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**PORT MORESBY**  
20<sup>th</sup> June 2007

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## 1. GENERAL OVERVIEW

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Indicators available to the Bank of PNG showed that economic activity increased in the first quarter of 2007, supported by stable macroeconomic conditions. Formal private sector employment was higher in almost all sectors of the economy. Credit to the private sector continue to grow in the first quarter of 2007 as a result of more business investments, while the Government recorded a budget surplus reflecting strong corporate profits and high income tax revenues. General imports increased in the March quarter, compared to the corresponding quarter of 2006. Whilst the export volumes of most of PNG's major commodities declined, these were offset by increases in their prices, reflecting higher international prices. Inflation increased partly as a result of the depreciation of the kina against the Australian dollar. The Bank of PNG maintained a neutral stance of monetary policy over the quarter but is concerned about the high liquidity levels, growth in monetary aggregates, further depreciation in the exchange rate and, increase in election related Government expenditures and their potential impact on inflation.

The Bank's Employment Index showed that the level of employment in the formal private sector, excluding the mineral sector increased by 4.1 percent in the March quarter of 2007, compared to an increase of 3.7 percent in the December quarter of 2006. Employment levels increased in all regions and sectors, except for the financial/business and other services sectors. Over the year to March 2007, the level of employment, excluding the mineral sector increased by 9.9 percent, compared to 8.6 percent over the year to December 2006.

The headline inflation rate was 0.1 percent in the March quarter of 2007, compared to 0.3 percent in the December quarter of 2006. The increase was due to higher prices in the 'Food', 'Rents, Council charges, Fuel/Power', 'Transport and Communication' and the 'Miscellaneous' expenditure groups. By region, all urban areas, except Lae and Rabaul, recorded higher prices. The annual headline inflation rate was 4.5 percent in the March quarter of 2007, compared to 1.3 percent in the December quarter of 2006.

The exclusion-based inflation measure was 5.3 percent in the March quarter of 2007, compared to 1.8

percent in the December quarter of 2006. Annual exclusion-based inflation was 6.9 percent in March 2007, compared to 2.9 percent in December 2006. Trimmed mean inflation was 5.6 percent in the March quarter of 2007, compared to a decline of 0.7 percent in the December quarter of 2006. Annual trimmed mean inflation was 6.0 percent in March 2007, compared to 0.4 percent in December 2006.

In the March quarter of 2007, the daily average kina exchange rate depreciated against all the major currencies except the yen. The daily average kina exchange rate depreciated by 0.3 percent against the US dollar to 33.00 US cents and by 2.3 percent against the Australian dollar to 42.00 cents. These movements resulted in the quarterly average Trade Weighted Index (TWI) depreciating by 1.3 percent during the March quarter.

Higher international prices for mineral, most agricultural commodities and log exports resulted in a 11.5 percent increase in the weighted average kina price of Papua New Guinea's exports in the March quarter of 2007, compared to the corresponding quarter of 2006. There was a 9.6 percent increase in the weighted average price of mineral exports, with higher kina prices of copper and gold. For the agricultural, forestry and marine product exports, the weighted average kina price increased by 23.3 percent and was attributed to higher kina prices of coffee, cocoa, palm oil, copra oil, tea, rubber and log exports, which more than offset declines in export prices of copra and marine products.

The overall deficit in the balance of payments was K106 million in the March quarter of 2007, compared to a deficit of K27 million in the corresponding period of 2006. This outcome was due to a deficit in the current account, which more than offset a surplus in the capital and financial accounts.

The current account recorded a deficit of K395 million in the March quarter of 2007, compared to a surplus of K151 million in the corresponding period of 2006. This outcome was mainly attributed to a lower trade surplus and higher net service payments, which more than offset lower net income payments and higher net transfer receipts.

The capital account recorded a higher net inflow of K40 million in the March quarter of 2007, an increase

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of 48.2 percent from the corresponding period of 2006. The increase reflected higher capital transfers by donor agencies through direct project financing<sup>1</sup>.

The financial account recorded a net inflow of K223 million in the March quarter of 2007, compared to a net outflow of K175 million in the corresponding period of 2006. This outcome reflected higher draw down of investments in short-term money market instruments and financial derivative instruments, combined with higher draw down of loans and foreign currency account balances by the mineral companies.

The level of gross foreign exchange reserves at the end of March 2007 was K4,219.2 (US\$1,400.6) million, sufficient for 6.6 months of total and 9.3 months of non-mineral import covers.

The Bank of Papua New Guinea maintained a neutral monetary policy stance during the March quarter of 2007. The Kina Facility Rate (KFR) was kept unchanged at 6.00 percent and the dealing margin for the Repurchase Agreements (Repos) was maintained at 150 basis points on both sides of the KFR. Central Bank Bill (CBB) rates showed increasing trends reflecting higher issuance of CBBs to sterilise excess liquidity and realign short-term domestic interest rates with the KFR. Domestic interest rates for loans and deposits showed mixed trends during the quarter.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy over the March quarter of 2007. The CBBs were mainly used to sterilise excess liquidity, which was complemented by the increased issuance of Treasury bills by the Government. For daily liquidity management purposes, the commercial banks utilised the inter-bank market and Repo with the Bank of PNG to meet their liquidity needs. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) of commercial banks were maintained at 3.0 percent and 25.0 percent, respectively, in the March quarter of 2007.

The average level of broad money supply (M3\*) increased by 7.5 percent in the March quarter of 2007, compared to an increase of 9.4 percent in the December quarter of 2006. The outcome was due to increases of 31.9 percent in average net claims on the Government, 9.3 percent increase in average private

sector credit and 3.4 percent increase in net foreign assets of the depository corporations. Net domestic claims outstanding, excluding advances to the Central Government and outstanding loans under the Government's Agricultural export commodity price support schemes increased by 7.9 percent in the March quarter of 2007, compared to an increase of 7.3 percent in the previous quarter.

Total domestic credit extended by depository corporations to the private sector, public non-financial corporations, Provincial and Local Level Governments, and other financial corporations, increased by K222.3 million to K3,258.7 million, compared to an increase of K218.9 million in the previous quarter. This was mainly due to an increase of K228.1 million in private sector credit, which more than offset declines of K4.5 million in claims on public non-financial corporations and K1.8 million in claims on Provincial and Local Level Governments. The annualised growth in domestic credit, excluding Central Government and advances under the price support schemes was 20.0 percent in the first quarter of 2007.

Preliminary estimates of the fiscal operations of the National Government over the three months to March 2007 showed an overall surplus of K231.5 million, compared to a deficit of K70.4 million in the corresponding period of 2006. This represents 1.3 percent of nominal Gross Domestic Product (GDP). The surplus resulted from higher revenue combined with lower expenditure.

Total revenue, including grants, during the March quarter of 2007 was K780.9 million, 9.5 percent higher than the receipts collected in the corresponding period of 2006. This represents 14.4 percent of the 2007 budgeted revenue.

Total expenditure over the three months to March 2007 was K549.4 million, 29.9 percent lower than in the corresponding period of 2006, and represents 10.1 percent of the budgeted expenditure for 2007.

As a result of these developments in revenue and expenditure, the Government recorded a surplus of K231.5 million in the first three months of 2007. The surplus was used to make net external loan repayments of K35.1 million and net negative financing of K196.4 million.

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<sup>1</sup> See 'For the Record' on page 35 of the December 2006 Quarterly Economic Bulletin.

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## 2. INTERNATIONAL DEVELOPMENTS

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The world economy experienced strong growth in 2006 and is projected to continue in 2007 but at a moderate pace. The latest International Monetary Fund's (IMF) forecast made in April 2007 is for real Gross Domestic Product (GDP) to grow by 4.9 percent in 2007, compared to 5.4 percent in 2006. Growth in Europe, Japan, China, India and the other emerging economies are expected to remain strong in 2007. Weaker growth is expected for the major industrialised countries mainly reflecting a slow down in the United States (US). Nevertheless, concerns remain that the slump in the US housing market could intensify with likely spill over to other countries.

International commodity prices fluctuated but remained high in the first quarter of 2007, though the upward momentum of most commodities has slowed down since reaching record levels in 2006. Over the March quarter of 2007, developments in commodity prices was led by increases in metal prices, including gold (17 percent), copper (20 percent), lead (44 percent), nickel (178 percent), and zinc (54 percent) reflecting surge in demand for steel and automotive production, especially in China. Uranium price also rose by 71 percent, attributed mainly to the revival of interest in nuclear energy. Oil prices, however, after reaching a record high of US\$78 a barrel in 2006, fell to US\$50 a barrel and rebounded to almost US\$70 a barrel in late March 2007. The prices recovered due to strengthening of global demand, further oil production cuts by the Organisation for Petroleum Exporting Countries (OPEC), geo-political tensions in the Middle East and declining inventories in the Organisation for Economic Cooperation and Development (OECD) member countries.

