CONTENTS

PORT MORESBY

21st September, 2004

1. 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.

Current Transfers Account — This account records all foreign transactions that are not transfers of capital and can not be repaid. These includes donations, gifts and grants, superannuation funds and licensing fees.

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

Exclusion-based CPI measure[1] — This involves zero weighting of volatile sub-groups or items such as fruit & vegetables, betelnut and prices which 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 of an economy.

Headline Consumer Price Index (CPI) — A measure of inflation as calculated and published quarterly by the National Statistical Office (NSO).

Income Account — Records foreign transactions such as compensation of employees, which covers wages, salaries, and other benefits in cash and kind, dividends and interest earned on investments.

Inscribed Stock — A Government bond or debt instrument sold to the public for a maturity term of one year or longer for the purpose of Budget financing. A coupon is paid to the holders every six months.

Kina Facility Rate (KFR) — Official benchmark rate used by the Bank of Papua New Guinea 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 near liquid form, comprising cash, ESA balances, Treasury bills and Inscribed stocks less than 3 years to maturity.

Minimum Liquid Asset Ratio (MLAR) — A prudential requirement imposed by the Central Bank on commercial banks to hold liquid assets as a percentage of total deposits and other prescribed liabilities at all times.

[1] (See 'For the Record: Measures of Inflation' on p.46 in the 2001 December QEB)

Monetary Base	Comprised of currency held by the public and liquidity assets of the commercial banks, including deposits held with the Central Bank under the Repurchase Agreement Facility (RAF) or Repos.
Narrow Money	A component of total money supply that is considered liquid or can be converted easily to cash on demand, and comprises of currency in circulation (held outside the banking system) and demand deposits.
Open Market Operations (OMO)	Operations of liquidity management conducted by the Central Bank with commercial banks and other financial intermediaries involving Government securities, Repos and foreign exchange trading to influence short-term interest rates.
Over the year CPI	Percentage change in the CPI of a quarter compared to the corresponding quarter of the previous year (Also called 'annual' CPI).
Portfolio Investment	Investments, mainly in equity and debt securities such as bonds and notes, money market debt instruments and financial derivatives, as well as long-term debt, equity and securities.
Quasi Money	A component of total money supply that is not easily convertable to cash on demand and comprises of savings and term deposits.
Repurchase Agreement Facility (RAF)	An agreement between the commercial banks and the Central Bank to sell and repurchase a Government security (e.g. Government Treasury bills) for overnight to 14 days. Transaction can be collateralised or unsecured (Also called Repos).
Reserve Money	A measure of money, which includes currency holdings of commercial banks and their deposits at the Central Bank and money in circulation.
Tap Facility	A facility conducted by the Central Bank 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. A surplus means that exports have exceeded imports, while the reverse will result in a deficit.
Treasury bill	Government security or debt instrument sold at a discount value, but redeemed at face value on maturity for purposes of Budget financing. In PNG, Treasury bills are issued for 28,61,91 and 182 day maturities.
Trimmed-mean CPI measure[1]	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	A measure of inflation that excludes short-term volatile movements in prices, such as seasonal factors (prices of fruit, vegetables and betelnut), Government policy decisions (tax system reforms, etc.) and price controlled items. The exclusion-based and trimmed-mean CPI measures are both underlying CPI measures.

2. GENERAL OVERVIEW

The main indicators available to the Bank of PNG support the positive growth in economic activity during the first half of 2004. The external sector remained strong with a surplus in the balance of payments, reflecting higher international prices for most of PNG's export commodities combined with increased production of most agricultural export commodities. In domestic developments, employment increased in the March quarter of 2004 and tight Government expenditure controls resulted in a large surplus in the first half of 2004. As a result of the high foreign exchange inflows, international reserves increased, the exchange rate stabilised and inflation rate declined to a historical low level. Interest rates continued to decline reflecting the easing stance of monetary policy and thus, helped to create the environment conducive for lending and private sector activity.

Latest data from the Bank's Quarterly Employment Survey indicates that the level of employment in the formal private sector, excluding mining and petroleum, and the North Solomons Province (NSP) increased by 3.9 percent over the year to March 2004, compared to an increase of 4.4 percent in the corresponding period in 2003. The increase reflected higher employment levels in all sectors except the finance and other services sector, and in all regions except the NCD and Morobe regions.

The headline inflation rate as measured by the Consumer Price Index (CPI) was zero in the June quarter of 2004, compared to 1.4 percent in the March quarter of 2004. The lower outcome was due to a fall in the index for 'Drinks, tobacco and betelnut' and 'Transport and communication' expenditure groups, which offset increases in all the other expenditure groups. By region, all urban areas from which CPI is collected recorded increases in the June quarter of 2004 except Port Moresby. The annual headline inflation rate was 1.9 percent in the June quarter of 2004, compared to 19.0 percent in the June quarter of 2003.

The underlying exclusion-based CPI measure increased by 0.8 percent in the June quarter of 2004, compared to 1.0 percent in the previous quarter, while the underlying trimmed-mean CPI remained unchange. The annual underlying exclusion-based and trimmed-mean measures were 2.6 percent and 0.8 percent respectively, in the June quarter of 2004.

The average daily nominal kina exchange rate remained stable against the major currencies over the June quarter of 2004. The kina marginally appreciated against the US and Australian dollars and euro, while it depreciated against the British pound sterling and remained unchanged against the Japanese yen.

The weighted average kina price of exports increased by 11.9 percent in the June quarter of 2004, relative to the corresponding quarter of 2003 due to higher international prices for mineral exports. There was a 15.6 percent increase in the weighted average price of mineral exports, with higher kina prices of all mineral exports. For the agricultural, forestry and marine product exports, the weighted average price declined by 1.6 percent, accounted for by lower kina prices of most agricultural export commodities except palm oil, copra, copra oil and marine product exports.

The overall surplus in the balance of payments for the first six months of 2004 was K19 million, compared to a deficit of K96 million in the corresponding period of 2003. This outcome was the result of a significant improvement in the current account surplus, which more than offset a deterioration in the capital and financial accounts.

The current account recorded a surplus of K198 million in the first six months of 2004, compared to a surplus of K19 million in the corresponding period of 2003. This outcome was the result of a higher surplus in the trade account, combined with lower net income payments, which more than offset higher net service payments and lower net transfer receipts.

The capital and financial account recorded a deficit of K197 million in the first six months of 2004, compared to a deficit of K66 million in the corresponding period of 2003. The deterioration reflected an increase in foreign asset holdings comprising of a build-up in foreign currency account balances of the mineral companies and increased net foreign assets of the commercial banks, combined with a reduction in foreign liabilities reflecting higher loan repayments by the Government.

The level of gross foreign exchange reserves at the end of June 2004 was K1,750.9 (US$550.2) million, sufficient for 5.0 months of total and 6.7 months of non-mineral import covers.

The Bank of PNG maintained its easing of monetary policy stance during the second quarter of 2004, reducing the Kina Facility Rate (KFR) by 200 basis points in aggregate to 10.0 percent at end June 2004, from 12.0 percent in March 2004. As a result, domestic interest rates including Treasury bill rates, Indicator Lending Rates (ILRs) and wholesale deposit rates declined.

Given the persistent high liquidity levels in the banking system emanating mainly from foreign exchange inflows and net retirement of Treasury bills by the Government, the Bank utilised its holding of Treasury bills, the Repurchase Agreement Facility (RAF) and to an extent, Inscribed stocks to diffuse excess liquidity. In addition, the Tap Facility for Treasury bills was closed in May 2004 to allow maturing volumes to be shifted to the auction to smoothen the decline in interest rates. Inter-bank market activity was also minimal, reflecting the high liquidity levels.

The average level of broad money supply (M3*) increased by 4.2 percent in the June quarter of 2004, compared to a revised increase of 5.5 percent in the first quarter of 2004. The growth resulted from increases of 10.7 percent in average net foreign assets of the banking system and 3.9 percent in net credit to the Government. The average level of broad monetary base grew by 4.5 percent over the June quarter of 2004, compared to an increase of 5.1 percent in the previous quarter. The increase was due to higher holdings of Government securities by the commercial banks, partly reflecting purchase of Inscribed stocks from the new issuance by the Government.

Total domestic credit extended by the commercial banks to the private sector, official entities and the non-monetary financial institutions decreased by K39.9 million to K1,442.2 million. This compares with a decline of K77.7 million during the corresponding quarter of 2003. The continued decline was due to lack of demand for loans. The annualised rate of decline in domestic credit, excluding the Central Government and advances under the price support schemes, was 5.5 percent over the first half of 2004.

Preliminary estimates of the fiscal operations of the National Government for the six months to June 2004 showed an overall surplus of K157.2 million, compared to a deficit of K18.6 million in the corresponding period in 2003, and represents 1.2 percent of nominal GDP. The surplus was due to higher revenue combined with lower expenditure.

Total revenue, including grants during the first six months of 2004 was K1,601.8 million, 12.0 percent higher than the receipts collected in the corresponding period of 2003, and represents 41.8 percent of the budgeted revenue. The increase was attributed to higher collections in all categories of revenue, except the non-tax category. Total expenditure over the six months to June 2004 was K1,444.6 million, 0.3 percent lower than in the corresponding period of 2003, and represents 35.8 percent of the budgeted expenditure for 2004. The decrease was due to lower interest payments and continued tight control on expenditures.

The budget surplus combined with a net domestic borrowing of K60.5 million was used to make a net overseas loan repayment of K217.7 million. Domestic financing was mainly sourced from the non-banking system and the commercial banks reflecting higher holdings of Government securities, which more than offset net repayments by the Central Bank and other domestic sources.

