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PORT MORESBY

16th June, 2004

1. GLOSSARY OF TERMS AND ACRONYMS

Balance of Payments	A statistical statement that systematically summarises a country's economic transactions with the rest of the world, over a specific time period. It comprises the Current and Capital and Financial Accounts.
Broad Money Supply (M3*)	Total volume of money comprising narrow money (M1*) and quasi money in the economy at a point in time. See narrow and quasi money.
Cash Reserve Requirement (CRR)	A requirement imposed on commercial banks to hold cash as a percentage of total deposits and other prescribed liabilities at all times.
Capital Account	Records all transactions that involves the receipts or capital transfers and acquisitions/disposal of non-produced, non-financial assets such as purchase of production facilities, i.e. plants and machinery, etc.
Current Transfers Account	This account records all 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 measure¹	This involves zero weighting of volatile sub-groups or items such as fruit & vegetables, betelnut, and prices which are largely determined by non-market (seasonal) forces, as well as alcoholic drinks, cigarettes & tobacco, etc.
Financial Account	Records all transactions associated with changes of ownership in the foreign financial assets such as holdings of monetary gold, special drawing rights (SDR), claims on non-residents and liabilities of an economy.
Headline Consumer Price Index (CPI)	A measure of inflation as calculated and published quarterly by the National Statistical Office (NSO). See 'Underlying CPI'.
Income Account	Records transactions such as compensation of employees, which covers wages, salaries, and other benefits in cash and kind, dividends and interest earned on investments.
Inscribed Stock	A Government bond or debt instrument sold to the public for a maturity term of one year or longer for the purpose of Budget financing. A coupon is paid six-monthly.
Kina Facility Rate (KFR)	Official benchmark rate used by the Bank of Papua New Guinea to signal its monetary policy stance. The KFR is announced monthly by the Governor and published in the newspapers and on the Bank's website.
Liquid Assets	Assets of the commercial banks, which are near liquid form, comprising cash, ESA balances, Treasury bills and Inscribed stocks less than 3 years to maturity.
Minimum Liquid Asset Ratio (MLAR)	A prudential requirement imposed by the Central Bank on commercial banks to hold liquid assets as a percentage of total deposits and other prescribed liabilities at all times.

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

Monetary Base	Comprised of currency held by the public and liquidity assets of the commercial banks, including deposits held with the Central Bank under the Repurchase Agreement Facility (Repo).
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, Kina Facility, Repo 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 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 (Repo)	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 7 days. Transaction can be collateralised or unsecured.
Reserve Money	A measure of money, which includes currency holdings of commercial banks and their deposits at the Central Bank.
Tap	A facility conducted by the Central Bank for sale of Treasury bills and Inscribed Stocks to the public.
Temporary Advance Facility	A statutory mechanism stipulated under Section 54 of the Central Banking Act 2000, that provides the National Government with access to short-term financing to meet mismatches in revenue.
Trade Account	Records all economic transactions associated with merchandise exports and imports of physical goods. A surplus means that exports have exceeded imports, while the reverse will result in a deficit.
Treasury bill	Government security or debt instrument sold at a discount value, but redeemed at face value on maturity for purposes of Budget financing. In PNG, treasury bills are issued for 28,61,91 and 182 day maturities.
Trimmed-mean CPI measure¹	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.
Underlying CPI	A measure of inflation that excludes short-term volatile movements in prices, such as seasonal factors (prices of fruit, vegetables and betelnut), Government policy decisions (tax system reforms, etc.) and price controlled items. The exclusion-based and trimmed-mean CPI measures are both underlying CPI measures.

2. GENERAL OVERVIEW

Major economic indicators available to the Bank of PNG, reaffirmed the positive growth in economic activity estimated for 2003. Both employment and nominal sales in the formal private sector in 2003 showed increases, and provided support for the improvements experienced in the export sector during the year. This trend continued into the March quarter of 2004, with improved outcomes in the Government's fiscal operations, balance of payments, inflation and sustained stability in the exchange rate.

The Bank's Business Liaison Survey (BLS) results show that domestic economic activity in the private sector, excluding the North Solomons province (NSP), continued to show positive growth in 2003, compared to 2002. The total nominal value of sales increased by 9.3 percent in 2003, compared to an increase of 21.9 percent in 2002, with increases in all sectors except the retail sector and in all regions except the Highlands region.

Latest data from the Bank's Quarterly Employment Survey indicates that the level of employment in the formal private sector, excluding mining and petroleum and the NSP, grew by 6.4 percent over the year to December 2003, compared to an increase of 2.9 percent in the corresponding period in 2002. There were increases in all sectors except the other business services sector, and in all regions except the National Capital District (NCD) and Southern regions.

The headline inflation rate as measured by the Consumer Price Index (CPI) was 1.4 percent in the March quarter of 2004, compared to 0.4 percent in the December quarter of 2003. The higher rate was due to increased prices for the 'Drinks, tobacco, betelnut', 'Rents, council charges, fuel and power' and 'Miscellaneous' expenditure groups. By urban areas, all surveyed centres recorded increases, except for Lae and Rabaul. The annual headline inflation rate was 2.9 percent in the March quarter of 2004, compared to 20.7 percent in the corresponding quarter of 2003.

The underlying exclusion-based and trimmed-mean inflation measures were 0.9 and 0.4 percent, respectively, in the March quarter of 2004. No change was recorded for both measures from the previous quarter. The trimmed-mean measure was slightly lower than the exclusion-based measure due to the exclusion of

soft drinks and school fee subsidies. The annual exclusion-based and trimmed-mean measures were 5.3 percent and 1.6 percent respectively, in the March quarter of 2004, compared to 21.1 percent and 18.4 percent, in the corresponding period in 2003.

Movements in the daily nominal kina exchange rate were mixed in the March quarter of 2004. The kina appreciated against the US dollar and Japanese yen by 2.4 percent and 0.2 percent, respectively. The appreciation against the US dollar reflected favourable inflows by the petroleum and agricultural sectors. The kina depreciated against the British pound sterling, the Australian dollar and the euro by 6.5 percent, 7.0 percent and 4.0 percent, respectively. The decline was due to movements in cross-rates between the US dollar and the other countries reflecting the strong growth of the US economy and concerns over the widening US current account deficit.

Higher international prices for mineral exports and most of Papua New Guinea's agricultural export commodities resulted in a 2.0 percent increase in the weighted average kina prices in the March quarter of 2004, compared to the corresponding quarter of 2003. There was an increase of 5.1 percent in the weighted average kina price of mineral exports, with higher prices of gold and copper. Despite the increase in international prices for agricultural, marine and forestry product exports, the weighted average kina price declined by 8.8 percent, due to the appreciation of the kina against the US dollar in the March quarter of 2004, compared to the corresponding period in 2003.

In the March quarter of 2004, there was an overall deficit of K64 million in the balance of payments, compared to a deficit of K156 million in the corresponding period of 2003. The lower deficit resulted from an improvement in the capital and financial account, combined with a surplus in the current account.

The surplus in the trade account was K955 million in the March quarter of 2004, unchanged from the corresponding quarter of 2003. This outcome was due to a combined decline in the value of merchandise exports and the value of merchandise imports. Both the services and income accounts recorded higher deficits, while the surplus in the transfers account was higher than the respective levels in the March quarter of 2003.

As a result of the worsening deficits in the services and income accounts, the surplus in the current account

was reduced significantly to K120 million in the March quarter of 2004, compared to a surplus of K407 million in the corresponding period of 2003.

The financial account recorded a significantly lower net outflow of K262 million in the March quarter of 2004, compared to a net outflow of K537 million in the corresponding quarter of 2003. The improvement reflected increased equity inflow from direct investments combined with increased draw down of short term money market instruments, by the mineral companies. This more than offset increased loan repayments by the Government and resident mineral companies. The capital account recorded no transactions during the March quarter of 2004, relative to the corresponding quarter of 2003.

The level of gross foreign exchange reserves at the end of the March quarter of 2004 was K1,667.6 (US\$515.7) million, sufficient for 5.1 months of total and 6.9 months of non-mineral import covers.

The Bank of PNG continued to ease its monetary policy stance during the first quarter of 2004 by reducing the Kina Facility Rate (KFR) to 12.0 percent in March 2004, from 14.0 percent in December 2003. In addition, the Repurchase Agreement Facility (RAF) dealing margins were increased to 200 basis points in January and later to 300 basis points in March 2004, on both the buy and sell sides from the KFR. As a result, domestic interest rates including Treasury bills, Indicator Lending Rates (ILRs) and wholesale deposit rates all declined.

Given the high liquidity levels in the banking system resulting mainly from increased foreign exchange inflows, the Bank utilised Treasury bills and RAF to diffuse some of the excess liquidity. As a result, activity in the inter-bank market was subdued.

The average level of broad money supply (M3*) increased by 7.2 percent in the first quarter of 2004, compared to a revised increase of 3.6 percent in the December quarter of 2003. The growth resulted from increases in average net foreign assets of the banking system of 17.4 percent and net credit to the Government of 3.7 percent. The average level of broad monetary base grew by 5.1 percent over the first quarter of 2004, compared to an increase of 8.6 percent in the December quarter of 2003. The increase re-

flected higher average level of liquid assets held by commercial banks.

Total domestic credit extended by the commercial banks to the private sector, official entities and the non-monetary financial institutions decreased by K15.0 million to K1,482.1 million. This compares with an increase of K16.5 million during the corresponding quarter of 2003. Lending to the private sector and official entities decreased by K6.8 million and K9.0 million respectively, while lending to non-monetary financial institutions increased by K0.8 million. The decline in lending to the private sector was due to net repayments by the commerce sector, particularly retail trade, transport and communication sector and other businesses. Large loan repayments by the public enterprises accounted for the decline in credit to official entities. The annualised decline in domestic credit, excluding the Central Government and advances under the Government's Agricultural export commodity price support schemes, was 4.1 percent in the first quarter of 2004.

