



BANK OF PAPUA NEW GUINEA

MONTHLY ECONOMIC REVIEW

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Economic Activity

There were signs of a weakening in global economic growth in the first two months of 2014 amid adverse weather conditions in the United States, a softening manufacturing sector in China and financial instability in some emerging countries. The global economy is expected to continue its recovery in 2014, though uncertainties over the robustness of this recovery remain. The International Monetary Fund projects a growth of 3.7 percent in 2014. Its latest estimates for 2013 show that the global economy grew by 3.0 percent, up from the 2.9 percent anticipated earlier in October 2013.

Reflecting the continued but moderate growth in the PNG economy, the Bank's Employment Index shows that private sector employment increased slightly in the December quarter 2013, following a slump in the September quarter. This was driven primarily by the building and construction sector. Employment increased in all regions except in the Highlands and Momase regions. Over the year to December 2013, the total level of employment in the private sector increased by 2.5 percent, whilst non-mineral sector employment growth remained stagnant.

Balance of Payments

Preliminary balance of payments data for 2013 show an overall deficit of K1,685 million, compared to a deficit of K850 million in the corresponding period of 2012. A higher deficit in the current account more than offset a surplus in capital and financial accounts. The deficit in the current account was due to a lower trade surplus and higher income and net service payments, which more than offset an increase in transfer receipts. The surplus in the capital and financial account was due to higher net inflows from foreign direct investment and other investments more than offsetting net outflows from portfolio investments. The level of gross foreign exchange reserves at the end of December 2013 was

US\$2,854.7 (K6,841.8) million, sufficient for 7.2 months of total and 10.6 months of non-mineral import covers. As at 28th February 2014, the level of gross foreign exchange reserves was US\$2,796.7 (K6,690.7) million.

Exchange Rate

Over the month to 28th February 2014, the kina remained steady against the US dollar at US\$0.4130. Against the Australian dollar, the kina depreciated by 135 basis points on average to AU\$0.4607, as the Australian dollar appreciated against the US dollar. The average TWI¹ declined by 0.9 percent to 38.04 over the month to 28th February 2014, mainly reflecting the kina's depreciation against the Australian dollar.

Inflation

The annual headline Consumer Price Index (CPI) for the December quarter of 2013 increased by 4.7 percent, compared to an increase of 3.5 percent in the September quarter. This was due to price increases in the 'Drinks, Tobacco and Betelnut', Transport and Communication, Clothing and Footwear' and 'Food' expenditure groups. The quarterly headline inflation increased by 1.9 percent. The underlying measures also recorded increases - the annual trimmed-mean measure increased by 1.8 percent and exclusion-based CPI by 5.9 percent.

Annual headline Retail Price Index (RPI)¹ to January 2014 increased by 0.1 percent, compared to a decrease of 0.3 percent in December 2013. RPI ex-seasonal increased by 1.4 percent and RPI ex-seasonal & kerosene increased by 0.5 percent.

Fiscal Operations

Further preliminary estimates of the fiscal operations of the National Government in 2013 show an overall deficit of K2,497.8 million, compared to a deficit of K1,377.9 million in 2012. This represents 4.2 percent of nominal GDP and reflected higher expenditure.

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.

Total revenue, including foreign grants was K9,374.6 million in 2013, 2.0 percent lower than in 2012. This represents 89.4 percent of the 2013 revised budgeted revenue. The decrease in revenue resulted from lower non-tax revenue and foreign grants. Total expenditure was K11,872.4 million in 2013, 8.5 percent higher than in 2012 and represents 89.8 percent of the revised budgeted appropriation for 2013. This resulted from higher expenditures in both the recurrent and development budgets. The National Government's cash flow for week-ending 28th February 2014 show a credit position of K154.6 million.

Domestic Interest Rates & Monetary Aggregates

Over the month ending 28th February 2014, all Central Bank Bill (CBB) rates increased. The 28-day rate increased from 1.83 percent to 1.88 percent, the 63-day rate from 2.11 percent to 2.22 percent and the 91-day rate from 2.18 percent to 2.32 percent. There was no auction in the 182-day term during the month. Treasury bill rates also increased. The 182-day rate increased from 2.77 percent to 2.95 percent and the 364-day rate from 4.44 percent to 4.80 percent. The wholesale deposit rates increased in most maturities, except the 60-day term.

Credit conditions continue to remain conducive for consumption and investment activity. Broad money supply (M3*) grew by 9.5 percent on an annual basis in January 2014, largely underpinned by an increase in net claims on the Central Government, drawdown of Government deposits and an increase in private sector credit. Over the year to 28th February 2014, average lending by commercial banks increased by 18.2 percent to K8,791.6 million. Total liquidity of the banking system, comprising cash, balance of exchange settlement accounts, Central Bank Bills, Treasury bills and Inscribed stock of less than 3 years to maturity, was K8.4 billion as at the end of February 2014, compared to K8.2 billion at the end of January.

