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PORT MORESBY

27th December 2006

1. GENERAL OVERVIEW

Indicators available to the Bank of Papua New Guinea (BPNG) showed that with the on-going macroeconomic stability, economic activity was buoyant in the nine months to September 2006. Although the volume of major mineral and agricultural exports declined except for copper, palm oil and logs, the general increase in export prices resulted in a significant trade account surplus. Lending to the private sector continued the increasing trend reflecting low interest rates and strong economic activity. Employment by the private sector continued to grow, while the increase in general imports indicated strong domestic demand. The Government's fiscal surplus was at a record high, which also contributed to increased spending and thus, stimulating a pick-up in economic activity. Inflation was low and stable despite volatile seasonal price movements in the headline inflation. As a result, the BPNG maintained a neutral monetary policy stance during the nine months to September 2006. However, with the windfall in Government revenue and the passing of a supplementary budget in August 2006, the BPNG is closely monitoring its impact on liquidity, exchange rate and inflation.

According to the Bank's Employment Index, the level of employment in the formal private sector, excluding mineral, declined by 2.1 percent in the September quarter of 2006, compared to an increase of 3.9 percent in the June quarter of 2006. By industry, employment declined in all sectors except the wholesale, transportation and financial/business and other services sectors. By region, the level of employment declined in the National Capital District (NCD), Highlands and Islands regions. Over the year to September 2006, the level of employment increased by 4.6 percent.

Annual headline inflation rate was 5.3 percent in the September quarter of 2006, compared to 2.3 percent in the June quarter of 2006. The higher headline inflation reflected increased prices for seasonal items, including fruits, vegetables and betelnut. There were increases in all expenditure groups, except the clothing and footwear, household equipment and operations, and miscellaneous expenditure groups. By region, all surveyed urban centers recorded higher prices.

Annual trimmed mean inflation was 1.2 percent in the September quarter of 2006, compared to 1.4 percent in the June quarter. Annual exclusion-based inflation measure was negative 0.7 percent in the September quarter, compared to negative 0.6 percent in the June quarter. The low underlying inflation outcomes reflects the continuing price stability in the September quarter due to the stable exchange rate as a result of high mineral tax receipts, sustainable levels of Government expenditure and improved confidence in the economy.

In the September quarter of 2006, the quarterly average kina exchange rate appreciated against the US dollar, euro and Japanese yen, while it depreciated against the Australian dollar and British pound. The average kina exchange rate appreciated by 0.38 percent against the US dollar, 1.83 percent against the yen and 0.17 percent against the euro. However, the average kina exchange rate depreciated by 0.54 percent against the Australian dollar and 0.80 percent against the pound sterling. These movements resulted in the quarterly average Trade Weighted Index (TWI) depreciating by 0.68 percent during the September quarter.

Higher international prices for mineral, some agricultural commodities, logs and marine products more than offset the appreciation of the kina against the US dollar. This resulted in a 48.1 percent increase in the weighted average kina price of exports in the September quarter of 2006, compared to the corresponding quarter of 2005. There was a 59.7 percent increase in the weighted average price of mineral exports, with higher kina prices for all mineral exports. For the agricultural, logs and marine product exports, the weighted average kina price increased by 3.0 percent. This was accounted for by higher kina prices of cocoa, tea, rubber, logs and marine products.

The overall surplus in the balance of payments for the nine months to September 2006 was K1,536 million, compared to a deficit of K11 million in the corresponding period of 2005. This outcome was the result of a significant improvement in the current account surplus, combined with a net inflow in the capital and financial accounts.

The current account recorded a surplus of K1,538 million in the nine months to September 2006, compared to a surplus of K1,159 million in the corresponding period of 2005. This outcome was the result of a higher surplus in the trade account, which more than offset higher net service and income payments and lower net transfer receipts.

The capital and financial accounts recorded a surplus of K39 million in the nine months to September 2006, compared to a deficit of K1,175 million in the corresponding period of 2005. The outcome reflected portfolio investment of K130 million from draw downs of short term money market instruments and foreign currency account balances of mineral companies and a lower net loan repayment by the Government.

The level of gross foreign exchange reserves at the end of September 2006 was K3,903.8 (US$1,296.1) million, sufficient for 8.5 months of total and 11.7 months of non-mineral import covers.

The BPNG maintained a neutral monetary policy stance during the September quarter of 2006, with the Kina Facility Rate (KFR) kept unchanged at 6.0 percent. The dealing margin for the Repurchase Agreements (Repos) was further reduced by 0.50 percent to 150 basis points on both sides of the KFR in order to realign domestic interest rates to the KFR. Domestic interest rates increased slightly during the quarter.

The Bank continued to utilise its Open Market Operation (OMO) instruments in the conduct of monetary policy over the September quarter of 2006. As the Government continued to retire Treasury bills, the Central Bank used the Central Bank Bills (CBBs) and Reverse Repos to sterilise the excess liquidity. Interbank borrowing picked up as a result of the uneven distribution of liquidity among banks. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) of commercial banks were maintained at 3.0 percent and 25.0 percent, respectively, over the September quarter of 2006.

The average level of broad money supply (M3*) increased by 8.2 percent in the September quarter of 2006, compared to an increase of 9.0 percent in the June quarter of this year. The outcome was due to increases of 27.7 percent in average net foreign assets of the depository corporations and 3.9 percent in average net private sector credit, which more than offset a decline of 34.3 percent in average net credit to the Central Government. Net domestic credit outstanding, excluding advances to the Central Government and outstanding loans under the Government's Agricultural export commodity price support scheme increased by 3.4 percent in the September quarter of 2006, compared to an increase of 14.1 percent in the June quarter. The average level of monetary base or reserve money grew by 9.4 percent over the September quarter of 2006, compared to an increase of 5.9 percent in the previous quarter.

Total domestic credit extended by depository corporations to the private sector, public non-financial corporations, Provincial and Local Governments, and other financial corporations, increased by K91.4 million to K2,815.0 million in the September quarter of 2006, compared to an increase of K329.8 million in the June quarter of 2006. Lending to the private sector and the public non-financial corporations increased by K70.0 million and K20.6 million, respectively. The annualised growth in domestic credit, excluding the Central Government and advances under the price support schemes was 36.2 percent in the nine months to September 2006.

Preliminary estimates of the fiscal operations of the National Government for the nine months to September 2006 showed an overall surplus of K1,085.9 million, compared to a surplus of K498.2 million in the corresponding period of 2005. This represents 6.8 percent of nominal Gross Domestic Product (GDP). The higher surplus was mainly due to significant mineral tax receipts. A Supplementary Budget was introduced in August 2006 to appropriate the surplus revenue of K682.5 million mainly to priority expenditure areas.

Total revenue, including foreign grants, during the nine months to September 2006 was K4,266.8 million, 34.3 percent higher than the receipts collected in the corresponding period of 2005. This represents 77.4 percent of the Supplementary Budgeted revenue.

Total expenditure over the nine months to September 2006 was K3,180.9 million, 18.7 percent higher than in the corresponding period of 2005, and represents 57.7 percent of the 2006 Supplementary Budgeted expenditure.

The budget surplus was used to make net overseas loan repayments of K133.5 million and net negative financing of K952.4 million to domestic sources. Net domestic financing comprises of K308.1 million in loan repayment to other resident sectors, and K644.3 million in net deposits with the Central Bank.

2. INTERNATIONAL DEVELOPMENTS

World economic growth as measured by real Gross Domestic Product (GDP) is expected to continue in 2006. In the latest International Monetary Fund's (IMF) World Economic Outlook (WEO) report of September 2006, a revised real GDP growth of 5.1 percent is projected for 2006 and a slightly lower growth of 4.9 percent in 2007. Broad based growth in the first half of 2006 is expected to continue in the second half of the year in all the major economies and regions. Growth in the United States (US) is starting to slow down, while the expansion in the Euro area gathered momentum despite a slow start in Germany. The Japanese economy continued to expand while emerging developing markets, led by China at 10.0 percent and India at 8.3 percent, are experiencing impressive growth rates. Sustained high rates of growth have absorbed spare capacity and combined with buoyant demand for fuel and raw materials contributed to the record high prices for oil and other commodities. This has led to inflationary pressures. As a result, central banks in the major industrialised economies have taken steps to tighten monetary policy to contain inflation. However, the short-term risks to the global economy would stem from a sharp slow down in the housing market in the US, a further increase in global inflationary pressures and an abrupt unwinding of global imbalances.

In July, the Doha Round of trade talks were suspended due to unresolved issues regarding cuts in agriculture subsidies by the US, greater access to European markets, and other trade related issues between the US, Europe and other countries. The IMF cautioned that the lengthy breakdown would represent a missed opportunity and could lead to a more pronounced shift toward bilateral deals with reduced transparency, more discrimination, and added bureaucratic procedures.

Also in July, the Group of Eight (G8) major industrialised nations held their annual summit at St. Petersburg, Russia. They discussed amongst other issues, the military conflict between Israel and Lebanon, and North Korea's nuclear programme.

In September, the IMF-World Bank Annual Meetings were held in Singapore. A package of measures that better aligned members' quotas with changes in the world economy and to protect the participation and voice of its low-income members was endorsed. The IMF Managing Director Rodrigo de Rato mentioned that these reforms were important in enhancing the effectiveness of the IMF and to add legitimacy to other reforms that will be implemented in the future. The IMF also received strong support for its medium-term strategy including, amongst other things, improved economic surveillance and a new push to help low-income countries to reach the 2015 Millennium Development Goals, particularly on reducing poverty from the 1990 level by half.

Also in September, finance ministers and central bank governors of the Group of Seven (G7) major industrialised countries met with the IMF in Singapore. They discussed issues relating to the sharp decline of the Japanese yen against the euro to record low levels since 2000, increasing pressure on China to revalue its currency, the renminbi, to help ease the current global trade imbalance and the threat of protectionism arising from the stalled Doha trade talks. The G7 economic assessment for their economies noted that, performance remains strong amid moderating growth in the US, while the IMF renewed concern about inflationary pressures.

In the US, real GDP grew by 3.0 percent over the year to September 2006, compared to 3.6 percent over the corresponding period in 2005. The slow down was mainly due to weak private consumption reflecting high interest rates, a decline in the housing market and low employment gains. The latest IMF forecast is for a growth of 3.4 percent in 2006, the same as the forecast made in April.