In January, business and political leaders and other delegates from around the world attended the World Economic Forum (WEF) in Davos, Switzerland. Trade Ministers at the forum discussed among other issues the revival of the Doha Round of Trade Negotiations, which was effectively endorsed by the World Trade Organisation (WTO). This resulted from a closer bilateral engagement between the US and European Union (EU) in recent months, after concerns were raised by developing and emerging countries, especially India on the unconceded efforts by the EU and US to resume trade negotiations. The revival of the Doha Round would contribute to multilateral trade reforms and

improve existing trade rules to reduce the risk of protectionism.

In February, the IMF and Bruegel, a Brussels-based think-tank held a two day conference to review the progress towards a more integrated financial system in the Euro zone. It was agreed that whilst much has been achieved there was still the need to accelerate financial integration, improve economic and regulatory issues, including Europe's crisis prevention, management, and resolution framework.

In March, the Finance Ministers from the Group of Eight (G8) major industrialised countries for the first time, met with their counterparts from the developing countries represented by Brazil, China, India, Mexico and South Africa and other organisations including OECD, African Union (AU), African Development Bank (ADB), East African Community (EAC), Economic Community of West African States (ECOWAS), Intergovernmental Authority on Development (IGAD) and the Southern African Development Community (SADC) in Berlin, Germany to discuss development policy issues. The meeting signalled the G8's desire to work in partnership with developing countries and relevant development agencies to find answers to the challenges for sustainable economic growth. The main issue was the level of assistance the G8 is willing to contribute towards the achievement of the Millennium Development Goals and sustainable growth. Specific issues discussed relate to investment in Africa, health, climate change, gender and empowering women, global partnerships, peace and security, regional integration and economic cooperation and improving official development assistance.

In the US, real GDP grew by 2.1 percent over the year to March 2007, compared to 3.5 percent over the same period in 2006. The slow down in economic activity was a result of the slump in the housing market and a decline in corporate investments in plant and equipment. The growth was due to strong consumer demand reflecting improvements in the labour market and declines in fuel prices, which resulted in a higher household spending. The IMF forecast is for GDP to grow by 2.2 percent in 2007.

Industrial production increased by 2.3 percent over the year to March 2007, compared to an increase of 3.6 percent over the corresponding period of 2006. The Institute of Supply Management's Purchasing Managers' Index (PMI) recorded 49.3 in January, 52.3 in

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February and 50.9 in March 2007. An index rating of over 50 indicates an expansion in the manufacturing sector. Retail sales increased by 3.3 percent over the year to March 2007, compared to 6.2 percent over the same period in 2006. The level of unemployment declined to 4.4 percent in March 2007, compared to 4.7 percent in March 2006. Industries which reported growth in employment were apparel, leather and allied products, transportation equipment, chemical products, miscellaneous manufacturing and construction.

Consumer prices rose by 2.8 percent over the year to March 2007, compared to 3.4 percent over the corresponding period of 2006. Broad money supply increased by 6.1 percent over the year to March 2007, compared to 4.7 percent over the same period in 2006. With inflationary pressures easing in the first quarter of 2007, the US Federal Reserve Board kept the federal funds rate at 5.25 percent.

The trade deficit was US\$827.2 billion over the year to March 2007, compared to a deficit of US\$782.1 billion over the corresponding period of 2006. The increase in the deficit was due to higher imports combined with lower exports.

In Japan, the economy continued to expand moderately in the first quarter of 2007. Real GDP grew by 2.0 percent in the year to March 2007, compared to 3.0 percent over the same period in 2006. The growth was due to increased exports and fixed investment, high corporate profits, moderate rise in household income, and strong private consumption. Housing investment has also increased moderately. The IMF forecast is for GDP to grow by 1.9 percent in 2007.

Industrial production increased by 1.6 percent over the year to March 2007, compared to an increase of 3.1 percent over the corresponding period of 2006. Retail sales increased by 1.6 percent in the year to March 2007, compared to 3.1 percent in the corresponding period of 2006. The unemployment rate was 4.0 percent in March 2007, compared to 4.1 percent in March 2006.

Consumer prices declined by 0.1 percent over the year to March 2007, compared to an increase of 0.3 percent over the same period in 2006. Core consumer prices, excluding fresh food but including energy, fell by 0.3 percent over the year to March 2007. Broad money supply increased by 1.1 percent over the year to March 2007, compared to 1.5 percent in the same period in

2006. With declines in inflation, the Bank of Japan maintained its call rate at 0.25 percent.

The current account surplus was US\$181.5 billion over the year to March 2007, compared to a surplus of US\$166.7 billion over the corresponding period of 2006. The surplus was due to higher exports to Europe and the rest of Asia.

In the Euro Area, real GDP grew by 3.1 percent over the year to March 2007, compared to 2.0 percent in the same period in 2006. The growth in the Euro Area was broad-based across all member countries led by strong growth in Germany. The European Central Bank (ECB) continued to raise interest rates, increasing the Euro Refinancing Rate to 3.75 percent in March 2007 from 3.50 percent in December 2006, attributed to a higher inflation forecast reflecting the increase in oil prices. The increases caused concerns among member countries that the tight monetary policy might threaten economic recovery in the single currency zone.

Industrial production rose by 3.7 percent over the year to March 2007, compared to 3.8 percent in the same period in 2006. Retail sales increased by 2.6 percent over the year to March 2007, compared to an increase of 0.6 percent over the corresponding period of 2006. The unemployment rate declined to 7.2 percent in March 2007, from 8.1 percent in March 2006, reflecting improved business confidence and increased investment by the private sector.

Consumer prices increased by 1.9 percent over the year to March 2007, compared to an increase of 2.2 percent over the corresponding period of 2006. Broad money supply increased by 10.9 percent over the year to March 2007, compared to an increase of 1.5 percent over the corresponding period of 2006.

The current account deficit was US\$12.5 billion over the year to March 2007, compared to US\$41.4 billion in the same period in 2006.

In Germany, real GDP grew by 3.6 percent over the year to March 2007, compared to 1.6 percent over the same period in 2006. The growth was associated with higher demand for industrial goods, strong consumer spending, and higher export growth and investment. The IMF forecast is for GDP to grow by 1.8 percent in 2007.

Industrial production grew by 7.7 percent over the year

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to March 2007, compared to 3.9 percent over the same period of 2006. New orders have increased by 2.4 percent in March 2007. Retail sales rose by 0.6 percent over the year to March 2007, compared to a decline of 1.2 percent over the same period in 2006. The unemployment rate fell to 9.2 percent in March 2007 from 11.4 percent in March 2006, reflecting the pick up in economic activity.

Consumer prices rose by 1.9 percent over the year to March 2007, the same as in the corresponding period of 2006.

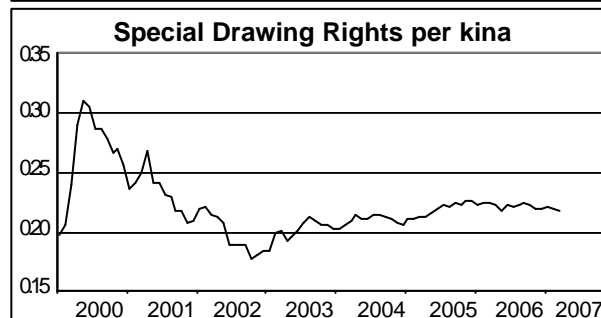
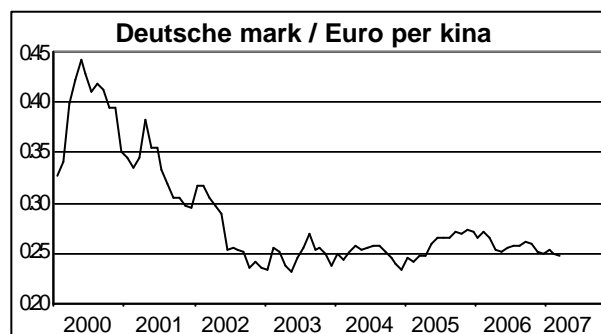
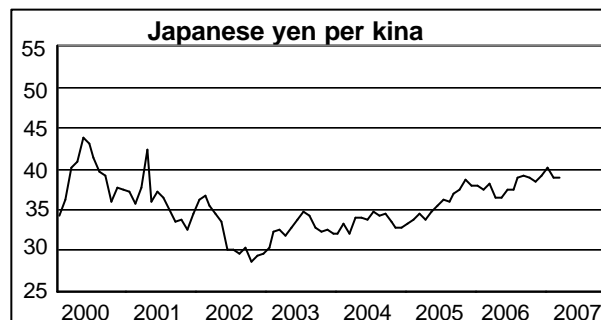
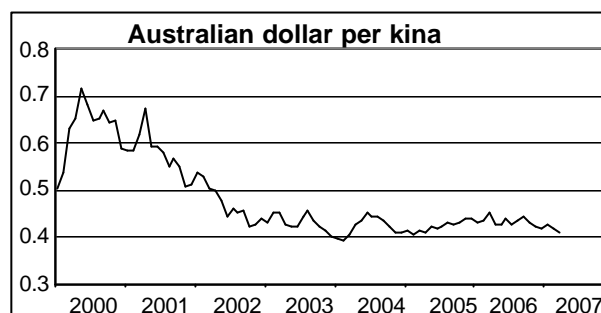
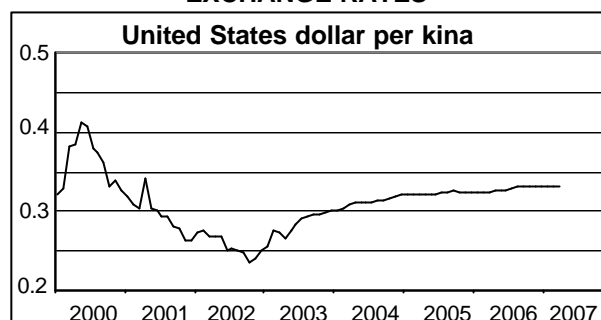
The current account surplus was US\$165.0 billion over the year to March 2007, compared to US\$108.4 billion over the same period in 2006, as a result of strong export performance.

