BANK OF PAPUA NEW GUINEA

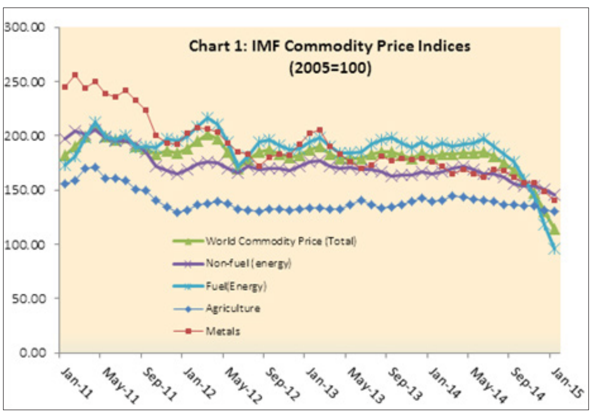
# MONTHLY ECONOMIC REVIEW

Vol. 2 No. 1 Month Ended January 2015

## Economic Activity

In its *World Economic Outlook* (WEO) for January 2015, the International Monetary Fund (IMF) maintained 3.3 percent, from its October WEO, as the global economic growth for 2014, and revised downwards its global economic growth forecast for 2015 by 0.3 percent to 3.5 percent. This is due to weaker growth prospects in the Euro area in light of lower investments, expected lower growth in China, weaker outlook in Russia and decline in demand from major oil exporting countries. Japan is expected to recover from the recession as monetary policy is eased and tax increase is delayed. On the other hand, growth in the United States gained momentum due to increased domestic demand, supported by lower oil prices and highly accommodative monetary policy.

The growth forecast for 2015 also accounts for a general decline in international commodity prices as reported by the IMF in its February *Commodity Market Monthly* update. The update reports that commodity prices fell by 12.0 percent in January, reflecting sharp decline in oil prices. Energy prices fell by 18.1 percent, attributed mainly to the plunge in the crude oil prices by 21.7 percent to around $ 47.5/barrel. Natural gas price for both US and Europe recorded declines of 13.4 percent and 9.1 percent to $3.0/mmbtu and $ 9.5/mmbtu, respectively due to high supply and lower demand. The non-energy price index fell by 3.2 percent, partly resulting from the strengthening of the US dollar. Agriculture prices dropped by 2.2 percent as a result of good supplies of most commodities, while metals decreased by 5.7 percent mainly influenced by low demand from China. The lower prices driven by increased supplies in most commodity markets led to a reduction in capital expenditure which is expected to result in lower production (See Chart 1).




The decline in international commodity prices, especially for oil, can lead to a decline in lower revenue for PNG's exports. On the other hand, reduction in fuel prices is benefiting business houses and motorists, and this could stimulate economic activity in non-mineral private sector.

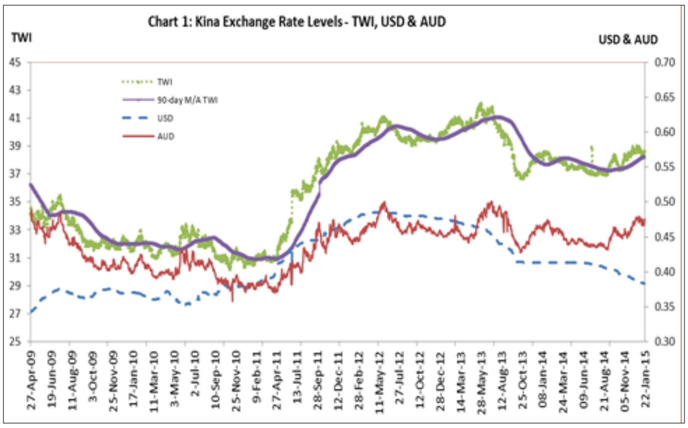
## Balance of Payments

Preliminary balance of payments data for the twelve months to December 2014 show a deficit of K861 million in the overall balance, compared to a deficit of K1,574 million in the corresponding period of 2013. The lower deficit is due to a surplus in the current account in contrast to a deficit in 2013. The overall deficit was to due to a deficit in the capital and financial accounts which more than offset the surplus in the current account. The surplus in the current account was the result of higher trade surplus, reflecting export receipts from the PNG LNG project combined with lower service and income payments. The deficit in the capital and financial account was mainly due to higher net outflows from other investments, reflecting build up in net foreign assets of domestic banking system and foreign currency account balances of mineral companies.