Industrial production increased by 5.6 percent over the year to September 2006, compared to an increase of 2.0 percent over the year to September 2005. The increase was mainly associated with construction spending on commercial and public projects. The Purchasing Manager's Index (PMI) which indicates the level of factory production was 52.9 in September 2006, compared to 53.8 in June 2006. While the index declined, the level above 50.0 implies that factory production increased but at a slower pace. Retail sales increased significantly by 6.1 percent over the year to September 2006, compared to an increase of 2.6 percent over the year to September 2005. The increase was associated with higher property prices and strong consumer spending as home owners drew down their equity on valuable homes and used it to purchase consumer goods. Consumer confidence was also boosted as a result of cheaper petrol and energy prices. The unemployment rate declined to 4.6 percent in September 2006 from 5.1 percent in September 2005.

Consumer prices rose by 2.1 percent over the year to September 2006, compared to an increase of 4.7 percent over the year to September 2005. Although inflationary pressure eased, the risk of inflation remains the Federal Reserve's dominant concern as core inflation remain uncomfortably high, with rising commodity prices and tight labour market conditions, which could put upward pressure on wages. As a result, the US Federal Reserve Board maintained a tight monetary policy stance and left the federal funds rate unchanged at 5.25 percent. Broad money supply increased by 4.4 percent over the year to September 2006, compared to an increase of 6.6 percent over the year to September 2005.

The trade account deficit was US$849.5 billion over the year to September 2006, compared to a deficit of US$753.2 billion in the corresponding period in 2005. The deficit reflected higher crude oil imports combined with increased demand for imports. The trade imbalance between the US and other countries, particularly with China, continue to widen.

In Japan, real GDP grew by 1.6 percent over the year to September 2006, compared to an increase of 0.3 percent over the year to September 2005. The growth reflected a further pick-up in private investment and strong export performance. The latest IMF forecast is for a growth of 2.7 percent in 2006, slightly lower than the 2.8 percent forecasted in April.

Industrial production increased by 5.2 percent over the year to September 2006, compared to an increase of 1.2 percent over the year to September 2005. The increase reflected higher private investment and strong export demand for machinery and equipment. The unemployment rate declined slightly to 4.2 percent in September 2006 from 4.3 percent in September 2005.

Consumer prices increased by 0.6 percent over the year to September 2006, compared to a decrease of 0.3 percent over the year to September 2005. Broad money supply increased by 0.6 percent over the year to September 2006, compared to an increase of 2.1 percent in the corresponding period in 2005. The Bank of Japan ended its zero interest rate policy in July 2006 and raised its official rate to 0.25 percent, the first increase in almost six years, to deal with concerns about the increasing inflation trend.

The current account surplus was US$168.1 billion over the year to September 2006, compared to a surplus of US$111.1 billion in the corresponding period in 2005. The surplus mainly reflected strong exports of machinery and semi-conductor equipment, and the large inflows of profit remittances from Japanese companies based overseas.

In the Euro area, real GDP grew by 2.6 percent over the year to September 2006, compared to an increase of 1.5 percent in the corresponding period in 2005. The growth was associated with a pick-up in Germany, the biggest economy in the Euro area. The latest IMF forecast is for a growth of 2.4 percent in 2006, higher than the 2.0 percent forecasted in April 2006.

Industrial production increased by 3.3 percent over the year to September 2006, compared to an increase of 1.0 percent over the year to September 2005. Retail sales increased by 1.4 percent over the year to September 2006, compared to an increase of 0.9 percent in the corresponding period in 2005. The unemployment rate for the 12-nation group decreased to 7.8 percent in September 2006 from 8.5 percent in September 2005. The decline in the unemployment rate reflected the overall trend in economic recovery in the Euro area.

Consumer prices in the Euro area rose by 1.8 percent over the year to September 2006, compared to an increase of 2.5 percent in the corresponding period in 2005. Broad money supply increased by 8.5 percent over the year to September 2006, the same as in the corresponding period in 2005. However, given the emerging signs of inflationary pressure the European Central Bank (ECB) increased its benchmark Refinancing Operations Rate from 2.75 percent in the June quarter of 2006 to 3.00 percent in the September quarter.

In Germany, real GDP grew by 2.8 percent in the year to September 2006, compared to an increase of 1.4 percent over the year to September 2005. The growth was mainly driven by strong exports. The latest IMF forecast is for a growth of 2.0 percent in 2006, higher than the 1.3 percent forecasted in April 2006.

Industrial production increased by 6.3 percent over the year to September 2006, compared to an increase of 2.3 percent over the year to September 2005. The increase was mainly due to higher exports of machinery and equipment. Retail sales declined by 1.2 percent over the year to September 2006, compared to a decline of 0.7 percent over the year to September 2005, reflecting weak consumer spending. The unemployment rate was 10.6 percent in September 2006, compared to 11.7 percent in September 2005, the second highest unemployment rate in the Euro area.

Consumer prices increased by 1.0 percent over the year to September 2006, compared to an increase of 2.5 percent over the year to September 2005.

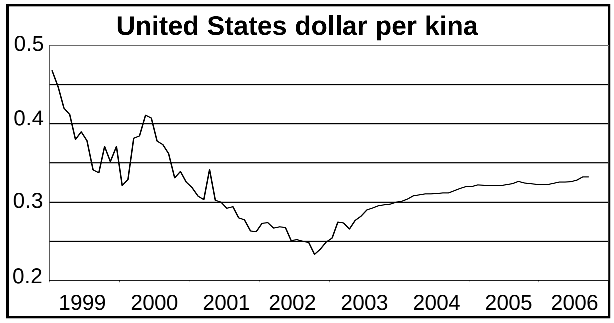
The current account surplus was US$107.5 billion over the year to September 2006, compared to a surplus of US$113.6 billion over the year to September 2005. This outcome was the result of a huge trade account surplus of US$187.4 million, reflecting strong exports.

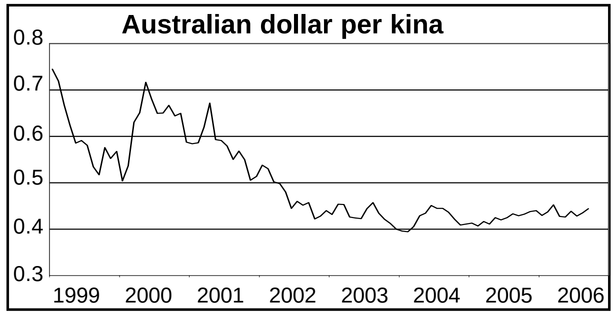
In the United Kingdom (UK), real GDP increased by 2.8 percent over the year to September 2006, compared to an increase of 1.6 percent in the year to September 2005. The increase was due to a continued growth in the manufacturing and services sectors, and a pick-up in business investment underpinned by strong demand and high rate of return. The latest IMF forecast is for a growth of 2.7 percent in 2006, slightly higher than the 2.5 percent forecasted in April 2006.

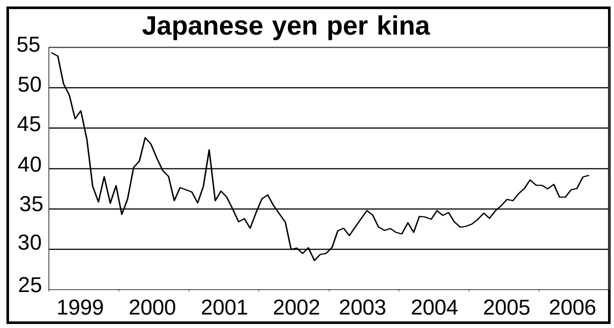
Industrial production increased by 0.4 percent over the year to September 2006, compared to a decline of 1.1 percent over the year to September 2005. Retail sales increased by 3.2 percent over the year to September 2006, compared to an increase of 0.7 percent over the year to September 2005. The increase was associated with higher household spending reflecting growth in real household income. The unemployment rate increased to 5.6 percent in September 2006, from 4.7 percent in September 2005.

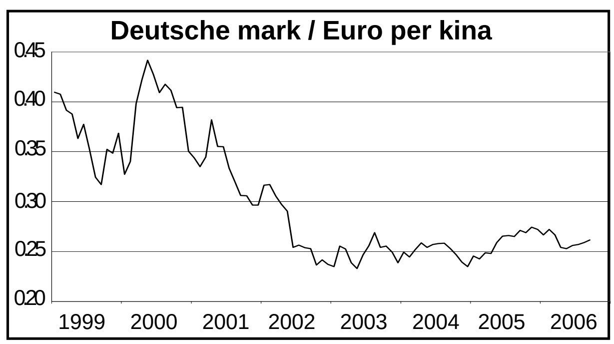
Consumer prices increased by 2.4 percent over the year to September 2006, compared to an increase of 2.5 percent over the year to September 2005. Soaring utility bills and rising food prices helped push inflation above the Bank of England's 2.0 percent target. Broad money supply increased by 14.5 percent over the year to September 2006, compared to an increase of 11.4 percent over the year to September 2005. Given the inflationary pressure, the Bank of England increased its benchmark Repo Rate from 4.50 percent in the June quarter of 2006 to 4.75 percent in the September quarter.

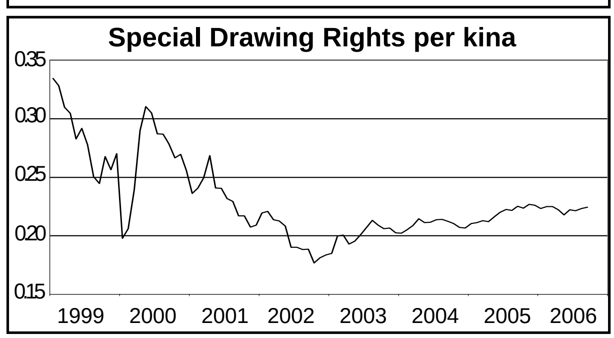
EXCHANGE RATES











The trade account deficit was US$144.2 billion over the year to September 2006, compared to a deficit of US$ 116.7 billion over the year to September 2005. The increase was a result of higher import demand.

