CONTENTS

PORT MORESBY

31st May, 2005

1. GLOSSARY OF TERMS AND ACRONYMS

Balance of Payments	A statistical statement that systematically summarises a country's economic transactions with the rest of the world, over a specific time period. It comprises the Current and Capital and Financial Accounts.
Broad Money Supply (M3*)	Total volume of money comprising narrow money (M1*) and quasi money in the economy at a point in time. See 'narrow' and 'quasi' money.
Cash Reserve Requirement (CRR)	A requirement imposed on commercial banks to hold cash as a percentage of total deposits and other prescribed liabilities at all times.
Capital Account	Records all transactions that involves the receipts or transfers of capital and acquisitions/disposal of non-produced, non-financial assets such as purchase of production facilities, i.e. plants and machinery, etc.
Central Bank Bill (CBB)[1]	An indirect monetary policy instrument used by the Central Bank for liquidity management. The CBB is a liability of the Central Bank and has similar features as the Government Treasury bills.
Current Transfers Account	This account records all foreign transactions that are not transfers of capital and can not be repaid. These includes donations, gifts and grants, superannuation funds and licensing fees.
Exchange Settlement Account (ESA)	Accounts of the commercial banks with the Central Bank for settlement transactions with each other.
Exclusion-based CPI measure	This involves zero weighting of volatile sub-groups or items such as fruit & vegetables, betelnut and prices which are largely determined by non-market (seasonal) forces, as well as alcoholic drinks, cigarettes & tobacco, etc. See 'Underlying CPI'.
Financial Account	Records all transactions associated with changes of ownership of foreign financial assets such as holdings of monetary gold, special drawing rights (SDR), claims on non-residents and foreign liabilities of an economy.
Headline Consumer Price Index (CPI)	A measure of inflation as calculated and published quarterly by the National Statistical Office (NSO).
Income Account	Records foreign transactions such as compensation of employees, which covers wages, salaries, and other benefits in cash and kind, dividends and interest earned on investments.
Inscribed Stock	A Government bond or debt instrument sold to the public for a maturity term of one year or longer for the purpose of Budget financing. A coupon is paid to the holders every six months.
Kina Facility Rate (KFR)	Official benchmark rate used by the Bank of Papua New Guinea to signal its monetary policy stance. The KFR is announced monthly by the Governor and published in the newspapers and on the Bank's website.
Liquid Assets	Assets of the commercial banks, which are near liquid form, comprising cash, ESA balances, Treasury bills and Inscribed stocks less than 3 years to maturity.
Minimum Liquid Asset Ratio (MLAR)	A prudential requirement imposed by the Central Bank on commercial banks

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

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

Monetary Base — Comprised of currency held by the public and liquidity assets of the commercial banks, including deposits held with the Central Bank under the Repurchase Agreement Facility (RAF) or Repos.

Narrow Money — A component of total money supply that is considered liquid or can be converted easily to cash on demand, and comprises of currency in circulation (held outside the banking system) and demand deposits.

Open Market Operations (OMO) — Operations of liquidity management conducted by the Central Bank with commercial banks and other financial intermediaries involving Government securities, Repos and foreign exchange trading to influence short-term interest rates.

Over the year CPI — Percentage change in the CPI of a quarter compared to the corresponding quarter of the previous year (Also called ‘annual’ CPI).

Portfolio Investment — Investments, mainly in equity and debt securities such as bonds and notes, money market debt instruments and financial derivatives, as well as long-term debt, equity and securities.

Quasi Money — A component of total money supply that is not easily convertible to cash on demand and comprises of savings and term deposits.

Repurchase Agreement Facility (RAF) — An agreement between the commercial banks and the Central Bank to sell and repurchase a Government security (e.g. Government Treasury bills) for overnight to 14 days. Transaction can be collateralised or unsecured (Also called Repos).

Reserve Money — A measure of money, which includes currency holdings of commercial banks and their deposits at the Central Bank and money in circulation.

Tap Facility — A facility conducted by the Central Bank for sale of Treasury bills and Inscribed stocks to the public.

Temporary Advance Facility — A statutory mechanism stipulated under Section 54 of the Central Banking Act 2000, that provides the National Government with access to short-term financing to meet mismatches in revenue.

Trade Account — Records all economic transactions associated with merchandise exports and imports of physical goods. A surplus means that exports have exceeded imports, while the reverse will result in a deficit.

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

Trimmed-mean CPI measure — A fixed proportion of prices at each end of the distribution of price changes are zero weighted and the mean of the remaining price changes recomputed. See also ‘Underlying CPI’.

Underlying CPI — A measure of inflation that excludes short-term volatile movements in prices, such as seasonal factors (prices of fruit, vegetables and betelnut), Government policy decisions (tax system reforms, etc.) and price controlled items. The exclusion-based and trimmed-mean CPI measures are both underlying CPI measures.

2. GENERAL OVERVIEW

The steady growth and macroeconomic stability achieved during 2004 continued in the first quarter of 2005. A budget surplus arising from sound fiscal management, in addition to low inflation, a stable exchange rate and low interest rates support conditions for economic growth. The effect of low interest rates was evident in a significant increase in lending during the quarter. Following the appreciation of the kina in the second half of 2004 and prudent fiscal management the headline inflation rate fell to negative 1.2 percent in the March quarter. The challenge now is to translate the positive macroeconomic conditions into strong and sustainable growth.

The Bank's latest Business Liaison Survey results show that private sector activity, excluding the mineral sector and the North Solomons Province (NSP) grew in 2004. The total nominal value of sales increased by 3.0 percent, compared to an increase of 6.7 percent in 2003, reflecting increases in all sectors except the transportation and agriculture/forestry/fisheries sectors. The value of sales increased in all regions except the Momase region.

According to the Bank's Employment Index, the level of employment in the formal private sector, excluding mining and petroleum and the NSP, grew marginally by 0.3 percent over the year to December 2004. The increase in the wholesale, manufacturing, transportation and finance and other services sectors more than offset declines in the agriculture/forestry/fisheries, building and construction, and retail sectors. Employment increased in all regions except the Highlands and Southern regions.

The headline inflation rate, as measured by the Consumer Price Index (CPI), was negative 1.2 percent in the March quarter of 2005, compared to an increase of 1.3 percent in the December quarter of 2004. The outcome was due to a reduction in the prices for all expenditure groups except the 'Food' and 'Miscellaneous' groups. By region, all urban areas, except Lae, recorded a decline in prices.

The exclusion-based inflation measure was negative 1.2 percent in the March quarter of 2005, the same value as in the December quarter of 2004. Trimmed mean inflation was 1.8 percent in the March quarter of 2005, compared to zero percent in the December quarter of 2004.

The kina exchange rate against the US and Australian dollars remained stable during the March quarter of 2005. The quarterly average exchange rate appreciated by 1.48 percent against the US dollar, but depreciated by 1.20 percent against the Australian dollar.

Higher international prices for mineral exports and most of Papua New Guinea's agricultural export commodities resulted in a 9.1 percent increase in the weighted average kina export price in the March quarter of 2005, compared to the corresponding quarter of 2004. There was an 11.7 percent increase in the weighted average kina price of mineral exports, influenced by higher prices of copper and crude oil. For the agricultural, forestry and marine product exports, the weighted average kina price declined by 1.8 percent. This was due to the appreciation of the kina against the US dollar, which more than offset the increase in international prices for all agricultural commodities, except cocoa and palm oil.

In the March quarter of 2005, there was an overall deficit of K255 million in the balance of payments, compared to a deficit of K64 million in the corresponding period of 2004. The outcome was a result of deficits in the current, capital and financial accounts.

The deficit in the current account was due to net deficits in the services and income accounts, which more than offset lower surpluses in the trade and transfers accounts. The deficit in the capital and financial accounts was due to net outflows of portfolio investments, reflecting investments in short-term money market instruments by mineral companies combined with the purchase of financial derivatives. This more than offset a net inflow in other investments.

The level of gross foreign exchange reserves at the end of March 2005 was K1,805.7 (US$607.6) million, sufficient for 4.1 months of total and 5.3 months of non-mineral import covers.

The Bank of Papua New Guinea maintained a neutral monetary policy stance during the March quarter of 2005 by keeping the KFR unchanged at 7.0 percent. The Repurchase Agreement Facility (RAF) dealing margins were also maintained at 3.0 percent on either side of the KFR. In line with the monetary policy stance domestic interest rates were relatively stable, following declines in the previous quarter.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy during the March quarter of 2005. Given the persistent high level of liquidity in the banking system, the Bank mainly used Treasury bills and Central Bank Bills (CBB) to diffuse some of the excess liquidity and maintain stability in domestic interest rates. As a result of the excess liquidity in the banking system, there was limited activity in the daily inter-bank market.

The average level of the broad money supply (M3*) decreased by 0.3 percent in the first quarter of 2005, compared to a revised increase of 6.0 percent in the December quarter of 2004. The outcome was mainly due to a decline of 6.1 percent in average net foreign assets of the banking system. This more than offset increases of 9.9 percent in the average net credit to the Government and 3.3 percent in average net credit to the private sector, official entities and non-monetary financial institutions. The average level of the monetary base fell by 1.0 percent during the first quarter of 2005, compared to an increase of 8.2 percent in the December quarter of 2004. The decline reflected the lower average level of liquid assets of the commercial banks and a decline in currency in circulation.

Total domestic credit extended by the commercial banks to the private sector, official entities and non-monetary financial institutions increased by K108.2 million to K1,559.2 million in the March quarter of 2005, compared to a decline of K15.0 million during the corresponding quarter of 2004. Lending to the private sector and official entities increased by K84.4 million and K32.1 million, respectively, while lending to the non-monetary financial institutions decreased by K8.3 million. The increase in lending to the private sector was mainly to the building and construction, agriculture and forestry sectors and private households, whilst lending to official entities was mainly to non-financial public enterprises. Loan repayments from non-monetary financial institutions resulted in a decline in lending to that sector. The annualised growth in domestic credit, excluding the Central Government and advances under the price support schemes was 34.6 percent in the first quarter of 2005.

