CONTENTS

PORT MORESBY

24th May 2006

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

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

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

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

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

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

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

Inscribed Stock
A Government bond or debt instrument sold to the public for a maturity term of one year or longer for Budget financing.

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

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

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

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

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

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

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

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

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

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

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

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

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

Trade Account — Records all economic transactions associated with merchandise exports and imports of physical goods.

Trade Weighted Index[2] — The Trade Weighted Index (TWI) measures the value of the kina against a basket of currencies of PNG's major trading partners.

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

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

Underlying CPI (exclusion-based and trimmed-mean CPI measures) — A measure of inflation that excludes short-term volatile movements in prices, such as seasonal factors, Government policy decisions and price controlled items.

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

2. GENERAL OVERVIEW

The stable macroeconomic conditions and economic growth experienced in 2005 continued into the first quarter of 2006. There was a surplus in the current account underpinned by strong export performance from high international mineral prices and increased production. Despite the mild depreciation in the kina exchange rate during the March quarter, inflation outcomes were low reflecting the stability of the kina exchange rate in the second half of 2005 . The level of employment also increased across most sectors of the economy. This enabled the Bank of PNG to maintain a neutral monetary policy stance in the March quarter of 2006. Interest rates continued to remain low, reflecting the persistently high level of liquidity, while lending to the private sector continued to grow substantially. Whilst price stability has been achieved, the risks to this stability include the substantial increase in lending, the possibility of a fall in commodity prices and any slippages in fiscal management.

The Bank's Employment Index shows that the level of employment in the formal private sector grew by 8.1 percent over the year to March 2006. Excluding the mineral sector, the growth in employment was 8.0 percent. The level of employment increased in all the sectors except the transportation sector, with the agriculture/forestry/fisheries and construction sectors recording the largest increases. Employment levels increased in all regions.

Annual headline Consumer Price Index (CPI) inflation was 1.8 percent in the March quarter of 2006, compared to 4.6 percent in the December quarter of 2005. The lower headline inflation outcome was caused by large declines in the prices of seasonal products, alcoholic drinks, cigarettes and tobacco during the March quarter. By region, all surveyed urban centres recorded declines, except Rabaul.

Annual trimmed mean inflation was 1.5 percent in the March quarter of 2006, compared to 3.3 percent in the previous quarter. Annual exclusion-based inflation was 0.1 percent in the March quarter, compared to negative 1.4 percent in the December quarter of 2005. The low underlying inflation outcomes reflect the price stability achieved since 2003 as a result of the stable kina exchange rate and improved fiscal management of the Government.

During the March quarter of 2006, the kina depreciated mildly against all the other major currencies except the Australian dollar. Compared to the December quarter of 2005, the quarterly average kina exchange rate depreciated by 0.46 percent against the US dollar to 32.30 US cents and appreciated by 0.42 percent against the Australian dollar to 43.71 Australian cents. These movements resulted in the quarterly average Trade Weighted Index (TWI) depreciating by 0.31 percent during the March quarter.

Higher international prices for mineral exports and some of Papua New Guinea's agricultural export commodities resulted in a 34.3 percent increase in the weighted average kina price of exports in the March quarter of 2006, compared to the corresponding quarter of 2005. There was a 42.1 percent increase in the weighted average kina price of mineral exports. For the agricultural, forestry and marine product exports, the weighted average kina price declined by 2.9 percent. This was due to lower prices of cocoa, copra, copra oil, palm oil and tea.

The overall deficit in the balance of payments was K17 million in the March quarter of 2006, compared to a deficit of K255 million in the corresponding quarter of 2005. The improved outcome was due to a surplus in the current account, combined with a lower deficit in the capital and financial accounts.

The current account recorded a surplus of K83 million in the March quarter of 2006, compared to a deficit of K99 million in the corresponding quarter of 2005. This improvement reflected a higher trade surplus and lower net service payments.

The capital and financial accounts recorded a deficit of K143 million in the March quarter of 2006, compared to a deficit of K174 million in the corresponding period of 2005. This outcome was due to net loan repayments by mineral companies and the Government combined with a build up in the foreign currency account balances of mineral companies.

The level of gross foreign exchange reserves at the end of March 2006 was K2,299.5 (US$757.1) million, sufficient for 5.5 months of total and 7.5 months of non-mineral import covers.

The Bank of Papua New Guinea maintained a neutral monetary policy stance during the March quarter of

2006 by keeping the Kina Facility Rate (KFR) unchanged at 6.0 percent. The dealing margins for the Repurchase Agreements (Repo) were also maintained at 300 basis points on both the buy and sell sides of the KFR. However, domestic interest rates trended downwards as a result of the continued high level of liquidity in the banking system.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy in the March quarter of 2006. The Bank mainly used Central Bank Bills (CBB) and Reverse Repos in its attempt to diffuse the excess liquidity and stabilise domestic interest rates. Trading in the inter-bank market was active due to the uneven distribution of liquidity among banks. 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.

The average level of broad money supply (M3*) increased by 3.8 percent in the first quarter of 2006, compared to an increase of 8.6 percent in the December quarter of 2005. The outcome was due to an increase of 6.5 percent in average net credit to the private sector, official entities and non-monetary financial institutions and a 0.5 percent increase in the average net foreign assets of the banking system. These more than offset a decline of 18.7 percent in average net credit to the Government. The average level of monetary base fell by 1.9 percent over the first quarter of 2006, compared to an increase of 3.7 percent in the December quarter of 2005. The decline reflected the lower average level of commercial banks' deposits with the Bank of PNG and a decline in holdings of currency by commercial banks.

Total domestic credit extended by the banking system to the private sector, official entities and non-monetary financial institutions increased by K113.5 million to K1,940.5 million, compared to an increase of K108.2 million during the corresponding quarter of 2005. Lending to the private sector and official entities increased by K131.5 million and K1.0 million, respectively, while lending to the non-monetary financial institutions decreased by K19.1 million. The growth in lending to the private sector was mainly to the manufacturing, transport and communication, building and construction and the private household sectors. The annualised growth in domestic credit, excluding the Central Government and advances under the price support scheme, was 28.1 percent in the first quarter of 2006.

Preliminary estimates of the fiscal operations of the National Government over the three months to March 2006 showed an overall deficit of K30.6 million, compared to a surplus of K128.3 million in the corresponding period of 2005. The deficit represents 0.2 percent of nominal GDP and resulted from higher expenditure, which more than offset an increase in revenue.

Total revenue, including grants, during the March quarter of 2006 was K713.3 million, 4.3 percent higher than the receipts collected in the corresponding period of 2005. This represents 15.1 percent of the budgeted revenue. The increase was a result of higher direct and indirect tax revenue, which more than offset a decline in non-tax revenue.

Total expenditure over the three months to March 2006 was K743.9 million, 33.8 percent higher than in the corresponding period of 2005, and represents 15.4 percent of the budgeted expenditure for 2006. The increase was influenced by higher recurrent and development expenditures.

As a result of these developments in revenue and expenditure, the Government recorded a deficit of K30.6 million in the first three months of 2006. The budget deficit and net external loan repayments of K65.7 million were financed through a net domestic borrowing of K96.3 million.

3. INTERNATIONAL DEVELOPMENTS

World economic growth as measured by real Gross Domestic Product (GDP) is projected to increase slightly in 2006, compared to 2005. The latest International Monetary Fund (IMF) forecast made in April 2006 is for a growth of 4.9 percent in 2006, compared to 4.8 percent in 2005. Inspite of high oil prices and natural disasters global growth continued to exceed expectations, partly aided by favourable financial market conditions and continued accommodative macroeconomic policies. However, expected economic growth differ between countries. The industrialised countries are expected to grow modestly, while strong growth is projected for Asia, particularly China, most emerging markets and developing countries. Major concerns for the global economy in 2006 are the global trade imbalance, the high oil prices and realignment of exchange rates over the medium term, with the US dollar expected to depreciate significantly from current levels.

On 9 January 2006 gold price reached a 25-year high of US$547 an ounce following speculations by the People's Bank of China to diversify its investment of foreign reserves, geopolitical tensions, and expectations that the US dollar would resume its downward trend this year. The People's Bank of China indicated that the State Reserves Bureau should optimise the investment of the country's foreign exchange reserves to other high yielding assets. This raised speculations that China maybe planning to diversify into gold investment. On 24 March 2006, the price of gold further increased to US$559.50 surpassing the earlier record level.

In February, the European Union announced its decision to contain cheap imports from Asia by introducing anti-dumping duties of almost 20 percent on shoes from China and Vietnam. The duties will affect 8 percent of shoes sold in the European market.

In March, copper and zinc prices reached historical levels while silver price reached a 22-year high ahead of an expected announcement by the Securities and Exchange Commission, the US regulator on the launch of a silver-backed exchange-trade fund that would make it easier to gain exposure to the metal. Silver price peaked at US$10.74 a troy ounce, while copper and zinc prices reached US$5,281 a tonne and US$2,582 a tonne respectively reflecting a decline in stockpiles for both metals in warehouses registered with the London Metal Exchange.

