



# BANK OF PAPUA NEW GUINEA

## MONTHLY ECONOMIC REVIEW

Vol. 1

No. 5

Month Ended  
May 2014

### Economic Activity

Global economic growth, which strengthened in the fourth quarter of 2013, lost momentum slightly in the first quarter of 2014 amid unusually cold weather in the US, a softening manufacturing sector in China, as well as financial and political instability in many emerging countries. However, the outlook for 2014 remains positive. In advanced economies, growth is expected to increase by 2.2 percent in 2014, driven mainly by expansionary fiscal policy and accommodative monetary policy. The growth in the United States continues at an annualized rate of 0.1 percent and is driven by the recovery of the real estate sector and relaxed lending conditions. In the Euro area, the recovery is expected to reach a growth of 1.2 percent in 2014 as construction, industrial and retail sectors improve. Growth in emerging economies is expected to reach 4.9 percent in 2014 driven mainly by improved economic activities in China and India. China expects a growth of 7.5 percent, while India has projected a growth of 5.4 percent, reflecting government's investment plans and export support.

The domestic economy continues to grow but at a slower pace, reflecting the completion of the LNG construction project. Its spillover effects to the non-mineral sectors have resulted in lower employment levels in the affected sectors such as manufacturing and transportation. The Bank's Employment Index show that the level of employment in the private sector declined by 0.2 percent in the March quarter of 2014, compared to an increase of 1.5 percent in the December quarter of 2013. Excluding the mineral sector, the level of employment increased by 0.4 percent, driven by the building and construction sector associated with Government infrastructure spending. Employment declined in all regions, except in the Momase, NDC and Islands regions. Over the year to March 2014, the total level of employment increased by 0.5 percent, whilst the non-mineral employment declined by 0.2 percent.

Production at the PNG LNG project has commenced and the first shipment of LNG export is expected in early June, ahead of schedule.

### Balance of Payments

Preliminary balance of payments data for three months to March 2014 show an overall deficit of K182 million, com-

pared to a deficit of K430 million in the corresponding period of 2013. This outcome was due to a deficit in the current account, which more than offset a surplus in the capital and financial account. The level of gross foreign exchange reserves at the end of March 2014 was US\$2,778.0 (K6,659.60) million, sufficient for 6.9 months of total and 9.9 months of non-mineral import covers. As at 26th May 2014, the level of gross foreign exchange reserves declined to US\$2,644.4 (K6,326.4) million, reflecting further intervention by BPNG.

### Exchange Rate

The average inter-bank kina exchange rate against the US dollar continued to remain stable against the US dollar at US\$0.4130 over the month to 23rd May 2014. In the same period, the average kina exchange rate depreciated against the Australian dollar by 16 basis points to AU\$0.4438. This was due to cross currency movements as the Australian dollar appreciated against the US dollar on the back of positive manufacturing data from China. As a result, the average TWI decreased by 0.4 percent to 37.47 over the month to 23rd May 2014, mainly reflecting the depreciation of the kina against the Australian dollar. In spite of the stability in the inter-bank exchange rate against the USD, and some good foreign exchange inflows recently, commercial banks continued to quote market rates well below the interbank or official rate.

### Inflation

Annual headline Retail Price Index (RPI) to April 2014 increased by 8.7 percent, compared to 2.0 percent in March 2014. The significant increase was due to price increases in the 'Motor vehicle operations (petrol only)' sub group, and the 'Drinks, tobacco and betelnut' expenditure group, influenced by a substantial increase in betel nut prices. Prices in the 'Rents, council charges fuel/power' group also increased. RPI ex-seasonal increased by 3.9 percent while RPI ex-seasonal and fuel increased by 3.0 percent over the twelve months to April 2014. The monthly RPI for April increased by 1.8 percent, compared to a rise of 2.0 percent in the previous month. The long awaited new CPI basket was finally released by the National Statistical Office (NSO) on the 20th May 2014. Using the new CPI basket, NSO released a quarterly inflation outcome of 2.0 percent for the March quarter 2014 and an annual inflation of 3.8 percent over the year to March 2014. The

<sup>1</sup> The Trade Weighted Index (TWI) measures the value of the kina against a basket of currencies of PNG's major trading partners.

<sup>2</sup> The RPI survey covers the major supermarkets in Port Moresby and is compiled monthly.

quarterly underlying exclusion based inflation measure was 2.5 percent in March, while the annual rate was 3.4 percent.

## **Fiscal Operation**

Preliminary estimates of the fiscal operations of the National Government over the three months to March 2014 show an overall surplus of K105.2 million, compared to a deficit of K403.9 million in the corresponding period of 2013. This represents 0.3 percent of nominal GDP, and reflected higher revenue. The surplus of K105.2 million and net external borrowing of K420.4 million was used to make net payments to the domestic sector of K525.6 million.

Total revenue, including foreign grants, during the March quarter of 2014 was K2,004.3 million, 12.2 percent higher than the receipts collected in the corresponding period of 2013. This represents 15.8 percent of the budgeted revenue for 2014. The increase in revenue mainly reflected higher collections in direct, indirect and non-tax receipts, which more than offset lower foreign grants. Total expenditure for the first three months to March 2014 was K1,899.1 million, 13.3 percent lower than in the corresponding period of 2013 and represents 12.6 percent of the budget appropriation for 2014.