The level of gross foreign exchange reserves at the end of December 2014 and January 2015 were K5,997.7 (U$2,342.1) and K5,782.1 (US2,234.8) million, respectively. As of 13th February 2015, the level of gross foreign exchange reserves was US$2,228.4 (K5,795.6) million. The decline in international reserves was due to interventions by the central bank to provide foreign exchange liquidity to meet high import demand.

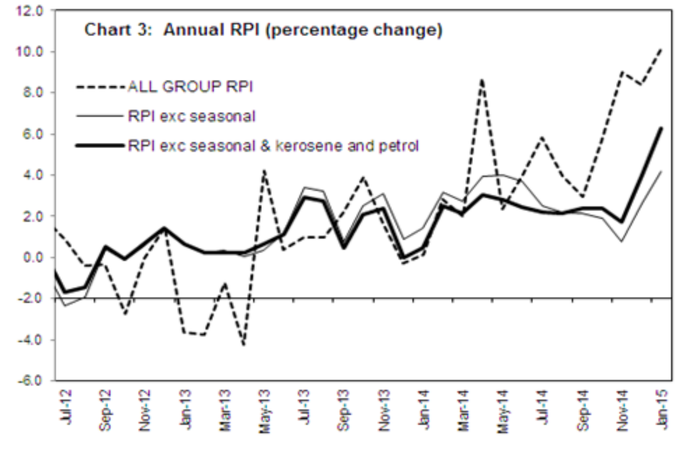
## Exchange Rate

The daily average kina exchange rate depreciated against the US dollar by 61 basis points to US$0.3824 over the month to 30th January 2015, mainly reflecting higher import demand and low export receipts. Over the same period, the average kina exchange rate appreciated against the Australian dollar by 42 basis points to AU$0.4750, due to cross-currency movements as the Australian dollar depreciated against the US dollar on the back of strong performance in the US economy and speculation about more economic stimulus in Europe. The average Trade Weighted Index (TWI) decreased by 0.2 percent to 38.61 over the month to 30th January 2015, reflecting the depreciation of kina against the US dollar and other major currencies, which more than offset the effect of the appreciation of the kina against the Australian dollar.




## Inflation

The annual headline Retail Price Index (RPI) increased by 10.2 percent over the twelve months to January 2015, compared to an increase of 8.4 percent in December 2014. There were price increases in the 'Drinks, Tobacco & Betelnut' expenditure group, driven mainly by a substantial rise in the price of 'betel nut' and 'Alcoholic drinks" sub-groups of 208.5 percent and 18.9 percent, respectively. Prices in 'Fruits and Vegetables' sub-group also increased by 12.0 percent. Over the twelve months to January 2015, the RPI ex-seasonal and RPI ex-seasonal & fuel increased by 4.2 percent and 6.3 percent, respectively. The monthly RPI for January increased by 3.2 percent, compared to a decline of 1.0 percent in December.




## Fiscal Operations

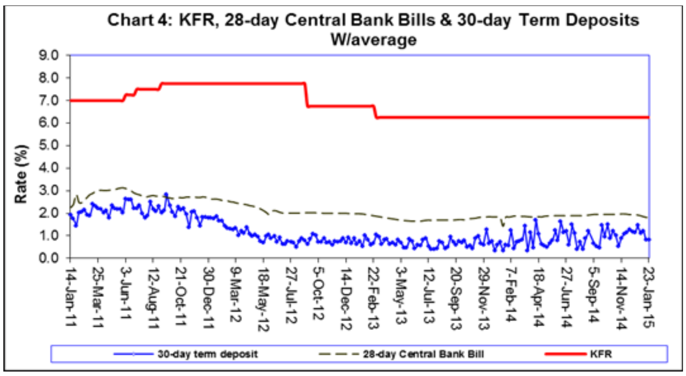
Preliminary estimates of the fiscal operations of the National Government over the eleven months to November 2014 show an overall deficit of K2,164.1 million, compared to a deficit of K1,190.2 million in the corresponding period of 2013. This represents 5.5 percent of nominal GDP and reflects higher expenditure which more than offset an increase in revenue. The budget deficit and net external loan repayment of K198.7 million were financed from domestic sources totalling K2,362.8 million.