Also in March, the IMF Managing Director Rodrigo de Rato made his fourth visit to sub-Saharan Africa, visiting Zambia and Equatorial Guinea. In Equatorial Guinea, he met with leaders from Ethiopia, Ghana, Malawi, Mozambique, Tanzania, Uganda and Zambia for a regional summit. He warned that economic growth in Africa needs to be raised above the current levels of 5 percent if they are to meet the Millennium Development Goals. He also urged the leaders to tackle corruption and ensure that increased aid flows were used effectively through policy frameworks that allowed resource flows to reach their targets, especially education and health – including measures to counter the HIV/AIDS pandemic.

In March, Japan suspended a soft loan of more than ¥3,000 (US$25.7) billion to China. This followed disagreements between the two countries over territory, natural resources and their war time history.

In the US, real GDP grew by 3.5 percent over the year to March 2006, compared to 3.2 percent over the corresponding period in 2005. Real GDP grew by an annualised rate of 4.8 percent in the March quarter of 2006, recovering from its post-hurricane weakness. The growth was mainly associated with heavy purchases of durable goods, more federal government defense spending and increased business investment in equipment and software. The IMF forecast is for GDP to grow by 3.4 percent in 2006.

Industrial production increased by 3.6 percent in the year to March 2006, compared to an increase of 3.9 percent over the year to March 2005. With higher consumer spending on durable goods, retail sales increased by 6.2 percent in the year to March 2006, compared to an increase of 3.0 percent in the year to March 2005. The increase in economic activity resulted in a lower unemployment rate of 4.7 percent in March 2006, compared to 5.1 percent in March 2005.

Consumer prices rose by 3.4 percent in the year to March 2006, compared to an increase of 3.1 percent in the year to March 2005. Broad money supply increased by 4.7 percent in the year to March 2006, compared to an increase of 4.9 percent in the year to March 2005. To prevent the economy from overheating, the US Federal Reserve Board tightened monetary policy in the first quarter of 2006, increasing the federal funds rate from 4.25 percent in the December quarter of 2005 to 4.50 percent in February 2006.

The trade deficit was US$782.1 billion in the year to March 2006, compared to a deficit of US$665.2 billion in the year to March 2005. The increase reflected higher oil prices as well as the growing trade imbalance with Asia, particularly China and Japan. The US plans to apply more pressure on China to introduce a market-oriented exchange rate regime that would see the Chinese Renminbi appreciate against the US dollar.

In Japan, real GDP grew by 3.0 percent over the year to March 2006, compared to an increase of 1.2 percent over the year to March 2005. Real GDP grew by an annualised rate of 1.9 percent in the March quarter of 2006. The growth reflected a pick-up in domestic demand associated with higher personal and private consumption. It was also influenced by strong export performance and increased corporate capital investments. The IMF forecast is for GDP to grow by 2.8 percent in 2006.

Industrial production increased by 3.1 percent in the year to March 2006, compared to an increase of 1.1 percent in the year to March 2005. The increase reflected higher demand for transport equipment, electronics and paper products. Retail sales decreased by 0.2 percent in the year to February 2006, compared to an increase of 1.2 percent in the year to February 2005. With continued improvement in the economy, the unemployment rate fell slightly to 4.1 percent in March 2006 from 4.5 percent in March 2005, the lowest level in seven years.

Consumer prices increased by 0.3 percent in the year to March 2006, compared to a decrease of 0.2 percent in the year to March 2005. Core prices, excluding fresh food, rose by 0.5 percent, the fifth quarterly increase in a row. Broad money supply increased by 1.5 percent in the year to March 2006, compared to an increase of 4.9 percent in the year to March 2005. The Bank of Japan ended its zero interest rate policy in March following the increase in the CPI outcome, which indicated that inflation is beginning to set in after years of deflation.

The current account surplus was US$166.7 billion in the year to March 2006, compared to a surplus of US$170.1 billion in the year to March 2005. The surplus reflected remittance of profits of Japanese companies and increased exports of cars and electronic products.

For the Euro area the IMF estimate is for GDP to grow by 2.0 percent in 2006. In the first quarter of 2006, the European Central Bank (ECB) maintained its benchmark Refinancing Rate at 2.25 percent. While threats of inflation from high oil prices and credit expansion remained a concern, the ECB monetary policy continued to support growth and employment creation activities by keeping interest rates low.

Consumer prices in the Euro area rose by 2.2 percent in the year to March 2006, compared to an increase of 2.1 percent in the year to March 2005. The unemployment rate in the 12-nation group declined to 8.1 percent in March 2006 from 8.8 percent in March 2005.

In Germany, real GDP grew by 1.4 percent in the year to March 2006, compared to a decline of 1.0 percent in the year to March 2005, mainly driven by an export-led recovery while domestic demand continue to remain subdued. Real GDP grew by an annualised rate of 1.6 percent in the March quarter of 2006. The IMF forecast is for GDP to grow by 1.3 percent in 2006.

Industrial production increased by 3.9 percent in the year to March 2006, compared to an increase of 1.6 percent in the year to March 2005. The increase was associated with improved international competitiveness and a significant increase in exports. Retail sales declined by 1.2 percent in the year to March 2006, compared to a decline of 0.7 percent in the year to March 2005. Optimism in the retail industry dropped significantly, setting back hopes that the export-led recovery was finally feeding through into a sustained pick-up in consumer spending. Lack of consumer spending was partly due to a fall in real wages. German export success boosted company profitability but there was little sign of the high unemployment level falling significantly. The unemployment rate was 11.4 percent in March 2006, compared to 12.0 percent in March 2005.

Despite the high oil prices inflation remained stable, with consumer prices increasing by 1.9 percent in the year to March 2006, compared to an increase of 1.8 percent in the year to March 2005.

The current account surplus was US$108.4 billion in the year to March 2006, compared to a surplus of US$109.0 billion in the year to March 2005, reflecting the significant growth in exports.

In the United Kingdom (UK), real GDP increased by 2.2 percent in the year to March 2006, compared to an increase of 2.8 percent in the year to March 2005. The lower growth was attributed to a sharp slowdown in household spending however, companies picked up the slack to help the economy grow. The service sector which accounts for 73 percent of the economy also grew slightly by 0.8 percent. Real GDP grew by an annualised rate of 2.6 percent in the March quarter of 2006. The IMF forecast is for GDP to grow by 2.5 percent in 2006.

Industrial production increased by 0.3 percent in the year to March 2006, compared to a decline of 1.8 percent in the year to March 2005. The growth was due to the production of transport equipment and electrical and optical items to meet demand from abroad, which helped to increase exports by 4.7 percent. Retail sales increased by 2.6 percent in the year to March 2006, compared to an increase of 2.7 percent in the year to March 2005, reflecting the sharp slowdown in household spending. The unemployment rate increased to 5.2 percent in March 2006 from 4.7 percent in March 2005.

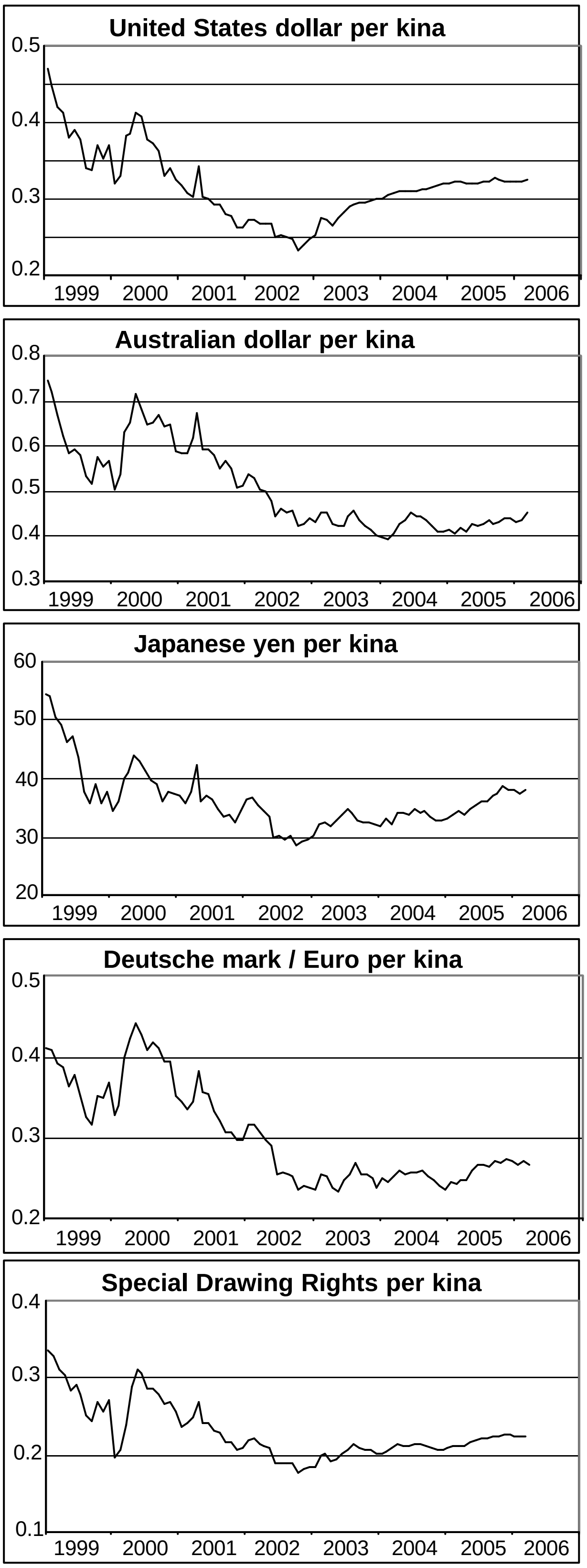
Consumer prices increased by 1.8 percent in the year to March 2006, compared to an increase of 1.9 percent in the year to March 2005. Broad money supply increased by 12.4 percent in the year to March 2006, compared to an increase of 10.4 percent in the year to March 2005. With inflation levels within the target range, the Bank of England maintained its benchmark Repo Rate at 4.50 percent in the March quarter of 2006.

