CONTENTS

PORT MORESBY

13th September 2006

1. GENERAL OVERVIEW

Stability in macroeconomic conditions and a pick-up in economic activity resulted in continued growth in the first half of 2006. Growth was underpinned by high production and international prices of Papua New Guinea's major export commodities and prudent fiscal management by the Government, which resulted in large fiscal and balance of payments surpluses and stability in the exchange rate. Employment in the private sector was relatively high, while lending increased substantially at an annualised rate of 46.8 percent reflecting the low interest rate environment and improved confidence in the business community. Given these conditions, headline inflation rate remained low despite the high international oil prices. The Government should take advantage of its strong fiscal position to fast-track the necessary reforms in its Medium Term Development Strategy, while being mindful of the fact that any slippages in expenditure in the lead up to the 2007 National Elections will have adverse consequences.

According to the Bank's Employment Index, the level of employment in the formal private sector grew by 7.7 percent over the year to June 2006. Excluding the mineral sector, the growth in employment was 7.8 percent. The level of employment increased in all sectors except the transportation sector, with the agriculture/forestry/fisheries and building and construction sectors recording the highest growth. Employment levels increased in all the regions except the Momase region, excluding Morobe.

Annual headline inflation was 2.3 percent in the June quarter of 2006, compared to 1.8 percent in the March quarter of 2006. The higher headline inflation was due to increased prices in all expenditure groups, except the household, equipment and operations group. By region, all surveyed urban areas recorded higher prices.

Annual trimmed mean inflation was 1.4 percent in the June quarter of 2006, compared to the 1.5 percent in the March quarter. Annual exclusion-based inflation measure was negative 0.6 percent in the June quarter of 2006, compared to 0.1 percent in the March quarter. The low underlying inflation outcomes reflect the continuing price stability in the June quarter due to the stable exchange rate, prudent fiscal management and improved confidence in the economy.

In the June quarter of 2006, the quarterly average kina exchange rate depreciated against the Australian dollar, pound sterling, euro and the Japanese yen, while it appreciated against the US dollar. The average kina exchange rate depreciated by 0.42 against the Australian dollar, 3.45 percent against the pound sterling, 3.69 percent against the euro and 1.53 against the Japanese yen. However, the average kina exchange rate appreciated against the US dollar by 0.59 percent. These movements resulted in the quarterly average Trade Weighted Index (TWI) depreciating by 0.55 percent during the June quarter.

Higher international prices for mineral and most agricultural export commodities resulted in a 44.6 percent increase in the weighted average kina price of Papua New Guinea's exports in the June quarter of 2006, compared to the corresponding quarter of 2005. There was a 54.3 percent increase in the weighted average kina price of mineral exports, with higher prices for gold, copper and crude oil. For the agricultural, forestry and marine product exports, the weighted average kina price declined by 0.5 percent, accounted for by lower prices of coffee, copra and copra oil.

The overall surplus in the balance of payments was K749 million for the first six months of 2006, compared to a deficit of K304 million in the corresponding period of 2005. The improved outcome was the result of a higher surplus in the current account combined with a lower deficit in the capital and financial accounts.

The current account recorded a surplus of K1,277 million in the first six months of 2006, compared to a surplus of K481 million in the corresponding period of 2005. This outcome was the result of a significant improvement in the trade account, which more than offset higher net service and income payments and lower net transfer receipts.

The capital and financial accounts recorded a deficit of K505 million in first six months of 2006, compared to a deficit of K826 million in the corresponding period of 2005. The lower deficit reflected a higher net inflow in direct investments and drawdowns in net foreign assets of the banking system and lower net loan repayments by the Government.

The level of gross foreign exchange reserves at the end of June 2006 was K3,040.3 (US$1,002.8) million, sufficient for 8.0 months of total and 11.7 months of non-mineral import covers.

The Bank of Papua New Guinea maintained a neutral monetary policy stance during the June quarter of 2006. As a result, the Kina Facility Rate (KFR) was kept unchanged at 6.0 percent. The dealing margin for the Repurchase Agreements (Repos) was reduced by 1.0 percent in aggregate to 200 basis points on both sides of the KFR in order to realign domestic interest rates to the official rate and to maintain positive real interest rates. Other domestic interest rates were relatively stable during the quarter.

The Bank continued to utilise its Open Market Operation (OMO) instruments in the conduct of monetary policy over the June quarter of 2006. Given the Government's retirement of its maturing Treasury bills, the Bank issued additional Central Bank Bills (CBB) and utilised Reverse Repos to manage liquidity. Interbank borrowing was moderate given the high level of liquidity among banks. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) of commercial banks were maintained at 3.0 percent and 25.0 percent, respectively, over the June quarter.

The average level of broad money supply (M3*) increased by 9.0 percent in the June quarter of 2006, compared to an increase of 4.0 percent in the March quarter of this year. The outcome was due to increases of 17.6 percent in average net credit to the Central Government, 13.2 percent in average net private sector credit and 7.0 percent in average net foreign assets of the depository corporations. Net domestic credit outstanding, excluding advances to the Central Government and outstanding loans under the Government's Agricultural export commodity support scheme increased by 14.1 percent in the June quarter of 2006, compared to 7.0 percent in the March quarter of this year.

Total domestic credit extended by depository corporations to the private sector, public non financial corporations, Provincial and Local Governments, and other financial corporations, increased by K329.8 million to K2,723.6 million in the June quarter of 2006, compared to an increase of K152.7 million during the first quarter of 2006. Growth in lending was mainly influenced by an increase of K339.2 million to the private sector, in particular to the building and construction, transport and communication, fisheries and forestry sectors, as well as to other business and household sector. The annualised growth in domestic credit, excluding Central Government and advances under the price support schemes was 48.8 percent in the first half of 2006.

Preliminary estimates of the fiscal operations of the National Government over the six months to June 2006 showed an overall surplus of K327.7 million, compared to a surplus of K192.1 million in the corresponding period of 2005. This represents 2.1 percent of nominal GDP. The surplus resulted from higher revenue, which more than offset an increase in expenditure.

Total revenue, including foreign grants during the first six months of 2006 was K2,280.7 million, 23.8 percent higher than the receipts collected in the corresponding period of 2005. This represents 48.1 percent of the budgeted revenue for 2006. The increase was attributed to higher collections in most categories of revenue, which more than offset lower grants.

Total expenditure over the six months to June 2006 was K1,953.0 million, 18.4 percent higher than in the corresponding period in 2005, and represents 40.4 percent of the budgeted expenditure for 2006. The increase was due to higher recurrent and development expenditures, combined with higher interest payments.

As a result of these developments in revenue and expenditure, the Government recorded a surplus of K327.7 million in the first six months of 2006. The budget surplus was used to make net overseas and domestic loan repayments of K89.4 million and K238.3 million, respectively.

2. INTERNATIONAL DEVELOPMENTS

World economic growth as measured by real Gross Domestic Product (GDP) is expected to increase slightly in 2006, compared to 2005. In the International Monetary Fund's (IMF) latest World Economic Outlook (WEO) in April 2006, real GDP growth of 4.9 percent is projected for 2006, easing to 4.7 percent in 2007. Growth was broad based in 2005 and is expected to continue in 2006 across the major economies and regions, with the United States (US) and developing Asia, particularly China, being the main driving forces. The economic expansion in Japan is also gaining momentum. The recovery in the Euro zone is improving despite weak domestic demand, while growth in the emerging economies like China, India and Russia remains strong. However, the risks to the global financial system in 2006 would stem from higher interest rates and inflation, deterioration in the credit quality of various debtors, and a sudden unwinding of global trade imbalances.

In April, the finance ministers and central bank governors of the major industrialised countries (G7) met in Washington, D.C., for the Spring Meeting of the IMF's International Monetary and Financial Committee (IMFC). The meeting focused on the risks of global imbalances and high oil prices and agreed to mandate the IMF to negotiate between countries with the largest trade imbalances. Its goal will be to secure agreements to reform economic and exchange rate policies to close trade gaps and prevent a global financial crisis. The G7 countries also stepped up pressure on oil producing countries to be transparent on their oil reserves and increase investment in production and refining capacity.

Also in April, the G7 ministers met in New York with the United Nations (UN) Economic and Social Council (ECOSOC), the IMF, the World Bank and the World Trade Organisation (WTO) on trade and development issues. The meeting reviewed the progress in implementing the Monterrey Consensus on financing for development and the outcomes of the 2005 UN World Summit. While it was noted that the 2005 UN Summit had advanced development efforts worldwide, including on aid and debt relief, member states pledged to adopt by end of 2006 a comprehensive national development plan to achieve the Millennium Development Goals (MDGs).

In May, trade ministers from Australia, Japan, US and Brazil, and the WTO met in Geneva, Switzerland to restart the stalled world trade negotiations. The WTO meeting scheduled for 30th April 2006 was aborted due to disagrement on key issues regarding agriculture subsidies, tariffs and market access. They reached an understanding that any substantial cut in domestic agriculture subsidies and industrial tariffs must be complemented with substantial improvements in market access of sensitive products in developed countries.

Also in May, leaders of the Asian nations met in Tokyo, Japan to discuss issues on peace and stability, increased economic integration and future direction of the region. They noted that tensions between Japan and China about their military history and resource boundaries threaten stability in the region and urged them to resolve their differences.

In June, members of the Organisation of the Petroleum Exporting Countries (OPEC) met in Caracas, Venezuela to discuss the current oil production levels and high oil prices. The OPEC rejected calls by Venezuela to cut oil production, claiming that a reduction in production will lead to further price increases which would seriously threaten world growth and stability. OPEC noted that while production by the cartel is near full-capacity, their members were now making new investments to improve and expand existing production facilities as well as increasing exploration for new oil fields.

Also in June, the IMF approved a US$119 million loan for Afghanistan under the Poverty Reduction and Growth Facility. The IMF noted the country's strong economic performance and implementation of key structural reforms under an IMF program amid continuing violence and turmoil.

In the US, real GDP grew by 3.5 percent over the year to June 2006, compared to 3.6 percent over the corresponding period in 2005. The slowdown in the US was mainly due to uncertainties with its large fiscal and current account deficits.

Industrial production increased by 4.5 percent over the year to June 2006, compared to an increase of 3.9 percent over the year to June 2005. Retail sales increased by 3.4 percent over the year to June 2006, compared to an increase of 3.9 percent over the year to June 2005. The unemployment rate was 4.6 percent in June 2006, compared to 5.0 percent in June 2005.