3. INTERNATIONAL DEVELOPMENTS

World economic growth, as measured by real Gross Domestic Product (GDP), is projected to increase in 2004. The International Monetary Fund (IMF) forecast made in April 2004 was for a growth of 4.6 percent following an increase of 3.9 percent in 2003. Despite the significant rise in oil prices during the second half of the year, growth in the major world economies is expected to continue.

In April 2004, officials from the International Monetary Fund (IMF) and the World Bank met in Washington D.C., USA, to discuss the appointment of a new managing director for IMF following the resignation of Horst Koehler in March 2004, and the progress of the United Nations (UN) Millennium Development Goals, aimed at tackling poverty-related problems as per the United Nations resolution in September 2000. The goals are to uphold human dignity and equality, strengthening of peace, alleviating and reducing world poverty and protection of the vulnerable. Reports however, confirm that the progress in achieving these goals has been slow.

Also in April, the IMF and World Bank met with members of the Group of Seven (G-7) major industrialised countries to discuss the outlook of the world economy. While noting a pick-up in world economic growth it was pointed out that high oil prices remain a risk if sustained. In addition, the G-7 reiterated their statement made earlier in the year on the need to contain exchange rate volatility.

In June, the Asia-Pacific Economic Cooperation (APEC) forum held the 10th annual trade ministers meeting in Pucon, Chile. The meeting called for a special commitment from the World Trade Organisation (WTO) members to abolish all forms of agricultural export subsidies by a target date. Additionally, trade facilitation, which is a process that makes doing business easier and less costly, was agreed to be submitted as an item for negotiation in the Doha round of WTO.

Also in June, the leaders and government representatives from the African, Caribbean and Pacific (ACP) group held a summit in Maputo, Mozambique to discuss greater regional cooperation through the theme 'together shaping our future'. The summit was the fourth of its kind and issues discussed included ACP and EC cooperation, intra-ACP cooperation, the on-going WTO talks, the UN Millennium Development Goals and security issues confronting ACP countries. The summit concluded by adopting a declaration (the Maputo Declaration) as well as a number of decisions including the Sugar Resolution.

In the United States (US), real GDP grew by 4.7 percent over the year to June 2004, compared to an increase of 2.5 percent over the year to June 2003. The latest revised IMF forecast is for a growth of 4.5 percent in 2004. The increase was better than expected, however, there are signs of a slowdown due to rising energy prices and widening budget and current account deficits.

Industrial production increased by 5.6 percent over the year to June 2004, compared to a decline of 1.4 percent over the year to June 2003. The Institute for Supply Management's factory index was 61.1 in June 2004 indicating a robust underlying expansion in the industrial sector and continued business spending. Retail sales increased by 5.6 percent over the year to June 2004, compared to an increase of 5.2 percent over the year to June 2003. The unemployment rate was 5.6 percent in June 2004, compared to 6.3 percent in the corresponding period of 2003.

Consumer prices rose by 3.3 percent over the year to June 2004, relative to an increase of 2.1 percent over the year to June 2003. This is the biggest twelve-month increase since May 2001 and mainly reflected rising energy prices. Broad money supply increased by 5.8 percent over the year to June 2004, compared to an increase of 7.1 percent over the year to June 2003. Given the above developments, the Federal Open Market Committee (FOMC) increased the Federal Funds rate by 25 basis points to 1.25 percent in June 2004, the first increase in four years.

The trade deficit continues to widen reaching US$589.5 billion over the year to June 2004, compared to a deficit of US$535.6 billion over the corresponding period in 2003. The increase was due to higher prices and imports of crude oil and lower exports to Japan and China.

In Japan, real GDP grew by 4.2 percent over the year to June 2004, compared to an increase of 3.0 percent over the year to June 2003. The increase was due to higher private consumption and exports during the period. The latest IMF forecast is for a growth of 4.5

percent in 2004, revised upwards from the 2.5 percent forecast made earlier in the year.

Industrial production increased by 8.9 percent over the year to June 2004, compared to an increase of 2.8 percent over the year to June 2003. This was due to increases in both final demand and producer goods. Capital expenditures recorded the highest rise indicating increased business spending. Retail sales declined by 2.9 percent over the year to June 2004, compared to a decline of 1.8 percent over the year to June 2003. The decline was due to bad weather and fewer shopping days keeping many consumers at home. The unemployment rate was 4.6 percent in June 2004, compared to 5.3 percent in June 2003.

While the Bank of Japan (BOJ) continued its efforts to curb deflation, consumer prices showed no change over the year to June 2004, compared to a decline of 0.4 percent over the corresponding period of 2003. Since 2001, the BOJ started implementing 'quantitative' monetary policy by targeting the reserve money and setting an upper limit of 35 trillion yen. As a result, the BOJ used money supply as the target of monetary policy. Broad money supply increased by 1.8 percent over the year to June 2004, the same as in the corresponding period of 2003. With deflation still a cause of concern, the BOJ continued to hold short-term interest rates at zero.

The current account surplus was US$163.6 billion over the year to June 2004, compared to US$112.6 billion over the year to June 2003. The increase was due to higher exports to the US and other Asian countries.

In Germany, real GDP grew by 2.0 percent over the year to June 2004, compared to an increase of 1.9 percent over the year to June 2003. The increase was mainly attributed to higher exports to Asia, particularly China.

Industrial production increased by 2.7 percent over the year to June 2004, compared to a decline of 2.1 percent over the year to June 2003. The increase was due to higher export demand. Retail sales decreased by 2.2 percent over the year to June 2004, compared to a decline of 0.5 percent over the year to June 2003. Rising unemployment in Europe's largest economy has dampened consumer spending over the last two years. The unemployment rate was 10.5 percent in June 2004, compared to 10.6 percent in June 2003. The growth was marginal as German firms are now seeking longer hours from existing employees rather than hiring new staff.

Consumer prices increased by 1.7 percent over the year to June 2004, compared to an increase of 1.0 percent over the year to June 2003. The increase was driven by higher prices of oil products.

The current account surplus was US$93.7 billion over the year to June 2004, compared to a surplus of US$54.4 billion over the year to June 2003. The higher surplus reflected strong export performance over imports.

In the United Kingdom (UK), real GDP grew by 3.7 percent over the year to June 2004, compared to a growth of 3.8 percent over the year to June 2003. The growth was mainly driven by increased consumer demand.

Industrial production increased by 0.5 percent over the year to June 2004, compared to a growth of 2.2 percent over the year to June 2003 with growth in the manufacturing, construction and other sectors. Retail sales increased by 7.2 percent over the year to June 2004, compared to an increase of 6.0 percent over the year to June 2003. The increase was due to rising consumer confidence with credit card loans. The unemployment rate was marginally lower in June 2004 at 4.8 percent, compared to 5.0 percent in June 2003.

Consumer prices rose by 1.6 percent over the year to June 2004, compared to an increase of 1.1 percent over the year to June 2003. The increase was mainly attributed to recreational and cultural activities including holidays. Broad money supply increased by 7.8 percent over the year to June 2004, compared to an increase of 8.0 percent over the year to June 2003. With the UK economy showing signs of overheating, the Bank of England raised its official repo rate four times since November 2003 from 3.75 percent to 4.50 percent in June 2004.

The trade deficit was US$93.6 billion over the year to June 2004, compared to a deficit of US$75.7 billion over the year to June 2003.

In Australia, real GDP grew by 4.1 percent over the year to June 2004, compared to a growth of 2.5 percent over the year to June 2003. The Australian economy has been robust for the last two years due to good macroeconomic conditions, supported by strong consumer demand and investment spending.

Retail sales grew by 7.9 percent over the year to June 2004, compared to an increase of 3.6 percent over the year to June 2003. The significant increase was due to a A$2.2 billion federal government cash handout for baby bonus payments and middle-to-upper class workers tax cuts, resulting in higher consumer spending over the period. The unemployment rate was 5.6 percent in June 2004, compared to 6.1 percent in June 2003.

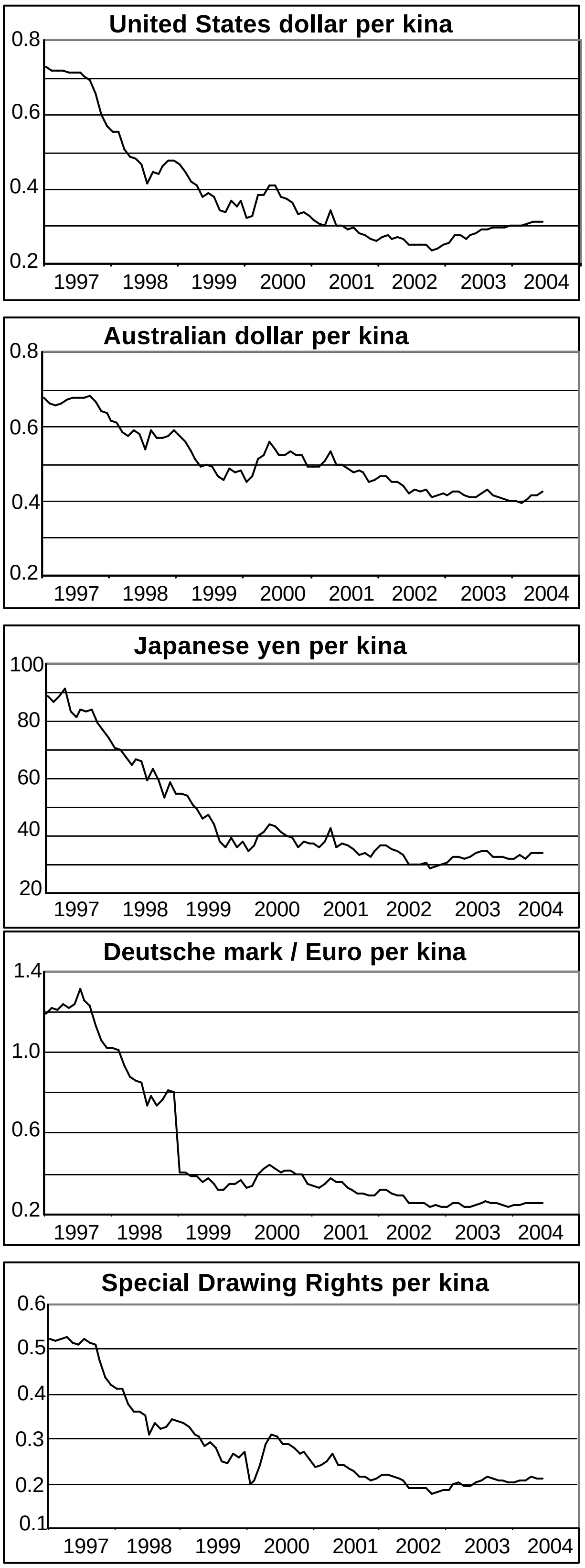
Consumer prices increased by 2.5 percent over the year to June 2004, compared to an increase of 2.7 percent over the year to June 2003. The lower increase was due to reduced prices for food and electrical items. With the inflation rate threatening the official inflation target of 2 - 3 percent, the Reserve Bank of Australia (RBA) left its official cash rate unchanged since December 2003 at 5.25 percent in June 2004. Broad money supply increased by 11.8 percent over the year to June 2004, compared to an increase of 13.0 percent over the year to June 2003.