The trade deficit was US$123.0 billion in the year to March 2006, compared to a deficit of US$108.9 billion in the year to March 2005. While exports increased by 4.7 percent, imports also rose by 5.5 percent resulting in the higher trade deficit.

For Australia, the IMF forecast is for GDP to grow by 2.9 percent in 2006. Growth is expected to be driven by strong global demand for commodity exports, high domestic spending and business investment. However, growth maybe adversely affected given little spare capacity in the economy, the tight labour market and solid growth in wages.

Retail sales increased by 2.7 percent in the year to March 2006, compared to an increase of 1.8 percent

EXCHANGE RATES



in the year to March 2005. This resulted from strong household spending and house purchases for owner-occupation as well as cheaper imports and large discounting. The unemployment rate decline slightly to 5.0 percent in March 2006 from 5.2 percent in March 2005.

Consumer prices increased by 3.0 percent in the year to March 2006, compared to an increase of 2.4 percent in the year to March 2005. The increase was mainly due to high fuel prices, school fees, child-care fees, health-care costs and strong wage growth. Broad money supply increased by 9.1 percent in the year to March 2006, compared to an increase of 8.2 percent in the year to March 2005. Given the threat to inflation outlook the RBA increased its official cash rate to 5.50 percent in the March quarter of 2006 from 5.25 percent in the December quarter of 2005.

The trade deficit was US$12.4 billion in the year to March 2006, compared to a deficit of US$18.3 billion in the year to March 2005. The significant improvement in the trade deficit reflected high commodity prices and increased exports, mainly mineral exports to Asia.

During the March quarter of 2006 the US dollar depreciated against the euro and Japanese yen, while it appreciated against the Australian dollar. The quarterly average exchange rate depreciated by 1.2 percent against the euro and 1.3 percent against the Japanese yen, while it appreciated by 0.8 percent against the Australian dollar. The depreciation was mainly due to the on-going US current account and budget deficits. The potential for further depreciation of the US dollar stems from the on-going US current account deficit and the pressure from the US for China to realign its exchange rate to a market-based regime.

In the March quarter of 2006 the kina depreciated against the US dollar, pound sterling and yen, and appreciated against the Australian dollar. The average kina exchange rate depreciated by 0.46 percent against the US dollar to 32.30 US cents, 0.64 percent against the pound sterling and 0.71 percent against the yen. However, the average kina exchange rate appreciated by 0.42 percent against the Australian dollar to 43.71 cents. The improvement was associated with higher international prices for mineral and most agricultural commodities.

4. EMPLOYMENT

According to the Bank's employment index, the level of employment in the formal private sector grew by 2.8 percent in the March quarter of 2006, compared to the December quarter of 2005. By industry, all sectors increased, except the retail/wholesale sector, with the agriculture/forestry/fisheries and building and construction sectors recording the highest growth. By region, the level of employment increased in all the regions. Over the year to March 2006, the level of total employment increased by 8.1 percent.

In the manufacturing sector, the level of employment increased by 1.1 percent in the March quarter of 2006, compared to the December quarter of 2005. The increase reflected the expansion of production capacity and new product lines by manufacturers, combined with higher casual employment. Over the year to March 2006, the level of employment increased by 8.0 percent.

In the building and construction sector, the level of employment increased by 6.0 percent in the March quarter of 2006, compared to the December quarter of 2005. The increase was due to work on the floatation plant for a mine, the redevelopment of a town market and higher casual employment. Over the year to March 2006, the level of employment increased by 15.2 percent.

In the agriculture/forestry/fisheries sector, the level of employment increased by 8.8 percent in the March quarter of 2006, compared to the December quarter of 2005. The growth reflected higher employment by coffee producers, increased palm oil and other agriculture production, the re-commencement of the beche-de-mer harvesting season and higher casual employment. Over the year to March 2006, the level of employment increased by 15.3 percent.

In the transportation sector, the level of employment increased marginally by 0.7 percent in the March quarter of 2006, compared to the December quarter of 2005. Higher casual employment, recruitment of management trainees and increased activity by some transport companies were offset by a reduction in employment following the retrenchment exercise undertaken by a third-level airline. Over the year to March 2006, the level of employment declined by 3.2 percent.

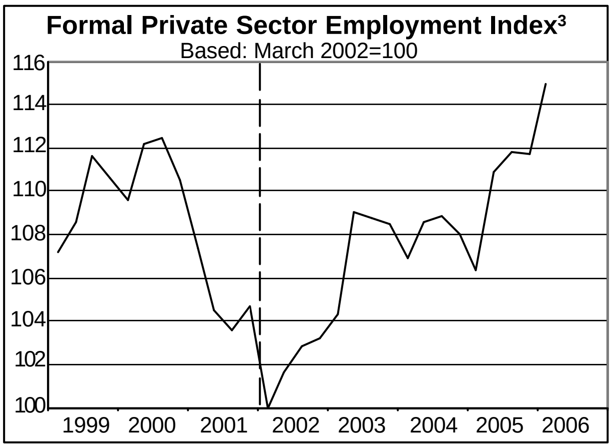
In the financial/business and other services sector, the level of employment increased by 0.2 percent in the March quarter of 2006, compared to the December quarter of 2005. Higher employment by the hotel, financial and real estate companies offset a decline by the security companies and other services sector. Over the year to March 2006, the level of employment remained unchanged.

In the retail/wholesale sector, the level of employment decreased by 2.3 percent in the March quarter of 2006, compared to the December quarter of 2005. The decrease mainly reflected the laying-off of casual employees after the Christmas festive season. Over the year to March 2006, the level of employment increased by 5.5 percent.

In the mineral sector, the level of employment increased by 1.7 percent in the March quarter of 2006, compared to the December quarter of 2005. The increase reflected the construction work on roads at a new mine site and recruitment of university graduates by a mineral company. Over the year to March 2006, the level of employment increased by 8.1 percent.

By region, all the regions recorded higher employment in the March quarter of 2006, compared to the December quarter of 2005. In the NCD, employment increased by 1.0 percent due to higher employment in the building and construction, transportation and financial/business and other services sector. The increase in the building and construction sector reflected higher casual employment for on-going contracts in the NCD and for mine sites in the Highlands and Islands regions. Higher casual employment and the merger of two accounting firms resulted in the increase in the financial/business and other services sector. The increase in the transportation section reflected the hiring of management trainees by an airline and drivers by a trucking firm, as well as increased activity by an air-charter company. Over the year to March 2006, the level of employment increased by 4.2 percent.

In the Southern region, the level of employment increased by 4.0 percent in the March quarter of 2006, compared to the December quarter of 2005. Higher employment levels were recorded in the agriculture/forestry/fisheries, building and construction, retail and transportation sectors. The increase in the agriculture/



forestry/fisheries sector reflected higher production in the palm oil, fisheries and forestry industries, combined with the re-commencement of the beche-de-mer harvesting season. Increased work in the mining industry contributed to the increase in the building and construction sector. Higher casual employment and workers for a recording studio resulted in the increase in the retail sector. The hiring of security guards and casual employees accounted for the increase in the other services sector. Over the year to March 2006, the level of employment increased by 12.4 percent.

