



BANK OF PAPUA NEW GUINEA

MONTHLY ECONOMIC REVIEW

The release of this review does not mean accuracy of the information is guaranteed nor does it mean any views expressed therein are endorsed

Volume: 2

No. 12

Month Ended: December 2015

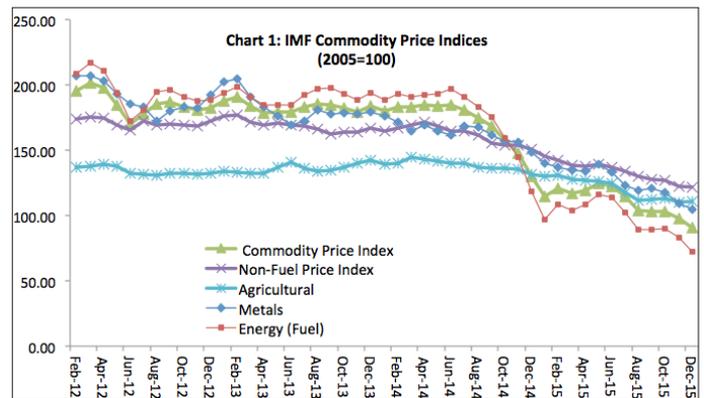
Economic Activity

Global economic growth in 2015 is estimated to have slowed down to 2.4 percent from 2.6 percent in 2014. The slowdown was due to deceleration in growth amongst emerging and developing economies amidst post-crisis lows in commodity prices, weaker capital flows and subdued global trade. This overshadowed the modest recovery experienced in the advanced economies. In US, the recovery was driven by strong domestic demand with robust employment conditions. The US Federal Reserve raised the benchmark interest rate by 25 basis points in December 2015, the first increase since June 2006. The Euro area recorded a decline in unemployment and pick up in credit growth, while recovery remains fragile in Japan despite substantial policy stimulus. China's gradual slowdown and rebalancing continued in 2015.

For the domestic economy, growth for 2015 is revised downwards to be below 9 percent (that was projected in the March Monetary Policy Statement) as a result of low international commodity prices, decline in activity in the mining and manufacturing sectors and slow growth in other sectors of the economy, compounded with the adverse effects of the El Nino weather phenomenon.

Commodity Prices

The International Monetary Fund's (IMF's) *Commodity Market Monthly* for January 2016 shows that the global commodity prices declined in December 2015. The overall commodity price index declined by 7.07 percent compared to a 5.5 percent decline in November 2015. This was primarily due to a significant fall of 12.9 percent in the energy prices, attributed mainly to lower crude oil prices. The non-fuel price index fell by 0.25 percent with a decline in metals prices by 3.75 percent while agricultural commodities prices increased by 0.10 percent. The decline in energy and metal prices can translate to lower export earnings for PNG's energy and mineral exports if the kina depreciation effect on kina prices does not offset the effect of lower prices.



Source: IMF

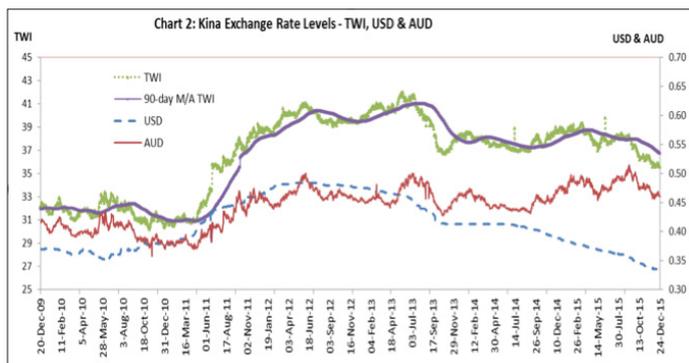
Balance of Payments

Preliminary balance of payments data for the ten months to October 2015 show an overall deficit of K166.2 million, compared to a deficit of K549.0 million in the corresponding period of 2014. A deficit in the capital and financial account more than offset a surplus in the current account. The deficit in the capital and financial account came from a build-up in foreign currency account balances of resident mineral companies, combined with net loan repayments by the Government. The current account surplus was due to a higher trade surplus, combined with net transfer receipts. The level of gross foreign exchange reserves at the end of October 2015 was K5,814.2 (US\$2,013.4) million, which can cater for 11.1 months of total and 20.5 months of non-mineral import covers. As at 31st December 2015, the level of gross foreign exchange reserves was US\$1,865.1 (K5,526.2) million.