Consumer prices rose by 4.3 percent over the year to June 2006, compared to an increase of 2.5 percent over the year to June 2005. Broad money supply increased by 4.8 percent over the year to June 2006, compared to an increase of 4.8 percent over the year to June 2005. Given the increase in inflationary pressure, the US Federal Reserve Board further tightened monetary policy in the second quarter of 2006, increasing the federal funds rate twice by 25 basis points from 4.75 percent at end of March 2006 to 5.25 percent by June 2006.

The trade deficit was US$830.2 billion over the year to June 2006, compared to a deficit of US$723.4 billion over the year to June 2005. The higher deficit reflected strong demand for imported consumer goods and petroleum products. A significant portion of this trade imbalance was between the OPEC member countries and China.

In Japan, real GDP grew by 2.0 percent over the year to June 2006, compared to an increase of 1.4 percent over the year to June 2005. The growth reflected a pick-up in investment spending and strong export performance.

Industrial production increased by 5.0 percent over the year to June 2006, compared to an increase of 0.2 percent over the year to June 2005. The increase reflected higher production of cars and machinery for export**.** Retail sales decreased by 0.6 percent over the year to June 2006, compared to an increase of 3.1 percent over the year to June 2005. The unemployment rate was 4.2 percent in June 2006, the same as in June 2005.

Consumer prices increased by 1.0 percent over the year to June 2006, compared to a decrease of 0.5 percent over the year to June 2005. Broad money supply increased by 1.2 percent over the year to June 2006, compared to an increase of 1.7 percent over the year to June 2005. The Bank of Japan maintained its zero interest rate policy in the second quarter of 2006.

The current account surplus was US$164.5 billion over the year to June 2006, compared to a surplus of US$113.2 billion over the year to June 2005. The surplus mainly reflected strong exports and large remittances of profits by Japanese companies from overseas.

In the Euro area, real GDP grew by 2.4 percent over the year to June 2006, its fastest pace since 2000, compared to an increase of 1.1 percent in the corresponding period in 2005. Germany and Spain grew at around the same rate as the whole Euro area, while France and Italy grew slightly lower.

Industrial production increased by 4.3 percent over the year to June 2006, compared to an increase of 0.3 percent over the year to June 2005. This was reflected by the growth in the Euro zone manufacturing sector boosted by domestic demand. The strong manufacturing purchasing managers' index (PMI) of 57.7 in June highlighted the strength of the industrial recovery, the highest since August 2000. Retail sales increased by 1.5 percent over the year to June 2006, compared to an increase of 0.9 percent over the year to June 2005 reflecting a recovery in consumer spending. The unemployment rate for the 12-nation group decreased to 7.8 percent in June 2006 from 8.6 percent in June 2005. The decline in the unemployment rate reflected a broadening of the economic recovery in the Euro area, with Germany the largest economy taking the lead.

Consumer prices in the Euro area rose by 2.5 percent over the year to June 2006, compared to an increase of 2.1 percent over the year to June 2005. Broad money supply increased by 8.5 percent over the year to June 2006, compared to an increase of 7.5 percent over the year to June 2005. The European Central Bank (ECB) maintained its benchmark Refinancing Rate at 2.75 percent over the first half of 2006 following the last increase in December 2005.

In Germany, real GDP grew by 2.4 percent in the year to June 2006, compared to an increase of 0.6 percent over the year to June 2005**.** The growth was mainly due to strong exports, high domestic demand and increased business investment.

Industrial production increased by 4.5 percent over the year to June 2006, compared to an increase of 2.8 percent over the year to June 2005. The increase mainly reflected higher manufacturing activity to meet both domestic and export demands**.** Retail sales declined by 0.4 percent over the year to June 2006, compared to an increase of 1.9 percent over the year to June 2005 due to lower consumer spending. The unemployment rate was 10.9 percent in June 2006, compared to 11.9 percent in June 2005.

Consumer prices increased by 2.0 percent over the year to June 2006, compared to an increase of 1.8 percent over the year to June 2005. Despite the high energy prices, little seems to be generated into the inflation outcome.

The current account surplus was US$106.2 billion over the year to June 2006, compared to a surplus of US$108.5 billion over the year to June 2005. The large surplus was associated with a strong and competitive export sector.

In the United Kingdom (UK), real GDP increased by 2.6 percent over the year to June 2006, compared to an increase of 1.7 percent in the year to June 2005. The increase reflected strong growth in the manufacturing and services sectors, a surge in consumer demand supported by the growth in labour income and moderate recovery in investment.

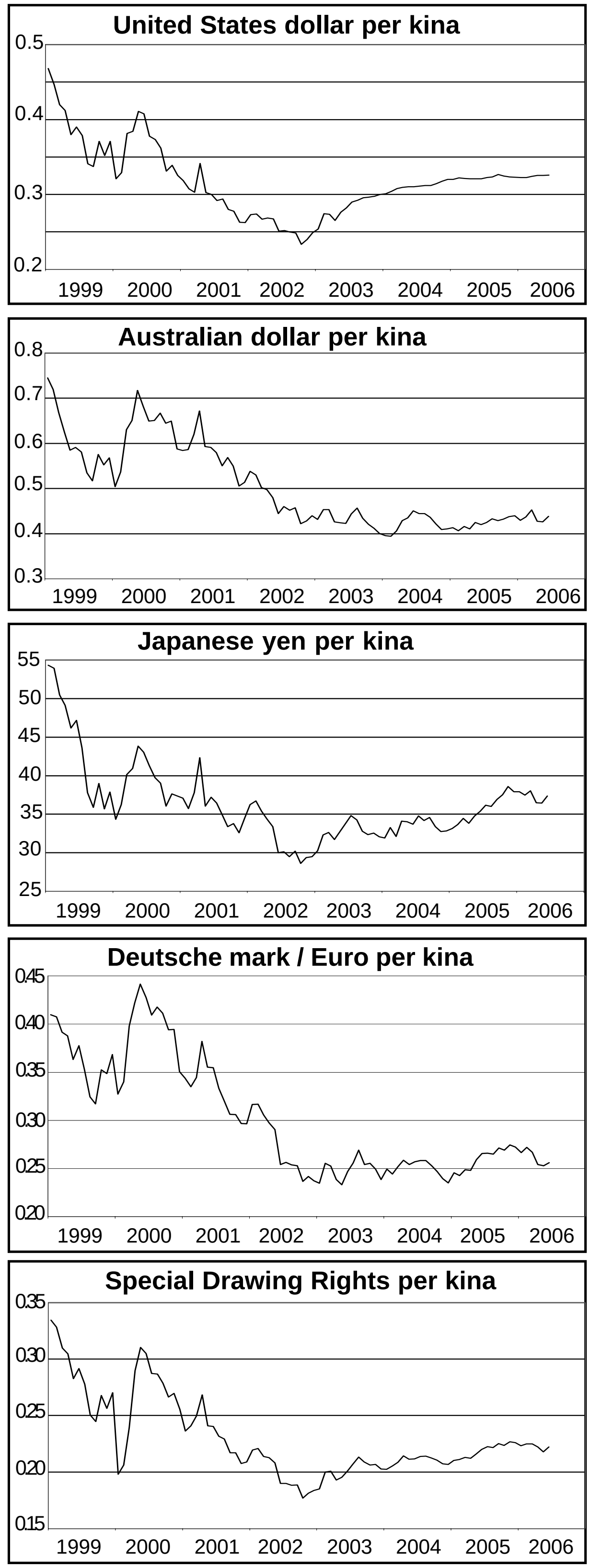
The Government unveiled a package of pension reforms to rebuild Britain's private savings culture. The Government intend to double the value of the state pension over 40 years, to be paid for by a rise in the pension age from 65 to 68 by 2046 and set up a new low-cost national pension savings scheme for employees with no pension plan.

Industrial production decreased by 0.7 percent over the year to June 2006, compared to a decline of 1.9 percent over the year to June 2005. Retail sales increased by 3.6 percent over the year to June 2006, compared to an increase of 1.7 percent over the year to June 2005. The unemployment rate was 5.5 percent in June 2006, compared to 4.8 percent in June 2005.

Consumer prices increased by 2.5 percent over the year to June 2006, compared to an increase of 2.0 percent over the year to June 2005. Broad money supply increased by 13.7 percent over the year to June 2006, compared to an increase of 11.0 percent over the year to June 2005. In spite of the high oil prices, there was little inflationary pressure. As a result, the Bank of England maintained its benchmark Repo Rate at 4.50 percent in the June quarter of 2006.

The trade deficit was US$132.1 billion over the year to June 2006, compared to a deficit of US$111.2 billion over the year to June 2005. The deterioration in the trade account reflected a sharp rise in import growth and higher costs of imported goods and services.

EXCHANGE RATES



In Australia, real GDP increased by 1.9 percent over the year to June 2006, compared to an increase of 2.6 percent in the year to June 2005. The growth was associated with high commodity prices, strong domestic demand and improved business confidence combined with healthy corporate profits.

In May, the Government announced its Federal Budget with tax cuts, boost in family benefits and increased spending on roads, defence and border protection. Whilst the budget aims to keep interest rates low and avoid pressure on inflation, concerns have been raised that the tax cuts and increased family benefits could fuel consumer spending and put further pressure on interest rates.

Retail sales increased by 3.6 percent over the year to June 2006, compared to an increase of 1.6 percent over the year to June 2005. The increase was a result of strong consumer spending. The unemployment rate was 4.9 percent in June 2006, compared to 5.0 percent in June 2005.

Consumer prices increased by 4.0 percent over the year to June 2006, compared to an increase of 2.5 percent over the year to June 2005. The increase was mainly associated with higher petrol prices, food and construction costs combined with increased domestic demand which enabled businesses to pass on the cost to consumers. Broad money supply increased by 9.6 percent over the year to June 2006, compared to an increase of 10.6 percent over the year to June 2005. Inflationary pressure from high energy costs, house prices and tight labour market resulted in the Reserve Bank of Australia raising its cash rate from 5.50 percent to 5.75 percent in the June quarter of 2006.

The current account deficit was US$41.0 billion over the year to June 2006, compared to a deficit of US$43.1 billion over the year to June 2005. The improvement in the trade deficit was due to strong export performance mainly reflecting high commodity prices.

During the June quarter of 2006, the US dollar depreciated against all the major currencies. The quarterly average US dollar exchange rate depreciated by 0.97 percent against the Australian dollar, 4.48 percent against the Euro, 1.10 percent against the Japanese yen and 4.18 percent against the pound sterling. The depreciation was mainly due to concerns about the sustainability of the US current account and budget deficits combined with lack of business confidence as investors moved away from US dollar denominated assets.