In the Highlands region, the level of employment grew by 6.1 percent in the March quarter of 2006, compared to the December quarter of 2005. There were increases in the agriculture, manufacturing and financial/business and other services sectors. The increase in the agriculture sector reflected higher employment by coffee producers, while in the building and construction sector, the redevelopment of a town market more than offset the decline following the completion of contracts. Higher employment by hotels, legal and accounting firms contributed to the increase in the financial/business and other services sector. Over the year to March 2006, the level of employment grew by 11.7 percent

In the Morobe region, the level of employment increased by 1.5 percent in the March quarter of 2006, compared to the December quarter of 2005, with increases mainly in the retail/wholesale, manufacturing and building and construction sectors. Higher employment in the retail/wholesale sector reflected the acquisition of a retailer by another, opening of new

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

agencies and casual employment. Higher casual employment for on-going contract work accounted for the increase in the building and construction sector. The decline in the agriculture/forestry/fisheries sector was due to the down-sizing of a fishing company and reduced work due to the maintenance of vessels by another company. Over the year to March 2006, the level of employment increased by 8.4 percent.

In the Momase region, the level of employment increased marginally by 0.4 percent in the March quarter of 2006, compared to the December quarter of 2005. There was higher employment in the manufacturing, building and construction, transportation and mining sectors. The increase in the manufacturing sector reflected higher production by a cannery, casual employment for expansion work on a factory and sugar harvesting. Higher employment in the building and construction sector was due to casual employees for on-going contracts, while increased employment by a third-level airline accounted for the growth in the transportation sector. Over the year to March 2006, the level of employment grew by 4.1 percent.

In the Islands region, the level of employment increased by 4.6 percent in the March quarter of 2006, compared to the December quarter of 2005. There were increases in the wholesale, agriculture/forestry, building and construction, manufacturing and transportation sectors. Higher employment in the retail/ wholesale sector was due to opening of new outlets by a company in Kimbe. The increase in the agriculture/ forestry sector reflected casual employment by palm oil companies, due to higher production as well as higher casual employment for additional work in preparation for the change in ownership of one of the companies. Casual employment for on-going contracts contributed to the increases in both the building and construction and manufacturing sectors. Higher employment by a land transportation company accounted for the increase in the transportation sector. Over the year to March 2006, the level of employment increased by 8.3 percent.

5. CONSUMER PRICE INDEX

The Consumer Price Index (CPI) declined by 3.8 percent in the March quarter of 2006, following an increase of 4.3 percent in the December quarter of 2005. The substantial quarterly deflation was driven by price falls in the ‘Food’ and ‘Drinks, tobacco and betelnut’ expenditure groups. These falls were mainly caused by lower prices of fruits and vegetables, alcoholic drinks, cigarettes, tobacco and betelnut. By urban area prices fell in all towns other than Rabaul. The annual headline inflation rate for the March quarter of 2006 was 1.8 percent, compared to 4.6 percent in the December quarter of 2005.

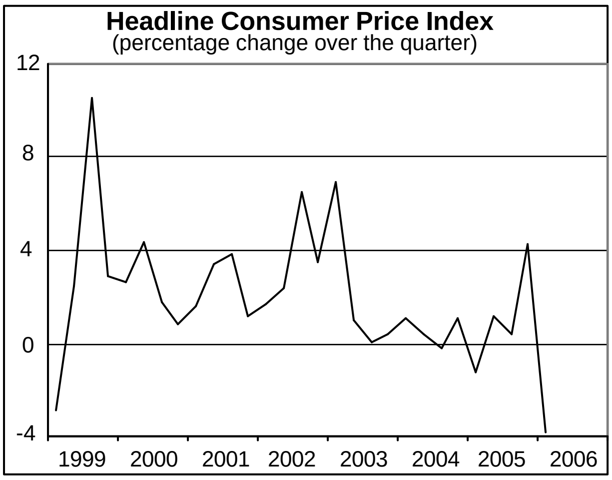
The CPI for the ‘Food’ expenditure group declined by 1.7 percent in the March quarter of 2006, compared to an increase of 2.0 percent in the December quarter of 2005. The decline was driven by fruits and vegetables prices, which decreased by 17.5 percent during the March quarter. Cereals prices rose by 3.8 percent and meat and fish prices increased by 2.4 percent. The group contributed negative 0.7 percentage points to the overall quarterly movement in the CPI.

The CPI for the ‘Drinks, tobacco and betelnut’ expenditure group fell by 12.4 percent in the March quarter of 2006, compared to an increase of 14.2 percent in the December quarter of 2005. The fall was driven by betelnut prices, which declined by 40.4 percent combined with lower prices of soft drinks, alcoholic drinks, cigarettes and tobacco. The group contributed negative 2.5 percentage points to the overall quarterly movement in the CPI.

The CPI for the ‘Clothing and footwear’ expenditure group increased by 1.4 percent in the March quarter of 2006, compared to a fall of 0.2 percent in the December quarter of 2005. The rise was due to price increases of 5.3 percent for other clothing and footwear and 3.2 percent for women’s and girl’s clothing. The group contributed 0.1 percentage points to the overall quarterly movement in the CPI.

The CPI for the ‘Rents, council charges, fuel and power’ expenditure group increased by 3.9 percent in the March quarter of 2006, compared to an increase of 3.8 percent in the December quarter of 2005. The rise was driven by an increase of 7.9 percent in the price of fuel and power, which more than offset a fall of 2.3 percent in council charges. The group contributed 0.3 percentage points to the overall quarterly movement in the CPI.

The CPI for the ‘Household equipment and operations’ expenditure group fell by 3.7 percent in the March quarter of 2006, compared to a fall of 2.4 percent in the December quarter of 2005. The fall was driven by price



decreases of 4.9 percent for semi-durable goods and 8.7 percent for durable goods. The group contributed negative 0.2 percentage points to the overall quarterly movement in the CPI.

The CPI for the 'Transport and communication' expenditure group increased by 1.0 percent in the March quarter of 2006, compared to a fall of 0.2 percent in the December quarter of 2005. The largest quarterly price movement in the 'Transport and communication' group was for airline, PMV and taxi fares, which rose by 17.4 percent. Telephone and postal charges also increased by 3.9 percent, while the cost of motor vehicle purchases fell by 3.4 percent. The group contributed 0.1 percentage points to the overall quarterly movement in the CPI.

The CPI for the 'Miscellaneous' expenditure group increased by 0.2 percent in the March quarter of 2006, compared to negative 0.3 percent in the December quarter of 2005. The marginal rise was the result of an increase of 4.7 percent in the price of entertainment and cultural items, just outweighing falls of 5.8 percent in the cost of medical and health care and 6.3 percent in the price of other goods. While the group's CPI increased slightly, it had no impact on the overall quarterly movement in the CPI.

By urban centres, only Rabaul recorded a price increase in the March quarter of 2006. In Rabaul prices increased by 2.1 percent following an increase of 0.2 percent in the December quarter of 2005. Port Moresby, Lae, Goroka and Madang all recorded price falls. In Port Moresby prices fell by 5.5 percent, compared to an increase of 6.4 percent in the December quarter of 2005. In Madang prices fell by 5.0 percent, compared to an increase of 0.7 percent in the previous quarter. In Goroka prices fell by 3.9 percent, compared to an increase of 9.9 percent in the previous quarter. The smallest price fall was in Lae where prices fell by 2.0 percent, compared to an increase of 0.5 percent in the previous quarter.

Trimmed mean inflation was zero percent in the March quarter of 2006, compared to 0.1 percent in the December quarter of 2005. Annual trimmed mean inflation was 1.5 percent in March 2006, compared to 3.3 percent in December 2005.

Exclusion-based inflation was 0.3 percent in the March quarter of 2006, compared to negative 1.7 percent in the December quarter of 2005. Annual exclusion-based inflation was 0.1 percent in March 2006, compared to negative 1.4 percent in December 2005.

6. EXPORT COMMODITIES REVIEW

The total value of merchandise exports in the March quarter of 2006 was K2,589 million, an increase of 14.3 percent from the corresponding quarter of 2005. Higher export values were recorded for copper, gold, crude oil, coffee, palm oil, rubber and other non-mineral exports, while there were declines in the export values of cocoa, copra, copra oil, tea, logs, marine and refined petroleum products. Mineral export receipts, excluding crude oil were K1,440.0 million and accounted for 55.6 percent of total merchandise exports in the March quarter of 2006, compared to 60.9 percent in the corresponding quarter of 2005. Crude oil exports totalled K652.8 million and accounted for 25.2 percent of total merchandise exports in the March quarter of 2006, compared to 11.5 percent in the corresponding quarter of 2005.

The value of agricultural, marine products and other non-mineral exports, excluding forestry and refined petroleum product exports was K279.9 million and accounted for 10.8 percent of total merchandise exports in the March quarter of 2006, compared to 11.6 percent in the corresponding quarter of 2005. Forestry product exports were K92.1 million and accounted for 3.6 percent of total merchandise exports in the March quarter of 2006, compared to 5.3 percent in the corresponding quarter of 2005. Refined petroleum product exports were K124.4 million and accounted for 4.8 percent of total merchandise exports in the March quarter of 2006, compared to 10.6 percent in the corresponding quarter of 2005.