Preliminary estimates of the fiscal operations of the National Government to March 2004 showed an overall surplus of K13.8 million, compared to a surplus of K25.4 million in the corresponding period of 2003, and represents 0.1 percent of nominal GDP. The lower surplus was due to a decline in revenue, combined with an increase in expenditure.

Total revenue, including grants was K573.6 million in the March quarter of 2004, 1.1 percent lower than the receipts collected in the corresponding period of 2003, and represents 15.0 percent of the budgeted revenue. The decline was due to lower non-tax revenue, which more than offset an increase in tax revenue. Total expenditure over the three months to March 2004 was K559.8 million, 0.9 percent higher than in the corresponding period in 2003, and represents 13.9 percent of the budgeted expenditure for 2004. The increase was due to higher recurrent expenditure.

The budget surplus combined with a net domestic borrowing of K108.7 million was used to finance net overseas loan repayment of K122.5 million. Domestic financing was mainly sourced from the non-banking system and commercial banks through increased holding of Treasury bills.

3. INTERNATIONAL DEVELOPMENTS

World economic growth, as measured by real Gross Domestic Product (GDP) is projected to increase in 2004. The latest International Monetary Fund (IMF) forecast made in April 2004 was for a growth of 4.6 percent, compared to 4.1 percent made in September 2003. The improved outlook was influenced by rapid growth in the United States (US) and Asia, especially China. With the exception of the Euro Area, improvements in global economies have placed significant price pressures on international commodity prices, whilst major currencies continued to be influenced by the appreciation of the US dollar. In addition, the announced cuts in production by the Oil and Petroleum Exporting Countries (OPEC) has led to increased oil and petrol prices in the early months of 2004. In Japan the outlook for 2004 is positive, however deflation remains a concern with stronger appeal for banking and corporate sector reforms. The Euro Area continued to struggle with three of its largest countries facing higher budget deficits. Other emerging markets and developing countries are expected to grow by 6.0 percent in 2004. This is due to a projected real GDP growth of 7.4 percent in the developing Asia region, of which China and India are expected to grow by 8.5 and 6.8 percent, respectively. The growth in these countries is mainly due to the expansion in the technological and communications sectors.

In the US, real GDP grew by 4.9 percent over the year to March 2004, compared to an increase of 2.1 percent over the year to March 2003. The latest IMF forecast is for a growth of 4.0 percent in 2004.

Industrial production increased by 3.4 percent over the year to March 2004, compared to a decline of 0.5 percent over the year to March 2003 with improvement in all sectors of the economy. Domestic and foreign demand has led to an increase in factory orders of 4.3 percent in March for machines, electronics and petrol, the biggest increase since July 2002. The Institute for Supply Management's (ISM) manufacturing activity index for March was 62.5 percent, compared to 63.4 percent in December 2003, above the 50 percent level and reflected the expansion in the industry. Retail sales grew strongly by 9.2 percent over the year to March 2004, compared to an increase of 4.6 percent over the year to March 2003. The increase was due to higher consumer spending mainly reflecting tax refunds. The unemployment rate was 5.7 percent in

March 2004, compared to 5.8 percent in March 2003.

Consumer prices increased by 1.7 percent over the year to March 2004, compared to an increase of 3.0 percent over the year to March 2003. The increase mainly reflected higher energy prices. Broad money supply increased by 4.5 percent over the year to March 2004, compared to an increase of 6.4 percent over the year to March 2003. Given the above developments, especially with core inflation remaining relatively low, the Federal Reserve Bank maintained the federal funds rate at 1.00 percent in March 2004.

However, the main concern for the US economy was the widening current account deficit, which was US\$560.4 billion over the year to March 2004, compared to US\$514.3 billion over the corresponding period in 2003. This reflected the growing economy's demand for imports and rising oil prices. The deficit has led to a decline in investor confidence, which contributed to the depreciation of the US dollar.

In Japan, real GDP grew by 4.7 percent over the year to March 2004, compared to an increase of 2.7 percent over the year to March 2003. The recovery was led by a strong growth in exports combined with investment with improvements in corporate profits and domestic demand. The latest IMF forecast is for a growth of 2.5 percent in 2004.

Industrial production increased by 8.3 percent over the year to March 2004, compared to an increase of 3.8 percent over the corresponding period of 2003. The strong growth mainly reflected higher international demand for information technology (IT) products and capital goods. Retail sales declined by 2.2 percent over the year to March 2004, compared to a decline of 0.8 percent over the same period in 2003. The unemployment rate was 4.7 percent in March 2004, compared to 5.4 percent in March 2003, its lowest level since March 2001.

Consumer prices decreased by 0.1 percent over the year to March 2004, the same as in the corresponding period in 2003. This was the fifty-fifth monthly decline in consumer prices. The Bank of Japan has been continuously concerned with this rate and whether or not deflation is disappearing. Broad money supply increased by 1.9 percent over the year to March 2004, compared to an increase of 1.8 percent over the year to March 2003. The Bank of Japan continued to pursue its zero interest rate policy until such time that the year

on year change in the CPI reaches zero percent or higher.

The current account surplus was US\$153.2 billion over the year to March 2004, compared to a surplus of US\$109.9 billion over the same period in 2003. This was a record high current account surplus and was influenced by the expansion in exports of electronics, cars and heavy machinery.

In Germany, real GDP grew by 1.5 percent over the year to March 2004, compared to a growth of 0.2 percent over the year to March 2003. The increase was due to higher net exports, which more than offset lower domestic demand. The German economy continued to face difficulties with high wage costs and taxes, and an over-generous welfare system. Compounded with this was the slow growth in jobs since the re-unification of East and West Germany in 1990, and the budget deficits for three consecutive years. The latest IMF forecast is for a growth of 1.4 percent in 2004.

Industrial production decreased by 0.7 percent over the year to March 2004, compared to a decline of 0.4 percent over the year to March 2003. The decline was due to lower than expected domestic demand and slower recovery in exports. Retail sales declined by 0.7 percent over the year to March 2004, compared to a decline of 4.0 percent over the year to March 2003. The marginal improvement in sales indicated growing consumer confidence albeit at a slow pace. The lack of demand was caused in part by the country's high propensity to save. The unemployment rate remained high at 10.4 percent in March 2004, compared to 10.6 percent in March 2003.

Consumer prices increased by 1.1 percent over the year to March 2004, compared to an increase of 1.2 percent over the year to March 2003. The increase was mainly due to a rise in tax on tobacco on 01 March 2004.

The current account surplus was US\$63.3 billion over the year to March 2004, compared to a surplus of US\$48.0 billion over the year to March 2003, reflecting growth in net exports.

In the United Kingdom (UK), real GDP grew by 3.0 percent over the year to March 2004, compared to a growth of 2.3 percent over the year to March 2003. The growth was mainly due to increased private consumption. The latest IMF forecast is for a growth of 3.3

percent in 2004.

Industrial production decreased by 0.6 percent over the year to March 2004, compared to a decrease of 0.8 percent over the year to March 2003. The decline was mainly due to lower output in the manufacturing sector. Retail sales increased by 6.4 percent over the year to March 2004, compared to an increase of 4.3 percent over the corresponding period in 2003. The growth was due to a record volume of sales for non-durable goods since June 2000. The unemployment rate was 4.7 percent in February 2004, compared to 5.1 percent in February 2003. Unemployment continues to decline with average earnings rising, all of which add to the sustainable growth in the UK.

Consumer prices increased by 1.1 percent over the year to March 2004, compared to an increase of 1.6 percent over the year to March 2003. The increase reflected higher prices for recreational activities. Broad money supply increased by 7.7 percent over the year to March 2004, compared to an increase of 7.2 percent over the year to March 2003 with the Bank of England maintaining the repo rate at 4.0 percent in March 2004.

The trade deficit was US\$83.3 billion over the year to March 2004, compared to a deficit of US\$56.8 billion over the year to March 2003. Despite an appreciation of the pound sterling against the US dollar, the deficit reflected higher prices of European imports, which more than offset an increase in exports.

In Australia, real GDP increased by 4.0 percent over the year to December 2003, compared to an increase of 3.0 percent in the corresponding period of 2002. The latest IMF forecast is for a growth of 3.0 percent in 2004.

Industrial production decreased by 0.9 percent over the year to December 2003, compared to an increase of 2.3 percent over the corresponding period of 2002. The slowdown is attributed to low business margins, the rising Australian dollar and lack of pricing power, which meant that Australian exports became expensive when compared with low cost goods from countries like China. The decline in Australian exports more than offset higher domestic demand. Retail sales increased by 7.7 percent over the year to March 2004, compared to an increase of 4.0 percent over the year to March 2003. The increase was due to strong business activity in hotels and restaurants, and demand for recreational and household goods. Although high, it also reflected

a lower outcome compared to annual sales in 2003, due to the effect of interest rate hikes in 2003. The unemployment rate was 5.6 percent in March 2004, compared to 6.2 percent in March 2003. This rate was the lowest in 14 years and reflected the high economic growth, reflecting high production and export of coal, copper and steel to overseas markets.

