



# BANK OF PAPUA NEW GUINEA

## MONTHLY ECONOMIC REVIEW

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### Economic Activity

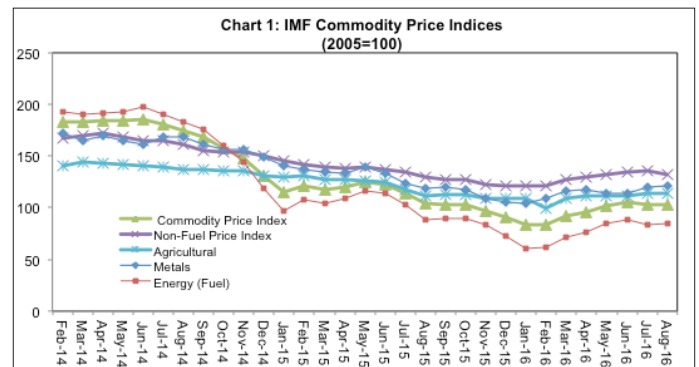
The slow pace of growth in global economic activity continued in the second quarter of 2016. US economic growth was 1.2 percent in the quarter, with weaker investment and a surge in consumer spending. In the UK, growth surprisingly peaked at 2.2 percent in the second quarter, regardless of the Brexit vote, attributed to strong investment and consumer spending. The Euro Area recorded 1.6 percent growth in the second quarter, mainly driven by exports, while growth in Japan nearly stalled despite government spending and an easing monetary policy stance. Amongst the developing and emerging market economies, China's economy grew by 6.7 percent in the second quarter with buoyant property market and government stimulus. Structural rebalancing of the Chinese economy was slow with consumption spending surpassing investment growth. Brazil and Russia economic growth plunged further with negative growths of -3.8 and -0.6, respectively, while India's growth slowed at 7.1 percent in the second quarter of 2016.

In the domestic economy, growth in economic activity continued at a slow pace, if we take the employment numbers as a guide, although a quarter late. The Bank's Employment Index shows that the total level of employment in the private sector increased by 1.7 percent in the June quarter 2016, compared to 1.4 percent in the March quarter 2016. Excluding the mineral sector, the level of employment increased by 2.3 percent, with increases in the agriculture/forestry/fisheries and transportation sectors more than offsetting declines in the other sectors. By region, employment increased in the Highlands and Southern regions while the Islands, Momase, NCD and Morobe regions recorded declines. Over the year to June 2016, the total level of employment declined by 4.4 percent, and excluding the mineral sector, it fell by 4.6 percent.

### Commodity Prices

The International Monetary Fund's (IMF's) preliminary commodity price data available as at 7<sup>th</sup> September 2016 shows that the overall Commodity Price Index declined by 0.10 percent in August compared to the fall of 2.48 percent in July. Metals and energy price indices increased by 1.4 percent and 1.64 percent, less than July's increases, while agriculture and the non-fuel price indices declined by 0.26

percent and 1.95 percent, respectively (Chart 1). Crude oil price improved with an increase of 2.38 percent after a fall of 7.03 percent in the previous month, while LNG price improved by 1.38 percent. Copper prices fell by 2.33 percent from the previous month. Low international commodity prices for PNG's major exports continue to adversely affect exports earnings and revenue for the Government budget.



