forestry/fisheries sector, the level of employment declined by 1.2 percent in the December quarter of 2010, following a decrease of 5.8 percent in the September quarter. The decrease in the agriculture sub-sector was due to a drop in palm oil and cocoa production and a seasonal decline in coffee production. In 2010, the level of employment decreased by 2.3 percent, compared to 2009.

In the building and construction sector, the level of employment increased by 1.8 percent in the December quarter of 2010, following a decrease of 0.2 percent in the September quarter. The increase was mainly attributed to pick up in building and construction activity in Port Moresby, Lae and Mount Hagen, and maintenance work on the Magi and Hiritano highways in the Central province, and upgrading of the Daru Airport. In 2010, the level of employment increased by 5.3 percent, compared to 2009.

In the manufacturing sector, the level of employment increased by 7.0 percent in the December quarter of 2010, following an increase of 5.1 percent in the previous quarter. The increase was mainly associated with increased processing of tuna, timber, balsa wood, and copra processing, and production of liquor. In 2010, the level of employment increased by 2.9 percent, compared to 2009.



In the mineral sector, the level of employment increased by 2.2 percent in the December quarter of 2010, after an increase of 3.9 percent in the September quarter. This was due to increased exploration activity. In 2010, the level of employment increased by 9.0 percent, compared to 2009.

In the wholesale sector, the level of employment increased by 3.3 percent in the December quarter of 2010, following an increase of 1.9 percent in the September quarter. In the retail sector, the level of employment rose by 9.3 percent in the December quarter, after increasing by 1.8 percent in the previous quarter. The increases in both sectors were mainly associated with hiring of additional casual staff for the festive season and expansion of operations in NCD and other centers. In 2010, employment in the wholesale sector increased by 6.2 percent, while it rose by 10.6 percent in the retail sector, compared to 2009.

By region, the level of employment increased in all regions except the Highlands region, which recorded a decline. In the Southern region, the level of employment increased by 1.7 percent in the December quarter of 2010, after a decline of 3.2 percent in the previous quarter. The increase was in the manufacturing, building and construction, wholesale and retail sectors. The increase in the building and construction sector was associated with road projects in the Central province and LNG-related construction. The increase in the manufacturing sector was due to higher production of plywood. In the wholesale and retail sectors, the increases reflected higher demand due to the festive season. In 2010, the level of employment declined by 6.4 percent, compared to 2009.

In the Momase region, the level of employment increased by 7.3 percent in the December quarter of 2010, following a decline of 2.9 percent in the September quarter.The increase was mainly in the manufacturing, retail, building and construction, and transportation sectors.The increase in the manufacturing sector was mainly due to increased tuna processing and copra production. In the retail sector, the increase was due to hiring of casual employees for the festive season. The increase in the building and construction sector was due to road maintenance work in Lae, while the increase in the transportation sector reflected higher employment by an airline company. In 2010, the level of employment declined by 8.3 percent, compared to 2009.

In the Islands region, the level of employment increased by 2.1 percent in the December quarter of 2010, following a decrease of 1.1 percent in the September quarter. The increase was in the agriculture/forestry/fisheries, manufacturing, financial/business and other services, wholesale and retail sectors. The increase in the agriculture/forestry/fisheries sector was due to higher production of balsa wood and palm oil.The increase in the financial/business and other services sector was due to higher demand for catering and hotel services.The increase in the wholesale and retail sectors was due to hiring of casuals for the festive season and business expansion. In 2010, the level of employment increased by 3.6 percent, compared to 2009.

In NCD, the level of employment increased by 1.7 percent in the December quarter of 2010, following a 5.6 percent increase in the September quarter. The increase was in the building and construction, retail, financial/business and others services, and transportation sectors. The increase in the building and construction sector was due to pick up in road maintenance work and building construction . The increase in the retail sector was due to hiring of casuals for the festive season and business expansion. In the financial/business and other services sector, the increase was due to higher demand for security services. In 2010, the level of employment increased by 8.8 percent, compared to 2009.

In Morobe, the level of employment increased by 4.0 percent in the December quarter of 2010, following no change in the previous quarter. The increase was in the retail, agriculture/forestry/fisheries, and building and construction sectors.The increase in the retail sector was mainly due to business expansion and hiring of casuals for the festive season. The increase in the agriculture/forestry/fisheries sector was due to increase in fishing activity and cocoa production. The increase in the building and construction sector was due to road maintenance in Lae. In 2010, the level of employment increased by 2.7 percent, compared to 2009.

In the Highlands region, the level of employment dropped by 6.6 percent in the December quarter of 2010, after decreasing by 6.5 percent in the previous quarter. The decrease was mainly in the agriculture/forestry sector due to a seasonal decline in coffee production. In the building and construction sector, the decline was due to the completion of building and road projects. In 2010, the level of employment dropped by 2.7 percent, compared to 2009.

CONSUMER PRICE INDEX

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 2.7 percent in the December quarter of 2010, compared to 1.3 percent in the September quarter. There were increases in all expenditure groups with the 'Drinks, Tobacco and Betelnut' expenditure group recording the highest. Annual headline inflation was 7.2 percent in the December quarter, higher than the 5.6 percent in the September quarter. By region, all urban areas recorded price increases in the December quarter, with Rabaul having the highest increase and Madang the lowest.

The CPI for the 'Food' expenditure group increased by 0.9 percent in the December quarter of 2010, compared to an increase of 1.4 percent in the September quarter. The increase was in all sub-groups except fruits and vegetables. Meat and fish sub-group recorded the highest increase of 1.5 percent followed by miscellaneous food items and cereals sub-group with 1.3 percent and 1.1 percent, respectively. This expenditure group contributed 0.4 percentage points to the overall movement in the CPI.

The CPI for 'Drinks, Tobacco and Betelnut' expenditure group increased by 8.5 percent in the December quarter of 2010, compared to an increase of 1.2 percent in the previous quarter. All sub-groups recorded price increases, except cigarettes and tobacco. Betelnut recorded a massive 115.6 percent increase which contributed the most in this group's outcome, while soft drinks and alcoholic drinks sub-groups recorded increases of 0.1 percent and 0.3 percent, respectively. This expenditure group contributed 1.7 percentage points to the overall movement in the CPI.

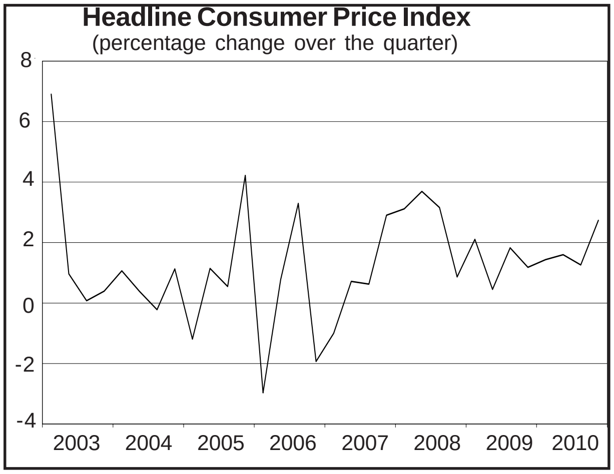
The CPI for 'Clothing and Footwear' expenditure group increased by 4.1 percent in the December quarter of 2010, compared to an increase of 3.0 percent in the September quarter. All sub-groups recorded price increases, with men and boy's clothing sub-group recording the highest increase of 3.5 percent and, women and girls clothing and other clothing and footwear sub-groups recording 5.8 percent and 3.2 percent, respectively. This expenditure group contributed 0.3 percentage points to the overall movement in the CPI.

The CPI for the 'Rents, Council charges, Fuel/power' expenditure group increased by 0.5 percent in the December quarter of 2010, compared to a decline of 0.4 percent in the previous quarter. The price increase was in the council charges for water, sewerage, garbage and fuel/power sub-group of 0.8 percent and 0.4 percent, respectively. This expenditure group's contribution to the overall movement in the CPI was negligible.

The CPI for the 'Household equipment and operations' expenditure group increased by 1.6 percent in the December quarter of 2010, compared to an increase of 0.5 percent in the previous quarter. All sub-groups recorded increases with the semi-durable sub-group recording the highest increase of 3.1 percent, followed by durable goods of 0.9 percent and non-durable goods of 0.6 percent. This expenditure group contributed 0.1 percentage points to the overall movement in the CPI.

The CPI for the 'Transport and communication' expenditure group increased by 0.2 percent in the December quarter of 2010, compared to an increase of 1.2 percent in the September quarter. The increase was mainly in the motor vehicle operations sub-group which recorded 0.7 percent, while there were no price changes in the motor vehicle purchases sub-group and the airline, bus fare and PMV category. This expenditure group's contribution to the overall movement in the CPI was negligible.

The CPI for the 'Miscellaneous' expenditure group, increased by 0.9 percent in the December quarter of



2010, compared to an increase of 0.4 percent in the previous quarter. The increase was across all the sub-groups, with the medical and health care sub-group recording 0.7 percent, entertainment and culture sub-group recording 0.2 percent and other groups recording 3.0 percent. This expenditure group contributed 0.1 percentage points to the overall movement in the CPI. By urban areas, inflation increased in all the surveyed centers in the December quarter of 2010. Rabaul recorded the highest increase, while Madang recorded the least. In Rabaul, prices increased by 3.3 percent, while Port Moresby and Lae both recorded the second highest of 2.9 percent. This was followed by Goroka with 2.1 percent increase, while Madang recorded an increase of 1.9 percent.

In Rabaul, prices increased by 3.3 percent in the December quarter of 2010, compared to an increase of 0.6 percent in the previous quarter. This increase was in all expenditure groups with the 'Drinks, Tobacco and Betelnut' expenditure group recording the highest of 6.9 percent followed by the 'Clothing and footwear' expenditure group of 2.6 percent.

In Port Moresby, prices increased by 2.9 percent in the December quarter of 2010, compared to an increase of 1.0 percent in the September quarter. All expenditure groups recorded increases with the 'Drinks, tobacco and betelnut' expenditure group recording the highest of 11.0 percent, followed by 'Clothing and footwear' expenditure group of 4.1 percent.

In Lae, prices increased by 2.9 percent in the December quarter of 2010, compared to an increase of 2.2 percent in the September quarter. The "Drinks, Tobacco and Betelnut" expenditure group recorded the highest of 8.6 percent, followed by the 'clothing and footwear' expenditure group of 7.3 percent. All the other expenditure groups recorded price increases as well.

In Goroka, prices increased by 2.1 percent in the December quarter of 2010, compared to an increase of 1.4 percent in the September quarter. This outcome was driven by increases in the 'Drinks, Tobacco and Betelnut' expenditure group of 4.6 percent, followed by 'Clothing and footwear' and 'Food' expenditure groups of 2.8 percent and 2.4 percent, respectively. All the other expenditure groups also recorded price increases.

In Madang, prices increased by 1.9 percent in the December quarter of 2010, compared to 0.6 percent in the previous quarter. There were increases in all expenditure groups. The 'Drinks, tobacco and betelnut' expenditure group recorded the highest of 5.3 percent followed by the 'Rent, council charges and fuel/power' expenditure group of 2.0 percent.

The quarterly exclusion-based and trimmed-mean measures of underlying inflation recorded increases of 1.1 percent and 1.0 percent, respectively, in the December quarter of 2010. This compares with increases of 1.2 percent and 1.3 percent, respectively, in the previous quarter.

The annual exclusion-based inflation rate was 5.4 percent in the December quarter of 2010, compared to 5.1 percent in the previous quarter, while the annual trimmed-mean inflation was 5.5 percent in the December quarter of 2010, compared to 5.7 percent in the September quarter of 2010.

4.0 EXPORT COMMODITIES REVIEW

The total value of merchandise exports was K15,277 million in 2010, an increase of 26.3 percent from 2009. There were increases in the values of gold, crude oil, copper, coffee, copra, copra oil, palm oil, rubber, logs, refined petroleum product and other non-mineral exports, with the exception of cocoa, tea and marine product exports. The value of agricultural, marine products and other non-mineral exports, excluding forestry product and refined petroleum product exports was K2,245.6 million and accounted for 14.7 percent of total merchandise exports in 2010, compared to 17.4 percent of total merchandise exports in 2009. Forestry product exports were K699.9 million and accounted for 4.6 percent of total merchandise exports in 2010, compared to 3.9 percent in 2009. Refined petroleum product exports were K617.0 million and accounted for 4.0 percent of total merchandise exports in 2010, compared to 3.1 percent in 2009. Mineral export receipts, excluding crude oil were K9,558 million and accounted for 62.6 percent of total merchandise exports in 2010, compared to 62.0 percent in 2009. Crude oil exports totalled K2,156.7 million and accounted for 14.1 percent of total merchandise exports in 2010, compared to 13.6 percent in 2009.

The weighted average kina price of Papua New Guinea's exports increased by 28.5 percent in 2010, compared to 2009.There was an increase of 30.9 percent in the weighted average kina price of mineral exports, with higher kina prices of all mineral exports. For agricultural, logs and marine product exports, the weighted average kina price increased by 19.0 percent and was attributed to higher prices of coffee, copra, copra oil, palm oil, tea, rubber and logs, which more than offset the decline in prices of marine export products.The higher kina prices of all agricultural export commodities reflected increase demand associated with the recovery of the world economy from the global financial crisis. Excluding logs, the weighted average price of agricultural and marine product exports increased by 22.8 percent in 2010, compared to 2009.

Mineral Exports

Total mineral export receipts were K11,714.7 million in 2010, an increased of 28.1 percent from 2009. The increase was due to higher kina prices of all mineral exports, which more than offset the decline in export volumes of gold and crude oil.

Gold export volumes were 61.5 tonnes in 2010, a decline of 3.9 percent from 2009. This outcome was due to declines in production at all the mines, including the Lihir, Ok Tedi, Porgera, Tolukuma and Hidden Valley mines, from extraction of lower ore grades. The average free on board (f.o.b.) price received for Papua New Guinea's gold exports was K103.7 million per tonne in 2010, an increase of 22.5 percent from 2009. The outcome is mainly attributed to higher international prices. The average gold price at the London Metal Exchange was US$1,209 per fine ounce in 2010, an increase of 24.6 percent from 2009. The increase was due to higher demand for gold-based assets as a safe-haven investment after increased volatility of prices in the equity markets and higher demand from China and India. The increase in export price more than offset a decline in export volume and resulted in export receipts of K6,380.3 million in 2010, an increase of 17.7 percent from 2009.

Copper export volume was 154.7 thousand tonnes in 2010, a marginal increase of 0.7 percent from 2009. The increase was due to higher shipment in spite of lower production associated with extraction of lower ore grades combined with lower milling as a result of industrial strike action by workers at the Ok Tedi mine.The average f.o.b. price of Papua New Guinea's copper exports was K19,970 per tonne in 2010, an increase of 51.5 percent from 2009. The increase was due to higher international prices, resulting from increased demand from China and India. The combined increase in export price and volume resulted in 52.5 percent increase in export receipts to K3,089.3 million in 2010, from 2009.

Crude oil export volumes were 10,099.6 thousand barrels in 2010, a decline of 0.5 percent from 2009. The decline reflected lower extraction rates and production due to the natural decline from mature oil fields at the Kutubu, Gobe main and South East Gobe and Moran oil projects. The average export price of crude oil in 2010 was K214 per barrel, an increase of 32.1 percent from 2009. This outcome was due to higher international prices reflecting increased demand from the US, European and Asian economies, especially China and India. The increase in the export price more than offset a decline in the export volume and resulted in an export receipt of K2,156.7 million, an increase of 31.1 percent from 2009.

Export receipts of refined petroleum products from the Napanapa Oil Refinery were K617 million in 2010 , an increase of 63.0 percent from 2009. The increase was mainly due to higher export volumes and prices of various refined petroleum products.