Domestic financing comprised of a net drawdown of K1,222.0 million in Government deposits at the Central Bank, and net purchases of Government securities totalling K1,541.3 million and K63.9 million by Other Depository Corporations (ODCs) and Other Financial Corporations (OFCs), respectively. These more than offset K464.4 million in cheque floats not presented for encashment.

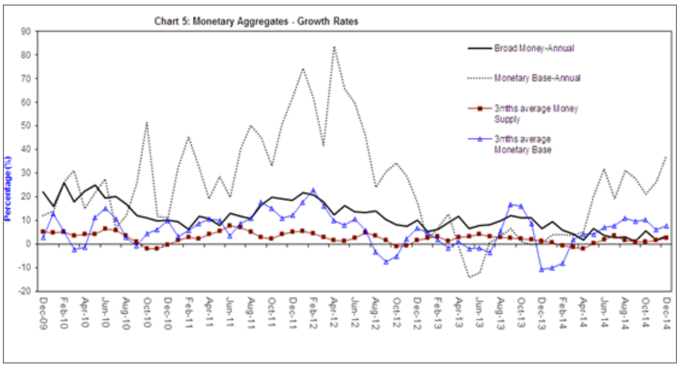
In January, average expenditure was K378.7 million, while average revenue was K227.8 million, yielding a deficit financing of K150.9 million.

## Domestic Interest Rates & Monetary Aggregates

Over the month of week-ending 24th January 2015, Central Bank Bill (CBB) and Treasury Bills interest rates declined, reflecting the persistent high level of liquidity in the banking system. 182-day term there was no auction allocation. The CBB rates for the 28-day, 63-day and 91-day terms decreased to 1.81 percent, 2.73 percent, and 2.86 percent, respectively, from 1.92 percent, 2.83 percent, and 2.98 percent. There was no auction allocation for the 182-day term. At the Treasury bill auction, the 182-day and 364-day rates decreased to 4.65 percent and 7.40 percent, respectively from 4.66 percent and 7.42 percent. Over the same period, weighted average interest rates on wholesale deposits above K500,000 also recorded declines for most terms. The 30-day, 60 day and 180-day rates declined to 0.82 percent, 0.95 percent and 1.79 percent, respectively from 1.46 percent, 1.48 percent and 1.82 percent, whilst the 90-day rate increased to 1.67 percent from 1.24 percent. The KFR was maintained at 6.25 percent in January 2015 (Chart 4). The Cash Reserve Requirement (CRR) was maintained at 10.0 percent. The Central Bank continued to use its weekly Open Market Operation (OMO) instruments for liquidity management. The Government's issuance of new Treasury bills and Inscribed stock partly aided the Bank's effort in diffusing excess liquidity from the banking system.




Broad money supply increased by 3.1 percent over the year to December 2014, compared to an increase of 6.7 percent in the corresponding period of 2013 (Chart 5). This was driven by increases in private sector credit and net claims on the Government, which outweighed a decline in net foreign assets. Monetary base grew significantly by 37.1 percent in December 2014, compared to an increase of 0.5 percent recorded in December 2013. This was due to increases in deposits of commercial banks at the Central Bank and currency in circulation. In the month of January, lending declined by K15.6million. Over the year to 30th January 2015, average lending by banks increased by 13.9 percent to K9,960.3 million. Commercial bank deposits increased by K72.7 million to K19,300.4 million in January 2015. Over the year to 30th January 2015, average deposits increased by 2.9 percent to K18,837.5 million.




## Financial System Stability

The total assets of the banking sector as at the end of December 2014 was K30.3 billion, of which 91.7 percent was for the commercial banks, 4.3 percent for licensed financial institutions, 0.7 percent for the micro banks and 3.2 percent for the savings & loan societies. Total deposits were K23.1 billion, of which commercial banks accounted for 93.6 percent while the licensed financial institutions, microfinance institutions and savings & loan societies accounted for 3.5 percent, 0.8 percent, and 2.1 percent, respectively. Total loans were K13.7 billion. The ratio of non-performing loans to total loans was 2.1 percent, whilst the ratio of non-performing loans to total assets was 1.0 percent. The capital adequacy ratio for the banking sector was 35.3 percent, well above the minimum requirement of 12.0 percent. The return on assets and equity was 2.1 percent and was 19.0 percent, respectively. These figures indicate a sound financial system.