Exchange Rate

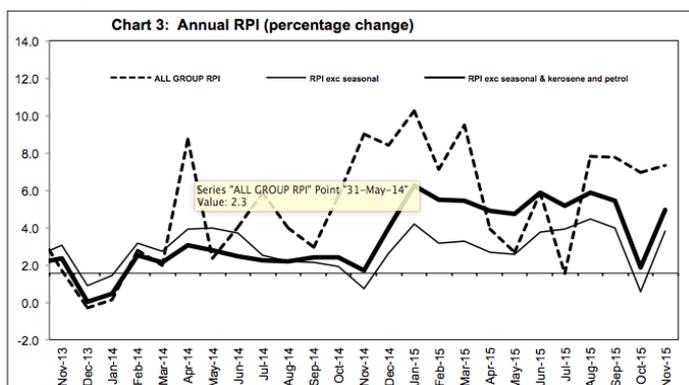
The Kina depreciated against the US dollar (USD) by 56 basis points to US\$0.3356 over the month to 24th December 2015, with low foreign currency inflows relative to demand for foreign currency. Over the same period, the kina depreciated against the Australian dollar (AUD) by 132 basis points to AU\$0.4636. This was on the back of the AUD's appreciation against the USD following market perceptions that monetary policy tightening in the US would have gradual impact on inflation, hence luring investor confidence in the AUD. The average Trade Weighted Index (TWI) decreased by 1.6 percent to 35.78

over the month to 24th December 2015, indicating the depreciation of the kina against both the USD and AUD as well as other major currencies. (Chart 2)



Inflation

Annual headline Retail Price Index (RPI) to November 2015 increased by 7.3 percent, compared to an increase of 6.9 percent over the twelve months to October 2015. There were price increases for the medical and health care (exc. Hospital) and non-durable goods sub-groups, and 'Food' and 'Drinks, tobacco & betelnut' expenditure groups. RPI ex. seasonal increased by 3.8 percent and annual RPI ex. seasonal and fuel by 5.0 percent, compared to an increase of 0.7 percent and 1.7 percent for both groups, respectively, over the twelve months to October 2015. The quarterly headline RPI increased by 4.3 percent in November 2015, while the monthly headline RPI increased by 2.0 percent. Going forward low international commodity prices and low imported inflation are expected to offset the effects of the depreciation of the kina. (Chart 3)



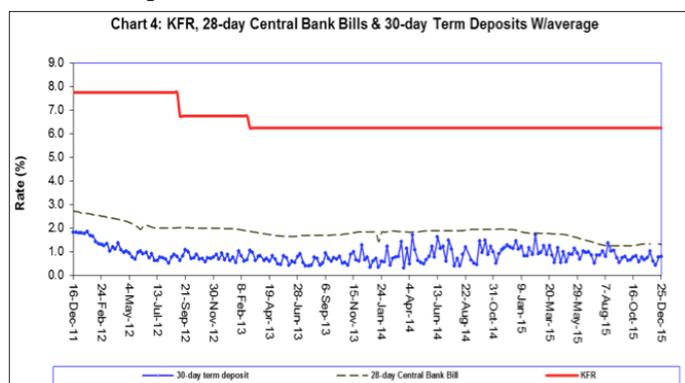
Fiscal Operations

The National Government's cash-flow has continued to come under pressure in recent months, because of high Government expenditure commitments and continuous low revenue. As a result, there have been regular debit positions recorded in the weekly cash-flows in the months of November and December 2015. The weekly cash-flow position as at 31st December 2015 projects a debit of K147.3 million. In light of priority expenditure plans such as the District and Provincial Support Improvement Programs (DSIP/PSIP) and education grants and transfer payments and low revenue, the cash-flow is projected to remain in deficit for some time. The Temporary Advance Facility (TAF) has relieved the temporary mismatches in the

revenue and expenditure of the Government, while some Central Bank Bills (CBBs) were retired upon maturity to allow the Government to raise funds from its Treasury bill issuance.

Domestic Interest Rates & Monetary Aggregates

Over the month to 24th December 2015, the CBB rates declined for the 28-day and 63-day terms while there were no auctions for the 91-day and 182-day terms, to allow the Government to raise funds under these terms in Treasury bills. The 28-day and 63-day CBB rates fell to 1.32 percent and 2.32 percent from 1.34 and 2.34 percent, respectively. At the Treasury bill auction, the 182-day and 364-day rates rose to 4.65 and 7.60 percent, respectively from 4.57 and 7.51 percent, while the 91-day rate declined to 2.57 percent from 2.58 percent. Outside the auction, the Government also issued Treasury bills to certain interested buyers under the 28-day and 63-day terms and their interest rates were 1.44 and 2.44 percent, respectively. Over the same period, the weighted average interest rates on wholesale deposits above K500,000 recorded mixed movements. The weighted average rates for the 60-day and 90-day terms increased to 0.72 and 0.99 percent from 0.28 and 0.99 percent, while the rate for 28-day and 90-day terms decreased to 0.86 and 1.36 percent from 1.02 and 2.41 percent, respectively. (Chart 4). There were two Repo deals done during the month, where Bank South Pacific (BSP) borrowed a total of K174.0 million from BPNG at a rate of 2.34 percent each.