Agriculture, Logs and Fisheries Exports

Export prices of all agricultural export commodities increased in 2010, compared to 2009. Coffee prices increased by 25.9 percent, copra by 37.5 percent, copra oil by 44.2 percent, palm oil by 24.8 percent, cocoa by 19.5 percent, tea by 21.7 percent and rubber by 46.3 percent. The average export price of logs was K231 per cubic metre in 2010, an increase of 8.8

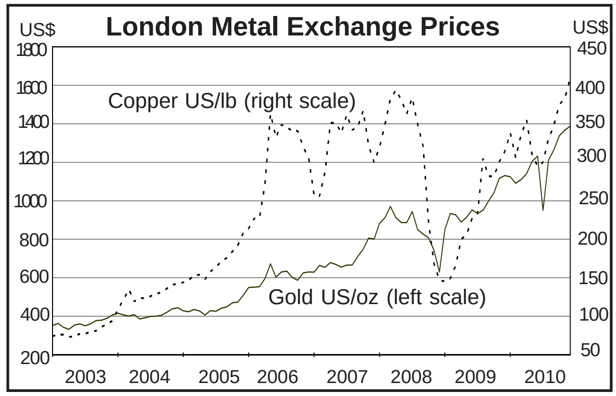
percent from 2009. The increase in export prices of all agricultural and log exports, more than offset the decline in export price of marine products resulting in a 19.0 percent increase in the weighted average price of agricultural, logs and marine exports. Excluding logs, the weighted average price of agricultural and marine product exports increased by 22.8 percent in 2010, compared to 2009.

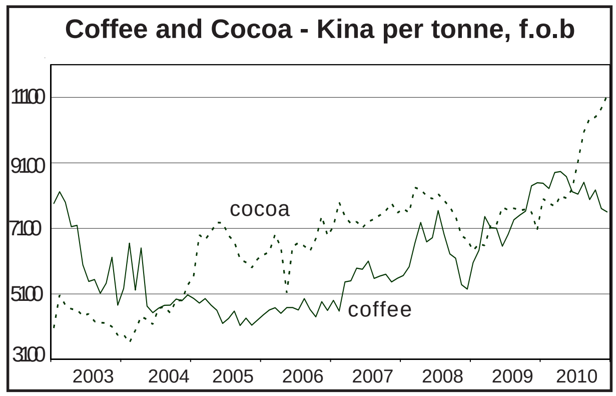
The volume of coffee exported was 55,900 tonnes in 2010, a decline of 10.1 percent from 2009. The decline was mainly attributed to replanting activities in most plantations in the major coffee producing areas under the industry's rehabilitation program and the unfavourable dry weather conditions caused by the drought. The average export price of coffee was K9,320 per tonne in 2010, an increase of 25.9 percent from 2009. This outcome was mainly due to higher international prices reflecting a decline in global supply following bad weather patterns from climate change affecting the quality of coffee in major producing countries located close to the equator, leading to shortage of quality coffee in the world market, especially in Europe and the US. The increase in export price more than offset decline in volume resulting in export receipts of K521 million in 2010, an increase of 13.2 percent from 2009.

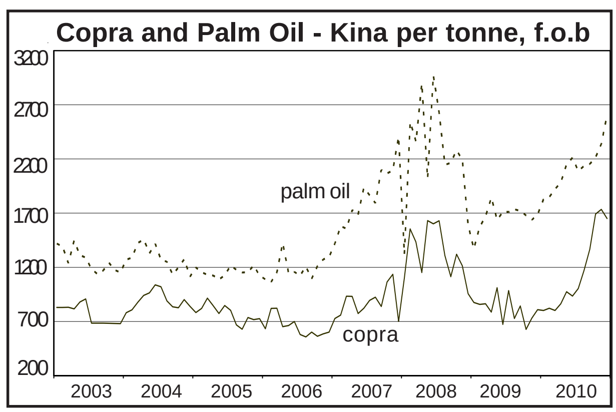
The volume of cocoa exported was 27,100 tonnes in 2010, a decline of 43.8 percent from 2009. This outcome was attributed to a decline in production from East New Britain province, a major cocoa producer, due to the cocoa pod borer disease. The lower production more than offset higher production in other cocoa growing areas, especially the Autonomous Region of Bougainville (ARB). The average export price of cocoa was K8,362 per tonne in 2010, an increase of 19.5 percent from 2009. The increase resulted from higher international prices due to lower production from the Ivory Coast, the world's largest producer, due to a trade embargo imposed by European Union as a result of continuous political unrest associated with the recent election. The decline in export volume more than offset the increase in export price resulting in export receipts of K226.6 million in 2010, a decline of 32.8 percent from 2009.

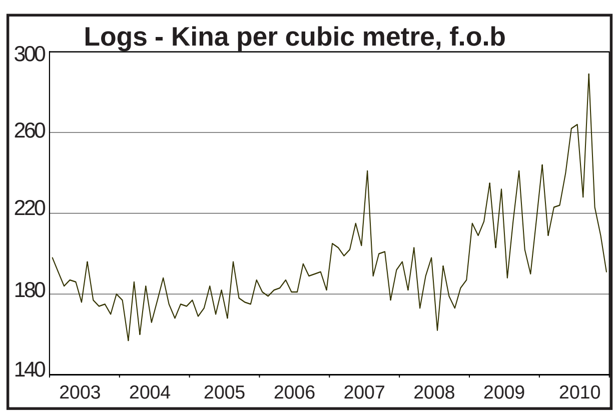
The volume of copra exported was 16,400 tonnes in 2010, an increase of 7.9 percent from 2009. The increase was mainly associated with higher international prices, which prompted farmers to increase production. The average export price of copra was K1,122 per tonne in 2010, an increase of 37.5 percent

EXPORT COMMODITY PRICES









from 2009. The outcome was due to higher international prices as a result of lower global supply due to lower production from the major producers, the Philippines and Indonesia. The combined increase in export price and volume resulted in export receipts of K18.4 million in 2010, an increase of 37.5 percent from 2009. The volume of copra oil exported in 2010 was 44,800 tonnes, the same as in 2009. The outcome was mainly due to lower shipment by the two domestic mills as result of cancellation of shipping contracts with overseas buyers. The average export price of copra oil was K2,830 per tonne in 2010, an increase of 44.2 percent from 2009. The increase was due to higher international prices as a result of increased global demand as consumers switch from palm kernel oil, the close substitute of copra oil, due to high prices of the rival product and lower copra production by the major producers. The increase in export price more than offset the stable export volumes and resulted in an increase of 43.3 percent in export receipts of K126.8 million in 2010, from 2009.

The volume of palm oil exported was 453,300 tonnes in 2010, an increase of 5.8 percent from 2009.This outcome was due to higher production from all major palm oil producing provinces by large and small holders as a result of high international prices.The average export price of palm oil was K2,081 per tonne in 2010, an increase of 24.8 percent from 2009. The increase was due to higher demand as a result of low production and supply on the world market, resulting from unfavourable wet weather conditions affecting pollination and yields in Malaysia and Indonesia, the world's major producers.The combined increase in export price and volume resulted in export receipts of K943.3 million in 2010, an increase of 32.1 percent from 2009.

The volume of tea exported was 4,600 tonnes in 2010, a decline of 17.9 percent from 2009. The decline was mainly due to lower production caused by unfavourable wet weather conditions. The average export price of tea was K4,000 per tonne in 2010, an increase of 21.7 percent from 2009. The increase reflected lower production from India, Kenya and Sri Lanka due to unfavourable dry weather conditions, combined with higher global demand. The export receipt of tea was K18.4 million in 2010, the same as in 2009.

The volume of rubber exported was 4,600 tonnes in 2010, a decline of 14.8 percent from 2009. The decline was attributed to unfavourable wet weather conditions in the major rubber producing regions. The average export price was K7,043 per tonnes in 2010, an increase of 46.3 percent from 2009. The increase was due to lower supply in the world market, resulting from unfavorable wet weather conditions in Malaysia, Thailand and Indonesia. The increase in export price more than offset a decline in export volume resulting in export receipts of K32.4 million in 2010, an increase of 24.6 percent from 2009.

The volume of logs exported was 2,862 thousand cubic metres in 2010, an increase of 38.5 percent from 2009. The increase was due to higher production and export from the major logging projects. The average export price of logs was K231 per cubic metre in 2010, an increase of 8.5 percent from 2009. The increase resulted from higher international prices due to increased demand from the Asian region, mainly China. The combined increase in export volume and export price resulted in export receipts of K662.1 million in 2010, an increase of 50.7 percent from 2009.

The value of marine product exports was K91.7 million in 2010, a decline of 60.6 percent from 2009. This outcome was due to declines in both export price and volume.

5.0 BALANCE OF PAYMENTS

There was an overall surplus in the balance of payments of K1,066 million in 2010, compared to a surplus of K1,725 million in 2009. A surplus in the capital and financial accounts more than offsetted a deficit in the current account. The surplus in the capital and financial accounts reflect net inflows from capital transfers, foreign direct and other investments, which more than offset a net outflow from investments in portfolio and financial derivative instruments. The deficit in the current account was due to net services and income payments, which more than offset the trade surplus and net transfer receipts. In 2010, the kina appreciated against most of the currencies of Papua New Guinea's major trading partner countries with the exception of the Australian dollar and Japanese yen, compared to 2009. This resulted in a decline in the kina value of some balance of payments transactions.

The trade account recorded a surplus of K5,913 million in 2010, an increase of 41.1 percent from 2009. The higher surplus was due to an increase in the value of merchandise exports, which more than offset an increase in the value of merchandise imports. The value of merchandise exports was K15,277 million in 2010, an increase of 26.2 percent from 2009. The increase was attributed to higher export values of all export commodities, except cocoa and marine product exports.

The value of merchandise imports was K9,364 million in 2010, an increase of 18.4, percent, from 2009. The increase was due to higher imports by all sectors. General imports increased by 19.0 percent to K6,803 million in 2010, compared to 2009, reflecting an increase in aggregate demand associated with the construction of the LNG project. Imports by the mining sector increased by 25.0 percent to K1,875 million in 2010, compared to 2009. The increase was due to higher capital expenditure undertaken by the Ok Tedi, Lihir and Porgera mines. Petroleum sector imports increased by 4.6 percent to K686 million in 2010, compared to 2009. The outcome reflected higher exploration activities associated with the Mananda 5, Wasuma and Korka exploration wells.

The deficit in the services account was K6,621 million in 2010, an increase of 45.2 percent from 2009. The outcome was due to higher payments for transportation, travel, other financial, communication, other business, cultural and recreational, government services n.i.e. and construction services, combined with lower service receipts by resident companies.

The deficit in the income account was K1,608 million in 2010, a decline of 6.6 percent from 2009. The outcome was due to lower interest and dividend payments, combined with lower income receipts by residents.

The surplus in the transfers account was K553 million in 2010, an increase of 15.9 percent from 2009. The higher surplus was mainly due to higher receipts from superannuation funds, gifts and grants, tax and immigrant funds, which more than offset higher transfer payments.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a higher deficit of K1,762 million in 2010, compared to a deficit of K1,611 million in 2009. Higher net service and income payments more than offset the trade surplus and net transfer receipts.

The capital account recorded a net inflow of K101 million in 2010, compared to K74 million in 2009, reflecting higher transfers by donor agencies through direct project financing.

The financial account recorded a net inflow of K2,794 million in 2010, compared to a net inflow of K3,220 million in 2009. This outcome was due to net inflows from foreign direct and other investments. Net inflows from direct investments reflected equity inflow by the mineral sector, while in other investments it reflected draw-downs in foreign currency account balances of mineral companies and trade credit receipts of funds owed to PNG resident entities by foreign entities. These more than offset an increase in net foreign assets of the banking system and higher loan repayment by the Government. These net inflows more than offset net outflows in portfolio investments reflecting investments in short-term money market instruments, and investments in financial derivative instruments reflecting hedge payments by resident companies.

As a result of these developments, the capital and financial accounts balance recorded a lower surplus of K2,895 million in 2010, compared to a surplus of K3,294 million in 2009.

In the December quarter of 2010, the balance of payments recorded an overall surplus of K542 million, compared to a surplus of K387 million in the corresponding quarter of 2009. This outcome was due to a surplus in the capital and financial accounts, which more than offset a deficit in the current account.

The value of merchandise exports was K3,940 million in the December quarter of 2010, an increase of 13.7 percent from the corresponding quarter of 2009. The increase was due to higher export values of gold, copper, crude oil, cocoa, copra, copra oil, palm oil, rubber and forestry products. Agricultural, forestry, marine products and other non-mineral exports, excluding refined petroleum product exports totalled K673 million comprising 17.1 percent of total merchandise exports in the December quarter of 2010, compared to 19.7 percent in the corresponding quarter of 2009. Refined petroleum product exports totalled K91.5 million in the December quarter of 2010 and accounted for 2.3 percent of total merchandise exports, compared to 3.9 percent in the corresponding quarter of 2009. Mineral exports totalled K3,175.5 million, comprising 80.6 percent of total merchandise exports in the December quarter of 2010, compared to 76.4 percent in the corresponding quarter of 2009.

The value of merchandise imports was K2,345 million in the December quarter of 2010, an increase of 7.3 percent from the corresponding quarter of 2009. The outcome reflected higher mining and petroleum sector imports, which more than offset lower general imports. Mining sector imports increased by 43.3 percent to K604.7 million in the December quarter of 2010, compared to the corresponding quarter of 2009. This outcome was due to higher capital expenditure by the Ok Tedi, Lihir and Porgera mines. Imports by the petroleum sector increased by 58.2 percent to K232.9 million in the December quarter of 2010, compared to the corresponding quarter of 2009. The outcome reflected higher exploration activities associated with the Mananda 5, Wasuma and Korka exploration wells. General imports declined by 4.4 percent to K1,507.4 million in the December quarter of 2010, compared to the corresponding quarter of 2009.

The deficit in the services account was K1,749 million in the December quarter of 2010, an increase of 21.9 percent from the corresponding quarter of 2009. The higher deficit was due to an increase in payments for transportation associated with higher imports, travel, communication, other business, cultural and recreational and construction services, combined with lower service receipts by resident companies.

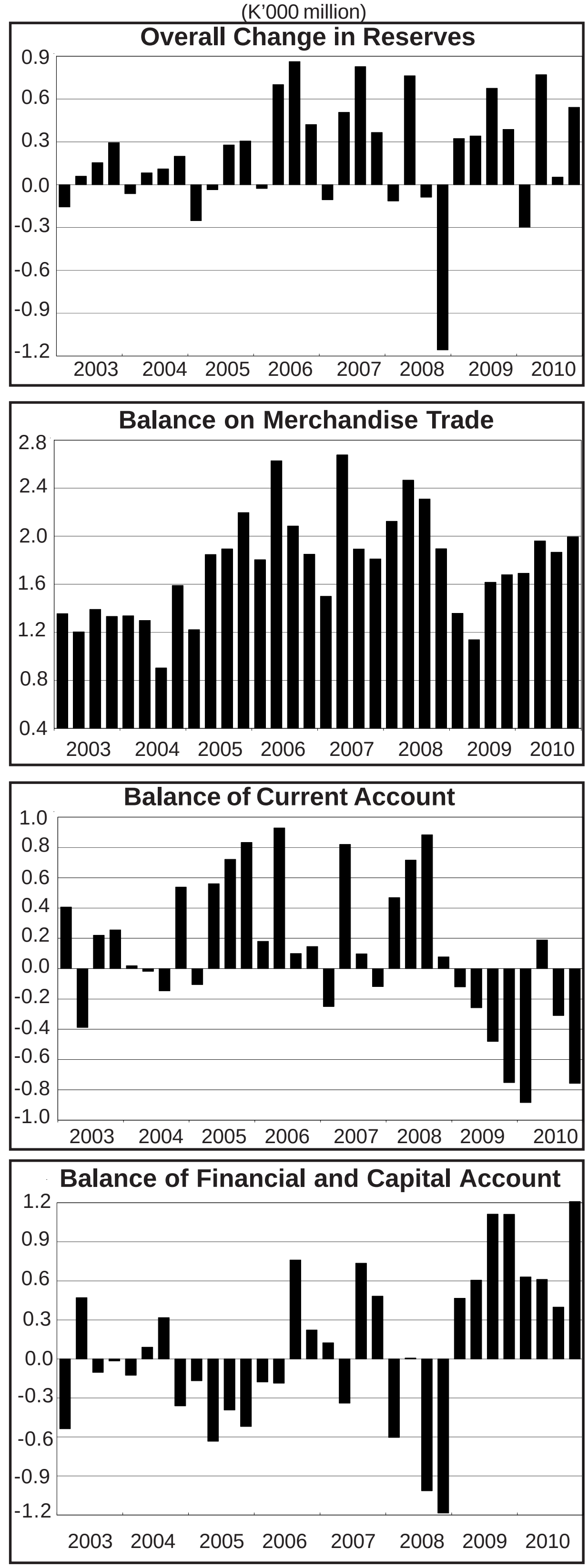
The deficit in the income account was K756 million in the December quarter of 2010, a decline of 3.6 percent from the corresponding quarter of 2009. This outcome was due to lower interest and dividend payments, which more than offset higher interest receipts.

