CONTENTS

PORT MORESBY

3rd December, 2004

1. GLOSSARY OF TERMS AND ACRONYMS

Balance of Payments — A statistical statement that systematically summarises a country's economic transactions with the rest of the world, over a specific time period. It comprises the Current and Capital and Financial Accounts.

Broad Money Supply (M3*) — Total volume of money comprising narrow money (M1*) and quasi money in the economy at a point in time. See narrow and quasi money.

Cash Reserve Requirement (CRR) — A requirement imposed on commercial banks to hold cash as a percentage of total deposits and other prescribed liabilities at all times.

Capital Account — Records all transactions that involves the receipts or 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.24 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 main economic indicators available to the Bank of Papua New Guinea showed that economic activity continued to improve in the nine months to September 2004. The improvement in the external sector was driven by higher international prices, which led to a surplus in the balance of payments, a built up in international reserves and appreciation of the exchange rate. A disciplined fiscal management by the Government resulted in a large fiscal surplus, and contributed to stability in macroeconomic conditions. The appreciation of the exchage rate, surplus in the balance of payments, marginal increase in employment and fiscal surplus led to low inflation. As a result of these positive developments, the Bank of PNG further eased the stance of monetary policy by lowering interest rates.

Latest data from the Bank's Quarterly Employment Survey indicates that the level of employment in the formal private sector, excluding mining and petroleum and the NSP, increased marginally by 0.1 percent over the year to June 2004, compared to a revised increased of 10.4 percent in the corresponding period of 2003. The increase reflected higher employment levels in all sectors except the transportation, wholesale, construction and agriculture/forestry/fisheries sectors and in all regions except the NCD, Southern, Highlands and Momase regions.

The headline inflation as measured by the Consumer Price Index (CPI) decreased by 0.3 percent in the September quarter of 2004, compared to zero percent in the June quarter of 2004. The decline was attributed to decreases in the indices of 'Drinks, tobacco and betelnut', 'Food', and 'Clothing and footwear' expenditure groups, which more than offset increases in the other groups. By region, all surveyed urban areas recorded decreases in the September quarter of 2004 except Rabaul. The annual headline CPI was 1.5 percent to September 2004, compared to 11.8 percent in the corresponding period of 2003.

The underlying exclusion-based CPI measure increased by 1.4 percent in the September quarter of 2004, compared to 0.8 percent in the previous quarter. The trimmed-mean underlying CPI, increased by 0.1 percent in the September quarter of 2004, compared to 1.5 percent in the previous quarter. The exclusion-based and trimmed-mean underlying measures were 1.5 percent and 2.0 percent respectively, over the year to September 2004.

The increase in the international prices for mineral and most agricultural exports offset the appreciation of the kina against the US dollar. This resulted in a 14.7 percent increase in the weighted average kina price of exports in the September quarter of 2004, compared to the corresponding quarter of 2003. There was a 19.2 percent increase in the weighted average price of mineral exports, with higher prices of gold, copper and crude oil. For the agricultural, forestry and marine export products, the weighted average price increased by 1.0 percent. This was accounted for by higher prices of most agricultural export commodities, with the exception of cocoa, tea and logs.

The overall surplus in the balance of payments for the nine months to September 2004 was K130 million, compared to a surplus of K58 million in the corresponding period of 2003. This outcome was the result of an improvement in the capital and financial account, which more than offset a deterioration in the current account.

The current account recorded a deficit of K57 million in the nine months to September 2004, compared to a surplus of K240 million in the corresponding period of 2003. This outcome was a result of a lower surplus in the trade account, combined with higher net service payments, which more than offset lower net income payments and higher net transfer receipts.

The capital and financial accounts recorded a net inflow of K195 million in the nine months to September 2004, compared to a net outflow of K169 million in the corresponding period of 2003. The improvement reflected a drawdown in foreign currency account balances of the mineral companies combined with an inflow of equity financing for a mineral project.

The level of gross foreign exchange reserves at the end of the September quarter of 2004 was K1,861.6 (US$ 589.0) million, sufficient for 4.6 months of total and 5.3 months of non-mineral import covers.

The Bank of PNG continued to ease monetary policy during the September quarter of 2004, reducing the Kina Facility Rate (KFR) to 9.0 percent in September 2004 from 10.0 percent in June 2004. The easing stance was in response to the favourable inflation outcome, a stable exchange rate, high foreign exchange reserves and sound fiscal management. In response, domestic interest rates continued to decline.

The continued intervention by the Bank of PNG in the foreign exchange market and net retirement of Treasury bills by the Government resulted in a significant increase in liquidity in the banking system. In order to stabilise liquidity conditions and interest rates, the Bank of PNG introduced an additional instrument called the Central Bank Bill (CBB) in August 2004. The Bank also increased the minimum bid for Treasury bills from K100,000 to K500,000 with the aim of encouraging the development of a secondary market for Government securities.

The average level of broad money supply (M3*) increased by 4.0 percent in the September quarter of 2004, compared to a revised increase of 4.4 percent in the June quarter of 2004. The growth resulted from increases of 7.5 percent and 6.6 percent in average net foreign assets of the banking system and net credit to the Government, respectively. The average level of the broad monetary base grew by 12.4 percent over the September quarter of 2004, compared to an increase of 4.5 percent in the previous quarter. The increase was due to higher holdings of Government securities, reflecting the purchase of new Inscribed stocks and an increase in commercial bank deposits at the Bank of PNG.

Total net domestic credit extended by the commercial banks to the private sector, official entities and the non-monetary financial institutions decreased by K1.8 million to K1,466.4 million. This compares to an increase of K16.1 million during the corresponding quarter of 2003. The decline reflects a net repayment of loans. The annualised rate of decline in domestic credit, excluding the Central Government and advances under the agricultural commodity price support schemes, was 2.8 percent over the nine months to September 2004.

Preliminary estimates of the fiscal operations of the National Government during the nine months to September 2004 showed an overall surplus of K476.0 million, compared to a surplus of K78.1 million in the corresponding period in 2003, and represents 3.8 percent of nominal Gross Domestic Product (GDP). The higher surplus was due to increased revenue combined with lower expenditure.

Total revenue, including grants, during the nine months to September 2004 was K2,880.4 million, 6.6 percent higher than the receipts collected in the corresponding period of 2003, and represents 75.1 percent of the budgeted revenue. The increase was attributed to higher collections in all categories of tax revenue, which more than offset a decline in non-tax revenue and grants. Total expenditure over the nine months to September 2004 was K2,404.4 million, 8.4 percent lower than in the corresponding period in 2003, and represents 59.6 percent of the budgeted expenditure for 2004. The decrease was due to lower interest payments and development expenditures.

The budget surplus of K476.0 million, combined with the proceeds from the sale of assets of K25.0 million was used to make a net overseas loan repayment of K300.0 million and K176.0 million in domestic loans.

3. INTERNATIONAL DEVELOPMENTS

World economic growth, as measured by real GDP, is projected to increase in 2004. The latest International Monetary Fund (IMF) made in September 2004 was for a growth of 5.0 percent, an upward revision from the 4.6 percent made in April. This is the highest annual growth in almost thirty years, with the revisions reflecting upward growth estimates for most economies, except the United States (US) and United Kingdom (UK). Whilst nominal oil prices have risen, these are expected to have limited effect in 2004, because real oil prices, adjusted for inflation, were not historically high, compared to the previous crises in 1973, 1979 and 1990-91. There is also currently much higher energy efficiency and the weak US dollar, which inflated US dollar oil prices, compared to oil prices in other stronger currencies. In September, the IMF also reported that the global financial system was in a more resilient state since the equity bubble burst in 2001, in spite of rising interest rates, security concerns and high oil prices. The high oil prices are expected to slow down economic growth in 2005.

In August, the 147 members of the World Trade Organisation (WTO) reached an interim accord that revives the stalled Doha trade round and re-established confidence in the multilateral trading system. The accord committed the developed countries to cut billions of dollars in trade-distorting farm subsidies and allow for more open markets for agricultural products, industrial goods and services. The members also agreed to extend the negotiations deadline to December 2005.

In September, the WTO confirmed that billions of dollars in farm subsidies on sugar by the European Union (EU) and on cotton by the US violated international trade rules. The EU's annual sugar exports of over 5 million tonnes were subsidised, twice the allowable amount. The US cotton subsidies of more than US$3 billion a year and export credits of US$1.6 billion for cotton and other commodities exceeded the US permitted subsidy limits.

In September, nominal oil prices reached its historical high of US$50 per barrel, despite attempts by members of the Organisation of Petroleum Exporting Countries (OPEC) to increase daily production by 500,000 barrels in August to lower prices. The increase reflected higher demand from China and limited spare capacity of exporters. There were also concerns following the sabotage of oil pipelines in Iraq, political elections in Venezuela, the on-going crisis in Russia between the Government and Yukos, its largest oil and gas producer, disruptions to oil production in the Gulf of Mexico by a hurricane and in Nigeria by rebel activities, as well as growing fears of terrorism worldwide. The US tapped into its emergency oil supplies in August. OPEC member countries produced almost 30 million barrels a day, its highest rate of production in 25 years.

Also in September, gold prices reached US$400 per ounce, due to higher demand from central banks, China and India and as a substitute for the declining US dollar.

In the United States (US), real GDP grew by 3.9 percent over the year to September 2004, compared to an increase of 3.3 percent over the year to September 2003, reflecting strong consumer spending. The latest revised forecast by the IMF is for a growth of 4.3 percent in 2004, a downward revision from an earlier forecast of 4.6 percent.