Preliminary estimates of the fiscal operations of the National Government in the three months to March 2005 showed an overall surplus of K127.1 million, compared to a surplus of K13.8 million in the corresponding period of 2004. This represents 0.9 percent of GDP. The higher surplus was mainly due to increased revenue, while there was a marginal decline in expenditure.

Total revenue, including grants during the March quarter of 2005 was K684.2 million, K110.6 million higher than the receipts collected in the corresponding period of 2004. This represents 14.8 percent of the budgeted revenue. The increase was a result of higher collections in direct tax and non-tax revenue, which more than offset a decline in indirect tax receipts.

Total expenditure over the three months to March 2005 was K557.1 million, 0.5 percent lower than in the corresponding period in 2004. This represents 11.7 percent of the budgeted expenditure for 2005. The decline was influenced by a fall in recurrent expenditure reflecting lower interest payments, which more than offset an increase in development expenditure.

As a result of these developments in revenue and expenditure, and the Budget surplus in the first three months of 2005, the Government made net overseas and domestic loan repayments of K100.8 million and K26.3 million, respectively.

3. INTERNATIONAL DEVELOPMENTS

World economic growth as measured by real Gross Domestic Product (GDP) is projected to increase at a slower rate in 2005 than in 2004. The latest International Monetary Fund (IMF) forecast made in April 2005 is for a growth of 4.3 percent in 2005, down from 5.1 percent in 2004. The expected slowdown is attributed to the adverse effects of high oil prices and a return to a more sustainable rate of growth. However, expected economic performances differ between countries. The United States (US), China and most emerging markets and developing countries are expected to continue to perform strongly. Chinese growth is projected to be 8.5 percent in 2005, compared to 9.5 percent in 2004. By contrast the Euro area and Japan are expected to produce sluggish growth as they continue to battle with faltering exports and weak domestic demand. Euro area growth is projected to be 1.6 percent in 2005 down from 2.0 percent in 2004. The two principal sources of concern for the global economy in 2005 are the risks of further oil price increases and a sharp depreciation of the US dollar. The potential for further depreciation of the US dollar stems from the large US current account deficit and the corresponding current account surpluses in Asia and in oil producing countries.

In January, Iraq held its first national elections since the overthrow of Saddam Hussein by a US-led coalition force in 2003. A Shia-led alliance received 48 percent of the vote, followed by the Kurdish alliance with 26 percent.

In February, finance ministers of the Group of Seven major industrialised economies (G7) met in London, United Kingdom (UK) to discuss how they could work together to relieve all the debt owed by the world's poorest countries. Also in February the Kyoto Protocol came into effect despite the refusal of the US, the world's largest emitter of greenhouse gases, to ratify the protocol.

Oil prices increased during the March quarter after falling slightly at the end of 2004. The price of UK Brent increased by 12 percent in January, 3 percent in February and 17 percent in March to reach US$53 per barrel. The increase in March occurred in spite of a decision by the Organisation of Petroleum Exporting Countries (OPEC) to raise its official production ceiling by 500,000 barrels a day to 27.5 million barrels a day.

In the US, real GDP grew by 3.2 percent in the year to March 2005, compared to 4.9 percent over the year to March 2004. The IMF projects GDP to grow by 3.6 percent in 2005.

Industrial production increased by 3.9 percent in the year to March 2005, compared to 3.4 percent in the year to March 2004. Retail sales increased by 3.0 percent in the year to March 2005, compared to 9.2 percent in the year to March 2004. The unemployment rate for March 2005 was 5.2 percent, down from 5.4 percent in December 2004 and 5.7 percent in March 2004.

Consumer Price inflation was 3.1 percent in the year to March 2005, compared to 1.7 percent in the year to March 2004. The Federal Reserve's measure of core personal-consumption prices, which excludes food and energy prices, recorded its highest monthly increase in more than two years in March 2005. Broad money increased by 4.9 percent in the year to March 2005, compared to 4.5 percent over the year to March 2004. The Federal Reserve increased the Federal Funds Rate by 25 basis points in February, and again in March, taking it from 2.25 percent to 2.75 percent. Following its March meeting the Federal Reserve warned that inflationary pressures had picked up, but said that it still expects to raise rates at a "measured" pace in the future.

The trade account deficit was US$700.9 billion over the year to March 2005, compared to a deficit of US$560.4 billion over the year to March 2004. Strong US growth increased import demand, while exports suffered from slow growth in Europe and Japan.

In Japan, real GDP grew by 0.8 percent in 2004 compared to 3.4 percent in 2003. The slowdown partly reflected adjustments in production and inventories in information technology related sectors. GDP growth in the December quarter was 0.5 percent at an annual rate. The IMF projects GDP to grow by 0.8 percent in 2005.

Industrial production increased by 1.1 percent in the year to March 2005, compared to 8.3 percent over the year to March 2004. Retail sales increased by 1.2 percent in the year to February 2005 compared to a 2.2 percent decline over the year to March 2004. The Bank of Japan's Tankan survey showed business confidence ebbing during the first quarter of 2005, but the Bank is still confident that the recovery will remain solid. The unemployment rate for March 2005 was 4.5 percent, down from 4.7 percent twelve months previously.

Consumer prices fell for the seventh fiscal year in a row. Consumer Price inflation was negative 0.2 percent in the year to March 2005, compared to negative 0.1 percent in the year to March 2004. Broad money supply increased by 2.1 percent in the year to March 2005, compared to 1.9 percent over the year to March 2004. The Bank of Japan maintained its zero percent interest rate policy during the March quarter of 2005, injecting liquidity into the banking system to keep the financial system afloat and encourage economic activity.

Part of the counterpart to the US current account deficit is a large Japanese current account surplus, which reached US$169.5 billion over the year to February 2005, compared to a surplus of US$118.4 billion over the year to February 2004. The increase also reflected exports to the growing East Asian economies.

In Germany, real GDP grew by 1.0 percent in the year to March 2005, compared to 1.5 percent in the year to March 2004. GDP growth in the March quarter was 4.1 percent at an annual rate. The IMF projects a real GDP growth of 0.8 percent in 2005.

Industrial production rose by 1.6 percent in the year to March 2005, compared to a 0.7 percent fall over the year to March 2004. Retail sales were unchanged in the year to March 2005 following a 0.7 percent decline over the year to March 2004. The unemployment rate for March 2005 was 12.0 percent, an increase from 10.4 percent in March 2004.

Broad money supply in the Euro area grew by 6.5 percent in the year to March 2005. The European Central Bank left its refinancing rate unchanged at 2.0 percent during the March quarter of 2005. Euro area Consumer Price inflation was 2.1 percent in the year to March 2005, a slight increase from 1.7 percent a year earlier.

The trade account surplus in Germany was US$199.4 billion in the year to March 2005, up from US$166.7 billion over the year to March 2004.

In the UK, real GDP growth was 2.8 percent in the year to March 2005, compared to 3.0 percent over the year to March 2004. GDP growth in the March quarter was 2.2 percent at an annual rate. The IMF projects a real GDP growth of 2.6 percent in 2005.

Industrial production fell by 1.8 percent in the year to March 2005, compared to a 0.6 percent decline over the year to March 2004. Retail sales increased by 2.7 percent in the year to March 2005, compared to an increase of 4.3 percent over the year to March 2004. The unemployment rate for February 2005 was 4.8 percent, unchanged from a year earlier.

Consumer Price inflation was 1.9 percent in the year to March 2005, up from 1.1 percent in the year to March 2004. Broad money supply increased by 10.4 percent in the year to March 2005, compared to 7.7 percent in the year to March 2004. The Bank of England maintained its Repo Rate at 4.75 percent during the March quarter of 2005. It has now left the Repo Rate unchanged for nine months.

The trade account deficit was US$108.9 billion in the year to March 2005, compared to a deficit of US$83.3 billion in the year to March 2004.

In Australia, real GDP grew by 1.5 percent in 2004, compared to 4.0 percent in 2003. GDP growth in the fourth quarter was 0.6 percent at an annual rate. The IMF projects a real GDP growth of 2.6 percent in 2005.

Australian industrial production fell by 0.4 percent in 2004, compared to a 0.9 percent fall in 2003. Retail sales grew by 1.8 percent in the year to March 2005, compared to a 7.7 percent increase over the year to March 2004. The unemployment rate was 5.1 percent in March 2005. This was the same as in December 2004, but is lower than the 5.6 percent recorded in March 2004.

Consumer Price inflation was 2.4 percent in the year to March 2005, an increase from 2.0 percent in the year to March 2004 due to high housing costs and petrol prices. With inflation edging upwards, the Reserve Bank of Australia tightened monetary policy by raising its Cash Rate for the first time in 15 months from 5.25 percent to 5.50 percent in March 2005. Broad money supply increased by 8.2 percent in the year to March 2005, compared to 13.9 percent in the year to March 2004.

The trade account deficit was US$18.3 billion in the year to March 2005, compared to a deficit of US$17.0 billion in the year to March 2004. The increase reflected higher oil prices and fuel imports, combined with lower rural exports due to the effects of the drought.

During the March quarter of 2005 the US dollar continued to depreciate against other major currencies, although at a slower rate than in the December quarter of 2004. The quarterly average exchange rate depreciated by 1.3 percent against the euro, 1.3 percent against the Japanese yen and 2.7 percent against the Australian dollar. The depreciation was mainly driven by the on-going US current account and budget deficits.

