CONTENTS

PORT MORESBY

30th September, 2005

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.
Central Bank Bill (CBB)[1]	An indirect monetary policy instrument used by the Central Bank for liquidity management. The CBB is a liability of the Central Bank and has similar features as the Government Treasury bills.
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	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

[1] (See 'For the Record: p.34 in the 2004 September QEB)

	to hold liquid assets as a percentage of total deposits and other prescribed liabilities at all times.
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 convertible 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	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

In the first half of 2005, there was continued macroeconomic stability and a mild pick-up in economic activity in Papua New Guinea. This was largely due to high export commodity prices and sound fiscal operations which led to low interest rates, a stable exchange rate and an improvement in the current account surplus. Lending to the private sector increased at an annualised rate of 40 percent reflecting the stable and low interest rate environment. As a result of these positive developments, the headline inflation rate remained low in the June quarter. The current macroeconomic stability provides conditions conducive to investment and growth. To ensure the sustainability of these achievements, it is important that the Government fast-track reforms necessary for the success of its Medium Term Development Strategy.

According to the Bank's Employment Survey, the level of employment in the formal private sector excluding the mineral sector and the North Solomons Province (NSP) increased by 0.7 percent in the March quarter of 2005, compared to the corresponding quarter in 2004. By industry, the increase was due to higher levels of employment in the manufacturing, transportation and finance and other services sector. By region, the Morobe and Momase (excluding Morobe) regions recorded increases, while all the other regions recorded declines.

The headline inflation rate, as measured by the Consumer Price Index (CPI), was 1.1 percent in the June quarter of 2005, compared to negative 1.2 percent in the March quarter of 2005. All expenditure groups recorded price increases except for the 'Drinks, tobacco and betelnut' and 'Miscellaneous' groups. The increase was dominated by higher prices for the 'Food' and 'Rents, council charges, fuel and power' expenditure groups. By region, all urban areas, except Rabaul, recorded higher prices. The annual headline inflation rate was 0.9 percent in the June quarter of 2005, compared to negative 0.3 percent in the March quarter of 2005.

The exclusion-based inflation was 1.6 percent in the June quarter of 2005, compared to negative 1.2 percent in the March quarter of 2005. Trimmed mean inflation was 0.7 percent in the June quarter of 2005, compared to 1.8 percent in the March quarter of 2005. The annual exclusion-based and trimmed-mean measures were negative 0.3 percent and positive 2.6 percent respectively, in the June quarter of 2005.

The kina exchange rate appreciated against the major currencies in the June quarter of 2005. The quarterly average exchange rate appreciated by 0.14 percent against the US dollar and 1.21 percent against the Australian dollar.

Higher international prices for mineral and some agricultural export commodities resulted in the weighted average kina price of Papua New Guinea's exports increasing by 10.5 percent in the June quarter of 2005, compared to the corresponding quarter of 2004. There was a 14.5 percent increase in the weighted average kina price of mineral exports, with higher prices for copper and crude oil. For the agricultural, forestry and marine product exports, the weighted average kina price declined by 2.7 percent, accounted for by lower prices for all agricultural export commodities except coffee, copra oil, tea, rubber and log exports.

There was an overall deficit of K304 million in the balance of payments for the first six months of 2005, compared to a surplus of K20 million in the corresponding period of 2004. This outcome was the result of a substantial deterioration in the capital and financial accounts, which more than offset a significant improvement in the current account surplus.

The current account recorded a surplus of K273 million in the first six months of 2005, compared to a surplus of K2 million in the corresponding period of 2004. This outcome was the result of improvements in the trade account, service and income accounts, which more than offset a deterioration in the transfers account.

The capital and financial accounts recorded a deficit of K561 million in the first six months of 2005, compared to a deficit of K36 million in the corresponding period of 2004. The deterioration reflected outflows for loan repayments by mineral companies, the purchase of short-term money market and financial derivative instruments by mineral companies. This more than offset direct investment inflows and draw downs in both foreign currency account balances of mineral companies and net foreign assets of commercial banks.

The level of gross foreign exchange reserves at the end of June 2005 was K1,757.2 (US$550.2) million, sufficient for 4.3 months of total and 5.8 months of non-mineral import covers.

The Bank of Papua New Guinea continued its neutral stance of monetary policy over the June quarter of 2005, keeping the Kina Facility Rate (KFR) unchanged at 7.0 percent. Consistent with the neutral stance, domestic interest rates were relatively stable during the June quarter. The dealing margins for the Repurchase Agreement Facility (RAF) were also maintained at 300 basis points from the KFR on the buy and sell sides of the market.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy during the June quarter of 2005. Treasury bills and Central Bank Bills (CBBs) were actively utilised to manage the high level of liquidity in the banking system. Despite the high level of liquidity, the volume of trades in the inter-bank market was high during the June quarter of 2005, compared to the previous quarter, reflecting uneven distribution of liquidity among the commercial banks.

The average level of broad money supply (M3*) increased by 3.3 percent in the June quarter of 2005, compared to a decline of 0.3 percent in the first quarter. The growth resulted from increases of 8.7 percent in average net credit to the Government and 9.3 percent in net credit to the private sector, official entities and non-monetary financial institutions. The average level of the monetary base increased by 1.7 percent over the June quarter of 2005, compared to a decline of 0.9 percent in the previous quarter, reflecting higher holdings of Inscribed stocks.

Total domestic credit extended by the commercial banks to the private sector, official entities and the non-monetary financial institutions increased by K135.5 million to K1,694.7 million during the June quarter of 2005, compared to a revised decline of K13.9 million during the corresponding quarter of 2004. Lending to the private sector increased by K145.5 million, which more than offset repayments of K7.7 million by official entities and K2.3 million by the non-monetary financial institutions. The pick-up in lending to the private sector was to the palm oil and fisheries sub-sectors, the household sector for personal housing and consumption, and the construction sector. The annualised rate of growth in domestic credit, excluding the Central Government and advances under the price support schemes, was 37.7 percent over the first half of 2005.

Preliminary estimates of the fiscal operations of the National Government over the six months to June 2005 showed an overall surplus of K192.2 million, compared to a surplus of K157.2 million in the corresponding period of 2004. This represents 1.3 percent of nominal GDP. The higher surplus was mainly due to increased revenue, which more than offset an increase in expenditure.

Total revenue, including grants during the first six months of 2005 was K2,077.6 million, 29.7 percent higher than the receipts collected in the corresponding period of 2004. This represents 44.8 percent of the budgeted revenue. The increase was attributed to higher collections in most categories of revenue.

Total expenditure over the six months to June 2005 was K1,885.4 million, 30.5 percent higher than in the corresponding period in 2004, and represents 39.5 percent of the budgeted expenditure for 2005. The increase was due to both higher recurrent and development expenditures.

The budget surplus was used to make net overseas and domestic loan repayments of K185.5 million and K6.7 million, respectively. The net external loan repayments comprised of K94.8 million in concessionary, K8.3 million in commercial and K82.4 million for extraordinary loans.

3. INTERNATIONAL DEVELOPMENTS

World economic growth, as measured by real Gross Domestic Product (GDP), is projected to increase in 2005. The International Monetary Fund (IMF) forecast made in April 2005 was for a growth of 4.3 percent in 2005. A World Bank report in April 2005 projected the world economy to grow by 3.1 percent in 2005, down from 3.8 percent in 2004, with slowdowns in both the industrialised and developing countries. Continuing high oil prices in the June quarter raised fears of a slowdown in global economic growth.

In April, members of the Organisation of Petroleum Exporting Countries (OPEC) agreed to increase their daily production quota by 500,000 barrels a day in May and by another 500,000 barrels in the September quarter to reduce the rise in oil prices. The high oil prices were due to rising demand and limited supply as a result of low spare production capacity.

In early June, the United States (US) only provided an additional US$674 million in emergency aid to Africa, in support of the United Kingdom's (UK) initiative known as the International Finance Facility. The Facility plans to inject an additional US$25 - US$50 billion a year in development assistance to Africa by issuing bonds in global capital markets against future aid budgets of the industrialised countries.

Also in June, finance ministers, then political leaders of the European Union (EU) met in Brussels, Belgium to reaffirm their support for the euro, following rejection of the European constitution by France and the Netherlands, and concerns by some of the member countries over the inflexible interest rate policy contributing to low economic performances.

In the United States (US), real GDP grew by 3.6 percent over the year to June 2005, compared to an increase of 4.8 percent in the corresponding period in 2004, reflecting higher consumer spending and investment. The IMF forecasts a GDP growth of 3.6 percent in 2005.