The weighted average price of Papua New Guinea's exports increased by 34.3 percent in the March quarter of 2006, compared to the corresponding quarter of 2005. There was a 42.1 percent increase in the weighted average price of mineral exports, with higher kina prices of copper, crude oil and gold. For the agricultural, forestry and marine product exports, the weighted average price declined by 2.9 percent and was attributed to lower kina prices of cocoa, copra, copra oil, palm oil, tea and marine product exports. The lower export prices reflected the appreciation of the kina against the US dollar as international prices increased during the March quarter of 2005.

Mineral Exports

Total mineral export receipts were K2,092.8 million in the March quarter of 2006, compared to K1,641.9 million in the corresponding quarter of 2005. The increase was due to higher export values of copper, crude oil and gold.

The volume of gold exported in the March quarter of 2006 was 13.7 tonnes, a decline of 20.3 percent from the corresponding quarter of 2005. The decline was mainly due to lower production and shipment, combined with wet weather conditions. In addition, an industrial strike by workers at the Porgera mine more than offset higher production from the Lihir mine and commencement of production and export from the Kainantu mine. The higher exports in the same period of 2005 reflected the clearing of 2004 stock levels at the Ok Tedi, Porgera and Tolukuma mines. The average f.o.b. price received for Papua New Guinea's gold exports was K55.6 million per tonne during the March quarter of 2006, an increase of 32.7 percent from the corresponding quarter of 2005. The increase was mainly attributed to higher international prices resulting from increased demand. The average gold price at the London Metal Exchange increased by 28.4 percent to US$551 per fine ounce in the March quarter of 2006, compared to the corresponding quarter of 2005. 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, due to the weakening of the US dollar against other major currencies. The higher export price more than offset the decline in export volume, resulting in an increase in export receipts by 5.7 percent to K761.9 million from the March quarter of 2005.

The volume of copper exported in the March quarter of 2006 was 46.6 thousand tonnes, a decline of 28.1 percent from the corresponding quarter of 2005. The decline was due to lower production and shipment of copper ore, compared to higher exports from the clearing of 2004 stock levels by the Ok Tedi mine in the same period of 2005. The average f.o.b. price of Papua New Guinea's copper exports was K14,369 per tonne in the March quarter of 2006, an increase of 43.3 percent from the corresponding quarter of 2005, due to higher international prices. The increase in international prices reflected lower stock levels at the London Metal Exchange combined with higher demand from Asia, one of the major copper-consuming regions. The increase in export price more than offset the decline in export volume, resulting in an increase in export receipts of 3.1 percent to K669.6 million from the corresponding quarter of 2005.

The volume of crude oil exported in the March quarter of 2006 was 3,435.9 thousand barrels, an increase of 63.3 percent from the corresponding quarter of 2005. The increase reflected higher extraction rates from the Kutubu and Moran oil fields combined with the commencement of production at the South East Mananda oil project, which more than offset declines from the Gobe Main and South East Gobe oil projects. The average export price of crude oil was K190 per barrel in the March quarter of 2006, an increase of 53.2 percent from the corresponding quarter of 2005, attributed to higher international prices. Higher international prices resulted from the cut to production quota by the Organisation of Petroleum Exporting Countries (OPEC), tension from the continued US lead occupation of Iraq, lower North American oil stocks, increased demand from Asia, strike by oil workers in Venezuela and supply disruptions from a leading Russian oil company. The combined increase in export price and volume resulted in a rise in export receipts by 150.4 percent to K652.8 million from the corresponding quarter of 2005.

Export receipts of refined petroleum products from the Napanapa Oil Refinery declined by 48.3 percent to K124.4 million in the March quarter of 2006, compared to the corresponding period of 2005. The lower export receipt was due to a shift by the petroleum company to reduce the export of lower value products and increase refined petroleum production for domestic use, combined with disruptions to production at the refinery.

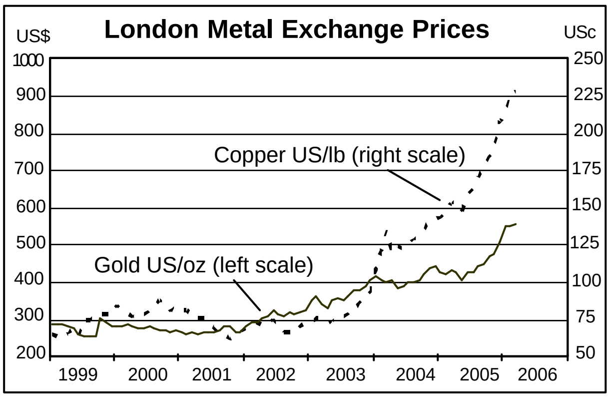
Agriculture, Logs and Fisheries Exports

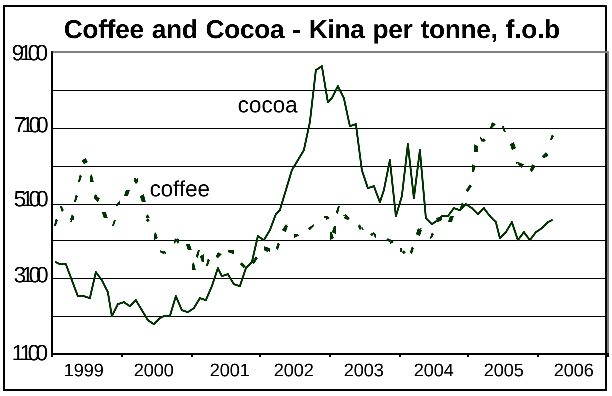
Export prices of most agricultural export commodities declined in the March quarter of 2006, compared to the corresponding quarter of 2005. Cocoa prices declined by 7.8 percent, copra by 10.5 percent, copra oil by 4.6 percent, palm oil by 6.2 percent and tea by 1.9 percent. Coffee prices increased by 7.7 percent and rubber by 26.5 percent. The average export price of logs was K180 per cubic meter in the March quarter of 2006, an increase of 4.0 percent from the corresponding quarter of 2005. The average export price of marine products declined by 51.3 percent in the March quarter of 2006, from the corresponding period of 2005. The decline in the export price of cocoa, copra, copra oil, palm oil, tea and marine products more than offset the increase in prices of other agricultural and log exports resulting in a 2.9 percent decline in the weighted average price of agricultural, logs and marine product exports. Excluding logs, the weighted average price of agricultural and marine product exports declined by 5.4 percent in the March quarter of 2006, compared to the corresponding period of 2005.

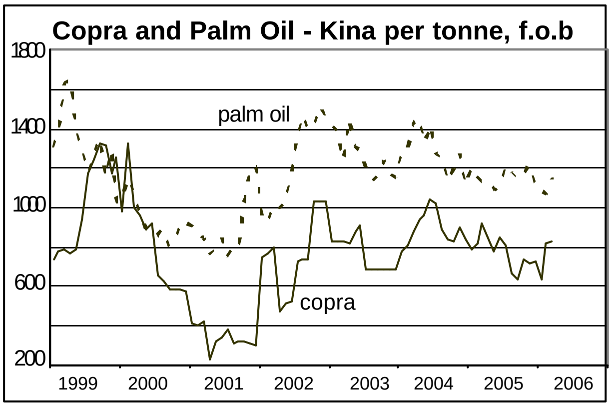
The volume of coffee exported in the March quarter of 2006 was 9,200 tonnes, an increase of 53.3 percent from the corresponding quarter of 2005. The increased production was attributed mainly to a supply response to higher prices and favourable weather conditions in the coffee producing regions. The average export price of coffee was K6,533 per tonne in the March quarter of 2006, an increase of 7.7 percent from the corresponding quarter of 2005. 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 combined increase in export price and volume resulted in export receipts of K60.1 million, an increase of 65.1 percent from the corresponding quarter of 2005.

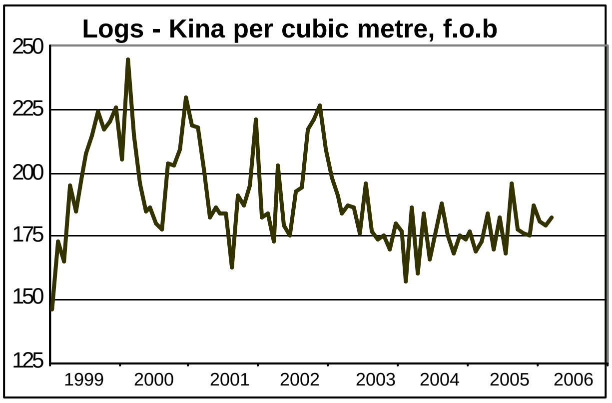
The volume of cocoa exported in the March quarter of 2006 was 8,200 tonnes, a decline of 4.7 percent from the corresponding quarter of 2005. The outcome was attributed to lower production as a result of unfavourable weather conditions in the major cocoa producing regions. The average export price of cocoa was K4,537 per tonne in the March quarter of 2006, a decline of 7.8 percent from the corresponding quarter

EXPORT COMMODITY PRICES









of 2005. This was due to lower international prices, resulting from higher supply in the world market reflecting increased production from countries in Africa, mainly the Ivory Coast, Latin America and Asia. The combined decline in the export price and volume resulted in an export value of K37.2 million, a decrease of 12.1 percent from the corresponding quarter of 2005.