In the United Kingdom (UK), real GDP grew by 2.8 percent over the year to March 2007, compared to 2.2 percent over the year to March 2006, mainly due to buoyant domestic demand. Business investment was stronger than expected, while consumer spending was volatile. The IMF forecast is for GDP to grow by 2.8 percent in 2007.

Industrial production declined by 0.2 percent over the year to March 2007, compared to an increase of 0.3 percent over the same period in 2006. Retail sales rose by 4.8 percent over the year to March 2007, compared to 2.6 percent in the same period in 2006 reflecting high consumer demand. The unemployment rate was 5.5 percent in March 2007, compared to 5.2 percent in March 2006. Strong labour force growth, due to high immigration, outstripped employment growth and pushed the unemployment rate higher.

Consumer prices rose by 3.1 percent over the year to March 2007, compared to an increase of 1.8 percent over the same period in 2006. The outcome was due to the increase in prices of oil, gas and electricity combined with higher prices of imports. Broad money supply increased by 12.8 percent over the year to March 2007, compared to 12.4 percent over the same period in 2006. With limited spare capacity, businesses passed on price increases resulting in higher domestic inflation exceeding the inflation target of 2.0 percent set by the Bank of England. As a result, the Bank of England raised its benchmark Repo Rate by 0.25 percentage points to 5.25 percent in January 2007.

## EXCHANGE RATES



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The trade deficit was US\$157.6 billion over the year to March 2007, compared to a deficit of US\$123.0 billion over the same period in 2006.

In Australia, real GDP grew by 3.8 percent in the year to March 2007, compared to 3.1 percent in the same period of 2006. The increase was associated with strong exports, high domestic demand supported by increased corporate earnings, tight labour market and strong growth in real wages. The IMF forecast is for GDP to grow by 2.6 percent in 2007.

Industrial production increased by 3.7 percent over the year to December 2007, compared to a decrease of 1.0 percent in the same period in 2006, reflecting higher demand for industrial goods. Retail sales increased by 4.8 percent over the year to March 2007, compared to an increase of 2.6 percent over the same period in 2006. The increase was due to pick up in consumer spending reflecting rising household wealth and higher level of consumer confidence. The level of private business investment remained high and resulted in strong growth in the capital stock. Whilst the unemployment rate fell from 5.2 percent in March 2006 to 4.5 percent in March 2007, skill shortages however, remained a major constraint to growth.

Consumer prices increased by 2.4 percent over the year to March 2007, compared to 3.0 percent over the same period in 2006. The increase was mainly due to higher prices of fruit, furniture, overseas holiday travel and accommodation, audio visual and computer equipment and cheaper imports. The Reserve Bank of Australia maintained its cash rate at 6.25 percent in the first quarter of 2007, its highest level in six years.

The current account deficit was US\$43.8 billion over the year to March 2007, compared to a deficit of US\$40.6 billion over the year to March 2006.

During the March quarter of 2007, the US dollar depreciated against the Japanese yen, Euro, pound sterling and the Australian dollar. The quarterly average US dollar exchange rate depreciated by almost 2.0 percent against the Australian dollar, 2.0 percent against pound sterling, 1.6 percent against the Euro and 1.4 percent against the yen. The depreciation was mainly associated with the down turn in the US housing market, and large US budget and current account deficits.

In the March quarter of 2007, the daily average kina

exchange rate depreciated slightly against the US dollar, pound sterling and the Australian dollar but appreciated against the yen. The average kina exchange rate depreciated by 0.3 percent against the US dollar to 33.00 US cents, 2.3 percent against the Australian dollar to 42.00 cents, 2.3 percent against pound sterling and appreciated against the yen by 1.1 percent. These movements resulted in the quarterly average Trade Weighted Index (TWI) depreciating by 1.3 percent during the March quarter.

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### 3. EMPLOYMENT

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According to the Bank's Employment Index, the level of employment in the formal private sector, excluding the mineral sector increased by 4.1 percent in the March quarter of 2007, compared to an increase of 3.7 percent in the December quarter of 2006. Employment levels increased in all regions and in all sectors, except for the financial/business and other sectors. Over the year to March 2007, the level of employment excluding the mineral sector increased by 9.9 percent compared to 8.6 percent over the year to December 2006.

In the agriculture/forestry/fisheries sector, the level of employment grew by 8.9 percent in the March quarter of 2007, compared to an increase of 3.6 percent in the December quarter of 2006. In the agriculture sub-sector, the increase was mainly associated with the start of the coffee season, pick up in sugar production and the establishment of a new palm oil operation in Ramu, Madang. In the forestry sub-sector, the increase reflected the expansion into new logging sites. In the fisheries sub-sector, the increase was a result of the commencement of a new tuna loining operation in Lae and increased capacity and production by another fishing company in Madang. Over the year to March 2007, the level of employment increased by 9.5 percent.

In the building and construction sector, the level of employment increased by 5.4 percent in the March quarter of 2007, compared to an increase of 2.0 percent in the December quarter of 2006. The increase was mainly due to Government and donor funded projects including the maintenance of the Highlands highway combined with increased building construction activity by the private sector. Over the year to March 2007, the level of employment increased by 23.1 percent.

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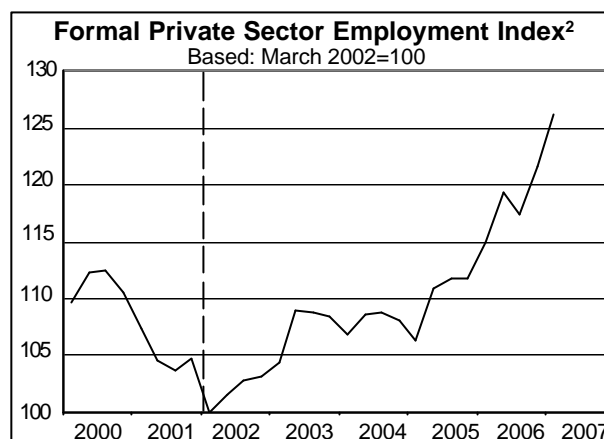
In the manufacturing sector, the level of employment increased by 1.4 percent in the March quarter of 2007, compared to an increase of 2.9 percent in the December quarter of 2006. The increase was due to the recruitment of casual staff to increase production and stock levels as well as increase marketing and distribution of products. Over the year to March 2007, the level of employment increased by 4.9 percent.

In the retail/wholesale sector, the level of employment increased by 5.6 percent in the March quarter of 2007, compared to an increase of 8.9 percent in the December quarter of 2006. The increase was associated with high demand that continued from the festive season reflecting the start of the coffee season, combined with expansion of operations in both existing and new locations. Over the year to March 2007, the level of employment increased by 16.2 percent.

In the transportation sector, the level of employment increased by 4.0 percent in the March quarter of 2007, compared to an increase of 1.5 percent in the December quarter of 2006. The increase mainly reflected higher demand for passenger travel and increased transportation of general cargo and materials and equipment for construction activities. Over the year to March 2007, the level of employment increased by 10.5 percent.

In the financial/business and other services sector, the level of employment declined by 4.2 percent in the March quarter of 2007, compared to an increase of 0.7 percent in the December quarter of 2006. The decrease in the hotel and catering and other services sub-sectors more than offset the increase in the finance and insurance sub-sector. In the hotel and catering and other services sub-sectors, the decrease reflected the reduction in casual employees. Over the year to March 2007, the level of employment grew by 4.6 percent.

The level of employment increased in all regions. In the Islands region, employment grew moderately by 2.5 percent in the March quarter of 2007, compared to an increase of 10.3 percent in the December quarter of 2006. The increase was due to higher employment in the agriculture/forestry/fisheries, building and construction, retail/wholesale and financial/business and other services sectors. In the agriculture/forestry/fisheries sector, the increase was associated with the



harvesting of palm oil and expansion of operations into new logging sites. In the building and construction sector, the growth in employment was mainly due to the construction activity at the Simberi gold mine, while the increase in the retail/wholesale sector was due to higher demand and expansion of operations. The increase in employment in the financial/business and other services sector was associated with the expansion and improvement of hotel facilities and higher guest turnover. Over the year to March 2007, the level of employment grew by 13.4 percent.