The surplus in the transfers account was K152 million in the December quarter of 2010, a decline of 19.1 percent, from the corresponding quarter of 2009. This outcome was mainly due to lower payments for superannuation funds, family maintenance, tax, licensing fees and emigrant transfers, which more than offset lower transfer receipts.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a deficit of K757 million in the December quarter of 2010, compared to a deficit of K752 million in the corresponding quarter of 2009.

The capital account recorded a net inflow of K18 million in the December quarter of 2010, compared to K16 million in the corresponding quarter of 2009, reflecting higher capital transfers by donor agencies through

BALANCE OF PAYMENTS
(K'000 million)



direct project financing. The financial account recorded a net inflow of K1,239 million in the December quarter of 2010, compared to a net inflow of K1,095 million in the corresponding period of 2009. This outcome was due to net inflows from foreign direct investments reflecting equity inflow by the mineral sector, while the net inflow from portfolio investments reflected drawdown from investments in short-term money market instruments. Net inflows from other investments reflected a draw-down in the foreign currency account balances of resident mineral companies and inflows from trade related funds owned to PNG resident entities. These more than offset net outflows from investments in financial derivative instruments reflecting hedge payments by resident companies and from a build-up in net foreign assets of the banking system and net loan repayments by the Government.

As a result of these developments, the capital and financial accounts balance recorded a surplus of K1,257 million in the December quarter of 2010, compared to a surplus of K1,111 million in the corresponding quarter of 2009.

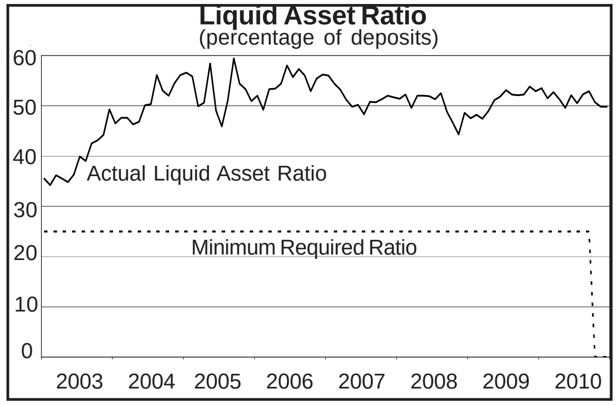
The level of gross foreign exchange reserves at the end of December 2010 was K8,169.6 (US$3,146.5) million, sufficient for 10.5 months of total and 14.4 months of non-mineral import covers.

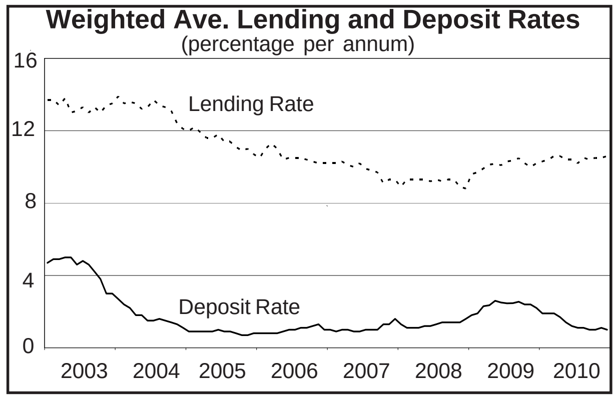
6.0 MONETARY DEVELOPMENTS

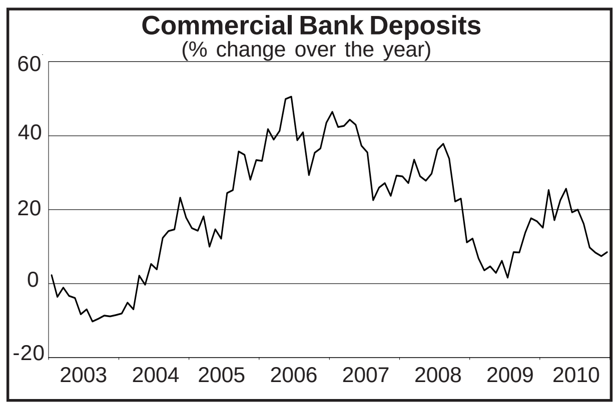
INTEREST RATES AND LIQUIDITY

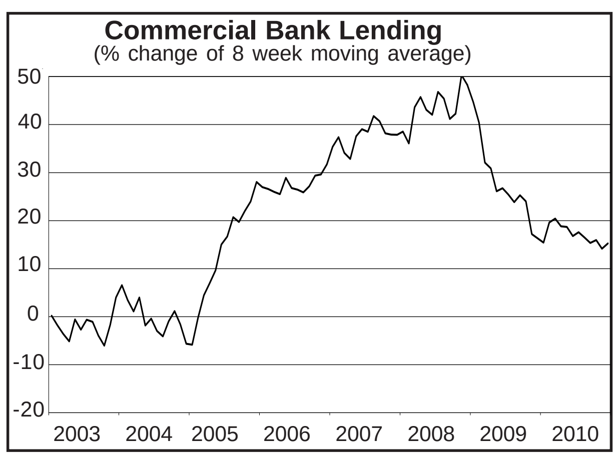
Headline inflation increased in the December quarter, while underlying inflation remained relatively stable and below expectations. The Bank of PNG continued to pursue a cautious approach to its monetary policy stance, and kept the KFR unchanged at 7.0 percent in the December quarter of 2010. The dealing 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 over the year to December 2010. At the Central Bank Bill (CBB) market, the 28-day CBB rate decreased from 5.15 percent to 2.35 percent, 63-day rate from 5.08 percent to 2.27 percent and the 91-day rate from 6.01 percent to 3.18 percent. The Bank commenced issuing the 182-day CBB rate in August 2010 at 4.02 percent, which declined to 3.43 percent

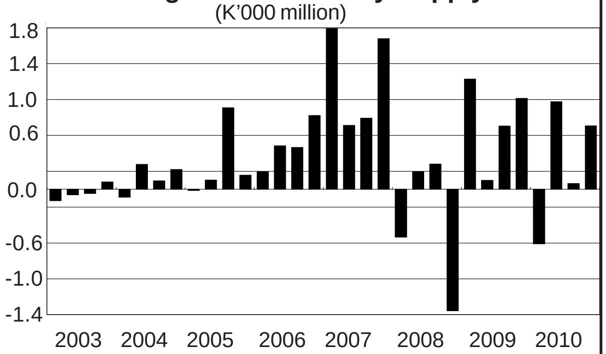




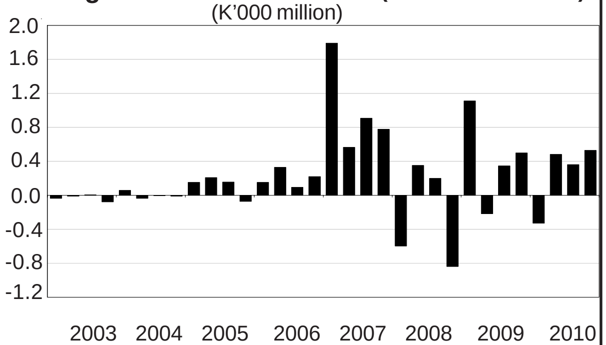




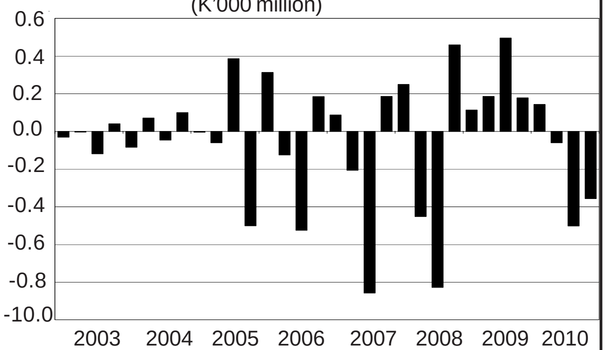
Change in Total Money Supply
(K'000 million)



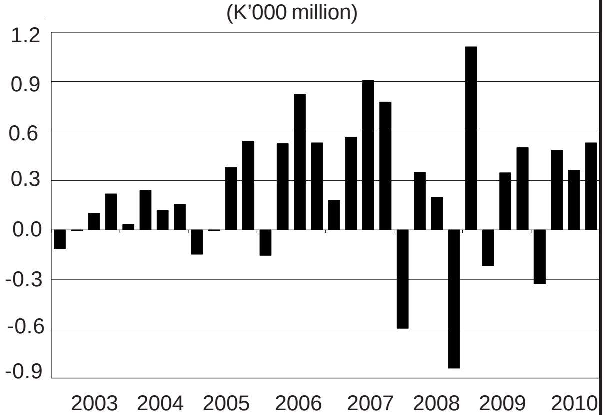
Change in Domestic Claims (Excl. Central Gov't)
(K'000 million)



Change in Net Claims to Government
(K'000 million)



Change in Net Foreign Assets
(K'000 million)



in December 2010. Government Treasury bill rates also decreased during the year with the 182-day rate declining from 7.00 percent to 3.23 percent and the 364-day rate from 7.43 percent to 3.58 percent. The Government did not issue any 91-day Treasury bill in 2010. The weighted average deposit rates quoted by commercial banks on wholesale deposits (K500,000 and above) decreased across all maturities in 2010. The 30-day rate declined from 4.01 percent to 1.54 percent, 60-day rate from 4.14 percent to 1.63 percent, 91-day rate from 4.09 percent to 1.50 percent and the 182-day rate from 4.35 percent to 2.17 percent. The declining rates reflected high liquidity in the banking system. The weighted average interest rate on total deposits decreased from 2.2 percent to 1.0 percent over the year to December 2010, while the weighted average interest rate on total loans increased from 10.2 percent to 10.6 percent. The commercial banks' Indicator Lending Rates (ILR) spread remained at 10.95 – 11.95 percent in 2010.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy in 2010. There was limited Treasury bill auction in 2010 due to the Government's positive cash flow position, while Inscribed stock auctions were conducted in line with the Government's debt strategy to shift debt to longer term. Therefore, much of the effort to diffuse excess liquidity was done through the issuance of CBBs by the Central Bank. Although the level of liquidity was high, the banks were active in the inter-bank market throughout the year due to the uneven distribution of liquidity in the system. As part of the strategy to mop up excess liquidity, the Bank increased the Cash Reserve Requirement (CRR) of the commercial banks by 1.0 percentage point to 4.0 percent, while the Minimum Liquid Assets Ratio (MLAR) of commercial banks was reduced from 25.0 percent to zero in October 2010.

MONEY SUPPLY

The average level of broad money supply (M3*) increased by 17.0 percent in 2010, compared to an increase of 13.9 percent in 2009. This outcome was due to an increase of 17.4 percent in average net private sector credit and an increase of 16.0 percent in average net foreign assets of depository corporations. Net domestic claims outstanding, excluding net claims on the Central Government increased by 16.5 percent in 2010, compared to an increase of 24.1 percent in 2009. The average level of monetary base (reserve money) grew by 20.4 percent in 2010, compared to an increase of 17.8 percent in 2009. 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*) increased by 21.8 percent in 2010, compared to an increase of 3.2 percent in 2009. This was due to increases in average transferable deposits and currency outside depository corporations. The average level of quasi money increased by 10.9 percent in 2010, compared to an increase of 28.4 percent in 2009, resulting from an increase in average term deposits.

The average level of deposits of the ODCs increased by 14.0 percent to K13,759.3 million in 2010 from K12,071.8 million in 2009. This reflected increases in transferable and other deposits including Central Government deposits.

LENDING

In 2010, 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 K1,093.4 million to K7,184.6 million, compared to an increase of K811.1 million in 2009. This was due to an increase in private sector credit of K1,058.4 million. The growth in private sector credit was broad-based reflecting advances to the mining and quarrying, commerce, transport and communications, building and construction and other business services sectors, in particular real estate, as well as for personal loans. The increase in lending also reflected businesses expanding their capacities to cater for demand coming from the PNG LNG project. The annual growth in domestic credit, excluding Central Government was 18.0 percent in 2010.

7.0 PUBLIC FINANCE

Preliminary estimates of the fiscal operations of the National Government in 2010 showed an overall surplus of K186.3 million, compared to a deficit of K36.3 million in 2009. This represents 0.7 percent of nominal GDP. Given the high revenue inflows during the year, the Government budgeted K653.3 million through a supplementary budget, details of which are reported in Total revenue, including foreign grants, in 2010 was

Table A: 2010 Supplementary Budget Allocation (Km)

Item	2010 Supplementary
LNG Related Commitments	170.0
PNG LNG High Impact Infrastructure Projects	40.0
PNG LNG Related MOA's	100.0
ILG and issues Committee	20.0
Police LNG Support	10.0
Roads	270.0
Highlands Highway	100.0
Lae Roads	50.0
Port Moresby Roads	70.0
Rural District Roads	50.0
Government Administration & Services	75.0
Provincial Services Improvement Programme	40.0
Electoral Commission	10.0
PM's Department	5.0
National Parliament	20.0
Business & Investment	52.0
Business Growth Centres	20.0
SBDC	10.0
Cooperative Societies Programme	2.0
National Development Bank Equity Retail Banking	20.0
Miscellaneous	86.3
District Offices Rehabiliation	30.0
IRC (Income Tax refund)	15.0
PM's commitment (coastal areas)	10.0
Defence Ex-servicemen entitlements	9.0
REDD Programme	3.3
Incentive fund support	3.0
Audit & Legal Team support-Finance Dept	2.0
Bainik University (via Vudal Uni)	2.0
Mining Office rehab	2.0
Varirata National park rehab	1.0
Mining Legal costs	2.0
Mobile police barracks	5.0
CIS-prison industries programme	2.0
Total	**653.3**

K8,278.9 million, 24.5 percent higher than in 2009. This represents 100.4 percent of the revised budgeted revenue. The higher revenue reflected an increase in all categories of tax revenue combined with higher foreign grants, which more than offset lower non-tax receipts.

Total tax revenue amounted to K6,434.7 million, 29.4 percent higher than the receipts collected in 2009 and represents 99.3 percent of the revised budgeted tax receipts. Direct tax receipts totalled K4,668.1 million, 32.6 percent higher than the receipts collected in 2009, and represents 99.2 percent of the revised budgeted appropriation. The increase in personal income tax was due to higher remuneration and an increase in employment reflecting growth in the economic. The increase in company tax receipts reflected improvement in profitability by companies and high mineral prices.The increase in other direct tax mainly reflected higher dividend withholding tax receipts and stamp duties.

Indirect tax receipts totalled K1,766.6 million, 21.4 percent higher than in 2009 and represents 103.6 percent of the revised budget. The increase in excise duties reflected higher demand of imported and domestically produced items. The increase in import tax resulted from high import volumes. The increase in export tax was attributed to higher volume of exports, while the increase in GST reflected higher collections in major centres.

Total non-tax revenue amounted to K435.1 million, 43.2 percent lower than in 2009 and represents 106.2 percent of the revised budgeted amount. The decrease mostly reflected the non-inclusion of injections from trust accounts which was prominently featured in 2009 outcome, combined with lower collections from services provided by National Departments. This more than offset an increase in dividend payments by statutory bodies and mining and petroleum companies. Foreign grants totalled K1,391.1 million in 2010, 58.5 percent higher than in 2009. Infrastructure tax credits was K18.0 million, 46.3 percent lower than in 2009.

Total expenditure over the twelve months to December 2010 was K8,092.6 million, 21.0 percent higher than in 2009 and represents 98.2 percent of the 2010 revised budget appropriation. This outcome reflects higher capital expenditure, which more than offset a decline in recurrent expenditure.

Total capital expenditure was K3,932.2 million, 56.0 percent higher than in 2009 and comprises the development outlay totalling K3,278.9 million and the Supplementary Budget of K653.3 million to be spent on additional investment priorities. Total development expenditure for 2010 was 39.6 percent higher than in 2009 and represents 95.6 percent of the 2010 revised budget appropriation. The higher development expenditure mainly reflected increased funding for infrastructure projects and higher project grants by donors.