In the June quarter of 2006 the kina depreciated against the Australian dollar, pound sterling, euro and the Japanese yen, while it appreciated against the US dollar. The average kina exchange rate depreciated by 0.42 percent against the Australian dollar, 3.45 percent against the pound sterling, 1.53 percent against the yen and 3.69 against the euro. However, the average kina exchange rate appreciated against the US dollar by 0.59 percent. These movements resulted in the quarterly average Trade Weighted Index (TWI) depreciating by 0.55 percent during the June quarter.

3. Employment

According to the Bank's Employment Index, the level of employment in the formal private sector, excluding mineral, grew by 4.0 percent in the June quarter of 2006, compared to the March quarter of 2006. By industry, all sectors increased, with the building and construction sector recording the highest growth. By region, the level of employment increased in all the regions except the Momase region. Over the year to June 2006, the level of employment increased by 7.8 percent.

In the retail and wholesale sectors, the level of employment increased by 2.0 percent in the June quarter of 2006, compared to the March quarter of 2006. The increase in the retail sector reflected expansion in the retail of building supplies and hardware materials in the Highlands region, as well as higher casual employment. The growth also reflected increased activity in the mining sector. In the wholesale sector, the increase was due to expansion of activity, the coffee and beche-de-mer harvesting seasons and higher demand for groceries and hardware supplies. Over the year to June 2006, the level of employment increased by 6.6 percent.

In the manufacturing sector, the level of employment increased by 2.7 percent in the June quarter of 2006, compared to the March quarter of 2006. The increase was due to the coffee season, higher production and expansion of operations by a fish cannery and a fishing company, increased production for drinks, canned meat and biscuits, and higher casual employment.

Expansion of printing work to Lae by a newspaper also contributed to the increase. Over the year to June 2006, the level of employment increased by 3.0 percent.

In the building and construction sector, the level of employment increased by 17.2 percent in the June quarter of 2006, compared to the March quarter of 2006. The increase reflected higher casual employment and on-going projects in NCD and Lae, a donor-funded project in the Islands region, and a market-redevelopment project in the Highlands region. Over the year to June 2006, the level of employment increased by 32.3 percent.

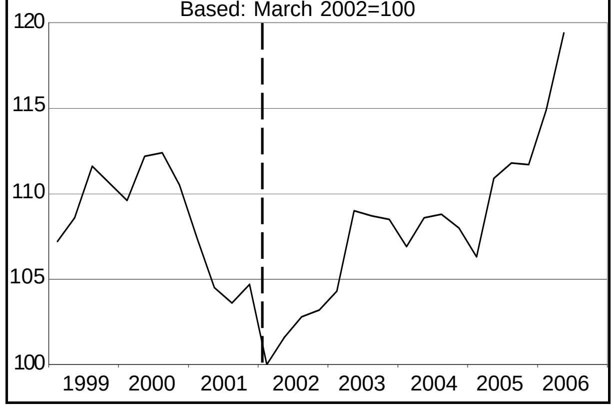
In the agriculture/forestry/fisheries sector, the level of employment increased by 3.2 percent in the June quarter of 2006, compared to the March quarter of 2006. The increase reflected higher casual employment for the coffee season, as well as increased employment for a new fish cannery. Higher employment for logging, rubber processing and palm oil companies also contributed to the increase. Over the year to June 2006, the level of employment increased by 9.0 percent.

In the financial/business and other services sector, the level of employment increased by 6.2 percent in the June quarter of 2006, compared to the March quarter of 2006. The increase reflected higher employment by security companies, hotels and restaurants, as well as expansion of operations to other centres. Over the year to June 2006, the level of employment increased by 7.8 percent.

In the transportation sector, the level of employment increased by 0.7 percent in the June quarter of 2006, compared to the March quarter of 2006. Higher casual employment, and increases by a helicopter company and a land transport company were offset by reduced employment by a third-level airline and a coastal shipping company. Over the year to June 2006, the level of employment declined marginally by 0.5 percent.

By region, employment increased in all regions except the Momase region. In the NCD, the level of employment increased by 3.9 percent in the June quarter of 2006, compared to the March quarter of 2006. The increase was in all sectors except the agriculture/fisheries sector. The increase in the manufacturing sector reflected activity for furniture making, canned meat processing and biscuit manufacturing. Higher casual employment and new projects in the NCD, Morobe and Highlands regions contributed to the increase in the construction sector. Over the year to June 2006, the level of employment increased by 7.5 percent.

Formal Private Sector Employment Index[3]



In the Southern region, the level of employment grew by 3.5 percent in the June quarter of 2006, compared to the March quarter of 2006. The increase was in all sectors except the retail sector. The increase in the agriculture/forestry/fisheries sector reflected activity by the palm oil, forestry and fishing companies. Higher casual employment for road works and engineering activity contributed to the increase in the construction sector. The harvesting of beche-de-mer and casual employment resulted in the increase in the wholesale sector, while higher employment by a shipping company led to the increase in the transportation sector. Increased employment by hotels and real estate companies contributed to the increase in the financial/business and other services sector. Over the year to June 2006, the level of employment increased by 8.4 percent.

In the Highlands region, the level of employment grew by 12.5 percent in the June quarter of 2006, compared to the March quarter of 2006. Higher casual employment for the coffee season contributed to the increase

[3] The dotted vertical line indicates a break in series from 2002. See "For the Record" in the March 2003 QEB on page 31 and the September 2005 QEB on page 29.

in the agriculture, wholesale and manufacturing sectors. Over the year to June 2006, the level of employment increased by 17.8 percent.

In the Morobe region, the level of employment increased by 1.6 percent in the June quarter of 2006, compared to the March quarter of 2006. The increase in the agriculture/forestry/fisheries sector reflected employment for a new fish cannery and for coffee exporting companies. Higher casual employment and expansion of operations contributed to the increase in the retail/wholesale sector. The increase in the transportation sector was due to a road transportation company expanding its operations into the Southern region. Higher employment in the financial/business and other services reflected increased employment by hotels. Over the year to June 2006, the level of employment increased by 9.2 percent.

In the Islands region, the level of employment increased by 2.0 percent in the June quarter of 2006, compared to the March quarter of 2006. The increase was in all sectors except the manufacturing and transportation sectors. Higher employment in the retail/wholesale sector was due to the expansion of operations by a wholesale company, while higher casual employment contributed to the growth in the agriculture/forestry sector. Construction projects in other parts of the region and in the Southern region by Rabaul-based companies resulted in the increase in the building and construction sector. Higher employment by hotels and security firms contributed to the increase in the financial/business and other services sector. Over the year to June 2006, the level of employment increased by 6.3 percent.

In the Momase region, the level employment declined marginally by 0.1 percent in the June quarter of 2006, compared to the March quarter of 2006. The decline was in all the sectors except the manufacturing, retail/wholesale and financial/business and other services sectors. The decline in the agriculture/forestry/fisheries sector reflected lower employment by forestry and fishing companies, while reduced employment by a third level airline contributed to the decline in the transportation sector. Lower employment by hotels resulted in the decline in the financial/business and other services sector. Over the year to June 2006, the level of employment declined by 2.9 percent.

4. CONSUMER PRICE INDEX

The headline inflation rate, as measured by the Consumer Price Index (CPI), was 1.6 percent in the June quarter of 2006, compared to negative 3.8 percent in March 2006. The outcome was due to higher prices in all expenditure groups. By region all urban areas recorded increases in prices, except Lae and Rabaul. The annual headline inflation rate was 2.3 percent in the June quarter of 2006, compared to 1.8 percent in the March quarter of 2006.

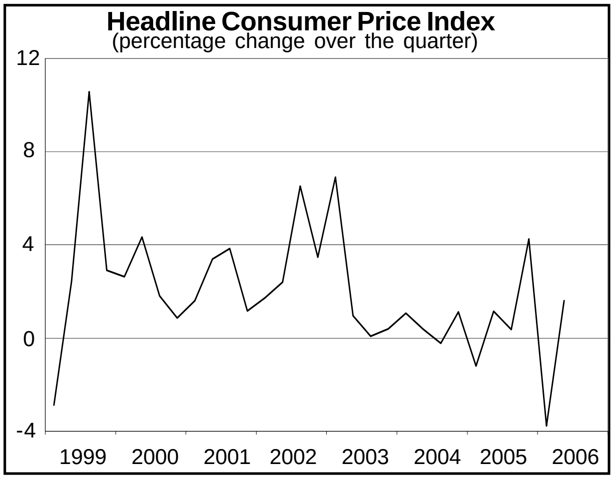
The CPI for the 'Food' expenditure group increased by 3.0 percent in the June quarter of 2006, compared to a decline of 1.7 percent in the March quarter of 2006. The increase was driven by fruits and vegetables prices which increased by 15.3 percent during the June quarter. Cereals prices rose by 0.7 percent and meat and fish prices increased marginally by 0.2 percent. The group contributed 1.2 percentage points to the overall quarterly movement in the CPI.

The CPI for the 'Drinks, tobacco and betelnut' expenditure group increased by 0.2 percent in the June quarter of 2006, compared to a decline of 12.4 percent in the March quarter. The increase reflected higher cigarettes, tobacco and soft drink prices, which more than offset a decline in betelnut prices. The group contributed 0.4 percentage points to the overall quarterly movement in the CPI.

The CPI for the 'Clothing and footwear' expenditure group increased by 1.3 percent in the June quarter of 2006, compared to an increase of 1.4 percent in the March quarter of 2006. The rise was due to higher prices for materials, footwear, shirts, trousers and jeans. The group contributed 0.1 percentage points to the overall quarterly movement in the CPI.

The CPI for the 'Rents, council charges, fuel and power' expenditure group increased by 1.3 percent in the June quarter of 2006, compared to an increase of 3.9 percent in the March quarter. The rise was driven by higher prices of fuel and power, which more than offset a decline in council charges. The group contributed 0.1 percentage points to the overall quarterly movement in the CPI.

The CPI for the 'Household equipment and operations' expenditure group increased by 2.3 percent in the June quarter of 2006, compared to a fall of 3.7 percent in the



March quarter. The increase was due to higher prices for durable, semi-durable and non-durable goods. The group contributed 0.1 percentage points to the overall quarterly movement in the CPI.

The CPI for the 'Transport and communication' expenditure group increased by 0.5 percent in the June quarter of 2006, compared to an increase of 1.0 percent in the March quarter. Higher prices for motor vehicle operations more than offset lower prices for motor vehicle purchases. There were no changes in airline, PMV and taxi fares and telephone and postal charges. The group contributed 0.1 percentage points to the overall quarterly movement in the CPI.

The CPI for the 'Miscellaneous' expenditure group increased by 0.7 percent in the June quarter of 2006, compared to an increase of 0.2 percent in the March quarter. The marginal increase was the result of higher prices for entertainment, cultural items and medical and health care. The group contributed 0.1 percentage points to the overall quarterly movement in the CPI.