Industrial production increased by 4.6 percent over the year to September 2004, compared to a decline of 1.0 percent over the corresponding period in 2003. The Institute for Supply Management's PMI (purchasing managers' index) was 58.5 percent in September, lower than the 61.1 percent recorded in June 2004, but indicating continued expansion in the industrial sector. The increase in September reflected the sixteenth consecutive month of growth. Retail sales increased by 6.3 percent over the year to September 2004, compared to an increase of 8.3 percent over the year to September 2003, with higher vehicle sales. Consumer confidence declined in August and September, reflecting concerns on slower job growth and rising oil prices. The housing market however continued to show strong growth, with sales of new homes growing by 3.5 percent in September, while sales of existing homes increased by 3.1 percent, due to effects of the strong economy in the 1990s and low interest rates in recent years. The US Congressional Budget Office reported that the US budget deficit would reach a record level of US$422 billion in 2004, due to lower revenue and higher expenditure as a result of tax cuts, increased spending on health and the cost of the war on terrorism. The unemployment rate was 5.4 percent in September 2004, compared to 6.1 percent in September 2003.

Consumer prices rose by 2.3 percent over the year to September 2004, relative to an increase of 2.1 percent over the same period in 2003, partly reflecting higher costs for lodging and used cars in September. Broad money supply increased by 4.8 percent over the year to September 2004, compared to an increase of 7.1 percent over the year to September 2003. Following the 25 basis points increase in June 2004, the US Federal Reserve Board increased the Federal Funds rate by another 25 basis points in July to 1.5 percent.

The trade account deficit was US$621.1 billion over the year to September 2004, compared to a deficit of US$542.6 billion over the corresponding period in 2003. The deterioration partly reflected high oil import prices.

In Japan, real GDP grew by 3.9 percent over the year to September 2004, compared to an increase of 2.3 percent over the year to September 2003. The latest IMF forecast is for a growth of 4.4 percent in 2004, an upward revision from the 3.3 percent forecast made earlier in the year.

Industrial production increased by 3.8 percent over the year to September 2004, compared to an increase of 4.1 percent over the corresponding period in 2003. Japanese car makers increased domestic output to 964,164 vehicles in September, from a year ago, with new models boosting demand. Retail sales declined by 0.4 percent over the year to September 2004, compared to a decline of 1.8 percent in the corresponding period in 2003. The unemployment rate was 4.6 percent in September 2004, compared to 5.1 percent in September 2003.

Consumer prices declined by 0.2 percent over the year to September 2004, the same as in the corresponding period of 2003. The Bank of Japan maintained its zero interest rate policy, while it injected cash into the economy to remove the effects of six years of deflation. Broad money supply increased by 2.1 percent over the year to September 2004, compared to an increase of 1.8 percent in the corresponding period in 2003.

The current account surplus was US$169.0 billion over the year to September 2004, compared to US$123.3 billion over the year to September 2003, reflecting continued high exports, including motor vehicles to the US, Europe and China.

In Germany, real GDP grew by 1.3 percent over the year to September 2004, compared to a decrease of 0.2 percent over the year to September 2003. The latest IMF forecast is for a GDP growth of 2.0 percent in 2004, an upward revision from the 1.5 percent made in April 2004.

Industrial production increased by 2.5 percent over the year to September 2004, compared to a decline of 3.6 percent over the same period in 2003. Retail sales decreased by 1.4 percent over the year to September 2004, compared to a decline of 3.1 percent over the year to September 2003. The unemployment rate was 10.7 percent in September 2004, slightly up from 10.5 percent in September 2003.

Consumer prices increased by 1.1 percent over the year to September 2004, the same as in the corresponding period in 2003.

The current account surplus was US$90.2 billion over the year to September 2004, compared to a surplus of US$56.4 billion over the year to September 2003.

In the United Kingdom (UK), real GDP grew by 3.0 percent over the year to September 2004, compared to a growth of 1.9 percent over the same period in 2003, driven by strong domestic spending. The latest IMF forecast is for a real GDP growth of 3.4 percent in 2004, a downward revision from the 3.5 percent made earlier in the year.

Industrial production decreased by 0.9 percent over the year to September 2004, compared to a decrease of 1.0 percent over the corresponding period in 2003. The decline reflected rising cost of inputs for oil, steel and metal in manufacturing and strong competition in the export market. Retail sales increased by 6.9 percent over the year to September 2004, compared to an increase of 3.9 percent over the year to September 2003. The unemployment rate was 4.6 percent in September 2004, an improvement from 5.0 percent in September 2003.

Consumer prices rose by 1.4 percent over the year to September 2004, compared to an increase of 1.7 percent over the same period in 2003. The Bank of England's medium term inflation target is 2.0 percent. Broad money supply increased by 9.3 percent over the year to September 2004, compared to an increase of 7.4 percent over the year to September 2003. Following the increase in June, the Bank of England increased its repo rate to 4.75 percent in August 2004.

The current account deficit was US$101.1 billion over the year to September 2004, compared to a deficit of US$73.9 billion over the year to September 2003.

In Australia, economic activity continued to show strong growth. The latest IMF forecast is for a GDP growth of 3.6 percent in 2004, slightly higher than the forecast of 3.5 percent made in April.

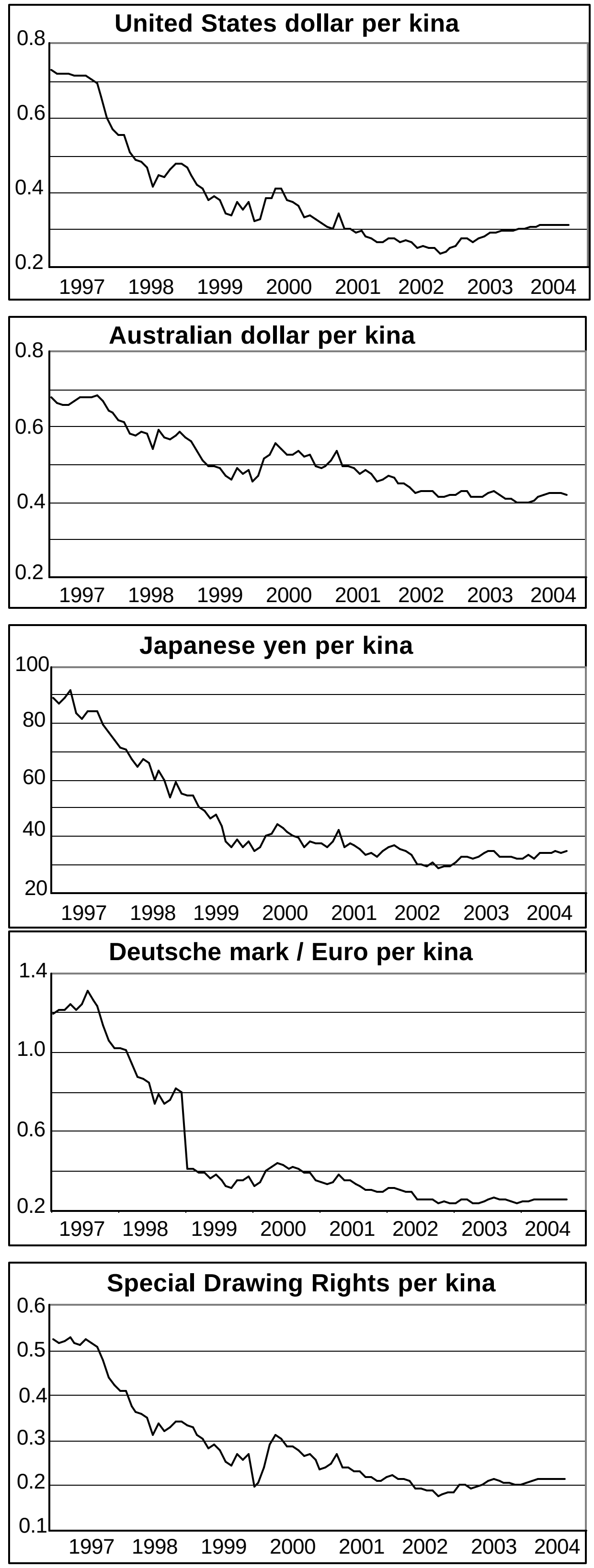
Industrial production increased by 4.6 percent over the year to June 2004, compared to an increase of 1.3 percent over the year to June 2003. Retail sales increased by 5.7 percent over the year to September 2004, compared to an increase of 5.3 percent over the same period in 2003. In the lead-up to the October national elections, Prime Minister John Howard promised an A$5.97 billion expenditure for families, small businesses, education and health care. This brought the Government's new spending over the year to A$63 billion. The Labour Party on the other hand pledged an A$2.9 billion spending on hospital care for the elderly, if they won the elections. About 63,000 new jobs were created in September 2004, which improved unemployment rate to 5.6 percent in September 2004, compared to 5.9 percent a year ago

Consumer prices increased by 2.6 percent over the year to September 2004, compared to an increase of 3.2 percent over the same period in 2003. This reflected the higher prices for fuel, housing, property rates and charges, and overseas travel, which more than offset prices for cars, fresh food and pharmaceuticals. Inflation was 2.3 percent in the September quarter, compared to the previous quarter, which is within the Reserve Bank of Australia's (RBA) medium term inflation target of 2.0 to 3.0 percent. The RBA left its official cash rate unchanged at 5.25 percent in the September quarter. Broad money supply increased by 9.7 percent over the year to September 2004, compared to an increase of 12.9 percent over the year to September 2003.