Industrial production increased by 3.9 percent over the year to June 2005, compared to an increase of 5.6 percent over the year to June 2004. The Institute for Supply Management's Purchasing Managers' index was 53.8 percent in June 2005, down from 55.2 percent in March 2005. Whilst an index over 50 percent indicates expansion in the manufacturing sector, the weakness reflects the ending of tax incentives for business investments, a strong US dollar, and increases in inventories due to slower sales. Retail sales increased by 9.6 percent over the year to June 2005, compared to an increase of 5.6 percent over the year to June 2004 with higher spending on vehicles in June and durable goods. New and existing home sales reached record annual rates of 1.4 million and 7.2 million respectively in June 2005. The unemployment rate was 5.0 percent in June 2005, compared to 5.6 percent in June 2004, its lowest level in four years.

Consumer prices rose by 2.5 percent over the year to June 2005, relative to an increase of 3.3 percent over the year to June 2004, reflecting high oil prices. Broad money supply increased by 4.8 percent over the year to June 2005, compared to an increase of 5.8 percent over the year to June 2004. With concerns over high oil prices adversely affecting economic activity and producing inflationary pressures, the Federal Open Market Committee (FOMC) tightened monetary policy by increasing the federal funds rate by 25 basis points to 3.00 percent in May 2005.

The trade deficit was US$723.4 billion over the year to June 2005, compared to a deficit of US$589.5 billion over the corresponding period in 2004, due to higher imports.

In Japan, real GDP grew by 1.4 percent over the year to June 2005, compared to an increase of 4.4 percent over the year to June 2004. The IMF forecast a GDP growth of 0.8 percent in 2005.

Industrial production increased by 0.2 percent over the year to June 2005, compared to an increase of 8.9 percent over the year to June 2004. Retail sales increased by 3.1 percent over the year to June 2005, compared to a decline of 2.4 percent over the year to June 2004, with higher spending on clothing, fuel and cars as a result of rising wages and job prospects. The unemployment rate was 4.2 percent in June 2005, compared to 4.6 percent in June 2004.

Consumer prices decreased by 0.5 percent over the year to June 2005, compared to zero percent over the corresponding period of 2004. Broad money supply increased by 1.7 percent over the year to June 2005, compared to an increase of 1.8 percent in the corresponding period of 2004. Despite concerns over economic growth, currency instability and the effects of high oil prices, the Bank of Japan continued its zero percent interest rate policy, injecting liquidity to combat deflation.

The current account surplus was US$113.2 billion over the year to June 2005, compared to a surplus of US$128.9 billion over the year to June 2004, due to lower imports.

In Germany, real GDP grew by 0.6 percent over the year to June 2005, compared to an increase of 1.5 percent over the year to June 2004. The latest IMF estimate is for a GDP growth of 0.8 percent in 2005.

Industrial production increased by 2.8 percent over the year to June 2005, compared to an increase of 2.2 percent over the year to June 2004. Retail sales increased by 1.9 percent over the year to June 2005, compared to a decline of 2.2 percent over the year to June 2004. The unemployment rate rose to 11.7 percent in June 2005, compared to 10.5 percent in June 2004.

Consumer prices increased by 1.8 percent over the year to June 2005, compared to an increase of 1.7 percent over the year to June 2004.

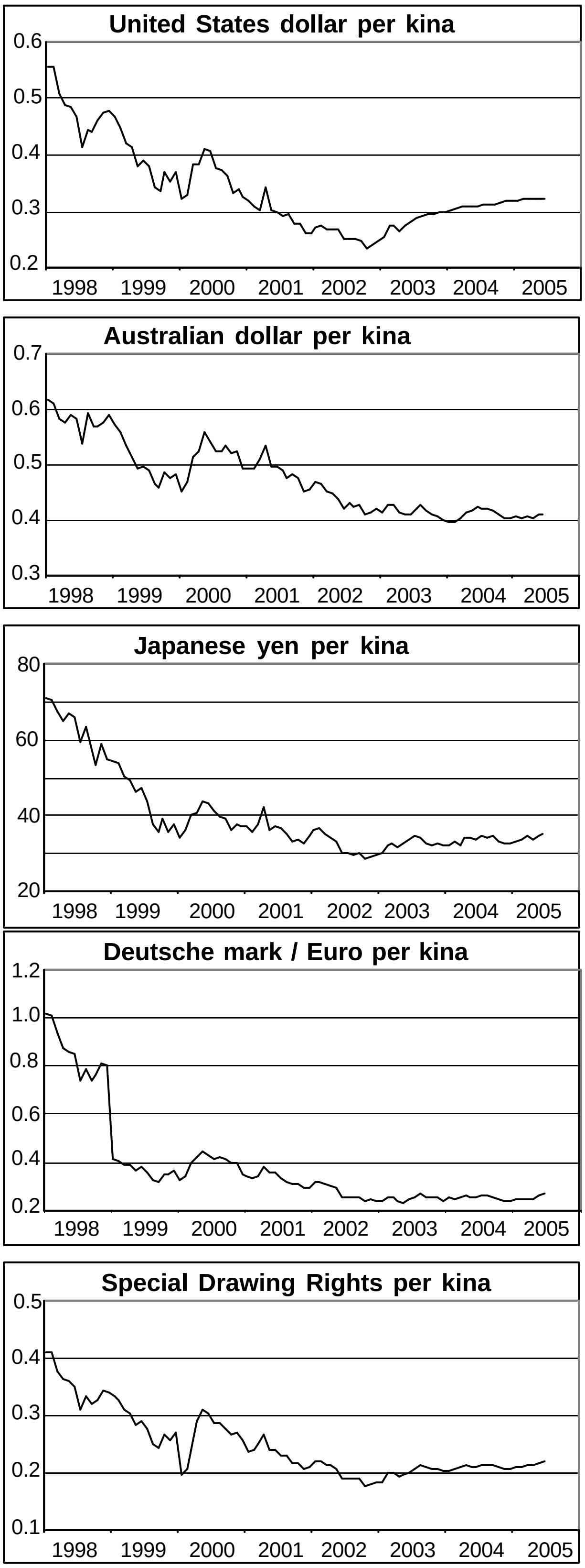
The current account surplus was US$198.5 billion over the year to June 2005, compared to a surplus of US$93.7 billion over the year to June 2004.

In the UK, real GDP increased by 1.7 percent over the year to June 2005, compared to 3.7 percent over the year to June 2004 reflecting declining retail sales, weak industrial production, increasing prices and political developments. The IMF forecasted a GDP growth of 2.6 percent in 2005.

Industrial production declined by 1.9 percent over the year to June 2005, compared to an increase of 0.5 percent over the year to June 2004. Retail sales increased by 1.7 percent over the year to June 2005, compared to an increase of 7.2 percent over the year to June 2004, reflecting lower consumer spending as a result of higher mortgage and fuel costs. The unemployment rate in June 2005 was 4.8 percent, the same as in June 2004.

Consumer prices rose by 2.0 percent over the year to June 2005, compared to an increase of 1.6 percent over the year to June 2004. Broad money supply increased by 11.0 percent over the year to June 2005,

EXCHANGE RATES



compared to an increase of 7.8 percent over the year to June 2004. The Bank of England maintained its benchmark repo rate at 4.75 percent over the June quarter, amidst signs that consumer spending was falling.

The trade deficit was US$111.2 billion over the year to June 2005, compared to a deficit of US$93.6 billion over the year to June 2004.

In Australia, real GDP grew by 1.9 percent over the year to March 2005, compared to a growth of 3.2 percent over the year to March 2004. In May, the Government announced its fiscal budget for 2005/6.

Industrial production increased by 1.2 percent over the year to March 2005, compared to a decline of 1.1 percent over the year to March 2004. Retail sales increased by 1.6 percent over the year to June 2005, compared to an increase of 7.9 percent over the year to June 2004. The unemployment rate was 5.0 percent in June 2005, compared to 5.6 percent in June 2004, the lowest levels since the 1970s.

Consumer prices increased by 2.5 percent over the year to June 2005, the same as in the corresponding period in 2004. The increase reflected higher prices for automotive fuel, house purchase, medical services and tobacco. The Reserve Bank of Australia (RBA) left its official cash rate unchanged at 5.50 percent in the June quarter of 2005. The RBA's inflation target range is between 2 and 3 percent. Broad money supply increased by 10.6 percent over the year to June 2005, compared to an increase of 11.8 percent over the year to June 2004.

The trade deficit was US$17.1 billion over the year to June 2005, compared to a deficit of US$16.9 billion over the year to June 2004.

During the June quarter of 2005, the US dollar appreciated against the euro, the British pound sterling, the Japanese yen and the Australian dollar. The appreciation reflected improved economic conditions in the US and rising domestic interest rates. The euro depreciated against the US dollar due to continuing political problems and depressed economic conditions in member countries of the EU. The depreciation of the Australian dollar reflected the strong US dollar, low commodity prices and lower than expected domestic economic data.