Source: IMF

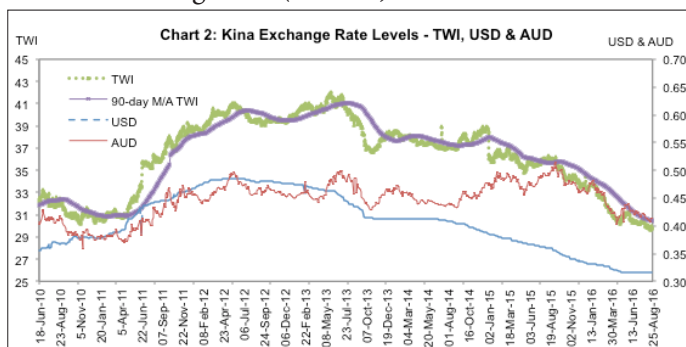
### Balance of Payments

Preliminary balance of payments data for the six months to June 2016 show an overall deficit of K73.3 million, compared to a deficit of K388.4 million in the corresponding period of 2015. A deficit in the capital and financial account more than offset a surplus in the current account. The lower deficit was due to a higher surplus in the current account, compared to the corresponding six months in 2015. The higher surplus in the current account was due to a higher trade surplus, combined with net transfer receipts. The deficit in the capital and financial account stemmed from net outflows in portfolio and other investments, reflecting investments in short term money market instruments and build-up in net foreign assets of commercial banks, and foreign currency account balances of resident mineral companies, respectively. The level of gross foreign exchange reserves at the end of June 2016 was US\$1,628.4 (K5,153.2) million, sufficient for 10.6 months of total and 17.0 months of non-mineral import covers. As at 31<sup>st</sup> August 2016, the level of gross foreign exchange reserves was US\$1,620.8 (K5,057.1) million.

### Exchange Rate

The average kina exchange rate depreciated against the US dollar (USD) by 5 basis points to US\$0.3155 and against the Australian dollar (AUD) by 75 basis points to AU\$0.4139

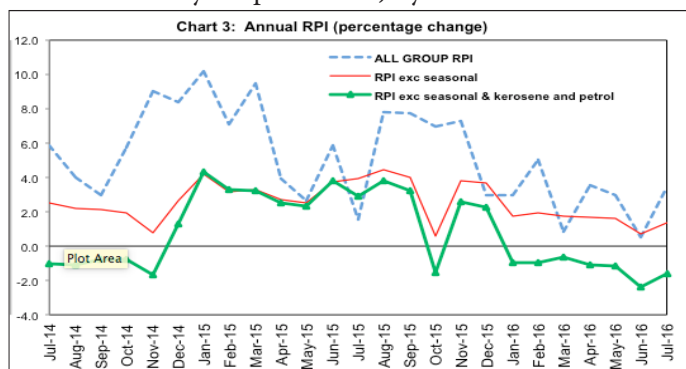
over the month to 25<sup>th</sup> August 2016. The kina stabilised against the USD in August at that rate as there were some good inflows from the mining and agriculture sectors, and the first tranche of the external loan from Credit Suisse was received. The kina weakened against the Australian dollar as the AUD strengthened against USD, following an huge increase in volumes of mining exports, especially iron ores, from Australia. The average Trade Weighted Index (TWI) decreased by 1.47 percent to 29.9 over the month to 25<sup>th</sup> August 2016, reflecting the depreciation of kina against the AUD. Persistent imbalance in the foreign exchange market continues to exert downward pressure on the kina exchange rate. (Chart 2)



### Inflation

Annual headline Consumer Price Index (CPI) increased by 6.8 percent in the June quarter 2016, compared to 6.5 percent in the March quarter. All expenditure groups recorded increases, with notable increases in the ‘Drinks, tobacco, and betelnut’ (24.2 %), ‘Health, (8.2 %), ‘Food’ (6.4%) and ‘Household Equipment’ (5.9%) expenditure groups. All centres recorded increases in prices. Annual CPI Exclusion-based and Trimmed-mean measures both increased by 2.6 percent and 1.7 percent, respectively.

Annual headline Retail Price Index (RPI) to July 2016 increased by 3.4 percent, compared to an increase of 0.5 percent in June 2016. There were price increases in the ‘Drinks, tobacco, and betelnut’ and ‘food’ expenditure groups. The increase in the ‘Drinks, tobacco, and betelnut’ expenditure group was mainly driven by rise in betelnut prices. The ‘food’ expenditure group’s increase was due to increases in the prices of cereal, fruit and vegetable, meat and fish and miscellaneous items. Annual RPI ex-seasonal and annual RPI ex-seasonal & fuel both increased by 1.3 percent and 1.8 percent, respectively. (Chart 3) Quarterly headline RPI decreased by 2.4 percent, while the monthly RPI increased by 2.1 percent in July 2016.



