BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

19th December 2008

QUARTERLY ECONOMIC BULLETIN SEPTEMBER QUARTER OF 2008

Mr. L. Wilson Kamit, CBE, Governor of the Bank of Papua New Guinea (Bank of PNG), today released the September 2008 Quarterly Economic Bulletin. This statement provides an overview of the financial and economic developments during the September quarter of 2008 as well as developments since September 2008.

1. DEVELOPMENTS SINCE SEPTEMBER 2008

The Governor noted that the annual headline inflation rate, as measured by the September quarter 2008 Consumer Price Index (CPI), released by the National Statistical Office (NSO), was 13.5 percent over the twelve months to September 2008, compared to 10.7 percent over the twelve months to June 2008. The significant increase was largely due to the feed-through effect of increased international food and fuel prices. It also reflected, to an extent, strong domestic demand pressures. This combined with continued growth in credit to the private sector and growth in monetary aggregates prompted the Bank to increase its policy signalling rate, the Kina Facility Rate, by 1.00 percent to 8.00 percent in December 2008, in line with the tightening monetary policy stance announced in the July 2008 Monetary Policy Statement (MPS). Since August, international food and fuel prices have declined, owing to a slow down in global demand as a result of the financial turmoil. Together with the appreciation of the kina against the trade-weighted exchange rate index (TWI), this should lead to an easing in inflationary pressures.

The global financial crisis, which began in the middle of 2007, continued past the third quarter of 2008, placing the financial systems of major developed economies under considerable stress. Most major economies, including the United States and United Kingdom, are now reported to be in recession. Central Banks in a lot of these economies have responded by reducing their key policy interest rates and the governments introduced fiscal stimulus packages and specific measures to support failing industries, in an attempt to stimulate growth and reduce unemployment. Key commodity prices continued to decline from record high levels. The price of oil, in particular, fell below US$40 per barrel in early December as demand continued to fall due to the slowdown in global economic growth.

The financial sector in Papua New Guinea is insulated from the direct effects of the global financial market turmoil. This is because banks are funded primarily by domestic deposits and the banks and financial institutions do not have large exposures to external investments, and therefore the tight liquidity conditions in international capital markets are not affecting their liquidity.

The kina has depreciated against the US dollar from US$0.3845 at the end of September to US$0.3750 on 18th December 2008. The depreciation of the kina reflects a lower inflow of export receipts and high import demand. Over this period, the US dollar appreciated against the Australian dollar and the pound sterling and depreciated against the euro. The kina appreciated against the Australian dollar from A$0.4793 at the end of September to a high of A$0.6271 on 27th October before settling at A$0.5326 on 18th December. The level of foreign exchange reserves fell from K6,479.7 million (US$2,513.0 million) at the end of September to K5,925.6 million (US$2,251.7 million) on the 18th December 2008.

The commercial banks' Indicator Lending Rate spread changed from 8.95 – 9.70 percent at the end of September 2008 to 8.95 – 9.95 percent on 18th December 2008. There were upward movements in domestic interest rates, especially the 28 day Central Bank Bill rate, reflecting the tightening stance of monetary policy. Lending to the private sector continued to grow but at a slower rate, reflecting the pace of growth in economic activity.

2. OVERVIEW OF THE DEVELOPMENTS IN THE SEPTEMBER QUARTER OF 2008

Economic indicators available to the Bank of Papua New Guinea (the Bank) show continued but lower economic growth in the economy into the third quarter of 2008. Growth in employment, surplus in the trade account, continued credit growth to the private sector and increased sales by the private sector are supportive of the growth. The growth in lending to the private sector reflected expansion of business activity in some sectors, including the construction sector. The Consumer Price Index (CPI) inflation increased by 13.5 percent over the twelve months to September 2008, attributable to: the feed-through of increased international food and fuel prices to other domestic prices; increases in the prices of seasonal produces; and strong domestic demand pressures. The kina appreciated against the US and Australian dollars, which resulted in the Trade Weighted Index (TWI) appreciating by 9.5 percent in the September quarter. This combined with the retreating of international food and fuel prices in the September quarter from their historic highs, as a result of a slow down in global demand from the financial crisis, should contribute to an easing in inflationary pressures in the next two to three quarters. In line with the tightening stance of monetary policy announced in the July 2008 Monetary Policy Statement (MPS), the Bank increased the Kina Facility Rate (KFR) by 25 basis points to 6.50 percent in August and by 50 basis points to 7.00 percent in September 2008.