In the Momase region (excluding Morobe), the level of employment increased by 1.4 percent in the March quarter of 2007, compared to 6.5 percent in the December quarter of 2006. Higher employment was recorded in the agriculture/forestry/fisheries and financial/business and other services sectors. In the agriculture/forestry/fisheries sector, the growth was mainly associated with the pick up in the sugar production and the establishment of a new palm oil operation in Ramu, Madang. In the financial/business and other services sector, the increase was due to the recruitment of additional guards for a new contract awarded to a security company. Over the year to March 2007, the level of employment grew by 8.4 percent.

In Morobe, the level of employment increased by 4.1 percent in the March quarter of 2007, compared to an increase of 4.7 percent in the December quarter of 2006. Higher employment was recorded in the building and construction and agriculture/forestry/fisheries sectors. The growth in the building and construction sector was associated with the rehabilitation of the main wharf and maintenance of roads in Lae. In the

<sup>2</sup> The dotted vertical line indicates a break in series from 2002. See 'For the Record' in the March 2003 QEB on page 31 and the September 2005 QEB on page 29.



agriculture/forestry/fisheries sector, the increase was due to the commencement of a new tuna loining operation in Lae. Over the year to March 2007, the level of employment grew by 12.2 percent.

In NCD, the level of employment increased by 5.0 percent in the March quarter of 2007, compared to an increase of 2.5 percent in the December quarter of 2006. The retail/wholesale, transportation and financial/business and other services sectors experienced higher growth. The increase in the retail/wholesale sector was due to expansion of operations by companies reflecting opening of new shops and branches. In the transportation sector, the growth reflected the recruitment of permanent staff by airlines to meet high demand for passenger travel. Employment in the financial/business and other services sector increased slightly reflecting the hiring of casual employees and security guards. Over the year to March 2007, the level of employment grew by 10.8 percent.

In the Southern region, the level of employment increased by 0.7 percent in the March quarter of 2007, compared to an increase of 0.4 percent in the December quarter of 2006. The increase was due to a higher crop production in the agriculture/forestry/fisheries sector, commencement of new projects in the construction sector and expansion of operations by hotels. Over the year to March 2007, the level of employment grew by 5.4 percent.

In the Highlands region, the level of employment increased by 9.0 percent in the March quarter of 2007, compared to a decline of 4.1 percent in the December quarter of 2006. Higher employment was recorded in the manufacturing, agriculture and building and construction sectors, mainly reflecting the start of the coffee harvest season and maintenance of the highlands highway. Over the year to March 2007, the level of employment increased by 9.1 percent.

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#### **4. CONSUMER PRICE INDEX**

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The headline inflation rate, as measured by the Consumer Price Index (CPI), was 0.1 percent in the March quarter of 2007, compared to 0.3 percent in the December quarter of 2006. The increase was due to higher prices in the 'Food', 'Rents, Council charges, Fuel/Power', 'Transport and Communication' and the 'Miscellaneous' expenditure groups. By region, all

urban areas, except Lae and Rabaul, recorded higher prices. The annual headline inflation rate was 4.5 percent in the March quarter of 2007, compared to 1.3 percent in the December quarter of 2006.

The CPI for the 'Food' expenditure group increased by 2.6 percent, compared to a decline of 6.6 percent in the December quarter of 2006. The increase was due to higher prices for cereals, and meat and fish which increased by 8.2 percent and 8.1 percent respectively, offsetting declines in the price of fruits and vegetables. This group contributed 1.1 percentage points to the overall movement in the CPI. The increase in prices was also associated with measurement errors reflecting the substitution of highly priced items, namely coffee and butter.

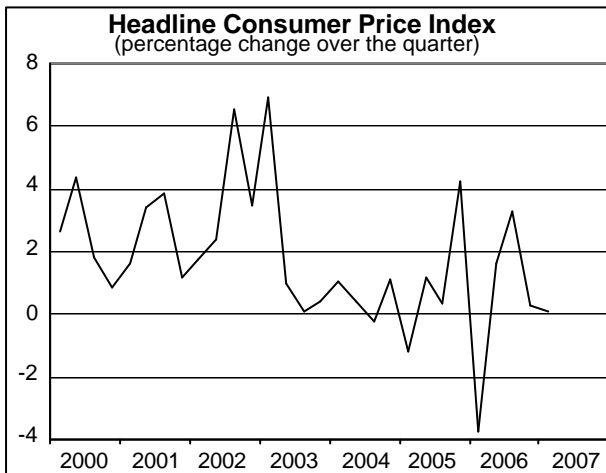
The CPI for the 'Rents, Council charges, Fuel/Power' expenditure group increased by 9.7 percent in the March quarter of 2007, compared to a decrease of 10.7 percent in the December quarter of 2006. The increase was mainly due to higher prices for council charges, water, sewerage and garbage which increased by 6.7 percent and fuel/power which increased by 15.7 percent. The group contributed 0.7 percentage points to the overall movement in the CPI.

The CPI for the 'Transport and communication' expenditure group increased by 1.1 percent in the March quarter of 2007, compared to an increase of 20.6 percent in the December quarter of 2006. The increase was mainly due to higher prices of motor vehicles, air fares and PMV fares. The group contributed 0.1 percentage points to the overall movement in the CPI.

The CPI for the 'Miscellaneous' expenditure group increased by 6.7 percent in the March quarter of 2007, compared to 2.1 percent in the December quarter of 2006. The increase reflected higher prices for entertainment and cultural activities and other goods. The group contributed 0.5 percentage points to the overall movement in the CPI.

The CPI for the 'Drinks, tobacco and betelnut' expenditure group, declined by 6.6 percent in the March quarter of 2007, compared to a decline of 2.7 percent in the December quarter of 2006. The decline was associated with falls in the prices of 'alcoholic drinks', 'cigarettes and tobacco,' and 'betelnut' which fell by 4.1, 16.8 and 17.5 percent respectively. The decline was also due to measurement errors following the replacement of cigarettes and aerated water combined

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with technical errors in the calculation of tobacco prices in the previous quarter. The group contributed negative 1.3 percentage points to the overall movement in the CPI.

The CPI for the 'Clothing and footwear' expenditure group declined by 1.6 percent in the March quarter of 2007, compared to an increase of 8.4 percent in the December quarter of 2006. This was due to a fall in the prices of women's and girl's clothing by 13.2 percent, compared to an increase of 29.1 percent in the December quarter of 2006. The group contributed negative 0.1 percentage points to the overall movement in the CPI.

The CPI for the 'Household equipment and operations' expenditure group declined by 5.8 percent, compared to a decline of 2.9 percent in the December quarter of 2006. The decline was attributed to falls in the durable, non-durable and semi-durable sub-groups. The group contributed negative 0.3 percentage points to the overall movement in the CPI.

By urban areas, all surveyed centres, except Lae and Rabaul, recorded increases in the March quarter of 2007. In Port Moresby, prices increased by 2.1 percent in the March quarter of 2007, compared to an increase of 3.1 percent in the December quarter of 2006. In Goroka, prices increased by 2.3 percent in the March quarter of 2007, following a decline of 14.1 percent in the December quarter of 2006. In Madang, prices increased by 1.6 percent in the March quarter of 2007, compared to a decline of 2.9 percent in the December quarter of 2006. Prices in Lae and Rabaul fell by 5.1 percent and 1.9 percent in the March quarter of 2007, following increases of 4.4 and 0.5 percent, respectively in the December quarter of 2006.

In Port Moresby, higher prices in the 'Food', 'Drinks, tobacco and betelnut', 'Rents, council charges, fuel/power' and 'Transport and communication' expenditure groups resulted in the increase. In Goroka, prices increased in all expenditure groups except the 'Drinks, tobacco and betelnut' and 'Household equipment and operations' expenditure groups, and contributed 0.3 percentage points to the overall increase. In Madang, prices increased in all expenditure groups, except 'Drinks, tobacco and betelnut' and contributed 0.2 percentage points to the overall CPI movement. In Lae, lower prices in the 'Drinks, tobacco and betelnut', and 'Transport and communication' expenditure groups contributed to the decline. In Rabaul, lower prices in 'Drinks, tobacco and betelnut', 'Household equipment and operation' and 'Transport and communication' expenditure groups resulted in the decline.

Both underlying inflation measures increased significantly in the March quarter of 2007. Quarterly exclusion-based inflation measure was 5.3 percent in the March quarter of 2007, compared to 1.8 percent in the December quarter of 2006. Annual exclusion-based inflation was 6.9 percent in March 2007, compared to 2.9 percent in December 2006. Quarterly trimmed mean inflation was 5.6 percent in the March quarter of 2007, compared to a decline of 0.7 percent in the December quarter of 2006. Annual trimmed mean inflation was 6.0 percent in March 2007, compared to 0.4 percent in December 2006. The higher underlying inflation outcomes were mainly due to the depreciation of the kina against the Australian dollar, increase in foreign inflation of PNG's main trading partners and the lagged effect of fuel price increases as companies passed on the cost to consumers.