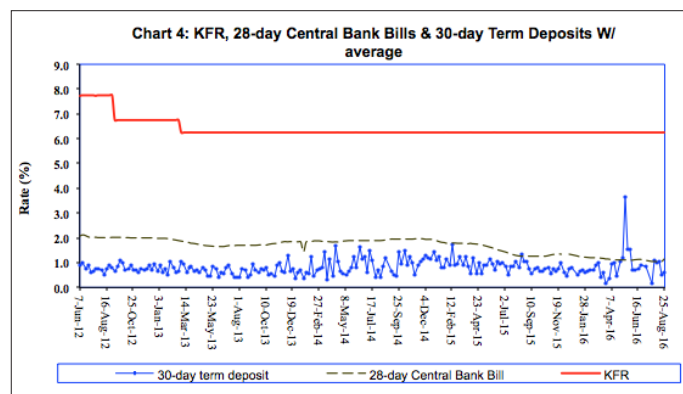
### Fiscal Operations

Preliminary estimates of the fiscal operations of the National Government over the six months to June 2016 show an overall deficit of K624.8 million, compared to a deficit of K942.0 million in the corresponding period of 2015. This represents 0.9 percent of nominal Gross Domestic Product (GDP). Total revenue, including foreign grants, in the period was K4,160.2 million, 6.2 percent lower than in the corresponding period of 2015 and this represents 32.9 percent of the budgeted amount for 2016. Total expenditure was K4,785.0 million, 11.0 percent lower than in the corresponding first six months of 2015 and represents 32.4 percent of the budgeted appropriation for 2016. The budget deficit of K624.8 million was financed from both external sources of K336.6 million and domestic sources of K288.2 million.

The Parliament passed a Supplementary Budget on the 25<sup>th</sup> of August 2016, entailing adjustments that include both expenditure savings of K928.0 million and additional revenue-raising of K958.0 million. The revised 2016 expenditure now amounts to K13,834.6 million, while revenue amounts to K11,722.1 million. This maintains the 2016 Budget deficit at original level of K2,112.5 million, or 3.8 percent of GDP and a Debt to GDP ratio of 28.9 percent.

### Domestic Interest rates & Monetary Aggregates

Over the month to 25<sup>th</sup> August 2016, the Central Bank Bill (CBB) rate for 28 day increased to 1.12 percent from 1.05 percent, while there were no allocations in the auctions for the other terms. At the Treasury bill auction, interest rates for the 91 day, 182 day and 364 day terms remained unchanged at 2.63 percent, 4.72 percent and 7.69 percent, respectively (Chart 4). For the same period, movements in the weighted average interest rates on wholesale deposits above K500,000 were mixed. The weighted average rates for the 30 day and 90 day declined to 0.61 percent and 1.21 percent from 1.08 percent and 2.00 percent, respectively, while the 60 day and 180 day rates increased to 0.48 percent and 1.81 percent from 0.36 percent and 0.40 percent, respectively.



Broad money supply increased by 11.0 percent over the year to June 2016, compared to an increase of 6.7 percent in the corresponding period of 2015. This was driven by increases in credit to the public nonfinancial corporations

(State Owned Enterprises), private sector and net claims on the Government, which outweighed a decline in net foreign assets of the Central Bank. Monetary base increased by 6.2 percent over the year to July 2016, compared to an increase of 9.5 percent in the corresponding period of 2015. This was due to increases in currency in circulation and commercial banks deposit at the Central Bank.

Commercial bank lending extended to public non-financial corporations, other financial corporations and other resident sectors increased by K792.3 million to K12,523.0 million between December 2015 25th August 2016. This mainly reflected advances to the Government, construction, finance, transport, retail, manufacturing and agriculture sectors. Over the year to 25<sup>th</sup> August 2016, the weekly average lending by banks increased by 10.6 percent

to K11,734.7 million. The commercial bank deposits increased by K177.5 million to K20,455.2 million between December 2015 and week-ending 25th August 2016, reflecting placements mainly by the finance, Government and Agriculture sectors. Over the year to 25<sup>th</sup> August 2016, the weekly average deposits increased by 3.6 percent to K20,034.0 million.

### **Monetary Policy**

While headline CPI inflation was 6.8 percent in the June quarter, the underlying measures increased marginally and remained low in the quarter. The Bank is mindful of the upward trend in headline inflation and is taking a cautious approach by maintaining the policy signalling rate, Kina Facility Rate (KFR), at 6.25 percent for the month of August 2016.

