



BANK OF PAPUA NEW GUINEA

MONTHLY ECONOMIC REVIEW

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Economic Activity

The International Monetary Fund's October 2014 *Commodity Market Monthly* reported a 3.8 percent fall in the world commodity prices for September 2014, reflecting high supply relative to demand. Crude oil prices declined by 4.2 percent, metal prices fell by 4.0 percent and prices of agricultural products fell by 3.6 percent. Over the nine months to September 2014, commodity prices dropped by 8.3 percent in total, mainly due to declines in the prices of metal, energy and agricultural products. This was due to a slowdown in the Euro area and emerging economies, a strong US dollar, increased oil supplies, and good crop production for most agricultural commodities.

On the domestic front, preliminary estimates of the Bank's Employment Index show that private sector employment increased by 0.2 percent in the September quarter of 2014, compared to an increase of 0.1 percent in the June quarter. The employment level in the non-mineral sector increased by 0.3 percent, driven by activities in the construction, retail and transportation sectors. The increase was also partly associated with Government's expansionary fiscal expenditure. By region, increases were recorded in the Highlands, Morobe and Islands regions. Over the twelve months to September 2014, the total level of employment in the private sector and non-mineral sector increased by 1.5 percent and 3.0 percent, respectively.

Balance of Payments

Over the nine months to September 2014, the preliminary balance of payments data show an overall deficit of K435 million, compared to a large deficit of K1,173 million in the corresponding period of 2013. There was a lower deficit in the current account, which more than offset a lower surplus in capital and financial accounts. The lower deficit in the current account reflects a lower service and income payments. The lower surplus in the capital and financial account resulted from inflows of portfolio investments, which more than offset outflows in direct and other investments. The level of gross foreign exchange reserves at the end of September 2014

was K6,101.3 (US\$2,489.3) million, sufficient for 7.6 months of total and 10.6 months of non-mineral import covers. As at 31st October 2014, the level of gross foreign exchange reserves was K6,420.3 (US\$ 2,577.8) million.

Exchange Rate

The average kina exchange rate depreciated against the US dollar by 48 basis points to US\$0.399 over the month of October 2014, reflecting high import demand. Over the same period, the average kina exchange rate appreciated against the Australian dollar by 83 basis points to AU\$0.4546. This was a result of cross currency movements with the AUD depreciating against the USD on the back of positive employment data on the US economy. The average TWI increased by 1.5 percent to 37.68 over same period, accounted for by the appreciation of the kina against the Australian dollar and other major currencies. At the end of October 2014, kina was trading at US\$0.3965.

Inflation

Annual headline Consumer Price Index (CPI) was 5.3 percent in the September quarter of 2014, compared to an increase of 5.1 percent in the June quarter. There were price increases of: 5.1 percent in 'Food and non-alcoholic beverages'; 10.0 percent in 'Household equipment'; 11.8 percent in 'Housing'; 8.3 percent in 'Transport'; 13.0 percent in 'Health'; 6.6 percent in 'Recreation'; 7.6 percent in 'Restaurants and hotels'; 7.0 percent in 'Miscellaneous'; and 4.3 percent in 'Clothing and footwear' expenditure groups. The quarterly headline inflation increased by 1.6 percent

The annual headline Retail Price Index (RPI) increased by 5.7 percent over the twelve months to October, 2014, compared to an increase of 3.0 percent in the previous month. This outcome was a result of an increase in prices in the 'Drinks, Tobacco & Betelnut' expenditure group by 11.3 percent,

mainly influenced by prices of betelnut and alcoholic drinks, as well as an increase in the 'Food expenditure group' with 5.7 percent. Annual RPI ex seasonal and annual RPI ex seasonal and fuel increased by 1.9 percent and 2.4 percent, respectively.

There is an upward trend in inflation, attributable to the lag effects of the kina depreciation associated with high import demand and low export receipts. The high import demand is associated with high Government spending and increased private sector activity. Expected annual headline for end year 2014 could be lower than the Bank's inflation forecast of 8.0 percent made in its September Monetary Policy Statement.

Fiscal Operations

Preliminary estimates of the fiscal operations of the National Government over the eight months to August 2014 show an overall deficit of K954.9 million, compared to a deficit of K717.2 million in the corresponding period of 2013. This represents 2.4 percent of nominal GDP, and reflected higher Government expenditure, which more than offset lower revenue. The budget deficit of K954.9 million was financed from both domestic and external sources with K839.4 million and K115.5 million, respectively.

Total revenue, including foreign grants, over the eight months to August 2014 was K5,668.1 million, 4.5 percent lower than the receipts collected in the corresponding period of 2013. This represents 44.7 percent of the budgeted revenue for 2014. The decrease in revenue reflected lower collection in tax receipts and foreign grants, which more than offset an increase in non-tax receipts. Total expenditure over the eight months to August 2014 was K6,623.0 million, 0.4 percent higher than the corresponding period in 2013 and represents 44.0 percent of the budgeted appropriation for 2014. This outcome reflects higher development expenditure, which more than offset a decline in the recurrent expenditure.