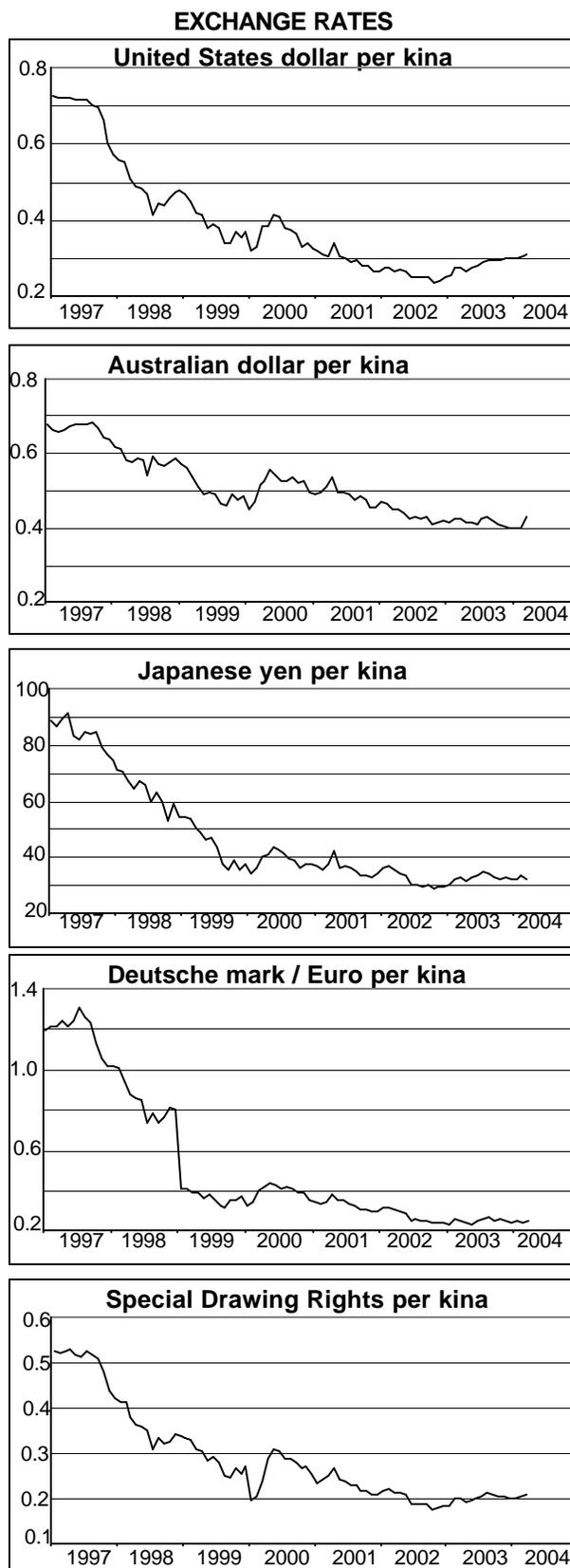
Consumer prices increased by 2.0 percent over the year to March 2004, compared to an increase of 3.4 percent over the year to March 2003. The increase was at the lowest band of the target range and reflected higher prices in housing, food, automotive fuel, education and other seasonal effects. Broad money supply grew by 13.9 percent over the year to March 2004, compared to an increase of 10.6 percent over the year to March 2003. With the improvement in both the world and domestic economy, the Reserve Bank of Australia kept the cash rate unchanged from December 2003 at 5.25 percent.

The trade deficit was US\$17.0 billion over the year to March 2004, compared to a deficit of US\$7.8 billion over the corresponding period in 2003. The result was due to lower exports and higher imports over the period. Rural exports performed badly after the drought in 2003, while the strong domestic economy led to a rise in imports.

In January, the annual World Economic Forum was held in Davos, Switzerland. Business executives, politicians, academics and campaigners, amongst others, met to discuss topics ranging from global terrorism and corruption. Concerns were raised regarding the future of the global economy, especially with the break-down in global trade talks, a weak US dollar and escalating budget deficits in the major industrialised countries.

In February, finance ministers and central bank governors of the group of seven (G-7) major industrialised countries met at Boca Raton, USA. They discussed the improved outlook for the global economy in 2004 with the main concern being the impact of the higher oil prices. The delegates reiterated the need for stricter policies to reduce external shocks, and for countries to be more flexible in reducing the impact of volatile exchange rate movements. Despite the talks, the US dollar continued to fall against all major currencies, reaching a 11 year low against the pound sterling.

Also in February, the OPEC announced cuts in oil



production to be effective in April 2004. The cuts were aimed at boosting oil prices in spring, when the demand for oil in its largest markets would begin to fall. The OPEC decision pushed oil prices higher with the Nymex crude, the US benchmark price, increasing by 72 cents to US\$33.55 a barrel.

During the March quarter of 2004, all major currencies continued to appreciate against the US dollar due to growing concerns over the widening US current account deficit. The US dollar depreciated against the Japanese yen, the British pound sterling, the euro and Australian dollar. Overall performance of exchange rates saw the pound sterling increasing to US\$1.90 against the US dollar for the first time since 1992. The pound reached a year high against the euro and a five-year high against the yen. High interest rate differentials were the main reason behind the gains in the pound.

Movements in the daily nominal kina exchange rate were mixed in the March quarter of 2004. The kina appreciated against the US dollar and Japanese yen by 2.4 percent and 0.2 percent, respectively. The kina depreciated against the pound sterling, the Australian dollar and the euro by 6.5 percent, 7.0 percent and 4.0 percent, respectively. The appreciation against the US dollar reflected favourable inflows by the petroleum and agricultural sectors. The decline was due to movements in cross-rates between the US dollar and the other currencies, reflecting strong growth in the US economy and concerns over the widening US current account deficit.

4. THE DOMESTIC ECONOMY

DOMESTIC ECONOMIC CONDITIONS

Information obtained from the Bank of Papua New Guinea's business liaison survey in conjunction with other economic indicators available to the Bank provided further support for the estimated positive growth in business activity in the private sector, excluding mining and petroleum and the NSP in 2003, compared to 2002. The total nominal value of sales increased by 9.3 percent in 2003, compared to 21.3 percent in 2002, with higher sales in all sectors except the retail sector. The nominal value of stock levels decreased by 1.8 percent in 2003. Although the Bank has started to

cover the NSP, it is not included for comparison purposes due to data limitations.

The nominal value of sales by the agriculture/forestry/fisheries sector increased by 18.5 percent in 2003, compared to 2002. The increase was due to higher production and export of agricultural commodities including coffee, cocoa, palm oil and vanilla beans. The international prices for most agricultural commodities increased but these were partially offset by the appreciation of the kina against the US dollar. The increase in volume and shipment of logs also contributed to the growth in the sector.

The nominal value of sales by the retail sector decreased by 6.4 percent, while in the wholesale sector, it increased by 11.1 percent in 2003, compared to increases of 4.5 percent and 43.1 percent respectively, in 2002. In the retail sector, the decline was in all regions except the Islands and Highlands regions, and was attributed to the closure of several retail outlets due to lower demand and increased competition by some new retailers. In the wholesale sector, increased sales in the NCD, Highlands, Southern, Morobe and Momase regions reflected higher prices and export volume of processed copra, cocoa and vanilla beans.

The nominal value of sales by the manufacturing sector, increased by 10.2 percent in 2003, compared to an increase of 23.3 percent in 2002. The increase reflected the production and export of canned mackerel and tuna, demand for cereals, higher price and production of soft drinks and sale of clothing and miscellaneous items.

The nominal value of sales by the transportation sector increased by 14.3 percent in 2003, compared to an increase of 24.7 percent in 2002. The increase was associated with the sea transportation of agricultural commodities for exports, combined with the demand for passenger travel and cargo haulage, and charter of third level airlines by mining companies for exploration and employee's travel during the vacation period.

The nominal value of sales by the building and construction sector increased by 15.6 percent in 2003, compared to an increase of 54.3 percent in 2002. The increase was associated with several on-going projects in the country, including the construction of new buildings for a university campus, renovation and maintenance of roads and buildings, extension and sealing of the Kokopo to Rabaul road and the construc-

tion of new bridges.

National Capital District

The nominal value of sales by the private sector, excluding quarrying, in the NCD increased by 11.8 percent in 2003, compared to an increase of 21.9 percent in 2002. The increase was associated with a general increase in prices, while business activity was subdued during the year.

Southern Region

The nominal value of sales in the Southern region increased by 4.2 percent in 2003, compared to a decline of 0.5 percent in 2002. The increase was associated with spin-off activities from mining and logging operations and higher stevedoring activities. Higher production and export of palm oil also contributed to the increase.

Highlands Region

The nominal value of sales in the Highlands region decreased by 9.0 percent in 2003, compared to an increase of 11.7 percent in 2002. The decline was attributed to reduced incomes from coffee, combined with increased law and order problems and the bad road conditions of some parts of the Highlands Highway, which affected the delivery of goods to and from Lae. Despite the high production and export of coffee, the kina receipts from exports were low as a result of the appreciation of the kina against the US dollar. This affected producer prices and resulted in lower income to smallholder producers as well as large companies.

Morobe Region

The nominal value of sales in the Morobe region increased by 13.5 percent in 2003, compared to an increase of 18.5 percent in 2002. The increase was due to higher sales by all sectors, except the agriculture sector. The growth reflected higher sale of soft drinks as a result of increased promotional activities and demand for food and clothing items. Higher volume of cargo haulage and stevedoring activities accounted for the increase in the transportation sector.

Momase Region

The nominal value of sales in the Momase region increased by 5.5 percent in 2003, compared to an

increase of 23.4 percent in 2002, with higher sales in all sectors. The increase was associated with the production of vanilla, production and shipment of canned and fresh tuna to overseas markets, and the expansion of logging operations.