The trade account deficit was US$17.0 billion over the year to September 2004, compared to a deficit of US$13.5 billion in the corresponding period in 2003.

During the September quarter of 2004, the US dollar appreciated against most of the major currencies, reflecting the strong US economy and high domestic interest rates in the US. This is despite the high current account and fiscal deficits, political uncertainty surrounding the forth-coming presidential elections, ter-

EXCHANGE RATES



rorism and the war in Iraq, and concerns about the US economy. The US dollar appreciated against the British pound sterling, Japanese yen and euro, while it depreciated against the Australian dollar.

In the September quarter of 2004, the daily average nominal kina exchange rate appreciated against all the major currencies. The kina appreciated against the US dollar, Australian dollar, pound sterling, yen and euro by 0.4, 2.7, 2.3, 1.2 and 1.0 percent, respectively. The appreciation reflects the favourable inflows of foreign exchange during the quarter.

3. EMPLOYMENT

According to the Bank's employment index, the level of employment in the formal private sector, excluding mining and petroleum and the NSP, increased marginally by 0.1 percent over the year to June 2004, compared to a revised increase of 10.4 percent in the corresponding period in 2003. The increase reflected higher employment levels in all sectors except the transportation, wholesale, construction and agriculture/forestry/fisheries sectors and in all regions except the NCD, Southern, Highlands and Momase regions.

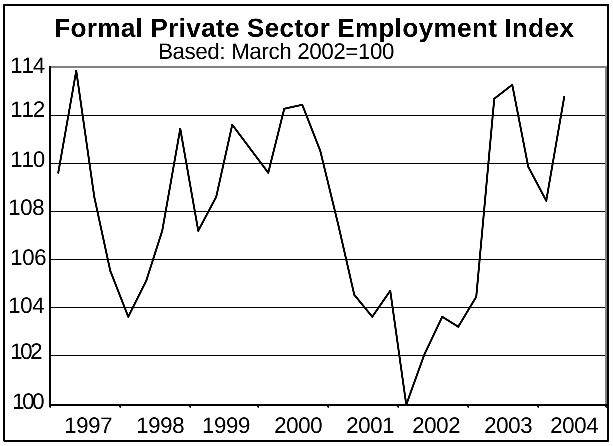
In the retail sector, employment increased by 3.7 percent, compared to a revised increase of 2.2 percent in the corresponding period in 2003. The increase reflected recruitment of student trainees, expansion of business by a retailer, opening of a branch in Mt. Hagen by a pharmacist, opening of a new retail shop in Madang, expansion of a bakery outlet, introduction of new line of business in retailing and installation of computers. In the wholesale sector, employment decreased by 0.8 percent, compared to a revised increase of 9.0 percent in the corresponding period in 2003. The decline was due to the reduction of casual staff by several major wholesalers and staff resignations.

In the manufacturing sector, employment increased by 5.9 percent over the year to June 2004, compared to a revised increase of 3.4 percent in the corresponding period in 2003. The increase was due to higher employment in all regions except the Momase region. The increase in the NCD was due to employment of student trainees and higher casual staff by a couple of printing companies for printing and delivery of newspapers and stationeries, respectively. The increase in the Southern region was due to the hiring of casuals to construct dinghies to meet higher orders from customers, combined with increased production of sawn timber and fly wood. The increase in the Highlands region was associated with metal and steel fabrication for renovation and maintenance of buildings. In Morobe, the increase was due to the demand for sawn timber and ply wood, increase in casual staff associated with production of gas bottles to meet higher demand and recruitment of casual staff by a soft drink and beverage manufacturer for sales and promotional activities. In the Islands region, the increase was associated with the expansion of mining operations and higher employment for processing and treatment of sawn timber for export.

In the construction sector, employment declined by 2.1 percent over the year to June 2004, compared to a revised increase of 7.0 percent in the corresponding period in 2003. Employment declined in the NCD, Morobe and Momase regions, while the other regions recorded increases. In the NCD, the decline was due to the laying-off of workers following the completion of some on-going projects and lack of new projects. In Morobe, the decline reflected the termination of employees due to the liquidation of a construction company, completion of maintenance and renovation of school buildings, completion of bridges and reduction in contract work with the Department of Works and statutory organisations.

In the transportation sector, employment decreased by 3.2 percent over the year to June 2004, compared to a revised decline of 5.3 percent in the corresponding period in 2003 due to reduction in employment levels in all regions except the NCD. The decline in the Southern region was due to the laying-off of casual staff attributed to low shipments, as a result of low water level of the Fly river. The decline in the Highlands region reflected loss of a contract with the mining operators and sale of two aircrafts, combined with low level of cargo haulage to and from the Highlands region. In Morobe, the decrease reflected reduction in staff level by two major shipping companies, while the decline in the Momase region was due to the lay-off of casuals.

In the agriculture/forestry/fisheries sector, employment decreased by 5.7 percent over the year to June 2004, compared to a revised increase of 24.2 percent in the corresponding period in 2003. Declines in employment levels in the NCD and Morobe regions more than offset increases in the other regions. Lower



employment in the NCD was due to the lay-off of staff at the head office of a logging company, following a court battle between the landowners and the operator regarding the royalty payment and other landowner entitlements. The decline in Morobe reflected the laying-off of employees by the fishing companies.

In the finance and other business services sector (which includes real estate, hotel and restaurants, finance and security services), employment increased by 6.4 percent over the year to June 2004, compared to a revised increase of 10.7 percent in the corresponding period in 2003. The recruitment of new staff by the hotels and restaurants, finance companies, security firms, law and accounting firms contributed to the increase in the finance and other business services sector.

In the mining/quarrying/petroleum sector, employment increased by 8.2 percent over the year to June 2004, compared to a revised decline of 4.4 percent in the corresponding period in 2003. The increase mainly reflected expansion in operations by one of the gold mines, while other mining and explorations activity remained stable during the period.

By region, the increase in employment levels in the Morobe and Islands regions more than offset declines in the other regions. In the Islands region, the level of employment increased by 4.2 percent over the year to June 2004, compared to an increase of 12.1 percent in the corresponding period in 2003. The increase was due to higher employment in all sectors except the finance and other business services sector. In the agriculture/forestry/fisheries sector, the increase reflected higher employment by the palm oil, cocoa and copra estates as a result of increased production. The extension of some logging operations and demand for log exports also contributed to the increase. The increase in the manufacturing sector reflected higher employment by the bakery, soft drinks and beverage manufacturers, and cocoa and copra processors. Higher employment level in the construction sector reflected increased civil and building construction activity in the region. The increase in the wholesale sector was associated with restructuring of a company and opening of a new shed, extension of a food bar by a wholesaler and higher employment by a cocoa processor and exporter.

In the Morobe region, employment increased by 11.6 percent over the year to June 2004, compared to a revised decline of 1.1 percent in the corresponding period in 2003. The increase reflected higher employment in all sectors except the agriculture/forestry/fisheries, construction, retail and transportation sectors. The increase in the manufacturing sector was associated with the demand for sawn timber and ply wood and increased casual staff associated with higher production of gas bottles and recruitment of casual staff by a soft drink and beverage manufacturer for sales and promotional activities. In the wholesale sector, the increase was due to recruitment of staff for a new wholesale store and the recruitment of new staff by another wholesaler to cater for increased market share. Higher employment by the finance, real estate, security service and hotels accounted for the increase in the finance and other services sector.

In the NCD, employment decreased by 0.3 percent over the year to June 2004, compared to a revised decline of 1.5 percent in the corresponding period in 2003 due to reduction in employment by the retail and construction sectors. The decline in the construction sector was attributed to the completion of some ongoing maintenance and building projects and lack of new projects. The decline in the retail sector was due to the laying-off of casual staff by several supermarkets, while a temporary closure of logging operations of a logging company resulted in the laying-off of staff at the head office.

In the Southern region, employment decreased by 3.8 percent over the year to June 2004, compared to a revised increase of 3.0 percent in the corresponding period in 2003. The decline reflected lower employment in the retail and transportation sectors. In the retail sector, the decline mainly reflected the liquidation of a major retailer in Tabubil, while the laying-off of staff by the shipping companies due to the dry season accounted for the decline in the transportation sector.

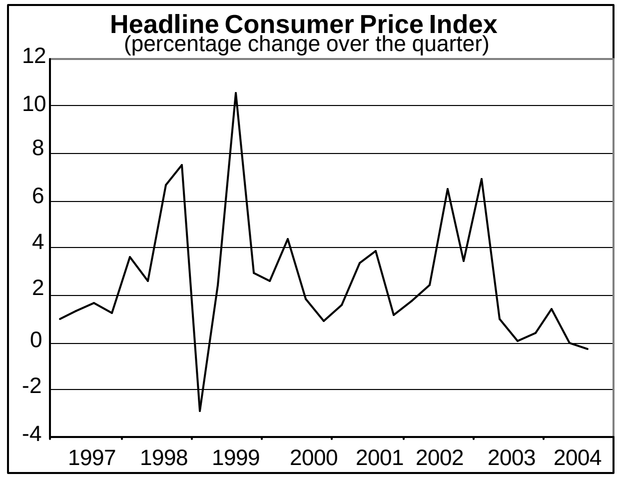
In the Highlands region, employment decreased by 5.9 percent over the year to June 2004, compared to a revised increase of 2.2 percent in the corresponding period in 2003. The decline in the transportation and finance and other services sectors more than offset increases in the other sectors. The decline in the transportation sector was due to the termination of staff as a result of the loss of contract with a mining operator and sale of two aircrafts by an airline company. Reduction in employment by the security firms due to the loss of contracts, combined with declines in exploration activities and manpower by a hotel and guest house operators accounted for the decline in the other services sector.