Papua New Guinea Key Economic Indicators		Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16
1. Consumer Price Index (CPI)	Headline	-	-	6.5	-	-	6.8	-	-
	Food	-	-	5.9	-	-	6.4	-	-
	Underlying	-	-	3.1	-	-	2.9	-	-
2. Retail Price Index (RPI) (YOY % Change)	Headline	3.0	5.0	0.8	3.4	3.0	0.5	3.4	0.8
	Ex-seasonal	1.8	2.0	1.6	1.5	1.6	0.7	1.3	0.9
3. Exchange Rates (mid-rate, eop*)	USD	0.3295	0.3280	0.3225	0.3175	0.3160	0.3160	0.3155	0.3155
	AUD	0.4624	0.4598	0.4224	0.4150	0.4363	0.4259	0.4198	0.4199
	GBP	0.2289	0.2364	0.2251	0.2169	0.2154	0.2363	0.2395	0.2410
	JPY	39.78	37.01	36.2400	34.1000	35.1500	32.4200	32.6800	32.5400
	NZD	0.5048	0.4981	0.4686	0.4554	0.4698	0.4467	0.4454	0.4357
4. Balance of Payments									
Current Account	PGK (millions of kina)	1219.0	1040.4	1039.5	1811.8 p	1240.4 p	1559.3 p	na	na
	Capital & Financial Account	PGK (millions of kina)	-783.6	-799.2	-1362.0	-1851.8 p	-1668.1 p	1544.1 p	na
Overall Balance	PGK (millions of kina)	435.0	246.4	-315.4	-35.6 p	-418.4 p	14.6 p	na	na
	Foreign Exchange Reserve (eop, US\$ mill)	1,847.60	1,807.30	1,806.90	1,773.50	1,622.40	1,626.60	1,620.80	1,743.60
5. Liquidity (eop)	Liquid Assets Margin to Deposit Ratio (%)	44.32	44.4	45.14	45.02	45.99	45.74	44.0	45.6
	Banks' Demand Deposits (K'bn)	15.1	14.98	14.52	14.86	14.4	14.4	14.6	14.8
6. Money and Credit (YOY % Change)	Broad Money	1.4	4.8	5.6	6.0	3.9	7.9	11.0	na
	Monetary Base	-4.5	0.6	7.2	7.8	8.3	2.5	6.2	na
	Private Sector Credit	-2.2	0.8	-0.2	2.1	1.8	3.2	8.7	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
	Central Bank Bill (28 day)	1.22	1.2	1.16	1.11	1.11	1.13	1.05	1.12
	Commercial bank Term Deposit (30 day)	0.59	0.69	0.6	0.45	1.53	0.96	1.08	0.61
	Government Treasury Bill (364 day)	7.65	7.72	7.71	7.7	7.67	7.67	7.69	7.69
	3-year Inscribed stock Rate	-	-	-	9	9	9	-	9
	16-year Inscribed stock Rate (> 10 years)	-	-	-	-	-	-	-	-
8. Commodity Prices (monthly average)(a)(b)(c)(d)	Oil (\$/bbl)	29.8	31.0	37.3	40.8	45.9	47.7	44.1	44.9
	LNG (\$/mmbtu) (c)	7.9	8.0	7.2	6.4	5.9	6.0	6.3	6.3
	Gold (\$/troy oz)	1,097.4	1,198.2	1,245.0	1,243.7	1,263.1	1,273.8	1,337.2	1,343.8
	Copper (\$/mt)	4,462.3	4,589.5	4,942.3	4,849.1	4,716.5	4,635.7	4,859.0	4,773.1
	Nickel (\$/tonne)	8,479.9	8,300.9	8,678.2	8,873.4	8,727.7	8,881.8	10,284.8	10,413.6
	Cobalt (\$/tonne)	23,208.5	22,312.6	23,094.4	22,961.8	23,443.1	23,788.6	25,139.0	26,297.8
	Coffee (\$/tonne) (d)	3,227.1	3,303.0	3,443.2	3,426.9	3,443.4	3,606.5	3,781.4	3,764.4
	Cocoa (\$/tonne) (d)	2,977.7	2,892.5	3,052.4	3,086.1	3,115.2	3,130.8	3,168.9	3,168.9
	Palm Oil (\$/tonne)	580.0	654.5	714.0	750.8	746.3	736.0	721.7	780.8

**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.
- \*end of period

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