In Australia, real GDP increased by 2.2 percent over the year to September 2006, compared to an increase of 3.0 percent in the year to September 2005. The slow down was associated with limited spare capacity, tight labour and monetary conditions, the on-going drought that affected the agriculture sector and a decline in industrial production. The latest IMF forecast is for a growth of 3.1 percent in 2006, higher than the 2.9 percent forecasted in April 2006.

Industrial production decreased by 3.0 percent over the year to June 2006, compared to an increase of 0.7 percent over the year to June 2005. The decline was associated with a weak demand due to strong competition from overseas companies. Retail sales increased by 3.2 percent over the year to September 2006, compared to an increase of 1.2 percent over the year to September 2005. The unemployment rate declined to 4.8 percent in September 2006 from 5.1 percent in September 2005.

Consumer prices increased by 3.9 percent over the year to September 2006, compared to an increase of 3.0 percent over the year to September 2005. The increase was mainly associated with higher prices for food, health, transportation, education, and financial and insurance services. Broad money supply increased by 11.2 percent over the year to September 2006, compared to an increase of 9.8 percent over the year to September 2005. Given the risk of inflation, the Reserve Bank of Australia maintained a tight monetary policy and left its cash rate at 5.75 percent in the September quarter of 2006. On 18th September 2006, Glenn Stevens replaced Ian Macfarlane as the new Governor of the Reserve Bank of Australia.

The trade account deficit was US$9.6 billion over the year to September 2006, compared to a deficit of US$16.1 billion over the year to September 2005, the lowest level in almost five years. The improvement in the trade account was due to high commodity prices and the strong export performance.

During the September quarter of 2006, the US dollar appreciated against all the major currencies except the yen. The quarterly average US dollar exchange rate appreciated by 0.95 percent against the Australian dollar, 0.23 percent against the Euro, and 1.19 percent against the British pound. However, it depreciated by 1.39 percent against the yen.

In the September quarter of 2006, the kina appreciated against the US dollar, euro and the yen, while it appreciated against the Australian dollar and pound sterling. The quarterly average kina exchange rate appreciated by 0.38 percent against the US dollar, 1.83 percent against the yen and 0.17 percent against the euro. However, the average kina exchange rate depreciated by 0.54 percent against the Australian dollar and 0.80 percent against the pound sterling. These movements resulted in the quarterly average Trade Weighted Index (TWI) depreciating by 0.68 percent during the September quarter of 2006.

3. EMPLOYMENT

According to the Bank's Employment Index, the level of employment in the formal private sector, excluding mineral, declined by 2.1 percent in the September quarter of 2006, compared to an increase of 3.9 percent in the June quarter of 2006. By industry, employment declined in all sectors except the wholesale, transportation and financial/business and other services sectors. By region, the level of employment declined in the NCD, Highlands and Islands regions. Over the year to September 2006, the level of employment increased by 4.6 percent.

In the agriculture/forestry/fisheries sector, the level of employment declined by 6.0 percent in the September quarter of 2006, compared to an increase of 3.2 percent in the June quarter of 2006. The decrease reflected the end of the coffee season, the closure of the bech-de-mer harvesting season, lower production by a major palm oil producer, and reduced casual employment by a logging company and closure of a logging site for another in the Islands region. Over the year to September 2006, the level of employment increased by 3.4 percent.

In the building and construction sector, the level of employment declined by 2.3 percent in the September quarter of 2006, compared to an increase of 17.2 percent in the June quarter of 2006. The decline reflected the completion of construction work on various projects around the country, including a town market redevelopment, airport fencing project, activities at mine sites and the lay-off of causal employees. Over the year to September 2006, the level of employment increased by 13.3 percent.

In the manufacturing sector, the level of employment declined by 2.1 percent in the September quarter of 2006, compared to an increase of 2.7 percent in the June quarter of 2006. The decrease was due to the completion of harvesting for coffee and sugar, the out-sourcing of sales activities by a major poultry manufacturer, down-sizing of operations by a logging company, lay-off of casual employees and natural decline through resignations and terminations. Over the year to September 2006, the level of employment increased marginally by 0.6 percent.

In the retail/wholesale sector, the level of employment decreased marginally by 0.8 percent in the September quarter of 2006, compared to 2.0 percent in the June quarter of 2006, with lower employment in the retail sector. The decline in the retail sector reflected the closure of a retailer, the destruction by fire of another, and the closure of branches in the Highlands region by a major retailer. In the wholesale sector, a marginal increase in employment reflected the take-over of a wholesale operation previously not included in the survey and recruitment of casual labour for the festive season. Over the year to September 2006, the level of employment increased by 4.8 percent.

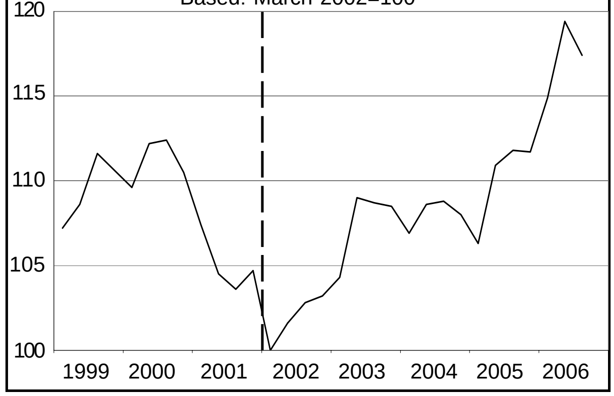
In the transportation sector, the level of employment increased by 4.0 percent in the September quarter of 2006, compared to 0.7 percent in the June quarter of 2006. The increase was due to higher employment by the air and land transportation companies. Over the year to September 2006, the level of employment increased by 4.7 percent.

In the financial/business and other services sector, the level of employment increased by 2.1 percent in the September quarter of 2006, compared to 6.2 percent in the June quarter of 2006. The increase reflected higher employment by security firms, hotels and restaurants, as well as expansion of operations into other centers and activities. Over the year to September 2006, the level of employment increased by 8.5 percent.

By region, employment declined in the NCD, Highlands and Islands regions, while it increased in the other regions. In the NCD, the level of employment decreased marginally by 0.9 percent in the September quarter of 2006, compared to an increase of 3.9 percent in the June quarter of 2006. The decline was in all sectors except the manufacturing, wholesale and transportation sectors. The decline in the building and construction sector mainly reflected the end of a contract at a mine site by an NCD-based company. Lower employment levels by motor dealers contributed to the decline in the retail sector. The decline in the financial/business and other services sector was due to the lay-off of trainee employees, and reduced employment by accounting firms and a restaurant. Over the year to September 2006, the level of employment increased by 6.4 percent.

Formal Private Sector Employment Index[3]

Based: March 2002=100



In the Highlands region, the level of employment declined by 7.2 percent in the September quarter of 2006, compared to an increase of 12.5 percent in the June quarter of 2006. There were declines in the agriculture, manufacturing, wholesale, retail, and transportation sectors. The declines mainly reflected the end of the coffee season. The reduction in the transportation sector was also due to the down-sizing of operations by a third-level airline and a road transportation company. Over the year to September 2006, the level of employment increased by 2.1 percent.

In the Islands region, the level of employment decreased by 3.0 percent in the September quarter of 2006, compared to an increase of 3.5 percent in the June quarter of 2006. The decrease was in the retail/

[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.

wholesale and agriculture/forestry sectors. Lower employment in the retail/wholesale sector was due to reduced operations by a wholesale company, while the closure of a logging operation and reduced activity by a major palm oil company contributed to the decline in the agriculture/forestry sector. Over the year to September 2006, the level of employment increased by 3.9 percent.

In the Morobe region, the level of employment increased by 1.3 percent in the September quarter of 2006, compared to 1.6 percent in the June quarter of 2006. There were increases in the agriculture/forestry/fisheries, wholesale, transportation and financial/business and other services sectors. The increase in the agriculture/forestry/fisheries sector reflected higher employment by a fishing company, while the increase in the wholesale sector was due to expansion by a wholesale company following a take-over. Higher employment in the transportation sector was due to increases by a sea transportation company. Higher employment in the financial/business and other services partly reflected increased employment by real estate companies. Over the year to September 2006, the level of employment increased by 6.1 percent.

In the Southern region, the level of employment grew marginally by 0.7 percent in the September quarter of 2006, compared to 3.5 percent in the June quarter of 2006. The increase was in the transportation, agriculture/forestry/fisheries, retail and financial/business and other sectors. The increase in the agriculture/forestry/fisheries sector reflected higher casual employment and new contracts for logging companies. Higher casual employment, expansion of business and increased employment by hotels accounted for the increase in the financial/business and other services sector. Over the year to September 2006, the level of employment increased by 10.4 percent.

In the Momase region, the level of employment increased by 0.5 percent, compared to a marginal decline of 0.1 percent in the June quarter of 2006. The increase was in the agriculture/forestry/fisheries and financial/business and other services sectors. The increase in the agriculture/forestry/fisheries sector reflected increased activity by logging companies, while higher employment by a restaurant contributed to the increase in the financial/business and other services sector. Over the year to September 2006, the level of employment increased marginally by 0.2 percent.

4. CONSUMER PRICE INDEX

The headline inflation rate, as measured by the Consumer Price Index (CPI), was 3.3 percent in the September quarter of 2006, compared to 1.6 percent in the June quarter of 2006. The outcome was due to higher prices in all expenditure groups, except the clothing and footwear, transport and communication, and miscellaneous expenditure groups. By region all urban areas recorded increases in prices, except Rabaul. The annual headline inflation rate was 5.3 percent in the September quarter of 2006, compared to 2.3 percent in the June quarter of 2006.