The current account deficit was US$34.2 billion over the year to June 2004, compared to a deficit of US$24.4 billion over the year to June 2003. The widening deficit was attributed to higher imports as a result of robust domestic demand.

During the June quarter of 2004, the US dollar performed relatively better than the previous quarter against all major world currencies despite a widening current account deficit. The US dollar appreciated against the British pound sterling and the euro, and marginally depreciated against the Australian dollar and Japanese yen. Interest rate differentials continue to play an important role in determining exchange rate movements in the major world economies.

The average daily nominal kina exchange rate remained stable against the major currencies over the June quarter of 2004. The kina marginally appreciated against the US and Australian dollars and euro by 0.03, 0.01 and 0.05 percent, respectively. It depreciated against the British pound sterling by 0.05 percent and remained unchanged against the Japanese yen. The stability in the kina continued to be supported by high export receipts and subdued import demand.

EXCHANGE RATES



4. EMPLOYMENT

According to the Bank's employment index, the level of employment in the formal private sector, excluding mining and petroleum and the NSP, increased by 3.9 percent over the year to March 2004, compared to an increase of 4.4 percent in the corresponding period of 2003. The increase reflected higher employment levels in all sectors except the finance and other business services sector, and in all regions except the NCD and Morobe regions.

In the retail and wholesale sectors, employment in both sectors increased by 1.3 percent respectively over the year to March 2004, compared to a decline of 3.2 percent and an increase of 2.5 percent in the corresponding period of 2003. In the retail sector, the increase reflected higher employment in the Highlands, Momase and Islands regions, while in the wholesale sector, the increase was due to higher employment in all regions except the Momase and Islands regions.

In the manufacturing sector, employment increased by 5.7 percent over the year to March 2004, compared to a growth of 3.5 percent in the corresponding period of 2003. The increase was due to higher employment in all regions, with notable increases in the Southern and Islands regions. In the Southern region, the increase was associated with higher production of sawn timber and plywood, while in the Islands and Morobe regions, the growth reflected higher employment by the food and beverage manufacturers.

In the construction sector, the level of employment increased by 4.5 percent over the year to March 2004, compared to a decline of 8.6 percent in the corresponding period of 2003. The increase was associated with the maintenance of parts of the Okuk Highway, construction of new residential blocks of a hotel in Port Moresby, maintenance of feeder roads, construction and maintenance of school buildings and hospitals funded by international donor organisations.

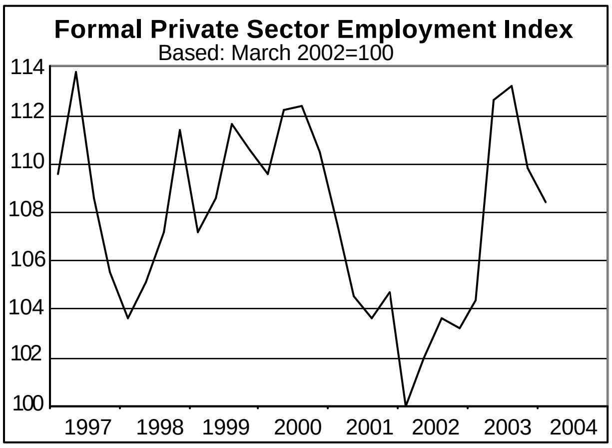
Employment levels in the transportation sector increased marginally by 0.8 percent over the year to March 2004, compared to an increase of 5.2 percent in the corresponding period of 2003. The increase was due to higher employment in the NCD, Southern, Morobe, and Islands regions. The increase in the Southern region reflected higher employment by the stevedoring companies associated with increased cargo shipment and passenger travel, combined with higher employment by third level airlines. In the Islands region, the increase was associated with the employment of casual staff by a major airline.

In the agriculture/forestry/fisheries sector, the level of employment increased by 8.1 percent over the year to March 2004, compared to an increase of 8.2 percent in the corresponding period of 2003. The increase was associated with higher employment in all regions except the Highlands and Morobe regions. In the Momase region, the increase was due to the expansion of logging operations, combined with higher employment by the cocoa and coconut plantations. In the Islands region, the increase reflected higher employment in the agriculture sub-sector, including palm oil, copra and cocoa, combined with the extension of logging operations. In the NCD, the increase was due to the recruitment of sales and promotional staff by a poultry and chicken processor and demand for fishermen by fishing companies.

In the finance and other business services sector (which includes real estate, hotel, restaurants, finance and security services), the level of employment decreased by 3.0 percent over the year to March 2004, compared to an increase of 8.0 percent in the corresponding period of 2003. The decline was in the real estate, hotel and catering, and security services, which more than offset higher employment by the finance companies.

Employment levels in the mining/quarrying/petroleum sector increased by 11.7 percent over the year to March 2004, compared to a decline of 1.2 percent in the corresponding period of 2003. The increase was due to higher employment by the mining and exploration companies in the Highlands region, as well as higher employment by the Ok Tedi copper mine and expansion of operations by the Lihir gold mine.

By region, employment increased in all regions except the NCD and Morobe regions. In the Southern region, employment increased by 4.7 percent over the year to March 2004, compared to a decline of 0.6 percent in the corresponding period of 2003. The increase reflected higher employment in all sectors except the retail sector. The increase in the manufacturing sector was mainly due to higher employment by a wood processing and exporting company. In the construction sector, the increase was associated with the maintenance of roads, and the construction and main-



tenance of school buildings. In the wholesale sector, the increase reflected higher employment by several general merchandisers. In the transportation sector, the increase was due to higher employment by the sea and air transportation sub-sectors. Higher employment by the hotel and catering, and finance and security services sub-sectors accounted for the increase in the finance and other business services sector.

In the Highlands region, employment increased by 8.0 percent over the year to March 2004, compared to a decline of 8.2 percent in the corresponding period of 2003. The increase reflected higher employment in the manufacturing, construction, wholesale and retail sectors. In the manufacturing sector, the increase was attributed to higher employment by several bakeries due to increased production, additional sales representatives of a soft drink manufacturer, and higher employment by a sheet metal and steel fabrication company. The increase in the retail sector was mainly due to higher employment by a Non Government Organisation associated with retail activities. The increase in the finance and other business services sector was attributed to higher employment by the finance companies.

The level of employment in the Momase region increased by 8.7 percent over the year to March 2004, compared to an increase of 13.5 percent in the corresponding period of 2003. The increase reflected higher employment by the agriculture/forestry/fisheries, manufacturing, retail, finance and other business services sectors. The expansion of logging operations, combined with higher employment by the cocoa and coconut plantations accounted for the increase in the agriculture/forestry/fisheries sector, while higher production and export of canned and fresh tuna accounted for the growth in the manufacturing sector. Higher employment by the hotels and finance companies accounted for the increase in the finance and other business services sector.

In the Islands region, the level of employment increased by 10.3 percent over the year to March 2004, compared to an increase of 7.5 percent in the corresponding period of 2003. The increase was recorded in all sectors except the wholesale, finance and other business services sectors. In the agriculture/forestry/fisheries sector, the increase reflected higher employment by the palm oil, cocoa and copra plantations, as well as extension of logging operations. The increase in the construction sector was due to increased civil and building construction projects in the region.

Employment levels in the NCD region decreased by 1.3 percent over the year to March 2004, compared to an increase of 2.2 percent in the corresponding period of 2003. The decrease was due to reduction in employment by the retail, finance and other business services sectors. The decline in the retail sector was due to the laying-off of staff by the general merchandise companies, while the decrease in the finance and other businesses services sector mainly reflected the termination of staff by the security firms, and reduction in employment by the real estate, and other services, including accounting and law firms.

In the Morobe region, the level of employment decreased by 3.6 percent over the year to March 2004, compared to an increase of 9.7 percent in the corresponding period of 2003. The decline in the agriculture/forestry/fisheries, construction and retail sectors more than offset increases in the other sectors. In the retail sector, the decline was due to reduction of casual staff by a major retailer, while lower building and construction activity accounted for the decline in the construction sector. In the agriculture/forestry/fisheries sector, the decline mainly reflected the downsizing of a fishing company.