During the June quarter of 2005, the kina appreciated against the major currencies. The average kina exchange rate against the US dollar during the June quarter was 32.10 US cents, an appreciation of 0.14 percent on the March quarter of 2005. The average kina exchange rate against the Australian dollar was 41.78 Australian cents, an appreciation of 1.21 percent on the March quarter. The average kina exchange rate also appreciated by 3.14 percent and 2.0 percent against the yen and sterling, respectively. The improvement was due to favourable foreign exchange inflows as a result of higher international prices for most export commodities.

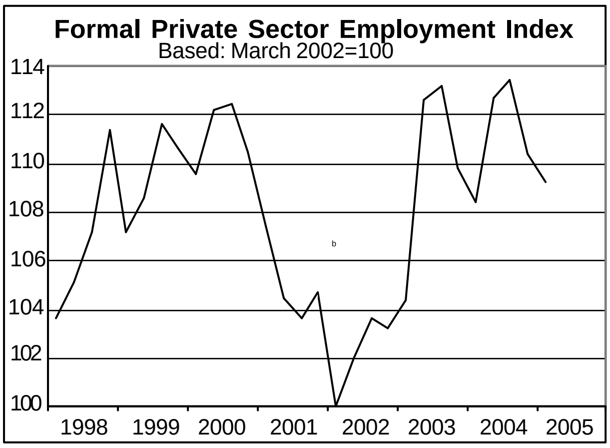
4. EMPLOYMENT

According to the Bank's Employment Index, the level of employment in the formal private sector, excluding mining and petroleum and the North Solomons Province (NSP), increased by 0.7 percent in the March quarter of 2005, compared to the corresponding quarter of 2004. By industry, the increase was due to higher levels of employment in the manufacturing, hotel and catering, transportation and other services sectors. By region, the Morobe and Momase (excluding Morobe) regions recorded increases, while all the other regions recorded decreases.

In the manufacturing sector, the level of employment increased by 7.7 percent in the March quarter of 2005, compared to the corresponding quarter of 2004. The increase was due to the hiring of casual staff by a company to move its inventories and the hiring of new staff by another company to expand its sales department. Higher employment was also associated with increased production by a major tuna loining company in Wewak.

In the transportation sector, the level of employment increased by 5.7 percent in the first quarter of 2005, compared to the corresponding quarter of 2004. The increase was associated with the haulage of general cargo as a stevedoring company introduced an additional work shift, the awarding of several cartage contracts to a trucking company in the Highlands region and higher shipping activity following the addition of a new ship by a shipping company.

In the finance and other services sector (which includes real estate, hotels and restaurants, finance and



security services), the level of employment increased by 6.8 percent, compared to the corresponding quarter of 2004. The increase was mainly due to the hiring of casual employees, trainees for on-the-job-training and security personnel in both the NCD and Islands (excluding NSP) regions.

In the retail and wholesale sector, the level of employment decreased by 2.0 percent in the March quarter of 2005, compared to the corresponding quarter of 2004. The decrease stemmed from a lower demand for exports resulting in the laying off of casual staff in the Highlands region, downsizing of a fuel wholesale company in NCD due to increased costs from higher international oil prices and the selling-off of the wholesale/retail operations of a company in Lae.

In the building and construction sector, the level of employment decreased by 5.7 percent in the March quarter of 2005, compared to the corresponding quarter of 2004. The decrease was mainly attributed to the completion of construction projects in the NCD and Morobe regions, and the temporary suspension of construction projects in the Momase region due to lack of funding. The rainy season in the Islands region that disrupted construction projects, resignations and voluntary retrenchments also contributed to the decline.

In the agriculture/forestry/fisheries sector, the level of employment decreased by 4.8 percent in the March quarter of 2005, compared to the corresponding quarter of 2004. The decrease was a result of downsizing and management restructuring in the Morobe and Southern regions, and laying-off of casual employees mainly due to the off-season for coffee production in the Highlands region.

In the mining /quarrying/petroleum sector, the level of employment decreased by 0.1 percent in the March quarter of 2005, compared to the corresponding quarter of 2004. This marginal decrease was associated with the closure of the Misima gold mine.

By region, employment increased in the Morobe and Momase region, while all other regions recorded decreases. In Morobe, the increase was attributed to higher employment in the manufacturing and transportation sectors. The increase in the manufacturing sector was due to the recruitment of casual and permanent staff of a company's sales department, while in the transportation sector, the increase was attributed to an additional shift by a stevedoring company. In the Momase region, higher employment in the manufacturing sector was due to increased tuna loining activity in Wewak.

In NCD, the level of employment decreased by 0.5 percent in the March quarter of 2005, compared to the corresponding quarter of 2004. The decrease was due to lower employment in the manufacturing, construction, wholesale, transportation and finance sectors. The decrease in the manufacturing sector was due to the laying-off of casual staff, mainly students returning to school, resignations and the downsizing by a company. In the construction sector, the decline was mainly due to the completion of projects. In the transportation sector, the decrease was associated with the laying-off of casual employees and a retrenchment exercise undertaken by a major airline operator, while the decline in the finance sector was due to staff resignations. The decrease in the wholesale sector resulted from a major fuel wholesale company reducing employment due to increased costs from higher international oil prices.

In the Southern region (excluding NCD), the level of employment decreased by 6.1 percent in the March quarter of 2005, compared to the corresponding quarter of 2004. The decrease was attributed to lower employment in the agriculture/forestry/fisheries and mining sectors. The decrease in the mining sector was associated with the closure of the Misima gold mine, while in the agriculture/forestry/fisheries sector, it reflected the downsizing of a fishing company and reduction in logging activities due to wet weather conditions.

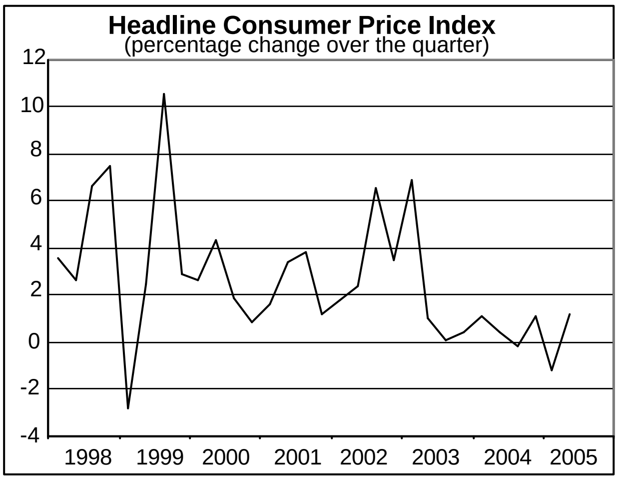
In the Highlands region, the level of employment decreased by 0.9 percent in the March quarter of 2005, compared to the corresponding quarter of 2004. The decrease was in the agriculture/forestry/fisheries, retail and other services sectors. The decline in agriculture reflected the laying-off of casual employees due to the off-season for coffee production, while in the retail sector the decrease was associated with a slowdown in business activity. The termination of a contract for a security company resulted in the decline in the other services sector.

In the Islands region (excluding NSP), the level of employment decreased by 0.8 percent in the March quarter of 2005, compared to the corresponding quarter of 2004. The decrease was due to lower levels of employment in the agriculture/forestry/fisheries and wholesale sectors. In the agriculture sub-sector, the decline was due to the reduction of casual staff and retrenchment of plantation workers, while in the wholesale sector the reduction in casual employment was due to a slowdown in activity.

5. CONSUMER PRICE INDEX

The headline inflation rate, as measured by the Consumer Price Index (CPI), was 1.1 percent in the June quarter of 2005, compared to negative 1.2 percent in the March quarter of 2005. All expenditure groups recorded price increases except for the 'Drinks, tobacco and betelnut' and 'Miscellaneous' groups. The increase was dominated by higher prices in the 'Food' and 'Rents, council charges, fuel and power' expenditure groups. By region, all urban areas, except Rabaul, recorded higher prices. The annual headline inflation rate was 0.9 percent in the June quarter of 2005, compared to negative 0.3 percent in the March quarter of 2005.

The 'Rents, council charges, fuel and power' expenditure group recorded the largest inflation in the June quarter of 2005. Prices increased by 8.7 percent in the June quarter of 2005, compared to a decline of 2.6 percent in the March quarter of 2005. The increase reflected higher prices approved for public utilities and higher international oil prices, which impacted on the domestic prices for kerosene and electricity. This expenditure group contributed 0.62 percentage points to the overall movement in the CPI. The CPI for the 'Food' expenditure group increased by 1.8 percent in the June quarter of 2005, compared to an increase of 2.3 percent in the March quarter of 2005, and



contributed 0.73 percentage points to the overall movement in the CPI. A significant increase in the prices of fruit and vegetables, combined with marginal increases for cereals, meat and fish and miscellaneous food items accounted for the increase.