In the March quarter of 2005 the kina appreciated slightly against the US dollar, but also depreciated slightly against the Australian dollar. The average kina exchange rate against the US dollar during the March quarter was 32.06 US cents, an appreciation of 1.48 percent on the December quarter of 2004. The average kina exchange rate against the Australian dollar was 41.27 Australian cents, a depreciation of 1.20 percent on the December quarter of 2004. The improvement was associated with higher international prices for mineral and most agricultural commodities. On the 31st December 2004 one kina was worth 32.00 US cents and 41.06 Australian cents. By the 31st March 2005 one kina was worth 32.14 US cents and 41.61 Australian cents.

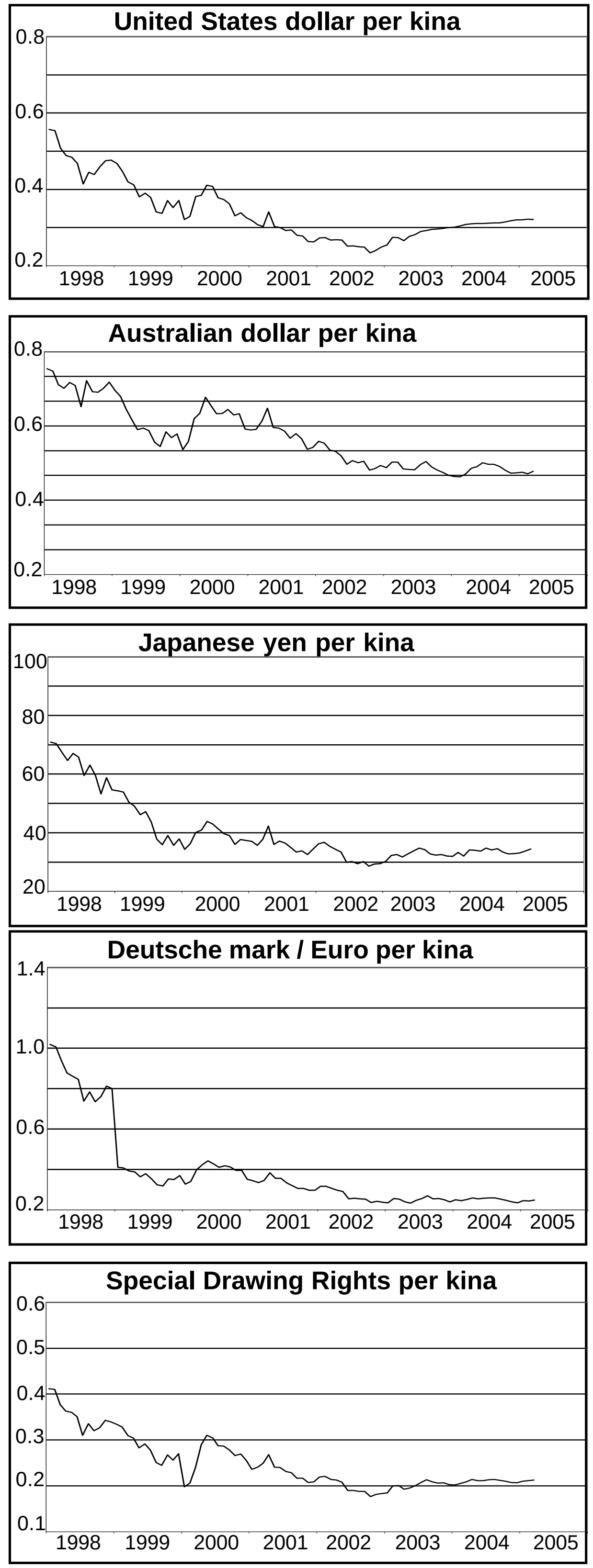
4. THE DOMESTIC ECONOMY

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, show that the level of business activity in the private sector, excluding mining and petroleum and the NSP grew in 2004. The total nominal value of sales increased by 3.0 percent in 2004, compared to an increase of 6.7 percent in 2003. The increase reflected growth in all sectors except the agriculture/forestry/fisheries and retail sectors. The value of sales increased in all regions except the Momase region.

The nominal value of sales by the retail sector increased by 2.7 percent in 2004, compared to an increase of 10.5 percent in 2003, while sales in the wholesale sector declined marginally by 0.1 percent, compared to an increase of 10.5 percent in 2003. The

EXCHANGE RATES



increase in the retail sector was associated with the expansion and opening of new shops in the National Capital District (NCD), combined with higher demand for building materials and expansion of operations by a pharmacy. In the wholesale sector the marginal decline was due to reduced purchases and export of vanilla beans as a result of low quality beans sold by local farmers.

In the manufacturing sector, the nominal value of sales increased by 7.9 percent in 2004, compared to an increase of 7.0 percent in 2003. The increase was due to higher production and distribution of canned mackerel, soft drinks, cereals and other food items. The growth was also attributed to demand for sheet metal and steel fabrication, ply wood and sawn timber, dinghies, and higher sale of explosives associated with mining and exploration activities.

The nominal value of sales by the building and construction sector increased by 4.9 percent in 2004, compared to a decline of 0.5 percent in 2003. The increase reflected the construction of school buildings, maintenance of roads and the construction and maintenance of staff residences of a palm oil company. The increase was also attributed to construction work at the mine sites.

The nominal value of sales by the finance and other services sector increased by 6.5 percent in 2004, compared to a decline of 25.6 percent in 2003. The increase reflected the extension of banking services and establishment of banking agents in several centres. Higher demand for hotel accommodation and catering services also contributed to the increase.

The nominal value of sales by the agriculture/forestry/fisheries sector declined by 5.0 percent in 2004, compared to a decline of 4.4 percent in 2003. This was associated with lower production for most agricultural export commodities, including coffee, copra, cocoa and palm oil, which more than offset higher international prices. The decline was also due to lower logging activity as a result of the wet season and the temporary closure of several logging operations due to land-owner problems.

In the transportation sector, the nominal value of sales decreased by 5.3 percent in 2004, compared to an increase of 21.0 percent in 2003. The decrease reflected lower levels of passenger travel, lower transportation of agricultural commodities to exporters and reduced flights by some third level airlines to remote areas as a result of less passenger travel and cargo haulage. The decline was also due to fewer trucks to transport cargoes from the wharf to the Highlands region due to the deterioration of the Okuk highway.

The nominal value of sales by the private sector, excluding quarrying, in the NCD increased by 6.2 percent in 2004, compared to an increase of 4.3 percent in 2003. The increase was associated with higher sales in all sectors except the fisheries sector. The increase in the manufacturing sector was due to higher demand for stationery and printing materials, and increased production of biscuits, cereals, and soft and alcoholic drinks. Higher demand for stationery, desks and tables by schools in the other regions and an increased market share by a fuel distributor accounted for the increase in the wholesale sector. Higher sales in the retail sector reflected an increase in general merchandise activity, higher demand for sheet metal and steel fabrication for construction of new buildings, and higher sales of tyres and accessories.

The nominal value of sales by the private sector in the Southern region increased by 18.1 percent in 2004, compared to an increase of 10.6 percent in 2003 with higher sales in all the sectors except the agriculture/forestry/fisheries, manufacturing and retail sectors. The increase was associated with demand for dinghies, and higher sale of medical supplies and merchandise goods by pharmacists and retailers, respectively. The increase was also attributed to demand for hotel accommodation, catering services and rental cars.

The nominal value of sales by the private sector in the Highlands region increased by 1.1 percent in 2004, compared to an increase of 7.7 percent in 2003. Higher sales in the wholesale sector more than offset declines in the other sectors. The increase in the wholesale sector was associated with the increase in market share by a fuel distributor and export of processed coffee by a coffee exporter.

The nominal value of sales by the private sector in the Morobe region increased by 8.5 percent in 2004, compared to an increase of 10.0 percent in 2003 with increases in all sectors except the construction sector. The growth was due to higher production of food items including canned fish, cereals and soft drinks, combined with higher demand for sheet metal and corrugated iron, explosives for mining activities and household items.

The nominal value of sales by the private sector in the Momase region decreased by 23.6 percent in 2004, compared to an increase of 83.8 percent in 2003. The decrease was attributable to lower sales in the agriculture/forestry/fisheries, wholesale and transportation sectors. The decline in the agriculture/forestry/fisheries sector reflected lower production of copra and cocoa, while the decline in the wholesale sector was due to a reduction in the volume of vanilla purchases due to poor quality. In the transportation sector, the decline was due to low stevedoring activity associated with the reduced sale of vanilla by local farmers.

The nominal value of sales by the private sector in the Islands region increased by 10.1 percent in 2004, compared to a decline of 13.6 percent in 2003. Sales increased in all sectors except the manufacturing sector. The increase in the agriculture/forestry/fisheries sector reflected higher volumes of log exports and higher sales by the palm oil estates. The increase in the retail sector was due to demand for building materials, agricultural equipment and merchandise goods. The construction and renovation of staff houses and maintenance of feeder roads of a palm oil company, combined with general road maintenance and gravelling accounted for the increase in the construction sector. The increase in the transportation sector reflected higher demand for rental cars and shipment of cocoa and copra for export.

EMPLOYMENT

According to the Bank's Employment Index, the level of employment in the formal private sector, excluding mining and petroleum and the NSP, grew marginally by 0.3 percent over the year to December 2004. Employment increased in the wholesale, manufacturing, transportation and finance and other services sectors, but declined in the agriculture/forestry/fisheries, building and construction, and retail sectors. Employment increased in all regions except the Highlands and Southern regions.

In the wholesale sector the level of employment increased by 12.6 percent over the year to December 2004. The increase reflected the hiring of staff for new shops, acquisition of other wholesalers, expansion projects and improved cocoa and copra production.