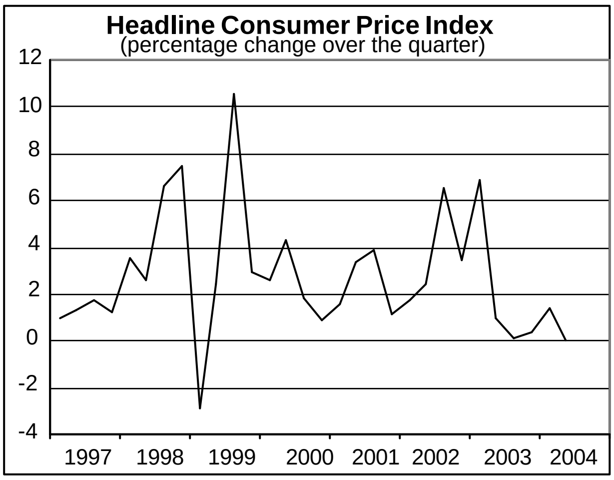
5. CONSUMER PRICE INDEX

The headline inflation rate as measured by the Consumer Price Index (CPI) was zero in the June quarter of 2004, compared to 1.4 percent in the March quarter of 2004. The decline was attributed to a fall in the index of the 'Drinks, tobacco and betelnut' and 'Transport and communication' expenditure groups, which offset increases in the other expenditure groups. By region, all urban areas from which CPI is collected recorded increases in the June quarter 2004, however these were offset by the decline in CPI in Port Moresby. The annual headline inflation rate was 1.9 percent in June quarter of 2004, compared to 19.0 percent in the June quarter of 2003.

The CPI for the 'Food' expenditure group increased by 1.8 percent in the June quarter, compared to an increase of 0.2 percent in the previous quarter. The increase was mainly attributed to higher prices in the meat and fish, fruits and vegetables, and cereals sub-groups. For the 'Drinks, tobacco and betelnut' expenditure group, the CPI decreased by 2.2 percent in the June quarter of 2004, compared to an increase of 3.0 percent in the previous quarter. This was mainly attributed to decreases in the prices of betelnut, cigarettes and tobacco. The CPI for the 'Clothing and footwear' expenditure group increased by 1.6 percent in the June quarter, compared to 0.1 percent in the previous quarter due to higher prices for men and boys' clothing, other clothing items and footwear.

The CPI for the 'Transport and communication' expenditure group decreased by 1.7 percent in the June quarter of 2004, compared to a decrease of 0.3 percent in the previous quarter, which reflected lower prices for motor vehicle operations and purchases. The CPI for the 'Household equipment and operation' expenditure group increased by 1.1 percent due to higher prices for non-durable and semi-durable goods. For the 'Miscellaneous' expenditure group, the CPI increased by 0.8 percent in the June quarter, compared to an increase of 14.5 percent in the previous quarter, while the 'Rents, council charges and fuel power' group recorded an increase of 1.4 percent in the June quarter, compared to an increase of 3.6 percent in the previous quarter.

By urban areas, the increase in the CPI in all surveyed areas were equally offset by the decrease for Port Moresby. Rabaul recorded an increase of 1.4 percent, compared to a decrease of 1.7 percent in the previous quarter. Goroka recorded an increase of 0.6 percent, compared to an increase of 3.1 percent in the previous quarter, followed by Madang and Lae with 0.5 percent each, compared to 2.0 percent and a decrease of 1.1 percent in the previous quarter, respectively. Port Moresby recorded a decline of 0.8 percent in the June quarter, compared to an increase of 2.8 percent in the previous quarter, mainly due to lower prices of betelnut, cigarettes and tobacco.



The underlying exclusion-based CPI measure increased by 0.8 percent, compared to 1.0 percent in the previous quarter, while the underlying trimmed-mean CPI remained the same for the June quarter, compared to the March quarter. Both the annual underlying exclusion-based and trimmed-mean measures were 2.6 percent and 0.8 percent respectively, in June 2004. The exclusion-based CPI was higher than the trimmed-mean and headline CPI because it excludes the declining impact of betelnut, cigarettes and tobacco prices.

6. EXPORT COMMODITIES REVIEW

The total value of merchandise exports in the June quarter of 2004 was K2,103 million, 12.2 percent higher than in the corresponding quarter of 2003. Increases in export values were recorded for gold, copper, crude oil, coffee, tea, copra, copra oil, palm oil and other non-mineral exports, which offset a decline in the values of cocoa, rubber, logs and marine product exports. Mineral export receipts, excluding crude oil were K1,132.9 million and accounted for 53.9 percent of total merchandise exports in the June quarter of 2004, compared to 48.5 percent in the corresponding quarter of 2003. Crude oil exports totalled K473.1 million and accounted for 22.5 percent of total merchandise exports in the June quarter of 2004, compared to 23.5 percent in the corresponding quarter of 2003.

The value of agricultural, marine products and other non-mineral exports, excluding forestry product exports was K408.9 million and accounted for 19.4 percent of total merchandise exports in the June quarter of 2004, compared to 23.0 percent in the corresponding quarter of 2003. Forestry product exports were K88.1 million and accounted for 4.2 percent of total merchandise exports in the June quarter of 2004, compared to 5.0 percent in the corresponding quarter of 2003.

The weighted average price of Papua New Guinea's exports was 11.9 percent higher in the June quarter of 2004, compared to the corresponding quarter of 2003. There was a 15.6 percent increase in the weighted average price of mineral exports, with higher kina prices of all mineral exports. For the agricultural, forestry and marine product exports, the weighted average price declined by 1.6 percent and was accounted for by lower kina prices of most agricultural export commodities, except palm oil, copra, copra oil and marine product exports. Excluding logs, the weighted average price of agricultural and marine product exports declined marginally by 0.3 percent in the June quarter of 2004, compared to the corresponding period of 2003. The lower export prices reflected an appreciation of the kina against the US dollar, as international prices increased during the June quarter of 2004, with the exception of cocoa.

Mineral Exports

Total mineral export receipts were K1,606.0 million in the June quarter of 2004, compared to K1,349.4 million in the corresponding quarter of 2003. This outcome was due to combined increases in the export volume and price of gold, and the export prices of copper and crude oil, which more than offset the decline in the volumes of copper and crude oil exports.

Gold export volumes were 17.0 tonnes during the June quarter of 2004, an increase of 16.4 percent in the corresponding quarter of 2003. The increase was due to higher gold production resulting from the mining of higher ore grades from all the mines with the exception of Misima mine, which is currently exporting stockpiles as it approaches total closure. The average free on board (f.o.b.) price received for Papua New Guinea's gold exports was K40.4 million per tonne during the June quarter of 2004, 0.8 percent higher than in the corresponding period of 2003. The increase was mainly due to higher international prices. The average gold price at the London Metal Exchange increased by 13.5 percent to US$395 per fine ounce in the June quarter of 2004, compared to the corresponding quarter of 2003. The increase was due to higher demand from Asia and North America, as investors considered gold-based investments as a safe haven after continued lower performance in the equity markets, depreciation of the US dollar against other major currencies, continued uncertainties surrounding the on-going conflict in Iraq and global fears on terrorism. The combined increase in export price and volume resulted in an export value of K686.0 million in the June quarter of 2004, an increase of 17.3 percent from the corresponding quarter of 2003.

Copper export volumes were 49.1 thousand tonnes in the June quarter of 2004, a decline of 7.7 percent in the corresponding quarter of 2003**.** The decline was due to lower production and shipment of copper ore as a result of lower water levels at the Fly River. The average f.o.b. price of Papua New Guinea's copper exports in the June quarter of 2004 was K8,929 per tonne, an increase of 48.8 percent from the corresponding quarter of 2003. This outcome was mainly due to higher international prices as a result of lower stock levels at the London Metal Exchange, combined with higher demand from Asia, one of the major copper-consuming regions. Higher export price more than offset the decline in export volume, resulting in an export value of K438.4 million in the June quarter of 2004, an increase of 37.3 percent from the corresponding quarter of 2003.

Crude oil export volumes were 3,709.9 thousand barrels in the June quarter of 2004, a decline of 7.7 percent from the corresponding quarter of 2003. The decline reflected lower extraction rates from the wells at Kutubu, Gobe Main and South East Gobe oil projects reflecting the natural decline in reserve levels. The average export price of crude oil was K125 per barrel in the June quarter of 2004, an increased of 16.8 percent from the corresponding quarter of 2003, reflecting higher international prices. The increase in international prices was due to higher global demand and fears of further attacks on the oil production facilities in Saudi Arabia and Iraq. The increase in the export price more than offset the decline in export volume, and resulted in an export value of K473.1 million in the June quarter of 2004, an increase of 7.3 percent from the corresponding quarter of 2003.