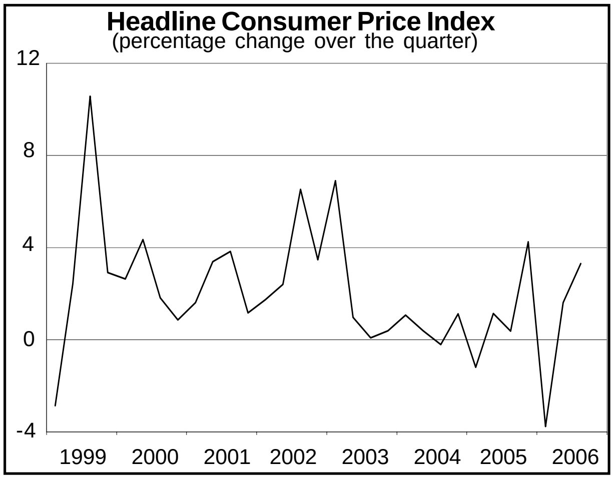
The CPI for the ‘Food’ expenditure group increased by 5.6 percent in the September quarter of 2006, compared to 3.0 percent in the June quarter of 2006. The increase was driven by fruits and vegetables prices which increased by 31.5 percent during the September quarter. Prices for cereals, and meat and fish rose by 1.0 percent and 0.8 percent, respectively. The group contributed 2.3 percentage points to the overall quarterly movement in the CPI.

The CPI for the ‘Rents, council charges, fuel and power’ expenditure group increased by 4.5 percent in the September quarter of 2006, compared to 1.3 percent in the June quarter of 2006. The rise was due to higher prices of fuel, power, and council charges. The group contributed 0.2 percentage points to the overall quarterly movement in the CPI.

The CPI for the ‘Drinks, tobacco and betelnut’ expenditure group increased by 4.3 percent in the September quarter of 2006, compared to a marginal increase of 0.2 percent in the June quarter of 2006. The increase reflected higher betelnut and soft drink prices, which more than offset a decline in prices of alcoholic drinks. The group contributed 0.9 percentage points to the overall quarterly movement in the CPI.

The CPI for the ‘Household equipment and operations’ expenditure group increased marginally by 0.9 percent in the September quarter of 2006, compared to 2.3 percent in the June quarter of 2006. The increase was due to higher prices of non-durable goods, which offset declines in the prices of durable and semi-durable goods. The group did not contribute any percentage points to the overall quarterly movement in the CPI.

The CPI for the ‘Clothing and footwear’ expenditure



group decreased by 2.8 percent in the September quarter of 2006, compared to an increase of 1.3 percent in the June quarter of 2006. The decline was due to lower prices for men's, boy's, girl's, women's and other clothing. The group contributed negative 0.2 percentage points to the overall quarterly movement in the CPI.

The CPI for the 'Miscellaneous' expenditure group decreased by 1.7 percent in the September quarter of 2006, compared to an increase of 0.7 percent in the June quarter of 2006. The decline was the result of lower prices for medical and health care, as well as for entertainment and cultural items. The group contributed negative 0.1 percentage points to the overall quarterly movement in the CPI.

The CPI for the 'Transport and communication' expenditure group decreased marginally by 0.3 percent in the September quarter of 2006, compared to 0.6 percent in the June quarter of 2006. Lower prices for motor vehicle purchases more than offset higher prices for motor vehicle operations. There were no changes in airline, PMV and taxi fares and telephone and postal charges. The group did not contribute to the overall quarterly movement in the CPI.

By urban areas, all surveyed centers recorded increases in the June quarter of 2006 except Rabaul. In Goroka, prices increased by 8.6 percent in the September quarter of 2006, compared to an increase of 1.3 percent the June quarter. In Lae, prices increased by 4.0 percent in the September quarter of 2006 after a decline of 0.2 percent in the June quarter. In Port Moresby, prices increased by 2.9 percent in the September quarter of 2006, following an increase of 1.3 percent in the June quarter. In Madang, prices increased by 0.9 percent in the September quarter of 2006 compared to 8.6 percent in the June quarter, while in Rabaul, prices declined by 0.1 percent in the September quarter of 2006 compared to a similar decline in the June quarter.

In Goroka, higher prices for betelnut, soft drinks, cigarettes and tobacco, fruits and vegetables, other food items, petrol, and other expenditure items contributed to the increase. In Lae, higher prices were recorded in all expenditure groups except the clothing and footwear, household equipment and operation and transport and communications groups. The increase in Port Moresby was due to higher prices in all expenditure groups except the drinks, tobacco and betelnut, clothing and footwear, and household equipment and operations expenditure groups. In Madang, there were higher prices in all expenditure groups except the household equipment and operations and miscellaneous groups. In Rabaul, the decrease was due to lower prices in the food and household, equipment and operations expenditure groups.

The exclusion-based inflation measure was negative 0.2 percent in the September quarter of 2006, compared to 0.9 percent in the June quarter of 2006. Trimmed mean inflation was 0.5 percent in the September quarter of 2006, compared to 0.7 percent in the June quarter of 2006.

5. EXPORT COMMODITIES REVIEW

The total value of merchandise exports in the September quarter of 2006 was K3,157 million, 23.6 percent higher than in the corresponding quarter of 2005. There were increases in the export values of gold, copper, crude oil, cocoa, palm oil, tea, rubber, forestry and marine products, which more than offset declines in the values of coffee, copra, copra oil, refined petroleum and other non-mineral export products. Mineral export receipts, excluding crude oil were K2,036.9 million and accounted for 64.5 percent of total merchandise exports in the September quarter of 2006, compared to K1,245.7 million or 48.8 percent in the corresponding quarter of 2005. Crude oil exports totalled K617.0 million and accounted for 19.5 percent of total merchandise exports in the September quarter of 2006, compared to K614.1 million or 24.0 percent of total merchandise exports 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 K366.8 million and accounted for 11.6 percent of total merchandise exports in the September quarter of 2006, compared to K447.6 million or 17.5 percent of total merchandise exports in the corresponding quarter of 2005. Forestry product exports were K121.4 million and accounted for 3.9 percent of total merchandise exports in the September quarter of 2006, compared to K115.5 million or 4.5 percent in the corresponding quarter of 2005. Refined petroleum product exports were K14.9 million and accounted for 0.5 percent of total merchandise exports in the September quarter of 2006, compared to K131.1 million or 5.1 percent in the corresponding quarter of 2005.

The weighted average price of Papua New Guinea's exports was 48.1 percent higher in the September quarter of 2006, compared to the corresponding quarter of 2005. There was a 59.7 percent increase in the weighted average price of mineral exports, with higher kina prices of gold, copper and crude oil. For the agricultural, logs and marine products exports, the weighted average price increased by 3.0 percent and was accounted for by higher kina prices of cocoa, tea, rubber, log and marine exports. Excluding logs, the weighted average price of agricultural and marine product exports increased by 3.2 percent in the September quarter of 2006, compared to the corresponding period of 2005.

Mineral Exports

Total mineral export receipts were K2,653.9 million in the September quarter of 2006, an increase of 42.7 percent from the corresponding quarter of 2005. The increase was due to higher prices of all mineral exports, combined with an increase in the volume of copper.

Gold export volumes in the September quarter of 2006 was 13.1 tonnes, a decline of 28.0 percent from the corresponding quarter of 2005. This outcome was due to lower production of high grade ore from the Lihir mine, combined with declines from the Porgera and Tolukuma mines. These more than offset increased production from the Ok Tedi and Kainantu mines. The average free on board (f.o.b.) price received for Papua New Guinea's gold exports was K55.2 million per tonne during the September quarter of 2006, 39.9 percent higher than in the corresponding period of 2005. The increase is mainly attributed to higher international prices during the quarter. The average gold price at the London Metal Exchange was US$622 per fine ounce in the September quarter of 2006, an increase of 41.8 percent compared to the corresponding quarter of 2005. The increase was due to higher demand from investors for gold-based investments as a safe haven investment after increased volatility of prices in the equity markets, and the uncertainty surrounding the US dollar and other major currencies. The increase in export price more than offset the decline in export volume, resulting in export receipts of K723.2 million in the September quarter of 2006, an increase of 0.7 percent from the corresponding quarter of 2005.

Copper export volumes in the September quarter of 2006 was 56.4 thousand tonnes, an increase of 21.0 percent from the corresponding quarter of 2005. This outcome was due to increased shipment of copper ore as a result of higher water levels at the Fly river. The average f.o.b. price of Papua New Guinea's copper exports was K23,046 per tonne in the September quarter of 2006, an increase of 106.6 percent from the corresponding quarter of 2005. The increase 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 combined increase in price and volume resulted in export receipts of K1,299.8 million in the September quarter of 2006, an increase of 150.0 percent from the corresponding quarter of 2005.

Crude oil export volumes in the September quarter of 2006 was 2,804.9 thousand barrels, a decline of 17.4 percent from the corresponding quarter of 2005. The decline reflected lower extraction rates and reduced production from the Kutubu, Moran and Gobe oil fields. The average export price of crude oil was K220 per barrel in the September quarter of 2006, an increase of 21.5 percent from the corresponding quarter of 2005. The higher international prices were associated with increased global demand resulting from lower strategic reserve levels in North America, the slow recovery of oil production in Iraq and continued global fears on terrorism. The increase in the export price more than offset the decline in volume resulting in export receipts of K617.0 million in the September quarter of 2006, an increase of 0.5 percent from the corresponding quarter of 2005.

Export receipts from refined petroleum products from the Napanapa Refinery in the September quarter of 2006 was K14.9 million, a decline of 88.6 percent from the corresponding period of 2005. The significant decline was a result of lower production following the shut down of the refinery to undertake capital improvements.