In the transportation sector, the level of employment increased by 7.7 percent over the year to December 2004. Higher employment in the air transportation sub-sector was due to increased staff levels by the third level airlines. The increase in the land transportation sub-sector was associated with higher casual employment.

In the manufacturing sector, the level of employment increased by 2.7 percent over the year to December 2004. The increase reflected higher casual employment to meet production back-orders, hiring of new staff due to increased demand, including for the export market, and recruitment following the settlement of a management dispute by a major manufacturer.

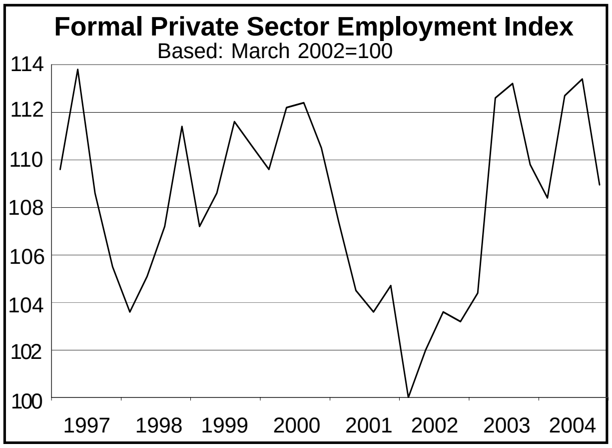
In the finance and other business services sector (which includes real estate, hotel and restaurants, finance and security services), the level of employment increased by 3.2 percent over the year to December 2004. The increase was due to higher casual employment by the hotels and a cartage company during the festive season, which offset declines in the finance and real estate sub-sectors.

In the retail sector, the level of employment declined by 3.3 percent over the year to December 2004. The decline was due to lower casual employment, reduced demand and business activity, closure of several retail branches and divisions, sale of a subsidiary by a major retailer and reduction of vanilla purchases.

In the agriculture/forestry/fisheries sector, the level of employment decreased by 2.8 percent over the year to December 2004. The decrease was due to retrenchment and lower casual employment in the agriculture sub-sector, the scaling down of operations by a number of logging operations in the forestry sub-sector, the closure of fishing grounds by the National Fisheries Authority, and the maintenance of vessels by a major fishing company in the fisheries sub-sector.

In the building and construction sector, the level of employment decreased by 11.0 percent over the year to December 2004. The decrease was attributed to the completion of construction projects and lack of new contracts, as well as the laying-off of casual employees for the festive period.

In the mining/quarrying/petroleum sector, the level of employment increased marginally by 0.4 percent over the year to December 2004. The increase was due to



recruitment by several major gold and copper producers, which more than offset lower employment following the winding-down of operations by a gold producer and completion of drilling activity by another company.

By region, higher employment in the NCD, Morobe, Momase and Islands regions more than offset declines in the other regions. In the NCD, the level of employment increased by 0.6 percent over the year to December 2004. This reflected higher employment in the agriculture/forestry/fisheries, building and construction, wholesale, transportation and finance and other services sectors. The increase in the wholesale and building and construction sectors was due to higher casual employment and recruitment of staff for the head office and terminals for a fuel wholesaler. In the finance and other services sector, higher employment reflected increased work and training of new staff by several accountancy and security firms.

In the Morobe region, the level of employment increased by 5.2 percent over the year to December 2004. The increase was due to higher employment in the agriculture/forestry/fisheries, wholesale, transportation, and finance and other services sectors. There was increased staff levels in the fisheries sub-sector and increased casual employment in the land transportation sub-sector.

In the Momase region, the level of employment increased by 4.2 percent over the year to December 2004. The increase reflected higher employment in all sectors except the building and construction sector. There was higher employment in the forestry and fisheries sub-sector and higher casual employment in the retail sector, as well as the agriculture and hotel sub-sectors. The increase in the transportation sector was due to higher staff levels at the head offices of third-level airlines. Staff levels increased in the manufacturing sector as a result of businesses increasing production levels to meet extra demand.

In the Islands region, the level of employment increased by 3.9 percent over the year to December 2004. The increase reflected higher staff levels in all sectors except the building and construction and finance and other services sectors. Higher employment in the oil palm and fisheries sub-sectors accounted for the increase in the agriculture/forestry/fisheries sector. In the manufacturing sector, there was higher casual employment and hiring of staff as a result of increased production to meet demand.

In the Southern region, the level of employment decreased by 6.7 percent over the year to December 2004. The decline was due to lower employment levels in the agriculture/forestry/fisheries, building and construction and mining and quarrying sectors. Lower employment in the mining and quarrying sector reflected the winding-down of operations by a mining company.

In the Highlands region, the level of employment decreased by 12.1 percent over the year to December 2004. The decline reflected lower employment levels in all sectors except the mining and quarrying and other services sectors. Lower employment in the construction sector resulted from less contract work, the coffee off-season and reduced manufacturing activity.

CONSUMER PRICE INDEX

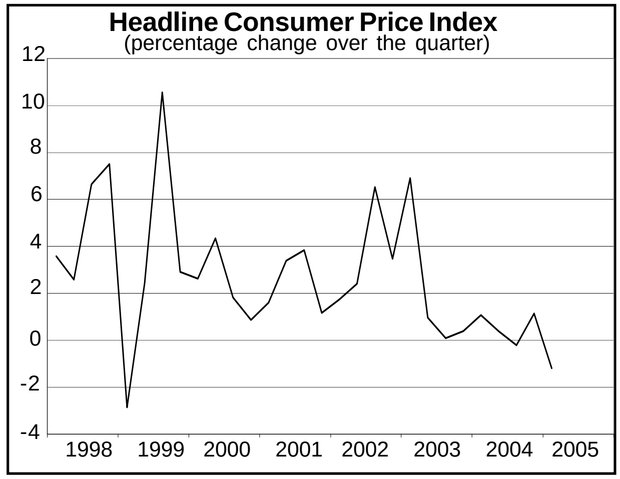
The headline inflation rate, as measured by the Consumer Price Index (CPI), was negative 1.2 percent in the March quarter of 2005, compared to an increase of 1.3 percent in the December quarter of 2004. The outcome was due to a reduction in the prices for all expenditure groups except the 'Food' and 'Miscellaneous' groups. By region all urban areas, except Lae, recorded declines in prices. The annual headline inflation rate was negative 0.3 percent in the March quarter of 2005, compared to increases of 2.4 percent in the December quarter of 2004 and 2.9 percent in the March quarter of 2004.

The 'Transport and communication' expenditure group recorded the largest deflation in the March quarter of 2005. Prices fell by 8.3 percent, compared to a 0.3 percent fall in the December quarter of 2004. A significant reduction in prices for motor vehicles, combined with fuel price decreases resulting from the appreciation of the kina, accounted for the decline. This expenditure group contributed negative 1.08 percentage points to the overall movement in the CPI. The CPI for the 'Drinks, tobacco and betelnut' expenditure group decreased by 1.1 percent in the March quarter of 2005, compared to an increase of 8.3 percent in the December quarter of 2004, and contributed negative 0.22 percentage points to the overall movement in the CPI. A large reduction in the price of betelnut, combined with lower prices for alcoholic drinks accounted for the decline.

The CPI for the 'Household equipment and operations' expenditure group continued to decrease and recorded a decline of 3.8 percent in the March quarter of 2005, following a fall of 1.0 percent in the December quarter of 2004. This decrease was due to a reduction in the prices of both durable items such as plates and cups and non-durable items such as laundry soap. It contributed negative 0.2 percentage points to the overall movement in the CPI. The CPI for the 'Rents, council charges, fuel and power' expenditure group decreased by 2.6 percent in the March quarter of 2005, compared to an increase of 5.1 percent in the December quarter of 2004 and reflected a reduction in the price of kerosene in all urban areas. The CPI for the 'Clothing and footwear' expenditure group decreased by 2.0 percent in the March quarter of 2005, following a decline of 0.7 percent in the December quarter of 2004.

The CPI for the 'Food' expenditure group increased by 2.3 percent in the March quarter of 2005, compared to a decrease of 2.0 percent in the December quarter of 2004. The rise was driven by price increases in the cereals, meat and fish, and other food sub-groups, which more than offset a decrease in the fruit and vegetables sub-group. The CPI for the 'Miscellaneous' expenditure group increased by 3.6 percent in the March quarter of 2005, compared to a decrease of 0.5 percent in the December quarter of 2004.

All urban areas included in the survey, except Lae, recorded decreases in the CPI in the March quarter of 2005. Goroka saw the largest reduction in prices of 6.1 percent and contributed negative 0.73 percentage points to the overall movement in the CPI. The second largest fall was 2.8 percent in Madang, which contributed negative 0.32 percentage points to the overall movement. Rabaul recorded a decline of 1.8 percent



in the CPI and contributed negative 0.19 percentage points, while in Port Moresby prices fell by 0.7 percent contributing negative 0.30 percentage points. The CPI for Lae increased by 1.8 percent due to higher prices for all expenditure groups, except the 'Transport and communication' expenditure group.

The exclusion-based inflation measure was negative 1.2 percent in the March quarter of 2005, the same value as in the December quarter of 2004. Trimmed mean inflation was 1.8 percent in the March quarter of 2005, compared to zero percent in the December quarter of 2004.

