



BANK OF PAPUA NEW GUINEA

MONTHLY ECONOMIC REVIEW

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Economic Activity

The world economy continues its slow recovery in the first three months of 2014, with the main impetus for growth lying with the advanced economies. The International Monetary Fund projects global growth to strengthen from 3.0 percent in 2013 to 3.6 percent in 2014. In the advanced economies, growth is expected to be driven mainly by expansionary fiscal policies and highly accommodative monetary conditions. Although downside risks have generally diminished, lower-than-expected inflation in advanced economies can lead to higher real interest rates, while there is increased financial market volatility in emerging market economies.

Growth in economic activity in the Papua New Guinea economy is envisaged to have grown at a moderate pace in the first quarter of 2014, supported by continued increase in lending by commercial banks to the private sector, and Government expenditure on major projects, including the construction of sporting facilities in Port Moresby in preparation for the Pacific Games in 2015.

Balance of Payments

Preliminary outcome of the balance of payments data for January 2014 show an overall deficit of K109.6 million, compared to a deficit of K132.5 million in the corresponding period of 2013. This outcome was due to a deficit in the current account more than offsetting a surplus in the capital and financial account. The deficit in the current account was due to lower payments on imports, services, income and transfers. The surplus in the capital and financial account was mainly due to net inflows from investments in short term money market instruments and drawdown of net foreign assets of the domestic banking system and foreign currency account balances of mineral companies. The level of gross foreign exchange reserves at the end of January 2014 was US\$2,811.3 (K6, 732.28) million, sufficient for 7.3 months of total and 10.9

months of non-mineral import covers. As at 31st March 2014, the level of gross foreign exchange reserves was US\$2,781.3 (K6,653.9) million.

Exchange Rate

The average inter-bank kina exchange rate against the US dollar continued to remain at US\$0.4130 over the month to 31st March 2014, and has been at that rate since October 2013. During the same period, the average kina exchange rate depreciated against the Australian dollar by 98 basis points to AU\$0.4579. This was due to cross currency movements as the Australian dollar appreciated against the US dollar on the back of positive economic data for the Australian economy as well as expectation that China will launch a stimulus program if growth continues to slow. The Trade Weighted Index (TWI) decreased by 1.7 percent to 37.6 between end of December 2013 and 31st March 2014, reflecting the depreciation of kina against both the US and Australian dollar. Given the high sell kina orders in the FX market, commercial banks have been quoting trading rates well below the interbank rate.

Inflation

Annual headline Retail Price Index (RPI) to February 2014 increased by 2.8 percent, compared to an increase of 0.1 percent in January 2014. This was due to price increases in the 'Drinks, Tobacco and Beletnut' expenditure group. RPI ex-seasonal declined by 0.1 percent and RPI ex-seasonal kerosene and petrol fell by 0.3 percent for the three months to February 2014. Although low, annual headline inflation has been trending upwards in 2013. In the first quarter of 2014, upside risks to inflation could stem from the depreciation of the kina, imported inflation and high Government spending.

Fiscal Operation

Weekly Government cash flow for week-ending 28th March 2014 showed a closing position of K297.1 million. This is relatively lower than the high balance

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

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

of around K500 million in the corresponding week last year. For the domestic financing of the budget deficit of K3,353 million for 2014, the Government has made a total net issuance of K53.9 million of Treasury bills and K325.7 million of Inscribed stocks between end of December 2013 and end of March 2014. It will also account for cheque floats of K550.0 million to March 2014, mainly from cheques issued in 2013.

Domestic Interest Rates & Monetary Aggregates

Over the month to week-ending 28th March 2014, Central Bank Bill (CBB) rates increased for most maturities, except the 28 day rate, which declined by 4 basis points to 1.84 percent. Treasury bill rates increased for both the 182 and 364-day terms. As a result, wholesale deposit rates also increased across all maturities. Continued Government financing of budget deficit through the domestic open market operations will provide an opportunity for retirement of CBBs. The wholesale deposit rates increased in all maturities.