Islands Region

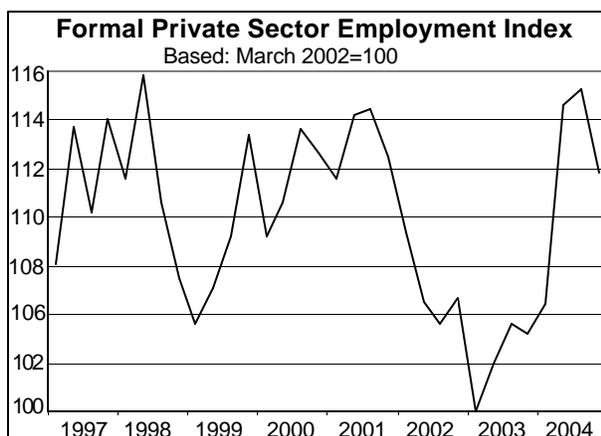
The nominal value of sales in the Islands region increased by 12.1 percent in 2003, compared to an increase of 40.2 percent in 2002, with higher sales in all sectors except the retail sector. The increase was attributed to higher prices and volume of copra and palm oil exports. There were also major construction projects including the expansion and sealing of the Kokopo to Rabaul road, and the maintenance and construction of school buildings.

EMPLOYMENT

According to the Bank's employment index, the level of employment in the formal private sector, excluding mining and petroleum, increased by 6.4 percent over the year to December 2003 (December 2003 quarter on December 2002 quarter), compared to the corresponding period in 2002. The growth reflected higher employment levels in all sectors except the finance and other services sector. Employment increased in all regions except the National Capital District and Southern regions.

In the retail and wholesale sectors, employment increased by 7.2 percent and 19.8 percent respectively, over the year to December 2003, compared to the corresponding period in 2002. In the retail sector, the increase reflected the opening of three new shops by a retailer, and higher casual employment by several hardware, electrical and general merchandise companies. In the wholesale sector, the increase was due to the expansion of operations by a company in the Highlands region, higher employment in the general merchandise sub-sector, and by copra and cocoa processors and exporters.

In the manufacturing sector, employment increased by 5.3 percent over the year to December 2003, compared to the same period in 2002. The increase was due to higher employment by manufacturers of food and beverage, including canned meat and fish, soft drinks, fresh meat and chicken as a result of increased production. There was also increased promotional and distributional activities for these products.



In the building and construction sector, employment increased by 23.0 percent over the year to December 2003, compared to the corresponding period in 2002. The increase was associated with the construction of the Tuna loining factory in the Momase region, and the maintenance of feeder roads, maintenance and construction of school buildings and hospitals, and the Kokopo to Rabaul road project in the Islands region.

In the transportation sector, employment increased by 2.8 percent over the year to December 2003, compared to the same period in 2002. The increase was due to the employment of casual staff to carry cargoes at the wharves as a result of higher stevedoring activity. Higher employment in the air transportation sub-sector was due to the recruitment of administration and engineering staff by a third level airline, while the recruitment of trainee and casual staff by several hire car companies also contributed to the increase.

In the agriculture/forestry/fisheries sector, employment increased by 8.7 percent over the year to December 2003, compared to the corresponding period in 2002. The increase was associated with the recruitment of sales and promotional staff by a poultry and chicken processor, the expansion of logging operations, demand for fishermen by the fishing companies, and higher employment of casual staff by the palm oil, cocoa and copra plantations, and the vanilla sector.

In the other business services sector (which includes real estate, hotel and restaurants, finance and security services), employment decreased by 2.0 percent over the year to December 2003, compared to the corresponding period in 2002. The decline reflected the termination and laying-off of security staff by the security firms, due to the expiry and loss of contracts

to other firms and reduction in casual staff by real estate agents, hotels and restaurants.

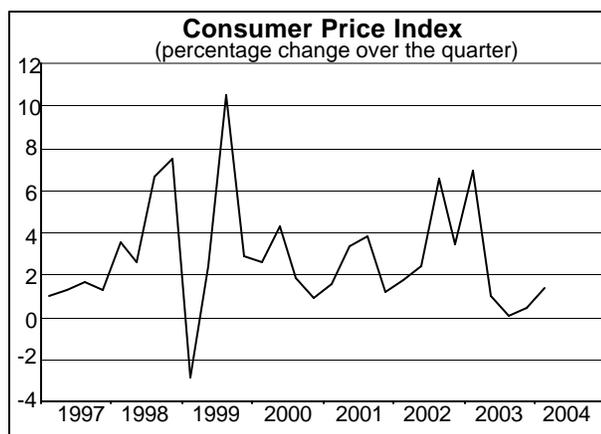
In the mining/quarrying/petroleum sector, employment decreased by 0.7 percent over the year to December 2003, compared to the corresponding period in 2002. The decline was due to lower employment by the mining and petroleum sub-sectors which partly reflected lower oil reserves and the scaling down of operations in a gold mine.

By region, employment increased in all regions except the NCD and Southern regions. In the Highlands region, employment increased by 21.1 percent over the year to December 2003, compared to the corresponding period in 2002. The increase was due to higher employment by the coffee and tea plantations, as well as for poultry farming, animal husbandry and the construction of bridges and maintenance of feeder roads. The processing of timber for building construction and furniture-making by a number of companies, and the expansion of operations by a general merchandise wholesale company also contributed to the increase.

In the Morobe region, employment increased by 14.7 percent over the year to December 2003, compared to the corresponding period in 2002. The increase was due to higher employment by the food and beverage manufacturers, including for production and more aggressive distribution and promotional activities, combined with casual employment due to increased shipment and haulage of general cargoes to and from the wharves.

In the Momase region, employment increased by 1.9 percent over the year to December 2003, compared to the same period in 2002. The growth reflected higher employment by the fisheries sub-sector, associated with increased production and export of fresh and canned tuna, and in logging operations and the cocoa and coconut plantations.

In the Islands region, employment increased by 12.9 percent over the year to December 2003, compared to the corresponding period in 2002. Higher employment levels were recorded in the agriculture sub-sector, including palm oil, copra and cocoa. The increase also reflected higher casual employment in the retail and wholesale sectors, as well as in the construction sector reflecting the maintenance and construction of school buildings and the Kokopo to Rabaul road.



school buildings and the Kokopo to Rabaul road.

In the NCD region, employment decreased by 0.9 percent over the year to December 2003, compared to the corresponding period in 2002. The decline reflected the laying-off of staff by several retail and wholesale companies, especially security staff, and by some construction companies due to the completion of major building and construction projects in Port Moresby.

In the Southern region, employment declined by 1.6 percent over the year to December 2003, compared to the corresponding period in 2002. The decline was due to the laying-off of casual staff by the palm oil plantations, lower logging activity due to wet weather conditions, the closure of a couple of retail outlets and the scaling down of operations by a hardware retailer.

CONSUMER PRICE INDEX

The headline inflation as measured by the Consumer Price Index (CPI) was 1.4 percent for the March quarter of 2004, compared to 0.4 percent in the December quarter of 2003. The increase was mainly due to higher prices in the 'Drinks, tobacco and betelnut', 'Rents, council charges, fuel and power' and 'Miscellaneous' expenditure groups. All surveyed urban areas recorded increases in the March quarter of 2004, except Lae and Rabaul. The annual inflation was 2.9 percent in the March quarter of 2004, compared to 20.7 percent in the corresponding quarter of 2003.

The CPI for the 'Food' expenditure group increased by 0.2 percent in the March quarter of 2004 due to higher prices of cereals, fruits and vegetables. For the 'Drinks, tobacco and betelnut' expenditure group, the CPI

increased by 3.0 percent and reflected higher prices of soft drinks, alcoholic drinks and betelnut and contributed 0.6 percentage points to the movement in the index. The CPI for the 'Clothing and footwear' group increased marginally by 0.1 percent due to higher prices of men's clothing and footwear. For the 'Miscellaneous' expenditure group, the CPI increased by 14.5 percent due to substantial increases in school fees for 2004 and contributed 1.1 percentage points to the movement in the index. The 'Rents, council charges, fuel and power' expenditure group increased by 3.6 percent attributed to higher kerosene prices in the fuel and power sub-group and contributed 0.3 percentage points to the overall movement.

The CPI for the 'Transport and communication' expenditure group decreased by 0.3 percent in the March quarter of 2004, reflecting lower prices for motor vehicles. The CPI for the 'Household equipment and operation' expenditure group decreased by 1.9 percent, due to lower prices for the durable, semi-durable and non-durable goods sub-groups.

By urban centres, Goroka recorded the highest increase with 3.1 percent followed by Port Moresby with 2.8 percent and Madang with 2.0 percent. Lae and Rabaul recorded declines in the CPI of 1.1 percent and 1.7 percent, respectively.

The underlying exclusion-based and trimmed-mean measures of inflation were 0.9 percent and 0.4 percent, respectively, in the March quarter of 2004. This compares with no changes recorded for both measures in the previous quarter. The trimmed-mean measure was slightly lower than the exclusion-based measure due to the exclusion of soft drinks and school fee subsidies. The annual exclusion-based and trimmed-mean inflation measures were 5.3 percent and 1.6 percent respectively, in the March quarter of 2004, compared to 21.1 percent and 18.4 percent in the corresponding period in 2003.

5. EXPORT COMMODITIES REVIEW

The total value of merchandise exports in the March quarter of 2004 was K1,946 million, 4.5 percent lower than in the corresponding quarter of 2003. Declines in export values were recorded for copper, crude oil, coffee, cocoa, copra oil, rubber, forestry and marine product exports, while there were increases in the

values of gold, palm oil, copra, tea and other non-mineral exports. Mineral export receipts, excluding crude oil were K1,103.6 million and accounted for 56.7 percent of total merchandise exports in the March quarter of 2004, compared to 54.9 percent in the corresponding quarter of 2003. Crude oil exports totalled K352.0 million and accounted for 18.1 percent of total merchandise exports in the March quarter of 2004, compared to 23.2 percent in the corresponding quarter of 2003.