5. EXPORT COMMODITIES REVIEW

The total value of merchandise exports in the March quarter of 2005 was K2,086 million, 5.8 percent higher than in the corresponding quarter of 2004. Declines in export values were recorded for gold, crude oil, cocoa, palm oil, tea and marine product exports, while there were increases in the values of copper, coffee, copra, copra oil, rubber, forestry products, and other non-mineral exports. Mineral export receipts, excluding crude oil were K1,233.6 million and accounted for 59.1 percent of total merchandise exports in the March quarter of 2005, compared to 56.4 percent in the corresponding quarter of 2004. Crude oil exports totalled K260.7 million and accounted for 12.5 percent of total merchandise exports in the March quarter of 2005, compared to 17.8 percent of total merchandise exports in the corresponding quarter of 2004.

The value of agricultural, marine products and other non-mineral exports, excluding forestry product exports was K471.1 million and accounted for 22.5 percent of total merchandise exports in the March quarter of 2005, compared to 20.8 percent of total merchandise exports in the corresponding quarter of 2004. Forestry product exports were K120.6 million and accounted for 5.8 percent of total merchandise exports in the March quarter of 2005, compared to 5.0 percent in the corresponding quarter of 2004.

The weighted average price of Papua New Guinea's exports increased by 9.1 percent in the March quarter of 2005, compared to the corresponding quarter of 2004. There was an 11.7 percent increase in the weighted average kina price of mineral exports, with higher prices of copper and crude oil. For the agricultural, forestry and marine product exports, the weighted average kina price declined by 1.8 percent and was associated with lower prices of cocoa, copra, copra oil, palm oil and log exports. The lower export prices reflected the appreciation of the kina against the US dollar as international prices for most agricultural exports increased during the March quarter of 2005.

Mineral Exports

Total mineral export receipts were K1,494.3 million in the March quarter of 2005, compared to K1,465.0 million in the corresponding quarter of 2004. The increase was due to higher export value of copper, which more than offset lower export receipts for gold and crude oil.

Gold export volumes during the March quarter of 2005 were 13.8 tonnes, a decline of 22.0 percent from the corresponding quarter of 2004. The decline was due to lower production and shipment caused by wet weather at the Porgera, Lihir and Tolukuma mines, which more than offset higher production from the Ok Tedi mine. The average f.o.b. price received for Papua New Guinea's gold exports was K40.8 million per tonne during the March quarter of 2005, 0.5 percent lower than in the corresponding period of 2004, due mainly to the appreciation of the kina against the US dollar as international prices increased. The average gold price at the London Metal Exchange increased by 5.1 percent to US$429 per fine ounce in the March quarter of 2005, compared to the corresponding quarter of 2004. The increase was due to higher demand from Asia and North America, as gold-based investments remained attractive and safe to investors after continued lower performance in the US equity markets, following the weakening of the US dollar against major currencies. The lower export price and volume resulted in gold export receipts of K563.4 million in the March quarter of 2005, a decline of 22.4 percent from the corresponding quarter of 2004.

Copper export volumes in the March quarter of 2005 were 64.8 thousand tonnes, an increase of 40.0 percent from the corresponding quarter of 2004. The increase was due to higher production and shipment of copper ore from the Ok Tedi mine. The average f.o.b. price of Papua New Guinea's copper exports was K10,025 per tonne in the March quarter of 2005, an increase of 23.3 percent from the corresponding quarter of 2004, due to higher international prices. The increase in international prices reflected lower stock levels at the London Metal Exchange combined with increased demand from Asia, one of the major copper-consuming regions. The combined increase in export price and volume resulted in an export value of K649.6 million in the March quarter of 2005, an increase of 72.5 percent from the corresponding quarter of 2004.

Crude oil export volumes in the March quarter of 2005 were 2,104.0 thousand barrels, a decline of 35.6 percent from the corresponding quarter of 2004. The decline reflected a lower extraction rate from wells at the Kutubu, Gobe Main and South East Gobe oil projects attributed to the natural decline in reserve levels, combined with the temporary closure of the Kumul oil loading terminal for maintenance. The average export price of crude oil was K124 per barrel in the March quarter of 2005, an increase of 14.8 percent from the corresponding quarter of 2004, due to increased international prices. Higher international prices resulted from the decision by the Organisation of Petroleum Exporting Countries (OPEC) to cut production and the continued US-led occupation of Iraq. This combined with lower North American oil stocks, increased demand from Asia, a strike by oil workers in Venezuela and supply disruptions from a leading Russian oil company resulted in the increase in prices. The decline in export volume more than offset the increase in export price and resulted in an export value of K260.7 million in the March quarter of 2005, a decline of 25.9 percent from the corresponding quarter of 2004.

Agriculture, Logs and Fisheries Exports

Export prices of most agricultural export commodities declined in the March quarter of 2005, compared to the corresponding quarter of 2004. Cocoa prices declined by 18.4 percent, copra by 4.2 percent, copra oil by 9.0

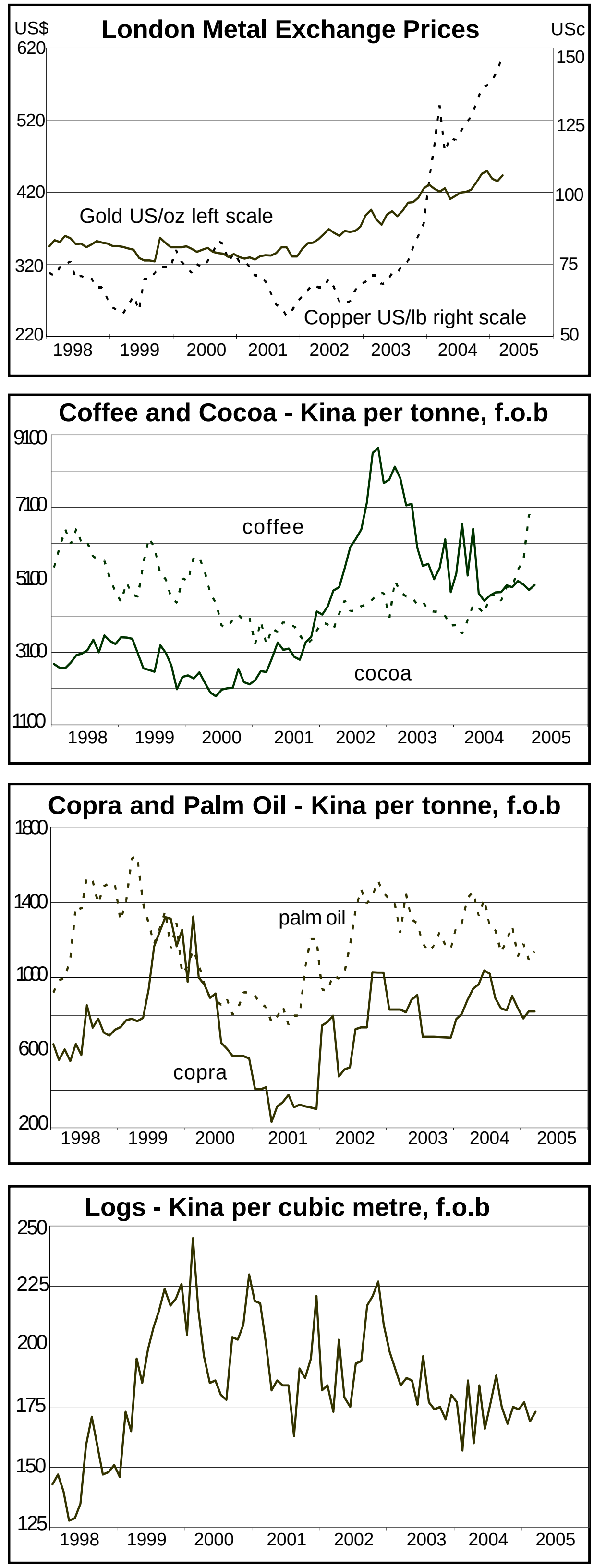
percent and palm oil by 14.6 percent. The average export price of logs was K173 per cubic meter in the March quarter of 2005, a decline of 0.6 percent from the corresponding quarter of 2004. The decline in the export price of cocoa, copra, copra oil, palm oil and logs more than offset the increase in prices of other agricultural export commodities and marine products resulting in a 1.8 percent decline in the weighted average price of agricultural, forestry and marine product exports. Excluding logs, the weighted average price of agricultural and marine product exports declined by 2.6 percent in the March quarter of 2005, compared to the corresponding period of 2004.

The volume of coffee exported in the March quarter of 2005 was 6,000 tonnes, a decline of 26.8 percent from the corresponding quarter of 2004. Despite significant increases in international prices, the lower production was mainly attributed to the biennial coffee production cycle and lower sales due to the deteriorating road infrastructure. The average export price of coffee was K6,400 per tonne in the March quarter of 2005, an increase of 68.2 percent from the corresponding quarter of 2004. The increase was mainly due to higher international prices attributed to a decline in world supply caused by unfavourable weather conditions in Brazil, the world's major coffee producer. The increase in export price more than offset the decline in export volume, resulting in an export value of K38.4 million in the March quarter of 2005, an increase of 23.1 percent from the corresponding period of 2004.

The volume of cocoa exported in the March quarter of 2005 was 8,600 tonnes, a decline of 17.3 percent from the corresponding quarter of 2004. This was attributed to lower production as a result of unfavourable weather conditions in the major cocoa producing regions. The average export price of cocoa was K4,919 per tonne in the March quarter of 2005, a decline of 18.4 percent from the corresponding period of 2004. This was due to lower international prices, resulting from higher supply in the world market reflecting increased production from Africa, mainly the Ivory Coast, Latin America and other major cocoa producing countries in Asia. The combined decrease in the export price and volume resulted in an export value of K42.3 million in the March quarter of 2005, a decline of 32.5 percent from the corresponding period of 2004.