The 'Household equipment and operations' and 'Transport and communication' expenditure groups recorded increases in the June quarter of 2005, compared to a deflationary outcome in the March quarter of 2005. The 'Household equipment and operations' expenditure group increased by 5.8 percent in the June quarter of 2005, compared to a decline of 3.8 percent in the March quarter of 2005 and contributed 0.31 percentage points to the overall CPI movement. A significant increase in prices for semi-durable goods, combined with a marginal increase in the price of durable goods, accounted for the increase. The 'Transport and communication' expenditure group increased by 3.0 percent in the June quarter of 2005, compared to a large deflation of 8.3 percent in the March quarter of 2005 and contributed 0.39 percentage points to the overall movement of the CPI. Price increases in motor vehicle operations and purchases and airline and public motor vehicle fares reflects the higher petrol prices captured in this expenditure group. The 'Clothing and footwear' expenditure group increased by 1.0 percent in the June quarter of 2005, compared to a decline of 2.0 percent in the March quarter of 2005.

The CPI for the 'Drinks, tobacco and betelnut' expenditure group continued to decrease and recorded a decline of 2.3 percent in the June quarter of 2005, following a fall of 1.1 percent in the March quarter of 2005. Betelnut prices continued to decline in the second quarter of 2005. Lower prices for cigarettes, tobacco and betelnut offset marginal increases for soft drinks and alcoholic drinks. The CPI for the 'Miscellaneous' expenditure group decreased by 1.2 percent in the June quarter of 2005, compared to an increase of 3.6 percent in the March quarter of 2005.

All urban areas included in the survey, except Rabaul, recorded increases in CPI in the June quarter of 2005. Goroka recorded the largest increase of 2.9 percent and contributed 0.35 percentage points to the overall movement in the CPI. The second highest increase was 1.5 percent in Port Moresby, which contributed 0.64 percentage points to the overall CPI movement. Madang recorded an increase of 0.9 percent in the CPI and contributed 0.10 percentage points, while prices in Lae increased by 0.8 percent contributing 0.17 percentage points. The CPI for Rabaul continued to fall in the June quarter of 2005 by 1.3 percent.

The exclusion-based inflation measure was 1.6 percent in the June quarter of 2005, compared to negative 1.2 percent in the March quarter of 2005. Trimmed mean inflation was 0.7 percent in the June quarter of 2005, compared to 1.8 percent in the March quarter of 2005.

6. EXPORT COMMODITIES REVIEW

The total value of merchandise exports in the June quarter of 2005 was K2,412 million, 12.6 percent higher than in the corresponding quarter of 2004. Increased values of copper, crude oil, coffee, copra oil and palm oil exports combined with export receipts from refined petroleum products, more than offset a decline in the values of gold, cocoa, tea, copra, rubber and other non-mineral exports. Mineral export receipts, excluding crude oil were K1,159.8 million and accounted for 48.1 percent of total merchandise exports in the June quarter of 2005, compared to K1,146.0 million or 53.5 percent in the corresponding quarter of 2004. Crude oil exports totalled K682.3 million and accounted for 28.3 percent of total merchandise exports in the June quarter of 2005, compared to K473.1 million or 22.1 percent in the corresponding quarter of 2004.

The value of agricultural, marine products, refined petroleum products and other non-mineral exports, excluding forestry product exports was K464.1 million and accounted for 19.2 percent of total merchandise exports in the June quarter of 2005, compared to K419.4 million or 19.6 percent in the corresponding quarter of 2004. Forestry product exports were K105.9 million and accounted for 4.4 percent of total merchandise exports in the June quarter of 2005, compared to K104.5 million or 4.9 percent in the corresponding quarter of 2004.

The weighted average price of Papua New Guinea's exports was 10.5 percent higher in the June quarter of 2005, compared to the corresponding quarter of 2004. There was a 14.5 percent increase in the weighted average price of mineral exports, with higher kina prices for copper and crude oil. For the agricultural, forestry and marine product exports, excluding refined petroleum products export, the weighted average price declined by 2.7 percent and was accounted for by lower kina prices for all agricultural export commodities, except coffee, tea, copra oil, rubber and log exports. Excluding logs, the weighted average price of agricultural and marine product exports declined by 4.1 percent in the June quarter of 2005, compared to the corresponding period of 2004. The lower export prices reflected declines in international prices during the June quarter of 2005.

Mineral Exports

Total mineral export receipts were K1,842.1 million in the June quarter of 2005, compared to K1,619.1 million in the corresponding quarter of 2004. The increase was due to higher export volumes and prices of copper and crude oil, which more than offset the decline in the export volume and price of gold.

Gold export volumes during the June quarter of 2005 was 16.0 tonnes, a decline of 7.5 percent from the corresponding quarter of 2004. The decline was due to lower production from the Porgera and Tolukuma mines, which more than offset higher production from the Lihir and Ok Tedi mines. The average free on board (f.o.b.) price received for Papua New Guinea's gold exports was K38.3 million per tonne during the June quarter of 2005, 5.1 percent lower than in the corresponding period of 2004. Whilst the domestic f.o.b. prices declined, the international price increased during the quarter. The average gold price at the London Metal Exchange increased by 6.6 percent to US$421 per fine ounce in the June quarter of 2005, compared to the corresponding quarter of 2004. The increase was due to higher demand from investors for gold-based investments as a safe haven investment after increased volatility of prices in the equity markets, and uncertainties surrounding the US dollar and other major currencies. The lower export price and volume resulted in gold export receipts of K612.3 million in the June quarter of 2005, a decline of 12.4 percent from the corresponding quarter of 2004.

Copper export volumes in the June quarter of 2005 were 49.3 thousand tonnes, an increase of 0.4 percent from the corresponding quarter of 2004. The increase was due to higher production and shipment of copper ore by the Ok Tedi mine as a result of improved water levels at the Fly river. The average f.o.b. price of Papua New Guinea's copper exports was K10,414 per tonne in the June quarter of 2005, an increase of 16.6 percent from the corresponding quarter of 2004, mainly due to higher international prices. The increase in international prices was due to lower stock levels at the London Metal Exchange, combined with higher demand from Asia, one of the major copper consuming regions. The combined increases in the export volume and price resulted in an export value of K513.4 million in the June quarter of 2005, an increase of 17.1 percent from the corresponding quarter of 2004.

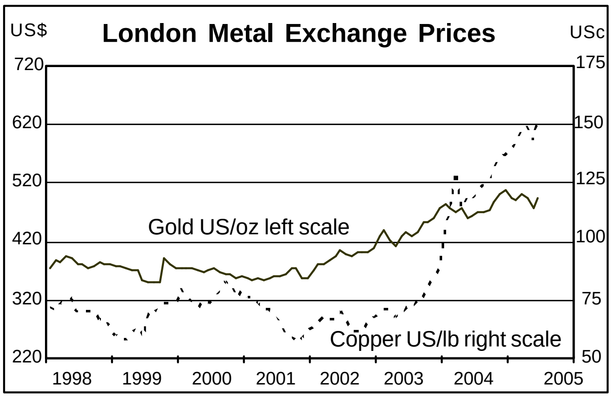
Crude oil export volumes in the June quarter of 2005 were 3,945.6 thousand barrels, an increase of 4.1 percent from the corresponding quarter of 2004. The increase reflected higher extraction rates and increased production from the Moran field and the newly developed wells at Kutubu. The average export price of crude oil was K173 per barrel in the June quarter of 2005, an increase of 38.4 percent from the corresponding quarter of 2004, due to higher international prices. The increase in international prices reflected higher global demand and fears of attacks on oil production facilities in Saudi Arabia and Iraq. The increase in export volume and price resulted in an export value of K682.3 million in the June quarter of 2005, an increase of 44.2 percent from the corresponding quarter of 2004.

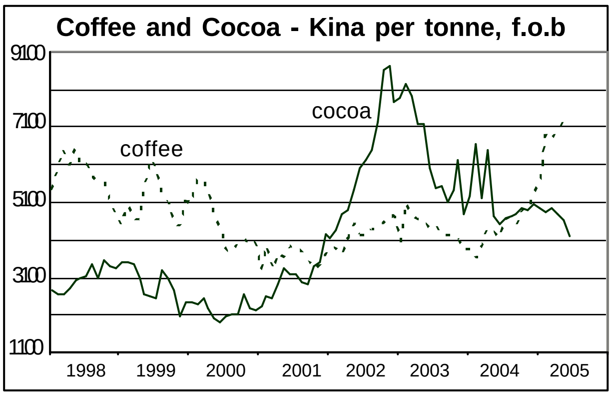
Exports of refined petroleum products from the Napa Napa Refinery, which commenced production in July 2004 will have its full year of production in the September quarter 2005. Over the six months to June 2005, the total export value of refined petroleum products was K302.7 million.