Monetary Policy

Whilst much of the pass-through of the kina depreciation from 2012 and most of 2013 did not pass through to prices in 2013, the Bank is taking a cautious approach in monetary policy management and has maintained a neutral stance of monetary policy. The policy rate, the Kina Facility Rate (KFR), has been kept at 6.25 percent in February 2014.

Financial System Stability

As at the end of December 2014, total assets of the financial system stood at K38.1 billion, of which the amount for the banking sector is 76.5 percent, superannuation system 22.4 percent, and life insurance 1.1 percent. Total deposits were K22.3 billion. Commercial banks accounted for 93.8 percent while licensed financial institutions, microfinance institutions and Savings & Loans societies accounted for 3.5 percent, 0.6 percent, and 2.1 percent, respectively. Total loans were K11.7 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 0.9 percent.

The capital adequacy ratio for the banking sector was 28.7 percent, well above the minimum requirement of 12 percent. The return on assets was 3.0 percent and return on equity was 42.6 percent. These indicators show that the financial system in PNG is very sound.

Payments System (KATS)

Following the launch of the first stage of the Kina Automated Transfer System (KATS) and Banking Services System (BSS) in October 2013, a number of minor issues needed to be addressed by BPNG and the commercial banks. Initially some banks had issues adjusting to the new real time environment, particularly in managing their intra-day liquidity. On at least two occasions, BPNG had to use its overnight loan facility to enable the banks to settle and run their close of the day processes.

The next stage of KATS involves the implementation of cheque truncation. This means all commercial banks and BPNG will exchange cheques electronically through KATS using cheque images and associated data. All processing of cheques, including signature verification and dishonouring, will subsequently be electronic. The main benefits of this are a faster processing time (particularly those cheques presented in remote areas) and a reduced risk of fraud. Following the implementation of cheque truncation the banks will focus on the introduction of direct credits.

Papua New Guinea Key Economic Indicators		Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb 14
1. Consumer (YOY % Change)	Headline	3.5	-	-	4.7	-	-
	Food	0.7	-	-	1.0	-	-
2. Retail Price Index (YOY % Change)	Headline	2.2	3.9	1.7	-0.3	0.1	-
	Ex-seasonal	0.8	2.5	3.1	0.9	1.4	-
3. Exchange Rates (mid rate, eop)	USD	0.4160	0.4130	0.4130	0.4130	0.4130	0.4130
	AUD	0.4468	0.4352	0.4538	0.4622	0.4710	0.4610
	GBP	0.2574	0.2579	0.2525	0.2506	0.2507	0.2475
	JPY	40.70	40.60	42.23	43.38	42.36	42.02
	NZD	0.5029	0.5006	0.5091	0.5024	0.5074	0.4922
4. Foreign Exchange Reserve (eop US\$ mill)		3,037	3,064	2,944	2,855	2,811.3	2,796.7
5. Liquidity (eop)	Liquid Assets Margin to Deposit Ratio (%)	45.4	42.5	41.9	44.6	44.9	46.2
	Banks Demand Deposits (K'bn)	10.3	10.2	10.6	10.7	13.4	-
6. Money and Credit (YOY % change)	Broad Money	11.9	11.0	11.0	6.5	9.5	-
	Monetary Base	6.6	0.9	-0.4	-0.5	10.5	-
	Private Sector Credit	17.6	17.7	16.1	17.5	4.0	-
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)	1.72	1.77	1.85	1.84	1.83	1.88
	Commercial bank Term Deposit (30 day)	0.75	0.55	0.61	0.35	0.82	-
	Government Treasury bill (364 day)	3.13	3.18	3.60	3.72	4.44	4.80
	3-year Inscribed stock Rate	4.36	4.37	4.66	4.52	6.02	-
	16-year Inscribed stock Rate (>10 years)	-	0.11	0.11	-	10.1	-
8. Commodity Prices (monthly average)	Oil (\$/bbl)	108.8	105.4	102.6	105.5	102.1	104.8
	Gold (\$/troy oz)	1348.6	1309.5	1280.8	1223.7	1246.3	1301.0
	Copper (\$/mt)	7159.3	7181.6	7096.3	7193.6	7285.0	7151.6
	Coffee (cents/kg)	132.3	130.4	123.1	127.0	134.4	104.8
	Cocoa (cents/kg)	261.6	273.0	276.0	279.1	171.0	180.0

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