The volume of copra exported in the March quarter of 2006 was 1,600 tonnes, a significant decline of 80.0 percent from the corresponding quarter of 2005. The decline was due to more copra sold to the two domestic copra oil mills. The average export price of copra was K750 per tonne in the March quarter of 2006, a decline of 10.5 percent from the corresponding quarter of 2005. This was mainly due to lower international prices resulting from higher supply in the world market, reflecting increased production from the Philippines and Indonesia, the world's major copra producers. The combined decreases in export price and volume resulted in an export value of K1.2 million, a significant decline of 82.1 percent from the corresponding quarter of 2005.

The volume of copra oil exported in the March quarter of 2006 was 12,100 tonnes, an increase of 4.3 percent from the corresponding quarter of 2005. The increase reflected higher quantities of copra sold to the two domestic copra mills for processing. The average export price of copra oil was K1,587 per tonne in the March quarter of 2006, a decline of 4.6 percent from the corresponding quarter of 2005. The decline was mainly attributed to lower international prices resulting from higher world supply due to increased copra production from the Philippines and Indonesia, two of the world's major copra producers. The increase in export volume more than offset the decrease in export price resulting in an export value of K19.2 million, a decline of 0.5 percent from the corresponding quarter of 2005.

The volume of palm oil exported in the March quarter of 2006 was 73,600 tonnes, an increase of 14.6 percent from the corresponding quarter of 2005. The outcome was due to higher production, attributed to favourable weather conditions in the palm oil producing regions. The average export price of palm oil was K1,092 per tonne in the March quarter of 2006, a decline of 6.2 percent from the corresponding quarter of 2005. This was due to the appreciation of the kina against the US dollar as international prices increased. The increase was the result of lower production from Malaysia and Indonesia, two of the world's leading producers. The increase in export volume more than offset the decline in export price, resulting in an export value of K80.4 million, an increase of 7.6 percent from the corresponding period of 2005.

The volume of tea exported in the March quarter of 2006 was 1,800 tonnes, the same as in the corresponding quarter of 2005, reflecting favourable weather conditions in the major producing regions. The average export price of tea was K2,889 per tonne in the March quarter of 2006, a decline of 1.9 percent from the corresponding quarter of 2005. The level of export volume more than offset the fall in export price resulting in an export value of K5.2 million, a decline of 1.9 percent from the corresponding quarter of 2005.

The volume of rubber exported in the March quarter of 2006 was 1,000 tonnes, a decline of 9.1 percent from the corresponding quarter of 2005. The decline was mainly attributed to unfavourable weather conditions in the rubber producing regions. The average export price was K4,600 per tonne in the March quarter of 2006, an increase of 26.5 percent from the corresponding period of 2005, due to higher international prices as a result of lower supply in the world market. The rise in export price more than offset the decline in export volume resulting in an export value of K4.6 million, an increase of 15.0 percent from the corresponding quarter of 2005.

The volume of logs exported in the March quarter of 2006 was 472 thousand cubic meters, a decline of 22.4 percent from the corresponding quarter of 2005. This was mainly due to lower production and shipment of logs from the major logging projects as a result of unfavourable weather conditions. The average export price of logs was K180 per cubic meter in the March quarter of 2006, an increase of 4.0 percent from the corresponding quarter of 2005. The increase was attributed to higher international prices, reflecting lower supply of tropical hardwoods in the world market. The increase in export price more than offset the fall in export volume, resulting in an export value of K84.9 million, a decline of 19.3 percent from the corresponding period of 2005.

The value of marine products exported in the March quarter of 2006 was K7.5 million, a decline of 51.3 percent from the corresponding quarter of 2005. This resulted from a decline in export price, as the level of export volume remained unchanged.

7. BALANCE OF PAYMENTS

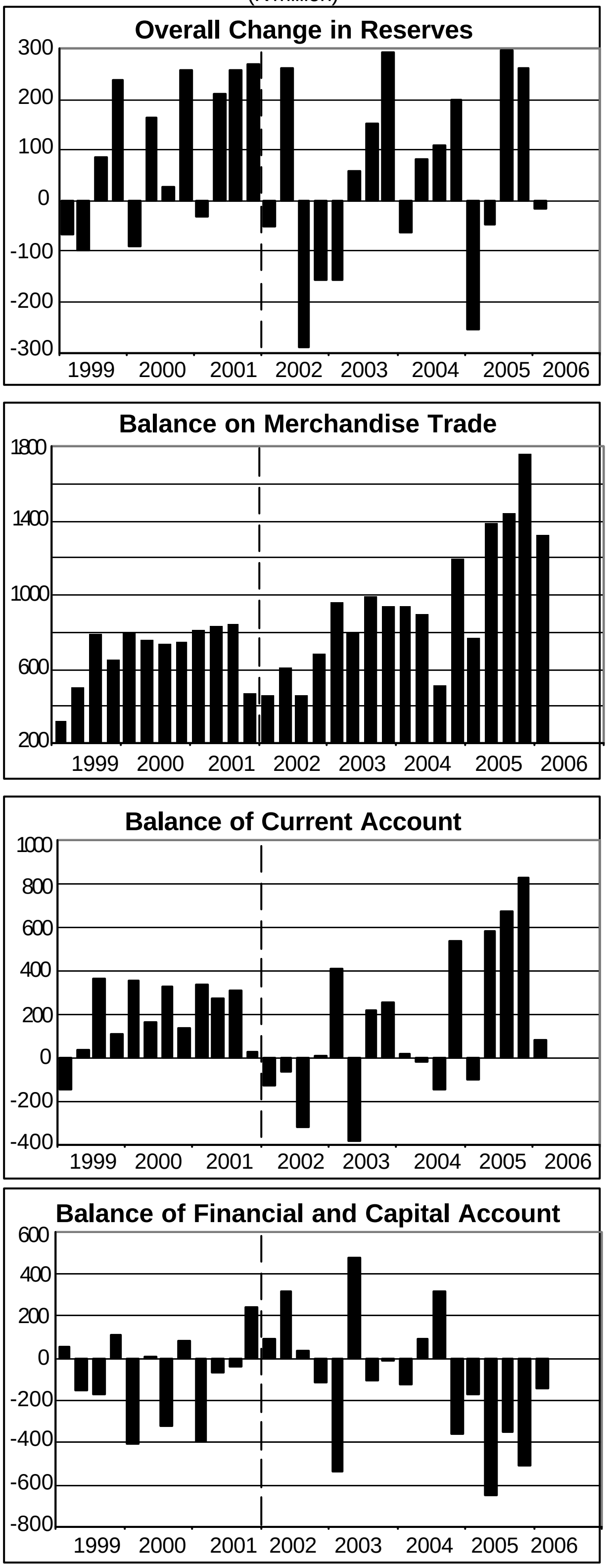
The overall deficit in the balance of payments was K17 million in the March quarter of 2006, compared to a deficit of K255 million in the corresponding period of 2005. The lower deficit resulted from a surplus in the current account and a lower deficit in the capital and financial accounts.

The surplus in the current account was attributed mainly to a higher trade surplus and lower net service payments, which more than offset higher net income and net transfer payments. The lower deficit in the capital and financial accounts reflected increased net inflow of direct and portfolio investments, which more than offset a build-up in foreign currency account balances of the mineral companies combined with net loan repayments by both the Government and private sectors. In the March quarter of 2006, the kina appreciated against all the currencies of Papua New Guinea's major trading partners, compared to the corresponding period in 2005.

The trade account recorded a surplus of K1,323 million in the March quarter of 2006, a significant increase of 62.5 percent from the corresponding quarter in 2005. The higher surplus was the result of an increase in exports, combined with a decline in imports. The value of merchandise exports in the March quarter of 2006 was K2,589 million, an increase of 14.3 percent from the corresponding period of 2005. This was attributed to higher values of gold, copper, crude oil, coffee, palm oil, rubber and other non-mineral exports.

The value of merchandise imports in the March quarter of 2006 was K1,266 million, a decline of 12.7 percent from the corresponding period in 2005. This was due to lower values of general and mining sector imports, which more than offset an increase in imports by the petroleum sector. General imports were K918 million in the March quarter of 2006, a decline of 17.7 percent from the corresponding period of 2005. Imports by the mining sector were K233 million in the March quarter of 2006, a decline of 11.1 percent from the corresponding period of 2005, mainly reflecting lower capital expenditure by all mining projects with the exception of the

BALANCE OF PAYMENTS[4]
(K'million)



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

Kainantu gold mine. Imports by the petroleum sector were K115 million in the March quarter of 2006, an increase of 55.4 percent from the corresponding period of 2005. The increase was due to higher capital expenditure associated with exploration activities in the petroleum sector due to the natural depletion of oil reserves in the existing oil fields.