Agriculture, Logs and Fisheries Exports

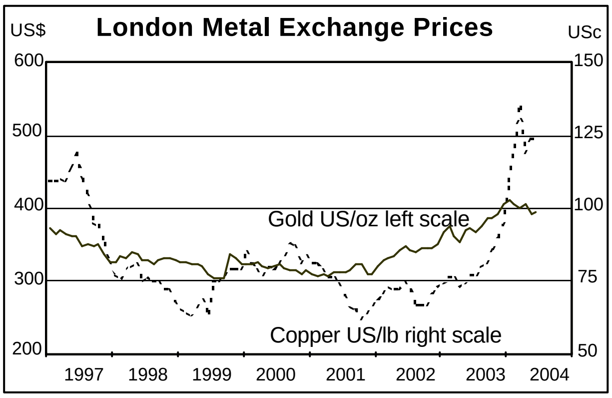
Export prices of most agricultural export commodities declined in the June quarter of 2004, compared to the corresponding quarter of 2003. Coffee prices declined by 6.0 percent, cocoa by 19.9 percent, tea by 6.3 percent and rubber by 3.2 percent. The average export price of logs declined by 6.5 percent to K173 per cubic meter in the June quarter of 2004, compared to K185 per cubic meter in the corresponding quarter of 2003. The net effect of these price movements was a 1. 6 percent decline in the weighted average price of agricultural, forestry and marine product exports

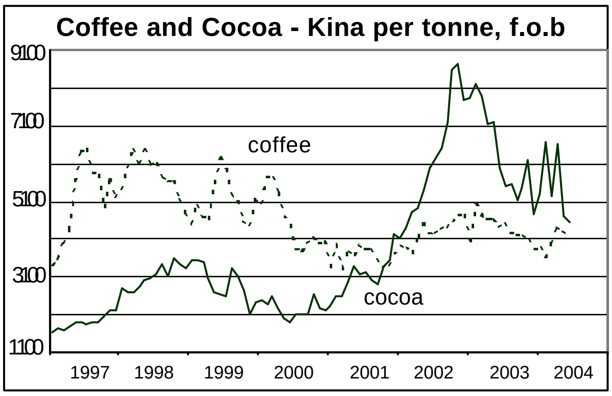
The volume of coffee exported was 17,300 tonnes in the June quarter of 2004, an increased of 19.3 percent from the corresponding quarter of 2003. The increase was due to higher production attributed mainly to favourable weather conditions combined with an early maturity of coffee cherries for harvest. The average export price of coffee was K4,272 per tonne in the June quarter of 2004, a decline of 6.0 percent from the corresponding quarter of 2003. The decline was due mainly to the appreciation of the kina against the US dollar as international prices increased, reflecting lower world supply following unfavourable weather conditions in Brazil, the world's largest coffee producer. The increase in export volume more than offset the decline in export price, resulting in an export value of K73.9 million in the June quarter of 2004, an increase of 12.1 percent from the corresponding period of 2003.

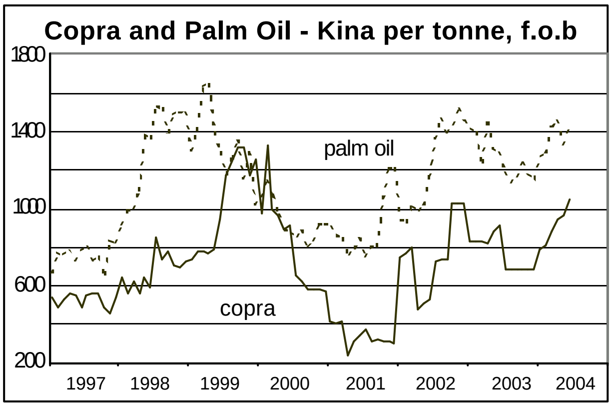
The volume of cocoa exported was 9,000 tonnes in the June quarter of 2004, a decline of 33.8 percent from the corresponding quarter of 2003. This outcome was attributed to lower production as a result of adverse weather conditions, combined with lower shipment of export tonnage due to a decline in shipping services. The average export price of cocoa was K5,322 per tonne in the June quarter of 2004, a decline of 19.9 percent from the corresponding period of 2003. The decline was due to lower international prices, as a result of increased supply in the world market caused by higher production from the Ivory Coast, and the Asian and Latin American countries. The combined decline in export price and volume resulted in an export value of K47.9 million in the June quarter of 2004, a decline of 47.0 percent from the corresponding period of 2003.

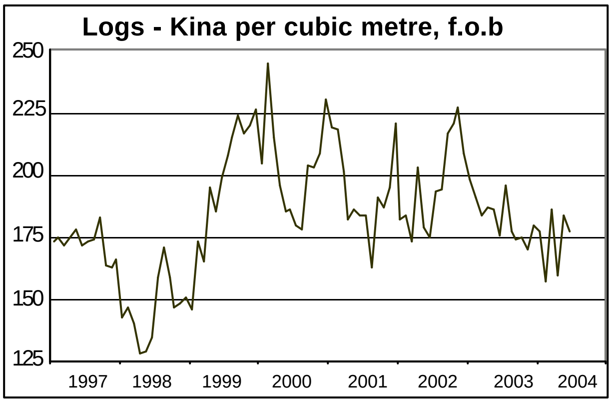
The volume of copra exported was 4,200 tonnes in the June quarter of 2004, an increase of 75.0 percent from the corresponding quarter of 2003. The increase was attributed to higher production from the major copra producing regions as a result of favourable supply

EXPORT COMMODITY PRICES









response to higher international prices and good weather conditions. The average export price for copra was K1,000 per tonne in the June quarter of 2004, an increase of 14.3 percent from the corresponding quarter of 2003. This outcome was due to higher international prices, resulting from declines in production from the Philippines and Indonesia, the world's major copra producers, combined with lower supply of edible oils in the world market. Increases in export price and volume resulted in an export value of K4.2 million in the June quarter of 2004, an increase of 100.0 percent from the corresponding period of 2003.

The volume of copra oil exported was 11,700 tonnes in the June quarter of 2004, a decline of 18.8 percent from the corresponding period of 2003. The decline was mainly due to lower quantities of copra purchased by the two domestic copra mills for processing, due to a deterioration in infrastructure limiting access to the mills combined with increased competition from copra buyers in Kavieng and Buka. The average export price of copra oil was K1,991 per tonne in the June quarter of 2004, an increase of 50.9 percent from the corresponding period of 2003. The increase was due to higher international prices as a result of declining copra production from Philippines and Indonesia, two of the world's major copra producers combined with a decline in production of other edible oils in the world market. The increase in export price more than offset the decline in export volumes, resulting in an export value of K23.3 million in the June quarter of 2004, an increase of 22.6 percent from the corresponding period of 2003.

The volume of palm oil exported was 92,900 tonnes in the June quarter of 2004, an increased of 11.8 percent from the corresponding period of 2003. The increase was due to higher production attributed to on-going plantation expansion, combined with favourable weather conditions. The average export price of palm oil was K1,372 per tonne in the June quarter of 2004, an increase of 1.6 percent from the corresponding quarter of 2003. The increase was attributed to higher international prices resulting from substitution to palm oil by China, the world's major importer of edible oil as international prices of other edible oils increased. The combined increase in export price and volume resulted in an export value of K127.5 million in the June quarter of 2004, an increase of 13.5 percent from the corresponding period of 2003.

The volume of tea exported was 2,100 tonnes in the June quarter of 2004, an increase of 16.7 percent from the corresponding quarter of 2003. The increase was due to higher production resulting from favourable weather conditions combined with the commencement of exports by a recently acquired plantation. The average export price of tea was K2,810 per tonne in the June quarter of 2004, a decline of 6.3 percent from the corresponding period of 2003. The increase in export volume more than offset the decline in export price, and resulted in an export value of K5.9 million in the June quarter of 2004, 9.3 percent higher than in the corresponding period of 2003.

The volume of rubber exported was 700 tonnes in the June quarter of 2004, a decline of 30.0 percent from the corresponding period of 2003. The decline was attributed to unfavourable weather conditions combined with deteriorating road infrastructure. The average export price was K3,000 per tonne in the June quarter of 2004, a decline of 3.2 percent from the corresponding period of 2003. The decline was due to the appreciation of the kina against the US dollar as international prices increased, following lower supply in the world market. The combined decline in export price and volume resulted in an export value of K2.1 million in the June quarter of 2004, 32.3 percent lower than in the corresponding period of 2003.

The volume of logs exported was 433.0 thousand cubic meters in the June quarter of 2004, 9.4 percent lower than in the corresponding period of 2003. This was mainly attributed to lower production and shipment from major logging projects as a result of unfavourable weather conditions. Production was also affected by the embargo imposed on the industry under the Forestry Conservation Program. The average export price of logs was K173 per cubic meter in the June quarter of 2004, a decline of 6.5 percent from the corresponding period of 2003. This outcome was mainly due to lower international prices reflecting higher supply of tropical hardwood in the world market. The combined decline in export price and volume resulted in an export value to K75.0 million in the June quarter of 2004, 15.0 percent lower than in the corresponding period of 2003.

The value of marine products exported was K11.8 million in the June quarter of 2004, a decline of 71.0 percent from the corresponding period of 2003. This outcome was a result of a decline in export volume, which more than offset an increase in export price.

7. BALANCE OF PAYMENTS

The overall surplus in the balance of payments for the first six months of 2004 was K19 million, compared to a deficit of K96 million in the corresponding period of 2003. This outcome was the result of a significant improvement in the current account surplus, which more than offset a deterioration in the capital and financial accounts.

The surplus in the current account was attributed mainly to further improvements in the trade and net income accounts, which more than offset higher net service payments and lower net transfer receipts. The deterioration in the capital and financial accounts reflected increases in holding of foreign assets by the commercial banks and offshore account balances of the mineral companies, combined with higher loan repayments by the Government. During the first six months of 2004, the kina appreciated against the currencies of Papua New Guinea's major trading partners, with the exception of the Australian dollar, compared to the corresponding period in 2003.

The trade account recorded a surplus of K1,975 million in the first six months of 2004, compared to a surplus of K1,758 million in the corresponding period of 2003. The higher surplus was due to an increase in the value of merchandise exports combined with a decline in the value of merchandise imports. The value of merchandise exports was K4,074 million in the first six months of 2004, an increase of 4.1 percent from the corresponding period of 2003. The increase was attributed to higher values of gold, copper, coffee, tea, copra, copra oil, palm oil and other non-mineral exports, which more than offset lower values of crude oil, logs, cocoa, rubber and marine product exports.

The value of merchandise imports was K2,099 million in the first six months of 2004, a decline of 2.6 percent from the corresponding period of 2003. The decrease was due to lower values of general and petroleum sector imports, which more than offset an increase in mining sector imports. General imports was K1,574 million in the first six months of 2004, 8.8 percent lower than in the corresponding period of 2003. Imports by the petroleum sector were K39 million in first six months of 2004, 9.3 percent lower than in the corresponding period of 2003, due to lower capital expenditures undertaken by all petroleum projects. Imports by the mining sector were K486 million in the first half of 2004, an increase of 25.6 percent from the corresponding period of 2003. The increase reflected higher capital expenditures undertaken by the Lihir and Tolukuma mines.