The value of agricultural and marine products, excluding forestry product exports was K402.3 million and accounted for 20.7 percent of total merchandise exports in the March quarter of 2004, compared to 15.9 percent in the corresponding quarter of 2003. Forestry product exports were K88.1 million and accounted for 4.5 percent of total merchandise exports in the March quarter of 2004, compared to 6.0 percent in the corresponding quarter of 2003.

The weighted average price of Papua New Guinea's exports increased by 2.0 percent in the March quarter of 2004, compared to the corresponding quarter of 2003. There was a 5.1 percent increase in the weighted average price of mineral exports, with higher kina prices of gold and copper. For the agricultural, forestry and marine product exports, the weighted average price declined by 8.8 percent and was associated with lower kina prices of all agricultural and log exports with the exception of copra, copra oil and rubber exports. The lower export prices reflected the appreciation of the kina against the US dollar as international commodity prices increased in the March quarter of 2004, except for cocoa. Excluding logs, the weighted average price of agricultural and marine product exports declined by 7.5 percent in the March quarter of 2004, compared to the corresponding period of 2003.

Mineral Exports

Total mineral export receipts were K1,455.6 million in the March quarter of 2004, compared to K1,591.5 million in the corresponding quarter of 2003. The decline was due to lower export volumes of all mineral exports, which more than offset increases in the export prices of gold and copper.

Gold export volumes during the March quarter of 2004 were 16.5 tonne, a decline of 3.5 percent from the corresponding quarter of 2003. The decline reflected

lower production and shipment by all the mines. The average free on board (f.o.b.) price received for PNG's gold exports was K43.4 million per tonne during the March quarter of 2004, 3.5 percent higher than in the corresponding period of 2003, due to increased international prices. The average gold price at the London Metal Exchange increased by 15.3 percent to US\$407 per fine ounce in the March quarter of 2004, compared to the corresponding quarter of 2003. The increase was due to higher demand from Asia and North America, as investors considered gold-based investments a safe haven after continued lower performance in the equity markets, combined with uncertainties surrounding the on-going conflict in Iraq. The higher export price and lower export volume resulted in a marginal increase in gold export receipts to K716.8 million in the March quarter of 2004, compared to the corresponding quarter of 2003.

Copper export volumes in the March quarter of 2004 were 46.3 thousand tonnes, a decline of 28.2 percent from the corresponding quarter of 2003. The decline was due to reduced shipment of copper ore as a result of lower water levels at the Fly river, combined with lower production. The average f.o.b. price of PNG's copper exports was K8,132 per tonne in the March quarter of 2004, an increase of 34.3 percent from the corresponding quarter of 2003, due to higher international prices. The higher international prices reflected lower stock levels at the London Metal Exchange, combined with increased demand from Asia, one of the major copper consuming region. The lower export volume more than offset the increase in export prices and resulted in an export value of K376.5 million in the March quarter of 2004, a decrease of 3.6 percent from the corresponding quarter of 2003.

Crude oil export volumes in the March quarter of 2004 were 3,267.8 thousand barrels, a decline of 12.8 percent from the corresponding quarter of 2003. The decline reflected lower extraction rates from oil wells at the Kutubu, Gobe Main and South East Gobe projects attributed to the natural decline in reserve levels. The average export price of crude oil was K108 per barrel in the March quarter of 2004, a decline of 14.3 percent from the corresponding quarter of 2003 due mainly to the appreciation of the kina against the US dollar, as international prices increased. Higher international prices resulted from the decision by the OPEC to cut production, uncertainties with the US-led intervention in Iraq, lower oil stocks in North America and the rise in demand from Asia, particularly from China. The

combined decline in the export price and volume resulted in an export value of K352.0 million in the March quarter of 2004, a decline of 25.5 percent from the corresponding quarter of 2003.

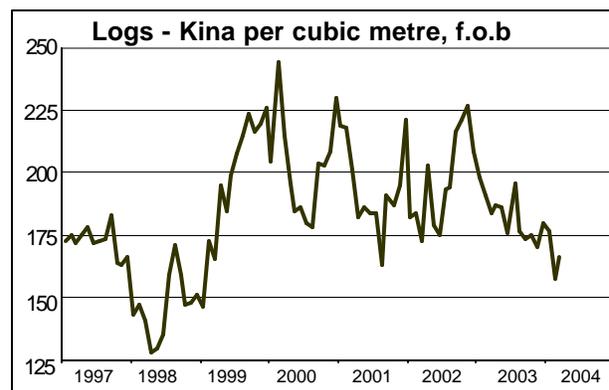
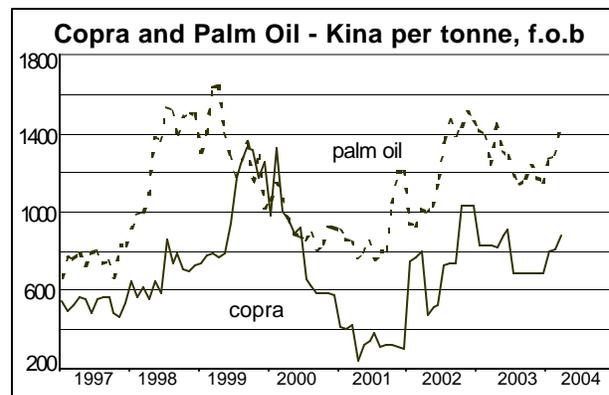
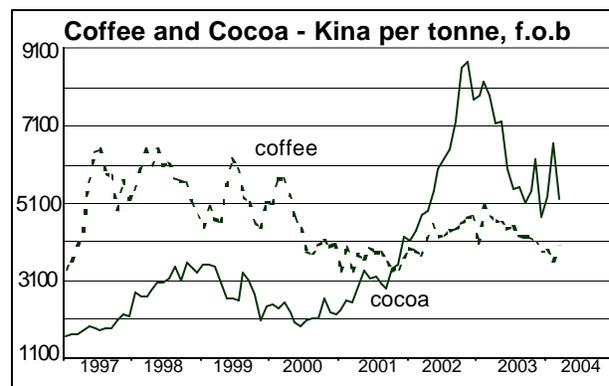
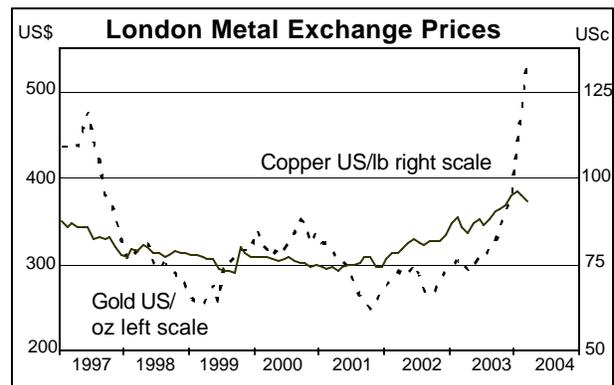
Agriculture, Logs and Fisheries Exports

Export prices of most agricultural commodities declined in the March quarter of 2004, compared to the corresponding quarter of 2003. Coffee prices declined by 17.2 percent, cocoa by 24.2 percent, palm oil by 4.9 percent and tea by 6.0 percent. The average export price of logs was K166 per cubic meter in the March quarter of 2004, a decline of 13.5 percent from the corresponding quarter of 2003.

The volume of coffee exported in the March quarter of 2004 was 8,200 tonnes, an increase of 3.8 percent from the corresponding quarter of 2003. This was due to higher production as a result of favourable weather conditions. The average export price of coffee was K3,805 per tonne in the March quarter of 2004, a decline of 17.2 percent from the corresponding quarter of 2003. The decline was mainly due to the appreciation of the kina against the US dollar, as international prices increased. Higher international prices were attributed to increased demand resulting from unfavourable weather conditions in Brazil, which affected the world supply of coffee. The decline in export price more than offset the increase in export volume, resulting in an export value of K31.2 million in the March quarter of 2004, a decline of 14.0 percent from the corresponding period of 2003.

The volume of cocoa exported in the March quarter of 2004 was 10,400 tonnes, an increase of 28.4 percent from the corresponding quarter of 2003. This was attributed to higher production as a result of favourable weather conditions in the major cocoa producing regions. The average export price of cocoa was K6,029 per tonne in the March quarter of 2004, a decline of 24.2 percent from the corresponding period of 2003. This was due to lower international prices, resulting from higher supply in the world market following increased production from the Ivory Coast, as well as from other major cocoa producing countries in Asia and Latin America. The decline in export price more than offset the increase in export volume, resulting in an export value of K62.7 million in the March quarter of 2004, a decline of 2.6 percent from the corresponding period of 2003.

EXPORT COMMODITY PRICES



The volume of copra exported in the March quarter of 2004 was 4,900 tonnes, a significant increase of 157.9 percent from the corresponding quarter of 2003. The increase was due to higher production from the major producing regions, attributed to an increase in export licenses issued to copra exporters by the Kokonas Industri Koporasan (KIK). The average export price of copra was K857 per tonne in the March quarter of 2004, an increase of 1.8 percent from the corresponding quarter of 2003, due to higher international prices. The increase in international prices resulted from lower supply in the world market, reflecting reduced production from the Philippines and Indonesia, the world's major copra producers. This was supported by higher demand as prices of other edible oils increased in the world market. The higher export price and volume resulted in an export value of K4.2 million in the March quarter of 2004, a significant increase of 162.5 percent from the corresponding period of 2003.