The deficit in the services account was K653 million in the March quarter of 2006, a decline of 12.8 percent from the corresponding period of 2005. The lower deficit was due to declines in payments relating to transportation, travel, education, insurance, computer and information services, other business services and construction services, which more than offset higher service receipts by resident companies.

The deficit in the income account was K564 million in the March quarter of 2006, an increase of 25.6 percent from the corresponding period of 2005. The higher deficit was mainly due to increased dividend payments by resident companies, which more than offset higher income receipts.

The deficit in the transfers account was K23 million in the March quarter of 2006, compared to a surplus of K285 million in the corresponding period of 2005. The deficit was due to lower receipts from gifts and grants, family maintenance, tax and licensing fees combined with higher net transfer payments for family maintenance, tax and licensing fees.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a surplus of K83 million in the March quarter of 2006, compared to a deficit of K99 million in the corresponding period of 2005.

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

The financial account recorded a net outflow of K143 million in the March quarter of 2006, compared to a net outflow of K174 million in the corresponding period of 2005. This outcome was due to net outflows of other investment totalling K429 million and mainly reflected net loan repayments by mineral companies and the Government, combined with a build-up in foreign currency account balances of mineral companies. These more than offset net inflows of direct and portfolio investments, reflecting share placement by a mining company to raise funds for on-going development work as well as refinancing of a new mine, and the purchase of equity interests in various petroleum projects by a petroleum company, respectively.

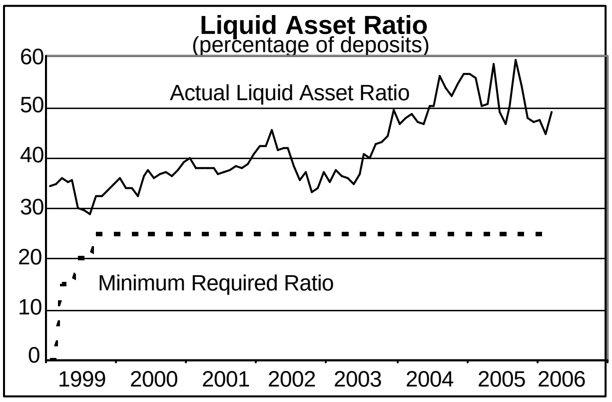
The level of gross foreign exchange reserves at the end of March 2006 was K2,299.5 (US$757.1) million, sufficient for 5.5 months of total and 7.5 months of non-mineral import covers.

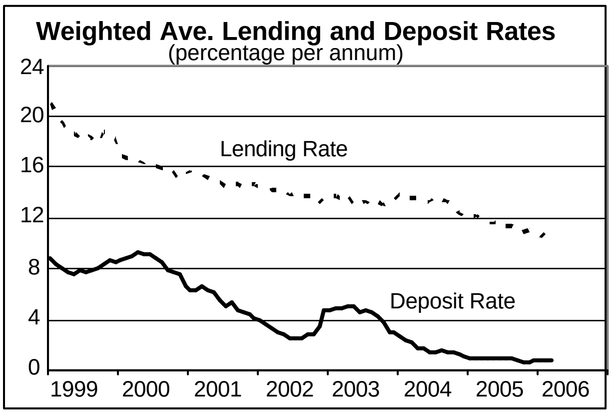
8. MONETARY DEVELOPMENTS

LIQUIDITY AND INTEREST RATES

The Bank of Papua New Guinea maintained a neutral monetary policy stance during the March quarter of 2006 by keeping the KFR unchanged at 6.0 percent. The dealing margins for the Repurchase Agreements (Repos) were also maintained at 300 basis points on both the buy and sell sides of the KFR during the same period. However, domestic interest rates trended downwards as a result of high liquidity in the banking system and lower issuance of Treasury bills following the restructuring of Government's domestic debt from short to longer term maturities. Interest rates on Treasury bills declined across all maturities. The 91-day rate declined from 3.84 percent to 1.99 percent, the 182-day rate from 4.91 percent to 3.13 percent and the 364-day rate from 5.69 percent to 4.55 percent during the period. At the Central Bank Bill (CBB) auction, the 28-day CBB rate declined from 2.99 percent to 2.94 percent. The weighted average deposit rates quoted on wholesale deposits (K500,000 and above) recorded a mixed trend. Between the end of December 2005 and March 2006, the 30 days deposit rate decreased from 0.82 percent to 0.52 percent, 60 days rate declined from 0.95 percent to 0.52 percent, and the 90 days from 1.45 percent to 1.40 percent, whilst 180 days rate increased from 2.18 percent to 3.03 percent.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy over the March quarter of 2006. The Bank mainly used CBBs and reverse repos to diffuse the excess liquidity and stabilise domestic interest rates. Trading in the inter-bank market was active due to the uneven distribution of liquidity among banks. There was no repo transaction 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.

Average liquid assets held by commercial banks decreased by 1.9 percent in the March quarter of 2006, following an increase of 4.1 percent in the December quarter of 2005. Commercial banks continued to hold the majority of their liquid assets in the form of Government securities and CBBs.

The weighted average interest rate on total loans extended by commercial banks increased from 10.7 percent to 11.3 percent, whilst the weighted average interest rate on total deposits remained at around 0.8 percent between December 2005 and March 2006. The commercial banks maintained their Indicator Lending Rates (ILR) with a spread of 9.45 to 10.70 percent.

MONEY SUPPLY

The average level of broad money supply (M3*) increased by 3.8 percent in the first quarter of 2006, compared to an increase of 8.6 percent in the December quarter of 2005. The outcome was due to an increase of 6.5 percent in average net credit to the private sector, official entities and non-monetary financial institutions and 0.5 percent in average net foreign assets of the banking system. These more than offset a decline of 18.7 percent in average net credit to the Government. The decline in average net credit to the Government was mainly due to a significant increase in Government deposits with the Central Bank. Domestic credit outstanding, excluding advances to the Central Government and outstanding loan under the Government's Agricultural export commodity price support scheme increased by 6.4 percent in the March quarter of 2006, compared to the December quarter of 2005. The average level of monetary base fell by 1.9 percent over the first quarter of 2006, compared to an increase of 3.7 percent in the December quarter of 2005. The decline reflected the lower average level of commercial banks' deposits with the Bank of PNG and a decline in currency in circulation.

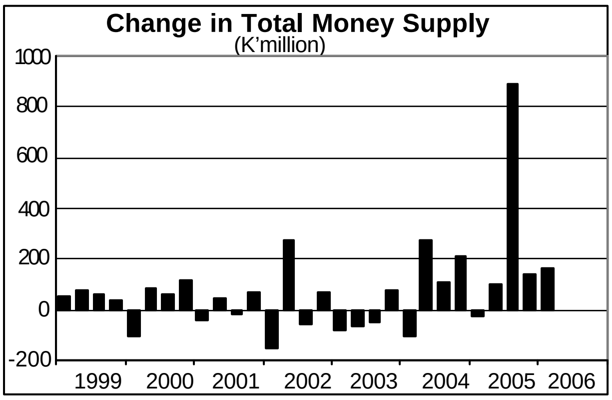
Net credit to the Government increased by 28.1 percent in the first quarter of 2006, compared to a decline of 37.4 percent in the December quarter of 2005. The increase was due to higher holdings of Government securities by both the commercial banks and Bank of PNG, lower deposits and the utilisation of the Temporary Advance Facility (TAF) at the Bank of PNG. Net foreign assets of the banking system declined by K146.0 million as a result of decreases of K18.3 million and K127.7 million in net foreign assets of the Central Bank and commercial banks, respectively.

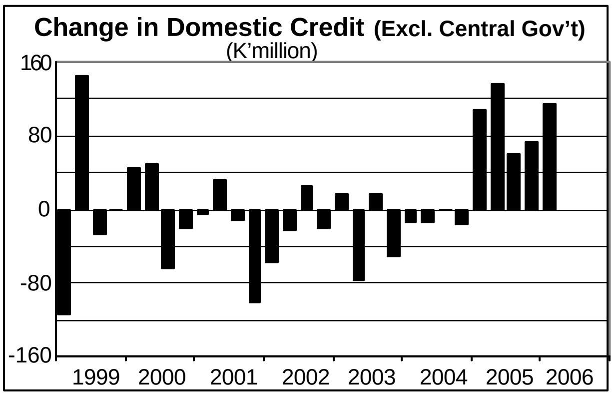
The average level of narrow money supply (M1*) increased by 0.4 percent in the March quarter of 2006, compared to 8.3 percent in the December quarter of 2005. The increase was due to growth in demand deposits. The average level of quasi money increased by 9.7 percent during the March quarter of 2006 as a result of an increase in term deposits, which more than offset a decline in savings deposits.