Data obtained from the Bank's Business Liaison Survey (BLS) show a lower growth in business sales by the formal private sector in the June quarter of 2008, compared to the previous quarter. The nominal value of sales increased by 2.6 percent in the June quarter of 2008, compared to an increase of 15.0 percent in the previous quarter. Excluding the mineral sector, the nominal value of sales increased by 9.3 percent in the June quarter, compared to an increase of 6.6 percent in the previous quarter. The increase was in all sectors, except the mineral sector. By region, there were increases in the NCD, Highlands, Momase and Morobe regions, while the Southern and Islands regions recorded decreases. Over the twelve months to June

2008, the total nominal value of sales increased by 8.3 percent. Excluding the mineral sector, annual sales increased by 25.6 percent.

The Bank's Employment Index for the September quarter of 2008 indicate an increase of 0.6 percent in the total level of employment in the formal private sector in the September quarter of 2008, compared to an increase of 3.3 percent in the previous quarter. Excluding the mineral sector, the level of employment increased by 0.5 percent in the September quarter, compared to an increase of 3.4 percent in the previous quarter. The mineral, manufacturing, construction, wholesale and transport sectors recorded increases in employment levels while the agriculture/forestry/fisheries, retail, financial/business and other services sectors experienced declines. All regions recorded increases in employment level, except the Southern region (excluding NCD). Over the twelve months to September 2008, the total level of employment increased by 8.5 percent. Excluding the mineral sector the level of employment increased by 9.3 percent.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), increased by 3.2 percent in the September quarter of 2008, compared to an increase of 3.7 percent in the June quarter. This outcome was due to higher prices in all expenditure groups, except the 'Transport and communication' and 'Miscellaneous' groups. Annual headline inflation was 13.5 percent in the September quarter of 2008, compared to an increase of 10.7 percent in the June quarter. The higher outcome was due to price increases in all expenditure groups. The largest increases were recorded in the 'Food', and 'Rents, council charges, fuel and power' groups, which reflected high international food and fuel prices and their feed-through to domestic prices, and increases in the prices of seasonal produces. By region, all urban areas recorded higher prices in the September quarter and over the twelve months to September 2008. The exclusion-based inflation rate was 3.1 percent in the September quarter of 2008, compared to 3.7 percent in the June quarter. The trimmed mean inflation rate was 2.5 percent in the September quarter of 2008, compared to 3.6 percent in the June quarter.

In the September quarter of 2008, the daily average kina exchange rate appreciated against all the major currencies. It appreciated by 4.9 percent against the US dollar, 11.7 percent against the Australian dollar, 9.0 percent against the euro, 9.4 percent against the pound sterling and 7.8 percent against the Japanese yen. These movements, mainly the appreciation against the Australian dollar, resulted in the daily average TWI appreciating by 9.5 percent during the September quarter.

Higher international prices for most mineral and agricultural exports resulted in a 16.2 percent increase in the weighted average kina price of exports in the September quarter of 2008, compared to the corresponding quarter of 2007. There was a 16.8 percent increase in the weighted average price of mineral exports, with higher kina prices of gold and crude oil. For agricultural, logs and marine product exports, the weighted average kina price increased by 13.5 percent. This was accounted for by higher kina prices of coffee, cocoa, palm oil, copra, copra oil, tea, rubber and marine product exports.

There was an overall surplus of K560 million in the balance of payments for the nine months to September 2008, compared to a surplus of K1,227 million in the corresponding period of 2007. The lower surplus was due to higher net outflows in the capital and financial accounts, which partially offset a higher surplus in the current account.