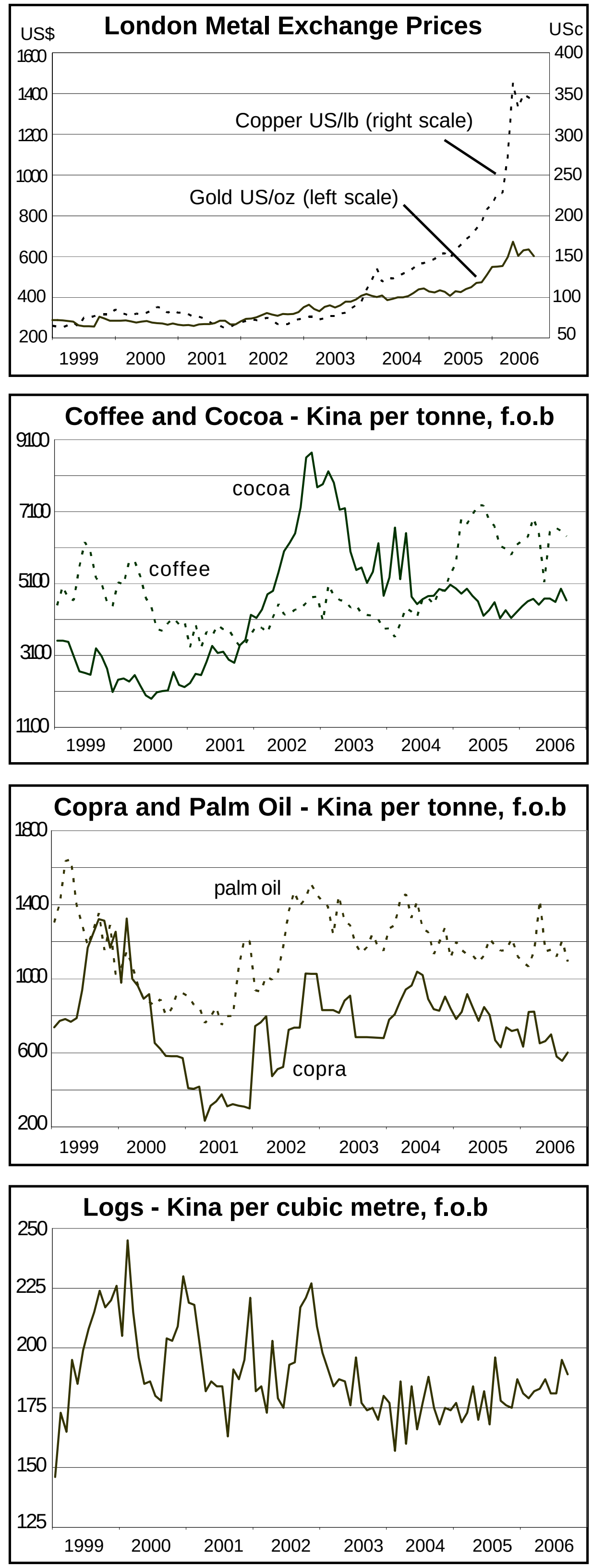
Agriculture, Logs and Fisheries Exports

Export prices of some agricultural commodities declined in the September quarter of 2006, compared to the corresponding quarter of 2005. Copra prices declined by 17.8 percent, copra oil by 21.9 percent and palm oil by 3.7 percent, while the price of coffee remained stable. Cocoa prices increased by 10.2 percent, tea by 15.2 percent and rubber by 59.5 percent. The average export price of logs was K188 per cubic metre in the September quarter of 2006, an increase of 2.7 percent from the corresponding quarter of 2005. The net effect of these price movements was a 3.0 percent increase in the weighted average price of agricultural, logs and marine export products. Excluding logs, the weighted average price of agricultural and marine export products increased by 3.2 percent in the September quarter of 2006, compared to the corresponding period of 2005.

The volume of coffee exported in the September quarter of 2006 was 17,600 tonnes, a decline of 42.7 percent from the corresponding quarter of 2005. The decline was due to lower production mainly associated with unfavourable weather conditions and deteriorating road infrastructure. The average export price of coffee was K6,545 per tonne in the September quarter of 2006, compared to K6,547 per tonne in the corresponding quarter of 2005. Despite the kina f.o.b. prices remaining stable, international prices declined due to higher world supply following increased output from Brazil and other major producing nations as a result of favourable weather conditions. The decline in volume and the constant price resulted in export receipts of K115.2 million in the September quarter of 2006, a fall of 42.7 percent from the corresponding period of 2005.

The volume of cocoa exported in the September quarter of 2006 was 12,300 tonnes, a decline of 1.6 percent from the corresponding quarter of 2005. The decline 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 K4,805 per tonne in the September quarter of 2006, an increase of 10.2 percent from the corresponding period of 2005. This outcome was due to higher

EXPORT COMMODITY PRICES



international prices resulting from lower supply in the world market as production declined in the Ivory Coast and countries in Asia and Latin America. The increase in export price more than offset the decline in volume resulting in export receipts of K59.1 million in the September quarter of 2006, an increase of 8.4 percent from the corresponding period of 2005.

The volume of copra exported in the September quarter of 2006 was 1,400 tonnes, a decline of 76.3 percent from the corresponding quarter of 2005. The decline was attributed to lower production and exports from the major copra producing regions. The average export price for copra was K571 per tonne in the September quarter of 2006, a decline of 17.8 percent from the corresponding quarter of 2005. This outcome was mainly due to lower international prices, resulting from higher production from the Philippines and Indonesia, two of the world's major copra producers. The combined decline in price and volume resulted in export receipts of K0.8 million in the September quarter of 2006, a decline of 80.5 percent from the corresponding period of 2005.

The volume of copra oil exported in the September quarter of 2006 was 9,200 tonnes, a decline of 11.4 percent from the corresponding period of 2005. The decline was mainly due to lower quantities of copra purchased by the two domestic copra mills for processing and exporting. The average export price of copra oil was K1,337 per tonne in the September quarter of 2006, a decline of 21.9 percent from the corresponding period of 2005. The decline was due to lower international prices resulting from increasing copra production from the Philippines and Indonesia, two of the world's major copra producers, combined with an increase in supply of other edible oils in the world market. The combined decline in the price and volume resulted in an export value of K12.3 million in the September quarter of 2006, a decline of 30.9 percent from the corresponding period of 2005.

The volume of palm oil exported in the September quarter of 2006 was 93,300 tonnes, an increase of 68.4 percent from the corresponding period of 2005. The increase was due to higher production following the commencement of harvesting from new estates combined with increased shipment from the major palm oil producing regions. The average export price of palm oil was K1,135 per tonne in the September quarter of 2006, a decline of 3.7 percent from the corresponding quarter of 2005. The decline reflected lower international prices associated with higher production from Malaysia and Indonesia, two of the world's major producers, combined with an increase in supply of other edible oils in the world market. The increase in export volume more than offset the decline in price resulting in an export value of K105.9 million in the September quarter of 2006, an increase of 62.2 percent from the corresponding period of 2005.

The volume of tea exported in the September quarter of 2006 was 1,600 tonnes, the same as in the corresponding quarter of 2005. The average export price of tea was K3,313 per tonne in the September quarter of 2006, an increase of 15.2 percent from the corresponding period of 2005. The increase in price resulted in an export value of K5.3 million in the September quarter of 2006, an increase of 15.2 percent from the corresponding period of 2005.

The volume of rubber exported in the September quarter of 2006 was 1,000 tonnes, a decline of 9.1 percent from the corresponding period of 2005. The decline was attributed to lower production resulting from unfavourable weather conditions combined with deteriorating road infrastructure. The average export price was K5,800 per tonne in the September quarter of 2006, an increase of 59.5 percent from the corresponding period of 2005. The increase was associated with higher international prices as a result of lower supply in the world market. The increase in export price more than offset the decline in volume resulting in an export value of K5.8 million in the September quarter of 2006, an increase of 45.0 percent from the corresponding period of 2005.

The volume of logs exported in the September quarter of 2006 was 596,000 cubic metres, an increase of 18.7 percent from the corresponding period of 2005. This outcome was mainly attributed to higher production and shipment from major logging projects due to favourable weather conditions. The average export price of logs was K188 per cubic metre in the September quarter of 2006, an increase of 2.7 percent from the corresponding period of 2005. The increase was due to higher international prices reflecting lower supply of tropical hardwoods in the world market. The combined increase in price and volume resulted in export receipts of K112.2 million in the September quarter of 2006, an increase of 21.8 percent from the corresponding period of 2005.

The value of marine products exported was K20.2

million in the September quarter of 2006, an increase of 25.5 percent from the corresponding period of 2005. This outcome was a result of an increase in export price, which more than offset the decline in volume.

6. BALANCE OF PAYMENTS

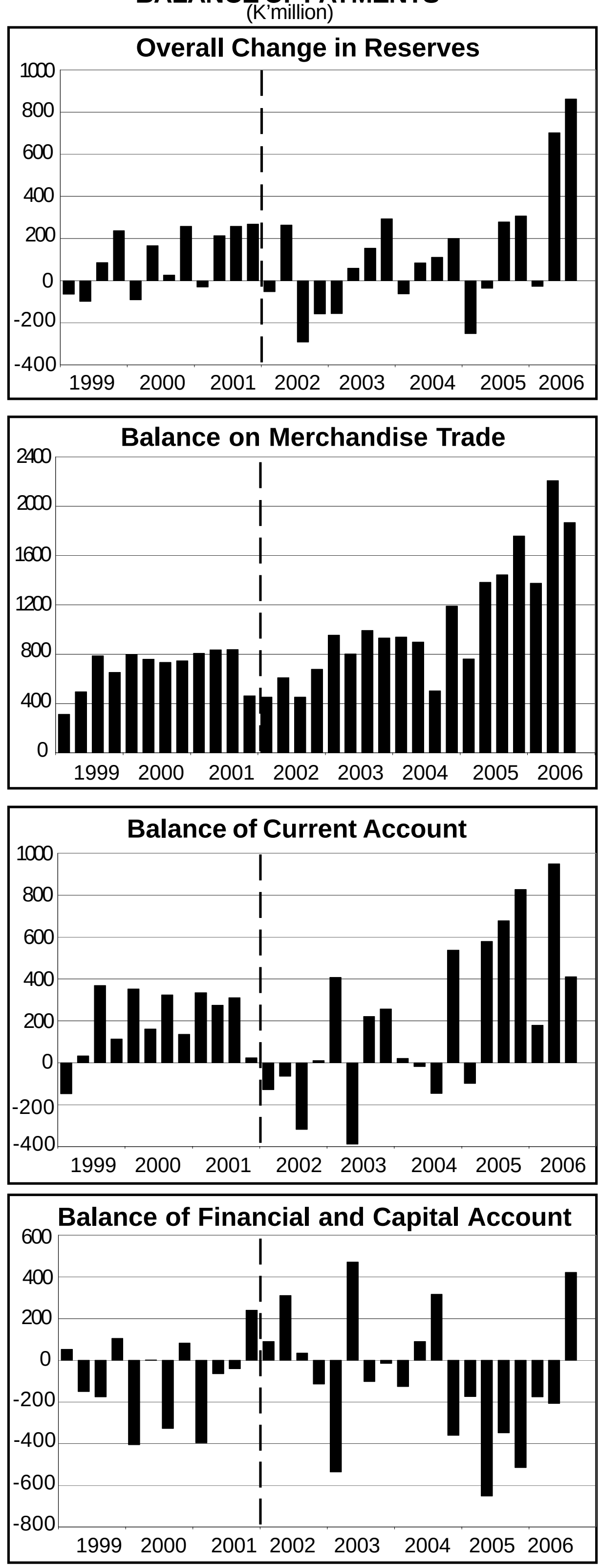
The overall surplus in the balance of payments for the nine months to September 2006 was K1,536 million, compared to a deficit of K11 million in the corresponding period of 2005. This outcome was the result of an improvement in the current account surplus combined with a net inflow in the capital and financial accounts.