## 5. EXPORT COMMODITIES REVIEW

The total value of merchandise exports in the March quarter of 2007 was K2,835 million, an increase of 1.5 percent from the corresponding quarter of 2006. Higher export values were recorded for copper, palm oil, copra oil, tea, rubber, other forestry and refined petroleum products, which more than offset declines in the values of coffee, cocoa, copra, logs, marine, gold and crude oil exports. Mineral export receipts, excluding crude oil were K1,547.2 million and accounted for 54.6 percent of total merchandise exports in the March quarter of 2007, compared to 52.4 percent in the corresponding quarter of 2006. Crude oil exports

totalled K637.8 million and accounted for 22.5 percent of total merchandise exports in the March quarter of 2007, compared to 27.2 percent in the corresponding quarter of 2006.

The export value of agricultural, marine products and other non-mineral exports, excluding forestry and refined petroleum products was K330.5 million and accounted for 11.7 percent of total merchandise exports in the March quarter of 2007, compared to 11.6 percent in the corresponding quarter of 2006. Forestry product exports were K127.1 million and accounted for 4.5 percent of total merchandise exports in the March quarter of 2007, compared to 4.4 percent in the corresponding quarter of 2006. Refined petroleum product exports were K192.4 million and accounted for 6.8 percent of total merchandise exports in the March quarter of 2007, compared to 4.5 percent in the corresponding quarter of 2006.

The weighted average kina price of Papua New Guinea's exports increased by 11.5 percent in the March quarter of 2007, compared to the corresponding quarter of 2006. There was a 9.6 percent increase in the weighted average kina price of mineral exports, reflecting higher prices of copper and gold. For the agricultural, forestry and marine product exports, the weighted average kina price increased by 23.3 percent and was attributed to higher prices of coffee, cocoa, palm oil, copra oil, tea, rubber and log exports, which more than offset the decline in the prices of copra and marine products. The higher kina export prices reflected increased international prices during the March quarter of 2007, compared to the corresponding quarter of 2006. Excluding logs, the weighted average price of agricultural and marine product exports increased by 27.0 percent in the March quarter of 2007, compared to the corresponding quarter in 2006.

### **Mineral Exports**

Total mineral export receipts were K2,185.0 million in the March quarter of 2007, a decline of 1.6 percent from the corresponding quarter of 2006. The decline was due to lower export volumes of copper, crude oil and gold, which more than offset higher kina prices for gold and copper.

Gold export volumes were 12.5 tonnes in the March quarter of 2007, a decline of 14.4 percent from the corresponding quarter of 2006. The decline was mainly due to production of lower ore grades at the Ok Tedi,

Porgera, Tolukuma and Kainantu gold mines, which more than offset higher production from the Lihir mine. The average f.o.b. price received for Papua New Guinea's gold exports was K60.3 million per tonne during the March quarter of 2007, an increase of 12.3 percent from the corresponding quarter of 2006. This was mainly attributed to higher international prices. The average gold price at the London Metal Exchange increased by 17.8 percent to US\$649 per fine ounce in the March quarter of 2007, compared to the corresponding quarter of 2006. The increase was due to higher demand for both jewellery and gold based investment in response to increased volatility of prices in the equity markets. The decline in export volume more than offset the higher export price, resulting in export receipts of K753.2 million, a decline of 4.0 percent from the corresponding quarter of 2006.

Copper export volumes were 43.3 thousand tonnes in the March quarter of 2007, a decline of 7.1 percent from the corresponding quarter of 2006. The decline was due to production of lower ore grades. The average f.o.b. price of Papua New Guinea's copper exports was K17,968 per tonne in the March quarter of 2007, an increase of 25.1 percent from the corresponding quarter of 2006. The increase in international prices reflected continued strong demand from Asia, particularly China and India, two of the major copper-consuming countries. The increase in export price more than offset the decline in export volume, resulting in export receipts of K778.0 million, an increase of 16.2 percent from the corresponding quarter of 2006.

Crude oil export volumes were 3,580.4 thousand barrels in the March quarter of 2007, a decline of 9.8 percent from the corresponding quarter of 2006. The decline was due to the shutdown of operations at the Kutubu and Agogo production facilities for maintenance. The average export price of crude oil was K178 per barrel in the March quarter of 2007, a decline of 6.8 percent from the corresponding quarter of 2006, due to lower international prices. The decline in international prices during the quarter resulted from higher holdings of crude oil stocks in the United States for domestic consumption. The combined declines in export price and volume resulted in export receipts of K637.8 million, a decline of 15.9 percent from the corresponding quarter of 2006.

Export receipts of refined petroleum products from the Napanapa Oil Refinery increased by 54.7 percent to K192.4 million in the March quarter of 2007, compared

to the corresponding period of 2006. This outcome was due to the increased production of high value-added export products at the refinery reflecting optimisation efforts undertaken in 2006.

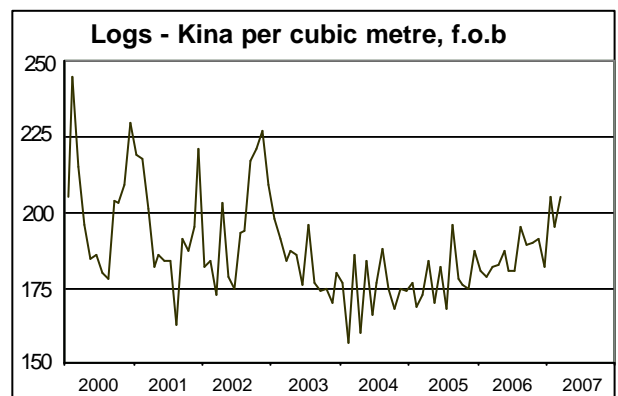
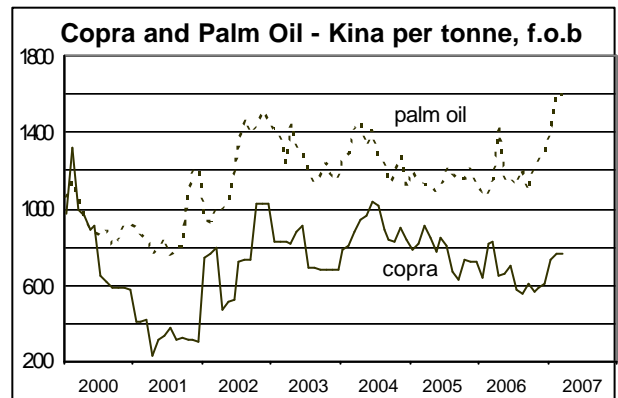
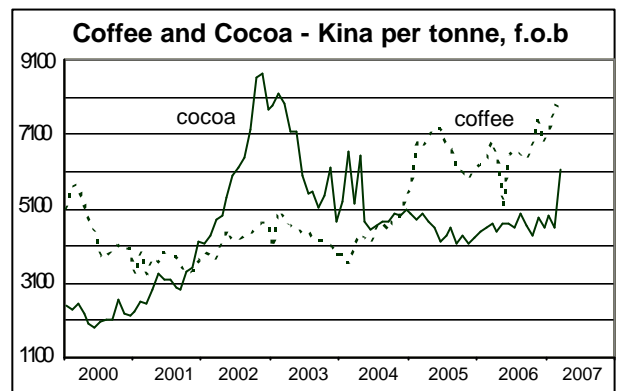
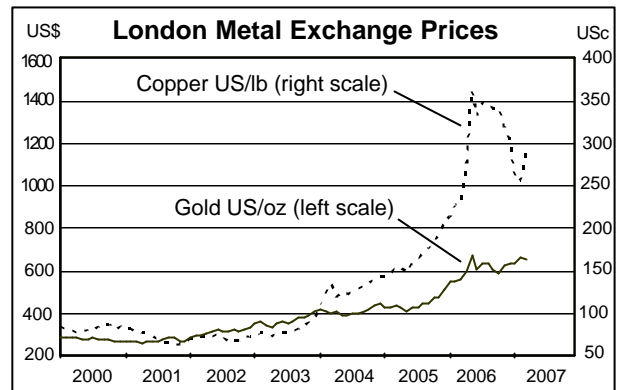
### Agriculture, Logs and Fisheries Exports

Export prices of most agricultural export commodities increased in the March quarter of 2007, compared to the corresponding quarter of 2006. Cocoa prices increased by 9.7 percent, coffee by 18.9 percent, tea by 14.8 percent, copra oil by 35.5 percent, palm oil by 40.7 percent and rubber by 10.7 percent. Copra prices declined by 11.6 percent. The average export price of logs was K206 per cubic meter in the March quarter of 2007, an increase of 14.4 percent from the corresponding quarter of 2006. The average export price of marine products declined by 19.5 percent in the March quarter of 2007, from the corresponding period of 2006. The increase in the export prices of coffee, cocoa, copra oil, palm oil, tea, rubber and logs more than offset the decline in prices of copra and marine product exports, resulting in a 23.3 percent increase in the weighted average price of agricultural, logs and marine product exports. Excluding logs, the weighted average price of agricultural and marine product exports increased by 27.0 percent in the March quarter of 2007, compared to the corresponding period of 2006.

