BANK OF PAPUA NEW GUINEA

MONTHLY ECONOMIC REVIEW

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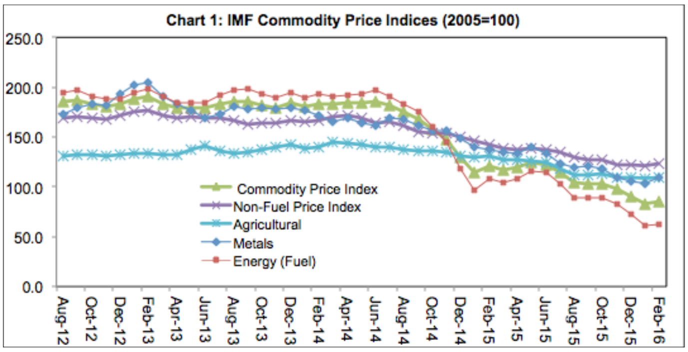
Economic Activity

Growth in global economic activity continued to be low. In the US, while domestic demand was strong there were weaknesses in the energy and export-exposed sectors which were influenced by sustained low energy prices, the strong US dollar and low global demand. Meanwhile, other major advanced economies show signs of slower growth. The Euro area continued its slow recovery supported by low oil prices, low euro exchange rate and accommodative monetary policy amidst deflationary pressures, whilst Japan struggles to return to a sustainable growth path given the strong yen, low exports and a decline in consumer confidence. Among emerging market economies, Brazil's recession worsened whilst activity in China's factory and service sectors dropped adding to the ripple effects of its structural reforms which continued to dampen activities especially in other emerging market and developing country economies. Most commodity export regions are affected by the prolonged depressed commodity prices.

Activity in the domestic economy was somewhat quiet, as is usually at the start of a year. Import demand is still high, suggesting sustained business activity. Export earnings on the other hand continued to be affected by the low international commodity prices.

Commodity Prices

Preliminary international commodity price data available from the International Monetary Fund (IMF) in early March 2016 show that commodity prices rebound by 2.3 percent in February 2016, the first increase in nine months. This reflected improvements in all the main indices with metals recording the highest increase of 5.0 percent, attributed to monetary stabilised global markets. The fuel price index increased by 2.74 percent mainly due to gains in crude oil prices. The non-fuel commodity price index, which includes food and beverages amongst others, increased by 1.41 percent, and the agriculture price index increased marginally by 0.09 percent. *(Chart 1)*



Source: IMF

Balance of Payments

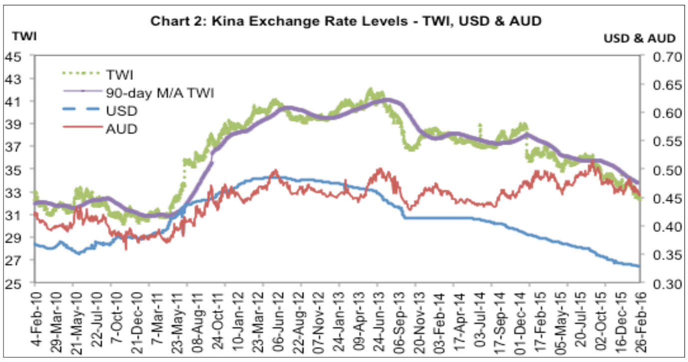
Preliminary balance of payments data for the twelve months to December 2015 show an overall deficit of K607 million, compared to a deficit of K861 million in 2014. A deficit in the capital and financial account more than offset a surplus in the current account. The surplus in the current account was mainly due to a higher trade surplus and transfers receipts. The deficit in the capital and financial account was a result of higher net outflows in other investments, reflecting a build-up in foreign currency account balances of mineral companies. These more than offset net inflows from foreign direct and portfolio investments attributed to equity inflows and drawdowns from investments in short term money market instruments, respectively. The level of gross foreign exchange reserves at the end of December 2015 was K5,226.3 (US$1,865.1) million, sufficient for 10.0 months of total and 15.8 months of non-mineral import covers. The level of gross foreign exchange reserves as at end of February 2016, was US$1,807.3 (K5, 427.3) million.

Exchange Rate

The average kina exchange rate depreciated against the US dollar (USD) by 29 basis points to US$0.3296 over the month to 26th February 2016 and by 61 basis points against the Australian dollar (AUD) to AU$0.4632. The kina weakened against the Australian dollar through cross currency movement as the AUD appreciated against the USD on the back of a rebound in the commodity prices of oil, iron ore and copper, combined with announcement of improvement in the private capital expenditure and employment data by the Australian Bureau of Statistics.