The volume of copra exported in the March quarter of 2005 was 6,400 tonnes, an increase of 20.8 percent from the corresponding quarter of 2004. The increase

EXPORT COMMODITY PRICES



was due to higher production from the major producing regions, resulting from a supply response to higher international prices. The average export price of copra was K813 per tonne in the March quarter of 2005, a decline of 4.2 percent from the corresponding quarter of 2004. This was mainly due to the appreciation of the kina against the US dollar, as international prices increased. 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. The increase in export volume more than offset the decline in export price resulting in an export value of K5.2 million in the March quarter of 2005, an increase of 15.6 percent from the corresponding period of 2004.

The volume of copra oil exported in the March quarter of 2005 was 11,600 tonnes, an increase of 52.6 percent from the corresponding period of 2004. The increase reflected higher quantities of copra sold to the two domestic copra mills for processing. The average export price of copra oil was K1,664 per tonne in the March quarter of 2005, a decline of 9.0 percent from the corresponding period of 2004. The decline was mainly attributed to the appreciation of the kina against the US dollar as international prices increased. The increase in international prices resulted from lower copra production from the Philippines and Indonesia, two of the world's major copra producers. The increase in export volume more than offset the decline in export price, resulting in an export value of K19.3 million in the March quarter of 2005, an increase of 38.8 percent from the corresponding period of 2004.

The volume of palm oil exported in the March quarter of 2005 was 64,200 tonnes, a decline of 36.5 percent from the corresponding period of 2004. This was due to lower production, as a result of unfavourable weather conditions in the palm oil producing regions. The average export price of palm oil was K1,146 per tonne in the March quarter of 2005, a decline of 14.6 percent from the corresponding quarter of 2004, due to lower international prices. International prices declined as a result of increased production from Malaysia and Indonesia, two of the world's leading producers. The combined decrease in the export price and volume resulted in an export value of K73.6 million in the March quarter of 2005, a decline of 45.8 percent from the corresponding period of 2004.

The volume of tea exported in the March quarter of 2005 was 1,800 tonnes, a decline of 21.7 percent from the corresponding quarter of 2004. This was due to lower production attributed to unfavourable weather conditions in the major producing regions. The average export price of tea was K2,944 per tonne in the March quarter of 2005, an increase of 2.6 percent from the corresponding period of 2004. The decrease in export volume more than offset the increase in export price resulting in an export value of K5.3 million in the March quarter of 2005, compared to K6.6 million in the corresponding period of 2004.

The volume of rubber exported in the March quarter of 2005 was 1,100 tonnes, an increase of 37.5 percent from the corresponding period of 2004. The increase was mainly attributed to favourable weather conditions in the rubber producing regions. The average export price was K3,636 per tonne in the March quarter of 2005, an increase of 7.7 percent from the corresponding period of 2004, due to higher international prices resulting from lower supply in the world market. The combined increase in export price and volume resulted in an export value of K4.0 million in the March quarter of 2005, an increase of 48.1 percent from the corresponding period of 2004.

The volume of logs exported in the March quarter of 2005 was 608 thousand cubic meters, an increase of 22.8 percent from the corresponding period of 2004. This was mainly due to higher production and shipment of logs from major logging projects as a result of favourable weather conditions. The average export price of logs was K173 per cubic meter in the March quarter of 2005, a decline of 0.6 percent from the corresponding period of 2004. The decline was attributed to lower international prices, reflecting higher supply of tropical hardwood in the world market. The increase in export volume more than offset the marginal decline in export price, resulting in an export value of K105.2 million in the March quarter of 2005, an increase of 22.3 percent from the corresponding period of 2004.

The value of marine products exported in the March quarter of 2005 was K9.8 million, a decline of 57.2 percent from the corresponding period of 2004. This resulted from a decline in export volume, which more than offset an increase in export price.

6. BALANCE OF PAYMENTS

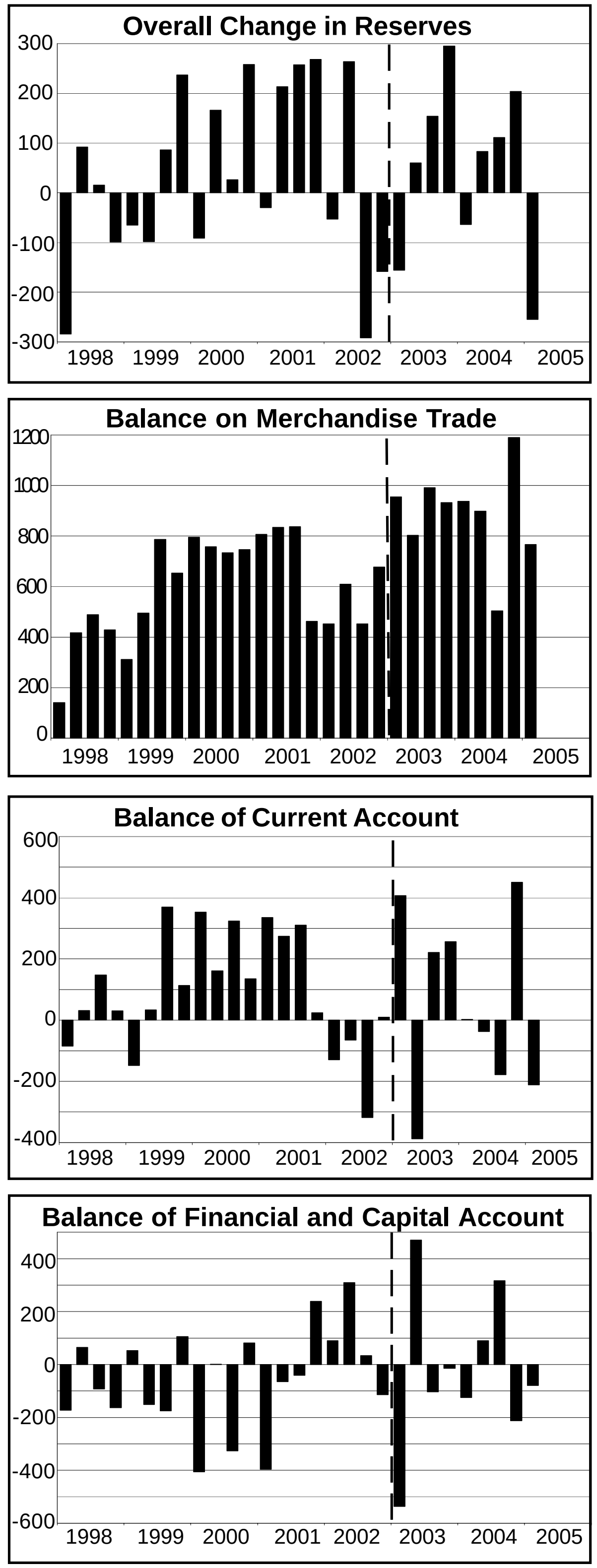
The overall deficit in the balance of payments was K255 million in the March quarter of 2005, compared to a deficit of K64 million in the corresponding period of 2004. The higher deficit resulted from deficits in the current and capital and financial accounts.

The deficit in the current account was attributed mainly to a lower surplus in the trade balance, higher net income payments and lower net transfer receipts, which more than offset lower net service payments. The deficit in the capital and financial accounts reflected an increase in portfolio and financial derivative assets held abroad, which more than offset a net inflow of direct equity investment, combined with the draw down of foreign currency account balances by the mineral companies. In the March quarter of 2005, the kina appreciated against the currencies of Papua New Guinea's major trading partners with the exception of the euro, compared to the corresponding period in 2004.

The trade account recorded a surplus of K766 million in the March quarter of 2005, compared to a surplus of K938 million in the corresponding quarter of 2004. This outcome was the result of an increase in imports, which more than offset an increase in exports. The value of merchandise exports in the March quarter of 2005 was K2,086 million, an increase of 5.8 percent from the corresponding period of 2004. This was attributed to higher values of copper, coffee, copra, copra oil, rubber, forestry products and other exports, which more than offset declines in gold, crude oil, cocoa, palm oil, tea and marine products exports.

The value of merchandise imports in the March quarter of 2005 was K1,320 million, an increase of 27.7 percent from the corresponding period of 2004. This was due to higher values of general and petroleum imports, which more than offset the decline in mining sector imports. General imports were K1,020 million in the March quarter of 2005, an increase of 31.8 percent from the corresponding period of 2004, due to higher import demand combined with the depreciation of the kina against a strong Australian dollar. Imports by the petroleum sector were K75 million in the March quarter of 2005, a significant increase of 341.2 percent from the corresponding period of 2004, mainly reflecting the construction work at the NW Moran oil project. Imports by the mining sector were K225 million in the March

BALANCE OF PAYMENTS[1]
(K'million)



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

quarter of 2005, a decline of 7.4 percent from the corresponding period of 2004. The decline was due to lower capital expenditure at the Porgera, Lihir, Tolukuma and Misima mines, which more than offset higher capital expenditure undertaken by the Ok Tedi mine.

The deficit in the services account was K632 million in the March quarter of 2005, compared to a deficit of K700 million in the corresponding period of 2004. The lower deficit was due to a decline in payments relating to travel, education, other financial services, communication, other business services, government services n.i.e., construction and other services.

The deficit in the income account was K420 million in the March quarter of 2005, compared to a deficit of K413 million in the corresponding period of 2004. The higher deficit was mainly due to increased dividend payments by resident companies, combined with lower income receipts.

The surplus in the transfers account was K75 million in the March quarter of 2005, compared to a surplus of K177 million in the corresponding period of 2004. The lower surplus was due to a decline in receipts from gifts and grants combined with higher payments from licensing fees, which more than offset higher family maintenance, tax and licensing fees receipts.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a deficit of K211 million in the March quarter of 2005, compared to a surplus of K2 million in the corresponding period of 2004.