The volume of coffee exported in the March quarter of 2007 was 6,900 tonnes, a decline of 25.0 percent from the corresponding quarter of 2006. The lower production was attributed mainly to declining yields resulting from the prolonged rainy season and lack of rehabilitation of aging coffee trees. The average export price of coffee was K7,768 per tonne in the March quarter of 2007, an increase of 18.9 percent from the corresponding quarter of 2006. The increase was mainly due to higher international prices attributed to a decline in world supply caused by unfavourable weather conditions in Brazil, the world's major coffee producer. The decline in export volume more than offset the increase in export price resulting in export receipts of K53.6 million, a decline of 10.8 percent from the corresponding quarter of 2006.

The volume of cocoa exported in the March quarter of 2007 was 6,800 tonnes, a decline of 36.4 percent from the corresponding quarter of 2006. The outcome was due to lower production associated with continuous heavy rain and lack of access to markets due to bad road infrastructure in the major cocoa producing re-

### EXPORT COMMODITY PRICES



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gions. The cocoa pod borer disease in some parts of the East New Britain Province was contained and had a negligible impact on production during the quarter. The average export price of cocoa was K4,941 per tonne in the March quarter of 2007, an increase of 9.7 percent from the corresponding quarter of 2006. The higher international prices was due to a decline in global supply reflecting unfavourable weather conditions in West Africa and on-going strong demand for cocoa and cocoa products. The decline in the export volume more than offset the increase in export price resulting in an export value of K33.3 million, a decline of 30.3 percent from the corresponding quarter of 2006.

The volume of copra exported in the March quarter of 2007 was 1,300 tonnes, a significant decline of 43.5 percent from the corresponding quarter of 2006. The decline was due to increased sale of copra to the two domestic copra oil mills. The average export price of copra was K692 per tonne in the March quarter of 2007, a decline of 11.6 percent from the corresponding quarter of 2006. Despite the increase in international prices resulting from lower supply in the world market, the appreciation of the kina reduced the kina price of copra exports. The combined decline in export price and volume resulted in export receipts of K0.9 million, a significant decline of 50.0 percent from the corresponding quarter of 2006.

The volume of copra oil exported in the March quarter of 2007 was 14,000 tonnes, an increase of 15.7 percent from the corresponding quarter of 2006. The increase reflected higher quantities of copra sold to the two domestic copra mills for processing. The average export price of copra oil was K2,150 per tonne in the March quarter of 2007, an increase of 35.5 percent from the corresponding quarter of 2006. The increase was mainly attributed to higher international prices resulting from lower copra production in the Philippines, one of the world's major copra producers due to typhoon related damages to coconut palms. The combined increase in export price and volume resulted in export receipts of K30.1 million, an increase of 56.8 percent increase from the corresponding quarter of 2006.

The volume of palm oil exported in the March quarter of 2007 was 84,800 tonnes, a decline of 7.5 percent from the corresponding quarter of 2006. The outcome was due to lower production as a result of rainy conditions during the harvesting period. The average

export price of palm oil was K1,552 per tonne in the March quarter of 2007, an increase of 40.7 percent from the corresponding quarter of 2006. This was due to higher international prices resulting from increased demand for palm oil in North America caused by lower production of soya oil. The increase in export price more than offset the decline in export volume, resulting in export receipts of K131.6 million, an increase of 30.2 percent from the corresponding period of 2006.

The volume of tea exported in the March quarter of 2007 was 1,900 tonnes, an increase of 5.6 percent from the corresponding quarter of 2006. This was attributed to favourable weather conditions in the major producing regions. The average export price of tea was K3,316 per tonne in the March quarter of 2007, an increase of 14.8 percent from the corresponding quarter of 2006. The combined increase in export price and volume resulted in export receipts of K6.3 million, an increase of 21.2 percent from the corresponding quarter of 2006.

The volume of rubber exported in the March quarter of 2007 was 1,100 tonnes, an increase of 10.0 percent from the corresponding quarter of 2006. The increase was mainly due to good weather conditions and improved road infrastructure, especially in Cape Rodney area in the Central Province. The average export price was K5,091 per tonne in the March quarter of 2007, an increase of 10.7 percent from the corresponding period of 2006, due to higher international prices resulting from lower supply in the world market. The combined increase in export price and volume resulted in export receipts of K5.6 million, an increase of 21.7 percent from the corresponding quarter of 2006.

The volume of logs exported in the March quarter of 2007 was 505 thousand cubic meters, a decline of 20.5 percent from the corresponding quarter of 2006. This outcome was mainly due to lower production and shipment of logs as a result of wet weather conditions. The average export price of logs was K206 per cubic meter in the March quarter of 2007, an increase of 14.4 percent from the corresponding quarter of 2006. The increase was attributed to higher international prices, reflecting lower supply of tropical hardwood in the world market. The decline in export volume more than offset the increase in export price, resulting in export receipts of K104.1 million, a decline of 8.7 percent from the corresponding period of 2006.

The value of marine products exported in the March

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quarter of 2007 was K6.8 million, a decline of 59.8 percent from the corresponding quarter of 2006. This resulted from the combined decline in export price and volume.

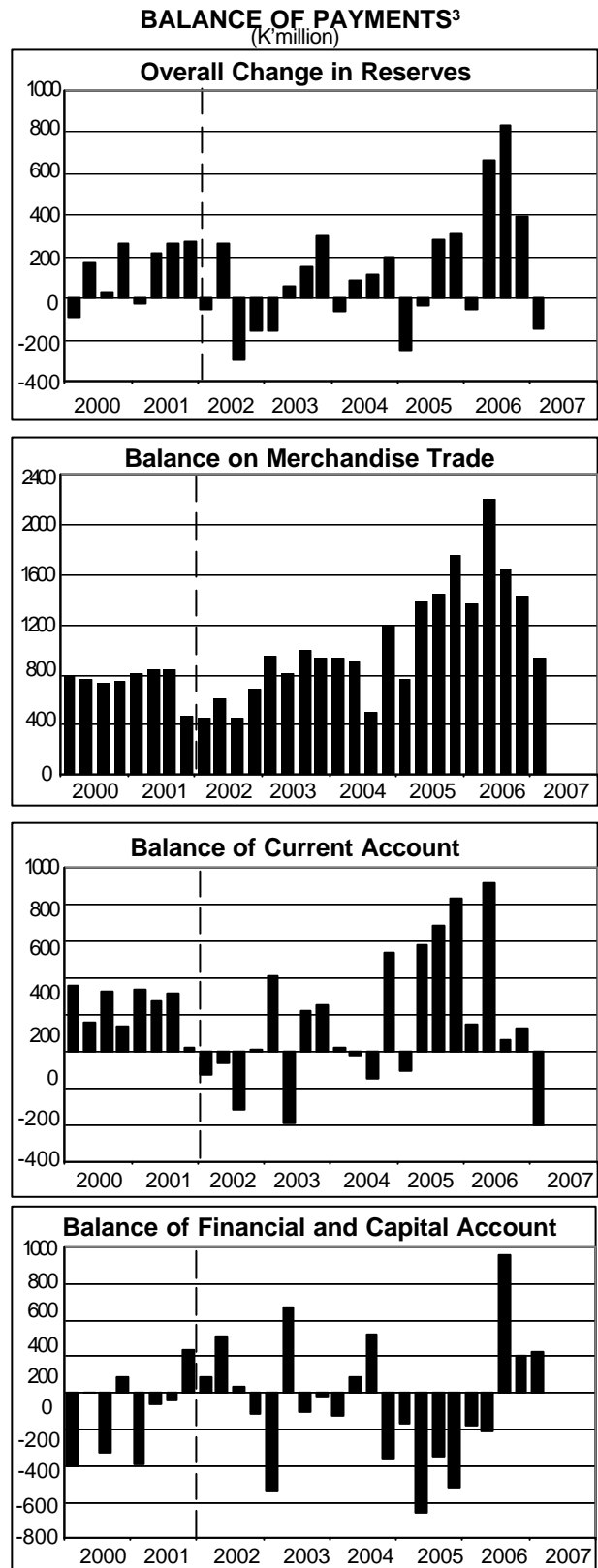
## 6. BALANCE OF PAYMENTS

The overall deficit in the balance of payments was K106 million in the March quarter of 2007, compared to a deficit of K27 million in the corresponding period of 2006. This outcome was due to a deficit in the current account, which more than offset a surplus in the capital and financial accounts.

The deficit in the current account was mainly attributed to a lower trade surplus and higher net service payments, which more than offset lower net income payments and higher net transfer receipts. The surplus in the capital account reflected a higher net inflow of capital transfers. The net inflow in the financial account reflected higher draw downs from investments in short-term money market and financial derivative instruments, combined with higher loans and foreign currency account balances by the mineral companies. During the first three months of 2007, the kina depreciated against the currencies of Papua New Guinea's major trading partners with the exception of the Japanese yen.