Broad money supply (M3*) increased by 5.9 percent over the year to February 2014, compared to an increase of 6.3 percent in the corresponding period of 2013. The

growth was mainly driven by increases in net credit to Government and private sector credit. Over the year to 28th March 2014, average lending by commercial banks increased by 16.9 percent to K8,826.0 million, while deposits decreased by K223.1 million to K18,148.5 million. Total liquid assets of the commercial banks slightly increased by 0.7 percent to K8,307.4 million between 28th March 2014 and December 2013. Over the year to 28th March 2014, average liquid assets of banks decreased by 5.4 percent to K8,512.3 million.

Monetary Policy

In the first quarter 2014, inflationary pressure is envisaged to have come mainly from high import demand associated with the expansionary fiscal policy and private sector demand. Given this scenario, the Bank has taken a cautious approach and maintained a neutral stance of monetary policy by keeping its policy rate, the Kina Facility Rate, at 6.25 percent in March 2014.

Papua New Guinea Key Economic Indicators							
		Oct-13	Nov-13	Dec-13	Jan-14	Feb 14	Mar 14
1. Consumer (YOY % Change)	Headline	-	-	4.7	-	-	-
	Food	-	-	1.0	-	-	-
2. Retail Price Index (YOY % Change)	Headline	3.9	1.7	-0.3	0.1	2.8	-
	Ex-seasonal	2.5	3.1	0.9	1.4	3.1	-
3. Exchange Rates (mid rate, eop)	USD	0.4130	0.4130	0.4130	0.4130	0.4130	0.4130
	AUD	0.4352	0.4538	0.4622	0.4710	0.4610	0.4475
	GBP	0.2579	0.2525	0.2506	0.2507	0.2475	0.2483
	JPY	40.60	42.23	43.38	42.36	42.02	42.490
	NZD	0.5006	0.5091	0.5024	0.5074	0.4922	0.4769
4. Foreign Exchange Reserve (eop US\$ mill)		3,064	2,944	2,855	2,811.3	2,796.7	2,781.3
5. Liquidity (eop)	Liquid Assets Margin to Deposit Ratio (%)	42.5	41.9	44.6	44.9	46.2	45.9
	Banks Demand Deposits (K'bn)	10.2	10.6	10.7	13.4	13.4	13.5
6. Money and Credit (YOY % change)	Broad Money	11.0	11.0	6.5	9.5	5.9	7.2
	Monetary Base	0.9	-0.4	-0.5	10.5	4.0	6.1
	Private Sector Credit	17.7	16.1	17.5	4.0	10.6	15.3
7. Interest Rates (% pa) (monthly weighted average)	Kina Facility Rate	6.25	6.25	6.25	6.25	6.25	6.25
	Central Bank Bill Rate (28 day)	1.77	1.85	1.84	1.83	1.88	1.84
	Commercial bank Term Deposit (30 day)	0.55	0.61	0.35	0.82	0.81	1.13
	Government Treasury bill (364 day)	3.18	3.60	3.72	4.44	4.80	5.54
	3-year Inscribed stock Rate	4.37	4.66	4.52	6.02	6.49	6.67
	16-year Inscribed stock Rate (>10 years)	0.11	0.11	-	10.1	10.45	11.59
8. Commodity Prices (monthly average)	Oil (\$/bbl)	105.4	102.6	105.5	102.1	104.8	104.0
	Gold (\$/troy oz)	1309.5	1280.8	1223.7	1246.3	1301.0	1338.3
	Copper (\$/mt)	7181.6	7096.3	7193.6	7285.0	7151.6	6669.1
	Coffee (cents/kg)	130.4	123.1	127.0	134.4	104.8	216.2
	Cocoa (cents/kg)	273.0	276.0	279.1	171.0	180.0	183.3

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