## **Domestic Interest Rates & Monetary Aggregates**

Over the month to 23rd May 2014, CBB rates increased across all maturity terms, except the 182-day term, for which there was no allocation during the month. The 28-day, 63-day and 91-day rates increased to 1.89 percent, 2.45 percent and 2.60 percent, respectively, from 1.84 percent, 2.29 percent and 2.44 percent. At the Treasury bill auction, the 182 and 365 days rates also increased to 3.76 percent and 6.06 percent respectively, from 3.53 percent and 5.80 percent. As a result, the weighted average interest rates on wholesale deposits increases across all maturities over the same period. The Government financing of the budget from the domestic market would induce a retirement in CBBs during the year.

Broad money supply (M3\*) slightly increased by 0.8 per-

cent over the year to April 2014, compared to an increase of 10.3 percent in the corresponding period in 2013. The lower growth was mainly due to slow down in private sector credit growth and increase in net credit to the Government. Over the year to 23rd May 2014, average lending by banks increased by 17.9 percent to K9,090.8 million. The commercial bank deposits increased by K879.6 million to K19,259.1 million between December 2013 and week-ending 23rd May 2014, reflecting net deposits by the real and government sectors. Over the year to 23rd May 2014, average deposits increased by 7.9 percent to K18,483.3

## **Monetary Policy**

With the expectation of increasing inflationary pressures coming from the effects of lagged depreciation of the kina and increasing demand pressures associated with large Government expenditure, the Bank is taking a cautious approach by maintaining its neutral stance of monetary policy. The policy rate, the Kina Facility Rate, is maintained at 6.25 percent for the month of May 2014.

## **Financial System Stability**

As at the end of March 2014, total assets of the financial system stood at K38.66 billion, of which the amount for the banking sector is 76.1 percent, superannuation system 22.7 percent, and life insurance 1.2 percent. Total deposits were K22.38 billion. Commercial banks accounted for 94.0 percent while licensed financial institutions, microfinance institutions and Savings & Loans societies accounted for 3.3 percent, 0.6 percent, and 2.1 percent, respectively. Total loans were K12.20 billion. The ratio of non-performing loans to total loans was 2.2 percent, whilst the ratio of non-performing loans to total assets was 0.9 percent.

The capital adequacy ratio for the banking sector was 29.1 percent, well above the minimum requirement of 12 percent. The return on assets was 2.6 percent and return on equity was 21.8 percent. These indi-

Papua New Guinea Key Economic Indicators							
		Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14
<b>1. Consumer Price Index (CPI)</b> (YOY % Change)	Headline	4.7	-	-	3.8	-	-
	Food	1.0	-	-	2.7	-	-
<b>2. Retail Price Index (RPI)</b> (YOY % Change) (a)	Headline	-0.3	0.1	2.8	2.0	8.7	-
	Ex-seasonal	0.9	1.4	3.1	2.7	3.9	-
<b>3. Exchange Rates</b> (mid rate, eop)	USD	0.4130	0.4130	0.4130	0.4130	0.4130	0.4130
	AUD	0.4622	0.4710	0.4610	0.4475	0.4448	0.4432
	GBP	0.2506	0.2507	0.2475	0.2483	0.2457	0.2468
	JPY	43.38	42.36	42.02	42.490	42.260	41.950
	NZD	0.5024	0.5074	0.4922	0.4769	0.4824	0.4855
<b>4. Foreign Exchange Reserve</b> (eop US\$ mill)		2,855	2,811.3	2,796.7	2,781.3	2,801.7	2,644.4
<b>5. Liquidity</b> (eop)	Liquid Assets Margin to Deposit Ratio (%)	44.6	44.9	46.2	45.9	45.5	42.9
	Banks Demand Deposits (K'bn)	10.7	13.4	13.4	13.5	13.9	14.3
<b>6. Money and Credit</b> (YOY % change)	Broad Money	6.5	9.5	5.9	4.3	0.8	-
	Monetary Base	-0.5	10.5	4.0	3.6	5.3	-
	Private Sector Credit	17.5	4.0	10.6	9.3	7.6	-
<b>7. Interest Rates (% pa)</b> (monthly weighted average)	Kina Facility Rate	6.25	6.25	6.25	6.25	6.25	6.25
	Central Bank Bill Rate (28 day)	1.84	1.83	1.88	1.84	1.87	1.89
	Commercial bank Term Deposit (30 day)	0.35	0.82	0.81	1.13	0.64	1.24
	Government Treasury bill (364 day)	3.72	4.44	4.80	5.54	5.88	6.12
	3-year Inscribed stock Rate	4.52	6.02	6.49	6.67	6.88	7.64
	16-year Inscribed stock Rate (>10 years)	-	10.1	10.45	11.59	13.21	14.65
<b>8. Commodity Prices</b> (monthly average)	Oil (\$/bbl)	105.5	102.1	104.8	104.0	104.9	105.7
	Gold (\$/troy oz)	1223.7	1246.3	1301.0	1338.3	1299.1	1285.9
	Copper (\$/mt)	7193.6	7285.0	7151.6	6669.1	6655.5	6857.7
	Coffee (cents/kg)	127.0	134.4	172.3	216.2	223.4	218.6
	Cocoa (cents/kg)	279.1	171.0	180.0	183.3	182.5	180.1

Authorised for release by Mr. Loi M. Bakani, Governor

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