The current account recorded a higher surplus of K2,157 million in the nine months to September 2008, compared to a surplus of K668 million in the corresponding period of 2007. This outcome was the result of a higher trade surplus and lower net service and income payments, which more than offset lower net transfer receipts.

The capital and financial accounts recorded a net outflow of K1,609 million in the nine months to September 2008, compared to a net inflow of K519 million in the corresponding period of 2007.

The capital account recorded a lower net inflow of K63 million in the nine months to September 2008, compared to a net inflow of K93 million in the corresponding period of 2007. The decline reflected lower capital inflows by donor agencies for project financing.

The financial account recorded a net outflow of K1,672 million in the nine months to September 2008, compared to a net inflow of K426 million in the corresponding period of 2007. This outcome was a result of higher net outflow from direct investments, investments in financial derivative instruments abroad and other investments and net loan repayments by the Government, which more than offset the lower net inflows from portfolio investments.

The level of gross foreign exchange reserves at the end of September 2008 was K6,479.7 (US$2,513) million, sufficient for 9.2 months of total and 13.4 months of non-mineral import cover.

In line with the tightening stance of monetary policy, the Bank increased the KFR by 25 basis points in August and by 50 basis points in September to 7.00 percent from 6.25 percent in June 2008. The dealing margin for the Repurchase Agreements (Repos) was maintained at 100 basis points on both sides of the KFR during the same period. Domestic Interest rates for short-term securities increased across all maturities during the quarter.

The Bank continued to utilise Open Market Operation (OMO) instruments in the conduct of monetary policy over the September quarter of 2008, using Central Bank Bills (CBBs) and Reverse Repos to diffuse excess liquidity. Trading in the inter-bank market was moderate during the same period. 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, in the September quarter of 2008.

The average level of broad money supply (M3*) increased by 3.5 percent in September quarter of 2008, compared to an increase of 7.0 percent in the June quarter of 2008. This was due to an increase of 4.1 percent in average net foreign assets of the depository corporations and an increase of 8.0 percent in average private sector credit, which more than offset a significant decline of 129.5 percent in average net claims on the Government. Average net domestic claims outstanding, excluding advances to the Central Government and outstanding loans under the Government’s Agricultural export commodity price support scheme increased by 8.0

percent in the September quarter of 2008, compared to an increase of 10.9 percent in the previous quarter.

During the September quarter of 2008, 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 K194.7 million to K5,222.0 million, compared to an increase of K508.0 million in the previous quarter. This was mainly due to increased credit of: K183.2 million to the private sector; and K11.7 million to public non-financial corporations. The annualised growth in domestic credit, excluding the Central Government and advances under the price support schemes was 37.5 percent in the third quarter of 2008.

Preliminary estimates of the fiscal operations of the National Government for the nine months to September 2008 show an overall surplus of K1,063.4 million, compared to a surplus of K1,617.2 million in the corresponding period of 2007. This represents 5.4 percent of nominal Gross Domestic Product (GDP). The lower surplus was due to lower revenue and an increase in expenditure compared to the corresponding period in 2007.

Total revenue, including foreign grants, during the nine months to September 2008 was K4,597.2 million, 6.8 percent lower than the receipts collected in the corresponding period of 2007. This represents 63.8 percent of the budgeted revenue for 2008. The decrease was attributed to lower collections in non-tax revenue and lower foreign grants, which more than offset an increase in tax revenue.

Total expenditure for the nine months to September 2008 was K3,533.8 million, 6.7 percent higher than in the corresponding period in 2007, and represents 50.5 percent of the budgeted expenditure for 2008. The increase was due to higher recurrent expenditure, which more than offset lower development expenditure.

As a result of these developments in revenue and expenditure, the Government recorded an overall budget surplus of K1063.4 million for the nine months to September 2008. The surplus was used to make overseas loan repayments totaling K115.1 million while K948.3 million was net negative financing to domestic sources.