In the Momase region, employment decreased by 11.1 percent over the year to June 2004, compared to a revised increase of 4.3 percent in the corresponding period in 2003. The decrease reflected lower employment by all sectors except the agriculture/forestry/fisheries, wholesale and retail sectors. The decline in the manufacturing sector was due to reduction in employment by the meat and tuna canneries, while the decline in the transportation sector reflected the laying-off of staff by the stevedoring companies due to a slow down in stevedoring activities, as well as the temporary lay-off of staff by a third level airline due to decline in cargo haulage and passenger travel.

5. CONSUMER PRICE INDEX

The headline inflation rate as measured by the Consumer Price Index (CPI) was negative 0.3 percent in the September quarter of 2004, compared to zero percent in the June quarter of 2004. The contributing factor to the decline were decreases in the indices of the 'Drinks, tobacco and betelnut', 'Food', and 'Clothing and footwear' expenditure groups, which more than offset increases in the other groups. By region all urban areas from which CPI is collected recorded decreases in the September quarter of 2004, except Rabaul. The annual headline CPI to September 2004 was 1.5 percent, compared to 11.8 percent in the corresponding period in 2003.

The CPI for the 'Food' expenditure group decreased by 0.9 percent in the September quarter of 2004, com-



pared to an increase of 1.8 percent in the previous quarter. This was mainly attributed to decreases in the meat and fish, and fruits and vegetables sub-groups. For the 'Drinks, tobacco and betelnut' expenditure group, the CPI continued to decline with a decrease of 2.1 percent in the September quarter of 2004, compared to a decrease of 2.2 percent in the previous quarter. This was mainly attributed to lower prices in the cigarettes and tobacco, and betelnut sub-groups. The CPI in the 'Clothing and footwear' expenditure group decreased by 0.3 percent in the September quarter of 2004, compared to an increase 1.6 percent in the previous quarter. Lower prices in the women and girls' clothing, and other clothing and footwear subgroups accounted for the decrease. The CPI for the 'Transport and communication' expenditure group increased by 2.0 percent in the September quarter of 2004, compared to a decrease of 1.7 percent in the previous quarter. The increase reflected higher prices for motor vehicle purchases, operations and airlines, bus and PMV fares. The CPI for the 'Household equipment and operation' expenditure group increased by 0.4 percent in the September quarter of 2004, compared to an increase of 1.1 percent in the previous quarter, due to higher prices for durable and semi durable goods. For the 'Miscellaneous' expenditure group, there was an increase of 0.2 percent in the September quarter of 2004, compared to an increase of 0.8 percent in the previous quarter. The 'Rents, council charges, fuel and power' expenditure group increased by 4.7 percent in the September quarter, compared to 1.4 percent in the previous quarter, mainly reflecting higher prices of fuel.

By urban areas, all CPI surveyed areas recorded decreases in the September quarter of 2004, except for

Rabaul. Goroka recorded a decrease of 2.1 percent in the September quarter of 2004, compared to an increase of 0.6 percent in the previous quarter, followed by Lae with a decrease of 0.5 percent, compared to an increase of 0.5 percent in the previous quarter. Madang recorded a decrease of 0.4 percent in the September quarter of 2004, compared to an increase of 0.5 percent in the previous quarter, while Port Moresby recorded the lowest decrease of 0.1 percent in the September quarter of 2004. Rabaul recorded an increase of 1.3 percent in the September quarter 2004 compared to an increase of 1.4 percent in the previous quarter.

The underlying exclusion-based CPI measure increased by 1.4 percent in the September quarter of 2004,, compared to an increase of 0.8 percent in the previous quarter. The increase was associated with the rise in prices for motor vehicle purchases and operation and durable items.The trimmed-mean measure increased by 0.1 percent in the September quarter of 2004, compared to 1.5 percent in the previous quarter.

6. EXPORT COMMODITIES REVIEW

The total value of merchandise exports in the September quarter of 2004 was K1,755 million, 8.7 percent lower than in the corresponding quarter of 2003. There were declines in the export values of gold, crude oil, coffee, cocoa, copra oil, palm oil, marine products and logs, which more than offset the increase in the values of copper, tea, copra, rubber and other non-mineral export products. Mineral export receipts, excluding crude oil were K967.9 million and accounted for 55.2 percent of total merchandise exports in the September quarter of 2004, compared to K1,006.5 million or 52.4 percent in the corresponding quarter of 2003. Crude oil exports totaled K317.7 million and accounted for 18.1 percent of total merchandise exports in the September quarter of 2004, compared to K418.5 million or 21.8 percent of total merchandise exports in the corresponding quarter of 2003.

The value of agricultural, marine products and other non-mineral exports, excluding forestry export products was K365.0 million and accounted for 20.8 percent of total merchandise exports in the September quarter of 2004, compared to K400.4 million or 20.8 percent of total merchandise exports in the corresponding quarter of 2003. Forestry export products were K104.4 million and accounted for 5.9 percent of total merchandise exports in the September quarter of 2004, compared to K96.6 million or 5.0 percent in the corresponding quarter of 2003.

The weighted average price of Papua New Guinea's exports was 14.7 percent higher in the September quarter of 2004, compared to the corresponding quarter of 2003. There was a 19.2 percent increase in the weighted average price of mineral exports, with higher kina prices of gold, crude oil and copper. For the agricultural, forestry and marine export products, the weighted average price increased by 1.0 percent and was accounted for by higher kina prices of coffee, copra, copra oil, palm oil and rubber exports with the exception of cocoa, tea and logs. The higher export prices for most of the agricultural export commodities, with the exception of cocoa and tea were consistent with the trend in international prices, which more than offset the appreciation of the kina against the US dollar.

Mineral Exports

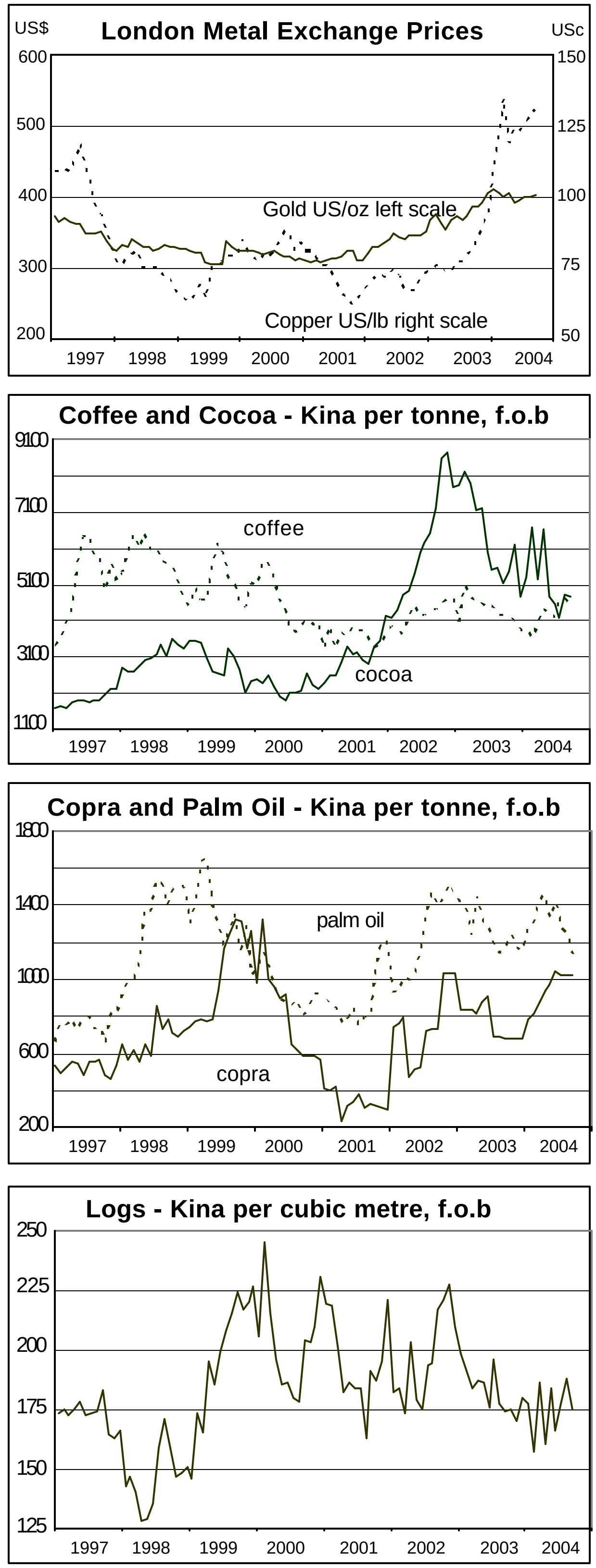
Total mineral export receipts were K1,285.6 million in the September quarter of 2004, compared to K1,425.0 million in the corresponding quarter of 2003. The decline was due to lower export volumes of all mineral products, which more than offset increases in export prices.