Recurrent expenditure for 2010 was K4,160.3 million, 0.1 percent lower than in 2009 and represents 100.0 percent of the revised budget appropriation for 2010. The marginal decline was mainly due to lower interest payments on Government debt, which more than offset increases in National Departmental spending and grants to statutory bodies. Provincial Government expenditure amounted to K1,046.1 million, almost the same as the amount in 2009 and represents 97.6 percent of the 2010 revised budget. Interest payments totalled K353.1 million, 21.4 percent lower than in 2009 and represents 91.2 percent of the revised budget appropriation. The decrease reflected lower interest payments on Inscribed stocks and Treasury bills associated with low volume and interest rates, combined with lower interest on external debt as a result of the appreciation of kina against most major currencies. National Departmental expenditure totalled K2,474.3 million, 2.9 percent higher than in 2009 and represents 101.5 percent of the revised budget appro priation. The increase mainly reflected higher payments for personnel emoluments, court orders and structural programs.

As a result of these developments in revenue and expenditure, the Government recorded an overall surplus of K186.3 million in 2010. The surplus was used to make net external loan repayments of K84.8 million and net negative financing of K101.5 million to domestic sources. The net external loan repayments comprised of K27.6 million, K19.4 million and K37.8 million to concessionary, commercial and extraordinary sources, respectively. The net negative domestic financing comprised of K363.4 million in Government deposits placed at the Central Bank and K32.0 million repayment to ODCs. These more than offset K70.9 million in borrowing by OFCs and K223.0 million in cheque floats held by other resident sectors. Given the increase in the mining and petroleum taxes resulting from high international commodity prices and taxes on international trade, the Government appropriated a surplus revenue of K653.3 million through the 2010

Supplementary Budget. The Government had expected to achieve a balanced budget through the Supplementary Budget. The expenditure items funded under the 2010 Supplementary Budget are shown in Table A. The key expenditure items include the funding for the Umbrella Benefit Sharing Agreement (UBSA) commitments associated with the LNG project and maintenance of road infrastructure, as well as other outstanding public service administrative costs.

Total public debt of the Government decreased by K447.5 million to K6,567.3 million in the December quarter of 2010, compared to K7,014.8 million in the same quarter of 2009. The decrease reflected lower external and domestic debts. The decrease in external debt mainly reflected the appreciation of the kina against the currencies of PNG's major creditors. The decrease in domestic debt mainly resulted from the retirement of Treasury bills.

The total amount of Government deposits in the depository corporations increased by K412.6 million to K3,262.1 million in December 2010, compared to K2,849.5 million in September 2010. At the Central Bank, the amount of trust account funds increased from K100.6 million in September 2010 to K212.3 million in December 2010, reflecting increase in Government deposits. As at end of 2010, there were 23 Government trust accounts at the Central Bank.

THE 2011 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 2011 National Budget, which was presented in Parliament on 16th November 2010. The 2011 Budget focuses on building the foundation for economic growth and prosperity. The implementation of the budget will be guided by the overarching frameworks – the Medium Term Fiscal Strategy (MTFS) 2008–2012, Medium Term Debt Strategy (Debt Strategy), the Development Strategic Plan (DSP) 2010–2030, the Medium Term Development Plan (MTDP) 2011–2015 and the Fiscal Responsibility Act 2006. 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 is the review of broad aggregates and trends.

The fiscal strategy for 2011 is framed against a background of global economic recovery and strong domestic economic growth expected to be influenced mainly by the construction of the PNG Liquefied Natural Gas (LNG) project and increased production from new and existing mines. The MTFS 2008–2012 aims for a balanced budget for 2011 in order to provide a stable macroeconomic and fiscal environment conducive to private sector investment in line with the other existing overarching frameworks. The global economic recovery combined with the high commodity prices and increased production is expected to result in additional revenues (mineral revenues above 4.0 percent of GDP) in 2011. This would trigger the MTFS rule of 70:30, in which 70.0 percent of additional revenue is allocated to public investments and 30.0 percent to debt repayment. In light of PNG's development priorities and reduction in public debt to GDP ratio, the MTFS rule will be modified to allow 100 percent of additional mineral revenues to public investments in future budgets. However, this change will only apply if public debt remains below 30.0 percent of GDP. The MTFS will be reviewed in conjunction with the Sovereign Wealth Fund (SWF) framework for managing mineral and LNG revenues. The MTFS also recognizes the inherent risks to the 2011 Budget, which include: the fragility of the global economy posing a key risk in terms of its impact on the demand for PNG exports and commodity prices; delays in the PNG LNG and other mining projects due to land owner issues; and the Government diverting from fiscal discipline and adding to the already strong inflationary pressures.

On the expenditure side, both Recurrent and Development Budgets are focused on the MTDP enablers. These include: unlocking land for development; universal access to quality primary and secondary education; higher and technical education; establishing quality national road transport corridors that connect rural populations to markets and services; improved health outcomes; and improving law, order and justice. To achieve a balanced budget, total expenditure and net lending has been increased to meet outstanding obligations and to support MTDP enablers.

Within the Development Budget, 80.0 percent of Government appropriations is allocated to the MTDP of which 70.0 percent is allocated to the MTDP enablers. The MTDP succeeds the Medium Term Development Strategy (MTDS) to guide the Development Budget. An estimate of K66.6 billion is required to effectively implement the MTDP over the five year period. Over this period, a financing gap is expected to address the funding shortfall and ensure MTDP is effectively implemented. The Development Budget comprises of 62.0 percent from Government sources and 38.0 percent from international donors.

The 2011 Budget introduces several tax policy measures with no new taxes introduced. The main tax policy measures include: undertaking further Tariff Reduction Program to promote international competitiveness and an efficient private sector; update housing tax concessions due to house price inflation; environmental tax measures by allowing tax deductions for environmental protection and clean up costs; social tax measures to reduce the alcohol content of beverages which receive concessional excise treatment; and improve tax compliance for salary and wages by companies and enhance retirement savings accounts.

The expenditure allocations for 2011 continue to build on from past reforms which PNG has benefited through sustained economic growth and conducive environment for private sector investment. Development policies and strategies will be aligned to key objectives of the PNG Vision 2050, the DSP and the MTDP. In 2011, the Government will continue with the existing public sector reforms such as the Public Expenditure Review and Rationalization program, Equitable Resource Allocations to Provincial Governments program and District Treasury Roll-out program. 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 2011, project support grants are expected to increase by K232.2 million to K1,526.1 million from the 2010 revised budget estimate, mainly attributed to the depreciation of the kina against the Australian dollar and an increase in AusAID grants. In seeking to promote sustained economic growth the Government has substantially increased its budgetary support for Development Expenditure by K259.1 million to K2,126.6 million, while loans from concessional sources increases by K119.5 million to K388.4 million. Of a total of K4,041.0 million, 62.2 percent (K2,515.0 million) comes from the Government sources, while 37.8 percent (K1,526.0 million) comes from donors in the form of grants.

The 2011 Budget was formulated based on projected strong real GDP growth of 8.0 percent in 2011, following an expected growth of 7.1 percent in 2010, mainly boosted by the construction of the LNG project and its impact on other sectors in the economy, mainly the transport and construction sectors. The growth is also driven by higher production and export prices in the mining and agriculture/fisheries/forestry sectors.

Table 1: Budgetary Indicators (K'million)

	2007	2008	2009	2010			2011
	Actuals			Original Budget	Revised Budget	December Outcome (p)	Budget
1. Total Internal Revenue & Grants	7,007	7,073	6,651	7,490	8,245	7,652	9,328
2. Appropriations	6,552	7,552	6,688	7,490	8,245	6,592	9,328
3. *of which:* Additional Priority Expenditure	1,727	2,155	0	0	653	0	0
4. Surplus/(Deficit) =1-2	454	-479	-36	0	0	1,059	0
5. Primary Balance	824	-97	413	467	387	1,315	430
6. *FINANCING*	***-452***	***479***	***36***	***0***	***0***	***-1,059***	***0***
External	-397	-456	-82	85	84	-133	183
Domestic	-54	935	118	-85	-84	-926	-183
Memorandum Items:							
7. Borrowed Funds	4,798	2,769	2,315	2,147	2,104	1,196	2,186
8. GDP (Nominal)	18,802	21,601	22,207	24,890	25,837	25,837	28,718
(Ratios to Nominal GDP in %)							
9. Appropriations/GDP	34.8	35.0	30.1	30.1	31.9	25.5	32.5
10. Total Internal Revenue & Grants/GDP	37.3	32.7	30.0	30.1	31.9	29.6	32.5
11. Surplus or Deficit/GDP	2.4	-2.2	-0.2	0.0	0.0	4.1	0.0
12. Borrowed Funds/GDP	25.5	12.8	10.4	8.6	8.1	4.6	7.6
(Growth rates in %, year on year)							
13. Appropriations	13.4	15.3	-11.4	12.0	23.3	-1.4	13.1
14. GDP (Nominal)	11.3	14.9	2.8	12.1	16.3	16.3	11.1
15. Headline Inflation (Over the Year) (a)	3.2	11.2	5.7	7.0	7.4	7.2	9.9

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

(a) Actual inflation figures are from the September 2010 QEB, while inflation figures for 2010 and 2011 is from the National Statistical Office and the 2011 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 2011 Budget Papers, Volume 1, Department of Treasury and Finance.

Table 1 summarizes fiscal developments from 2007 to 2010 and the Budget indicators for 2011. In 2011, the fiscal burden on the economy, as represented by the appropriations/GDP ratio and net external borrowing is expected to increase due to the planned increase in expenditure combined with Government borrowing from concessional sources. The higher burden reflects a projected increase in appropriations.

Net financing is comprised of an increase in expected net external financing of K183.0 million and an offsetting reduction in domestic debt by the same amount. The external borrowing will be mainly from concessional sources totaling K251.0 million, while external loan repayments will comprise of K19.5 million to commercial and K48.5 million to extraordinary sources. The external borrowing is consistent with the Debt Strategy, the drawdown of loans specifically for Government development priorities and within the budget ceiling.

The overall primary balance (Table 1) measures the effects of discretionary budgetary policy by adding net interest expenses on the conventional measure of overall fiscal balance. This balance indicates how the fiscal actions of the Government affect its net debt position. A balanced Budget in 2011 signifies that there will be a surplus in the primary balance of K430.3 million. Net public debt to GDP is expected to be at sustainable levels (below 30.0 percent) with borrowing from external sources to be offset by repayments to domestic debt. This means that there is a reduction in the debt burden and the Government can save the surplus.

Table 2 depicts the revenue components of the 2011 Budget as a percentage of total revenue, which are projected to increase for all categories of revenue. The total budgeted revenue and grants for 2011 is projected to be 13.1 percent higher than the 2010 revised Budget.

In 2011, total direct taxes are projected to increase by 12.4 percent and account for 56.7 percent of total revenue, compared to the revised Budget for 2010. The increase is due to higher personal, company and other direct tax receipts. Indirect taxes are expected to increase by 14.9 percent in 2011 with the ratio to total revenue of 21.9 percent. This reflects higher collec

Table 2: Distribution between Revenue and Financing items in the 2011 Budget (K' million)

	2007	2008	2009	2010			2011
	Actuals			Original Budget	Revised Budget	December Outcome	Budget
1. Total Internal Revenue & Grants	7,007	7,073	6,651	7,490	8,245	8,261	9,328
2. Direct Taxes	4,491	4,353	3,520	4,029	4,707	4,668	5,293
3. Indirect Taxes	1,363	1,404	1,455	1,706	1,774	1,767	2,039
4. Department Rev. & Services	291	93	107	115	111	339	122
5. Revenue from Assets	141	222	172	345	359	96	349
6. Grants	721	1,002	878	1,294	1,294	1,391	1,526
7. Trust Account Injection			521				
Memorandum Item:							
8. Borrowings	4,798	2,769	2,315	2,147	2,104	2,013	2,186
Ratios (%)							
9. Direct Taxes/Total Revenue	64.1	61.5	52.9	53.8	57.1	56.5	56.7
10. Indirect Taxes/Total Revenue	19.4	19.8	21.9	22.8	21.5	21.4	21.9
11. Dept. Revenue/Total Revenue	4.1	1.3	1.6	1.5	1.3	4.1	1.3
12. Revenue from Assets/Total Revenue	2.0	3.1	2.6	4.6	4.4	1.2	3.7
13. Grants/Total Revenue	10.3	14.2	13.2	17.3	15.7	16.8	16.4
Memorandum Item:							
14. Borrowings/Total Revenue	68.5	39.1	34.8	28.7	25.5	24.4	23.4

Source: Table 1

tions in all categories of indirect tax receipts.

Non-tax revenue is expected to increase by 0.4 percent, compared to the 2010 revised Budget. This is mainly due to higher National Departmental revenue which more than offset lower dividend payments by Statutory Authorities. Total project grants are estimated to increase by 17.9 percent in 2011, compared to the 2010 revised Budget. The increase is mainly accounted for by the depreciation of the kina exchange rate against the Australian dollar and an increase in AusAID grants.

The 2011 Budget shows that total expenditure is 13.1 percent higher than the 2010 revised appropriation. National recurrent expenditure is projected to increase by 35.2 percent, while Development and Recurrent Provincial Government expenditures are projected to decline by 1.0 percent and 3.4 percent, respectively.

Table 3 shows that the share of recurrent expenditure to total appropriation will increase to 44.8 percent in 2011, compared to 37.5 percent in the 2010 revised Budget. This trend reflects increases to support the MTDP enablers and meet outstanding obligations.The share of development expenditure to total appropriation is 43.3 percent in 2011, compared to 41.6 percent in the 2010 revised Budget. The increase reflects the continued increase in funding allocation for development projects.

Achieving the 2011 Budget revenue and expenditure targets is important because of its implications on financing and the level of public debt. The framing of the 2011 National Budget was based on higher mineral revenues that will contribute to greater Government spending. In order to reduce its impact on the monetary conditions, the exchange rate and inflation, a responsible Government should always maintain strict expenditure controls within the budgeted appropriations and effectively utilise any windfall revenue to fund public investment, retire debt or save it for future use. It is non-inflationary for funds meant for the development budget to be kept in trust accounts and its spending spread over time based on the capacity of implementing agencies. In the medium term, the approval of the SWF for PNG should assist the Central Bank in managing liquidity and its impact on inflation.

Table 3: Appropriation (K' million)

	2007	2008	2009	2010			2011
	Actuals			Original Budget	Revised Budget	December Outcome	Budget
1. Total Appropriation	6,552	7,552	6,688	7,490	8,245	8,093	9,328
2. Current Expend. National Level (a)	2,703	2,912	3,120	3,113	3,089	3,114	4,178
3. Development Expenditure (b)	1,327	1,630	2,349	3,394	3,430	3,279	4,041
4. Provincial Governments (c)	795	855	1,047	983	1,072	1,046	1,109
5. Additional Priority Expenditure/Reappropriation to Trust Acco	1,727	2,155	173		653	653	
6. Supplementary Budget							
Ratios (%)							
7. Current Expenditure/Total Appropriation	41.3	38.6	46.7	41.6	37.5	38.5	44.8
8. Dev. Expenditure/Total Appropriation	20.3	21.6	35.1	45.3	41.6	40.5	43.3
9. Provincial Govts/Total Appropriation	12.1	11.3	15.6	13.1	13.0	12.9	11.9

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.

The appreciation of the kina exchange rate due to large inflows of foreign exchange would reduce foreign debt.Therefore, adherence to the overarching frameworks including the MTFS, MTDP and debt strategy are important to ensure prudent management of public finances that will help achieve a balanced budget projected in 2011, sustainable debt levels in the medium term and maintain economic growth.

In light of expectations of high inflationary pressures emanating from the domestic sector through increased Government expenditure and demand associated with the construction of the LNG project, monetary and fiscal policies should be closely monitored to ensure non-inflationary economic growth can be achieved. This will require sound fiscal management of recurrent expenditure while any increase in development expenditure should be for the priority areas of education, health, law and order and physical infrastructure. The continuation of public sector reforms and removal of impediments to trade and investment will assist to sustain and enhance economic growth in the medium term. The Government should continue to spend within the parameters set out in the 2011 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 eight years and constrain further growth prospects.

MONETARY POLICY STATEMENT

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

Economic activity as measured by growth in real Gross Domestic Product (GDP) is estimated to have increased by around 8.0[1] percent in 2010, in line with the projections of the September 2010 Monetary Policy Statement (MPS). Growth was driven by the commencement of construction of the LNG project that in turn increased activity in the building and construction, transportation, manufacturing, housing, and some service industries. Increase in Government expenditure, which included the Supplementary Budget of K653.3 million passed in November 2010, also contributed to the growth. High international prices of copper, gold, oil, and agricultural commodities funded the increase in Government expenditure. Increased income from exports, combined with income from those industries benefiting from the LNG project, and the payments to landowners, led to an increase in private sector consumption and capital formation.