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

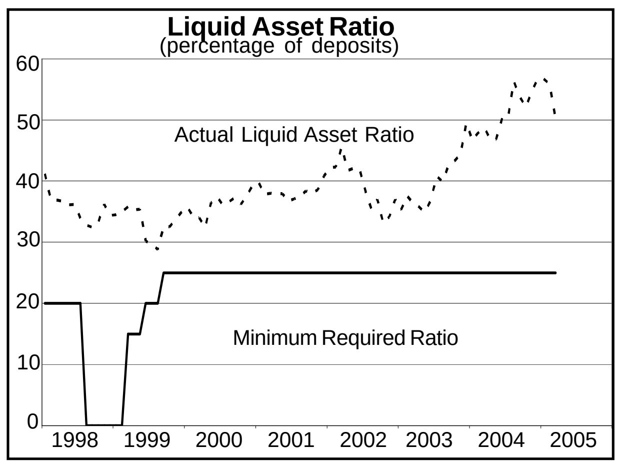
The financial account recorded a net outflow of K79 million in the March quarter of 2005, compared to a net outflow of K125 million in the corresponding quarter of 2004. This was due to net outflows of portfolio investments totalling K145 million, reflecting investments in short term money market instruments by mineral companies. This combined with the purchase of financial derivative instruments of K3 million more than offset a net inflow in Other Investments totalling K56 million, mainly reflecting payments of trade credits by non-residents, draw down in foreign currency account balances of mineral companies and lower loan repayments by the Government.

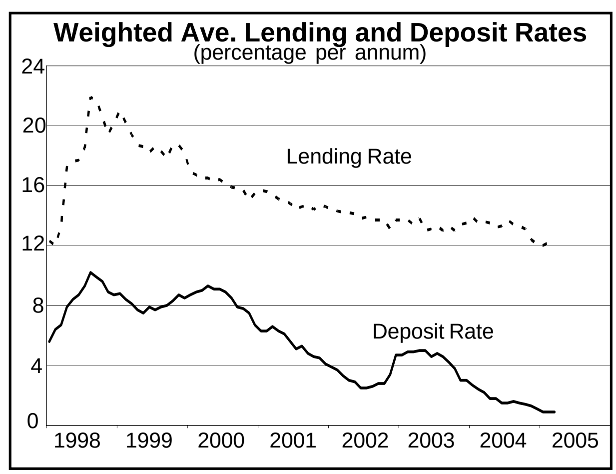
The level of gross foreign exchange reserves at the end of March 2005 was K1,805.7 (US$607.6) million, sufficient for 4.1 months of total and 5.3 months of non-mineral import cover.

7. MONETARY DEVELOPMENTS

LIQUIDITY AND INTEREST RATES

The Bank of Papua New Guinea maintained a neutral monetary policy stance during the first quarter of 2005 by keeping the Kina Facility Rate (KFR) unchanged at 7.0 percent. The Repurchase Agreement Facility (RAF) dealing margins were also maintained at 3.0 percent on both the buy and sell sides from the KFR. The 28 and 91-day Treasury bill rates increased from 3.14 and 3.70 percent at the end of 2004 to 3.54 and 4.09 percent, respectively at the end of March 2005, whilst the 63 and 182-day rates declined from 3.44 and 4.57





percent to 3.32 and 4.37 percent during the same period.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy over the March quarter of 2005. Given the high level of liquidity in the banking system, the Bank mainly used Treasury bills and Central Bank Bills (CBB) to diffuse some of the excess liquidity and maintain stability in domestic interest rates. With the excess level of liquidity in the banking system, inter-bank activity remained subdued. There was no transaction under the RAF during the period. The Cash Reserve Requirement (CRR) and Minimum Liquid Assets Ratio (MLAR) were maintained at 3.0 percent and 25.0 percent, respectively, over the March quarter of 2005.

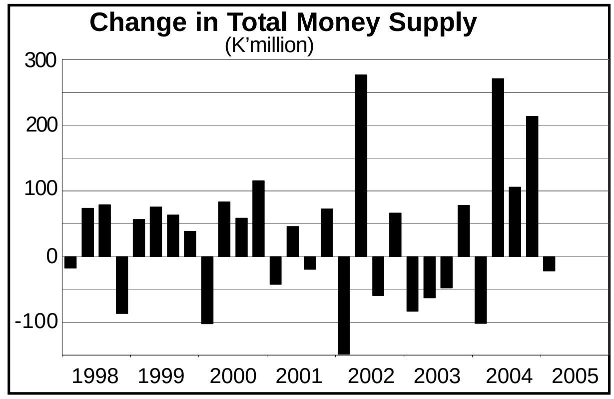
Average liquid assets held by commercial banks declined marginally by 0.5 percent in the March quarter of 2005, following an increase of 8.8 percent in the December quarter of 2004. Commercial banks continued to hold the majority of their liquid assets in the form of Government securities and CBBs.

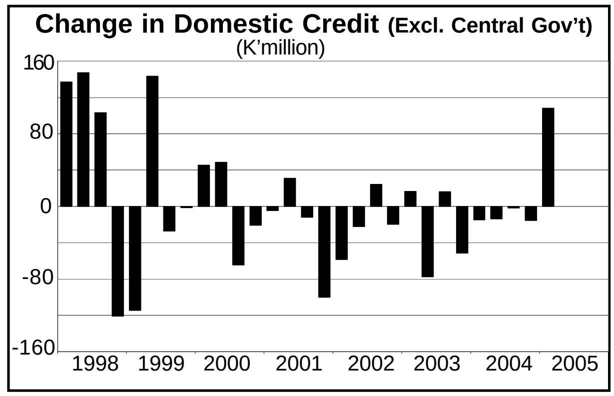
The weighted average deposit rates quoted on wholesale deposits (K500,000 and above) recorded a mixed trend. Between the end of December 2004 and March 2005, the 30 days deposit rate increased from 1.62 percent to 1.99 percent, 60 days from 1.51 percent to 1.71 percent, while the 90 days rate declined from 3.28 percent to 1.50 percent and 180 days from 4.68 percent to 3.60 percent.

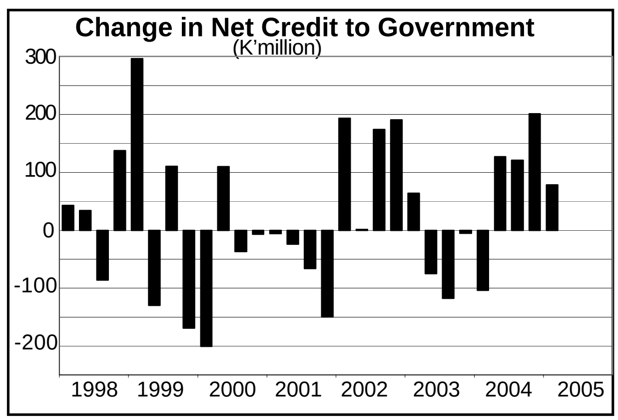
The weighted average interest rate on total loans extended by commercial banks declined from 12.1 percent to 11.9 percent between December 2004 and March 2005, while the weighted average interest rate on total deposits fell from 1.1 percent to 0.9 percent. The commercial banks maintained their Indicator Lending Rates (ILR) over the quarter with a spread of 10.50 percent to 11.25 percent.

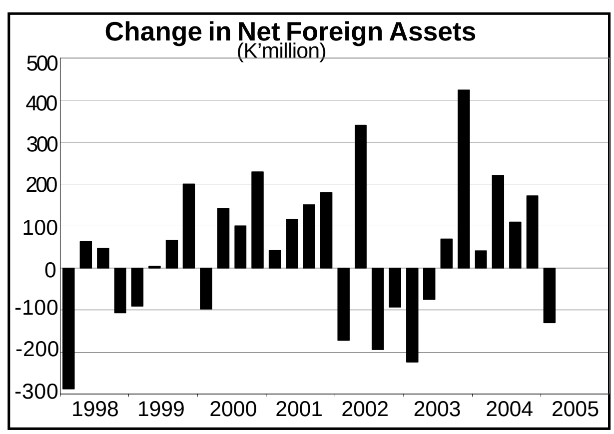
MONEY SUPPLY

The average level of broad money supply (M3*) decreased by 0.3 percent in the first quarter of 2005, compared to a revised increase of 6.0 percent in the December quarter of 2004. The outcome was mainly due to a decline of 6.1 percent in average net foreign assets of the banking system. This more than offset increases in average net credit to the Government of 9.9 percent and 3.3 percent in average net credit to the









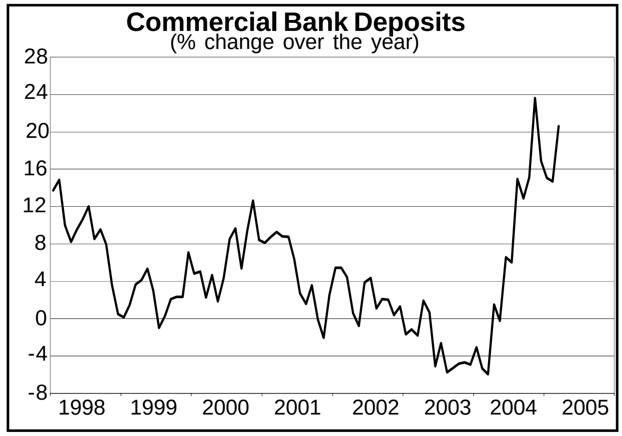
private sector, official entities and non-monetary financial institutions. The decline in net foreign assets of the banking system reflected reductions in both net foreign assets of the Central Bank and the commercial banks. The decline at the Central Bank was a result of its interventions in the foreign exchange market and net repayment of external debts, including repayments under the IMF Stand-By Facility. It also reflects revaluation losses due to the appreciation of the exchange rate.