Gold export volumes declined by 17.9 percent to 14.7 tonnes during the September quarter of 2004, compared to 17.9 tonnes in the corresponding quarter of 2003. The decline was due to lower production from all the mines, except Lihir mine, resulting from the mining of lower ore grades combined with a decline in shipment. The average free on board (f.o.b.) price received for Papua New Guinea's gold exports was K41.2 million per tonne during the September quarter of 2004, which is 1.5 percent higher than in the corresponding period of 2003. The increase reflected higher international prices, which more than offset the effect of the appreciation of the kina against the US dollar. The average gold price at the London Metal Exchange increased by 10.5 percent to US$401 per fine ounce in the September quarter of 2004, compared to an average of US$363 per fine ounce in the corresponding quarter of 2003. The increase was due to higher demand from Asia and North America, as investors considered gold-based investments as a safe haven after continued lower performance in the equity markets. Higher gold prices also reflected the depreciation of the US dollar against other major currencies, continued uncertainties surrounding the on-going conflict in Iraq and global fears on terrorism. The decrease in export volume more than offset the increase in export price, resulting in a decline of 16.7 percent in gold export receipts to K605.2 million in the September quarter of 2004, compared to K726.3 million in the corresponding quarter of 2003.

Copper export volumes declined by 9.1 percent to 39.8 thousand tonnes in the September quarter of 2004, compared to 43.8 thousand tonnes in the corresponding quarter of 2003**.** The decline was due to lower production and shipment of copper ore as a result of lower water levels at the Fly river. The average f.o.b. price of Papua New Guinea's copper exports increased by 43.4 percent to K8,967 per tonne in the September quarter of 2004, compared to K6,253 per tonne in the corresponding quarter of 2003. This outcome was mainly attributed to higher international prices, resulting from lower stock levels at the London Metal Exchange, combined with higher demand from Asia, one of the major copper-consuming regions. The increase in price more than offset the decline in volume resulting in an increase in export receipts by 30.3 percent to K356.9 million in the September quarter of 2004, compared to K273.9 million in the corresponding quarter of 2003.

Crude oil export volumes declined by 45.4 percent to 2,330.9 thousand barrels in the September quarter of 2004, compared to 4,271.6 thousand barrels in the corresponding quarter of 2003. The decline reflected lower extraction rates from wells at the Kutubu, Gobe Main and South East Gobe oil projects attributed to the natural decline in reserve levels. The average export price of crude oil increased by 38.8 percent to K136 per barrel in the September quarter of 2004, compared to K98 per barrel in the corresponding quarter of 2003. Despite exceeding the official production quotas set by the members of Organisation of Petroleum Exporting Countries (OPEC), higher international prices was associated with increased global demand resulting from lower strategic reserve levels in North America. This combined with the slow recovery of oil production in Iraq, uncertainties surrounding Russian oil production due to possible bankruptcy of Russia's leading oil company, strikes by oil workers in Venezuela and continued global fears on terrorism. The decline in the volume more than offset the increase in price, and resulted in a fall in export receipts by 24.1 percent to K317.7 million in the September quarter of 2004, compared to K418.5 million in the corresponding

EXPORT COMMODITY PRICES



quarter of 2003.

Agriculture, Logs and Fisheries Exports

Prices of most agricultural export commodities increased in the September quarter of 2004, compared to the corresponding quarter of 2003. Coffee prices increased by 7.2 percent, copra by 47.8 percent, palm oil by 5.0 percent, copra oil by 40.2 percent and rubber by 51.2 percent. The average export price of logs declined marginally by 0.6 percent to K180 per cubic meter in the September quarter of 2004, compared to K181 per cubic meter in the corresponding quarter of 2003. The net effect of these price movements was a 1.0 percent increase in the weighted average price of agricultural, forestry and marine export products. Excluding logs, the weighted average price of agricultural and marine export products increased by 1.4 percent in the September quarter of 2004, compared to the corresponding period of 2003.

The volume of coffee exported declined by 16.3 percent to 23,700 tonnes in the September quarter of 2004, compared to 28,300 tonnes in the corresponding quarter of 2003. The decline was due to lower production mainly associated with the biennial coffee production cycle and deteriorating road infrastructure. The average export price of coffee increased by 7.2 percent to K4,629 per tonne in the September quarter of 2004, compared to K4,318 per tonne in the corresponding quarter of 2003. The increase was mainly due to higher international prices resulting from a decline in world supply caused by unfavourable weather conditions in Brazil, the world's largest coffee producer. The decline in volume more than offset the increase in price, resulting in a decline in export receipts by 10.2 percent to K109.7 million in the September quarter of 2004, compared to K122.2 million in the corresponding period of 2003.

The volume of cocoa exported declined by 5.9 percent to 9,500 tonnes in the September quarter of 2004, compared to 10,100 tonnes in the corresponding quarter of 2003. This outcome was attributed to lower production resulting from unfavourable weather conditions in major cocoa producing regions. The average export price of cocoa declined by 17.6 percent to K4,505 per tonne in the September quarter of 2004, compared to K5,465 per tonne in the corresponding period of 2003. This was due to lower international prices, reflecting increased supply in the world market caused by higher production from the Ivory Coast, Asia and Latin American countries. The combined decline in price and volume, resulted in a decline in export receipts by 22.5 percent to K42.8 million in the September quarter of 2004, compared to K55.2 million in the corresponding period of 2003.

The volume of copra exported increased significantly by 238.5 percent to 4,400 tonnes in the September quarter of 2004, compared to 1,300 tonnes in the corresponding quarter of 2003. The increase was attributed to higher production from the major copra producing regions, resulting from favourable supply response to higher international prices as producers reduced sales to the domestic copra mills in favour of direct exports and good weather conditions. The average export price for copra increased by 47.8 percent to K1,023 per tonne in the September quarter of 2004, compared to K692 per tonne in the corresponding quarter of 2003. The increase was mainly related to higher international prices, which resulted from lower production from the Philippines and Indonesia, two of the world's major copra producers. The combined increase in price and volume resulted in a significant increase in export receipts by 400.0 percent to K4.5 million in the September quarter of 2004, compared to K0.9 million in the corresponding period of 2003.

The volume of copra oil exported declined by 35.9 percent to 8,200 tonnes in the September quarter of 2004, compared to 12,800 tonnes in the corresponding period of 2003. The decline was mainly due to lower quantities of copra purchased by the two domestic copra mills for processing. The average export price of copra oil increased by 40.2 percent to K1,720 per tonne in the September quarter of 2004, compared to K1,227 per tonne in the corresponding period of 2003. The increase was due to higher international prices resulting from declining copra production from the Philippines and Indonesia, two of the world's major copra producers, combined with a decline in supply of other edible oils in the world market. The decline in volume more than offset the increase in price resulting in a decrease in export value by 10.2 percent to K14.1 million in the September quarter of 2004, compared to K15.7 million in the corresponding period of 2003.

The volume of palm oil exported declined by 10.0 percent to 67,700 tonnes in the September quarter of 2004, compared to 75,200 tonnes in the corresponding period of 2003. The decline was due to delays in shipment of palm oil from the major palm oil producing regions. The average export price of palm oil increased by 5.0 percent to K1,220 per tonne in the September quarter of 2004, compared to K1,162 per tonne in the corresponding quarter of 2003. The increase reflected higher international prices associated with lower production from Malaysia and Indonesia, two of the world's major producers, combined with a decline in supply of other edible oils in the world market. The decline in volume more than offset the increase in price resulting in a 5.5 percent decrease in export value to K82.6 million in the September quarter of 2004, compared to K87.4 million in the corresponding period of 2003.

The volume of tea exported increased by 46.2 percent to 1,900 tonnes in the September quarter of 2004, compared to 1,300 tonnes in the corresponding quarter of 2003. The increase was due to higher production as a result of favourable weather conditions combined with commencement of exports by a recently acquired plantation. The average export price of tea declined by 1.2 percent to K2,737 per tonne in the September quarter of 2004, compared to K2,769 per tonne in the corresponding period of 2003. The increase in volume more than offset the decline in price and resulted in an increase in export value by 44.4 percent to K5.2 million in the September quarter of 2004, compared to K3.6 million in the corresponding period of 2003.

The volume of rubber exported increased by 20.0 percent to 1,200 tonnes in the September quarter of 2004, compared to 1,000 tonnes in the corresponding period of 2003. The increase was mainly attributed to the rehabilitation of some plantations, supply response to higher international prices and favourable weather conditions. The average export price increased by 51.2 percent to K4,083 per tonne in the September quarter of 2004, compared to K2,700 per tonne in the corresponding period of 2003. The increase was associated with higher international prices as a result of lower supply in the world market. The combined increase in price and volume resulted in an increase in the export value by 81.5 percent to K4.9 million in the September quarter of 2004, compared to K2.7 million in the corresponding period of 2003.

The volume of logs exported declined by 9.4 percent to 442.0 thousand cubic meters in the September quarter of 2004, compared to 488.0 thousand cubic meters in the corresponding period of 2003. This was mainly attributed to lower production and shipment of logs from major logging projects, due to unfavourable weather conditions. The average export price of logs declined marginally by 0.6 percent to K180 per cubic meter in the September quarter of 2004, compared to K181 per cubic meter in the corresponding period of 2003. This outcome was due to lower international prices reflecting increased supply of tropical hardwoods in the world market. The combined decline in price and volume resulted in a decrease in export receipts by 10.0 percent to K79.4 million in the September quarter of 2004, compared to K88.2 million in the corresponding period of 2003.