In 2011, continued construction of the LNG project, commencement of production at the Ramu Nickel/Cobalt mine, and higher expected international prices for mineral and agricultural commodities, as already seen in the first three months of the year, will result in high domestic demand by the Government and the private sector as well as capital formation at levels similar to those in 2010. Based on these developments, the Bank projects that real GDP growth in 2011 will be high at around 9.5 percent.

Annual headline inflation in 2010 was 7.2 percent in line with the Bank's projection in the September 2010 MPS of 7.0 percent. This was largely due to price increases of seasonal items. Underlying inflation was around 5.5 percent, indicating that inflationary pressures still remained. The Bank projects that inflation in 2011 will be around 8.5 percent. This is considered by the Bank as tolerable at a time of high economic growth.

To support the Bank's efforts in achieving and maintaining price stability in 2011 and the medium term, it is crucial that the following be pursued under the country's macroeconomic management agenda.

- Government expenditure will be as per the 2011 National Budget;
- All trust accounts, including some of the existing balances at commercial banks, will be maintained at the Central Bank for liquidity management purposes;
- The Bank will open an offshore bank account for the Government, to insulate unbudgeted foreign currency tax flows from impacting on domestic liquidity;
- The Government to appropriate in the 2012 Budget for interest payments on Treasury Bills, Inscribed Stock and Central Bank Bills (CBB's) to be placed on Tap for the public;
- Government to refrain from competing with the private sector for limited production resources and instead should concentrate on maintaining existing transportation and social sector infrastructure that have deteriorated in many parts of the country, in order to improve health, education, and law and order, during the construction phase of the LNG project;
- The Government should increase capacity of the workforce by providing appropriate training in

[1] The Numbers on the real sector used in the text are BPNG's. These differ from those in the Appendix, which are Treasury's.

schools and colleges. This would also allow for the utilization of the expertise, physical and human resources that are built up by the LNG project development, to be efficiently and productively used as and when they are released from the project;

- The private sector should behave prudently and responsibly in passing on the lower imported goods prices sourced from lower cost countries like China, India and other developing nations in our region. Agencies responsible for monitoring prices should strengthen their activities to ensure proper pass-through of price changes; and
- The Bank will revamp the payment system, and embark on a financial inclusion and education project, which are necessary for the benefits of development to reach the majority of the population.

If the above recommendations will be accepted and implemented, the Bank is confident that the *Dutch Disease*[2] phenomena will be minimized, and inflation would be contained to an acceptable rate of below the two digit level during the construction and the production stages of the LNG project. When the flows from dividends, royalties, and taxes of the LNG project commence, the nation will be ready to use them in a sustainable, efficient, and productive way that will benefit the majority of the population. This, combined with the Sovereign Wealth Fund to care for future generations, will secure the orderly development of the traditional and the introduction of more sophisticated industries. It will move Papua New Guinea from a developing to an emerging market economy, with high economic growth, acceptable levels of inflation and a continuous increase in the standard of living. The development of traditional and value-adding industries will move the country towards realizing its Vision 2050 objectives.

1.0 Monetary Policy Discussions

1.1 Monetary Policy Assessment and Issues

The global economy continued to recover in 2010, despite some setbacks as a result of the European debt crisis. Fears of a double-dip recession did not eventuate after the effects of the stimulus packages wore off. The recovery in PNG's major trading partners was not inflationary and contributed to the low imported inflation in PNG. For 2011, global economic recovery is expected to pick up in the US and the European countries. The recent events of the political unrests in North Africa and the Middle East and the earthquake and tsunami in Japan might adversely impact on the recovery.

Economic activity as measured by real GDP growth is estimated to be around 8.0 percent in 2010. This is in line with the projection of 7.5 percent in the September 2010 MPS. Growth was driven by construction of the LNG project that led to increased activity in the building and construction, transportation, manufacturing, housing, and some service industries. Increase in Government expenditure that included the Supplementary Budget of K653.3 million passed in November 2010 also contributed to the growth. High international prices of copper, gold, oil, and agricultural commodities funded the increase in Government expenditure. The increase in metal and oil prices were the outcome of an increase in demand by the industrialized countries, coming out of the recession of 2008 and 2009, as well as the relatively high demand from the major emerging market economies of China, India, Brazil and to a lesser extent Russia. Increased income from exports, combined with income from those industries benefiting from the LNG project, and the payments to landowners, led to an increase in private sector consumption and capital formation.

In 2011, the continued construction of the LNG project, the commencement of production at the Ramu Nickel/Cobalt mine, and with higher expected international prices for mineral and agricultural commodities, as seen in the first three months of the year, will result in high domestic demand by the Government and the private sector as well as capital

[2] *Dutch Disease* refers to an economic condition where a resource boom leads to an appreciation of the real exchange rate, which in turn depresses outputs in the traditional tradable sector. The real exchange rate appreciation can occur in two ways. First, a surge in exports from the booming sector leads to an appreciation in the nominal exchange rate, resulting in a rise in the domestic prices of tradable and a consequent reduction in the export of traditional tradable, non-tradable being unaffected. Second the increase in income from the resource boom may lead to an increase in demand for domestic non-traded goods and a consequent increase in their prices.

formation at levels similar to those in 2010. Based on these developments, the Bank projects that real GDP growth in 2011 will be high at around 9.5 percent.

Annual headline inflation in 2010 was 7.2 percent in line with the Bank's projection in the September 2010 MPS of 7.0 percent, reflecting increases in seasonal items. Underlying inflation is relatively stable and does not indicate that there are major inflationary pressures. The Bank projects that inflation in 2011 will be around 8.5 percent. A single digit inflation rate is considered tolerable by the Bank at a time of high economic growth. If inflation is largely driven by external factors such as higher food and fuel prices, which could be worsened by the political unrests in North Africa and the Middle East, it will exacerbate domestic demand pressures thereby making it difficult to maintain price stability. It is important that the private sector should behave prudently and responsibly in passing on the lower imported goods prices sourced from lower cost countries like China, India and other developing nations in our region. Agencies responsible for monitoring prices should strengthen their activities to ensure proper pass-through of price changes.

Annual growth in broad money supply (M3*) and monetary base were 10.0 and 11.1 percent, respectively, in 2010. The growth in broad money supply resulted mainly from increases in net foreign assets of depository corporations and private sector credit, which grew by 20.2 percent and 17.9 percent, respectively. The growth in monetary base is attributed to an increase in currency in circulation combined with higher deposits of the commercial banks at the Central Bank. The Bank issued net new CBBs of K481 million. Liquidity continued to remain high during the year, causing downward pressure on domestic interest rates. As a result, the Bank also utilised its direct policy instruments in October 2010. The Cash Reserve Requirement (CRR) was increased from 3.0 to 4.0 percent. The increase in the CRR diffused around K130 million. Commercial banks had high liquid asset ratios in excess of 50 percent, well above the Minimum Liquid Asset Ratio Requirement (MLAR) of 25 percent, prompting the Bank to reduce it to zero, as it was no longer appropriate. The Bank is considering introducing a supervisory liquidity ratio requirement. In addition, the Bank is considering issuing CBBs on Tap to promote savings by small investors and aid the transmission of monetary policy.

In 2011, broad money supply is expected to increase by 9.6 percent driven by growth in credit to the private sector arising from increased economic activities associated with the LNG project and Government expenditure. Monetary base is expected to grow by 9.2 percent. The growth in the monetary aggregates is considered sufficient to support the anticipated increase in economic activity and is non-inflationary. Business activities directly related to the LNG project would be funded by the developers, while other companies would continue to use their own resources.

Preliminary estimates of the Government's fiscal operations in 2010 show an overall surplus of K186.3 million, or 0.7 percent of nominal GDP, compared to a deficit of K36.3 million in 2009, mainly reflecting higher mining and petroleum tax revenue resulting from high international commodity prices. From the surplus generated during 2010, the Government appropriated K653.3 million in the 2010 Supplementary Budget. The key expenditure items are funding for the Umbrella Benefit Sharing Agreement (UBSA) commitments to land owners of the LNG project, road infrastructure, and other outstanding administrative costs. During the construction phase of the LNG project, Government should adhere to the parameters of its annual budgets, and prioritize its expenditure so as not to compete with the private sector on the limited resources within the country, especially in areas of construction, civil works, earthmoving and other infrastructure developments. It should instead concentrate on maintaining existing transportation and social sector infrastructure that have deteriorated in many parts of the country, in order to improve health, education, and law and order status, as well as the traditional industries such as agriculture that will not directly benefit from the LNG project.

In late 2010, the Government agreed to open all new trust accounts at the Central Bank, which included K592 million from the 2010 Supplementary Budget. As of 25th March 2011, only K399 million has been deposited at the Central Bank. Government deposits, including trust accounts, in commercial banks continue to remain high totaling K2,243 million. Depositing all trust account funds at the Central Bank will support monetary policy management and inflation objectives. A fast pace of drawdown of the trust account funds and Government spending, especially the LNG landowner-related payments, will impact on liquidity and inflation. Close monitoring of these trust accounts is required to ensure proper application of these funds and to minimize the impact on liquidity. The Bank reiterates the need for closer coordination and cooperation between the Treasury and Finance Departments and the Bank in the conduct of fiscal and monetary policies to achieve price stability.

In November 2010, the Government decided to establish an offshore SWF to manage revenue inflows from the LNG and mineral projects. The SWF comprises three components, namely a savings fund, a stabilization fund, and an infrastructure fund. The objective of the SWF is to improve the Government's management of the large revenue windfalls by ensuring prudent use of the funds and reduce the impact of these inflows on domestic liquidity, the exchange rate, and inflation. Prior to the establishment of the SWF, the Government should refrain from appropriating windfall mineral tax revenues and allow the Bank to manage them in an offshore bank account. The Bank already has experience and expertise from managing the nation's foreign exchange reserves and therefore can manage this offshore account.

The Government should increase capacity of the workforce by providing appropriate training in schools and colleges and improve the performance of implementing agencies. This would also allow for the utilization of the expertise, physical and human resources that are built up by the LNG project development, to be efficiently and productively used as and when they are released from the project.

All these are part of good macroeconomic management and will help minimize the effects of *Dutch Disease.* For 2011 and the medium term, continued high Government expenditure, private sector aggregate demand and capital formation emanating from the LNG project, high international food and fuel prices, and recovery in the global economy will contribute to inflationary pressures. This would be exacerbated by capacity constraints in the domestic economy. The Bank will continue to carefully assess the trade-off between high economic growth and inflation in an effort to support domestic economic activity while containing inflation.

1.2 Monetary Policy Stance

Inflation generally moderated in 2010, although there were concerns on inflationary pressures associated with high domestic demand as a result of construction of the LNG project and increased Government expenditure. Although headline inflation increased in the December quarter, underlying inflation remained relatively stable and below expectations. As a result, the Bank of PNG pursued a cautious approach to its monetary policy stance, and kept the KFR unchanged at 7.0 percent throughout the year.

Economic growth is expected to continue in 2011, but at a higher pace than in 2010, mainly reflecting the construction of the LNG project and spin-offs to the other industries, increased Government expenditure, and private sector aggregate demand and capital formation. Domestic demand pressures arising from this growth, and any wage increases would add to inflationary pressures.

The Bank projects broad money to grow by 9.6 percent, monetary base by 9.2 percent and private sector credit by 13.2 percent in 2011. The growth in the private sector credit and other monetary aggregates is considered sufficient to support economic activity and is non-inflationary.

The Bank projects headline inflation to be around 8.5 percent in 2011. Upside risks to this projection could arise from:

- the effect of recent political unrest in North Africa and the Middle East on oil prices;
- further increases in international food and fuel prices;
- any new appropriation of windfall mineral tax revenue to increase Government expenditure;
- any wage increases; and
- the effect of adverse weather conditions (La Niña) on supply of domestic food produce.

In view of the expected strong economic growth and associated demand pressures in 2011, combined with high international food and fuel prices, the Bank will continue to assess the trade-off between high economic growth and inflation, and will consider tightening monetary policy as necessary to contain inflation under the double digit level.

1.3 Conduct of Monetary Policy

Monetary policy will be conducted within the reserve money framework. The Monetary Policy Statement 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 and Inscribed Stock to the general public.

The Bank may also use direct instruments, including increasing the Cash Reserve Requirement to assist in the management of monetary policy.

2.0 Developments and Expectations

2.1 International Developments

The recovery in the global economy continued during the second half of 2010 as growth in advanced economies picked up while emerging economies continued to expand at a rapid pace. According to the International Monetary Fund's (IMF) World Economic Outlook (WEO) Update of January 2011, global economic growth is estimated to be 5.0 percent in 2010. For 2011 growth is projected to be 4.5 percent, with advanced economies projected to grow by 2.5 percent and emerging and developing countries by 6.5 percent. The outlook for economic growth in advanced economies remains positive, supported by low interest rates. However, this outlook is being threatened by the potential sovereign debt crises in peripheral European countries, the disasters in Japan, and political unrest in North Africa and Middle East.

In the United States (US), real GDP in the fourth quarter of 2010 increased at an annual rate of 2.8 percent following a 2.6 percent increase in the previous quarter. Growth was mainly driven by consumer spending and exports, which more than offset negative contributions from private inventory investment. The US economy is expected to grow at a rate of 3.0 percent in 2011. In Japan, real GDP contracted at an annual rate of 1.1 percent in the fourth quarter compared to an increase of 3.3 percent in the third quarter. The contraction mainly reflected a slowdown in exports which was due to a stronger Japanese yen. Private consumption in Japan also weakened during the fourth quarter. Japan's economy is expected to grow at a rate of 1.6 percent in 2011 but this could now be affected by the recent disasters. In the Euro-zone, real GDP increased at an annual rate of 0.3 percent during the December quarter of 2010 reflecting severe winter storms that affected economic activity and the implementation of tight fiscal measures. The Euro-zone is projected to grow by 1.5 percent in 2011. Emerging economies grew at an annual rate of 7.1 percent in 2010, supported by private consumption, investments and exports. Emerging economies are projected to grow by 6.5 percent in 2011, led by growth in China and India of 9.6 percent and 8.4 percent, respectively.

The US Federal Reserve has noted that the current pace of recovery in the US is still not sufficient to significantly lower unemployment, which recorded a 9.0 percent rate in January 2011. The impact of the winter storms during December 2010 and January 2011 also contributed to the high unemployment rate. In January 2011, the unemployment rate for the Euro-zone was at 9.9 percent and Japan was at 4.9 percent. The unemployment rate for the United Kingdom (UK) was 7.9 percent in December 2010, while in Australia the unemployment rate was 5.0 percent in February 2011.