Broad money supply increased by 5.8 percent over the year to November 2015, compared to an increase of 1.6 percent in the corresponding period of 2014. This was driven by increases in credit to the public non-financial corporations and net claims on the Government and private sector, which offset a decline in net foreign assets. Monetary base declined by 0.9 percent over the year to November 2015, compared to an increase of 26.3 percent in the corresponding period of 2014. This was due to a decrease in deposits of commercial banks at the Central Bank, which more than offset an increase in currency in circulation.

Commercial bank lending extended to public non-financial corporations, other financial corporations and other resident sectors increased by K882.5 million to K11,721.0 million between

December 2014 and week-ending 24th December 2015. This is attributed to advances made to the mining (mainly Ok Tedi Mine – Capital expenditure for equipment purchase & upgrading of power stations), petroleum (mainly Kumul Holdings Ltd – for Dividend payments to the State), construction, Government (National Capital District Commission (NCDC) – for ongoing road constructions), finance, real estate, retail, manufacturing, transport and agriculture sectors. Over the year to 24th December 2015, the weekly average lending by banks increased by 12.9 percent to K10,980.3 million. The commercial bank deposits increased by K1,051.7 million to K20,356.2 million between December 2014 and week-ending 24th December 2015, reflecting deposits by the government, petroleum, mining, finance, manufacturing, electricity, fisheries, retail, construction, transport and agriculture sectors. Over the year to 24th December 2015, the weekly average deposits increased by 4.2 percent to K19,540.5 million.

Monetary Policy

On one hand, some key developments such as the continued depreciation of the Kina, increase in the Retail Price Index, deficit in the balance of payments, and increased Government spending contributing to domestic demand may suggest a tightening of monetary policy. On the other hand, slower growth in the monetary aggregates (private sector credit, monetary base and broad money), a general

slowdown in economic activity, and a decline in the private sector employment level may suggest otherwise. The increases in CPI inflation in the first three quarters of 2015 are considered manageable while the Bank is mindful of the increases in the RPIs of October and December, and is keeping a close watch on this. Given all these, the Bank continued to take a cautious approach by maintaining its neutral monetary policy stance, keeping the policy signalling rate, Kina Facility Rate (KFR), at 6.25 percent December 2015.

Financial System Stability

Total assets of the financial system as at the end of September 2015 was K42.3 billion, of which 76 percent was by the other depository corporations and 24 percent by other financial corporations. Total deposits were K24.3 billion, of which commercial banks accounted for 93.7 percent while the licensed financial institutions share was 3.4 percent, and microfinance institutions and savings & loan societies accounted for 0.7 percent, and 2.1 percent, respectively. Total loans were K15.0 billion. The ratio of non-performing loans to total loans was 3.5 percent, whilst the ratio of non-performing loans to total assets was 1.6 percent. The capital adequacy ratio for the banking sector was 35.2 percent, well above the minimum requirement of 12.0 percent. The return on assets and equity was 2.2 percent and 28.0 percent, respectively. These figures indicate a very sound financial system in Papua New Guinea.