The value of marine products exported declined by 49.6 percent to K13.3 million in the September quarter of 2004, compared to K26.4 million in the corresponding period of 2003. This resulted from a combined decline in export price and volume.

7. BALANCE OF PAYMENTS

The overall surplus in the balance of payments for the nine months to September 2004 was K130 million, compared to a surplus of K58 million in the corresponding period of 2003. This outcome was the result of an improvement in the capital and financial account, which more than offset a deterioration in the current account. The improvement in the capital and financial account was due to a net inflow in the financial account, reflecting direct equity investment flows, combined with drawdown of foreign currency account balances by the mineral companies. The deficit in the current account was due to a lower trade surplus and higher net service payments, which more than offset lower net income payments and higher net transfer receipts. There were no flows recorded in the capital account during the period.

During the first nine months of 2004, the kina appreciated against the currencies of Papua New Guinea's major trading partners, except the Australian dollar and British pound, compared to the corresponding period in 2003.

The trade account recorded a surplus of K2,371 million in the nine months to September 2004, compared to a surplus of K2,679 million in the corresponding period of 2003. The lower surplus was due to an increase in the value of merchandise imports, which offset a marginal increase in merchandise exports. The value of merchandise exports increased by 0.6 percent to K5,870 million in the nine months to September 2004, compared to K5,835 million in the corresponding period of 2003. The increase was attributed to higher values of gold, copper and all non-mineral export commodities, with the exception of cocoa, coffee, logs and marine export products.

The value of merchandise imports increased by 10.9 percent to K3,499 million in the nine months to September 2004, compared to K3,156 million in the corresponding period of 2003. The increase was attributed to higher values of mining and general imports, which more than offset a decline in petroleum imports. Imports by the mining sector increased by 16.6 percent to K633 million in the nine months to September 2004, compared to K543 million in the corresponding period of 2003. The increase reflected higher capital expenditure undertaken by the Lihir and Tolukuma mines. General imports increased by 10.1 percent to K2,798 million in the nine months to September 2004, compared to K2,541 million in the corresponding period of 2003, mainly reflecting some pick-up in aggregate demand. Petroleum sector imports declined by 4.2 percent to K68 million in the same period, compared to K71 million in the corresponding period of 2003, due to lower capital expenditure undertaken by the Gobe, Moran and Kutubu oil projects.

The deficit in the services account was K1,965 million in the nine months to September 2004, compared to a deficit of K1,687 million in the corresponding period of 2003. The higher deficit this year was due to an increase in transportation, travel, education, other financial, computer and information, communication, cultural and recreation, governments services, n.i.e. and other service payments, combined with lower service receipts. These more than offset lower insurance, other business, construction and refining and smelting service payments.

The deficit in the income account was K1,139 million in the nine months to September 2004, compared to a deficit of K1,398 million in the corresponding period of 2003.This outcome reflected lower payments for dividend and interest on foreign loans by the Government and mineral companies, partly related to the appreciation of the kina against the US dollar. These combined with higher income receipts more than offset an increase in payments for compensation of employees.

The surplus in the transfers account was K676 million in the nine months to September 2004, compared to a surplus of K646 million in the corresponding period of 2003. The higher surplus was due to lower tax payments and more than offset increased outflows for superannuation, family maintenance, gifts and grants and licensing fees.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a deficit of K57 million in the nine months to September 2004, compared to a surplus of K240 million in the corresponding period of 2003.

The capital account recorded no transactions during the nine months to September 2004, the same as in the corresponding period of 2003.

The financial account recorded a net inflow of K195 million in first nine months of 2004, compared to a net outflow of K169 million in the corresponding period of 2003. The improvement reflected net inflows under Other Investments totalling K442 million, associated with the drawdown of foreign currency account balances by the mineral companies combined with an increase in trade credits owed by PNG residents to non-residents' abroad. Government loan repayments were lower this year. This combined with a net inflow of K83 million in direct investment associated with equity financing for a mineral project, more than offset outflows of K28 million and K302 million in financial derivative and portfolio investment. These outflows reflected increased hedging transactions by resident mineral companies and holdings of short-term money market instruments, respectively.

In the September quarter of 2004, the balance of payments recorded an overall surplus of K111 million, compared to a surplus of K154 million in the corresponding quarter of 2003.

The value of merchandise exports decreased by 8.7 percent to K1,755 million in the September quarter of 2004, compared to K1,922 million in the corresponding quarter of 2003. This outcome was due to lower values of gold, crude oil, cocoa, coffee, copra oil, palm oil, logs and marine export products, which more than offset increases in the values of copper, tea, copra, rubber and forest export product.

The value of merchandise imports increased by 22.1 percent to K1,222 million in the September quarter of 2004, compared to K1,001 million in the corresponding quarter of 2003, due to higher general and petroleum sector imports. General imports increased by 28.0 percent to K1,046 million in the September quarter of 2004, compared to K817 million in the same period last year, due to a pick-up in import demand. Imports by the petroleum sector increased by 7.1 percent to K30 million in the September quarter of 2004, compared to K28 million in the corresponding quarter of 2003, mainly associated with higher capital expenditure undertaken by the Gobe, Moran and Kutubu oil projects. Mining sector imports decreased by 6.4 percent to K146 million in the September quarter of 2004, compared to K156 million in the corresponding quarter of 2003, reflecting lower capital expenditures by the Misima, Ok Tedi and Tolukuma mines, which more than offset higher capital expenditure undertaken by the Porgera and Lihir mines.

The deficit in the services account was K558 million in the September quarter of 2004, compared to K476 million in the corresponding quarter in 2003. The higher deficit was associated with increases in payments for transportation, travel, other financial, computer and information, communication, cultural and recreational and government services, n.i.e. This combined with lower service receipts more than offset declines in education, insurance, other business services, construction, refining and smelting and other service payments by resident companies.

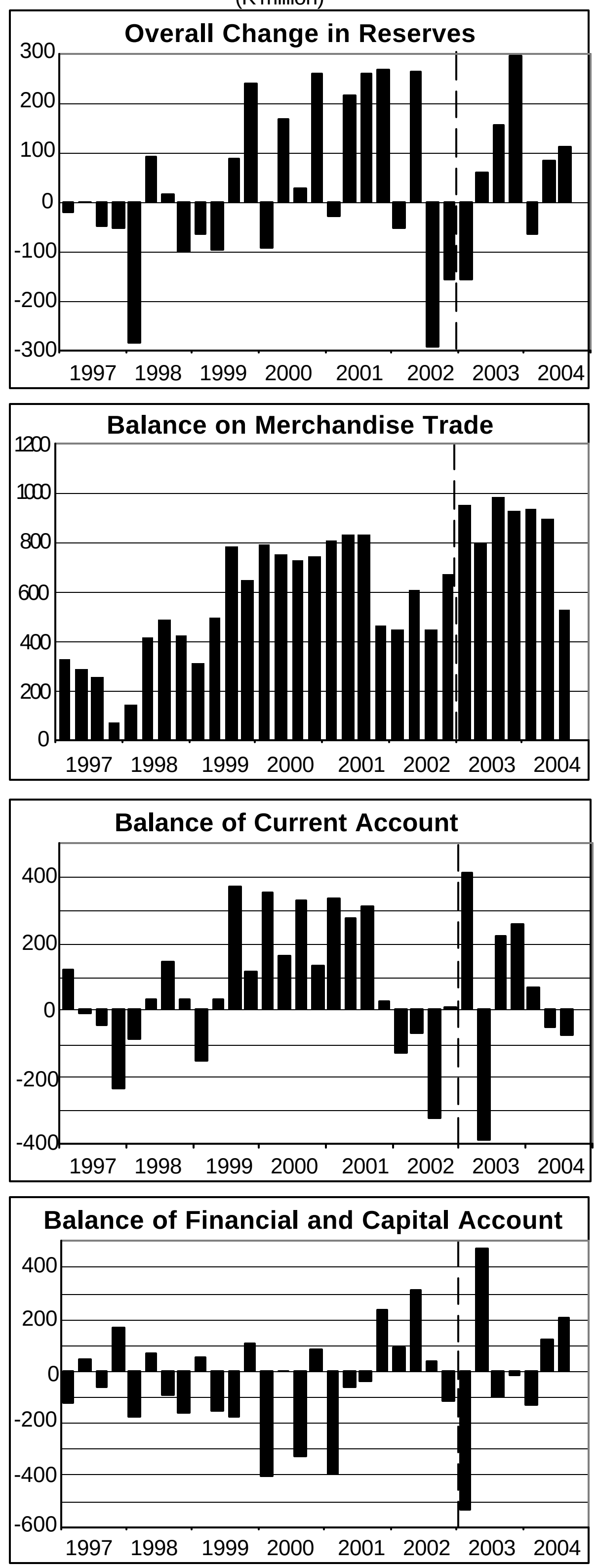
The deficit in the income account was K208 million in the September quarter of 2004, compared to a deficit of K306 million in the corresponding quarter of 2003. This improvement was due to an increase in income receipts, combined with lower compensation of employees, dividend and interest payments on foreign loans by both Government and resident companies.

The surplus in the transfers account was K159 million in the September quarter of 2004, compared in to a surplus of K82 million in the corresponding quarter of 2003. The improvement was related to increased receipts for family maintenance, gifts and grants and licensing fees combined with lower transfer payments.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a deficit of K74 million in the September quarter of 2004, compared to a surplus of K221 million in the corresponding quarter of 2003.