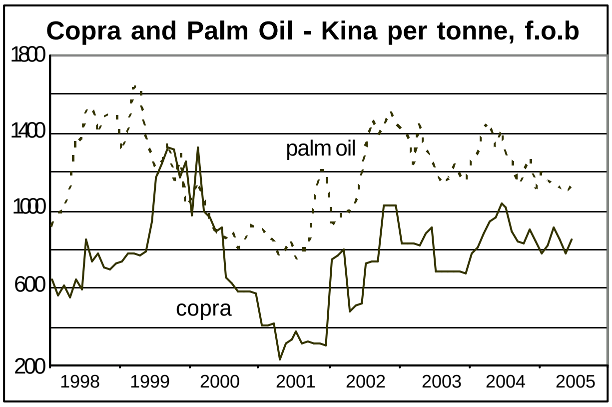
Agriculture, Logs and Fisheries Exports

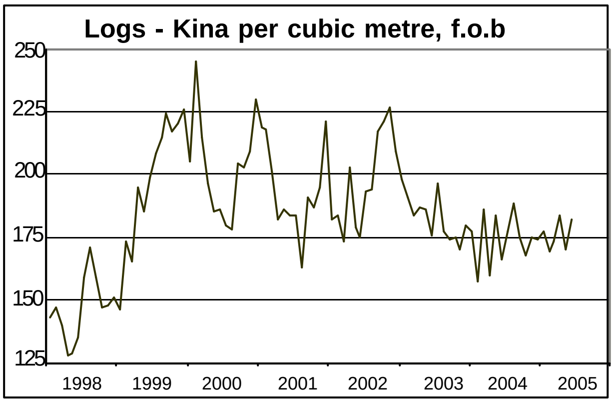
Export prices of most agricultural export commodities increased in the June quarter of 2005, compared to the corresponding quarter of 2004. Coffee prices in-

EXPORT COMMODITY PRICES









creased by 68.8 percent, copra oil by 2.5 percent, tea by 4.9 percent and rubber by 25.0 percent, while cocoa declined by 14.6 percent, copra by 19.2 percent and palm oil by 18.8 percent. The average export price of logs increased by 3.5 percent to K179 per cubic meter in the June quarter of 2005, compared to the corresponding quarter of 2004. The average export price of marine products declined by 49.3 percent. The net effect of these price movements was a 2.7 percent decline in the weighted average price of agricultural, forestry and marine product exports.

The volume of coffee exported in the June quarter of 2005 was 16,900 tonnes, a decline of 2.3 percent from the corresponding quarter of 2004. The decline was due to lower production attributed mainly to unfavourable weather conditions combined with a lack of transportation services. The average export price of coffee was K7,213 per tonne in the June quarter of 2005, an increase of 68.8 percent from the corresponding quarter of 2004. The increase was due to higher international prices, reflecting a decline in world supply following unfavourable weather conditions in Brazil, the world's largest coffee producer. The increase in export price more than offset the decline in export volume, resulting in an export value of K121.9 million in the June quarter of 2005, an increase of 65.0 percent from the corresponding period of 2004.

The volume of cocoa exported in the June quarter of 2005 was 10,300 tonnes, an increase of 13.2 percent from the corresponding quarter of 2004. This outcome was attributed to higher production as a result of favourable weather conditions and output from Bougainville. The average export price of cocoa was K4,553 per tonne in the June quarter of 2005, a decline of 14.6 percent from the corresponding period of 2004. 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, as well as from other Asian and Latin American countries. The decline in export price more than offset the increase in export volume resulting in an export value of K46.9 million in the June quarter of 2005, a decline of 3.3 percent from the corresponding period of 2004.

The volume of copra exported in the June quarter of 2005 was 5,200 tonnes, an increase of 13.0 percent from the corresponding quarter of 2004. The increase was attributed to higher production from the major copra producing regions as a result of favourable weather conditions. The average export price of copra was K808 per tonne in the June quarter of 2005, a decline of 19.2 percent from the corresponding quarter of 2004. This outcome was due to lower international prices resulting from higher world supply with increased production from the Philippines and Indonesia, the world's major copra producers, combined with higher supply of edible oils in the world market. The decline in export price more than offset the increase in export volume resulting in an export value of K4.2 million in the June quarter of 2005, a decline of 8.7 percent from the corresponding period of 2004.

The volume of copra oil exported in the June quarter of 2005 was 15,200 tonnes, an increased of 5.6 percent from the corresponding period of 2004. The increase was mainly due to higher quantities of copra purchased for processing by the two domestic copra mills. This reflected the improvement in road infrastructure enabling easier access to the mills and increased competition from copra buyers. The average export price of copra oil was K1,901 per tonne in the June quarter of 2005, an increase by 2.5 percent from the corresponding period of 2004. Whilst domestic prices increased, the international prices declined due to higher copra production from the Philippines and Indonesia, two of the world's major copra producers. The increase in export price and volume resulted in an export value of K28.9 million in the June quarter of 2005, 8.2 percent higher than in the corresponding period of 2004.

The volume of palm oil exported in the June quarter of 2005 was 125,100 tonnes, an increase of 34.7 percent from the corresponding period of 2004. The increase was due to higher production attributed to on-going expansion of plantations and favourable weather conditions. The average export price of palm oil was K1,114 per tonne in the June quarter of 2005, a decline of 18.8 percent from the corresponding quarter of 2004. The decline was attributed to lower international prices resulting from increased production from Malaysia and Indonesia, two of the world's leading producers. The increase in export volume more than offset the decline in export price resulting in an export value of K139.4 million in the June quarter of 2005, an increase of 9.3 percent from the corresponding period of 2004.

The volume of tea exported in the June quarter of 2005 was 1,900 tonnes, a decline of 9.5 percent from the corresponding quarter of 2004. The decline was due to lower production resulting from unfavourable weather conditions in the major tea producing regions. The average export price of tea was K2,947 per tonne in the June quarter of 2005, an increase of 4.9 percent from the corresponding period of 2004. The decline in export volume more than offset the increase in export price, resulting in an export value of K5.6 million in the June quarter of 2005, a decline of 5.1 percent from the corresponding period of 2004.

The volume of rubber exported in the June quarter of 2005 was 400 tonnes, a decline of 42.9 percent from the corresponding period of 2004. The decline was attributed to unfavourable weather conditions combined with deteriorating road infrastructure. The average export price was K3,750 per tonne in the June quarter of 2005, an increase of 25.0 percent from the corresponding period in 2004. The increase was due to higher international prices following lower supply in the world market. The decline in export volume more than offset the increase in export price resulting in an export value of K1.5 million in the June quarter of 2005, a decline of 28.6 percent from the corresponding period of 2004.

The volume of logs exported in the June quarter of 2005 was 531.0 thousand cubic meters, an increase of 22.6 percent from the corresponding period of 2004. This was mainly attributed to higher production and shipment from major logging projects as a result of favourable weather conditions and issuance of new logging licenses. The average export price of logs was K179 per cubic meter in the June quarter of 2005, an increase of 3.5 percent from the corresponding period of 2004. This outcome was due to higher international prices reflecting lower supply of tropical hardwood in the world market. The combined increase in export price and volume resulted in an export value of K94.8 million in the June quarter of 2005, an increase of 26.2 percent from the corresponding period of 2004.

The value of marine products exported in the June quarter of 2005 was K26.3 million, an increase of 122.9 percent from the corresponding period of 2004. This outcome was a result of an increase in export volume, which more than offset a decline in export price.

7. BALANCE OF PAYMENTS

The overall deficit in the balance of payments for the first six months of 2005 was K304 million, compared to a surplus of K20 million in the corresponding period of 2004. This outcome was the result of a deterioration in the capital and financial accounts, which more than offset the significant improvement in the current account surplus.

The surplus in the current account was attributed to improvements in the trade account, services account and income account, which more than offset lower net receipts in the transfers account. The deterioration in the capital and financial accounts reflected increased loan repayments by the mineral companies and the purchase of short-term money market instruments by mineral companies. This more than offset draw downs in both the foreign currency account balances of the mineral companies and the net foreign assets of the commercial banks. During the first six months of 2005, the kina appreciated against the currencies of Papua New Guinea's major trading partners, with the exception of the Australian dollar and the euro, compared to the corresponding period in 2004.

The trade account recorded a surplus of K2,156 million in the first six months of 2005, compared to a surplus of K1,836 million in the corresponding period of 2004. The higher surplus was due to an increase in the value of merchandise exports, which more than offset an increase in the value of merchandise imports. The value of merchandise exports in the first six months of 2005 was K4,624 million, an increase of 12.4 percent from the corresponding period in 2004. The increase was attributed to higher values of copper, crude oil, coffee, copra, copra oil, rubber and marine product exports combined with refined petroleum products, which more than offset lower values of gold, cocoa, palm oil, tea and other non-mineral exports.