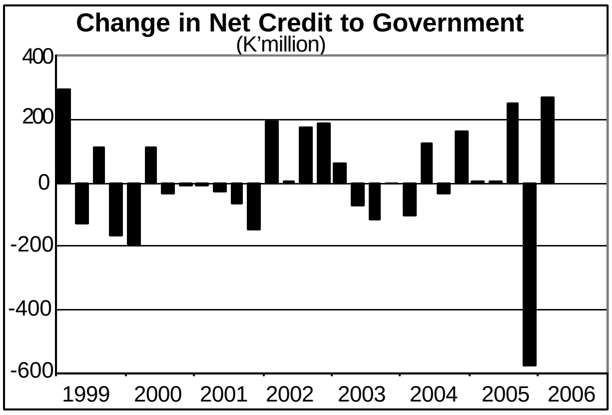
The average level of deposit base of the commercial banks increased by 4.0 percent in the March quarter of 2006 to K4,716.3 million, from K4,535.9 million in the December quarter of 2005. This represents an annualised growth rate of 16.9 percent.

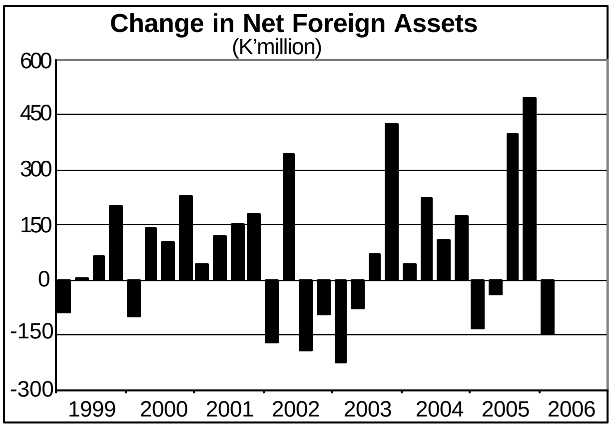
LENDING

During the March quarter of 2006, total domestic credit







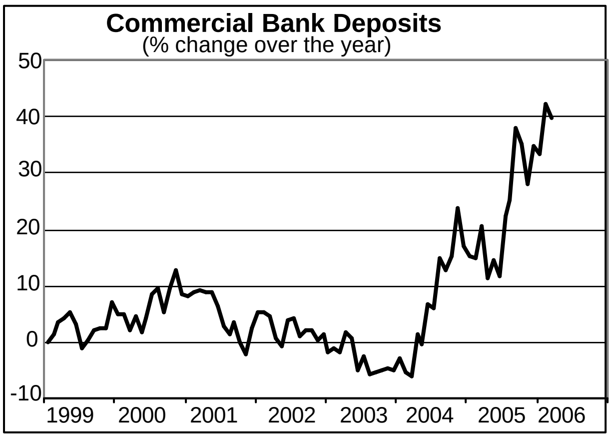


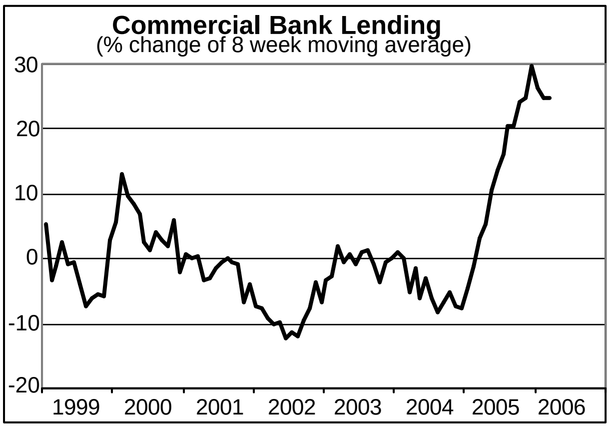
extended by the banking system to the private sector, official entities and non-monetary financial institutions increased by K113.5 million to K1,940.5 million, compared to an increase of K108.2 million during the corresponding quarter of 2005. Lending to the private sector and official entities increased by K131.5 million and K1.0 million, respectively, while lending to the non-monetary financial institutions decreased by K19.1 million. The growth in lending to the private sector was mainly to the manufacturing, transport and communication, building and construction and the private household sectors. Loan repayments from non-monetary financial institutions resulted in a decline in lending to that sector. There were no repayments under the price support schemes, whilst the Small Scale Business Credit Facility (SSBCF) was formally closed in March 2006. The annualised growth in domestic credit, excluding the Central Government and advances under the price support schemes was 28.1 percent in the first quarter of 2006. Foreign currency lending to the private sector and official entities was 6.3 percent of total lending to these sectors, compared to 5.9 percent in December 2005, 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 82.8 percent in March 2006, compared to 82.1 percent in December 2005. The increase in the rate of utilisation reflects the draw down of committed funds.

9. PUBLIC FINANCE

Preliminary estimates of the fiscal operations of the National Government over the three months to March 2006 showed an overall deficit of K30.6 million, compared to a surplus of K128.3 million in the corresponding period of 2005, and represents 0.2 percent of nominal GDP. The deficit resulted from higher expenditure, which more than offset an increase in





revenue.

Total revenue, including grants during the March quarter of 2006 was K713.3 million, 4.3 percent higher than the receipts collected in the corresponding period of 2005, and represents 15.1 percent of the budgeted revenue.

Total tax revenue amounted to K674.8 million, 4.6 percent higher than the receipts collected during the same period in 2005, and represents 19.6 percent of the budgeted tax receipts for 2006. Direct tax receipts totalled K390.3 million, K26.6 million lower than the receipts collected during the corresponding period in 2005, and represents 15.8 percent of the budgeted amount. The decline was mainly due to lower company tax receipts, which more than offset higher personal income and other direct tax receipts. The fall in company tax receipts reflected lower collections in mining and petroleum taxes. The increase in personal income tax receipts reflected payment of employment entitlements by a mining company and arrears by the Government. The increase in other direct taxes was due to higher stamp duty collections and dividend withholding tax receipts.

Indirect tax receipts was K284.5 million, 24.6 percent higher than in the corresponding period in 2005, and represents 29.1 percent of the budgeted receipts for 2006. The increase reflected higher Goods and Services Tax (GST), excise, export and import duty, which more than offset lower receipts for other indirect taxes. The increase in GST was due to improved collections in the provinces. The higher excise duties was related to the transfer of excise collected on fuels from import excise to domestic excise collections. The decline in other indirect tax receipts reflected lower mining levy.

Total non-tax revenue amounted to K38.5 million, K0.5 million lower than the amount collected in the corresponding period of 2005, and represents 12.9 percent of the budgeted amount for 2006. The decline mainly reflected lower receipts from services provided by Government Departments. Foreign grants were not recorded for the March quarter of 2006 due to non-reporting.

Total expenditure over the three months to March 2006 was K743.9 million, 33.8 percent higher than in the corresponding period of 2005, and represents 15.4 percent of the budgeted expenditure for 2006.

Recurrent expenditure over the first quarter of 2006 was K617.8 million, 24.3 percent higher than during the corresponding period of 2005, and represents 19.7 percent of the 2006 budgeted appropriation. The increase resulted from the growth in National and Provincial Government expenditures combined with higher interest payments and grants to statutory authorities. The National Departmental recurrent expenditure totalled K297.6 million, 9.9 percent higher than the amount spent during the corresponding period of 2005, and represents 17.6 percent of the budgeted appropriation. The increase reflects higher salaries and wages and high payments of other goods and services, including education subsidies, arrear payments and court orders. Provincial Government recurrent expenditure was K152.7 million, 10.5 percent higher than the expenditure level during the same period in 2005, and represents 20.5 percent of the budgeted amount. The higher Provincial Government expenditure resulted from the disbursement of administrative and conditional grants combined with grants to the Autonomous Bougainville Government. Interest payments totalled K115.3 million, K73.8 million higher than the amount paid in the corresponding period of 2005. The increase reflected the high level of domestic debt incurred through new issuance of Government securities.

Total development expenditure for the first quarter of 2006 was K126.1 million, K67.3 million higher than in the corresponding period of 2005, and represents 7.5 percent of the budgeted expenditure for 2006. The higher level of spending on developmental projects reflected the implementation of the 2006 Development Budget, due to increased counterpart funding for donor-funded projects.

As a result of these developments in revenue and expenditure, the Government recorded a budget deficit of K30.6 million in the first three months of 2006. The deficit and net external loan repayments of K65.7 million were financed through net domestic borrowing of K96.3 million. The net overseas loan repayments comprised K19.1 million and K46.6 million to concessionary and extraordinary sources, respectively. Domestic borrowing reflected K244.0 million from the banking system and K21.7 million from the non-banking system. These more than offset repayments to other domestic sources totalling K169.4 million, which represents the settlement of cheque floats issued in 2005.