By urban areas, all surveyed centres recorded increases in the June quarter of 2006 except for Lae and Rabaul. Prices in Port Moresby and Goroka increased by 1.3 percent in the June quarter, compared to declines of 5.5 and 3.9 percent respectively in the March quarter of 2006. In Madang, prices increased by 0.8 percent in the June quarter of 2006, following a decline of 5.0 percent in the March quarter. The increase in Port Moresby and Madang reflected higher prices in all expenditure groups except the drinks, tobacco and betelnut group. In Goroka, higher prices for fruits and vegetables, other food items, soft drinks, betelnut, petrol, kerosene, motor vehicle purchase and other expenditure items contributed to the increase. In Lae, prices declined by 0.2 percent in the June quarter of 2006 after a decline of 2.0 percent in the March quarter. In Rabaul, prices fell by 0.1 percent in the June quarter of 2006 following an increase of 2.1 percent in the March quarter.

The exclusion-based inflation measure was 0.9 percent in the June quarter of 2006, compared to 0.3 percent in the March quarter. Trimmed mean inflation was 0.7 percent in the June quarter of 2006, compared to zero percent in the March quarter.

5. EXPORT COMMODITIES REVIEW

The total value of merchandise exports in the June quarter of 2006 was K3,551 million, 43.8 percent higher than in the corresponding quarter of 2005. Higher export values were recorded for gold, copper, crude oil, cocoa, rubber, logs, marine products and other non-mineral export receipts, while there were declines in the export values of coffee, palm oil, copra oil, copra, tea and refined petroleum products. Mineral export receipts, excluding crude oil, were K2,103 million and accounted for 59.2 percent of total merchandise exports in the June quarter of 2006, compared to K1,200 million or 48.6 percent in the corresponding quarter of 2005. Crude oil exports totalled K912.4 million and accounted for 25.7 percent of total merchandise exports in the June quarter of 2006, compared to K682.3 million or 27.6 percent in the corresponding quarter of 2005.

The value of agricultural, marine products, and other non-mineral exports, excluding forestry and refined petroleum product exports was K351.9 million and accounted for 9.9 percent of total merchandise exports in the June quarter of 2006, compared to K417.7 million or 16.9 percent in the corresponding quarter of 2005. Forestry product exports were K122.1 million and accounted for 3.4 percent of total merchandise exports in the June quarter of 2006, compared to K106.6 million or 4.3 percent in the corresponding quarter of 2005. Refined petroleum product exports were K61.9 million and accounted for 1.7 percent of total merchandise exports in the June quarter of 2006, compared to K62.0 million or 2.5 percent in the corresponding quarter of 2005.

The weighted average price of Papua New Guinea's exports was 44.6 percent higher in the June quarter of 2006, compared to the corresponding quarter of 2005. There was a 54.3 percent increase in the weighted average price of mineral exports, with higher kina prices for gold, copper and crude oil. For the agricultural, forestry and marine product exports, the weighted average price declined by 0.5 percent and was accounted for by lower kina prices of coffee, copra and copra oil. Excluding logs, the weighted average price of agricultural and marine product exports declined by 1.8 percent in the June quarter of 2006, compared to the corresponding period of 2005. The lower kina export prices reflected declines in international prices combined with the appreciation of the kina against the US dollar.

Mineral Exports

Total mineral export receipts were K3,015.4 million in the June quarter of 2006, compared to K1,882.3 million in the corresponding quarter of 2005. This outcome was due to the combined increase in export volumes and prices of copper and crude oil, and an increase in the price of gold, which more than offset the decline in export volumes.

The volume of gold exported in the June quarter of 2006 was 13.2 tonnes, a decline of 26.3 percent from the corresponding quarter of 2005. The decline was due to unfavourable weather conditions, which affected production at the Porgera and Tolukuma mines, combined with a temporary shut down of operations at the Lihir mine for maintenance. The average free on board (f.o.b.) price received for Papua New Guinea's gold exports was K55.9 million per tonne during the June quarter of 2006, an increase of 47.4 percent from the corresponding period of 2005. The average gold price at the London Metal Exchange increased by 48.2 percent to US$624 per fine ounce in the June quarter of 2006, compared to the corresponding quarter of 2005. The price increase reflected higher demand for gold-based investments as investors considered gold attractive and safe form of investment as equity markets proved volatile and uncertainty surrounding the US dollar and other major currencies. The higher export price more than offset the decline in export volume resulting in an increase in export receipts by 8.7 percent to K737.5 million in the June quarter of 2006, from the corresponding quarter of 2005.

Copper export volumes increased by 39.1 percent to 68.6 thousand tonnes in the June quarter of 2006, compared to the corresponding quarter of 2005**.** The increase was due to higher production and shipment of copper ore by the Ok Tedi mine as a result of higher water levels at the Fly River. The average f.o.b. price of Papua New Guinea's copper exports increased by 89.1 percent to K19,695 per tonne in the June quarter of 2006, compared to the corresponding quarter of 2005. This outcome was mainly due to higher international prices resulting from 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 volume and price resulted in an increase in export receipts by 163.2 percent to K1,351.1 million in the June quarter of 2006, compared to the corresponding quarter of 2005.

Crude oil export volumes increased by 7.1 percent to 4,224.1 thousand barrels in the June quarter of 2006, compared to the corresponding quarter of 2005. The increase reflected higher production from the Kutubu, Moran and South East Mananda oil projects. This outcome more than offset declines from the Gobe Main and South East Gobe oil projects. The average export price of crude oil increased by 24.9 percent to K216 per barrel in the June quarter of 2006, compared to the corresponding quarter of 2005, due to higher international prices. The increase in international prices was due to higher global demand, especially by China and India, continued supply disruptions in Iraq and fears of attack on oil production in Saudi Arabia. The combined increases in volume and price resulted in an increase in export receipts by 33.7 percent to K912.4 million in the June quarter of 2006, compared to the corresponding quarter of 2005.

Exports receipts of refined petroleum products from the Napanapa Oil Refinery declined by 0.2 percent to K61.9 million in the June quarter of 2006, compared to the corresponding period in 2005.

Agriculture, Logs and Fisheries Exports

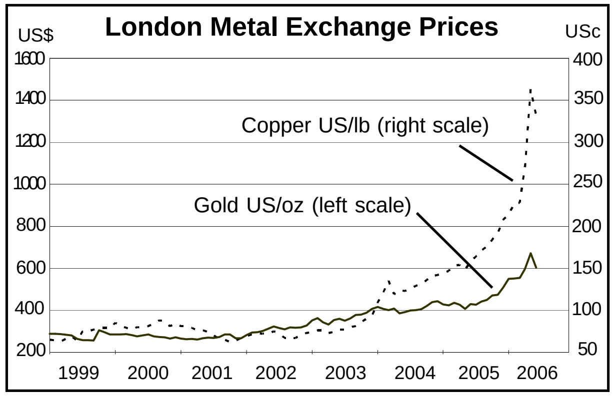
Export prices of some agricultural export commodities increased in the June quarter of 2006, compared to the corresponding quarter of 2005. Cocoa prices increased by 0.6 percent, palm oil by 9.1 percent, tea by 9.8 percent, and rubber by 46.6 percent while coffee prices declined by 17.9 percent, copra by 19.5 percent and copra oil by 21.9 percent. The average export price of logs increased by 3.1 percent to K184 per cubic meter in the June quarter of 2006, compared to the corresponding quarter of 2005. The average export price of marine products increased by 57.5 percent in the June quarter of 2006, from the corresponding period in 2005. The net effect of these price movements was a 0.5 percent decline in the weighted average price of agricultural, forestry and marine product exports.

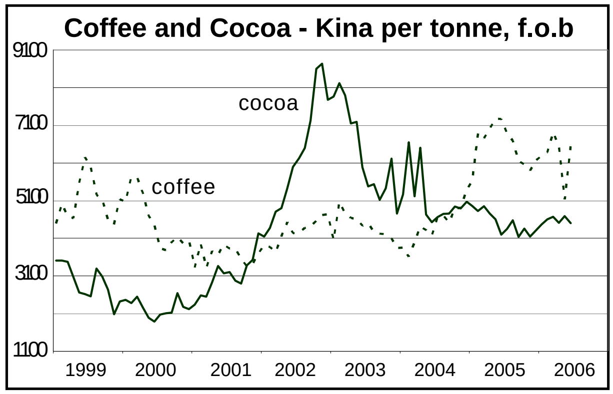
The volume of coffee exported declined by 4.7 percent to 16,100 tonnes in the June quarter of 2006, compared to the corresponding quarter of 2005. The decline was due to lower production attributed mainly to unfavourable weather conditions and deteriorating road infrastructure. The average export price of coffee declined by 17.9 percent to K5,925 per tonne in the June quarter of 2006, compared to the corresponding quarter of 2005. The decline was due to lower international prices reflecting an increase in world supply following higher output from Brazil and other major producing nations as a result of favourable weather conditions. The combined declines in volume and price resulted in a 21.7 percent decline in export receipts to K95.4 million in the June quarter of 2006, compared to the corresponding period in 2005.

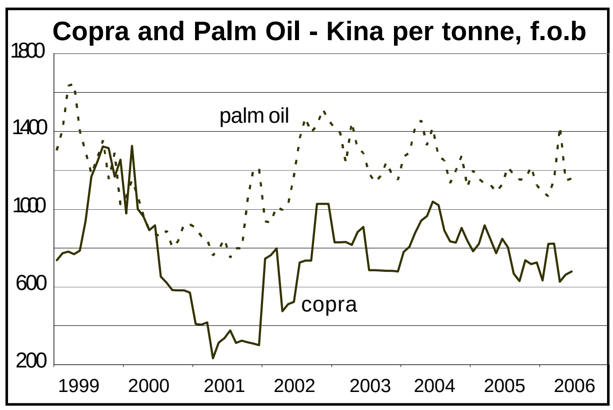
The volume of cocoa exported increased by 13.6 percent to 11,700 tonnes in the June quarter of 2006, compared to the corresponding quarter of 2005. This outcome was due to higher production from Bougainville combined with favourable weather conditions in other major cocoa producing regions. The average export price of cocoa increased by 0.6 percent to K4,581 per tonne in the June quarter of 2006, compared to the corresponding period in 2005. The increase was due to higher international prices, as a result of lower supply in the world market. The combined increases in price and volume resulted in a 14.3 percent increase in export receipts to K53.6 million in the June quarter of 2006, compared to the corresponding period in 2005.