The value of merchandise imports in the first six months of 2005 was K2,468 million, an increase of 8.3 percent from the corresponding period of 2004. The increase was due to higher values of petroleum sector and general imports, which more than offset a decline in mining sector imports. Imports by the petroleum sector in the first six months of 2005 were K177 million, a significant increase of 704.5 percent from the corresponding period of 2004 due to higher capital expenditures at the North West (NW) Moran and South East (SE) Mananda oil projects. General imports in the first six months of 2005 were K1,807 million, an increase of 2.0 percent from the corresponding period of 2004. Imports by the mining sector in the first half of 2005 were K483 million, a decline of 0.6 percent from the corresponding period of 2004. The decline reflected lower capital expenditures by all the mines except the Ok Tedi and Porgera mines.

The deficit in the services account was K1,277 million in the first half of 2005, compared to K1,393 million in the corresponding period of 2004. The lower deficit was due to a decline in payments for transportation, education, insurance, other financial services, other business services and Government services. Service receipts were also higher and more than offset increased payments for travel, computer and information, construction, refining and smelting, and other services.

The deficit in the income account was K918 million in the first half of 2005, compared to a deficit of K931 million in the corresponding period of 2004. This outcome was due to lower compensation payments for employees and interest payments on foreign loans, which more than offset lower income receipts.

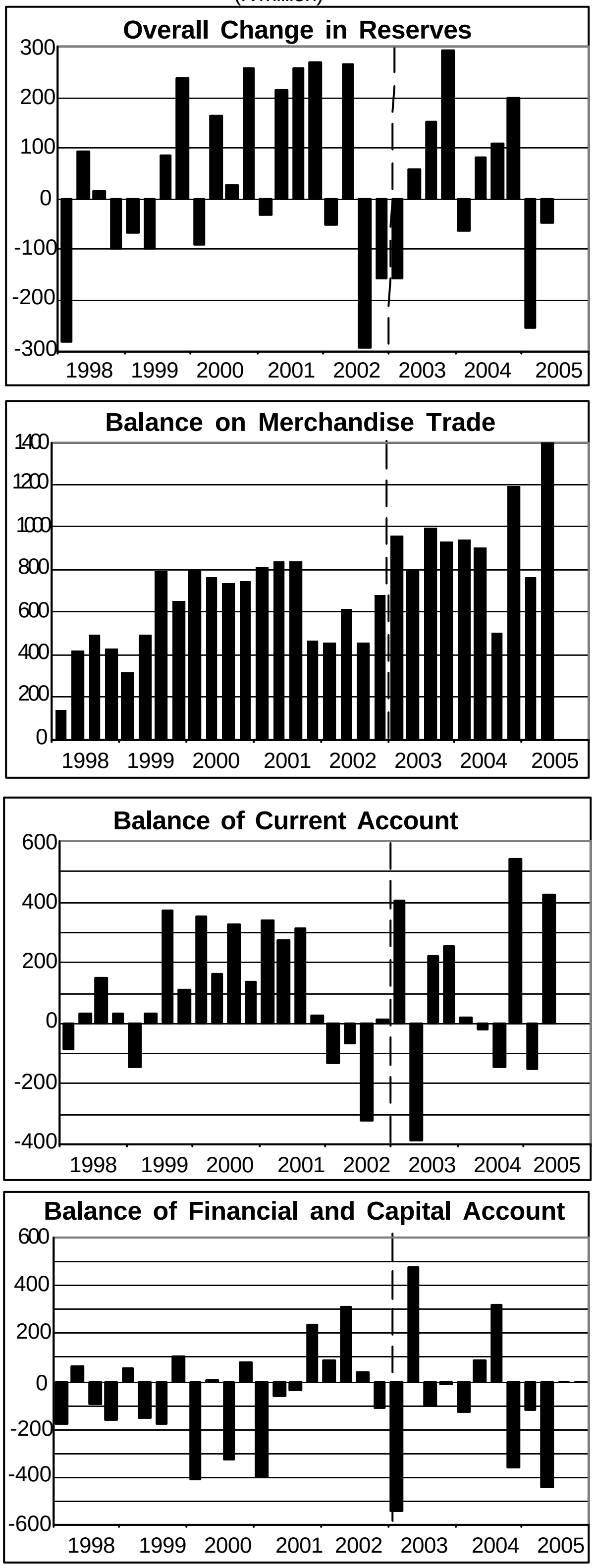
The surplus in the transfers account was K312 million in the first half of 2005, compared to a surplus of K490 million in the corresponding period of 2004. The lower surplus was due to increased payments for superannuation, family maintenance, gifts and grants and tax. This combined with lower transfer receipts more than offset lower licensing fee payments.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a surplus of K273 million in the first six months of 2005, compared to a surplus of K2 million in the corresponding period of 2004.

The capital account recorded no transactions during the first six months of 2005, the same as in the corresponding period of 2004.

The financial account recorded a deficit of K561 million in the first six months of 2005, compared to a deficit of K36 million in the corresponding period of 2004. The deterioration reflected higher net outflow of other investments totalling K600 million, which reflected loan repayments by mineral companies and trade credits owed by non-residents. There was also net outflows of K39 million in portfolio investment and K6 million in financial derivatives reflecting the purchase of short-term money market instruments and the purchase of financial derivative instruments, respectively. These more than offset a net inflow of K84 million in direct investments reflecting share placement by a mineral

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.

company to raise capital for exploration activities and working capital as well as draw downs in both foreign currency account balances of the mineral companies and net foreign assets of the commercial banks.

In the June quarter of 2005, the balance of payments recorded an overall deficit of K49 million, compared to a surplus of K83 million in the corresponding quarter of 2004.

The value of merchandise exports in the June quarter of 2005 was K2,412 million, an increase of 12.6 percent from the corresponding quarter of 2004. The increase was due to higher values of copper, crude oil, coffee, copra oil, palm oil, forest products and marine product exports combined with export receipts from refined petroleum products. These more than offset declines in the values of gold, cocoa, copra, rubber, tea and other non-mineral exports. The value of merchandise imports in the June quarter of 2005 was K1,017 million, a decline of 18.3 percent from the corresponding quarter of 2004. This outcome reflected declines in the general and mining sector imports, which more than offset increased petroleum sector imports. General imports in the June quarter of 2005 was K688 million, a decline of 29.8 percent from the corresponding quarter of 2004. Imports by the mining sector in the June quarter of 2005 was K227 million, a decline of 6.6 percent from the corresponding quarter of 2004, due to lower capital expenditures by the Ok Tedi, Lihir and Tolukuma mines. Imports by the petroleum sector in the June quarter of 2005 was K102 million, a significant increase of 363.6 percent from the corresponding quarter of 2004, due to higher expenditures on exploration and drilling at the NW Moran and SE Mananda oil projects.

The deficit in the services account was K528 million in the June quarter of 2005, compared to K687 million in the corresponding quarter of 2004. The lower deficit was due to the decline in payments for transportation and insurance associated with lower imports, education, other financial, computer and information services, Government services n.i.e., and construction. This combined with higher service receipts more than offset higher payments for travel, communications, refining and smelting and other services by resident companies.

The deficit in the income account was K469 million in the June quarter of 2005, compared to a deficit of K518 million in the corresponding quarter of 2004, due to lower payments for interest and dividends. Income receipts for the June quarter of 2005 were the same as in the corresponding quarter of 2004.

The surplus in the transfers account was K27 million in the June quarter of 2005, compared to a surplus of K289 million in the corresponding quarter of 2004. The lower surplus was the result of higher payments for family maintenance, grants and tax combined with lower transfer receipts.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a surplus of K425 million in the June quarter of 2005, compared to a deficit of K18 million in the corresponding quarter of 2004.

The capital account recorded no transactions during the June quarter of 2005, the same as in the corresponding period of 2004.

The financial account recorded a net outflow of K440 million in the June quarter of 2005, compared to a net inflow of K90 million in the corresponding period in 2004. This was due to loan repayments by mineral companies combined with net outflow in financial derivatives reflecting increased holdings of financial derivative assets and a build up in offshore account balances of the mineral companies. This more than offset a net inflow of K71 million in direct investment associated with share placement by a mineral company and a net inflow of K109 million in portfolio investment reflecting returns on short-term money market instruments by the mineral companies.

The level of gross foreign exchange reserves at the end of June quarter 2005 was K1,757.2 (US$550.2) million, sufficient for 4.3 months of total and 5.8 months of non-mineral import covers.