The average Trade Weighted Index (TWI) decreased by 2.6 percent to 32.95 over the month to 26th February 2016, reflecting the depreciation of kina against the USD *(Chart 2)*, AUD and other major currencies.

Chart 2: Kina Exchange Rate Levels - TWI, USD & AUD

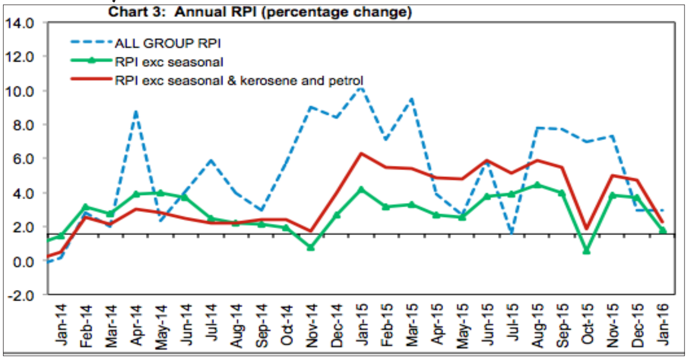


Inflation

The annual headline was 6.4 percent, as measured by the Consumer Price Index (CPI), in the December quarter of 2015, compared to 6.6 percent in the December quarter of 2014. Increases were recorded in the following expenditure groups: 'Housing' with 20.3 percent, 'Alcoholic beverages, tobacco, and betelnut' with 16.3 percent, 'Health' with 9.1 percent, 'Household Equipment' with 7.7 percent, 'Restaurants & hotels' with 7.6 percent, 'Food & Non-Alcoholic Beverages' with 6.3 percent and 'Clothing and footwear' with 6.1 percent. These more than offset declines of 2.9 percent in the 'Recreation', 6.5 percent in the 'Miscellaneous' and 5.0 percent in the 'Transport' expenditure groups. The 'Education' expenditure group recorded no change in the quarter. The annual trimmed mean and exclusion-based CPI measures increased by 2.3 percent and 1.4 percent, respectively.

Annual headline Retail Price Index (RPI) to January 2016 increased by 3.0 per cent, compared to 10.2 percent increase over the same period in 2015. The higher prices reflected price increases of 9.6 percent in Food and 13.0 per cent in Medical and health care (excluding Hospital fees). The increase in the 'Food' expenditure group was due to a 29.6 percent increase in the price of fruit and vegetables, 9.6 percent increase in cereal prices, and 1.8 percent increase in Meat and Fish prices. Annual RPI ex-seasonal and annual RPI ex-seasonal & fuel both increased by 1.8 percent and 2.3 percent respectively, over the twelve months to January 2016. This is in comparison to increases of 4.2 percent and 6.3 percent for both RPI measures over the twelve months to January 2015. *(Chart 3)*

Chart 3: Annual RPI (percentage change)



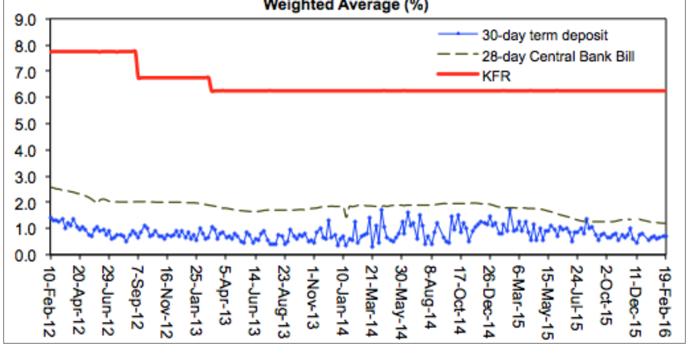
Fiscal Operations

Preliminary estimates of the fiscal operations of the National Government in 2015 show an overall deficit of K1,613.6 million, compared to a deficit of K2,815.2 million in 2014. This represents 3.2 percent of nominal Gross Domestic Product (GDP). Total revenue, excluding foreign grants, in December 2015 was K10,372.9 million, 0.1 percent lower than in the corresponding period of 2014. This represents 82.1 percent of the revised budgeted revenue for 2015. The decrease in revenue mainly reflected non-reporting of foreign grants which more than off-set higher direct, indirect and non-tax receipts. Total expenditure in 2015 was K11,986.5 million, 9.2 percent lower than in the corresponding period of 2014 and represents 79.2 percent of the revised budgeted appropriation for 2015. This outcome reflects lower recurrent and development expenditures.