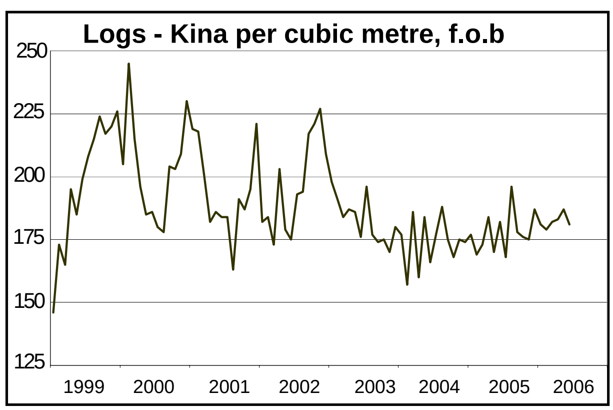
The volume of copra exported declined by 61.5 percent to 2,000 tonnes in the June quarter of 2006, compared to the corresponding quarter of 2005. The decline was attributed to lower production from the major copra producing regions as a result of unfavourable weather conditions. The average export price for copra declined by 19.5 percent to K650 per tonne in the June quarter of 2006, compared to the corresponding quarter of 2005. This outcome was due to lower international prices, resulting from an increase in production from the Philippines and Indonesia, the world's major copra producers. The combined declines in price and volume resulted in a 69.0 percent fall in export receipts to K1.3

EXPORT COMMODITY PRICES









million in the June quarter of 2006, compared to the corresponding period in 2005.

The volume of copra oil exported declined by 27.2 percent to 11,500 tonnes in the June quarter of 2006, compared to the corresponding period in 2005. The decline was primarily due to lower volume of copra sold to the domestic copra mills for processing. The average export price of copra oil declined by 21.9 percent to K1,478 per tonne in the June quarter of 2006, compared to the corresponding period in 2005. The decline in international prices was mainly due to increased supply in the world market resulting from higher copra production from the Philippines and Indonesia, two of the world's major copra producers. Declines in both price and volume resulted in lower export receipts by 43.1 percent to K17.0 million in the June quarter of 2006, compared to the corresponding period in 2005.

The volume of palm oil exported declined by 36.1 percent to 80,000 tonnes in the June quarter of 2006, compared to the corresponding period in 2005. The decline was due to lower production resulting from unfavourable weather conditions combined with lower shipments. The average export price of palm oil increased by 9.1 percent to K1,216 per tonne in the June quarter of 2006, compared to the corresponding quarter of 2005. The increase was attributed to higher international prices resulting from lower production from Malaysia and Indonesia, two of the world's leading producers. The decline in export volume more than offset the increase in export price and resulted in a 30.2 percent decline in export receipts to K97.3 million in the June quarter of 2006, compared to the corresponding period in 2005.

The volume of tea exported declined by 10.5 percent to 1,700 tonnes in the June quarter of 2006, compared to the corresponding period in 2005. The decline was due to lower production resulting from unfavourable weather conditions in the tea producing region. The average export price of tea increased by 9.8 percent to K3,235 per tonne in the June quarter of 2006, compared to the corresponding period in 2005. The decline in export volume more than offset the increase in export price and resulted in a 1.8 percent decline in export receipts to K5.5 million in the June quarter of 2006, compared to the corresponding period in 2005.

The volume of rubber exported declined by 23.1 percent to 1,000 tonnes in the June quarter of 2006, compared to the corresponding period in 2005. The decline was attributed to unfavourable weather conditions combined with deteriorating road infrastructure. The average export price increased by 46.6 percent to K5,300 per tonne in the June quarter of 2006, compared to the corresponding period in 2005. The increase was due to higher international prices following lower supply in the world market. The increase in the export price of rubber more than offset the decline in export volume and resulted in an increase in export receipts by 12.8 percent to K5.3 million in the June quarter of 2006, compared to the corresponding period in 2005.

The volume of logs exported increased by 18.1 percent to 627.0 thousand cubic metres in the June quarter of 2006, compared to the corresponding period in 2005. This was attributed to higher production and shipment from major logging projects resulting from the lifting of moratorium on some logging projects, commencement of new projects and favourable weather conditions. The average export price of logs increased by 3.1 percent to K184 per cubic metre in the June quarter of 2006, compared to the corresponding period in 2005. This outcome was due to higher international prices reflecting lower supply of tropical hardwoods in the world market. The combined increases in export price and volume resulted in an increase in the export receipts by 21.7 percent to K115.4 million in the June quarter of 2006, compared to the corresponding period in 2005.

The value of marine products exported increased by 0.4 percent to K26.4 million in the June quarter of 2006, compared to the corresponding period in 2005. This outcome was a result of an increase in export price which more than offset a decline in export volume.

6. BALANCE OF PAYMENTS

The overall surplus in the balance of payments for the first six months of 2006 was K749 million, compared to a deficit of K304 million in the corresponding period in 2005. This outcome was the result of a significant improvement in the current account surplus combined with a lower deficit in the capital and financial accounts.

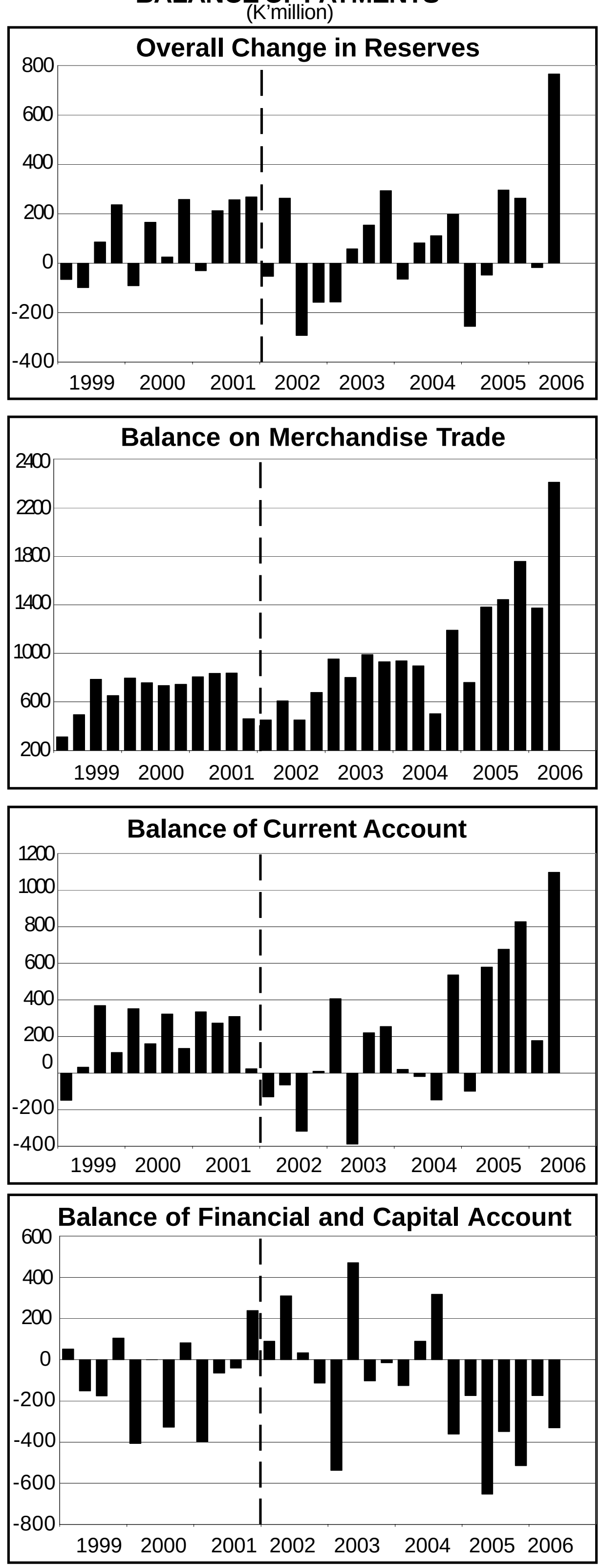
The surplus in the current account was due to a significant improvement in the trade account, which more than offset higher net service and income payments and lower net transfer receipts. The improvement in the capital and financial accounts reflected lower loan repayments by the Government, increased direct investment inflows and drawdowns in net foreign assets of commercial banks. These more than offset increased investments in portfolio and financial derivative instruments combined with increased loan repayments by the private sector and a build up in foreign currency account balances of the mineral companies. During the first six months of 2006, the kina appreciated against the currencies of Papua New Guinea's major trading partners, compared to the corresponding period in 2005.

The trade account recorded a surplus of K3,786 million in the first six months of 2006, a significant increase of 69.5 percent from the corresponding period in 2005. 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 2006 was K6,344 million, an increase of 34.0 percent from the corresponding period in 2005. The increase was attributed to higher values of gold, copper, crude oil, cocoa, rubber, logs, marine products and other non-mineral export receipts.

The value of merchandise imports increased by 2.3 percent to K2,558 million in the first six months of 2006, compared to the corresponding period in 2005. The increase was due to higher imports in all sectors. Imports by the mining sector increased by 24.3 percent to K496 million in the first half of 2006, compared the corresponding period of 2005. The increase reflected higher capital expenditures undertaken by all mines except the Porgera, Tolukuma and Kainantu gold mines. Petroleum sector imports increased by 20.3 percent to K213 million in first six months of 2006, compared to the corresponding period of 2005. The increase was due to higher capital expenditures, mainly reflecting continued drilling at the South East Mananda, Moran and Gobe oil fields. General imports increased by 1.3 percent to K1,849 million in the first six months of 2006, compared to the corresponding period in 2005.

The deficit in the services account was K1,544 million in the first half of 2006, an increase of 10.4 percent from the corresponding period in 2005. The higher deficit

BALANCE OF PAYMENTS[4]
(K'million)



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

was due to increased payments for transportation, other financial services, communication, refining and smelting and other services. This more than offset higher service receipts by resident companies.

The deficit in the income account was K1,213 million in the first half of 2006, an increase of 31.6 percent from the corresponding period in 2005. The deficit was due to higher payments for dividend and interest payments on foreign loans, which more than offset higher income receipts.

The surplus in the transfers account was K248 million in the first half of 2006, compared to a surplus of K567 million in the corresponding period of 2005. This outcome was due to lower transfer receipts combined with higher transfer payments, resulting from increased family maintenance and licensing fee payments.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a surplus of K1,277 million in the first six months of 2006, compared to a surplus of K481 million in the corresponding period in 2005.

The capital account recorded no transactions during the first six months of 2006, the same as in the corresponding period of 2005.

The financial account recorded a net outflow of K505 million in the first six months of 2006, compared to a net outflow of K826 million in the corresponding period in 2005. This outcome reflected a higher net inflow in direct investments of K116 million reflecting share placement by a mineral company to raise capital for exploration activities and operational expenses. In addition, there were drawdowns in net foreign assets of the banking system and lower net loan repayments by the Government. These more than offset higher net outflows for portfolio investments of K168 million reflecting purchase of short-term money market instruments and K13 million for the purchase of financial derivative instruments.