The capital account recorded no transactions during the

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.

September quarter of 2004, the same as in the corresponding period of 2003.

The financial account recorded a net inflow of K203 million in the September quarter of 2004, compared to a net outflow of K103 million in the corresponding period of 2003. The improvement reflected the net inflow of K520 million in Other Investment, associated with the drawdown of foreign currency account balances by the mineral companies, combined with an increase in trade credits owed by PNG residents to non- residents abroad. This more than offset increases in portfolio investment assets and financial derivatives abroad, reflecting increased holdings of short term money market instruments and hedging transactions by resident mineral companies, respectively.

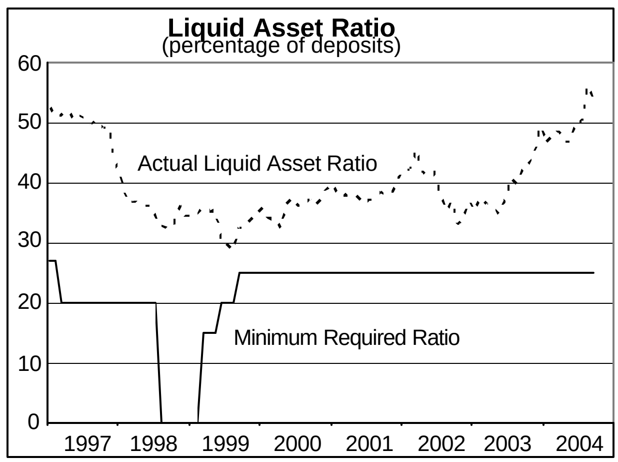
The level of gross foreign exchange reserves at the end of September quarter 2004 was K1,861.6 (US$589.0) million, sufficient for 4.6 months of total and 5.3 months of non-mineral import covers.

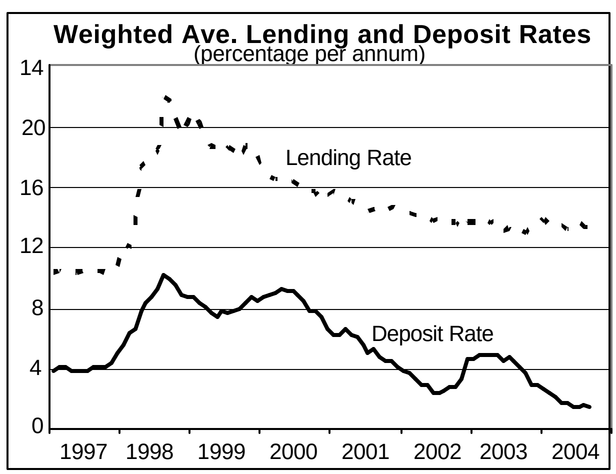
8. MONETARY DEVELOPMENTS

Interest Rates and Liquidity

The Bank of Papua New Guinea continued to ease its monetary policy stance by reducing the Kina Facility Rate (KFR) by 100 basis points to 9.0 percent in September 2004, from 10.0 percent in June 2004. The easing stance was in response to the favourable inflation outcome for the June and September quarters of 2004, a stable exchange rate, high foreign exchange reserves and sound fiscal management. The dealing margins for the Repurchase Agreement Facility (RAF) was also reduced by 100 basis points to 2.0 percent in September on both sides of the market. As a result, Treasury bill rates decreased across all maturities. The 28 day rate decreased from 6.90 percent to 4.44 percent, the 63 day rate from 6.76 percent to 4.06 percent, the 91 day rate from 7.02 percent to 4.74 percent and the 182 day rate from 8.26 percent to 5.43 percent. The weighted average deposit rates quoted on large term deposits (K500,000 and above) by commercial banks also trended downwards, with the exception of the 180 day rate, which increased from 2.75 percent to 3.97 percent during the September quarter of 2004. The 30 day rate declined from 3.14 percent to 2.63 percent, the 60 day rate from 2.77 percent to 2.48 percent and the 90 day rate from 2.77 percent to 2.56 percent.

The Bank continued to utilise its Open Market Operation (OMO) in the conduct of monetary policy during the September quarter of 2004, by actively using the Treasury bills and RAF to manage the high level of liquidity in the banking system. The volume of trading in the inter-bank market continued to remain low, reflecting the liquidity situation. As a result of the significant increase in liquidity levels arising from the Bank of PNG's intervention in the foreign exchange market and retirement of Treasury bills by the Government, the Bank of PNG introduced the Central Bank Bill (CBB) in August 2004 to absorb excess liquidity and stabilize interest rates. To complement the CBB, the Bank also increased the minimum bid for Treasury bills at the auction from K100,000 to K500,000. This change was also aimed at encouraging the development of a secondary market for Government securities, where other financial institutions and brokers can sell these bills at minimum parcels of K10,000 to the public. The Cash Reserve Requirement (CRR) and the





Minimum Liquid Asset Ratio (MLAR) were maintained at 3.0 percent and 25.0 percent, respectively.

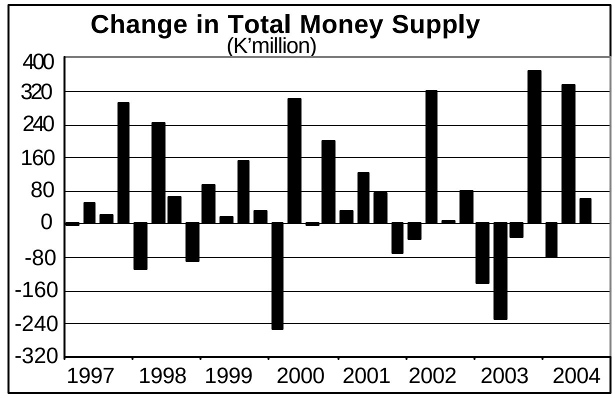
Average liquid assets held by the commercial banks increased by 15.5 percent over the September quarter of 2004, following an increase of 5.8 percent in the previous quarter. The increase reflected higher holdings of Government securities and deposits with the Central Bank under the Exchange Settlement Account (ESA) and RAF. Commercial banks continued to hold the majority of their liquid assets in short-term Government securities.

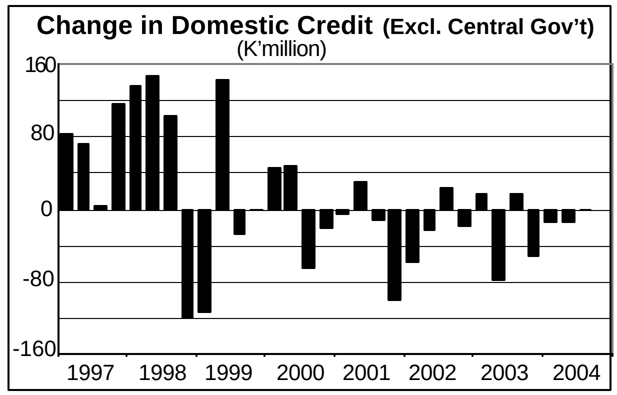
The weighted average rates on total deposits and lending by the commercial banks both remained unchanged at 1.5 percent and 13.3 percent, respectively, in the September quarter of 2004, compared to the June quarter. The weighted average rate on performing loans declined from 13.9 percent to 13.8 percent, with only one commercial bank reducing its Indicator Lending Rate (ILR), with the spread declining to 12.25 percent and 13.00 percent at the end of September 2004.

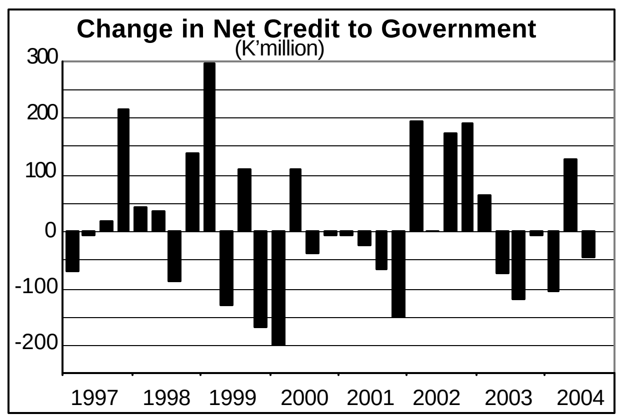
Money Supply

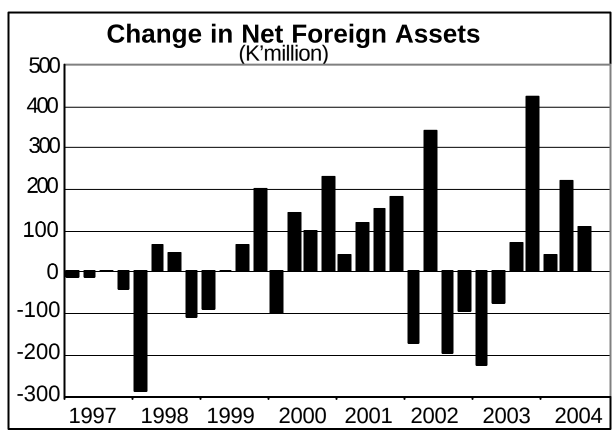
The average level of broad money supply (M3*) increased by 4.0 percent in the September quarter of 2004, compared to a revised increase of 4.4 percent in the June quarter of 2004. The growth resulted from increases of 7.5 percent and 6.6 percent in average net foreign assets and net credit to the Government by the banking system, respectively. These increases more than offset a decline of 1.9 percent in average net credit to the private sector, official entities and non-monetary financial institutions. Domestic credit outstanding, excluding advances to the Central Government and loans under the Agricultural export commodity price support schemes decreased by 0.1 percent in the September quarter of 2004, compared to the previous quarter. The average level of broad monetary base grew by 12.4 percent over the September quarter of 2004, compared to an increase of 4.5 percent in the previous quarter. The increase was due to higher holding of Government securities, reflecting the purchase of new Inscribed stocks and increase in commercial bank deposits at the Bank of PNG.