Domestic Interest rates & Monetary Aggregates

Over the month to 26th February 2016, the Central Bank Bill (CBB) rate for the 28-day term declined to 1.20 percent from 1.22 percent and the 63day term rate was 2.32 percent. There were no allocations for the other terms to assist the Government raise much needed funds through Treasury bills (T-bills) issuance in those terms. Also because of revenue considerations, the Government, after almost a decade, issued its T-bills in the shorter terms under 28-day and 63-day. The rates for 28-day and 63-day are currently at 1.43 percent and 2.58 percent, respectively. Over the reviewed period, T-bill rates for the 90-day, 182-day and 364-day terms increased to 2.77 percent, 4.74 percent and 7.71 percent, respectively from 2.56 percent, 2.60 percent and 7.65 percent. At commercial banks, there were mixed movements in the weighted average interest rates on wholesale deposits above K500,000. The weighted average rates for the 30-day and 180-day rose to 0.92 percent and 3.35 percent from 0.59 percent and 1.26 percent, while the 60-day and 90-day rates fell to 0.42 percent and 1.17 percent from 0.74 percent and 1.26 percent. *(Chart 4)* There were 11 interbank deals done during the month to 26th Febraury 2016 totalling K281.0 million. During the same period, the Repurchase Agreement (Repo) facility was utilised 11 times totalling K530 million.

Chart 4: KFR, 28-day Central Bank Bills & 30-day Term Deposits Weighted Average (%)



Broad money supply increased by 1.4 percent over the year to January 2016, compared to an increase of 6.5 percent in the corresponding period of 2015. This was driven by increases in net claims on the Government, which offset a declines in credit to the public nonfinancial corporations and private sector,and in net foreign assets. The monetary base declined by 4.5 percent over the year to January 2016, compared to an increase of 32.8 percent in the corresponding period of 2015. This was due to decreases in deposits of commercial banks at the Central Bank and *currency in circulation.*

Commercial bank lending extended to public non-financial corporations, other financial corporations and other resident sectors rose by K181.6 million to K11,907.3 million between December 2015 and week-ending 19th February 2016. This mainly reflected advances to the manufacturing, finance, retail, transport and agriculture sectors. Over the year to 19th February 2016, weekly average lending by banks increased by 11.5 percent to K11,123.4 million. Commercial bank deposits decreased by K120.5 million to K20,157.2 million between December 2015 and week-ending 19th February 2016, reflecting withdrawals by the petroleum, mining, finance, Government, maunfacturing, retail, construction and transport sectors. Over the year to 19th February 2016, weekly average deposits increased by 4.2 percent to K19,683.2 million.

Monetary Policy

The annual headline inflation outcome of 6.4 in 2015 is close to the Bank's projection of 6.0 percent for the year and is considered to be manageable. Considering this and other indicators, the Bank cautiously continued to maintain the policy signalling rate, Kina Facility Rate (KFR), at 6.25 percent for February 2016.