The volume of copra oil exported in the March quarter of 2004 was 7,600 tonnes, a decline of 18.3 percent from the corresponding period of 2003. The decline reflected lower quantities of copra sold to the two domestic copra mills for processing. The average export price of copra oil was K1,829 per tonne in the March quarter of 2004, an increase of 5.7 percent from the corresponding period of 2003. The increase was attributed to higher international prices as a result of declining copra production from the Philippines and Indonesia, two of the world's major copra producers. This was supported by higher demand for copra oil, as international prices of other edible oils increased. The decline in export volume more than offset the increase in export price, resulting in an export value of K13.9 million in the March quarter of 2004, a decline of 13.7 percent from the corresponding period of 2003.

The volume of palm oil exported in the March quarter of 2004 was 101,100 tonnes, an increase of 6.6 percent from the corresponding period of 2003. This was due to higher production, attributed to favourable weather conditions in the palm oil producing regions. The average export price of palm oil was K1,342 per tonne in the March quarter of 2004, a decline of 4.9 percent from the corresponding quarter of 2003. The decline was attributed to the appreciation of the kina against the US dollar as international prices increased, due to higher demand for palm oil as the international prices of other edible oils increased. The higher export volume more than offset the decline in export price and

resulted in an export value of K135.7 million in the March quarter of 2004, an increase of 1.4 percent from the corresponding period of 2003.

The volume of tea exported in the March quarter of 2004 was 2,300 tonnes, an increase of 21.1 percent from the corresponding quarter of 2003. This was due to higher production as a result of favourable weather conditions. The average export price of tea was K2,870 per tonne in the March quarter of 2004, a decline of 6.0 percent from the corresponding period of 2003. The higher export volume more than offset the decline in export price and resulted in an export value of K6.6 million in the March quarter of 2004, an increase of 13.8 percent from the corresponding period of 2003.

The volume of rubber exported in the March quarter of 2004 was 800 tonnes, a decline of 20.0 percent from the corresponding period of 2003. The decline was mainly attributed to unfavourable weather conditions, combined with deteriorating road infrastructure in the rubber producing regions. The average export price was K3,375 per tonne in the March quarter of 2004, an increase of 16.4 percent from the corresponding period of 2003, due to higher international prices resulting from lower supply in the world market. The decline in export volume more than offset the increase in export price and resulted in an export value of K2.7 million in the March quarter of 2004, a decline of 6.9 percent from the corresponding period of 2003.

The volume of logs exported in the March quarter of 2004 was 462.0 thousand cubic meters, a decline of 14.9 percent from the corresponding period of 2003. This was mainly due to lower production as a result of unfavourable weather conditions. The average export price of logs was K166 per cubic meter in the March quarter of 2004, a decline of 13.5 percent from the corresponding period of 2003. The decline was attributed to lower international prices, reflecting higher supply of tropical hardwood in the world market from Latin and North America. The declines in both the export price and volume resulted in an export value of K76.8 million in the March quarter of 2004, a decline of 26.3 percent from the corresponding period of 2003.

The value of marine products exported in the March quarter of 2004 was K22.9 million, a decline of 24.4 percent from the corresponding period of 2003. This was a result of a decline in the export volume, which more than offset an increase in the export price.

6. BALANCE OF PAYMENTS

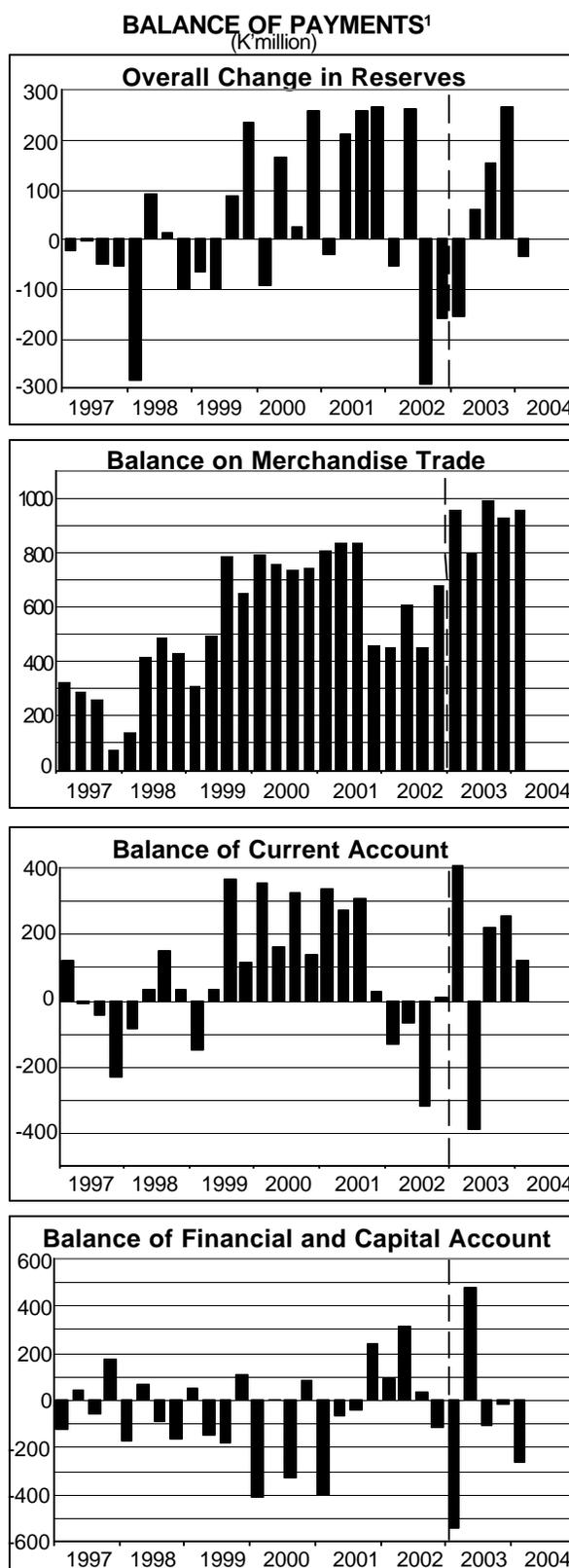
The overall deficit in the balance of payments was K64 million in the March quarter of 2004, compared to a deficit of K156 million in the corresponding period of 2003. The lower deficit resulted from a significant improvement in the capital and financial account, which more than offset a lower surplus in the current account.

The surplus in the current account was attributed mainly to a continued high surplus in the trade balance and an improvement in net transfer receipts, which more than offset higher net service and income payments. Net inflows in both direct and portfolio investments, reflecting funding for a new mining project accounted for the lower deficit in the capital and financial account.

The trade account recorded a surplus of K955 million in the March quarter of 2004, the same as in the corresponding quarter of 2003. This outcome was the result of a decline in exports, which was equally compensated for by a decrease in imports. The value of merchandise exports was K1,946 million in the March quarter of 2004, a decline of 4.5 percent from the corresponding period of 2003. This was attributed to lower export values of crude oil, copper, coffee, cocoa, copra oil, rubber and forestry product, which more than offset an increase in the export receipts of gold, copra, palm oil, tea and other non-mineral exports.

The value of merchandise imports in the March quarter of 2004 was K991 million, a decline of 8.5 percent from the corresponding period of 2003. This was due to lower values of general and petroleum imports, which more than offset an increase in mining sector imports. General imports were K731 million in the March quarter of 2004, a decline of 16.1 percent from the corresponding period of 2003. Imports by the petroleum sector were K17 million in the March quarter of 2004, a decline of 22.7 percent from the corresponding period of 2003, reflecting lower capital expenditure undertaken by the oil projects. Imports by the mining sector were K243 million in the March quarter of 2004, an increase of 27.9 percent from the corresponding period of 2003. The increase was due to higher capital expenditure at the Porgera, Lihir and Tolukuma mines.

The deficit in the services account was K733 million in the March quarter of 2004, compared to K611 million in



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

the corresponding period of 2003. The higher deficit was due to increased payments relating to travel, education, insurance, other financial, communication, government services n.i.e., construction and other services. There were lower payments for transportation, computer and information, other business and refining and smelting services.

The deficit in the income account was K383 million in the March quarter of 2004, compared to a deficit of K205 million in the corresponding period of 2003. This was due to higher compensation of employees and dividend payments, which more than offset a decline in interest payments.

The surplus in the transfers account was K281 million in the March quarter of 2004, compared to a surplus of K268 million in the corresponding period of 2003. Higher receipts for superannuation, family maintenance, gifts, grants and taxes, combined with lower transfer payments contributed to the improvement.

As a result of the worsening deficits in the services and income accounts, the current account recorded a surplus of K120 million in the March quarter of 2004, compared to a surplus of K407 million in the corresponding period of 2003.

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

The financial account recorded a net outflow of K262 million in the March quarter of 2004, which was significantly lower than K537 million in the corresponding quarter of 2003. This was due to net inflows of direct investments of K52 million, reflecting an equity financing for a new mining project and withdrawal of short-term money market investments by mineral companies of K355 million. There was an increased net outflow on other investments totalling K660 million, mainly reflecting higher loan repayments by both the Government and private sector.