Global inflation increased in 2010, driven mainly by higher commodity prices, as evident in the rising cost of food, minerals and energy products. Other factors such as supply constraints associated with adverse weather conditions, increased demand due to on-going economic recovery and a weaker US dollar also contributed to the increase. Annual inflation in January 2011 was 1.5 percent in the US, 2.3 percent in the Euro-zone, 4.0 percent in

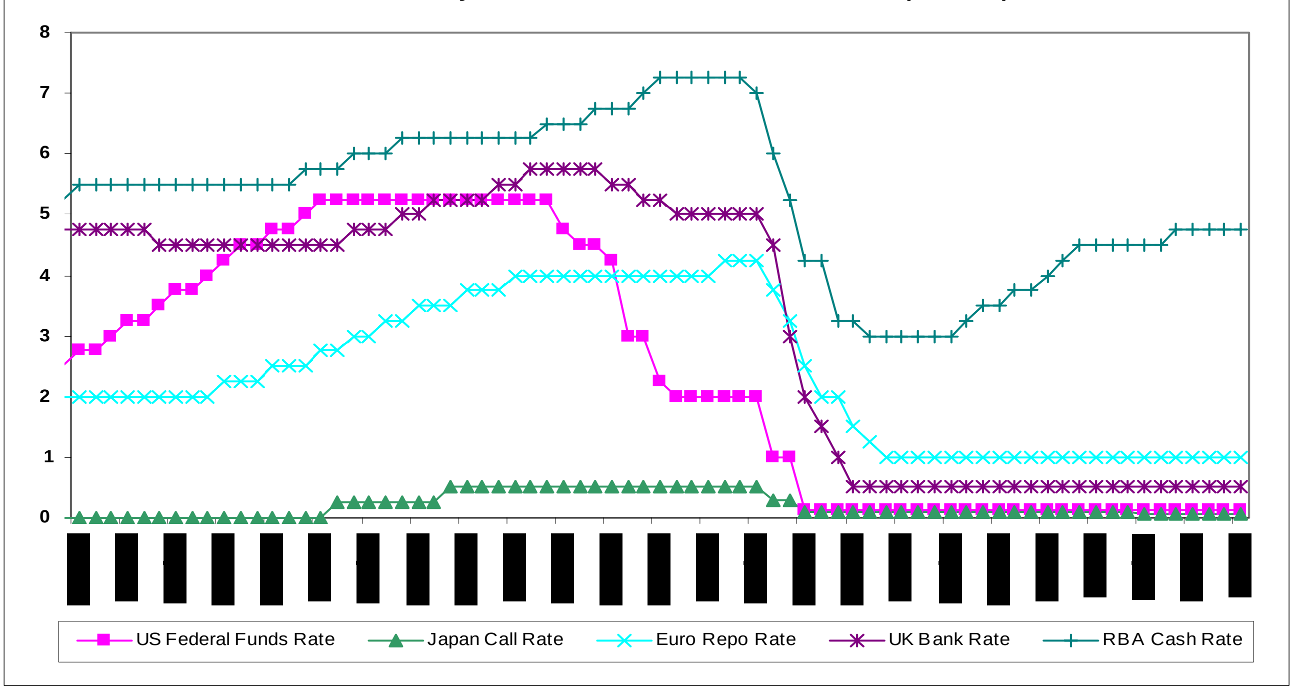
UK and -0.2 percent in Japan. Inflation in Australia was 2.7 percent in the December quarter. Inflation in January 2011 was 4.9 percent in China, 9.3 percent in India and 6.0 percent in Brazil. The recent political unrest in North Africa and the Middle East, which led to a spike in oil prices, has raised concerns on global inflation and its likely impact on global economic recovery.

Central banks in advanced economies kept their respective policy interest rates unchanged in the March quarter of 2011 to further stimulate economic growth, despite the inflation challenges. In March 2011, official interest rates were at 0.125 percent for the US, 0.05 percent in Japan, 0.5 percent in the UK and 1.0 percent in the Euro-zone. However, inflation in the Euro-zone and UK are above their respective ceiling targets of 2.0 percent. In contrast, a number of emerging and developing economies have started or are continuing to tighten monetary policy to curb inflation stemming from strong domestic economic growth and high food and energy prices.

Global financial markets remain focused on developments in Europe's sovereign debt crises. Government bond spreads for peripheral countries such as Ireland, Portugal and Spain remained wide reflecting high budget deficits and default risks. In response and as a first step, the European Union and the IMF announced that they will jointly fund an €85 billion financial assistance package for Ireland. Other peripheral countries planned to increase their government bond issuance in 2011 to raise funds. They would tie in their issuance programme with fiscal prudential reforms. Global stock markets picked up strongly since December 2010 in light of better than expected earnings reports and improving economic data in the US. However, equities have retreated slightly following the political unrest in North Africa and the Middle East. As a result of the unrest, oil prices surged to a 29-month high of US$103.4 a barrel on 24th February 2011.

In the foreign exchange markets, the US dollar generally depreciated against the major currencies during the first two months of 2011. Over this period it depreciated by 1.6 percent against the euro, 5.4 percent against the British pound sterling and 1.5 percent against the Australian dollar. Expectations of an increase in official interest rates in the Euro-zone and UK later in 2011 have resulted in the appreciation of the euro and the pound sterling. The Australian dollar continued to be supported by higher commodity prices while the Japanese yen has remained stable.

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



Source: Various Central Bank's websites

2.2 Domestic Economic Conditions

The PNG economy is estimated by the Central Bank to have expanded strongly by around 8.0 percent in 2010, in line with the projection made in the September 2010 MPS, mainly attributed to growth in the building and construction, transportation, storage and communication, manufacturing and commerce sectors. The increase was associated with the construction of the LNG project and its spill-over effects to the rest of the economy, higher Government funding of infrastructure, as well as higher production of non-mineral export commodities due to increased prices. The economy continued to expand rapidly in spite of the delay in the production of the Ramu Nickel/ Cobalt mine.

In 2011, the economy is projected to grow by around 9.5 percent, driven by increased activity in the mineral sector and a pick up in construction of the LNG project and its spill-over effects to most sectors of the economy. The manufacturing, commerce, transportation, storage and communication, agriculture/forestry/fisheries, and finance/ business and other services sectors are also expected to contribute to the growth. The increase in the building and construction sector is also associated with public investment on infrastructure and new building projects as well as those undertaken by the private sector. The growth in the mineral sector reflects the anticipated commencement of production at the Ramu Nickel/Cobalt mine and increased production at existing mines, which more than offset a decline in petroleum production. The increases in the manufacturing and commerce sectors are associated with the pick up in construction activity and higher prices of export commodities, respectively. The growth in the transportation, storage and communication sector is driven by the transportation sub-sector, reflecting increased activity in shipping, air and land transportation, associated with higher passenger travel and cargo haulage.

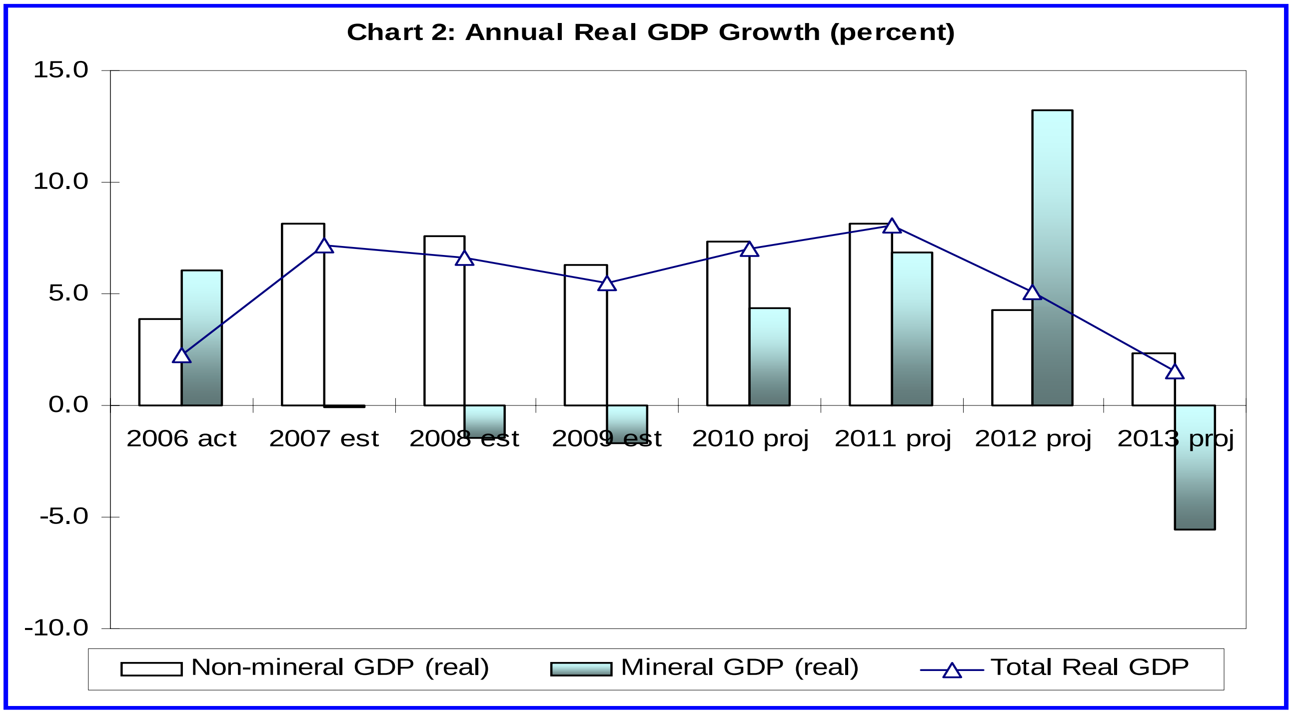
For the medium term, the Bank expects the economy to continue to grow in 2012 and 2013, but at a lower rate. This is due to the completion of the construction phase of the LNG project, especially in 2013. The growth will be driven mainly by the full year production by Ramu Nickel/Cobalt mine and increased production of gold at the Lihir, Hidden Valley and Simberi mines. High prices and production of non-mineral export commodities will also contribute to the growth. Other sectors are also expected to grow over this period.

The main downside risks to these projections include:

- any delays to the Ramu Nickel/Cobalt and the PNG LNG Projects;
- a slowdown in the world economic growth;
- lower international commodity prices;
- impact of the natural disaster in Japan on PNG's trade; and
- adverse weather conditions (La Niña and El Niño).

The Bank's private sector Employment Index indicated an increase in the level of employment of 1.9 percent in 2010, compared to an increase of 4.2 percent in 2009. The continued growth in employment was mainly in the building and construction, wholesale & retail, manufacturing, mineral and finance/business and other services sectors. By region, the level of employment increased in NCD, Highlands, Morobe and Islands regions, while Southern and Momase regions recorded declines over the same period. Total employment, excluding the mineral sector, increased by 1.2 percent in 2010. Employment level is expected to grow with the increase in LNG construction work and spin-off activities. There is some movement of labour from some industries to the LNG project. This is making it difficult and expensive for firms to find replacements from the domestic labour market.

Data from the Bank's Business Liaison Survey (BLS) showed that over the twelve months to September 2010, total sales increased by 20.4 percent, compared to 15.3 percent in the June quarter. Total sales excluding the mineral sector, increased by 28.5 percent, compared to 37.2 percent over the same period. Both the mineral and non-mineral sectors recorded increased sales as a result of improved business conditions, expansion of business operations, increased investments, high commodity prices and increased disposable incomes. The mineral, agriculture/ forestry/fisheries and retail/wholesale sectors have benefited from higher international commodity prices for PNG exports, while the transportation sector increased as a result of spin-off activities from the resource sector.



Source: 2011 National Budget

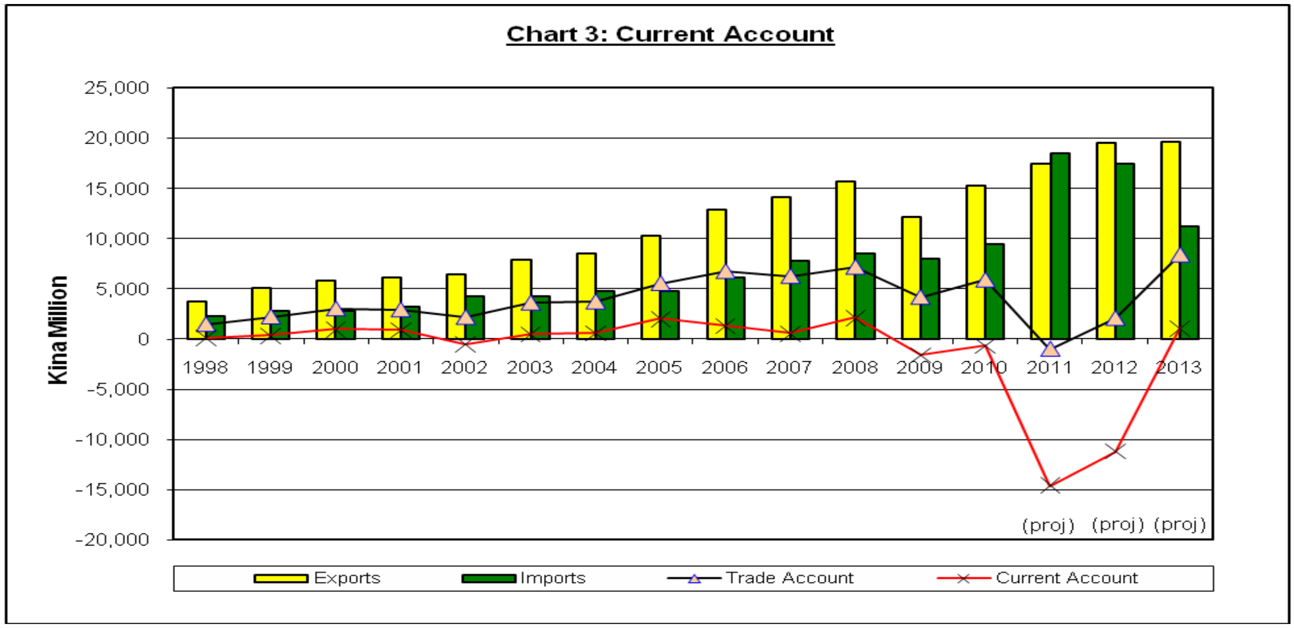
2.3 Balance of Payments

Preliminary balance of payments data for 2010 showed an overall surplus of K1,066 million, compared to a higher surplus of K1,725 million in 2009. 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 deficit in the current account was due to higher net service payments, which more than offset a higher trade surplus, lower net income payments and higher net transfer receipts. The surplus in the capital and financial accounts was due to net inflows from foreign direct and other investments. Net inflows from direct investments reflected equity inflows whilst other investments was due to draw-downs in foreign currency account balances of mineral companies and higher trade credits owed to PNG firms by foreign entities. These more than offset net outflows from portfolio investments, reflecting investments in short-term money market instruments, investments in financial derivative instruments, a build-up in the net foreign assets of the banking system, and higher net loan repayments by the Government.

The level of gross foreign exchange reserves at the end of December 2010 was US$3,146.5 (K8,169.6) million, sufficient for 10.5 months of total and 14.4 months of non-mineral import covers. As at 29th March 2011, the level of gross foreign exchange reserves was US$3,174.5 (K8,067.4) million.

The IMF's February 2011 price forecasts indicate that international prices for all of PNG's non-mineral export commodities will be higher in 2011, compared to 2010, except for copra, copra oil and logs. According to the mineral companies, the prices of all mineral exports are expected to increase during 2011.

The export volumes of all of PNG's major non-mineral commodities are projected to increase in 2011 and the medium term, compared to 2010. The projected higher production is associated with higher international prices resulting from increased global demand. The volume of gold exports is expected to increase in 2011, compared to 2010, while copper and oil export volumes are projected to decline. The increase in gold exports is due to on-going expansion at the Lihir mine combined with mining of higher ore grades from the existing mines. Copper volumes are expected



Source: Bank of PNG

to decline due to production of lower ore grades. In the petroleum sector, the decline in exports is associated with the natural decline in the reserves of the existing oilfields.

The main assumptions underlying the balance of payments projections for 2011 and the medium term are:

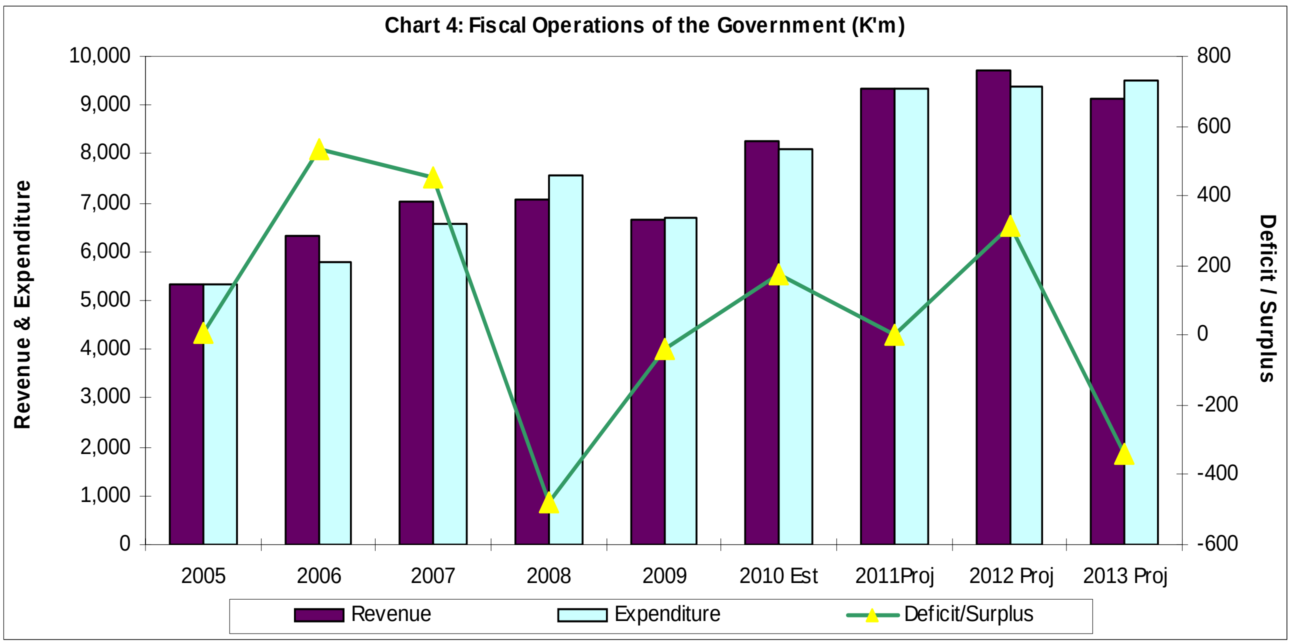
- a relatively stable kina exchange rate;
- ongoing construction of the LNG project;
- the commencement of production at Ramu Nickel/Cobalt mine in 2011; and
- the global economic recovery continues.