## Monetary Policy

The annual headline RPI outcomes show an upward trend over the recent months to January 2015, while the underline RPI increased moderately. These are considered manageable. Taken together with the decline in the international price of oil, the Bank continued to take a cautious approach by maintaining the policy-signalling rate, the Kina Facility Rate (KFR), at 6.25 percent for the month of January 2015.

**Papua New Guinea Key Economic Indicators**

| | | Aug-14 | Sep-14 | Oct-14 | Nov-14 | Dec-14 | Jan-15 |
|---|---|---|---|---|---|---|---|
| 1. **Consumer Price Index (CPI)** | Healine | - | 5.3 | - | - | - | - |
| | Food | - | 5.1 | - | - | - | - |
| 2. Retail Price Index (RPI) (YOY % Change)(a) | Healine | 4.0 | 3.00 | 5.7 | 9.0 | 8.4 | 10.2 |
| | Ex-seasonal | 2.2 | 2.10 | 1.9 | 0.7 | 2.6 | 4.2 |
| 3. **Exchange Rates** (mid-rate, eop) | USD | 0.4055 | 0.4030 | 0.3965 | 0.3910 | 0.3855 | 0.3815 |
| | AUD | 0.4337 | 0.4605 | 0.4511 | 0.4600 | 0.4708 | 0.4898 |
| | GBP | 0.2445 | 0.2479 | 0.2483 | 0.2489 | 0.2477 | 0.2529 |
| | JPY | 42.10 | 44.06 | 43.99 | 46.23 | 46.17 | 44.96 |
| | NZD | 0.4843 | 0.5164 | 0.5066 | 0.4988 | 0.4921 | 0.5234 |
| 4. **Balance of Payments** | | | | | | | |
| Current Account | PGK (millions of kina) | -1,162.6 | -604.1 | -618.5 | -646.1 | 7,067.0 | - |
| Capital & Financial Account | PGK (millions of kina) | 688.5 | 114.5 | 297.2 | 180.7 | -7,983.0 | - |
| Overall Balance | PGK (millions of kina) | -459.1 | -435.0 | -233.0 | -441.3 | -861.0 | - |
| Foreign Exchange Reserve (eop, US$ mill) | | 2,614.2 | 2,489.3 | 2,577.8 | 2,422.6 | 2342.1 (r) | 2,234.8 |
| 5. **Liquidity** (eop) | Liquid Assets Margin to Deposit Ratio (%) | 45.6 | 45.5 | 44.0 | 46.3 | 46.1 | 45.8 |
| | Banks' Demand Deposits (K'bn) | 14.4 | 14.2 | 14.7 | 14.4 | 15.1 | 14.95 |
| 6. **Money and Credit** (YOY % Change) | Broad Money | 2.8 | 2.8 | 5.5 | 1.7 | 3.1 | - |
| | Monetary Base | 31.0 | 27.9 | 21.1 | 26.3 | 37.1 | - |
| | Private Sector Credit | 5.2 | 3.2 | 4.3 | 4.4 | 3.5 | - |
| 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 (28 day) | 1.94 | 1.95 | 1.95 | 1.96 | 1.92 | 1.79 |
| | Commercial bank Term Deposit (30 day) | 1.19 | 1.46 | 1.01 | 1.16 | 1.46 | 1.16 |
| | Government Treasury Bill (364 day) | 7.20 | 7.30 | 7.36 | 7.42 | 7.42 | 7.38 |
| | 3-year Inscribed stock Rate | 7.98 | 8.03 | 8.06 | 8.01 | 7.95 | - |
| | 16-year Inscribed stock Rate (> 10 years) | 15.45 | 15.40 | 15.3 | 14.49 | 13.74 | - |
| 8. **Commodity Price**s (monthly average) | Oil ($/bbl) | 100.1 | 95.9 | 86.1 | 77.0 | 60.7 | 47.1 |
| | Gold ($/troy oz) | 1,295.8 | 1,240.9 | 1,221.3 | 1,176.3 | 1,200.4 | 1,255.8 |
| | Copper ($/mt) | 6,998.5 | 6,885.5 | 6,735.9 | 6,700.7 | 6,430.8 | 5,790.5 |
| | Coffee (cents/kg) | 213.7 | 215.3 | 226.5 | 213.9 | 202.4 | 190.6 |
| | Cocoa (cents/kg) | 195.5 | 195.7 | 195.0 | 184.6 | 188.6 | 193.5 |

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