The surplus in the current account was attributed to a higher trade surplus, which more than offset higher net service and income payments and lower net transfer receipts. The improvement in the capital and financial accounts was due to a net inflow in the financial account. This reflected drawdowns from short term money market instruments, a drawdown in foreign currency account balances of the mineral companies and lower net loan repayments by the Government. These more than offset lower foreign direct investment combined with increased investment in financial derivatives and net loan repayments by the private sector. There were no flows recorded in the capital account during the period.

The trade account recorded a surplus of K5,449 million in the nine months to September 2006, an increase of 48.2 percent from the corresponding period of 2005. The higher surplus was due to an increase in the value of merchandise exports, which more than offset an increase in merchandise imports. The value of merchandise exports in the nine months to September 2006 was K9,584 million, an increase of 31.5 percent from the corresponding period of 2005. The increase was attributed to higher values of gold, copper, crude oil, cocoa, palm oil, tea, rubber, logs and marine product exports.

The value of merchandise imports was K4,135 million in the nine months to September 2006, an increase of 14.5 percent from the corresponding period of 2005. The increase was due to higher imports by all sectors. Imports by the mining sector increased by 14.2 percent to K790 million in the nine months to September

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.

2006, compared to the corresponding period of 2005. The increase reflected higher capital expenditures undertaken by the Ok Tedi, Lihir and Hidden Valley mines. Petroleum sector imports increased by 27.3 percent to K340 million in the nine months to September 2006, compared to the corresponding period of 2005. This was due to higher capital expenditures reflecting continued drilling at the South East (SE) Mananda, Moran and Gobe oil projects. General imports increased by 13.4 percent to K3,005 million in the nine months to September 2006, compared to the corresponding period of 2005.

The deficit in the services account was K2,557 million in the nine months to September 2006, an increase of 27.0 percent from the corresponding period of 2005. The higher deficit was due to an increase in service payments for transportation associated with higher imports, education, other financial, communication, other business and refining and smelting services. These more than offset higher service receipts by resident companies.

The deficit in the income account was K1,994 million in the nine months to September 2006, an increase of 57.6 percent from the corresponding period of 2005. This outcome was due to higher payments for compensation of employees, dividend and interest on foreign loans, which more than offset higher income receipts.

The surplus in the transfers account was K640 million in the nine months to September 2006, a decline of 15.6 percent from the corresponding period of 2005. This outcome was due to lower transfer receipts for superannuation funds, family maintenance, tax and licensing fees. These more than offset increased receipts of gifts and grants and transfer payments.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a surplus of K1,538 million in the nine months to September 2006, compared to a lower surplus of K1,159 million in the corresponding period of 2005.

The capital account recorded no transactions in the nine months to September 2006, the same as in the corresponding period of 2005.

The surplus in the financial account was K39 million in the nine months to September 2006, compared to a deficit of K1,175 million in the corresponding period of 2005. The outcome reflected portfolio investment of K130 million from drawdowns of short-term money market instruments. This combined with a drawdown in foreign currency account balances of mineral companies and lower net loan repayment by the government more than offset net outflows for financial derivatives instruments and higher net loan repayments by the private sector.

In the September quarter of 2006, the balance of payments recorded an overall surplus of K862 million, compared to a surplus of K278 million in the corresponding quarter of 2005.

The value of merchandise exports was K3,157 million in the September quarter of 2006, an increase of 23.6 percent from the corresponding quarter of 2005. The increase was due to higher values of gold, copper, crude oil, cocoa, palm oil, tea, rubber, logs and marine product exports.

The value of merchandise imports was K1,291 million in the September quarter of 2006, an increase of 16.3 percent from the corresponding quarter of 2005. This outcome reflected higher imports in all sectors. Mining sector imports increased by 51.5 percent to K294 million in the September quarter of 2006, compared to the corresponding quarter of 2005. The increase was due to higher capital expenditures undertaken by the Ok Tedi, Lihir and Hidden Valley mines. Imports by the petroleum sector increased by 39.6 percent to K127 million in the September quarter of 2006, compared to the corresponding quarter of 2005, mainly associated with continued drilling at the South East (SE) Mananda, Moran and Gobe oil projects. General imports increased by 5.5 percent to K870 million in the September quarter of 2006, compared to the corresponding quarter of 2005.

The deficit in the services account was K887 million in the September quarter of 2006, an increase of 44.2 percent from the corresponding quarter of 2005. The higher deficit was due to increased service payments for transportation associated with higher imports, insurance, computer and information, communication, other business, refining and smelting and other services, combined with lower service receipts by resident companies.

The deficit in the income account was K687 million in the September quarter of 2006, a significant increase of 100.3 percent from the corresponding quarter of

2005. This outcome was due to increased compensation of employees and dividend payments by resident companies, which more than offset higher income receipts.

The surplus in the transfers account was K118 million in the September quarter of 2006, a decline of 38.2 percent from the corresponding quarter of 2005. This outcome resulted from lower receipts of superannuation funds, family maintenance, gifts and grants, tax and licensing fees, combined with higher transfer payments.

As a result of these developments in the trade, services, income and transfers accounts, the current account recorded a surplus of K410 million in the September quarter of 2006, compared to a surplus of K678 million in the corresponding quarter of 2005.

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

The financial account recorded a surplus of K421 million in the September quarter of 2006, compared to a deficit of K349 million in the corresponding period of 2005. This outcome was due to a net inflow in other investments reflecting a drawdown of foreign currency account balances of the mineral companies, redemption of money market instruments and lower net loan repayments by the Government. These more than offset net outflows for direct and financial derivative investments reflecting equity withdrawal by a mineral company and investment in financial derivative instruments, respectively.

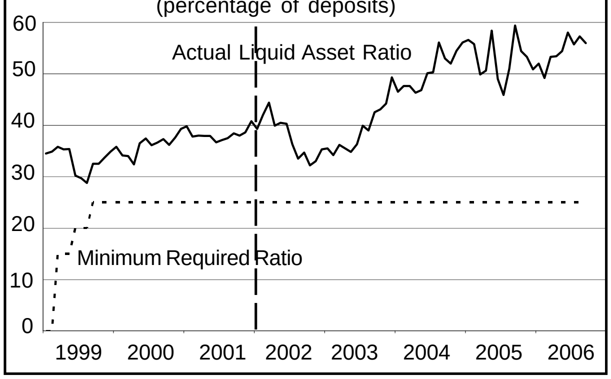
The level of gross foreign exchange reserves at the end of September 2006 was K3,903.8 (US$1,296.1) million, sufficient for 8.5 months of total and 11.7 months of non-mineral import cover.

7. MONETARY DEVELOPMENTS

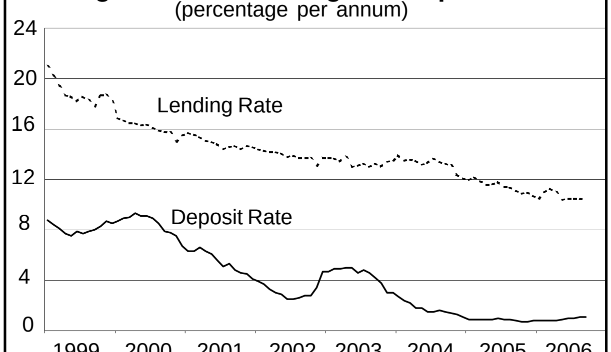
INTEREST RATES AND LIQUIDITY

The Bank of Papua New Guinea maintained a neutral monetary policy stance during the September quarter of 2006, with the Kina Facility Rate (KFR) kept unchanged at 6.0 percent. The dealing margin for the Repurchase Agreements (Repos) was further reduced by 0.50 percent to 150 basis points on both sides of the KFR in September in order to realign domestic interest rates to the KFR. Domestic interest rates increased slightly during the quarter. The 28-day CBB rate increased from 3.49 percent to 3.87 percent between the end of June and September 2006, whilst the 63-day CBB rate increased from 3.77 percent to 3.97 percent during the same period. The weighted average deposit rates quoted by commercial banks on wholesale deposits (K500,000 and above) also followed a similar trend between the end of June and September 2006. The 30 days deposit rate increased from 2.09 percent to 3.18 percent, 90 days from 1.74 percent to 2.78 percent, and 180 days from 1.76 percent to 2.99 percent, whilst the 60 days rate declined from 2.30 percent to 2.25 percent. The weighted average interest rate on total deposits paid by commercial banks increased from 1.0 percent to 1.1 percent, whilst the weighted average interest rate on total loans declined

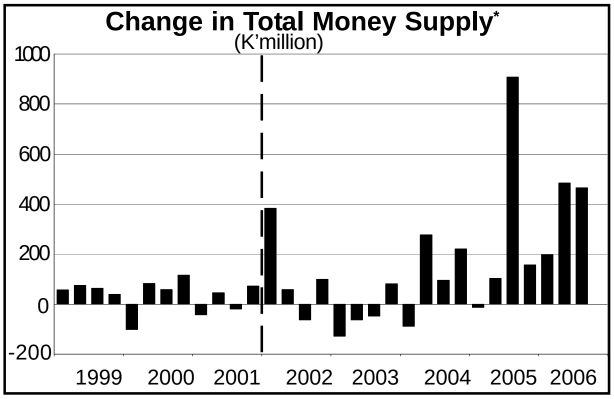
Liquid Asset Ratio[5]
(percentage of deposits)