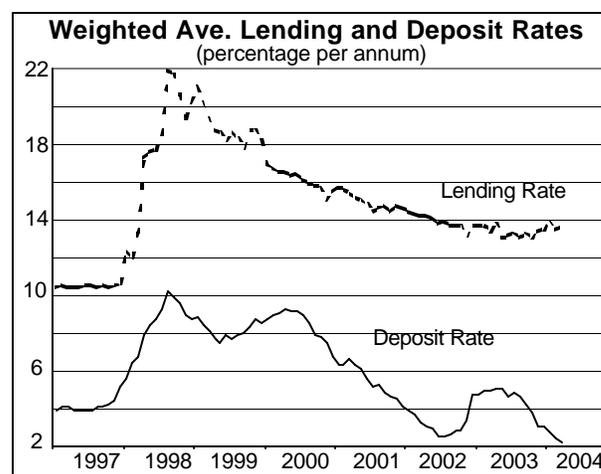
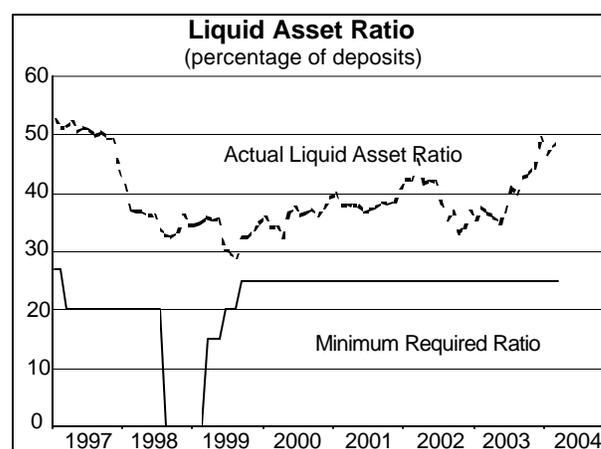
The average level of gross foreign exchange reserves at the end of the March quarter of 2004 was K1,667.6 (US\$515.7) million, sufficient for 5.1 months of total and 6.9 months of non-mineral import covers.

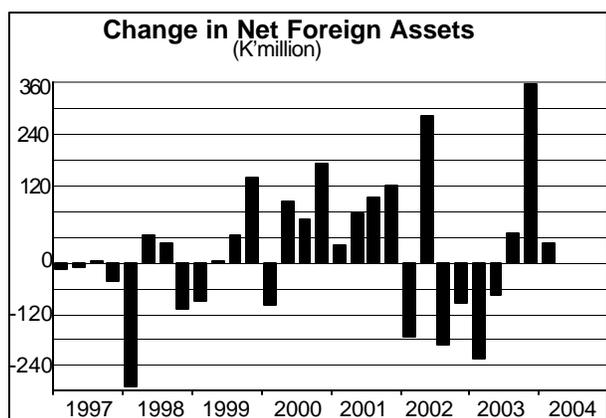
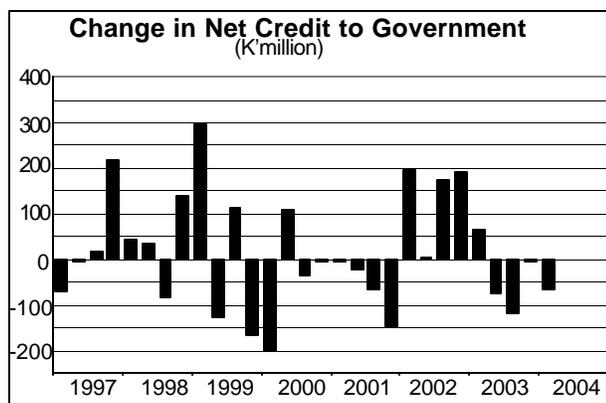
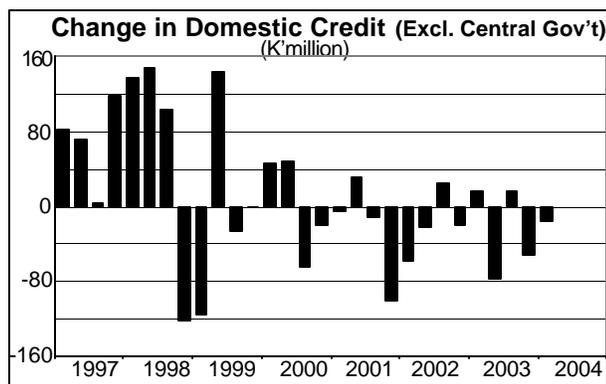
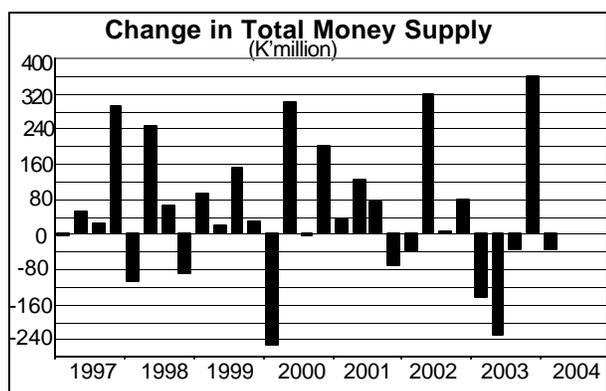
7. MONETARY DEVELOPMENTS

INTEREST RATES AND LIQUIDITY

The Bank of Papua New Guinea continued to ease its monetary policy stance during the first quarter of 2004 by reducing the Kina Facility Rate (KFR) to 12.0 percent in March 2004 from 14.0 percent in December 2003. In addition, the Repurchase Agreement Facility (RAF) dealing margins were increased to 200 basis points in January and later to 300 basis points in March 2004, on both the buy and sell sides from the KFR. As a result, Treasury bill rates decreased across all maturities during the March quarter. The 28 days rate decreased from 16.13 percent to 12.38 percent, the 63 days rate from 16.36 percent to 13.59 percent, 91 days rate from 16.30 percent to 13.90 percent and the 182 days rate from 16.91 percent to 14.16 percent.

The Bank utilised Open Market Operations (OMO)





instruments in the conduct of monetary policy over the March quarter of 2004. Given the high levels of liquidity in the banking system resulting mainly from increased foreign exchange inflows, the Bank used the Treasury bills and RAF to diffuse some of the excess liquidity. As a result, activity in the inter-bank market was subdued. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) were maintained at 3.0 percent and 25.0 percent, respectively, over the March quarter of 2004.

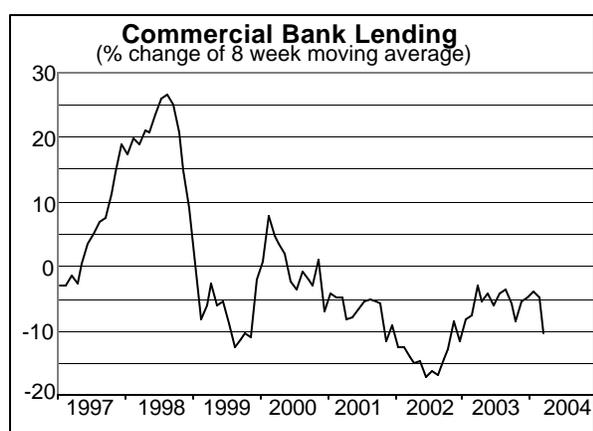
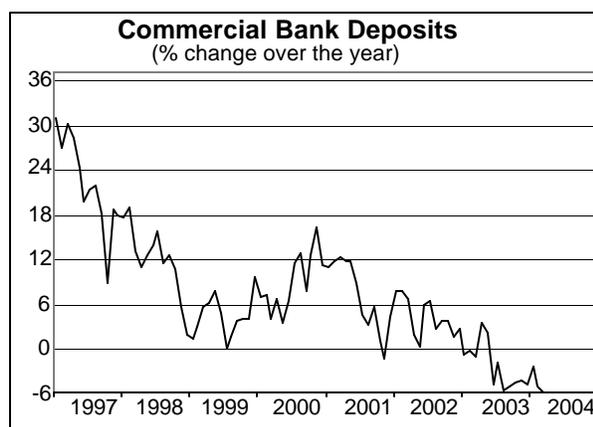
Average liquid assets held by commercial banks increased by 6.8 percent in the March quarter of 2004, following an increase of 10.3 percent in the final quarter of 2003. The increase was reflected in higher holdings of Government securities and deposits with the Central Bank under the RAF. Commercial banks continued to hold the majority of their liquid assets in the form of Government Treasury bills.

The weighted average deposit rates quoted on large term deposits (K500,000 and above) also recorded a decreasing trend, except for the 90 days maturity. Between the end of December 2003 and March 2004, the 30 days weighted average deposit rate decreased from 6.44 percent to 3.88 percent, 60 days from 5.65 percent to 3.06 percent and 180 days from 6.23 percent to 2.75 percent, while the 90 days rate increased from 5.99 percent to 6.25 percent.

The weighted average interest rate on total loans extended by commercial banks increased marginally from 13.5 percent to 13.6 percent between December 2003 and March 2004, while the weighted average interest rate on total deposits decreased from 3.0 percent to 2.2 percent. Some commercial banks reduced their Indicator Lending Rates (ILRs) over the quarter, with the spread declining to 12.75 percent to 14.25 percent by the end of March 2004.

MONEY SUPPLY

The average level of broad money supply (M3*) increased by 7.2 percent in the first quarter of 2004, compared to a revised increase of 3.6 percent in the December quarter of 2003. The growth resulted from increases in average net foreign assets of the banking system of 17.4 percent, net credit to the Government of 3.7 percent and net credit to the private sector, official entities and non-monetary financial institutions of 0.1 percent. The rise in average net foreign assets resulted from increases in net foreign assets of both



the Central Bank and commercial banks. The increase in average net credit to the Government was mainly due to higher holdings of Government securities by commercial banks. Domestic credit outstanding, excluding advances to the Central Government and outstanding loans under the Government's Agricultural export commodity price support schemes, decreased by 1.0 percent in the March quarter of 2004, compared to the December quarter of 2003. The average level of the broad monetary base grew by 5.1 percent over the first quarter of 2004, compared to an increase of 8.6 percent in the December quarter of 2003. The increase reflected the higher average level of liquid assets of the commercial banks.