Papua New Guinea Key Economic Indicators

		Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16
1. **Consumer Price Index (CPI)**	Headline	-	-	6.1	-	-	5.7	-	-	5.8	-	-	6.4	-	-
	Food	-	-	5.3	-	-	3.8	-	-	4.1	-	-	6.5	-	-
	Underlying	-	-	5.8	-	-	5.0	-	-	4.0	-	-	3.4	-	-
2. Retail Price Index (RPI) (YOY % Change)	Healine	10.2	7.1	9.5	3.9	2.7	5.9	1.6	7.8	7.8	6.9	7.3	3.0	3.0	n.a
	Ex-seasonal	4.2	3.2	3.3	2.7	2.5	3.8	4.0	4.5	4.0	0.6	3.8	3.7	1.8	n.a
3. **Exchange Rates** (mid-rate, eop*)	USD	0.3815	0.3785	0.3735	0.3715	0.3675	0.3645	0.3605	0.3565	0.3485	0.342	0.3375	0.3325	0.3295	0.328
	AUD	0.4898	0.4849	0.4892	0.4659	0.4797	0.4745	0.4943	0.4985	0.4971	0.4814	0.4693	0.4552	0.4624	0.4598
	GBP	0.2529	0.2451	0.2527	0.2412	0.2397	0.2318	0.231	0.231	0.2299	0.2232	0.2246	0.2243	0.2289	0.2364
	JPY	44.96	45.11	44.82	44.06	45.51	44.62	44.75	43.2	41.81	41.38	41.43	40.04	39.78	37.01
	NZD	0.5234	0.5013	0.4990	0.4891	0.5143	0.5427	0.5476	0.5551	0.5467	0.5071	0.5154	0.4855	0.5048	0.4981
4. **Balance of Payments** (a)															
Current Account	PGK (millions of kina)	1370 r	816 r	1075.4 r	836.3 r	1157.2 r	1435.5 r	626.4 r	939.2 r	913.8 r	1,319.1 p	1,503.8 p	1399.4 p	na	na
Capital & Financial Account	PGK (millions of kina)	-1691.7 r	-935.3 r	-711.9 r	-933.3 r	-1273.3 r	-1396.5 r	-701.7 r	-780.9 r	-930.2 r	-1,115.5 p	-1,718.1 p	-1764.4 p	na	na
Overall Balance	PGK (millions of kina)	-319.2	-114.8 r	370.6	-107.0	-110.3	38.7	-106.2 r	115.7 r	-14.7 r	227.3 p	-213.7 p	-373.5 p	na	na
Foreign Exchange Reserve (eop, US$ mill)		2,234.8	2,070.2	2,168.43	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	1,847.60	1,807.30
5. **Liquidity** (eop)	Liquid Assets Margin to Deposit Ratio (%)	45.8	46.3	46.9	46.0	44.5.	44.0	43.6	43.8	43.3	43.6	44.4	43.7	44.32	44.4
	Banks' Demand Deposits (K'bn)	14.95	14.82	14.5	14.77	14.67	15.12	15.10	14.83	14.8	15.0	15.1	15.5	15.1	14.98
6. **Money and Credit** (YOY % Change)	Broad Money	6.5	8.3	6.2	7.9	2.5	8.4	4.3	4.5	5.7	1.6	5.8	7.7	1.4	na
	Monetary Base	32.8	22.4	19.7	22.1	9.4	12.6	9.5	-2.6	8.6	4.5	-0.9	4.9	-4.5	na
	Private Sector Credit	8.9	9.4	5.7	7.2	5.1	7.4	-1.7	3.3	3.7	1.2	0.9	-2.2	-2.2	na
7. **Interest Rates** (% pa) (monthly weighted average)	Kina Facility Rate	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25
	Central Bank Bill (28 day)	1.79	1.78	1.76	1.72	1.63	1.46	1.32	1.26	1.26	1.28	1.34	1.32	1.22	1.2
	Commercial bank Term Deposit (30 day)	1.16	0.97	0.86	0.56	1.13	0.99	0.86	1.06	0.81	0.82	1.02	0.86	0.59	0.69
	Government Treasury Bill (364 day)	7.38	7.35	7.37	7.37	7.29	7.2	7.41	7.41	7.38	7.40	7.51	7.60	7.65	7.72
	3-year Inscribed stock Rate	-	9.78	9.76	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 average)(b)	Oil ($/bbl)	47.1	54.8	52.8	57.5	62.5	61.3	54.3	45.7	46.3	47.0	43.1	36.6	29.8	31.0
	LNG ($/mmbtu) (c)	14.3	13.4	14.3	10.2	8.7	8.6	8.9	9.2	9.6	9.4	8.9	8.5 r	8.3 r	8.3
	Gold ($/troy oz)	1,255.8	1,227.2	1,177.9	1,198.2	1,199.2	1,182.3	1133.0	1117.5	1124.7	1,155.7	1,086.9	1,068.2	1,097.4	1,198.2
	Copper ($/mt)	5,790.5	5,701.5	5,910.0	6,030.6	6,292.8	5,842.2	5480.5	5088.6	5232.1	5,210.7	4,818.3	4,634.8	4,462.3	4,589.5
	Nickel ($/tonne)	14,761.4	14,531.3	13,841.4	12,781.8	13,483.3	12,884.8	11430.2	10338.8	9889.7	10,319.3	9,253.4	8,688.0	8,479.9	8,300.9
	Cobalt ($/tonne)	30,709.5	29,038.8	27,623.8	28,444.2	30,156.6	30,453.0	31434.0	29271.3	27768.8	27,604.0	24,500.0	24,067.3	23,208.5	22,312.6
	Coffee ($/tonne) (d)	4,202.7	3,983.5	3,611.6	3,615.4	3,523.4	3,519.0	3407.0	3523.4	3257.3	3,393.8	3,290.4	3,279.8	3,227.1	3,303.0
	Cocoa ($/tonne) (d)	2,933.7	2,920.9	2,887.1	2,852.5	3,108.8	3,218.3	3343.4	3167.1	3266.8	3,202.4	3,360.0	3,331.2	2,977.7	2,892.5
	Palm Oil ($/tonne)	713.3	698.8	687.5	687.6	696.5	707.5	662.8	584.5	549.5	613.8	586.5	588.7	580.0	654.5

Notes:

a) Balance of Payments data are provisional (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.
b) Liquefied Natural Gas (LNG), nickel, cobalt and palm oil are also included as some of PNG's major commodities.
c) 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.
d) 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.
*end of period

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