The deficit in the services account was K1,270 million in the first half of 2004, compared to K1,211 million in the corresponding period of 2003. The higher deficit was due to increased payments on travel, other financial, computer and information, communication, government services n.i.e., and other services. Service receipts were also lower and more than offset the decline in payments for transportation and insurance associated with lower imports, education, other business, construction and refining and smelting.

The deficit in the income account was K901 million in the first half of 2004, compared to a deficit of K1,092 million in the corresponding period of 2003. This outcome was due to lower payments for dividend and interest on foreign loans by the Government and mineral companies, which more than offset higher compensation of employees and lower income receipts.

The surplus in the transfers account was K394 million in the first half of 2004, compared to a surplus of K564 million in the corresponding period of 2003. The lower surplus was due to increased payments for family maintenance, gifts and grants and licensing fees. This combined with lower transfer receipts more than offset lower superannuation and tax payments.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a surplus of K198 million in the first six months of 2004, compared to a surplus of K19 million in the corresponding period of 2003.

The capital account recorded no transactions during the first six months of 2004, the same as in the corresponding period of 2003.

The financial account recorded a net outflow of K197 million in the first six months of 2004, compared to a net outflow of K66 million in the corresponding period of 2003. The deterioration reflected higher net outflow of other investments totalling K267 million, reflecting the build-up in foreign currency account balances of the mineral companies, higher loan repayments by the Government and an increase in net foreign assets of the commercial banks. This combined with a net outflow of K24 million in financial derivatives reflecting increased hedging transactions by the mineral companies, more than offset the net inflows of K63 million and K31 million in direct investment and portfolio investments. These inflows were associated with the equity financing for a mineral project and the draw down of short-term money market investments by the mineral companies, respectively.

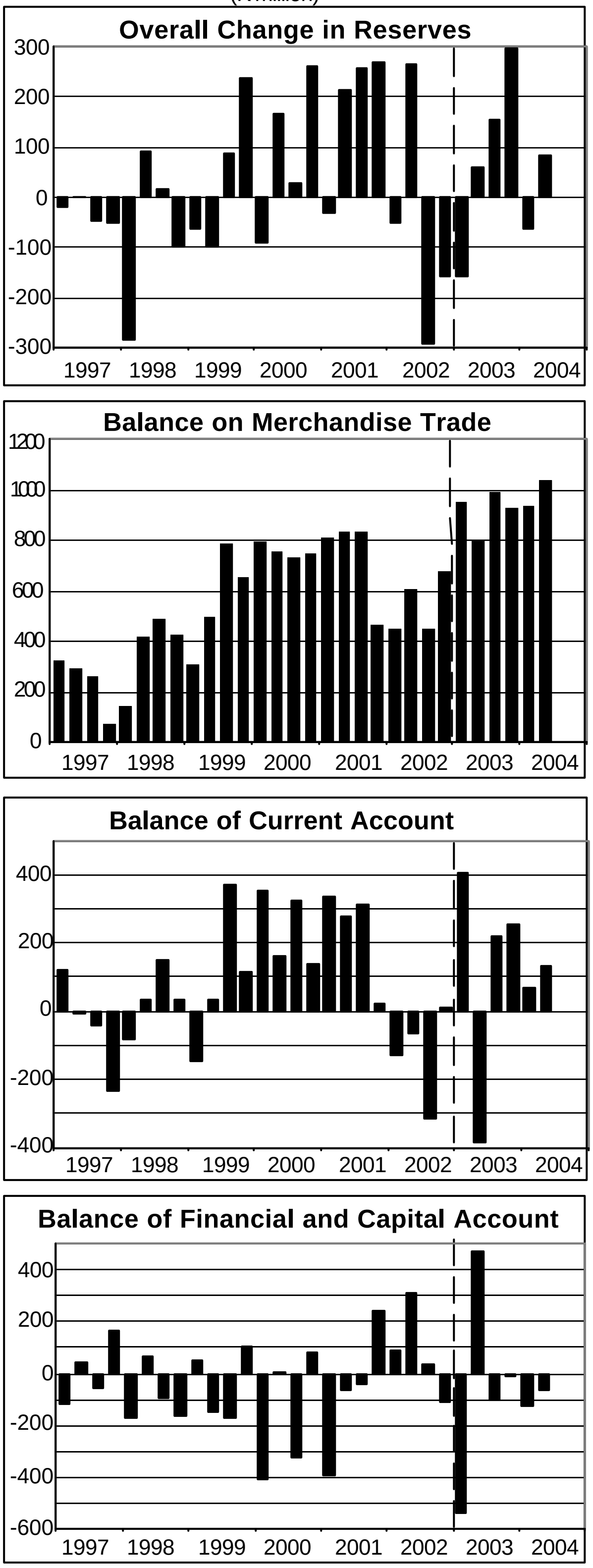
In the June quarter of 2004, the overall balance of payments recorded a surplus of K83 million, compared to a surplus of K60 million in the corresponding quarter of 2003.

The value of merchandise exports was K2,103 million in the June quarter of 2004, an increase of 12.2 percent from the corresponding quarter of 2003. The increase was due to higher values of all mineral, coffee, tea, copra, copra oil, palm oil and other non-mineral exports, which more than offset declines in the values of cocoa, rubber, logs and marine product exports. The value of merchandise imports was K1,067 million in the June quarter of 2004, a decline of 0.5 percent from the corresponding quarter of 2003. This outcome reflected a decline in general imports, which more than offset increases in mining and petroleum sector imports. General imports were K802 million in June quarter of 2004, a decline of 6.1 percent from the corresponding quarter of 2003. Imports by the mining sector were K243 million in the June quarter of 2004, an increase of 23.4 percent from the corresponding quarter of 2003, due to increased capital expenditures by the Ok Tedi, Lihir and Tolukuma mines. Petroleum sector imports were K22 million in the June quarter of 2004, an increase of 4.8 percent from the corresponding quarter of 2003, due to higher expenditures undertaken by all petroleum projects.

The deficit in the services account was K524 million in the June quarter of 2004, compared to K600 million in the corresponding quarter in 2003. The lower deficit was due to declines in payments for transportation and insurance associated with lower imports, travel, education, other business services, construction, refining and smelting and other services. This more than offset higher payments for other financial, computer and information, communications and government services n.i.e., and lower service receipts by the resident companies.

The deficit in the income account was K488 million in

BALANCE OF PAYMENTS[1]
(K'million)



[1] The dotted vertical lines indicate a break in series from 2002. See "For the Record" in March 2002 QEB on page 29.

the June quarter of 2004, compared to a deficit of K887 million in the corresponding quarter of 2003, due to lower payments for compensation of employees, interest and dividends. This combined with higher interest receipts and more than offset lower receipts from dividend and compensation of employees.

The surplus in the transfers account was K107 million in the June quarter of 2004, compared to a surplus of K296 million in the corresponding quarter of 2003. The lower surplus was the result of higher payments for gifts and grants, tax and licensing fees, combined with a decline in transfer receipts. These more than offset lower payments for superannuation and family maintenance.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a surplus of K131 million in the June quarter of 2004, compared to a deficit of K388 million in the corresponding quarter of 2003.

The capital account recorded no transactions during the June quarter of 2004, the same as in the corresponding period of 2003.

The financial account recorded a net outflow of K68 million in the June quarter of 2004, compared to a net inflow of K471 million in the corresponding period of 2003. The net outflow reflected an increase in portfolio investment assets and financial derivatives, which more than offset net inflows of direct and other investments.

The net inflow of K7 million in direct investments reflected the additional equity funding for mineral projects. The net outflow of K324 million in portfolio investment reflected an increase in holding of foreign assets from the purchase of short-term money market instruments by resident mineral companies. The net inflow of K265 million in other investments, mainly included trade credits owed by PNG residents to non-residents abroad, which more than offset higher net loan repayments by the Government and the private sector.

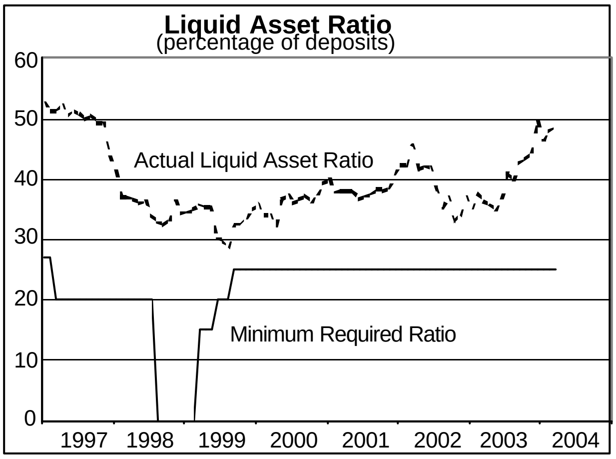
As a result of these developments, the capital and financial accounts recorded a deficit of K68 million in the June quarter of 2004, compared to a surplus of K471 million in the corresponding period of 2003.

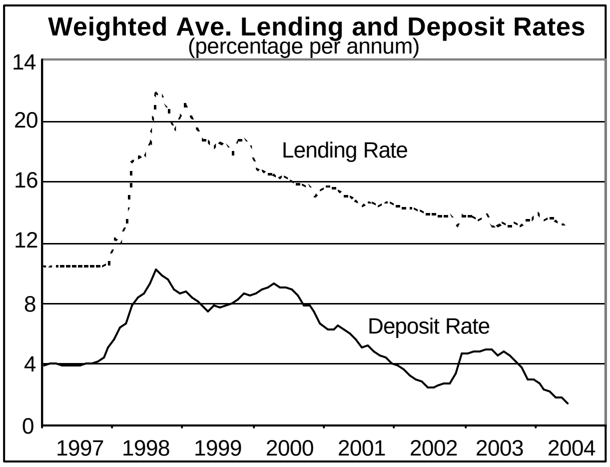
The level of gross foreign exchange reserves at the end of June quarter 2004 was K1,750.9 (US$550.2) million, sufficient for 5.0 months of total and 6.7 months of non-mineral import covers.