Papua New Guinea Key Economic Indicators		Apr-15	May-15	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	
1. Consumer Price Index (CPI)(e)	Headline	-	-	5.7	-	-	5.8	-	-	-	
	Food	-	-	3.8	-	-	4.1	-	-	-	
	Underlying	-	-	5.0	-	-	4.0	-	-	-	
2. Retail Price Index (RPI) (YOY % Change)	Headline	3.9	2.7	5.9	1.6	7.8	7.8	6.9	7.3	na	
	Ex-seasonal	2.7	2.5	3.8	4.0	4.5	4.0	0.6	3.8	na	
3. Exchange Rates	USD	0.3715	0.3675	0.3645	0.3605	0.3565	0.3485	0.342	0.3375	0.3325	
	AUD	0.4659	0.4797	0.4745	0.4943	0.4985	0.4971	0.4814	0.4693	0.4552	
	GBP	0.2412	0.2397	0.2318	0.231	0.231	0.2299	0.2232	0.2246	0.2243	
	JPY	44.06	45.51	44.62	44.75	43.2	41.81	41.38	41.43	40.04	
	NZD	0.4891	0.5143	0.5427	0.5476	0.5551	0.5467	0.5071	0.5154	0.4855	
4. Balance of Payments	Current Account	PGK (millions of kina)	812.30	1138.40	1420.4	1065.8 r	79.6 p	1350.2 p	203.1 p	na	na
	Capital & Financial Account	PGK (millions of kina)	-899.3 r	-1282.1 r	-1413.9 r	-1201 r	-33.9 p	-1365.5 p	20.9 p	na	na
	Overall Balance	PGK (millions of kina)	-107.0	-110.3	38.7	-106.6 r	116.1 p	-14.6 p	227.3 p	na	na
	Foreign Exchange Reserve (eop, US\$ mill)		2,128.90	2,058.80	2,059.50	2,025.8	2,018.40	1,972.60	2,013.40	1,909.86	1,865.10
5. Liquidity (eop)	Liquid Assets Margin to Deposit Ratio (%)	46.0	44.5	44.0	43.6	43.8	43.3	43.6	44.4	43.7	
	Banks' Demand Deposits (K'bn)	14.77	14.67	15.12	15.10	14.83	14.8	15.0	15.1	15.5	
6. Money and Credit (YOY % Change)	Broad Money	7.9	2.5	8.4	4.3	4.5	5.7	1.6	5.8	na	
	Monetary Base	22.1	9.4	12.6	9.5	-2.6	8.6	4.5	-0.9	na	
	Private Sector Credit	7.2	5.1	7.4	-1.7	3.3	3.7	1.2	0.9	na	
	Interest Rates (% pa) (monthly)	Kina Facility Rate	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25
7. Interest Rates (% pa) (monthly)	Central Bank Bill (28 day)	1.72	1.63	1.46	1.32	1.26	1.26	1.28	1.34	1.32	
	Commercial bank Term Deposit (30 day)	0.56	1.13	0.99	0.86	1.06	0.81	0.82	1.02	0.86	
	Government Treasury Bill (364 day)	7.37	7.29	7.2	7.41	7.41	7.38	7.40	7.51	7.60	
	3-year Inscribed stock Rate	9.77	9.71	9.71	9.73	9.76	9.76	9.79	9.79	9.97	
	16-year Inscribed stock Rate (> 10 years)	-	-	-	-	-	-	-	-	-	
	8. Commodity Prices (monthly)	Oil (\$/bbl)	57.5	62.5	61.3	54.3	45.7	46.3	47.0	43.1	36.6
		LNG (\$/mmbtu) (c)	10.2	8.7	8.6	8.9	9.2	9.6 r	9.4 r	9.0	8.8
Gold (\$/troy oz)		1,198.2	1,199.2	1,182.3	1133.0	1117.5	1124.7	1,155.7	1,086.9	1,068.2	
Copper (\$/mt)		6,030.6	6,292.8	5,842.2	5480.5	5088.6	5232.1	5,210.7	4,818.3	4,634.8	
Nickel (\$/tonne)		12,781.8	13,483.3	12,884.8	11430.2	10338.8	9889.7	10,319.3	9,253.4	8,688.0	
Cobalt (\$/tonne)		28,444.2	30,156.6	30,453.0	31434.0	29271.3	27768.8	27,604.0	24,500.0	24,067.3	
Coffee (\$/tonne) (d)		3,615.4	3,523.4	3,519.0	3407.0	3523.4	3257.3	3,393.8	3,290.4	3,279.8	
Cocoa (\$/tonne) (d)		2,852.5	3,108.8	3,218.3	3343.4	3167.1	3266.8	3,202.4	3,360.0	3,331.2	
Palm Oil (\$/tonne)		687.6	696.5	707.5	662.8	584.5	549.5	613.8	586.5	588.7	

Notes:

- Balance of Payments data are provincial (p) for the current and the two recent months hence updated in the next reporting quarter of the year. Small (r) means data has been revised.
- Liquefied Natural Gas (LNG), nickel, cobalt and palm oil are also included as some of PNG's major commodities.
- The LNG price is an estimate for the current month and subject to change thus updated in the next reporting month as per the data source.
- The unit price of measurement for cocoa and coffee have changed from US cents per pound to US\$ per tonne, which is widely reported internationally and to be consistent with many other commodities unit price of measurement.
- CPI figures for food (March) and underlying (June) was corrected.
*end of period

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