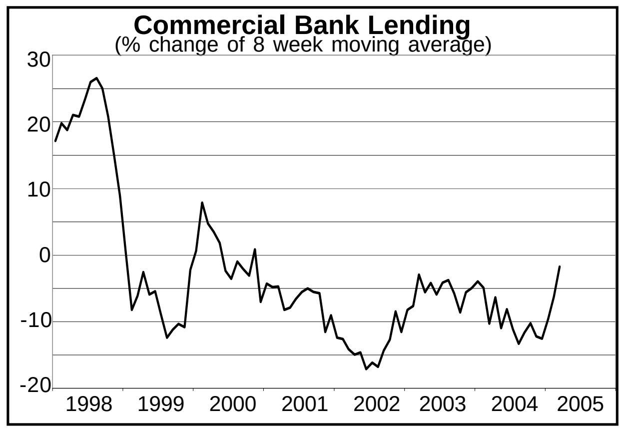
The increase in average net credit to the Government was mainly due to higher holdings of Government securities by the commercial banks and the utilisation of the Temporary Advance Facility (TAF) at the Central Bank. Domestic credit outstanding, excluding advances to the Central Government and outstanding loans under the Government's Agricultural export commodity price support schemes increased by 7.5 percent in the March quarter of 2005, compared to the December quarter of 2004. The average level of the monetary base declined by 1.0 percent over the first quarter of 2005, compared to an increase of 8.2 percent in the December quarter of 2004. The reduction reflected the lower average level of liquid assets of the commercial banks and a decline in currency in circulation.

Net credit to the Government increased by 5.3 percent in the first quarter of 2005, compared to an increase of 15.9 percent in the December quarter of 2004. The increase was due to the utilisation of the TAF and a decline in Government deposits at the Central Bank, as well as an increase in holding of Government securities by the commercial banks. A decline in net foreign assets of K130.4 million resulted from a decline in net foreign assets of the Central Bank of K148.8 million, which more that offset an increase in net foreign assets of commercial banks of K18.5 million.

The average level of narrow money supply (M1*) increased by 3.6 percent in the March quarter of 2005, compared to 10.2 percent in the December quarter of 2004. The increase was due to growth in demand deposits. Quasi money declined by 6.1 percent during the March quarter as a result of decreases in both savings and term deposits.

The average level of deposit base of commercial banks increased by 0.1 percent in the March quarter of 2005 to K3,433.3 million, from K3,430.7 million in the December quarter of 2004. This represents an annualised growth rate of 0.3 percent.





LENDING

During the March quarter of 2005, total domestic credit extended by the commercial banks to the private sector, official entities and non-monetary financial institutions increased by K108.2 million to K1,559.2 million, compared to a decline of K15.0 million during the corresponding quarter of 2004. Lending to the private sector and official entities increased by K84.4 million and K32.1 million, respectively, while lending to the non-monetary financial institutions decreased by K8.3 million. The increase in lending to the private sector was mainly to the building and construction and agriculture and forestry sectors, as well as private households. Lending to official entities was mainly to non-financial public enterprises. Loan repayments by non-monetary financial institutions resulted in a decline in lending to that sector. 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 2005. The annualised growth in domestic credit, excluding the Central Government and advances under the price support schemes was 34.6 percent in the first quarter of 2005. Foreign currency lending to the private sector and official entities was 6.0 percent of total lending to these sectors, compared to 8.5 percent in December 2004, with kina lending accounting for the remainder.

The utilisation 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 81.6 percent in March 2005, compared to 79.8 percent in December 2004. The increase in the rate of utilisation reflects draw down of committed funds.

8. PUBLIC FINANCE

Preliminary estimates of the fiscal operations of the National Government in the three months to March 2005 showed an overall surplus of K127.1 million, compared to a surplus of K13.8 million in the corresponding period of 2004. This represents 0.9 percent of nominal GDP. The higher surplus was mainly due to increased revenue, while there was a marginal decline in expenditure.

Total revenue, including grants during the March quarter of 2005 was K684.2 million, K110.6 million higher than the receipts collected in the corresponding period of 2004. This represents 14.7 percent of the budgeted revenue.

Total tax revenue amounted to K645.2 million, 18.3 percent higher than the receipts collected during the same period in 2004, and represents 21.6 percent of the budgeted tax receipts. Direct tax receipts totalled K416.9 million, K102.2 million higher than the receipts collected over the corresponding period in 2004, and represents 20.4 percent of the budgeted amount. The increase was due to higher company, personal income and other direct tax receipts. The growth in company tax receipts reflected improvement in profitability of companies because of higher mineral and agricultural export prices. The increase in personal tax receipts reflected high wages and salaries as a result of wage adjustments and increased employment by the private sector. The increase in other direct taxes was due to higher dividend withholding tax receipts.

Indirect tax receipts was K228.3 million, 1.0 percent lower than in the corresponding period in 2004, and represents 24.2 percent of the budgeted receipts for 2005. The decline reflected lower excise and other indirect tax receipts, which more than offset higher GST, and export and import duty tax receipts. The decline in excise duties was due to the transfer of the excise collected on fuels from import excise to domestic excise collections. The decline in other indirect tax receipts was related to lower mining levy.

Total non-tax revenue amounted to K39.0 million, K10.7 million higher than the amount collected in the corresponding period of 2004, and represents 10.5 percent of the budgeted amount. The increase mainly reflected higher dividend payments during the period.

Total expenditure over the three months to March 2005 was K557.1 million, 0.5 percent lower than in the corresponding period in 2004, and represents 11.7 percent of the budgeted expenditure for 2005.

Recurrent expenditure over the first quarter of 2005 was K498.3 million, 6.7 percent lower than the corresponding period in 2004, and represents 17.2 percent of the 2005 budgeted appropriation. The decline was due to lower interest payments and grants to statutory authorities, which more than offset the increase in National and Provincial Government expenditures. Interest payments totalled K41.4 million, K101.3 million lower than the amount paid in the corresponding period in 2004. The substantial decline reflected lower interest rates on domestic loans combined with the retirement of some domestic debt and lower kina value of payments of external loans due to the appreciation of the exchange rate. The National Departmental expenditure totalled K270.9 million, K37.8 million higher than the amount spent during the corresponding period in 2004, and represents 17.1 percent of the budgeted appropriation. The increase reflects higher salaries and wages and cost of other goods and services. Provincial Government recurrent expenditure was K139.1 million, 26.1 percent higher than the expenditure level during the same period in 2004, and represents 22.1 percent of the budgeted amount. The higher expenditure was due to increased salaries and wages and administrative grants.

Total development expenditure for the first quarter of 2005 was K58.8 million, K33.3 million higher than in the corresponding period in 2004 and represents 3.1 percent of the budgeted expenditure for 2005.The higher level of spending was related to the implementation of the 2005 Development Budget reflecting increased counterpart funding for donor funded projects and disbursement of District Support Grants.

As a result of these developments in revenue and expenditure, the Government recorded a surplus in the first three months of 2005 which was used to make net overseas and domestic loan repayments of K100.8 million and K26.3 million, respectively.

FOR THE RECORD

MONTHLY KINA FACILITY RATE ANNOUNCEMENTS

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

2003	06 January	Increased by 50 basis points to 14.50%
	03 February	Increased by 50 basis points to 15.00 %
	03 March	Maintained at 15.00 %
	07 April	Maintained at 15.00 %
	05 May	Maintained at 15.00 %
	02 June	Increased by 100 basis points to 16.00 %
	07 July	Maintained at 16.00 %
	04 August	Reduced by 100 basis points to 15.00 %
	01 September	Maintained at 15.00 %
	06 October	Reduced by 100 basis points to 14.00 %
	03 November	Maintained at 14.00 %
	01 December	Maintained at 14.00 %
2004	05 January	Reduced by 100 basis points to 13.00 %
	02 February	Maintained at 13.00 %
	01 March	Reduced by 100 basis points to 12.00 %
	05 April	Reduced by 100 basis points to 11.00 %
	03 May	Reduced by 100 basis points to 10.00 %
	07 June	Maintained at 10.00 %
	05 July	Maintained at 10.00 %
	02 August	Maintained at 10.00 %
	06 September	Reduced by 100 basis points to 9.00 %
	02 October	Reduced by 200 basis points to 7.00 %
	01 November	Maintained at 7.00 %
	06 December	Maintained at 7.00 %
2005	03 January	Maintained at 7.00 %
	01 February	Maintained at 7.00 %
	01 March	Maintained at 7.00 %

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

FOR THE RECORD

CHANGE TO TABLE 9.5 EXPORTS FROM THE NAPANAPA OIL REFINERY

The construction of the Napanapa Oil Refinery, Papua New Guinea's first oil refinery owned and operated by Inter oil Limited was completed in 2004 and officially commissioned in May 2005. It started production towards the end of the June quarter of 2004 and actual exports commenced later in the September quarter of 2004. The refinery is involved in producing a variety of refined petroleum products including gasoline, Jet A1, diesel, butane, low sulphur wax residue (LSWR), propane and light and mixed naphtha from crude oil.

It is an important project in terms of its potential contribution to the Papua New Guinea economy. These refined petroleum products constitute a significant share of total exports currently classified as other exports. Therefore the refined petroleum products have been shown separately from other exports in Table 9.5 (page S31).

CHANGES TO TABLES 1.2 AND 1.3 'OTHER ITEMS (NET)'

The **Other Items (Net)** was reclassified from the components to the determinants side of the money supply tables 1.2 and 1.3. The change was made to ensure consistency with the revised *IMF Monetary and Financial Statistics Manual 2000*.

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 1990.

Issue	Title
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
Sep 2004	Semi-annual Monetary Policy Statement, July 2004
Dec 2004	Semi-annual Monetary Policy Statement, January 2005
Dec 2004	The 2005 National Budget

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