Net credit to the Government declined by 4.0 percent in the September quarter of 2004, compared to an increase of 12.5 percent in the June quarter of 2004. The decrease was due to a net retirement of Treasury









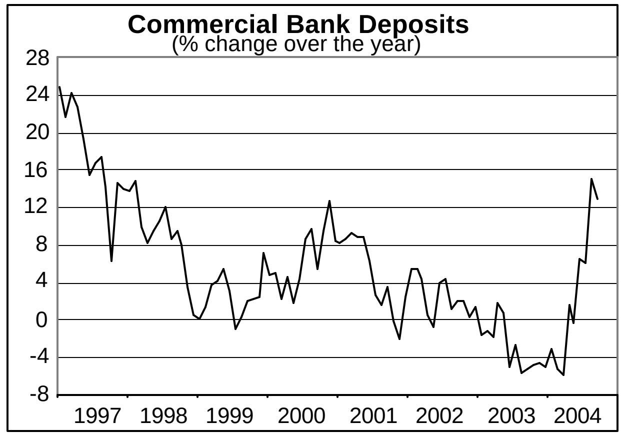
bills by the Government. Net foreign assets increased by K109.2 million to K1,984.0 million in the September quarter of 2004, compared to the previous quarter. The growth was attributed to a substantial increase in gross foreign assets of the Bank of PNG, which reflected the purchase of foreign exchange, higher mineral tax receipts and lower repayment of external debts.

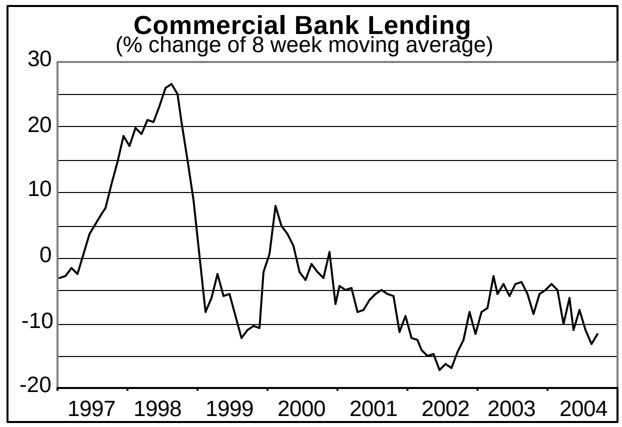
The average level of narrow money supply (M1*) increased by 5.4 percent in the September quarter of 2004, compared to an increase of 9.0 percent in the June quarter of 2004. The increase was due to the growth in both currency in circulation and demand deposits. The average level of quasi money declined by 0.5 percent during the September quarter, following an increase of 2.1 percent in the previous quarter, as a decline in term deposits more than offset an increase in savings deposits.

The monthly average level of deposit base of commercial banks increased by 3.6 percent in the September quarter of 2004 to K3,212.3 million, from K3,100.2 million in the June quarter. This represents an annualised rate of growth of 15.9 percent to September 2004.

Lending

During the September quarter of 2004, total domestic credit extended by the commercial banks to the private sector, official entities and the non-monetary financial institutions decreased by K1.8 million to K1,466.4 million, compared to an increase of K16.1 million during the corresponding quarter of 2003. Lending to the official entities fell by K23.7 million, whilst lending to the private sector and official entities increased by K18.9 million and K3.0 million, respectively. The decline in lending to official entities reflect repayments by public enterprises. In the private sector, the decline was attributed to net loan repayments by the building and construction sectors and other businesses, which includes hotels, real estate and business services. There were no repayments under the Government's Agricultural export commodity price support schemes, Small Scale Business Credit Facility (SSBCF) and the European Investment Bank (EIB) Global Loan Facility. The annualised rate of decline in domestic credit, excluding the Central Government and advances under the price support schemes, was 2.8 percent over the nine months to September 2004. Foreign currency lending to the private sector and official entities was 7.8 percent of total lending to these sectors, compared to 6.6 percent in June 2004, with kina lending accounting for the remainder.





The utilisation rate of credit is the ratio of total credit outstanding to total commitments outstanding to the private sector, official entities and non-monetary financial institutions. A higher utilisation rate indicates that firms are more efficient in drawing down funds to meet their operations and minimise 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 September 2004, compared to a revised 83.3 percent in June 2004. The decline reflects lower utilisation of committed funds.

9. PUBLIC FINANCE

Preliminary estimates of the fiscal operations of the National Government for the nine months to September 2004 showed an overall surplus of K476.0 million, compared to a surplus of K78.1 million in the corresponding period in 2003, and represents 3.8 percent of nominal GDP. The higher surplus was due to increased revenue combined with lower expenditure.

Total revenue, including grants during the first nine months of 2004 was K2,880.4 million, 6.6 percent higher than the receipts collected in the corresponding period of 2003, and represents 75.1 percent of the budgeted revenue. The increase was attributed to higher collections in all categories of tax revenue, which more than offset a decline in non-tax revenue and grants.

Total tax revenue amounted to K2,264.7 million, 13.5 percent higher than the receipts collected during the same period in 2003, and represents 81.1 percent of the 2004 budgeted tax receipts. Direct tax receipts totalled K1,526.7 million, K206.0 million more than the receipts collected over the corresponding period in 2003, and represents 83.8 percent of the budgeted amount. The increase was due to higher personal, company and other direct tax receipts. The growth in personal tax receipts reflect the adjustment in salaries and wages and increased employment by the private sector. The increase in company tax receipts reflected the improvement in the profitability by companies because of higher mineral and agricultural export prices. Other direct taxes increased due to higher receipts from gaming and dividend withholding taxes.

Indirect tax receipts was K738.0 million, 9.3 percent higher than in the corresponding period in 2003, and represents 76.0 percent of the budgeted receipts for 2004. All categories of indirect tax increased, except export tax and GST. Increases in import duties reflected higher imports, while other indirect tax receipts resulted from the 2.0 percent import duty. The decline in the export tax reflected the fall in log exports, while the decrease in GST collections was due to lower collections in the provinces.

Total non-tax revenue amounted to K234.6 million, K1.8 million higher than the amount collected in the corresponding period of 2003, and is substantially higher than the budgeted amount. The increase mainly reflected higher dividend payments by Government Statutory bodies and mineral sector. Total foreign grants was K381.1 million, compared to K474.1 million in the same period in 2003, due to delayed reporting of expenditures for AusAID funded projects.

Total expenditure over the nine months to September 2004 was K2,404.4 million, 8.4 percent lower than in the corresponding period in 2003, and represents 59.6 percent of the budgeted expenditure for 2004. The decrease was due to lower interest payments and development expenditures.

Recurrent expenditure for the first nine months of 2004 was K1,801.4 million, 2.6 percent lower than in the corresponding period in 2003, and represents 65.4 percent of the 2004 budgeted appropriations. Of this total, K886.3 million relate to National Departmental expenditure, 20.6 percent higher than the amount spent during the corresponding period in 2003, and represents 69.6 percent of the budgeted appropriation. The increase reflects higher wages and salaries, education subsidy, payment of arrears and expenses associated with the by-elections. Provincial Government recurrent expenditure was K426.7 million, which is 11.6 percent higher than the expenditure level during the same period in 2003, and represents 70.3 percent of the budgeted amount. The increase was due to higher administrative grants and salaries and wages. Interest payments totalled K319.7 million, K248.9 million lower than the amount paid in the corresponding period in 2003, and reflected lower interest rates on Treasury bills, combined with the retirement of some domestic debt and the appreciation of the kina against the US dollar.

Total development expenditure for the nine months to September 2004 was K603.0 million, 22.4 percent lower than in the corresponding period of 2003 and represents 47.2 percent of the budgeted expenditure for 2004. The decrease was partly related to delayed reporting of expenditures for AusAID funded projects.

The surplus of K476.0 million combined with the proceeds from the sale of assets of K25.0 million was used to make a net loan repayment of K300.0 million in overseas loans and K176.0 million in domestic loans. The overseas loan repayments comprised of K169.3 million in net concessionary, K9.9 million in commercial and K120.8 million for extraordinary loans. Domestic loan repayments were mainly to the banking sector through a net retirement of Treasury bills and settlement of cheque floats from 2003.

FOR THE RECORD

MONTHLY KINA FACILITY RATE ANNOUNCEMENTS

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

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

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

INTRODUCTION OF THE CENTRAL BANK BILL (CBB)

The Bank of PNG introduced an additional monetary policy instrument called " Central Bank Bill" (CBB) in August August 2004, to support its monetary operations in diffusing the significantly high level of excess liquidity and stabilise interest rates. The CBB is a liability of the Bank of PNG, and has the same features (such as maturity structure) as the Government Treasury bills, and is offered at the weekly auctions.

The creation of such an instrument is consistent with Section 10 of the Central Bank Act (CBA) 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 1989.

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

STATISTICAL SECTION

STATISTICAL NOTES

Sources

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

Government financial statistics are supplied by the Department of Finance 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