8. MONETARY DEVELOPMENTS

INTEREST RATES AND LIQUIDITY

The Bank of Papua New Guinea continued its neutral monetary policy stance over the June quarter of 2005, keeping the Kina Facility Rate (KFR) unchanged at 7.0 percent. Consistent with the neutral stance domestic interest rates, including Treasury bill rates, were relatively stable during the June quarter. The 28 and

182-day rates increased from 3.54 and 4.37 percent to 4.06 and 4.47 percent, respectively, whilst the 91-day rate declined from 4.09 percent to 3.95 percent. The 63-day rate remained at 3.32 percent because no auctions were conducted for this maturity.

The Bank continued to utilise its Open Market Operation (OMO) instruments in the conduct of monetary policy during the June quarter of 2005. Treasury bills and Central Bank Bills (CBBs) were actively utilised to manage the high level of liquidity in the banking system. Despite the high level of liquidity, the volume of trades in the inter-bank market was high during the June quarter of 2005, compared to the previous quarter, reflecting uneven distribution of liquidity among the commercial banks. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) were maintained at 3.0 percent and 25.0 percent, respectively.

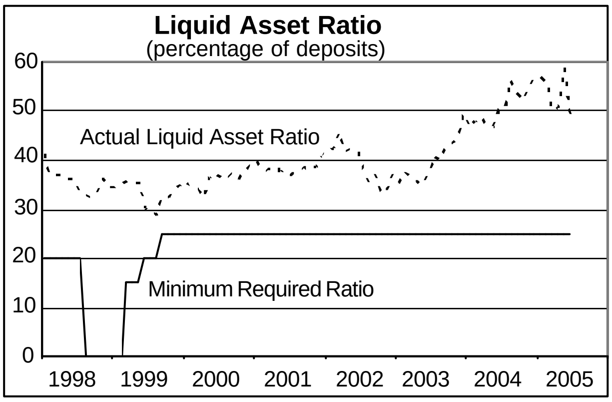
Average liquid assets held by the commercial banks increased by 0.8 percent over the second quarter of 2005, following a decline of 0.5 percent in the March quarter. The increase reflected higher levels of cash in vaults and increased holdings of Government securities, particularly Inscribed stocks.

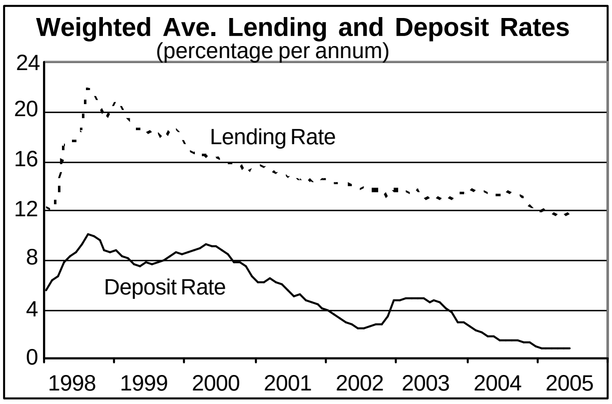
The weighted average deposit rates for term deposits of K500,000 and above by the commercial banks trended upwards between March and June 2005, with the exception of the 30-day rate, which declined from 1.99 percent to 1.69 percent. The 60-day rate increased from 1.71 percent to 2.07 percent, the 90-day rate from 1.50 percent to 2.98 percent and the 180-day rate from 3.60 percent to 4.52 percent.

The weighted average interest rate on total deposits paid by commercial banks increased while the lending rate declined in the June quarter of 2005. The deposit rate increased from 0.87 percent in March to 0.95 percent in June, whilst the weighted average lending rate declined from 11.88 percent in March to 11.77 percent in June 2005. Over the same period, the weighted average rate on performing loans increased from 12.14 percent to 12.19 percent. All four commercial banks reduced their indicator lending rates (ILRs) during the June quarter of 2005, with the spread declining to 9.95 percent to 11.00 percent.

MONEY SUPPLY

The average level of broad money supply (M3*) increased by 3.3 percent in the June quarter of 2005, compared to a decline of 0.3 percent in the March quarter of 2005. The growth resulted from increases of 8.7 percent in average net credit to the Government and 9.3 percent in average net credit to the private sector, official entities and non-monetary financial institutions, which more than offset a decline of 0.7 percent in average net foreign assets of the banking system. Domestic credit outstanding, excluding advances to the Central Government and loans under the Agricultural export commodity price support schemes increased by 9.0 percent in the June quarter of 2005, compared to the March quarter of 2005. The average level of the monetary base increased by 1.7 percent over the June quarter of 2005, compared to a decline of 0.9 percent in the previous quarter, reflecting higher holdings of Inscribed stocks.





Net credit to the Government increased by 5.5 percent in the June quarter of 2005, compared to an increase of 5.3 percent in the March quarter. The increase was due to the issuance of Inscribed stocks by the Government in line with its strategy of issuing long-term debt instruments and the utilisation of the Temporary Advance Facility (TAF) at the Bank of PNG. Net foreign assets fell by K39.3 million to K1,986.2 million in the June quarter of 2005, compared to the previous quarter. The decline was mainly due to the repayment of IMF obligations by the Central Bank and lower holdings of foreign exchange by the commercial banks.

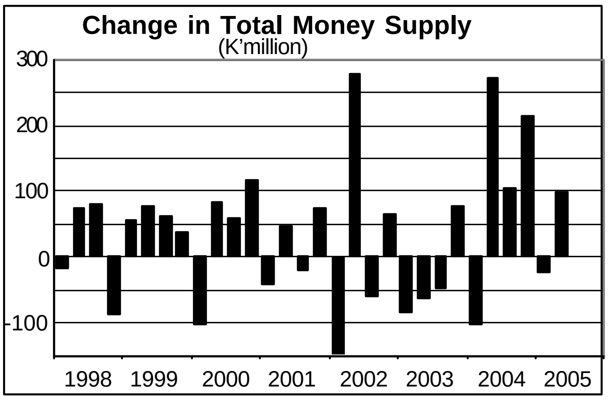
The average level of narrow money supply (M1*) increased by 4.4 percent in the June quarter of 2005, compared to an increase of 3.6 percent in the March quarter. The increase was due to the growth in both demand deposits and currency in circulation. The average level of quasi money increased by 1.4 percent during the June quarter, following a decline of 6.1 percent in the March quarter of 2005, reflecting an increase in saving deposits.

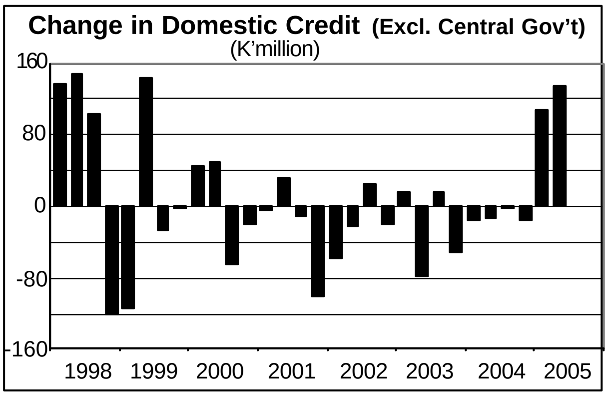
The monthly average level of deposit base of commercial banks increased by 3.4 percent in the June quarter of 2005 to K3,550.5 million, from K3,433.3 million in the March quarter. This represents an annualised growth rate of 7.1 percent.

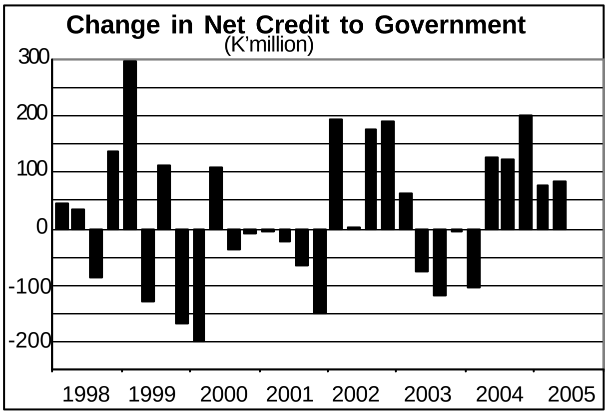
LENDING

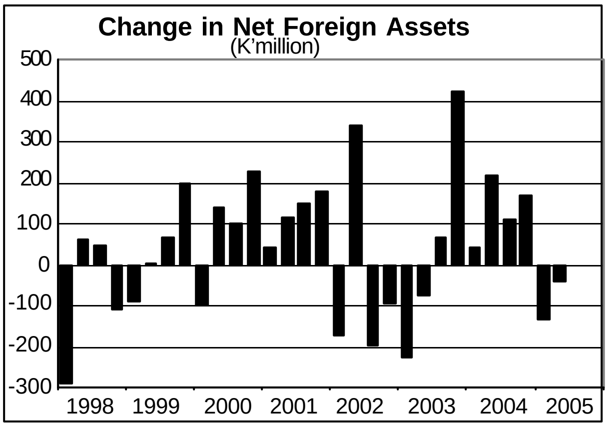
During the June quarter of 2005, total domestic credit extended by the commercial banks to the private sector, official entities and the non-monetary financial institutions increased by K135.5 million to K1,694.7 million, compared to a revised decline of K13.9 million in the corresponding quarter of 2004. Lending to the private sector increased by K145.5 million, which more than offset net repayments of K7.7 million by official entities and K2.3 million by the non-monetary financial institutions. The pick-up in lending to the private sector during the June quarter of 2005 was mainly to the palm oil and fisheries sub-sectors, the household sector for housing and consumption, and the construction sector, particularly in the National Capital District. There were no repayments under the Government's Agricultural export commodity price support scheme and the Small Scale Business Credit Facility (SSBCF), while there were some repayments under the European Investment Bank (EIB) Global Loan Facility. The annualised rate of growth in domestic credit, excluding the Central Government and advances under the price support schemes, was 37.7 percent over the first half of 2005. Foreign currency lending to the private sector and official entities was 8.0 percent of total lending to these sectors, compared to 6.0 percent in March 2005, with kina lending accounting for the remainder.