8. MONETARY DEVELOPMENTS

INTEREST RATES AND LIQUIDITY

The Bank of Papua New Guinea continued to ease its monetary policy stance during the June quarter of 2004, by reducing the Kina Facility Rate (KFR) by 200 basis points in aggregate to 10.0 percent at the end of June 2004, from 12.0 percent in March 2004. Consistent with the easing stance, Treasury bill rates decreased across all maturities during the June quarter. The 28-day rate decreased from 12.38 percent to 6.90 percent, the 63-day rate from 13.59 percent to 6.76 percent, the 91-day rate from 13.90 percent to 7.02 percent and the 182-day rate from 14.16 percent to 8.26 percent. While the dealing margins for the Repurchase Agreement





Facility (RAF) were maintained at 300 basis points on both sides of the market, the Tap Facility for Treasury bills was closed in May 2004 to allow maturing volumes to be shifted to the auction to smoothen the decline in interest rates.

The Bank continued to utilise its Open Market Operation (OMO) instruments in the conduct of monetary policy during the June quarter of 2004. Treasury bills and RAF were actively utilised to manage the high level of liquidity in the banking system. The volume of trade in the inter-bank market was low during the June quarter of 2004, reflecting the high liquidity levels of commercial banks. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) were maintained at 3.00 percent and 25.00 percent, respectively.

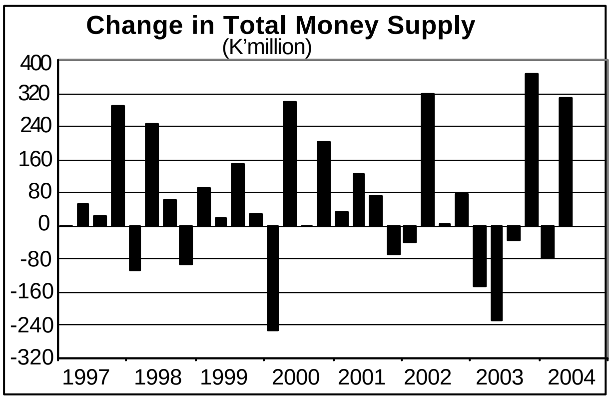
Average liquid assets held by the commercial banks increased by 5.8 percent over the second quarter of 2004, following an increase of 6.8 percent in the March quarter. The increase reflected higher holdings of Government securities and deposits with the Central Bank under the RAF. Commercial banks continued to hold the majority of their liquid assets in the form of short-term Government Treasury bills and Inscribed stocks.

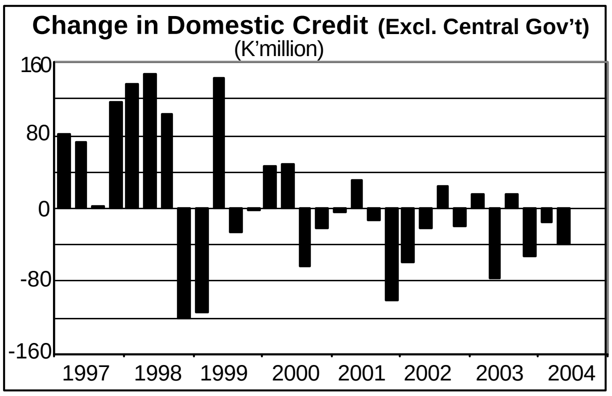
The weighted average deposit rates quoted on large term deposits (K500,000 and above) by commercial banks also trended downwards between end of March and June 2004. The 30-day rate declined from 3.88 percent to 3.14 percent, the 60-day rate from 3.06 percent to 2.77 percent, the 90-day rate from 6.25 percent to 2.77 percent, while the 180-day rate remained unchanged at 2.75 percent.

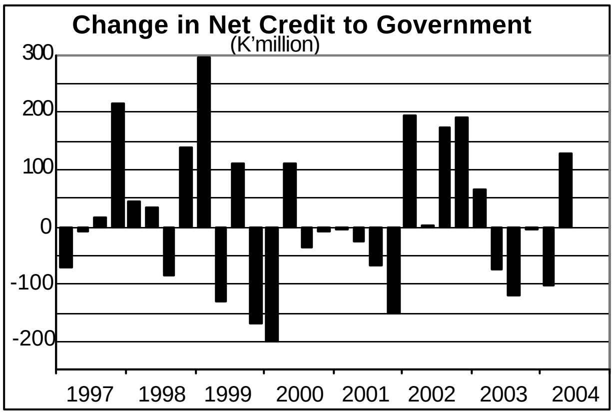
The weighted average rates on total deposits and lending by the commercial banks both declined in the June quarter of 2004. The weighted average deposit rate fell from 2.2 percent in March to 1.5 percent in June, whilst the weighted average lending rate declined from 13.6 percent to 13.3 percent. Over the same period, the weighted average rate on performing loans declined from 14.4 percent to 13.9 percent. All four commercial banks reduced their Indicator Lending Rates (ILRs) over the June quarter of 2004, with the spread declining to 12.25 percent to 13.25 percent.

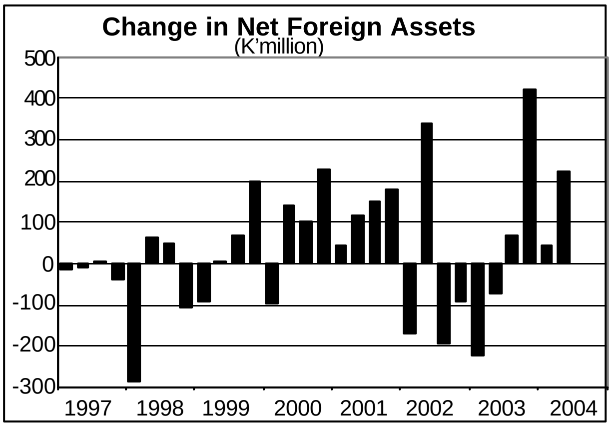
MONEY SUPPLY

The average level of broad money supply (M3*) increased by 4.2 percent in the June quarter of 2004, compared







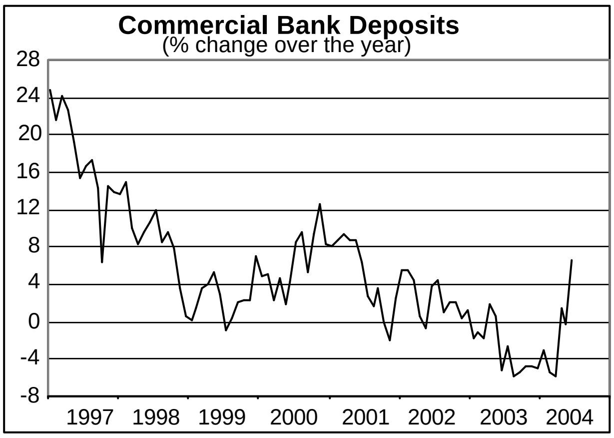


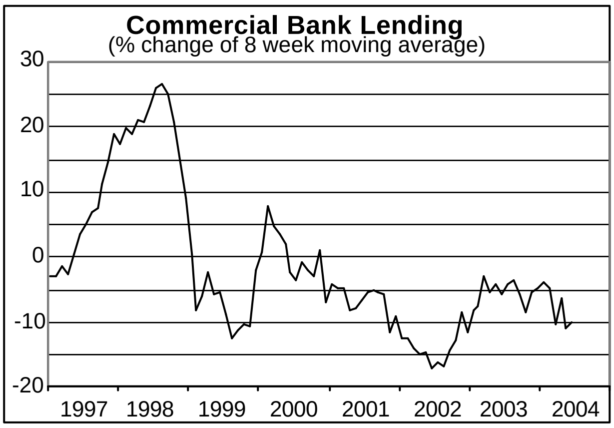
to a revised increase of 5.5 percent in the first quarter of 2004. The growth resulted from increases of 10.7 percent and 3.9 percent in average net foreign assets of the banking system and net credit to the Government respectively, which more than offset a decline of 2.9 percent in average net credit to the private sector, official entities and non-monetary financial institutions. Domestic credit outstanding, excluding advances to the Central Government and loans under the Agricultural export commodity price support schemes, decreased by 2.9 percent in the June quarter of 2004, compared to the March quarter of 2004. The average level of the broad monetary base grew by 4.5 percent over the June quarter of 2004, compared to an increase of 5.1 percent in the previous quarter. The increase was due to higher holdings of Government securities, partly reflecting the purchase of new Inscribed stocks issued by the Government.

Net credit to the Government increased by 12.5 percent in the June quarter of 2004, compared to a revised decline of 9.2 percent in the March quarter of 2004. The increase was due to higher holdings of Government securities by the commercial banks, combined with a decrease in deposits. Net foreign assets increased by K220.5 million to K1,874.8 million in the June quarter of 2004, compared to the previous quarter. The growth was due to higher foreign assets of both the Central Bank and commercial banks. The increase by the Central Bank reflected the purchase of foreign exchange and higher mineral tax receipts, while the continued favourable inflow of foreign exchange from export receipts contributed to higher holdings of foreign currency by the commercial banks.

The average level of narrow money supply (M1*) increased by 9.0 percent in the June quarter of 2004, compared to an increase of 3.8 percent in the March quarter of 2004. The increase was due to the growth in demand deposits, which more than offset a decline in currency in circulation. The average level of quasi money increased by 2.1 percent during the June quarter, following a decline of 1.7 percent in the March quarter of 2004, reflecting increases in both term and saving deposits.