The trade account recorded a surplus of K928 million in the March quarter of 2007, a decline of 32.5 percent from the corresponding quarter of 2006. The lower surplus was the result of a combined increase in exports and imports. The value of merchandise exports in the March quarter of 2007 was K2,835 million, an increase of 1.5 percent from the corresponding period of 2006. This was attributed to higher values of palm oil, copra oil, tea, rubber, other forestry products, copper and refined petroleum products.

The value of merchandise imports in the March quarter of 2007 was K1,907 million, an increase of 34.5 percent from the corresponding period of 2006. This was due to higher values of general, mining and oil sector imports. General imports were K1,369 million in the March quarter of 2007, an increase of 27.9 percent from the corresponding period of 2006. Mining sector imports were K408 million in the March quarter of 2007, an increase of 74.4 percent from the corre-



<sup>3</sup> The dotted vertical lines indicate a break in series from 2002. See 'For the Record' in the March 2002 QEB on page 29.

sponding period of 2006, mainly reflecting higher capital expenditure by all mining projects. Imports by the petroleum sector were K130 million in the March quarter of 2007, an increase of 13.0 percent from the corresponding period of 2006. The increase was due to higher capital expenditure by the Kutubu oil project, work on consolidating parts of the Moran project overlapping into other petroleum licensed areas and the construction of the Juha wells.

The deficit in the services account was K1,264 million in the March quarter of 2007, an increase of 59.2 percent from the corresponding period of 2006. The higher deficit was due to increased payments relating to transportation costs and insurance associated with higher imports, travel, education, computer and information services, other business services and financial services, combined with lower service receipts by resident companies.

The deficit in the income account was K330 million in the March quarter of 2007, a decline of 40.8 percent from the corresponding period of 2006. The lower deficit was due mainly to lower dividend payments by resident companies, which more than offset higher income receipts.

The surplus in the transfers account was K271 million in the March quarter of 2007, a significant increase of 113.4 percent from the corresponding period of 2006. The higher surplus was due to increased receipts from gifts and grants, and tax receipts, which more than offset payments for family maintenance, superannuation funds, gifts and grants and licensing fees.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a deficit of K395 million in the March quarter of 2007, compared to a surplus of K151 million in the corresponding period of 2006.

The capital account recorded a net inflow of K40 million during the March quarter of 2007, an increase of 48.2 percent from the corresponding period of 2006. The increase reflected higher capital transfers by donor agencies for project financing.

The financial account recorded a net inflow of K223 million in the March quarter of 2007, compared to a net outflow of K175 million in the corresponding period of 2006. This outcome was due to net inflows of portfolio

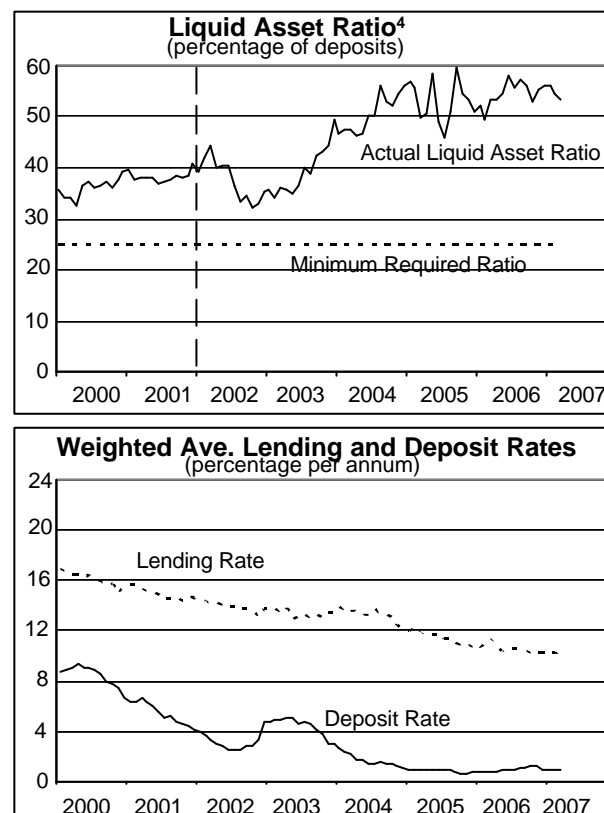
and financial derivatives reflecting draw downs from investments in short-term money market, financial derivative instruments, loans and foreign currency account balances of mineral companies.

The level of gross foreign exchange reserves at the end of March 2007 was K4,219.0 (US\$1,400.6) million, sufficient for 6.6 months of total and 9.2 months of non-mineral import covers.

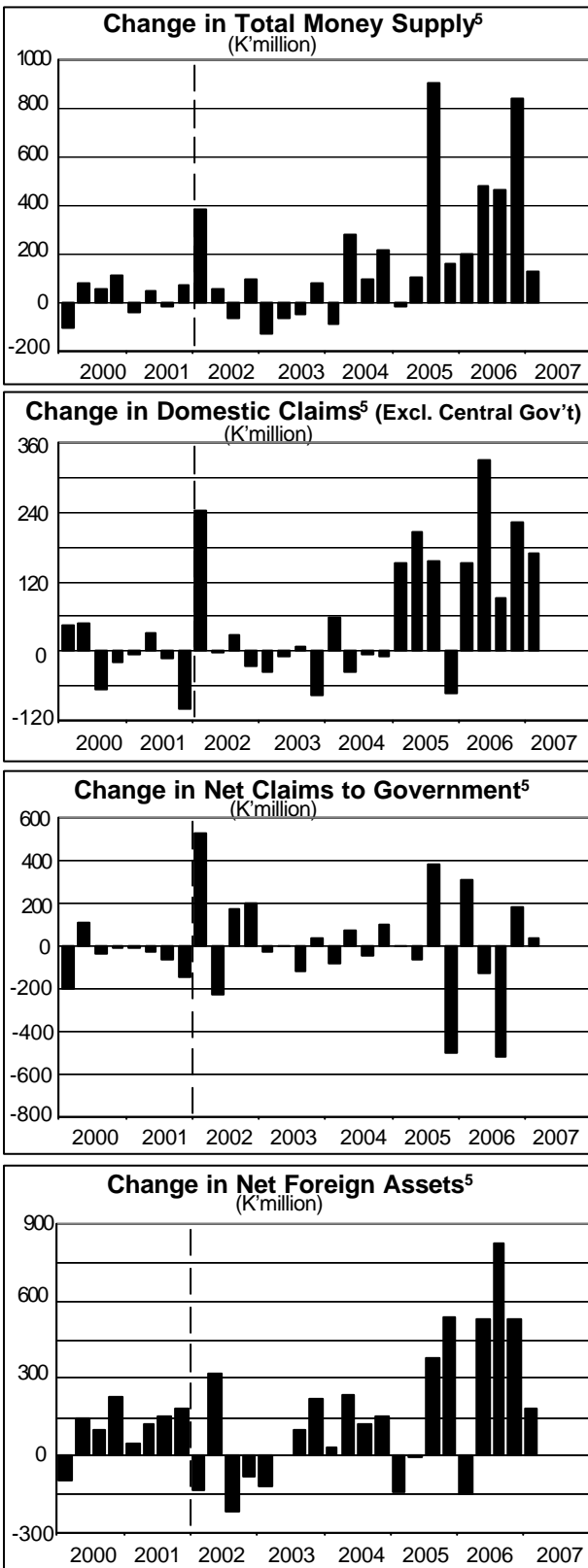
## 7. MONETARY DEVELOPMENTS

### INTEREST RATES AND LIQUIDITY

The Bank of Papua New Guinea maintained a neutral monetary policy stance during the March quarter of 2007. The KFR was kept unchanged at 6.00 percent while the dealing margin for the Repurchase Agreements (Repos) was maintained at 150 basis points on both sides of the KFR. Central Bank Bill (CBB) rates



<sup>4</sup> The dotted vertical lines indicate a break in series from 2002. See 'For the Record' in the June 2006 QEB on page 44.