Net credit to the Government decreased by 6.1 percent in the first quarter of 2004, compared to a decrease of 0.4 percent in the December quarter of 2003. The decline was mainly due to an increase in Government deposits at the commercial banks and higher sales of Treasury bills to the public. An increase in net foreign assets of K47.0 million resulted from higher net foreign assets of commercial banks of K64.1 million, which more than offset a

decline in net foreign assets of the Central Bank of K17.1 million. The improvement reflected increased holdings of foreign currency by commercial banks as a result of stability in the exchange rate and a pick-up in forward foreign exchange transactions.

The average level of narrow money supply (M1*) increased by 3.8 percent in the March quarter of 2004, compared to an increase of 2.0 percent in the December quarter of 2003. The increase was mainly due to growth in demand deposits. The average level of quasi money fell by 1.7 percent during the March quarter, following decreases in both savings and term deposits.

The monthly average level of deposit base of commercial banks increased by 2.5 percent in the March quarter of 2004 to K2,948.7 million, from K2,875.6 million in the December quarter of 2003. This represents an annualised growth rate of 10.6 percent.

LENDING

During the first quarter of 2004, total domestic credit extended by the commercial banks to the private sector, official entities and the non-monetary financial institutions decreased by K15.0 million to K1,482.1 million, compared to an increase of K16.5 million during the corresponding quarter of 2003. Lending to the private sector and official entities decreased by K6.8 million and K9.0 million respectively, while lending to non-monetary financial institutions increased by K0.8 million. The decline in lending to the private sector was due to net repayments by the commerce sector, particularly retail trade, as well as the transportation and communication sector and other businesses. The decline also reflected low demand for new borrowings by the public. Large loan repayments by the public enterprises accounted for the decline in credit to official entities. There were no repayments under the price support schemes, European Investment Bank (EIB) Global Loan Facility and Small Scale Business Credit Facility (SSBCF), over the March quarter of 2003. The annualised decline in domestic credit, excluding the Central Government and advances under the price support schemes, was 4.1 percent in the first quarter of 2004. Foreign currency lending to the private sector and official entities was 6.1 percent of total lending to these sectors, compared to 6.7 percent in December 2003, with kina lending accounting for the remainder.

The utilisation rate of credit is a fair indicator of the level of efficiency at which the private sector is able to draw

down committed funds to fund their operations. The measure adopted by the Central Bank is the ratio of total credit outstanding to total commitments outstanding to the private sector, official entities and non-monetary financial institutions. A higher utilisation rate indicates that firms are more efficient in drawing down funds and minimising commitment fees. Commitments include call and term lending and exclude any other contingent items. The utilisation rate, quarter on quarter, was 82.6 percent in March 2004, compared to a revised rate of 84.6 percent in December 2003. The decrease in the rate of utilisation reflects lower utilisation of committed funds.

8. PUBLIC FINANCE

Preliminary estimates of the fiscal operations of the National Government to March 2004 showed an overall surplus of K13.8 million, compared to a surplus of K25.4 million in the corresponding period of 2003, and represents 0.1 percent of nominal GDP. The lower surplus was due to a decline in revenue, combined with an increase in expenditure.

Total revenue, including grants during the March quarter of 2004 was K573.6 million, K6.4 million lower than the receipts collected in the corresponding period of 2003, and represents 15.0 percent of the budgeted revenue.

Total tax revenue amounted to K545.3 million, 0.5 percent higher than the receipts collected during the same period in 2003, and represents 19.5 percent of the budgeted tax receipts. Direct tax receipts totalled K315.0 million, K8.3 million lower than the receipts collected over the corresponding period in 2003, and represents 17.3 percent of the budgeted amount. There were lower company and other direct tax receipts, which more than offset an increase in personal tax receipts. The decline in company tax receipts was due to delayed payments by companies. The decrease in other direct taxes was due to lower dividend and interest withholding tax receipts.

Indirect tax receipts was K230.3 million, 5.1 percent higher than in the corresponding period of 2003, and represents 23.7 percent of the budgeted receipts for 2004. All categories of indirect tax receipts increased except the export tax receipts. The increase in excise duties reflected higher imports, while the increase in

VAT receipts was due to increased audit activities conducted by the Internal Revenue Commission. Other indirect tax receipts also increased as a result of the introduction of the 2.0 percent import duty.

Total non-tax revenue amounted to K28.3 million, K9.3 million lower than the amount collected in the corresponding period of 2003, and represents 14.5 percent of the budgeted amount. The decline mainly reflected lower collection of fees and charges from Government departments, which more than offset higher dividend payments from the Statutory organisations.

Total expenditure over the three months to March 2004 was K559.8 million, 0.9 percent higher than in the corresponding period in 2003, and represents 13.9 percent of the budgeted expenditure for 2004.

Recurrent expenditure over the first quarter of 2004 was K534.3 million, 7.2 percent higher than in the corresponding period in 2003, and represents 19.4 percent of the 2004 budgeted appropriation. Of this total, K233.1 million relates to National Departmental expenditure, K23.3 million higher than the amount spent during the corresponding period in 2003, and represents 18.3 percent of the budgeted appropriation. All categories of recurrent expenditure recorded increases except interest payments. National Department expenditure was higher due to increased salaries and wages. Provincial Government recurrent expenditure was K110.4 million, 23.9 percent higher than the expenditure level during the same period in 2003, and represents 18.2 percent of the budgeted amount. The increase reflected higher salaries and wages. Interest payments totalled K142.6 million, K11.3 million lower than the amount paid in the corresponding period in 2003. The decline reflected the falling interest rates on domestic loans and lower kina value of payments on external loans, due to the appreciation of the exchange rate.

Total development expenditure for the first quarter of 2004 was K25.5 million, K30.5 million lower than in the corresponding period in 2003, and represents 2.0 percent of the budgeted expenditure for 2004. The lower level of spending on developmental projects was partly related to the slow implementation of the 2004 Development Budget as well as low counterpart funding for projects provided by the Government.

The surplus combined with a net domestic borrowing of K108.7 million was used to finance the net overseas

loan repayment of K122.5 million. This comprised of K73.7 million in net concessionary, K16.3 million in commercial and K32.5 million in extraordinary loan sources. Domestic financing was mainly sourced from the non-banking system and commercial banks, which more than offset repayments by the Central Bank and

other domestic sources. Financing by the non-banking system of K184.2 million reflected higher holdings of Treasury bills issued by the Government. Repayments to other domestic sources of K81.3 million represent the settlements of cheques float issued in 2003.

FOR THE RECORD
MONTHLY KINA FACILITY RATE ANNOUNCEMENTS

The Central Bank introduced the Kina Facility Rate (KFR) in February 2001, as an official rate to indicate its stance of monetary policy. The KFR is a monthly rate and any changes to it should translate to changes in market interest rates. Changes to the KFR is based on assessment of economic fundamentals consistent with the overall objective of monetary policy of price stability in the economy. From January 2002, the KFR announced by the Bank were;

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

For details of the KFR, see Table 7.2 (S23) of the QEB.

KFR announcements prior to January 2002 are reported in the December 2002 QEB.

REFERENCE

Each issue of the Quarterly Economic Bulletin contains a review of economic conditions for the past quarter and a comprehensive set of updated statistical tables. Articles of special interest to current economic policy are also prepared by Bank staff for inclusion in the Bulletin. The following articles have appeared in the Quarterly Economic Bulletin since December 1988.

<u>Issue</u>	<u>Title</u>
Dec 1988	Monetary Policy for 1989
Dec 1989	Monetary Policy for 1990
Dec 1990	Monetary Policy for 1991
Dec 1990	The 1991 Budget
Dec 1990	Papua New Guinea's Total External Debt Outstanding
Dec 1991	Monetary Policy for 1992
Mar 1992	The 1992 National Budget
Mar 1992	Papua New Guinea's Total External Debt Outstanding
Dec 1992	The 1993 National Budget
Mar 1993	Papua New Guinea's Total External Exposure
Dec 1993	The 1994 National Budget
Dec 1993	Papua New Guinea's Total External Exposure
Mar 1995	The 1995 National Budget
Mar 1995	Papua New Guinea's Total External Exposure
Mar 1995	Monetary Policy for 1995
Dec 1995	The 1996 National Budget
Dec 1995	Monetary Policy for 1996
Mar 1996	Papua New Guinea's Total External Exposure
Dec 1996	The 1997 National Budget
Dec 1996	Monetary Policy for 1997
Mar 1997	Papua New Guinea's Total External Exposure
Dec 1997	Monetary Policy for 1998
Mar 1998	The 1998 National Budget
Mar 1998	Papua New Guinea's Total External Exposure
Dec 1998	The 1999 National Budget
Dec 1998	Monetary Policy for 1999
Mar 1999	Papua New Guinea's Total External Exposure
Sep 1999	The 1999 Supplementary Budget
Dec 1999	The 2000 National Budget
Jun 2000	Semi-annual Monetary Policy Statement, July 2000
Dec 2000	The 2001 National Budget
Dec 2000	Semi-annual Monetary Policy Statement, January 2001
Jun 2001	Semi-annual Monetary Policy Statement, July 2001
Dec 2001	Semi-annual Monetary Policy Statement, January 2002
Dec 2001	The 2002 National Budget
Jun 2002	Semi-annual Monetary Policy Statement, July 2002
Sep 2002	The 2002 Supplementary Budget
Dec 2002	Semi-annual Monetary Policy Statement, January 2003
Dec 2002	The 2003 National Budget
Mar 2003	Special article: Export Price Index, Volume Index and Weights Calculations Methodology
Jun 2003	Semi-annual Monetary Policy Statement, July 2003
Dec 2003	The 2004 National Budget
Dec 2003	Semi-annual Monetary Policy Statement, January 2004

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.

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