The monthly average level of deposit base of commercial banks increased by 5.1 percent in the June quarter of 2004 to K3,100.2 million, from K2,948.7 million in the March quarter. This represents an annualised rate of growth of 16.2 percent.





LENDING

During the June quarter of 2004, total domestic credit extended by the commercial banks to the private sector, official entities and the non-monetary financial institutions decreased by K39.9 million to K1,442.2 million, compared to a decline of K77.7 million during the corresponding quarter of 2003. Lending to the private sector, official entities and non-monetary financial institutions fell by K21.8 million, K12.5 million and K5.6 million, respectively. The continued decline was due to a lack of demand. There were no repayments under the Government's Agricultural export commodity price support schemes and Small Scale Business Credit Facility (SSBCF), while marginal repayments were made under the European Investment Bank (EIB) Global Loan Facility. The annualised rate of decline in domestic credit, excluding the Central Government and advances under the price support schemes, was 5.5 percent over the first half of 2004. Foreign currency lending to the private sector and official entities was 6.7 percent of total lending to these sectors, compared to 6.1 percent in March 2004, with kina lending accounting for the remainder.

The utilisation rate of credit is the ratio of total credit outstanding to total commitments outstanding to the private sector, official entities and non-monetary financial institutions. A higher utilisation rate indicates that firms are more efficient in drawing down funds to meet their operations and minimise commitment fees. Commitments include call and term lending and exclude any other contingent items. The utilisation rate, quarter on quarter, was 85.0 percent in June 2004, compared to 82.6 percent in March 2004. The increase reflects higher utilisation of committed funds.

9. PUBLIC FINANCE

Preliminary estimates of the fiscal operations of the National Government over the six months to June 2004 showed an overall surplus of K157.2 million, compared to a deficit of K18.6 million in the corresponding period in 2003, and represents 1.2 percent of nominal GDP. The surplus was due to higher revenue combined with lower expenditure

Total revenue, including grants during the first six months of 2004 was K1,601.8 million, 12.0 percent higher than the receipts collected in the corresponding period of 2003, and represents 41.8 percent of the budgeted revenue. The increase was attributed to higher collections in all categories of revenue, except the non-tax category.

Total tax revenue amounted to K1,362.7 million, 12.4 percent higher than the receipts collected during the same period in 2003, and represents 48.8 percent of the 2004 budgeted tax receipts. Direct tax receipts totalled K882.6 million, K110.8 million more than the receipts collected over the corresponding period in 2003, and represents 48.5 percent of the budgeted amount. The increase was due to higher personal, company and other direct tax receipts. The growth in personal tax receipts reflects the adjustment in salaries and wages and increased employment by the private sector. The increase in company tax receipts reflected the improvement in profitability by companies because of higher mineral and agricultural production and prices. Other direct taxes increased due to higher receipts from gaming and dividend withholding taxes.

Indirect tax receipts was K480.1 million, 8.9 percent higher than the corresponding period in 2003, and represents 49.5 percent of the budgeted receipts for 2004. All categories of indirect tax increased except export tax. The increase in excise duties reflected a pick-up in economic activity, while the higher VAT receipts was due to increased audit activities conducted by the Internal Revenue Commission (IRC). Other indirect tax receipts also increased as a result of the 2.0 percent import duty. The decline in the export tax reflected lower log exports.

Total non-tax revenue amounted to K81.8 million, K10.9 million lower than the amount collected in the corresponding period of 2003, and represents 41.8 percent of the budgeted amount. The decrease mainly reflected lower collection of fees from Government departments, which more than offset higher dividend payments from statutory bodies. Foreign grants to June 2004 totalled K157.3 million, compared to K124.9 million in the same period of 2003, due to improved reporting of AusAID funded projects.

Total expenditure over the six months to June 2004 was K1,444.6 million, 0.3 percent lower than in the corresponding period in 2003, and represents 35.8 percent of the budgeted expenditure for 2004. The decrease was due to lower interest payments and tight control on expenditures.

Recurrent expenditure for the first half of 2004 was K1,183.2 million, 1.1 percent lower than in the corresponding period in 2003, and represents 42.9 percent of the 2004 budgeted appropriation. Of this total, K562.5 million relates to National Departmental expenditure, 19.2 percent higher than the amount spent during the corresponding period in 2003, and represents 44.2 percent of the budgeted appropriations. The increase reflects higher wages and salaries and expenses associated with the by-elections. Provincial Government recurrent expenditure was K260.8 million, which is 2.0 percent higher than the expenditure level during the same period in 2003, and represents 42.9 percent of the budgeted amount. The increase was due to higher administrative grants and salaries and wages. Interest payments totalled K254.2 million, K120.7 million lower than the amount paid in the corresponding period in 2003, and reflected lower interest rates on Treasury bills and the appreciation of the kina against the US dollar.

Total development expenditure for the first six months of 2004 was K261.4 million, K9.3 million higher than in the corresponding period of 2003 and represents 20.5

percent of the budgeted expenditure for 2004. The increase was partly related to improve reporting of expenditures related to AusAID funded projects.

The budget surplus combined with a net domestic borrowing of K60.5 million was used to repay a net overseas loan of K217.7 million. This comprised of K112.4 million in net concessionary, K15.0 million in commercial and K90.3 million for extraordinary loan sources. Domestic financing was mainly sourced from the non-banking system of K233.2 million, through higher holding of Government securities. This more than offset net repayments by the banking system of K59.2 million and other domestic sources of K113.5 million, which represents the settlement of cheque floats issued in 2003 and proceeds from the sale of Revenue Haus.

FOR THE RECORD

MONTHLY KINA FACILITY RATE ANNOUNCEMENTS

The Central Bank introduced the Kina Facility Rate (KFR) in February 2001, as an 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 2002, the KFR announced by the Bank were;

2002	07 January	Maintained at 12.00 %
	04 February	Maintained at 12.00 %
	04 March	Maintained at 12.00 %
	01 April	Maintained at 12.00 %
	06 May	Maintained at 12.00 %
	03 June	Maintained at 12.00 %
	01 July	Maintained at 12.00 %
	05 August	Increased by 50 basis points to 12.50 %
	02 September	Maintained at 12.50 %
	07 October	Maintained at 12.50 %
	04 November	Increased by 150 basis points to 14.00 %
	02 December	Maintained at 14.00 %
2003	06 January	Increased by 50 basis points to 14.50%
	03 February	Increased by 50 basis points to 15.00 %
	03 March	Maintained at 15.00 %
	07 April	Maintained at 15.00 %
	05 May	Maintained at 15.00 %
	02 June	Increased by 100 basis points to 16.00 %
	07 July	Maintained at 16.00 %
	04 August	Reduced by 100 basis points to 15.00 %
	01 September	Maintained at 15.00 %
	06 October	Reduced by 100 basis points to 14.00 %
	03 November	Maintained at 14.00 %
	01 December	Maintained at 14.00 %
2004	05 January	Reduced by 100 basis points to 13.00 %
	02 February	Maintained at 13.00 %
	01 March	Reduced by 100 basis points to 12.00 %
	05 April	Reduced by 100 basis points to 11.00 %
	03 May	Reduced by 100 basis points to 10.00 %
	07 June	Maintained at 10.00 %

For details of the KFR, see Table 7.2 (S23) of the QEB.
KFR announcements prior to January 2002 are reported in the December 2002 QEB.

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 1989.

Issue	**Title**
Dec 1989	Monetary Policy for 1990
Dec 1990	Monetary Policy for 1991
Dec 1990	The 1991 Budget
Dec 1990	Papua New Guinea's Total External Debt Outstanding
Dec 1991	Monetary Policy for 1992
Mar 1992	The 1992 National Budget
Mar 1992	Papua New Guinea's Total External Debt Outstanding
Dec 1992	The 1993 National Budget
Mar 1993	Papua New Guinea's Total External Exposure
Dec 1993	The 1994 National Budget
Dec 1993	Papua New Guinea's Total External Exposure
Mar 1995	The 1995 National Budget
Mar 1995	Papua New Guinea's Total External Exposure
Mar 1995	Monetary Policy for 1995
Dec 1995	The 1996 National Budget
Dec 1995	Monetary Policy for 1996
Mar 1996	Papua New Guinea's Total External Exposure
Dec 1996	The 1997 National Budget
Dec 1996	Monetary Policy for 1997
Mar 1997	Papua New Guinea's Total External Exposure
Dec 1997	Monetary Policy for 1998
Mar 1998	The 1998 National Budget
Mar 1998	Papua New Guinea's Total External Exposure
Dec 1998	The 1999 National Budget
Dec 1998	Monetary Policy for 1999
Mar 1999	Papua New Guinea's Total External Exposure
Sep 1999	The 1999 Supplementary Budget
Dec 1999	The 2000 National Budget
Jun 2000	Semi-annual Monetary Policy Statement, July 2000
Dec 2000	The 2001 National Budget
Dec 2000	Semi-annual Monetary Policy Statement, January 2001
Jun 2001	Semi-annual Monetary Policy Statement, July 2001
Dec 2001	Semi-annual Monetary Policy Statement, January 2002
Dec 2001	The 2002 National Budget
Jun 2002	Semi-annual Monetary Policy Statement, July 2002
Sep 2002	The 2002 Supplementary Budget
Dec 2002	Semi-annual Monetary Policy Statement, January 2003
Dec 2002	The 2003 National Budget
Mar 2003	Special article: Export Price Index, Volume Index and Weights Calculations Methodology
Jun 2003	Semi-annual Monetary Policy Statement, July 2003
Dec 2003	The 2004 National Budget
Dec 2003	Semi-annual Monetary Policy Statement, January 2004
Mar 2004	Semi-annual Monetary Policy Statement, July 2004