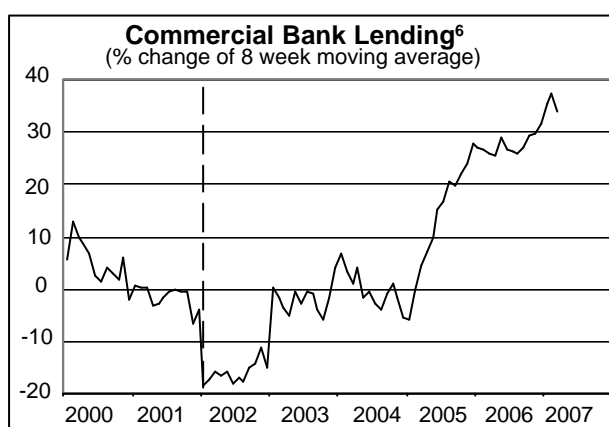
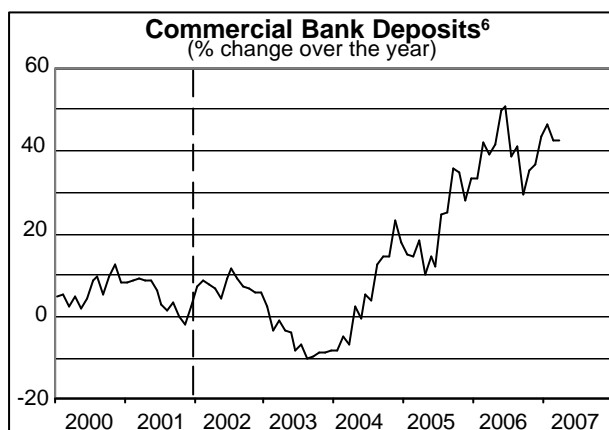
showed increasing trends with the 28-day rate increasing from 4.02 percent to 4.14 percent and the 63-day rate from 4.04 percent to 4.29 percent between the end of December 2006 and March 2007. The increase in rates reflected higher issuance of CBBs by the Central Bank to sterilise excess liquidity and realign short term domestic interest rates with the KFR. Treasury bill rates also increased with the 182-day rate increasing from 3.30 percent to 4.49 percent and the 364-day rate from 4.49 percent to 5.10 percent during the March quarter. The weighted average deposit rates quoted by commercial banks on wholesale deposits (K500,000 and above) showed mixed trends, with the 30-day and 180-day deposit rates declining, whilst the 60-day and 90-day rates increased during the March quarter of 2007. The 30-day rate declined from 2.02 percent to 1.81 percent and the 180-day rate from 4.11 percent to 2.93 percent, whilst the 60-day rate increased from 1.19 percent to 2.02 percent and the 90-day rate from 1.50 percent to 1.56 percent. The weighted average interest rate on total deposits paid by commercial banks remained unchanged at around 1.0 percent, whilst the weighted average interest rate on total loans increased marginally from 10.2 percent to 10.3 percent. The commercial banks maintained their Indicator Lending Rates (ILR) within the spread of 9.45 to 10.70 percent.

The Bank continued to utilise its Open Market Operation (OMO) instruments in the conduct of monetary policy over the March quarter of 2007. The CBBs were mainly used to sterilise excess liquidity, which was complemented by the increased issuance of Treasury bills by the Government. For daily liquidity management purposes, the commercial banks utilised the inter-bank market and the Repo facility with the Bank of PNG to meet their liquidity needs. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) of commercial banks were maintained at 3.0 percent and 25.0 percent, respectively, in the March quarter of 2007.

Average liquid assets held by other depository corporations (ODCs) increased by 10.2 percent in March quarter of 2007, compared to an increase of 8.1 percent in the previous quarter. The increase reflected higher holdings of currency, CBBs and Treasury bills, which more than offset a decline in Inscribed stocks and deposits held at the Central Bank.

<sup>5</sup> Break in series. Refer to footnote on page 15.





## MONEY SUPPLY

The average level of broad money supply (M3\*) increased by 7.1 percent in the March quarter of 2007, compared to an increase of 9.4 percent in the December quarter of 2006. The outcome was due to increases of 29.7 percent in average net claims on the Government, 8.7 percent in average private sector credit and 3.4 percent in average net foreign assets of the depository corporations. Net domestic claims outstanding, excluding advances to the Central Government and outstanding loans under the Government's Agricultural export commodity price support schemes increased by 7.3 percent in the March quarter of 2007, the same as in the previous quarter. The average level of monetary base (reserve money) declined by 6.6 percent in the March quarter of 2007, compared to an increase of 8.4 percent in the December quarter of 2006. The decline reflected lower deposits of ODCs at the Central Bank, which more than offset an increase in currency in circulation.

The increase in average net claims on the Government

in the March quarter of 2007 resulted mainly from the decline in Government deposits at the Central Bank and increased purchase of Government securities by ODCs.

The average level of narrow money supply (M1\*) increased by 7.3 percent in the March quarter of 2007, compared to an increase of 5.0 percent in the December quarter of 2006. There were increases in both currency in circulation and transferable deposits. The average level of quasi money increased by 6.9 percent in the March quarter of 2007, compared to an increase of 14.8 percent in the previous quarter, due to higher average savings deposits.

The average level of deposits of the ODCs increased by 10.8 percent in the March quarter of 2007 to K2,445.0 million, from K2,207.0 million in the December quarter of 2006, due to increases in both transferable and other deposits including Central Government deposits.

## LENDING

During the March quarter of 2007, 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 K168.3 million to K3,204.7 million, compared to an increase of K218.9 million in the previous quarter. This was mainly due to an increase of K174.1 million in private sector credit, which more than offset declines of K4.5 million in claims on public non-financial corporations and K1.8 million in claims on Provincial and Local Governments. Credit to the private sector was mainly influenced by lending to the agriculture, fisheries, forestry, mining and quarrying and other sectors, including the household sector for personal loans and advances for housing. There were no repayments under the price support schemes. The annualised growth in domestic credit, excluding Central Government and advances under the price support schemes was 20.0 percent in the first quarter of 2007.

## 8. PUBLIC FINANCE

Preliminary estimates of the fiscal operations of the National Government over the three months to March 2007 showed an overall surplus of K231.5 million,

<sup>6</sup> Refer to footnote on page 15.

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compared to a deficit of K70.4 million in the corresponding period of 2006. This represents 1.3 percent of nominal GDP. The surplus resulted from higher revenue combined with lower expenditure.

Total revenue, including grants, during the March quarter of 2007 was K780.9 million, 9.5 percent higher than the receipts collected in the corresponding period of 2006. This represents 14.4 percent of the budgeted revenue.

Total tax revenue amounted to K757.4 million, 12.2 percent higher than the receipts collected during the same period in 2006, and represents 18.3 percent of the budgeted tax receipts for 2007. Direct tax receipts totalled K435.2 million, K44.8 million higher than the receipts collected during the corresponding period in 2006, and represents 14.2 percent of the budgeted amount. The increase was mainly due to higher personal income and company tax receipts, which more than offset a decline in other direct taxes. The higher personal income tax receipts reflected increased collections in arrears and payments from Government agencies and the mining sector, respectively. The increase in company tax receipts reflected growth in corporate profits due to increased economic activity. The decline in other direct taxes reflected lower dividend withholding tax.

Indirect tax receipts was K322.2 million, 13.3 percent higher than in the corresponding period of 2006, and represents 30.5 percent of the budgeted receipts for 2007. The increase reflected higher Goods and Services Tax (GST), import duty, export tax and other indirect taxes, which more than offset lower receipts for excise duties. The increase in GST reflected improved collections in the provinces. The higher import duty was related to increases in imported items. The increase in export tax was due to higher prices of logs. There were increases in other indirect tax receipts despite the phasing out of the mining levy and reflected deferred tax payments by the mining industry.

Total non-tax revenue amounted to K23.5 million, K15.0 million lower than the amount collected in the corresponding period of 2006, and represents 5.7 percent of the budgeted amount for 2007. The decline mainly reflected lower receipts from dividends and services provided by Government Departments. Foreign grants were not recorded for the March quarter of 2007 due to non-reporting by donors.

Total expenditure over the three months to March 2007 was K549.4 million, 29.9 percent lower than in the corresponding period of 2006, and represents 10.1 percent of the budgeted expenditure for 2007.

Recurrent expenditure over the first quarter of 2007 was K437.8 million, 33.4 percent higher than during the corresponding period of 2006, and represents 13.0 percent of the 2007 budgeted appropriation. The increase resulted from lower National Departmental and Provincial Government expenditures, which more than offset higher interest payments and grants to statutory authorities. The National Departmental recurrent expenditure totalled K242.1 million, 35.0 percent lower than the amount spent during the corresponding period of 2006, and represents 12.6 percent of the budgeted appropriation. The decrease reflects lower salaries and wages, education subsidies, arrear payments and court orders. Provincial Government recurrent expenditure was K33.9 million, 77.8 percent lower than in the same period in 2006, and represents 4.5 percent of the budgeted amount. The decline in the Provincial Government expenditure resulted from lower disbursement of salaries and wages and conditional grants, including lower payments to village courts. Interest payments totalled K99.4 million, K19.0 million higher than the amount paid in the corresponding period of 2006. The increase reflected the issuance of Inscribed stocks.

Total development expenditure for the first quarter of 2007 was K111.6 million, K14.5 million lower than in the corresponding period of 2006, and represents 6.8 percent of the budgeted expenditure for 2007. The lower level of expenditure on developmental projects was related to the non-reporting of AusAID funded projects.

As a result of these developments in revenue and expenditure, the Government recorded a surplus of K231.5 million in the first three months of 2007. The surplus was used to make net external loan repayments of K35.1 million and net negative financing of K196.4 million. The net overseas loan repayments comprised K11.1 million and K24.0 million to concessionary and extraordinary sources, respectively. Domestic loan repayments comprised K461.9 million to other resident sectors, which represents the settlement of cheques issued in 2006. This more than offset domestic borrowing of K265.5 million from financial corporations.

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