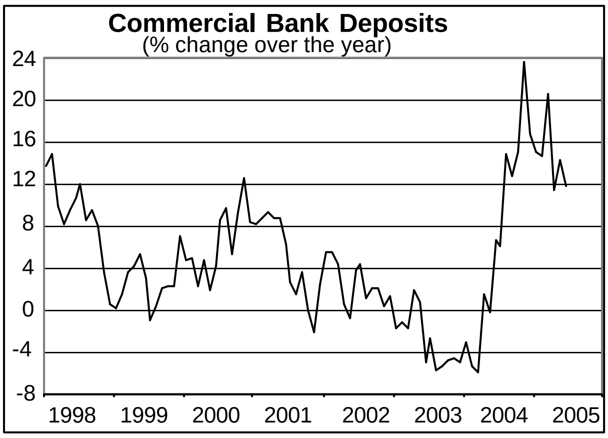
The utilisation rate of credit is the ratio of total credit

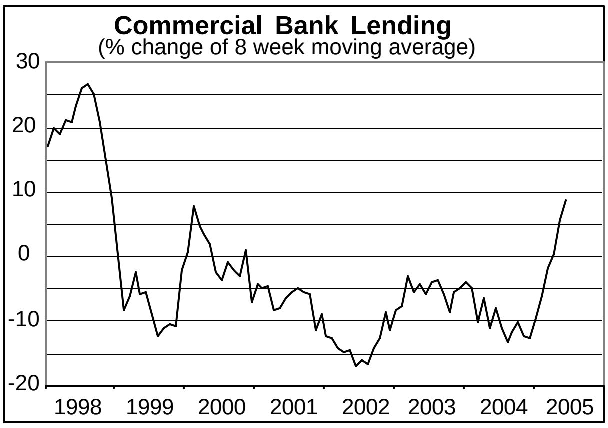












outstanding to total commitments outstanding to the private sector, official entities and non-monetary financial institutions. A higher utilisation rate indicates that firms are more efficient in drawing down funds and minimising commitment fees. Commitments include call and term lending and exclude any other contingent items. The utilisation rate, quarter on quarter, was 82.6 percent in June 2005, compared to 81.6 percent in March 2005. 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 2005 showed an overall surplus of K192.2 million, compared to a surplus of K157.2 million in the corresponding period of 2004. This represents 1.3 percent of nominal GDP. The higher surplus was mainly due to increased revenue, which more than offset an increase in expenditure.

Total revenue, including grants during the first six months of 2005 was K2,077.6 million, 29.7 percent higher than the revenue in the corresponding period of 2004. This represents 44.8 percent of the budgeted revenue. The increase was attributed to higher collections in most categories of revenue.

Total tax revenue amounted to K1,549.3 million, 13.7 percent higher than the receipts collected during the same period in 2004, and represents 51.9 percent of the budgeted tax receipts. Direct tax receipts totalled K1,067.0 million, K184.4 million more than the receipts collected over the corresponding period in 2004, and represents 52.3 percent of the budgeted amount. The increase was due to higher personal income and company taxes, which more than offset lower collections in other direct taxes. Personal tax receipts continued to improve due to higher employment by the private sector combined with increased enforcement activity by the Internal Revenue Commission (IRC). The growth in company tax receipts reflect improved profitability of companies resulting from continued higher mineral and agricultural export prices and the pick-up in aggregate demand. The decrease in other direct taxes was due to lower receipts from stamp duties, royalties and interest withholding taxes.

Indirect tax receipts was K482.3 million, 0.5 percent higher than in the corresponding period in 2004, and represents 51.1 percent of the budgeted receipts for 2005. All categories of indirect tax increased, except import duties and other indirect taxes. The increase in excise duties reflected lower fuel imports resulting from increased domestic production of fuel products, while the increase in export tax receipts reflected higher log exports. The goods and services tax (GST) also increased as a result of higher collections in the provinces. The decline in import duties was due to lower imports, while the decline in other indirect tax receipts was related to lower mining levy.

Total non-tax revenue amounted to K80.5 million, K1.3 million lower than the amount collected in the corresponding period of 2004, and represents 21.7 percent of the budgeted amount. The decrease mainly reflected lower dividend payments and fees collected by Government departments. Foreign grants to June 2005 totalled K447.8 million, K290.5 million higher than in the corresponding period of 2004, due to improved reporting of counterpart funding for AusAID funded projects.

Total expenditure over the six months to June 2005 was K1,885.4 million, 30.5 percent higher than in the corresponding period in 2004, and represents 39.5 percent of the budgeted expenditure for 2005. The increase was due to both higher recurrent and development expenditures.

Recurrent expenditure for the first half of 2005 was K1,218.0 million, 2.9 percent higher than in the corresponding period in 2004, and represents 42.2 percent of the 2005 budgeted appropriation. Of this total, K682.2 million relates to National Departmental expenditure, 21.3 percent higher than the amount spent in the corresponding period in 2004, and represents 43.0 percent of the budgeted appropriations. The increase was due to higher wages and salaries and other expenses. Provincial Government recurrent expenditure was K294.2 million, 12.8 percent higher than in the corresponding period in 2004, and represents 46.8 percent of the budgeted amount. The increase was due to higher administrative grants and salaries and wages. Interest payments totalled K146.4 million, K107.8 million lower than the amount paid in the corresponding period in 2004, and reflected lower interest rates on Treasury bills and the appreciation of the kina against the US dollar, which reduced expenses on overseas loans.

Total development expenditure for the first six months of 2005 was K667.4 million, K406.0 million higher than in the corresponding period in 2004, and represents 35.3 percent of the budgeted expenditure for 2005. The increase was related to the implementation of the 2005 Development Budget reflecting increased counterpart funding for donor funded projects and disbursement of District Support Grants.

The budget surplus was used to make net overseas and domestic loan repayments of K185.5 million and K6.7 million, respectively. The net overseas loan repayments comprised K94.8 million in concessionary, K8.3 million in commercial and K82.4 million for extraordinary loans. Domestic loan repayments comprised K26.9 million to the non-banking system and K105.1 million to other domestic sources, which represents the settlement of cheque floats issued in 2004. This more than offset domestic financing of K125.3 million by the banking system.

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;

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 %
	05 July	Maintained at 10.00 %
	02 August	Maintained at 10.00 %
	06 September	Reduced by 100 basis points to 9.00 %
	02 October	Reduced by 200 basis points to 7.00 %
	01 November	Maintained at 7.00 %
	06 December	Maintained at 7.00 %
2005	03 January	Maintained at 7.00 %
	01 February	Maintained at 7.00 %
	01 March	Maintained at 7.00 %
	04 April	Maintained at 7.00 %
	02 May	Maintained at 7.00 %
	06 June	Maintained at 7.00 %

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.

FOR THE RECORD

CHANGE TO TABLES 8.3 AND 8.5 ‘EXTERNAL PUBLIC DEBT’

Following a reconciliation exercise on the Government’s (public) external debt from 1998 with the Department of Treasury, the figures were revised in tables 8.3 Public Debt Outstanding: Classified by Source (External) on page S26 and table 8.5 External Public Debt: Analysis of Movements on page S27.

To be consistent with the Department of Treasury’s classifictaion of loans from international agencies as bilateral loans, loans that were previously shown under ‘Other Loans’ in table 8.3 were re-classified as loans outstanding to ‘International Agencies’. These loans include Australian Government loans, Private Treaty Loans held on the Australian Register and Private Treaty Loans held by Australian residents on the PNG Register.