In the June quarter of 2006, the balance of payments recorded an overall surplus of K766 million, compared to a deficit of K49 million in the corresponding quarter of 2005.

The value of merchandise exports increased by 43.8 percent to K3,551 million in the June quarter of 2006, compared to the corresponding quarter of 2005. The increase was due to higher values of gold, copper, crude oil, cocoa, rubber, logs, marine products and other non-mineral export receipts. These more than offset declines in the values of coffee, tea, copra, copra oil and palm oil exports.

The value of merchandise imports increased by 8.7 percent to K1,140 million in the June quarter of 2006, compared to the corresponding quarter of 2005. This outcome reflected increases in general and mining sector imports, which more than offset a decline in petroleum sector imports. General imports increased by 9.9 percent to K780 million in the June quarter of 2006, compared to the corresponding quarter of 2005. Imports by the mining sector increased by 10.5 percent to K262 million in the June quarter of 2006, compared to the corresponding quarter of 2005. This was due to higher capital expenditures by the Ok Tedi, Lihir and Hidden Valley mines. Imports by the petroleum sector declined by 3.9 percent to K98 million in the June quarter of 2006, compared to the corresponding quarter of 2005, due to the completion of construction at the South East Mananda oil project.

The deficit in the services account was K750 million in the June quarter of 2006, an increase of 15.6 percent from the corresponding quarter of 2005. The higher deficit was due to increases in payments for transportation, other financial, communication, refining and smelting and other services, which more than offset higher service receipts.

The deficit in the income account was K656 million in the June quarter of 2006, an increase of 38.7 percent from the corresponding quarter of 2005. This outcome was due to higher payments for interest on foreign loans and dividends by resident companies, which more than offset higher income receipts.

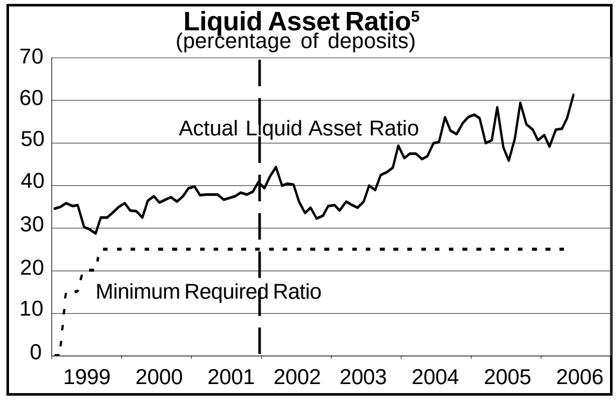
The surplus in the transfers account was K93 million in the June quarter of 2006, compared to a surplus of K282 million in the corresponding quarter of 2005. The lower surplus was the result of lower transfer receipts, combined with higher payments for family maintenance and licensing fees.

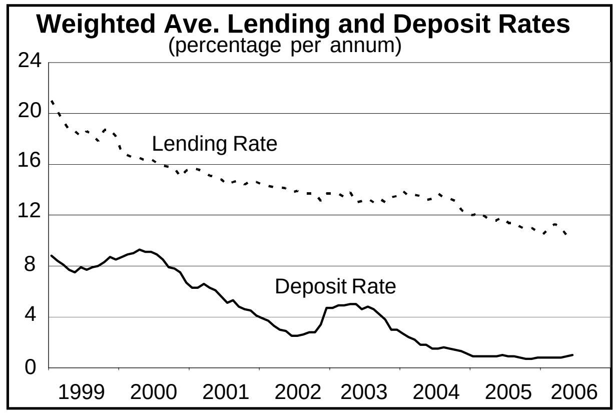
As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a surplus of K1,098 million in the June quarter of 2006, compared to a surplus of K580 million in the corresponding quarter of 2005.

The capital account recorded no transactions during the June quarter of 2006, the same as in the corresponding period of 2005.

The financial account recorded a net outflow of K330 million in the June quarter of 2006, compared to a net outflow of K652 million in the corresponding period in 2005. This outcome was due to draw downs in net foreign asset holdings of the banking system and foreign currency account balances, combined with lower net outflow of investments in financial derivatives. These more than offset net outflow of portfolio investments in short term money market instruments, lower foreign direct investment and lower loan repayment by the Government. In addition, there were higher loan repayments by mineral companies and trade credits owed to PNG resident companies.

The level of gross foreign exchange reserves at the end of June quarter 2006 was K3,040.3 (US$1,002.8) million, sufficient for 8.0 months of total and 11.7 months of non-mineral import covers.





7. MONETARY DEVELOPMENTS

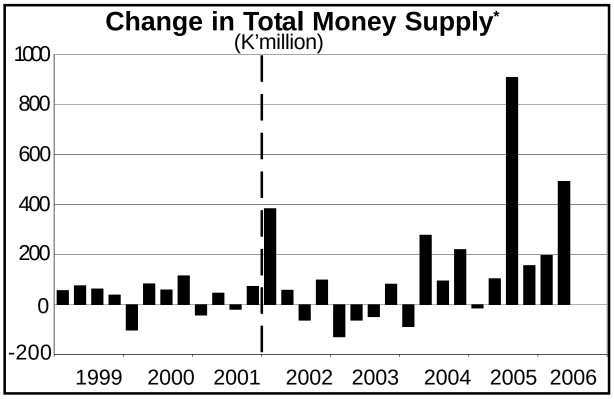
INTEREST RATES AND LIQUIDITY

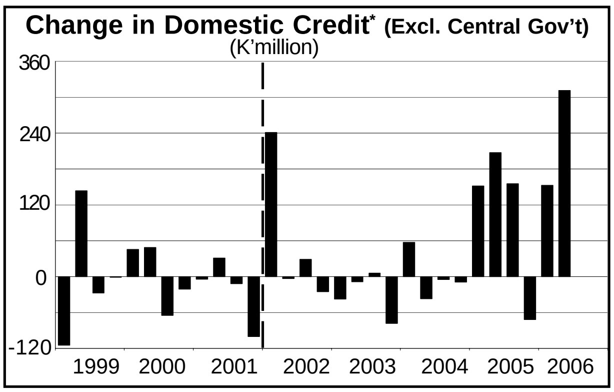
The Bank of Papua New Guinea maintained a neutral monetary policy stance during the June quarter of 2006. As a result, the Kina Facility Rate (KFR) was kept unchanged at 6.0 percent. The dealing margin for the Repurchase Agreements (Repos) was reduced by 1.0 percent in aggregate to 200 basis points on both sides of the KFR in order to realign domestic interest rates to the official rate and to maintain positive real interest rates. Other domestic interest rates were relatively stable during the quarter. Since the Government ceased issuing Treasury bills beginning May 2006 following high cash surpluses, the Bank issued additional Central Bank Bills (CBBs) to diffuse liquidity and stabilise interest rates. The 28-day CBB rate increased from 2.94 percent to 3.49 percent between end of March and June 2006, whilst the 63-day CBB rate increased from 3.78 percent in May (when introduced) to 3.77 percent in June 2006. The weighted average deposit rates quoted by commercial banks on wholesale deposits (K500,000 and above) also trended upwards between end of March and June 2006. The 30 days deposit rate increased from 0.52 percent to 2.09 percent, 60 days rate from 0.52 percent to 2.30 percent, 90 days from 1.40 percent to 1.74 percent whilst the 180 days decreased from 3.03 percent to 1.76 percent.

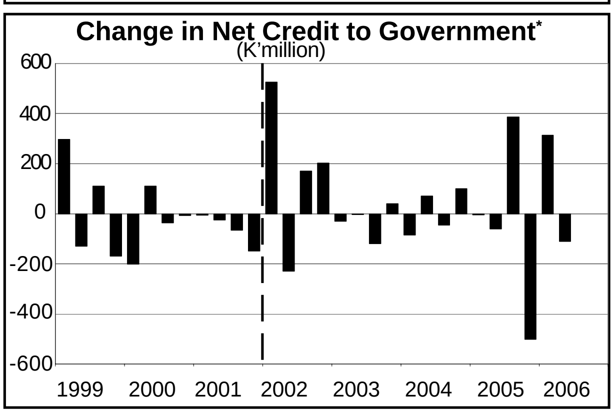
The Bank continued to utilise its Open Market Operation (OMO) instruments in the conduct of monetary policy over the June quarter of 2006. Given the Government's retirement of its maturing Treasury bills, the Bank issued additional CBBs and utilised Reverse Repos to manage liquidity. Inter-bank borrowing was moderate given the high level of liquidity among banks. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) of commercial banks were maintained at 3.0 percent and 25.0 percent, respectively, over the June quarter.

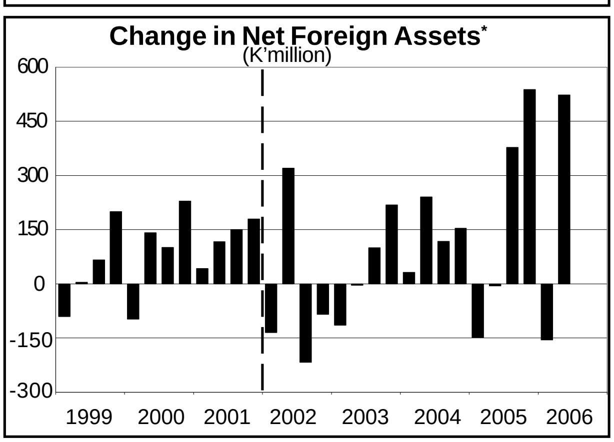
Average liquid assets held by Other Depository Corporations (ODCs) increased by 17.2 percent in the June quarter of 2006, compared to an increase of 2.4 percent

[5] The dotted vertical lines indicate a break in series from 2002. See "For the Record" in the June 2006 QEB on page 44.









in the previous quarter, reflecting an increase in holdings of CBBs.

The weighted average interest rate on total deposits paid by commercial banks increased from 0.8 percent to 1.0 percent, whilst the weighted average interest rate on total loans declined from 11.3 percent to 10.5 percent. The commercial banks maintained their Indicator Lending Rates (ILR) within the spread of 9.45 to 10.70 percent.