The current account is projected to record a significantly higher deficit in 2011, due to an increase in imports, service and income payments associated with the LNG project more than offsetting an increase in export receipts. This will be more than offset by a surplus in the financial account reflecting inflows, mainly associated with the injection of equity funds and the drawdown of loan funds for financing of the LNG project by the project partners. As a result, the overall balance of payments is projected to be in surplus by K1,412 million in 2011, compared to a surplus of K1,066 million in 2010. At the end of 2011, the gross foreign exchange reserves is projected to be around US$3,683.1 (K9,677.0) million, sufficient for 6.3 months of total and 17.1 months of non-mineral import covers. Gross reserves are projected to be higher in the medium term due to increased inflows associated mainly with higher international prices of PNG's export commodities. The impact of the inflows originating from the construction of the LNG project on the level of foreign exchange reserves will be minimal, since most of the transactions will be conducted through offshore accounts (see Appendix – Table 2).

2.4 Fiscal Operations of the National Government

Preliminary estimates of the Government's fiscal operations in 2010 show an overall surplus of K186.3 million, or 0.7 percent of nominal GDP, compared to a deficit of K36.3 million in 2009. Total revenue, including foreign grants, increased by 24.5 percent in 2010 compared to 2009, and represents 100.4 percent of the 2010 revised budget. This outcome reflected higher tax receipts attributed to increased commodity prices and domestic economic activity combined with higher foreign grants, which more than offset lower non-tax receipts. Total expenditure increased by 21.1 percent and represented 98.2 percent of the 2010 revised budget due to higher development expenditure, which more than offset lower recurrent expenditure. The increase in development expenditure was mainly attributed to increase in funding for infrastructure projects and higher project grants by donors. The decrease in recurrent expenditure resulted from lower spending by Provincial Governments and lower interest payments, which more than offset higher spending by National Departments and higher transfer payments to statutory bodies.

In late 2010, the Government agreed to open all new trust accounts at the Central Bank. A total of K592 million from the 2010 Supplementary Budget is expected to be deposited in trust accounts at the Central Bank, of which only K399.0 million has been deposited as at 25th March 2011. However, Government deposits, including trust accounts, in commercial banks continue to remain high totaling K2,243 million (see Chart 5). Depositing all trust accounts at the Central Bank will support monetary policy management by reducing liquidity. In light of the LNG related payments to the landowners, more prudent and stringent fiscal strategies are required to adequately control current and future spending. Under these circumstances, the Bank reiterates the need for closer coordination and cooperation between the Treasury and Finance Departments and the Bank in the conduct of fiscal and monetary policies to achieve price stability.

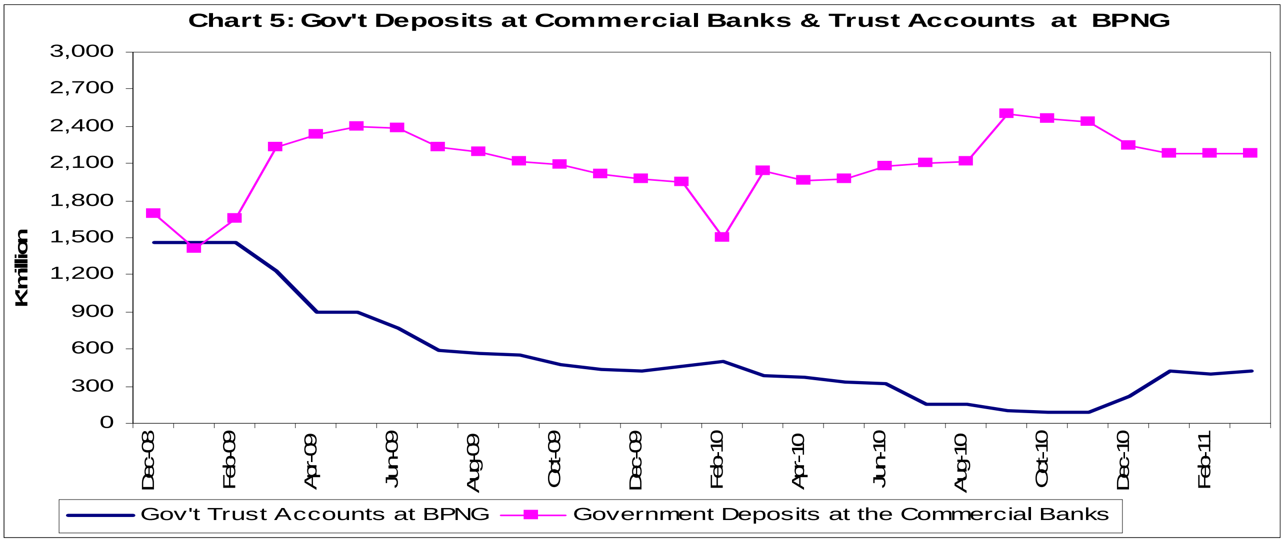


Source: Department of Treasury

In November 2010, the Government agreed to the establishment of an offshore SWF to manage revenue inflows from the LNG projects through three integrated funds, namely a savings fund, a stabilization fund and an infrastructure fund. The SWF will improve the Government's management of the large revenue windfalls by ensuring prudent use of the funds and reducing the impact of these inflows on domestic liquidity, the exchange rate, and inflation.

Total public debt to nominal GDP ratio decreased to 26.4 percent in 2010 from 32.8 percent in 2009, mainly reflecting GDP growth combined with the net retirement of domestic debt and external loan repayments. Total domestic debt decreased by 3.5 percent to K4,077.8 million, mainly due to the retirement of Treasury bills. Foreign debt declined by 14.4 percent to K2,489.5 million, reflecting higher loan repayments. The appreciation of the kina against most of the major currencies during the year also reduced the kina value of foreign debt stock.

For 2011, a balanced budget is projected based on the global economic recovery and strong domestic economic growth driven by the construction phase of the LNG project and increased production from new and existing mines. The total projected revenue for 2011 is K9,328.1 million, 12.7 percent higher than the 2010 outcome due to increased commodity prices and tax revenue. Accordingly, total expenditure will increase from K8,092.7 million in 2010 to

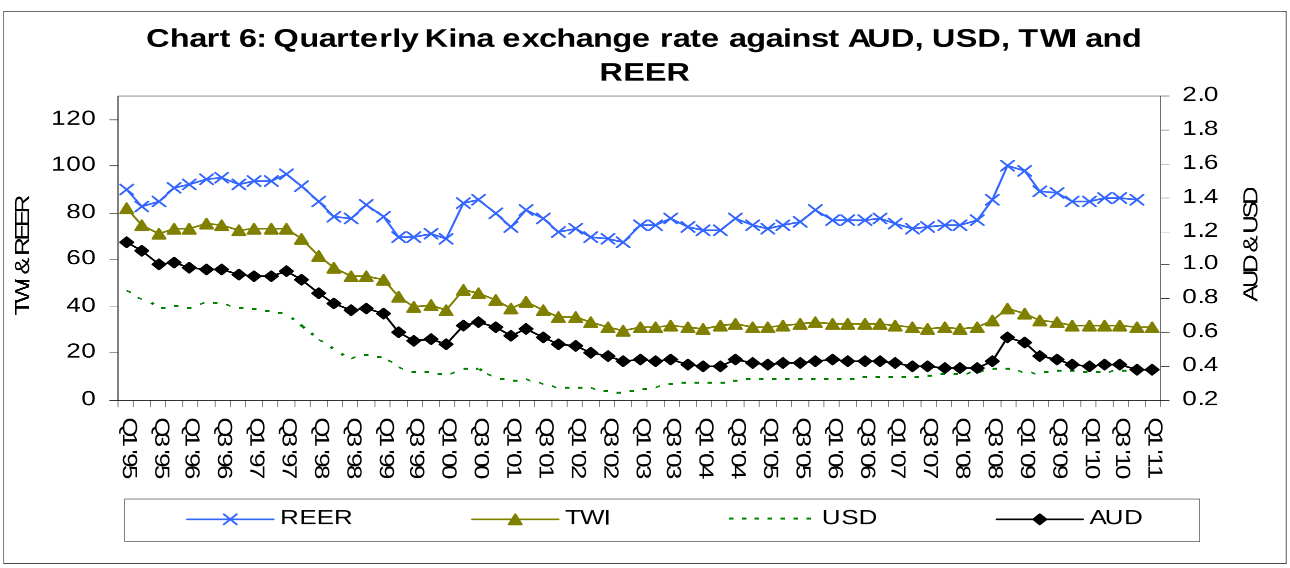


Source: Bank of PNG

K9,328.1 million in 2011, with increases in both recurrent and development expenditures. The financing of the 2011 Budget comprises of net borrowing of K183.0 million from external sources and net negative financing of the same amount to domestic sources. Public debt is projected to be 24.1 percent of GDP in 2011. The Government projects a budget surplus for 2012 and a budget deficit for 2013 when mineral tax revenue declines.

2.5 Exchange Rate

Between December quarter 2010 and first quarter up to 25th March 2011, the daily average kina exchange rate appreciated against the US dollar by 1.0 percent to US$0.3826 and depreciated against the Australian dollar by 0.5 percent to A$0.3814. The appreciation of the kina against the US dollar reflected higher 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 and favourable interest rate



Note: The REER uses IMF's revised CPI indices rebased to 2005, as contained in the June 2009 release of the International Financial Statistics (IFS), in contrast to the previous series with 2000 as the base year.
Source: Bank of PNG and IMF

differentials. As a result, the Trade Weighted Index (TWI) appreciated by 0.3 percent during the same period. The Real Effective Exchange Rate (REER) depreciated by 0.9 percent during the December quarter of 2010, increasing the competitiveness of PNG exports (see Chart 6).

2.6 Inflation

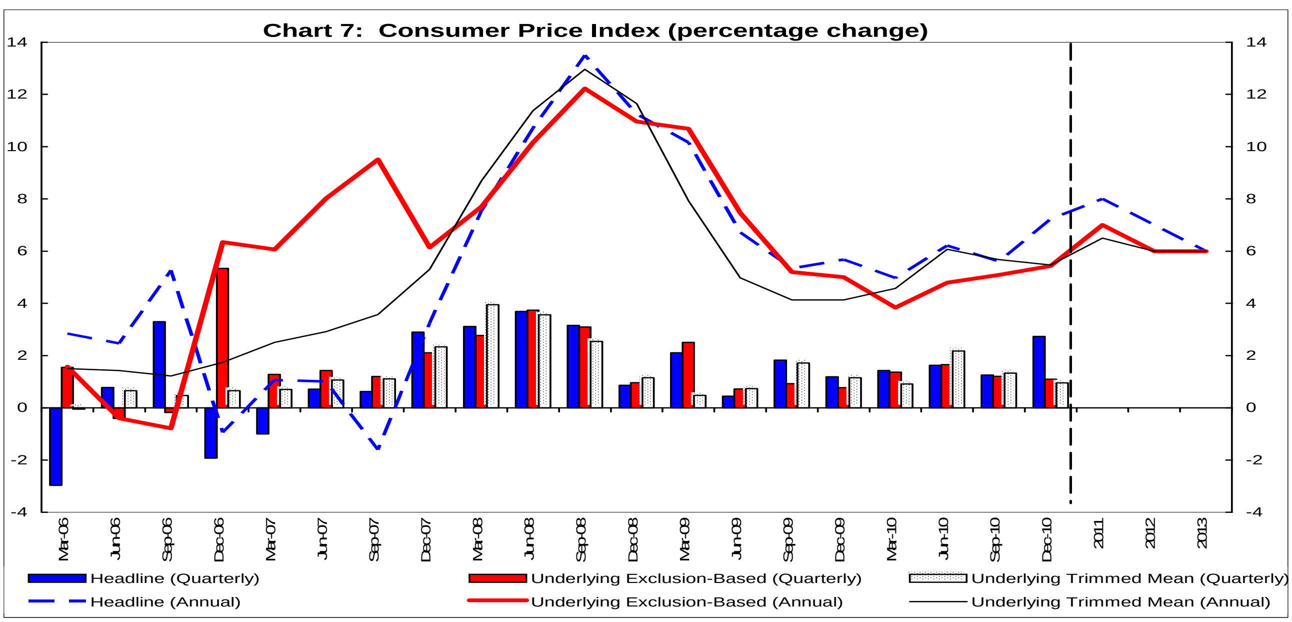
Annual headline inflation remained moderate between December 2009 and September 2010, but increased in the December quarter of 2010. Annual headline inflation in the December quarter of 2010 was 7.2 percent, higher than the 5.7 percent recorded in December quarter of 2009, but close to the Bank's projection of 7.0 percent. This higher outcome was mainly driven by price increases in the 'Drinks, tobacco and betelnut' expenditure group, especially betelnut prices. All expenditure groups and urban areas recorded increases during the quarter.

Underlying inflation also increased during the December quarter of 2010. Annual trimmed mean inflation was 5.5 percent, compared to 4.1 percent in the December quarter of 2009 while annual exclusion based inflation was 5.4 percent, compared to 5.0 percent. The increase is attributed mainly to imported inflation and a weak kina, especially against the Australian dollar.

The Bank projects annual headline inflation for 2011 to be around 8.5 percent, while trimmed-mean and the exclusion-based inflation are projected to be around 6.5 and 7.0 percent, respectively. The higher projected inflation is based on the following factors:

- Domestic demand pressures arising from the ongoing construction for the LNG project and associated activities, and increase in Government spending;
- Expected higher imported inflation from PNG's major trading partners, especially through higher food and fuel prices; and
- Higher inflation expectations by firms.

For the medium term, headline inflation is projected to be around 7.0 percent in 2012 and 6.0 percent in 2013. These projections are based on the expectation that most of PNG's major trading partners' currencies are expected to depreciate against the US dollar, as the recovery of US economy gains momentum. The LNG construction activity which is mainly driving the domestic inflationary pressures is expected to wind down in 2013.