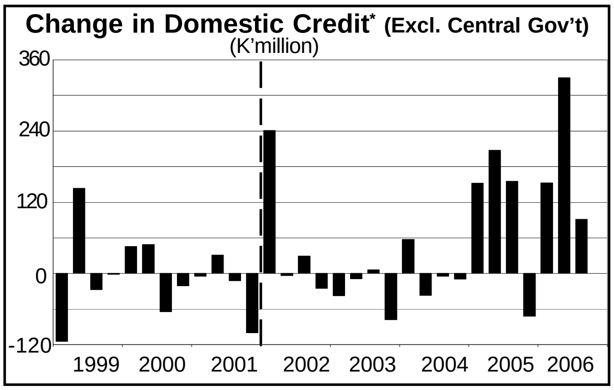


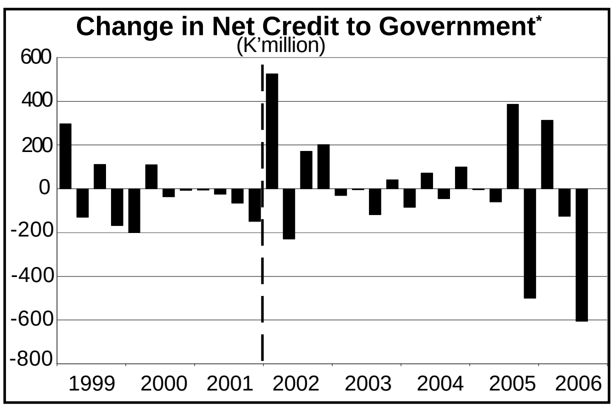
Weighted Ave. Lending and Deposit Rates
(percentage per annum)

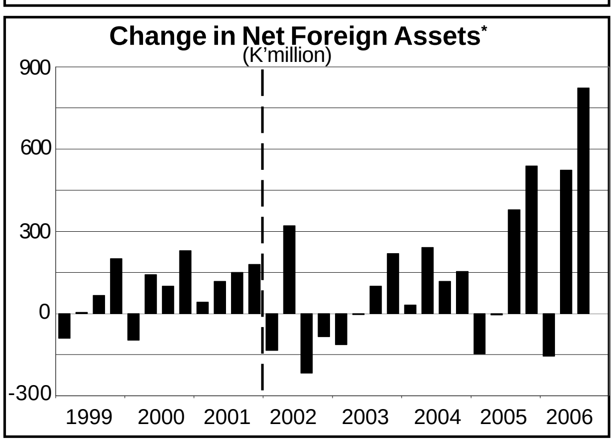


[5] The dotted vertical lines indicate a break in series from 2002. See "For the Record" in the June 2006 QEB on page 44.









from 10.5 percent to 10.4 percent. The commercial banks maintained their Indicator Lending Rates (ILR) within the spread of 9.45 percent to 10.70 percent.

The Bank continued to utilise its Open Market Operation (OMO) instruments in the conduct of monetary policy over the September quarter of 2006. As the Government continued to retire Treasury bills during the quarter, the Central Bank used the CBBs and Reverse Repos to sterilise the excess liquidity. Inter-bank borrowing picked up as a result of the uneven distribution of liquidity among banks. The Cash Reserve Requirement (CRR) and the Minimum Liquid Assets Ratio (MLAR) of commercial banks were maintained at 3.0 percent and 25.0 percent, respectively, over the September quarter of 2006.

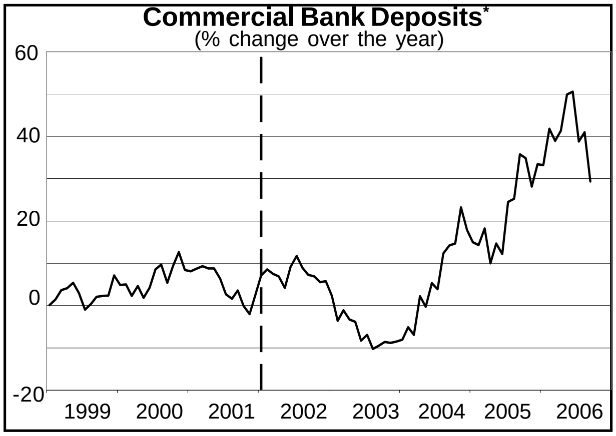
Average liquid assets held by Other Depository Corporations (ODCs) increased by 9.6 percent in the September quarter of 2006, compared to an increase of 17.2 percent in the previous quarter, reflecting higher holdings of CBBs.

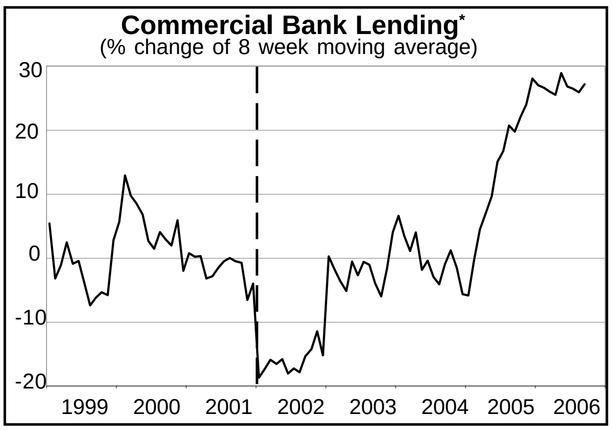
MONEY SUPPLY

The average level of broad money supply (M3*) increased by 8.2 percent in the September quarter of 2006, compared to an increase of 9.0 percent in the June quarter. The outcome was due to increases of 27.7 percent in average net foreign assets of the depository corporations and 3.9 percent in average net private sector credit, which more than offset a decline of 34.3 percent in average net credit to the Central Government. Net domestic credit outstanding, excluding advances to the Central Government and outstanding loans under the Government's Agricultural export commodity price support schemes increased by 3.4 percent in the September quarter of 2006, compared to an increase of 14.1 percent in the June quarter. The average level of monetary base (reserve money) grew by 9.4 percent over the September quarter of 2006, compared to an increase of 5.9 percent in the previous quarter. The increase reflected higher deposits of ODCs at the Central Bank and an increase in currency in circulation.

The decline in average net credit to the Government resulted mainly from increased Government deposits at the Central Bank and a decline in holdings of Government securities by ODCs. This partly reflected

* Break in series. Refer to footnote on page 16.





the retirement of Treasury bills by the Government.

The average level of narrow money supply (M1*) increased by 5.6 percent in the September quarter of 2006, compared to 7.0 percent in the June quarter. There were increases in both currency in circulation and demand (transferable) deposits. The average level of quasi money increased by 11.5 percent during the September quarter of 2006.

The average level of deposits of the ODCs increased by 7.5 percent in the September quarter of 2006 to K5,985.1 million, from K5,569.8 million in the June quarter of 2006. This represents an annualised growth rate of 30.8 percent.

LENDING

During the September quarter of 2006, total domestic credit extended by depository corporations to the private sector, public non-financial corporations, Provincial and Local Governments, and other financial corporations, increased by K91.4 million to K2,815.0 million, compared to an increase of K329.8 million during the June quarter of 2006. Growth in lending increased by K70.7 million and K20.6 million to the private sector and the public non-financial corporations, respectively. Credit to the private sector was mainly influenced by lending to the building and construction, transport and communication and mining sectors, as well as to forestry, other agriculture and personal loans. There were no repayments under the price support schemes. The annualised growth in domestic credit, excluding Central Government and advances under the price support schemes was 36.2 percent in the nine months to September 2006.

8. PUBLIC FINANCE

Preliminary estimates of the fiscal operations of the National Government for the nine months to September 2006 showed an overall surplus of K1,085.9 million, compared to a surplus of K498.2 million in the corresponding period of 2005. This represents 6.8 percent of nominal GDP. The higher surplus was due to significant mineral tax receipts, which more than offset an increase in expenditure. A Supplementary Budget was introduced in August 2006 to reallocate the surplus revenue of K682.5 million to priority expenditure areas, and achieve a targeted balance budget in 2006.

Total revenue, including foreign grants, during the nine months to September 2006 was K4,266.8 million, 34.3 percent higher than the receipts collected in the corresponding period of 2005. This represents 77.4 percent of the Supplementary Budget revenue for 2006. The increase was attributed to higher collections in most categories of tax revenue, as well as foreign grants.

Total tax revenue amounted to K3,528.7 million, 36.1 percent higher than the receipts collected during the same period in 2005, and represents 86.4 percent of the revised budgeted tax receipts. Direct tax receipts totalled K2,705.1 million, K829.5 million more than the receipts collected over the corresponding period in

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

2005, and represents 88.3 percent of the revised budgeted amount. The increase was due to higher personal, company and other direct taxes. The increase in personal income tax receipts continue to reflect the growth in employment by the private sector combined with increased enforcement by the Internal Revenue Commission (IRC) on collection of arrears. The increase in company tax receipts was due to improved profitability of companies resulting from continued higher mineral and agricultural export prices combined with strong aggregate demand. Other direct taxes increased due to higher receipts from dividend withholding tax, stamp duties and gaming machine turnover tax.

Indirect tax receipts was K823.6 million, 14.8 percent higher than in the corresponding period in 2005, and represents 80.6 percent of the revised budgeted receipts for 2006. The increase reflected higher collections from Goods and Services Tax (GST), excise duties and export tax, which more than offset lower receipts from import duties and other indirect tax. The growth in GST reflected increased collections from companies and higher sales, while the increase in excise duties reflected higher volumes of domestically produced and imported fuels. The decline in other indirect tax receipts was related to lower mining levy.

Total non-tax revenue amounted to K285.7 million, 109.6 percent higher than the amount collected in the corresponding period of 2005, and represents 66.0 percent of the revised budgeted amount for 2006. The increase mainly reflected higher dividend payments by Government statutory bodies. Foreign grants totalled K452.4 million in the nine months to September 2006, 1.0 percent higher than in the corresponding period of 2005, due to increased counterpart funding by the Government for the AusAID funded projects.

Total expenditure over the nine months to September 2006 was K3,180.9 million, 18.7 percent higher than in the corresponding period in 2005, and represents 57.7 percent of the 2006 Supplementary Budget expenditure. The increase was due to both higher recurrent and development expenditures.