MONEY SUPPLY

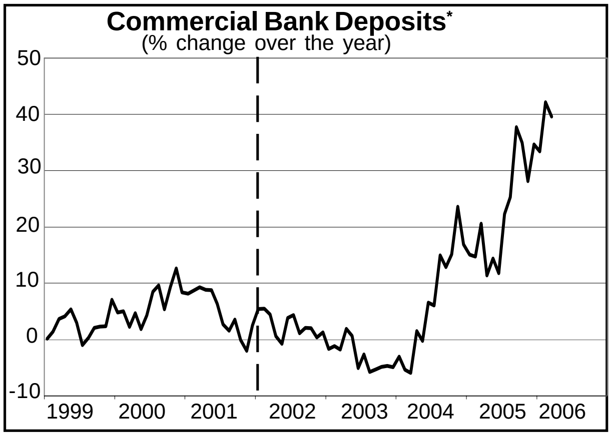
The average level of broad money supply (M3*) increased by 9.0 percent in the June quarter of 2006, compared to an increase of 4.0 percent in the March quarter of this year. The outcome was due to increases of 17.6 percent in average net credit to the Central Government, 13.2 percent in average net private sector credit and 7.0 percent in average net foreign assets of the depository corporations. Net domestic credit outstanding, excluding advances to the Central Government and outstanding loans under the Government's Agricultural export commodity support scheme increased by 14.1 percent in the June quarter of 2006, compared to 7.0 percent in the March quarter of this year.

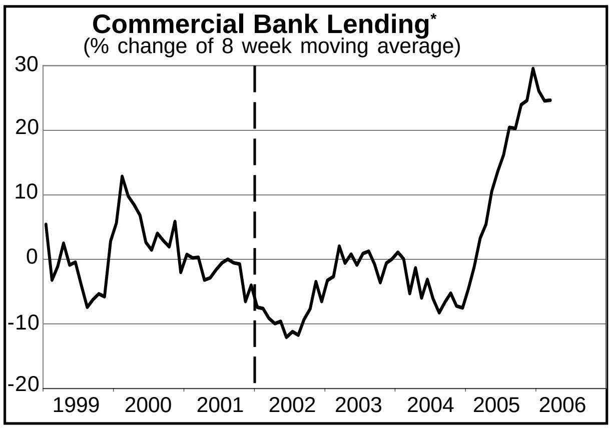
The growth in average net credit to the Government during the June quarter of 2006 resulted mainly from increased purchase of Government securities by ODCs. This reflected the issuance of Inscribed stocks by the Government, which were greater than an increase in Government deposits at the central bank.

The average level of narrow money supply (M1*) increased by 7.0 percent in the June quarter of 2006, compared to a marginal decline in the March quarter. There were increases in both currency in circulation and demand (transferable) deposits. The average level of quasi money increased by 11.6 percent during the June quarter of 2006.

The average level of deposits of the ODCs increased by 9.0 percent in the June quarter of 2006 to K5,569.8 million, from K5,108.1 million in the March quarter of 2006. This represents an annualised growth rate of 29.6 percent.

* Refer to footnote on page 16 of the June 2006 QEB.





LENDING

During the June quarter of 2006, total domestic credit extended by depository corporations to the private sector, public non financial corporations, Provincial and Local Governments, and other financial corporations, increased by K329.8 million to K2,723.6 million in the June quarter of 2006, compared to an increase of K152.7 million during the first quarter of 2006. Growth in lending during this quarter was mainly influenced by an increase of K339.2 million to the private sector, in particular to the building and construction, transport and communication, fisheries and forestry sectors, as well as to other business and household sector. There were no repayments under the Agricultural commodity price support schemes. The annualised growth in domestic credit, excluding Central Government and advances under the price support schemes was 48.8 percent in the first half of 2006.

8. PUBLIC FINANCE

Preliminary estimates of the fiscal operations of the National Government over the six months to June 2006 showed an overall surplus of K327.7 million, compared to a surplus of K192.1 million in the corresponding period of 2005. This represents 2.1 percent of nominal GDP. The surplus resulted from higher revenue, which more than offset an increase in expenditure.

Total revenue, including foreign grants during the first six months of 2006 was K2,280.7 million, 23.8 percent higher than the receipts collected in the corresponding period of 2005. This represents 48.1 percent of the budgeted revenue for 2006. The increase was attributed to higher collections in most categories of revenue, which more than offset lower grants.

Total tax revenue amounted to K1,937.3 million, 25.1 percent higher than the receipts collected during the same period in 2005, and represents 56.2 percent of the budgeted tax receipts for 2006. Direct tax receipts totalled K1,387.3 million, 30.0 percent higher than the receipts collected over the corresponding period in 2005, and represents 56.2 percent of the budgeted amount. The increase was due to higher collections of company and other direct tax receipts, which more than offset lower personal income taxes. The growth in company tax receipts reflected improved profitability of companies due to higher mineral and agricultural export prices, combined with the pick up in aggregate demand. The increase in other direct taxes resulted from higher receipts from sundry items including gaming machine tax and bookmakers' turnover taxes. Personal tax receipts declined as a result of non-payment of salary and wages tax by some Government agencies combined with the reduction in personal income tax.

Indirect tax receipts was K550.0 million, 14.1 percent higher than the corresponding period in 2005, and represents 56.2 percent of the budgeted tax receipts for 2006. All categories of indirect tax increased, except import duties and other indirect tax receipts. The increase in excise duties reflected higher volumes of domestically produced and imported fuels mainly due to higher international oil prices, while the increase in export tax receipts reflected higher log exports. The

* Refer to footnote on page 16 of the June 2006 QEB.

Goods and Services Tax (GST) also increased as a result of timely payments by companies. 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 K165.5 million, 105.6 percent higher than the amount collected in the corresponding period of 2005, and represents 55.6 percent of the budgeted amount. The increase mainly reflected higher dividend payments, which more than offset lower collection of service fees by Government Departments. Foreign grants to June 2006 totalled K177.9 million, 16.3 percent lower than in 2005, due to lower counterpart funding for AusAID funded projects.

Total expenditure over the six months to June 2006 was K1,953.0 million, 18.4 percent higher than in the corresponding period in 2005, and represents 40.4 percent of the budgeted expenditure for 2006. The increase was due to higher recurrent and development expenditures, combined with higher interest payments.

Recurrent expenditure for the first half of 2006 was K1,427.4 million, 17.2 percent higher than the corresponding period in 2005, and represents 45.4 percent of the 2006 budgeted appropriation. Of this total, K778.3 million relates to National Departmental expenditure, 14.1 percent higher than the amount spent in the corresponding period in 2005, and represents 46.0 percent of the budgeted appropriations. The increase reflects higher salaries and wages, education subsidies, payments relating to structural reforms and settlement of court orders. Provincial Government recurrent expenditure was K346.0 million, which is 17.6 percent higher than the corresponding period in 2005, and represents 46.4 percent of the budgeted amount. The increase was due to higher salaries and wages, education subsidies, derivation and conditional grants, including grants to the Autonomous Bougainville Government (ABG). Interest payments totalled K197.7 million, 35.0 percent higher than the amount paid in the corresponding period in 2005. The increase in interest payments reflects the increased issuance of Inscribed stocks.

Total development expenditure for the first six months of 2006 was K525.6 million, 21.6 percent higher than in the corresponding period in 2005, and represents 31.2 percent of the budgeted expenditure for 2006. The increase was related to higher budgetary allocations for the 2006 Development Budget, which more than offset lower foreign grants.

The budget surplus was used to make net overseas loan repayments of K89.4 million and net domestic loan repayment of K238.3 million, of which K81.1 million were net deposits with the financial corporations sector. The net overseas loan repayments comprised of K3.4 million for concessionary, K8.6 million to commercial and K77.4 million to extraordinary loan sources. Net domestic loan repayments comprised K89.0 million to the non-financial corporations and K68.2 million to other resident sectors. The repayment to other resident sectors reflects settlement of cheques issued in 2005.

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 2004, the KFR announced by the Bank were;

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 %
	04 July	Maintained at 7.00 %
	01 August	Maintained at 7.00 %
	05 September	Reduced by 100 basis points to 6.00 %
	03 October	Maintained at 6.00 %
	07 November	Maintained at 6.00 %
	05 December	Maintained at 6.00 %
2006	02 January	Maintained at 6.00 %
	06 February	Maintained at 6.00 %
	06 March	Maintained at 6.00 %
	03 April	Maintained at 6.00%
	01 May	Maintained at 6.00%
	05 June	Maintained at 6.00%
	03 July	Maintained at 6.00 %
	07 August	Maintained at 6.00 %
	04 September	Maintained at 6.00 %

For details of the KFR, see Table 6.3 (S33) of the QEB.
KFR announcements prior to January 2004 are reported in various bulletins starting from the March 2001 QEB.

FOR THE RECORD

EXPANSION OF MONETARY AND FINANCIAL DATA COVERAGE

Background

The Bank of Papua New Guinea's (PNG) current collection and presentation of monetary data is based on the *1984 Guide to Money and Banking Statistics*. In this regard, the Bank engaged technical assistance (TA) missions from the International Monetary Fund (IMF) Statistics Department (STA) in April 2005 and May 2006 to: (i) review the current collection and compilation procedures of monetary statistics by the BPNG; (ii) assist staff of the BPNG in developing a work program to facilitate implementation of the methodology recommended in the *Monetary and Financial Statistics Manual (MFSM) 2000*[1]; (iii) assist in preparing the *Standardised Report Forms* for reporting monetary data of other depository corporations (ODCs)[2] to the IMF; and (iv) assist in finalising the integrated monetary database (IMD) that meets the data needs of the BPNG, STA and Asia Pacific Department (APD) of the IMF. To this end, the main monetary aggregates were reclassified and reconciled with those published in the BPNG's *Quarterly Economic Bulletin (QEB)* to the methodology of the MFSM 2000. Accordingly, the statistics in the *QEB* were updated and reclassified to the new methodology.

Following these changes, BPNG has extended its data coverage to include other financial intermediaries. With the assistance of the TA missions, successful coverage of all ODCs reporting to the BPNG has been achieved. Further work is being undertaken by the Central Bank to extend the coverage to include other financial corporations (OFCs), such as the insurance companies (life and general insurance), superannuation funds, stockbrokers, investment managers, and fund administrators.

Importance of changing the QEB to the new format

The new QEB format for monetary tables extends the coverage of private sector credit and money supply to all financial intermediaries. A large share of private sector credit by the non-bank financial institutions is not covered by the current survey. For instance, over the year to June 2006, private sector credit grew by K434.6 million in the current monetary survey. However, with the expansion in coverage, private sector credit increased by K472.3 million during the same period. With the inclusion of other financial intermediaries, money supply grew by K690.4 million over the year to June 2006, compared to K674.5 million in the current monetary survey. It is important that the activities of the non-bank financial institutions are properly monitored because their assets are as big as the commercial banks' and any failure can cause a contagion effect on the rest of the financial sector. With the expansion, the Bank will be in a position to monitor the financial flows between the different sub-sectors of the ODCs, OFCs, Government and other sectors. The health of the entire financial sector can also be closely monitored. Given the additional information on monetary aggregates (i.e. monetary base, sub-sectoral aggregate balance sheets, etc.), the Central Bank can make sound policies.