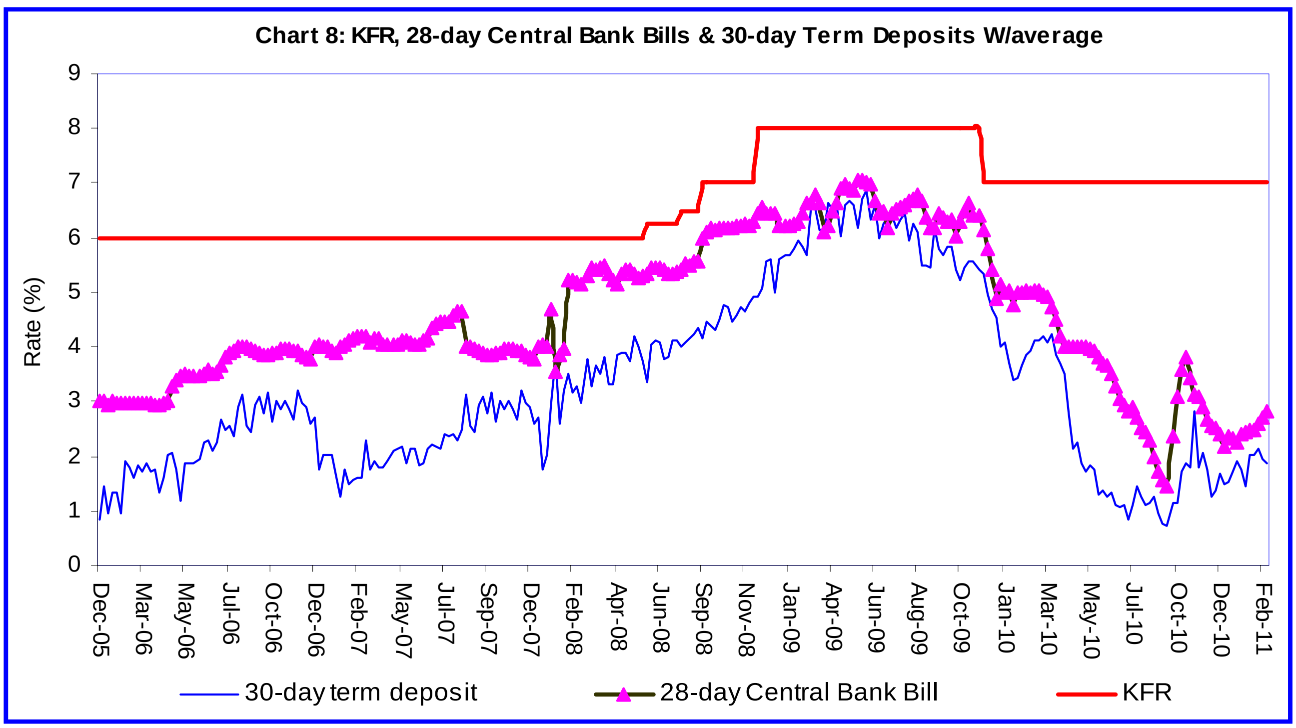
Source: Bank of PNG and National Statistical Office

The upside risks to these projections include the depreciation of the kina, any excessive Government spending in the lead up to the National Elections in 2012, higher than expected increases in fuel and commodity prices, and higher inflation in the major economies.

2.7 Monetary and Financial Market Developments

The Bank maintained a cautious approach to monetary policy in 2010 by keeping the KFR unchanged at 7.0 percent (see Chart 8). This was mainly in view of concerns on inflationary pressures from domestic demand arising from the LNG project and Government spending, in particular drawdown of trust account funds. The trading margin for the Repo was also maintained at 100 basis points on both sides of the KFR.

In 2010, the Bank issued CBBs totaling K4,613.1 million through its Open Market Operations, of which K481.2 million were net new CBBs, to diffuse excess liquidity in the banking system. However, CBB rates decreased from over 5.0 percent in 2009 to around 2.0 percent in 2010, due to high liquidity conditions. Treasury bill rates also decreased from over 6.0 percent to around 3.0 percent during the same period. In view of the persistently high liquidity conditions the Bank resorted to using its direct instruments of monetary policy. In October 2010, the Bank increased the CRR of the commercial banks from 3.0 to 4.0 percent, while the MLAR of commercial banks was reduced from 25.0 percent to zero. The increase in the CRR diffused around K130 million of liquidity and caused an increase in interest rates in October, before declining in November 2011. Indicator Lending Rates (ILR) of commercial banks remain unchanged at 10.95 – 11.95 percent in 2010. The weighted average interest rate on total deposits decreased from 2.2 percent in December 2009 to 1.0 percent in December 2010, while the weighted average lending rate on total loans increased from 10.2 percent to 10.6 percent. As a result, the spread between the weighted average lending and deposit rates widened over the year (see Chart 9).



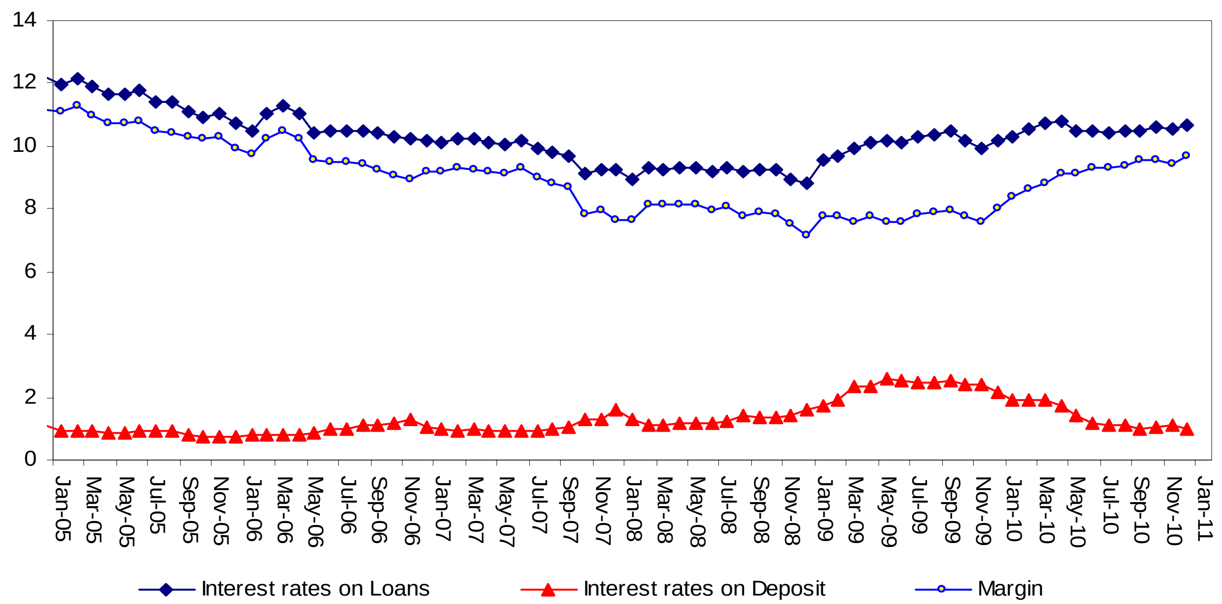
Source: Bank of PNG

Total liquidity of the banking system increased by 1.4 percent to K6,618.3 million in 2010, influenced mainly by draw downs in the trust account funds. Lending extended by ODCs to the private sector increased by 17.9 percent in 2010. The growth in private sector credit was broad based across all sectors, with notable increase to the transport and communication, finance, 'electricity, gas and water supply' and real estate and business services sectors, as well as personal loans. Net claims on the Government decreased by K776.4 million in 2010, mainly due to the net retirement of Treasury bills and increase in Government deposits in depository corporations.

The level of broad money supply increased by 10.0 percent in 2010 as a result of growth in private sector credit and increases in net foreign assets of the Central Bank and ODCs. The monetary base increased by 11.1 percent during the same period, mainly reflecting the increases in the Exchange Settlement Accounts of the commercial banks held at the Central Bank and currency outside depository corporations.

In 2011, broad money supply is expected to grow by 9.6 percent, influenced mainly by growth in credit to the private sector to cater for the projected increase in domestic economic activity and an increase in net foreign assets of depository corporations. Monetary base is expected to grow by 9.2 percent and private sector credit by 13.2 percent. While 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 (see Appendix-Table 1).

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



Source: Bank of PNG

APPENDIX

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

INDICATOR	2007 (actual)	2008 (actual)	2009 (actual)	Sep 2010 MPS	2010 (actual)	2011 (proj)	2012 (proj)	2013 (proj)
Broad Money Supply	27.3	11.2	21.8	20.6	10.0	9.6	7.9	5.5
Monetary Base	61.8	-12.0	11.9	14.9	11.1	9.2	8.1	6.5
Claims on the Private Sector	30.8	28.0	15.1	16.0	17.9	13.2	12.1	9.5
Net Claims on Gov't	-83.5	-174.3	-694.6	-21.3	-130.2	161.5	74.7	-22.3
Net Foreign Assets	51.7	-14.0	27.0	116.4	20.1	22.2	15.7	4.9

Table 2: Summary of Other Macroeconomic Indicators

INDICATOR	2007 (actual)	2008 (actual)	2009 (actual)	Sep 2010 MPS	2010 (actual)	2011 (proj)	2012 (proj)	2013 (proj)
CONSUMER PRICE INDEX (annual % changes)								
Headline	3.2	11.2	5.7	7.0	7.2	8.5	7.0	6.0
Trimmed-mean	5.3	11.7	4.1	6.5	5.5	6.5	6.0	6.0
Exclusion- based	6.1	11.0	5.0	7.0	5.4	7.0	6.0	6.0
BALANCE OF PAYMENTS (kina millions)								
Current account	550	2,145	-1,611	-11,939	-1,762	-14,566	-11,225	-2,760
Financial account	888	-2,863	3,220	13,022	2,794	15,902	12,526	3,128
Overall balance	1,592	-598	1,725	1,138	1,066	1,412	1,385	442
Gross Int. Reserves	5,919	5,321	7,046	7,817	8,170	9,677	11,057	11,498
IMPORT COVER (months)								
Total	9.1	7.9	10.7	5.5	10.5	6.3	7.6	12.4
Non-mineral	13.0	11.4	14.6	15.7	14.4	17.1	17.8	17.2
EXPORT PRICE								
Crude oil (US$/barrel)*	73.0	106.7	58.7	60.0	78.6	80.0	84.0	93.0
Gold (US$/ounce)	671.0	850.9	968.6	1,119.2	1,187.3	1,265.8	1,282.6	1,238.9
Copper (US$/pound)	320.4	327.8	217.6	323.9	333.4	350.0	300.0	300.0
FISCAL OPERATIONS OF THE GOVERNMENT**								
Surplus/Deficit (K'm)	476.2	-478.4	-36.3	533.3	186.3	0.0	312.8	-337.4
% of GDP	2.5	2.2	0.2	2.1	0.7	0.0	1.0	1.1
REAL GROSS DOMESTIC PRODUCT (annual % growth) ***								
Total GDP	7.2	6.6	5.5	7.5	7.1	8.0	5.1	1.8
Non-mineral GDP	8.1	7.6	6.3	7.6	7.3	8.2	4.3	2.3

* Prices take into account, company hedging and differ from market prices.
** Preliminary fiscal operations up to December 2010. 2011 - 2013 projections are from the 2011 National Budget
*** GDP figures are from the 2011 National Budget

Source: Bank of PNG, NSO and Department of Treasury

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 2009, the KFR announcements by the Bank were;

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 %
	03 May	Maintained at 7.00 %
	07 June	Maintained at 7.00 %
	05 July	Maintained at 7.00 %
	02 August	Maintained at 7.00 %
	06 September	Maintained at 7.00 %
	04 October	Maintained at 7.00 %
	01 November	Maintained at 7.00 %
	04 December	Maintained at 7.00 %
2011	03 January	Maintained at 7.00 %
	07 February	Maintained at 7.00 %
	07 March	Maintained at 7.00 %
	04 April	Maintained at 7.00 %
	02 May	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 (CB)	The Bank of Papua New Guinea (BPNG) is the monetary authority in Papua New Guinea (PNG) that has legislative power over the financial system and is responsible for issuing currency, managing international reserves, undertakes transactions with the IMF and providing credit to the commercial banks.
Central Bank Bill (CBB)[2]	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.
Central Bank Survey (CBS)	The CBS is the balance sheet of the Central Bank, which contains data on all components of the monetary base, comprising of currency in circulation and central bank liabilities to ODCs and other sectors.
Current Transfers Account	Records all foreign transactions that are not transfers of capital and cannot be repaid. This includes donations, gifts and grants, superannuation funds and licensing fees.
Depository Corporations Survey (DCS)	The survey is a consolidation of the CBS and the ODCS, which contains data on all depository corporations' liabilities in the national definition of broad money and data on depository corporations, assts that are claims on (i.e credit) other sectors of the economy, including the external sector.

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

Deposits	Deposits include all claims on the Bank of PNG and ODCs. These are further classified into transferable and other deposits. (I). Transferable deposits comprises all deposits that are: a). Exchangeable on demand at par and without penalty or restrictions; b). Directly usable for making payments by cheque, draft direct debit/credit or other direct payment facilities. ii.) Other deposits comprise all claims, other than transferable deposits. These include savings and term deposits and non transferable deposits in foreign currency.
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.
Financial Corporations Survey (FCS)	The FCS is the broadest set of monetary and financial statistics in terms of institutional coverage. The survey contains consolidated balance sheet data for all institutional units within the financial corporations sector, thereby providing the stock and flow data for analyzing claims on and liabilities to all other sectors of theeconomy, including the external sector.
Financial derivatives	A financial instrument linked to a specific financial instrument, indicator or commodity and through which specific financial risks (such as interest rates, currency equity and commodity price risk, credit risk, etc.) can be traded in their own right in financial markets.
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.
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.

Insurance Technical Reserves

Comprises of (i) net equity of households in life insurance corporations reserves, (ii) net equity of households in superannuation (pension) funds and (iii) prepayment of premiums. This is the major liability item of the superannuation funds and insurance corporations. On the assets side, this category records prepaid insurance premiums, which are relatively small amounts.

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.

Net Equity of Households in Life Insurance Reserves

Comprises of policyholders claims on the reserves of insurance corporations. These reserves must be ultimately used to provide benefits to policyholders, upon the occurrence of other specified events, or to compensate heirs upon the death of the policyholder. These claims constitute assets of the household sector rather than of insurance corporations.

Net Equity of Households in Pension Funds

Comprises policyholders' claims on pension funds. These reserves must be ultimately used to provide benefits to policyholders upon their retirement or to compensate heirs upon death of the policyholder. Pension funds are considered assets of the household sector rather than assets of the institutional units that manage the funds. Pension funds do not include social security funds, which are considered part of the general government sector.

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.

Other Depository Corporations (ODCs)

The ODC sub-sector in PNG comprises of the commercial banks, finance companies, merchant banks, savings and loans societies and microfinance companies. These financial corporations are mainly engaged in financial intermediation and issue liabilities included in the definition of broad.

Other Depository Corporations Survey (ODCS)

The ODCS shows the consolidated stock and flow balance sheet data for the institutional units covered under the ODC sub-sector.

Other Financial Corporations (OFCs)

The OFC sub-sector is made up of the insurancec orporations, superannuation (pension) funds, other financial intermediaries and financial auxiliaries such as insurance brokers, investment managers and fund administrators.

Other Financial Corporations Survey (OFCS)

The OFCS contains consolidated stock and flow balance sheet data for insurance corporations, superannuation funds, other financial intermediaries and financial auxiliaries.

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.

Prepayment of Premiums and Reserves against Outstanding Claims

These are current claims of policyholders rather than net equity of insurance corporations. Prepayments of premiums, which are made by customers at the beginning of the periods covered by their policies, generate reserves for insurance corporations. Such prepayments are considered to be earned by an insurance corporation on a prorated basis during the policy period. These reserves are assets of policyholders. Reserves against outstanding claims are funds set aside by insurance corporations to cover the amounts that are not settled or claims that may be disputed. Reserves against such outstanding claims are considered to be assets of the beneficiaries and liabilities of the insurance corporation. Policy benefits due to claimants are considered assets of the claimants. Until actually paid, these assets are held by insurance corporations as reserves.

Public non-financial corporations

Public non-financial corporations are resident non-financial corporations and quasi–corporations controlled by government units. Control may be exercised through ownership of more than half the voting shares, legislation, decree, or regulation that establish specific corporate policy or all the government to appoint the directors. In PNG this would include those institutions that are controlled by the Independent Public Business Corporation (IPBC).

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.

Securities other than Shares

These are negotiable instruments serving as evidence that units have obligations to settle by means of providing cash, a financial instrument, or some other items of economic value. Common securities in PNG include treasury bills and inscribed stocks issued by the Government and Central Bank Bills (CBBs) issued by the Bank of PNG.

Shares and Other equity

Shares and other equity comprises all instruments and records acknowledging, after claims of all creditors have been met, claims on the residual value of a corporation. The components of shares and other equity include: (a). Funds contributed by owners; (b). Retained earnings; (c). Current year profit and loss; (d). General and special reserve; and (e). Valuation adjustments.

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 [3]	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 or 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.

[3]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 2001.

Issue		For the Record
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.
Jun 2010	-	Expansion of Monetary and Financial Data Coverage.
Sep 2010	-	Recalculation of months of import cover

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 2000.

Issue	Title
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
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
Dec 2009	Monetary Policy Statement, March 2010
Mar 2010	Papua New Guinea’s Total External Exposure
Sep 2010	Monetary Policy Statement, September 2010
Dec 2010	The 2011 National Budget
Dec 2010	Monetary Policy Statement, March 2011

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