Recurrent expenditure during the nine months of 2006 was K2,168.2 million, 13.9 percent higher than in the corresponding period in 2005, and represents 56.7 percent of the 2006 revised budgeted appropriation. From this total, K1,192.2 million relates to National Departmental expenditure, 10.0 percent higher than the amount spent in the corresponding period in 2005, and represents 50.2 percent of the 2006 revised budgeted appropriations. The increase reflects higher purchase of goods and services, disbursement of education subsidies and settlement of court orders. Provincial Government recurrent expenditure was K582.9 million, which is 25.7 percent higher than in the corresponding period in 2005, and represents 78.2 percent of the 2006 revised budgeted amount. The increase was due to higher salaries and wages and conditional grants including grants to village courts and the Autonomous Bougainville Government (ABG). Interest payments totalled K224.1 million, 6.8 percent higher than the amount paid in the corresponding period in 2005, and reflected increased issuance of Inscribed stocks.

Total development expenditure for the nine months to September 2006 was K1,012.7 million, K237.9 million higher than in the corresponding period in 2005, and represents 45.7 percent of the revised budgeted expenditure for 2006. The increase was related to the implementation of the 2006 Development Budget reflecting higher counterpart funding for donor funded projects.

The budget surplus of K1,085.9 million was used to make net overseas loan repayments of K133.5 million and net negative financing of K952.4 million to domestic sources. The net overseas loan repayments comprised of K14.1 million in concessionary, K8.6 million in commercial and K110.8 million in extraordinary loans. Net domestic financing comprised of K308.1 million in loan repayments to other resident sectors reflecting the settlement of cheque floats issued in 2005, and K644.3 million in net deposits with the Central Bank. This more than offset net borrowing by other depository and financial corporations of K63.2 million and K9.1 million, respectively.

FOR THE RECORD

MONTHLY KINA FACILITY RATE ANNOUNCEMENTS

The Central Bank introduced the Kina Facility Rate (KFR) in February 2001, as an official rate to indicate its stance of monetary policy. The KFR is a monthly rate and any changes to it should translate to changes in market interest rates. Changes to the KFR is based on assessment of economic fundamentals consistent with the overall objective of monetary policy of price stability in the economy. From January 2004, the KFR announced by the Bank were;

2004	05 January	Reduced by 100 basis points to 13.00 %
	02 February	Maintained at 13.00 %
	01 March	Reduced by 100 basis points to 12.00 %
	05 April	Reduced by 100 basis points to 11.00 %
	03 May	Reduced by 100 basis points to 10.00 %
	07 June	Maintained at 10.00 %
	05 July	Maintained at 10.00 %
	02 August	Maintained at 10.00 %
	06 September	Reduced by 100 basis points to 9.00 %
	02 October	Reduced by 200 basis points to 7.00 %
	01 November	Maintained at 7.00 %
	06 December	Maintained at 7.00 %
2005	03 January	Maintained at 7.00 %
	01 February	Maintained at 7.00 %
	01 March	Maintained at 7.00 %
	04 April	Maintained at 7.00 %
	02 May	Maintained at 7.00 %
	06 June	Maintained at 7.00 %
	04 July	Maintained at 7.00 %
	01 August	Maintained at 7.00 %
	05 September	Reduced by 100 basis points to 6.00 %
	03 October	Maintained at 6.00 %
	07 November	Maintained at 6.00 %
	05 December	Maintained at 6.00 %
2006	02 January	Maintained at 6.00 %
	06 February	Maintained at 6.00 %
	06 March	Maintained at 6.00 %
	03 April	Maintained at 6.00 %
	01 May	Maintained at 6.00 %
	05 June	Maintained at 6.00 %
	03 July	Maintained at 6.00 %
	07 August	Maintained at 6.00 %
	04 September	Maintained at 6.00 %
	02 October	Maintained at 6.00 %
	06 November	Maintained at 6.00 %
	04 December	Maintained at 6.00 %

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

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 injecting 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.

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

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 (bond)	A Government 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 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)	A money market instrument used by Bank of PNG to lend to or borrow from the commercial banks, for liquidity management, and is unwound on maturity. The terms range from overnight to 14 days and can be collateralised, for instance, using Treasury bills.
Reserve Money	A measure of money, which includes currency holdings of commercial banks and their deposits at the Central Bank and money in circulation.
Tap Facility	A facility conducted by the Central Bank for sale of Treasury bills and Inscribed stocks to the public.
Temporary Advance Facility	A statutory mechanism stipulated under Section 54 of the Central Banking Act 2000, that provides the National Government with access to short-term financing to meet mismatches in revenue.
Trade Account	Records all economic transactions associated with merchandise exports and imports of physical goods.
Trade Weighted Index[2]	The Trade Weighted Index (TWI) measures the value of the kina against a basket of currencies of PNG's major trading partners.
Treasury Bill	Government security or debt instrument sold at a discount value, but redeemed at face value on maturity for purposes of Budget financing. In PNG, Treasury bills are issued for 28, 61, 91, 182 and 364 day maturities.
Trimmed-mean CPI measure	A fixed proportion of prices at each end of the distribution of price changes are zero weighted and the mean of the remaining price changes recomputed. See also 'Underlying CPI'.
Underlying CPI (exclusion-based and trimmed-mean CPI measures)	A measure of inflation that excludes short-term volatile movements in prices, such as seasonal factors, Government policy decisions and price controlled items.

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

REFERENCE "FOR THE RECORD"

Some issues of the Quarterly Economic Bulletin (QEB) have "For the Record" as additional information relating to changes introduced to various statistical tables. The following "For the Record" have appeared in the QEB since March 2000.

Issue		For the Record
Mar 2000	-	Removal of QEB Table 3.8
Jun 2000	-	Inflation - Consumer Price Index (CPI)
	-	Changes to Table 7.2: Other Domestic Interest Rates
Mar 2001	-	Introduction of Monthly Kina Facility Rate
Jun 2001	-	Changes to Table 10.2: Prices and Wages
Dec 2001	-	Measures of Inflation
	-	Changes to Table 7.1: Commercial Banks Interest Rates
	-	Changes to Table 7.2: Other Domestic Interest Rates
	-	Changes to Table 10.2 Prices and Wages
Jun 2002	-	Exclusion of QEB Tables 4.2: Rural Development Bank of PNG and Table 10.1: Indicators of Economic Activity
Mar 2003	-	Changes to Balance of Payments Tables
	-	Bank of PNG Employment Index: Changes to Table 10.4 and Table 10.5
	-	Regional and Industrial Classifications and Abbreviations
Jun 2003	-	Changes to Open Market Operations Instruments
	-	Directions of Merchandise Trade
Sep 2003	-	Changes to the Treasury Bills Auction Allocation Process
Dec 2003	-	Further Change to the Treasury Bills Auction Allocation Process
	-	Bank of PNG Employment Survey
Sep 2004	-	Introduction of Central Bank Bill (CBB)
Mar 2005	-	Changes to Table 9.5 to include Exports from Napanapa Oil Refinery
	-	Changes to Tables 1.2 and 1.3 "Other Items (Net)"
June 2005	-	Changes to Tables 8.2 and 8.5 "External Public Debt"
Sep 2005	-	Trade Weighted Exchange Rate Index
	-	Employment Index - Changes to Tables 10.4 and 10.5
	-	Central Bank Bill (CBB) Auction - Changes to Tables 3.8 and 7.2
Mar 2006	-	Updated Weights for the Trade Weighted Index (TWI)
June 2006	-	Expansion of Monetary and Financial Data Coverage
	-	Upgrade of PNG's Private Debt and Equity Recording System

REFERENCE

Each issue of the Quarterly Economic Bulletin contains a review of economic conditions for the past quarter and a comprehensive set of updated statistical tables. Articles of special interest to current economic policy are also prepared by Bank staff for inclusion in the Bulletin. The following articles have appeared in the Quarterly Economic Bulletin since March 1993.

Issue	**Title**
Mar 1993	Papua New Guinea's Total External Exposure
Dec 1993	The 1994 National Budget
Dec 1993	Papua New Guinea's Total External Exposure
Mar 1995	The 1995 National Budget
Mar 1995	Papua New Guinea's Total External Exposure
Mar 1995	Monetary Policy for 1995
Dec 1995	The 1996 National Budget
Dec 1995	Monetary Policy for 1996
Mar 1996	Papua New Guinea's Total External Exposure
Dec 1996	The 1997 National Budget
Dec 1996	Monetary Policy for 1997
Mar 1997	Papua New Guinea's Total External Exposure
Dec 1997	Monetary Policy for 1998
Mar 1998	The 1998 National Budget
Mar 1998	Papua New Guinea's Total External Exposure
Dec 1998	The 1999 National Budget
Dec 1998	Monetary Policy for 1999
Mar 1999	Papua New Guinea's Total External Exposure
Sep 1999	The 1999 Supplementary Budget
Dec 1999	The 2000 National Budget
Jun 2000	Semi-annual Monetary Policy Statement, July 2000
Dec 2000	The 2001 National Budget
Dec 2000	Semi-annual Monetary Policy Statement, January 2001
Jun 2001	Semi-annual Monetary Policy Statement, July 2001
Dec 2001	Semi-annual Monetary Policy Statement, January 2002
Dec 2001	The 2002 National Budget
Jun 2002	Semi-annual Monetary Policy Statement, July 2002
Sep 2002	The 2002 Supplementary Budget
Dec 2002	Semi-annual Monetary Policy Statement, January 2003
Dec 2002	The 2003 National Budget
Mar 2003	Special article: Export Price Index, Volume Index and Weights Calculations Methodology
Jun 2003	Semi-annual Monetary Policy Statement, July 2003
Dec 2003	The 2004 National Budget
Dec 2003	Semi-annual Monetary Policy Statement, January 2004
Sep 2004	Semi-annual Monetary Policy Statement, July 2004
Dec 2004	Semi-annual Monetary Policy Statement, January 2005
Dec 2004	The 2005 National Budget
June 2005	Papua New Guinea's Total External Exposure
June 2005	Semi-annual Monetary Policy Statement, July 2005
Dec 2005	The 2006 National Budget
Dec 2005	Semi-annual Monetary Policy Statement, January 2006
June 2006	Papua New Guinea's Total External Exposure
June 2006	Semi-annual Monetary Policy Statement, July 2006

STATISTICAL SECTION

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