An additional advantage of adopting the new reporting format is the consistency in publication of PNG's monetary and financial statistics according to internationally accepted methodologies and for comparability across countries. The expansion will also enable the Bank and the Department of Treasury to reconcile the monetary and fiscal accounts.

---

[1] Published by the IMF in 2000, on monetary and financial statistics and it exists alongside the *Balance of Payments Manual (BPM5)* and *Government Finance Statistics Manual*.

[2] Other depository corporations in PNG include the commercial banks, finance companies, merchant banks, savings & loan societies,

Changes to Monetary Tables

The required changes involve reclassification of financial instruments and sectors. Instrument classification involves changes to the reporting of balance sheet information of all reporting financial institutions as per the MFSM 2000.

Following are the major changes:

- The inclusion of finance companies, merchant banks, savings and loans societies and microfinance companies' data in the calculation of monetary aggregates;
- Inclusion of several new aggregate tables for different financial sub-sectors; and
- Renaming of instruments and sectoral classification according to the MFSM 2000.

Coverage and Output

Under the previous reporting framework, a total of 16 institutions were covered for the purpose of compiling monetary and financial statistics. However, with the new reporting requirements, over 120 financial corporations are expected to be covered on a monthly basis. Financial institutions were supportive of the proposed changes in the consultative meetings because of the increase in information disseminated and their usefulness.

Definitions of Concepts, Acronyms and Financial Instruments

1. **Central Bank (CB):** The Bank of Papua New Guinea (BPNG) is the monetary authority in Papua New Guinea (PNG) that has legislative power over the financial system and is responsible for issuing currency, managing international reserves, undertakes transactions with the IMF and providing credit to commercial banks.

2. **Other Depository Corporations (ODCs):** The ODC sub-sector, (excluding the CB) in PNG comprises of the commercial banks, finance companies, merchant banks, savings and loans societies, microfinance companies and micro banks. These corporations are mainly engaged in financial intermediation and issue liabilities included in the national definition of broad money.

3. **Other Financial Corporations (OFCs):** The OFC sub-sector is made up of the insurance corporations, superannuation (or pension) funds, other financial intermediaries and financial auxiliaries.

4. **Central Bank Survey (CBS):** The CBS is the balance sheet of the Central Bank, which contains data on all components of the monetary base, comprising of currency in circulation and central bank liabilities to ODCs and other sectors.

5. **Other Depository Corporations Survey (ODCS):** The ODCS shows the consolidated stock and flow balance sheet data for the institutional units covered under the other depository corporation sub-sector.

6. **Depository Corporations Survey (DCS):** The survey is a consolidation of the CBS and the ODCS, which contains data on all depository corporations' liabilities included in the national definition of broad money and data on depository corporations' assets that are claims on (i.e. credit) other sectors of the economy, including the external sector.

7. **Other Financial Corporations Survey (OFCS):** The OFCS contains consolidated stock and flow balance sheet data for insurance corporations, superannuation funds, other financial intermediaries and financial auxiliaries.

8. **Financial Corporation Survey (FCS):** The FCS is the broadest set of monetary and financial statistics in terms of institutional coverage. The survey contains consolidated balance sheet data for all institutional units within the financial corporations sector, thereby providing the stock and flow data for analyzing claims on and liabilities to all other sectors of the economy, including the external sector.

9. **Public nonfinancial corporations:** Public nonfinancial corporations are resident nonfinancial corporations and quasi-corporations controlled by government units. Control may be exercised through ownership of more than half the voting shares, legislation, decree, or regulations that establish specific corporate policy or allow the government to appoint the directors.

10. **Deposits:** Deposits include all claims on the Bank of PNG and ODCs. These are further classified into *transferable* and *other* deposits.

    a. Transferable deposits comprise all deposits that are:
        i. Exchangeable on demand at par and without penalty or restriction; and
        ii. Directly usable for making payments by cheque, draft, direct debit/credit or other direct payment facilities.
    b. Other deposits comprise all claims, other than transferable deposits, that are represented by evidence of deposit. These include savings and term deposits, non transferable deposits denominated in foreign currencies.

11. **Securities other than Shares:** These are negotiable instruments serving as evidence that units have obligations to settle by means of providing cash, a financial instrument, or some other items of economic value. Securities in PNG include Treasury bills and Inscribed stocks issued by the Government and Central Bank Bills (CBBs) issued by the Bank of PNG.

12. **Shares and other Equity:** Shares and other equity comprise all instruments and records acknowledging, after the claims of all creditors have been met, claims on the residual value of a corporation. The components of shares and other equity include:

    a. Funds contributed by owners;
    b. Retained earnings;
    c. Current year Profit & Loss;
    d. General and special reserves;
    e. SDR allocations; and
    f. Valuation adjustments.

13. **Financial derivative:** A financial instrument that is linked to a specific financial instrument, indicator, or commodity, and through which specific financial risk (such as interest rate risk, currency, equity and commodity price risk, credit risk, etc.) can be traded in their own right in financial markets.

Abbreviations and Acronyms used in Monetary Tables

ADB	Asian Development Bank
BPNG	Bank of Papua New Guinea
CBB	Central Bank Bills
CBO S&L	Central Bank Officers' Savings & Loans Society
CBS	Central Bank Survey
CRR	Cash Reserve Requirement
DCS	Depository Corporation Survey
DCs	Depository Corporations
ESA	Exchange Settlement Account
FCs	Finance companies
GST	Goods and Services Tax
IMF	International Monetary Fund
JBIC	Japanese Bank for International Corporation
KFR	Kina Facility Rate
LLR	Lender of Last Resort
M1*	Narrow Money
M3*	Broad Money
MBs	Merchant banks
MFs	Micro finance companies
MFSM	Monetary and Financial Statistics Manual
MLAR	Minimum Liquid Asset Ratio
MRSF	Mineral Resource Stabilization Fund
NFA	Net Foreign Assets
NPF	National Provident Fund (now called Nasfund)
ODs	Overdrafts
ODCs	Other Depository Corporations
ODCS	Other Depository Corporation Survey
OFCs	Other Financial Corporations
OIN	Other Items Net
QEB	Quarterly Economic Bulletin
Pub. Non Fin Corp.	Public Non Financial Corporations
POMSOX	Port Moresby Stock Exchange
PTLs	Private Treaty Loans
RBA	Reserve Bank of Australia
RDB	Rural Development Bank (formerly Agriculture Bank of PNG)
REPO	Repurchase Agreement
SDR	Special Drawing Rights
SLS	Savings and Loans Society
TAF	Temporary Advance Facility
TMS	Treasury Management System

FOR THE RECORD

UPGRADE OF PNG'S PRIVATE DEBT AND EQUITY RECORDING SYSTEM

The Bank of Papua New Guinea's Private Debt and Equity Recording System was upgraded from the Commonwealth Secretariat Debt Recording and Management System (CSDRMS) version 7.2 to the CSDRMS 2000 plus, Version 1.2.

A break in the series signifies the period from which BPNG officially commenced using and publishing data generated from the new system. The figures in the 'Total External Exposure' article (pages 20 - 28) from 1999 to 2003 were generated from the old system whereas from 2004 onwards the new system was used.

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]
A monetary policy instrument of the Central Bank used to manage liquidity in the banking system by either inject ing or defusing it in order to achieve a desired level of interest rate .

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
An underlying inflation measure which involves zero weighting of volatile sub-groups or items such as fruit & vegetables, betelnut and prices that are largely determined by non-market (seasonal) forces, as well as alcoholic drinks, cigarettes & tobacco, etc. See 'Underlying CPI'.

Financial Account
Records all transactions associated with changes of ownership of foreign financial assets such as holdings of monetary gold, special drawing rights (SDR), claims on non-residents and foreign liabilities.

Headline Consumer Price Index (CPI)
A measure of inflation as calculated and published quarterly by the National Statistical Office (NSO), which measures the total price movements in goods and services in the basket.

Income Account
Records transactions such as compensation of employees, which cover wages, salaries, and other benefits in cash and kind, dividends and interest earned on investments between PNG and the other countries.

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

Inscribed Stock (bond)	A Government debt instrument sold to the public for a maturity term of one year or longer for Budget financing. Official benchmark rate used by the Bank of Papua New Guinea to signal its monetary policy stance.
Kina Facility Rate (KFR)	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.
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, CBB, 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. Transactions 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.

Trade Weighted Index[2]

The Trade Weighted Index (TWI) measures the value of the kina against a basket of currencies of PNG's major trading partners.

Treasury Bill

Government security or debt instrument sold at a discount value, but redeemed at face value on maturity for purposes of Budget financing. In PNG, Treasury bills are issued for 28, 61, 91, 182 and 364 day maturities.

Trimmed-mean CPI measure

A fixed proportion of prices at each end of the distribution of price changes are zero weighted and the mean of the remaining price changes recomputed. See also 'Underlying CPI'.

Underlying CPI (exclusion-based and trimmed-mean CPI measures)

A measure of inflation that excludes short-term volatile movements in prices, such as seasonal factors, Government policy decisions and price controlled items.

[2] (See 'For the Record: p.24 in the 2005 September 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 March 1993.

Issue	**Title**
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
Sep 2004	Semi-annual Monetary Policy Statement, July 2004
Dec 2004	Semi-annual Monetary Policy Statement, January 2005
Dec 2004	The 2005 National Budget
June 2005	Papua New Guinea's Total External Exposure
June 2005	Semi-annual Monetary Policy Statement, July 2005
Dec 2005	The 2006 National Budget
Dec 2005	Semi-annual Monetary Policy Statement, January 2006
June 2006	Papua New Guinea's Total External Exposure
June 2006	Semi-annual Monetary Policy Statement, July 2006

STATISTICAL SECTION

STATISTICAL NOTES

Sources

Statistics for the commercial banks have been derived from returns submitted to the Bank. Statistics on Savings and Loan Societies and Papua New Guinea Government securities are derived from sources within the Bank.

Government financial statistics are supplied by the Department of Finance and Treasury.

Information on prices of Papua New Guinea exports are gathered from marketing boards or export producers; world indicator prices are reproduced from the Public Ledger published in London. Tea prices are from the Tea Market Report, London. The general indices of commodity prices are constructed from data published in The Economist, London.

Most other statistics are published initially by the National Statistical Office.

Symbols used

n.a	not available
..	figure less than half the digit shown
-	nil
e	estimate
f	forecast
p	provisional
r	revised
n.i.e	not included elsewhere