Domestic Interest Rates & Monetary Aggregates

Over the month to the 27th October 2014, Central Bank Bill (CBB) rates increased for the 63-day and 91-day terms while, the 28-day rate remained unchanged. There was no auction for the 182-day term since August 2014. The 63-day and 91-day rates increased to 2.82 percent and 2.95 percent from 2.77 percent and 2.89 percent, whilst the 28 day-rate remained at 1.95 percent. At the Treasury bill auction, the 182 and 365 day rates increased to 4.55 percent and 7.36 percent from 4.51 percent and 7.30 percent, respectively. The

Kina Facility Rate (KFR) was maintained at 6.25 percent in October with trading margins for Repos remaining at 100 basis points from the KFR. There was a net issuance of K157.24 million of CBBs and K318.4 million of Treasury bills by the Government in October.

Over the year to 24th October 2014, average lending by banks increased by 15.6 percent to K9550.6 million. The commercial bank deposits increased by K774.5 million to K19,146.1 million between December 2013 and week-ending 24th October 2014, reflecting net deposits by the construction, mining, petroleum, government, wholesale, finance and manufacturing, and other business sectors. Over the year to 24th October 2014, average deposits increased by 5.3 percent to K18,668.8 million.

Monetary Policy

Although inflation has been on an upward trend over the nine months to September 2014, the Bank perceives that the current inflation level at around 5.0 percent is manageable. The Bank continues to take a cautious approach by maintaining the policy signalling rate, the Kina Facility Rate, at 6.25 percent for the month of October 2014.

Financial System Stability

The total assets of the banking sector as at the end of September 2014 was K29.8 billion, of which 91.8 percent was for the commercial banks, 4.3 percent for licensed financial institutions, 0.7 percent for the micro banks and 3.2 percent for the savings & loan societies.. Total deposits were K22.5 billion, of which commercial banks accounted for 93.7 percent while the licensed financial institutions, microfinance institutions and savings & loan societies accounted for 3.5 percent, 0.7 percent, and 2.1 percent, respectively. Total loans were K12.8 billion. The ratio of non-performing loans to total loans was 2.5 percent, whilst the ratio of non-performing loans to total assets was 1.1 percent.

The capital adequacy ratio for the banking sector was 33.3 percent, well above the minimum requirement of 12.0 percent. The return on assets and equity was 2.7 percent and 37.8 percent, respectively. These figures indicate that the financial system in PNG is very sound.

Papua New Guinea Key Economic Indicators

		May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14
1. Consumer Price Index (CPI)	Headline	-	5.1	-	-	5.3	-
	Food	-	5.5	-	-	5.1	-
2. Retail Price Index (RPI) (YOY % Change)(a)	Headline	2.3	4.0	5.8	4.0	3.00	5.7
	Ex-seasonal	4.0	3.7	2.5	2.2	2.10	1.9
3. Exchange Rates (mid-rate, eop)	USD	0.4130	0.4120	0.4085	0.4055	0.4030	0.3965
	AUD	0.4432	0.4373	0.4382	0.4337	0.4605	0.4511
	GBP	0.2468	0.2420	0.2415	0.2445	0.2479	0.2483
	JPY	41.950	41.470	41.970	42.100	44.0600	43.9900
	NZD	0.4855	0.4706	0.4799	0.4843	0.5164	0.5066
4. Foreign Exchange Reserve (eop, US\$ mill)		2,644.4	2,593.4	2,615.8	2,614.2	2,489.3	2,577.8
5. Liquidity (eop)	Liquid Assets Margin to Deposit Ratio (%)	42.9	43.8	44.7	45.6	45.5	44.0
	Banks' Demand Deposits (K'bn)	14.3	14.2	14.2	14.4	14.2	14.7
6. Money and Credit (YOY % Change)	Broad Money	6.7	3.7	-0.6	2.8	2.8	-
	Monetary Base	20.0	31.8	19.0	31.0	27.9	-
	Private Sector Credit	9.2	3.8	-2.9	5.2	3.2	-
7. Interest Rates (% pa) (monthly weighted average)	Kina Facility Rate	6.25	6.25	6.25	6.25	6.25	6.25
	Central Bank Bill (28 day)	1.89	1.89	1.89	1.94	1.95	1.95
	Commercial bank Term Deposit (30 day)	1.24	1.22	0.39	1.19	1.46	1.01
	Government Treasury Bill (364 day)	6.12	6.35	6.84	7.20	7.30	7.36
	3-year Inscribed stock Rate	7.64	7.69	7.94	7.98	8.03	8.06
	16-year Inscribed stock Rate (> 10 years)	14.65	15.18	15.40	15.45	15.40	15.3
8. Commodity Prices (monthly average)	Oil (\$/bbl)	105.7	108.4	105.2	100.1	95.9	86.1
	Gold (\$/troy oz)	1,285.9	1,277.3	1,312.4	1,295.8	1240.9	1221.3
	Copper (\$/mt)	6,857.7	6,798.4	7,098.1	6,998.5	6885.5	6735.9
	Coffee (cents/kg)	218.6	198.5	198.6	213.7	215.3	226.5
	Cocoa (cents/kg)	180.1	187.0	187.2	195.5	195.7	195.0