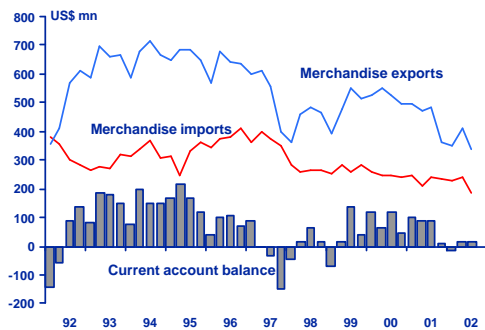


# Papua New Guinea Chartbook

## 1. Current account surplus has withered



Sources: Bank of Papua New Guinea, ANZ calculations

The current account surplus has shrunk significantly since 2001. The main reason is a trend decline in the volume of mineral exports, especially crude oil. For 2002, based on 11 months data, the central bank (BPNG) estimates there was a small deficit, but it is forecasting a surplus of K172mn (1.4% of GDP) in 2003. The improvement is expected to be driven by higher commodity prices, improved volumes of agricultural exports, and expanded production from the Moran oil field, currently in ramp-up.

This year's current surplus is, however, expected to be more than offset by capital outflows. BPNG expects a capital account deficit of K494 mn, which will result in a decline in reserves (see Chart 2).

## 2. Reserves at high levels – but will fall this year



Source: IMF: International Financial Statistics

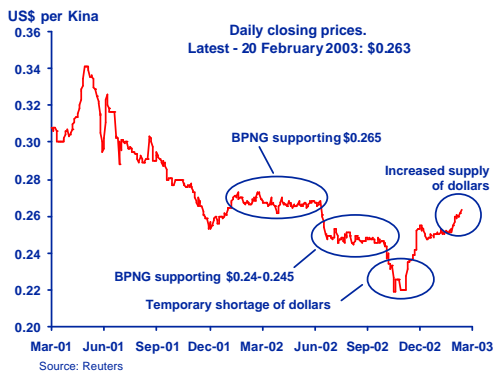
Reserves were boosted in 2000 and 2001 by loans from multilateral lenders and foreign governments, as well as by strong current account surpluses.

Now some of those loans are due for repayment. According to the budget papers, maturities in 2003 (converted to US\$) will be:

Concessional: US\$69 mn  
Commercial: US\$13 mn  
Extraordinary: US\$52 mn

Reserves stood at US\$340 mn at the end of December 2002. According to its January Monetary Policy Statement, BPNG expects reserves to average US\$260 mn in 2003.

## 3. Kina looking stronger



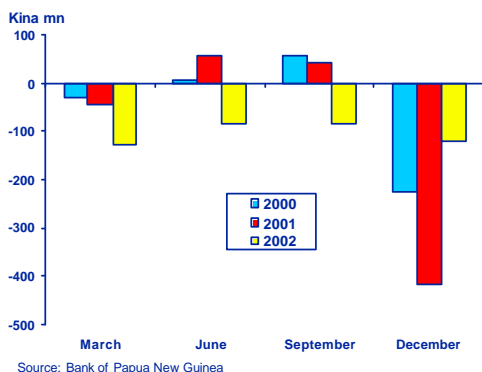
Source: Reuters

Looking back on 2002, the kina was much less volatile than in previous years, in the sense that there were some extended periods of stability, with BPNG intervening to smooth the currency.

Between those periods, though, there were some sharp moves, the most dramatic of which came between mid-October and early December, when the currency fell to 22 cents (with some intra-day trade at even lower levels) and then rebounded to 25 cents. One reason given was the hiatus in the flow of export dollars due to earlier production losses at Porgera and Ok Tedi. To the surprise of some market participants, BPNG did not support the currency in this period, possibly because it was not clear that the shortage of dollars was merely temporary.

In mid-February, the kina broke above its trading range thanks to better supply of dollars, with market participants backing the trend and some apparent nudging by BPNG.

#### 4. Quarterly budget deficits reveal fiscal blow-out in 2001-02



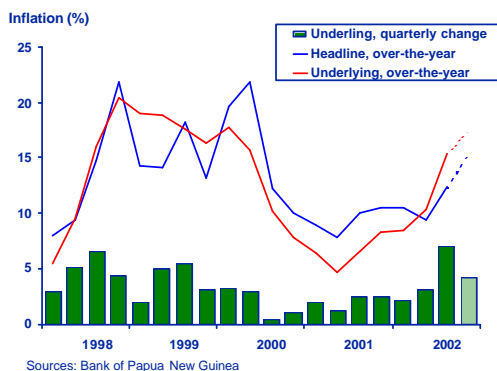
This chart shows quarterly budget balances in the last three years.

Some observations:

1. The deficit tends to be largest in the fourth quarter
2. The fiscal blow-out ran from the fourth quarter of 2002 to the third quarter of 2002.
3. The estimate for the fourth quarter of 2002 shows a significant improvement

The original budget for 2002 aimed at a deficit of 2% of GDP. Following the blow-out and a supplementary budget which aimed to tighten by K453 mn, the deficit is now estimated at K411.6 mn or 3.8% of GDP. For the current year, the government has a deficit target of K244 mn or 2% of GDP.

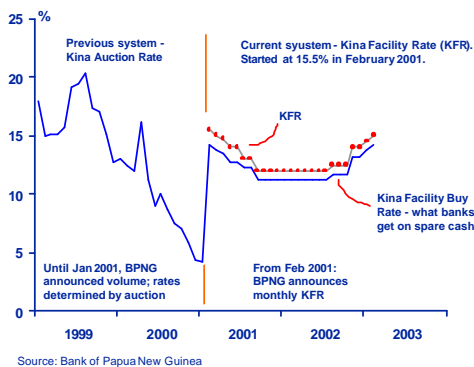
#### 5. Large increases in inflation in the second half of 2002



Both the "headline" and the "underlying" rates of inflation have rebounded after reaching low points in the June quarter of 2001. The underlying inflation rate excludes volatile items and the effects of government policy changes. As such it gives a better indication of trends in inflation than the headline rate which includes all items.

On a quarterly basis, the movement in the underlying CPI is alarming. It rose 7% in the September quarter, and the increase in the December quarter is estimated at 4%. Despite the weakness in the economy, pent-up cost pressures are working through to final prices.

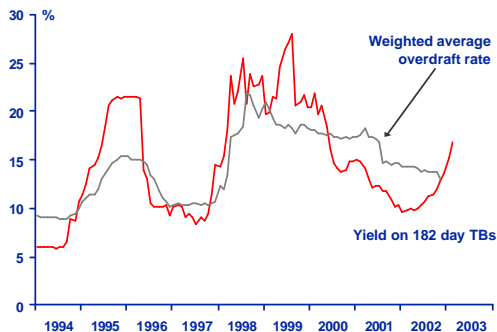
#### 6. BPNG guides lending rates



BPNG influences the level of interest rates by announcing a monthly Kina Facility Rate (KFR). Banks have tended to respond to changes in the KFR by moving their lending and deposit rates.

BPNG's primary objective is low and stable inflation, and, recognising the link between lending rates and demand in the economy, it adjusts the KFR depending on its views on future inflation. In recent months the KFR has been raised four times, from 12% last July to 15% in February, reflecting a sharp rise in inflation. But there are other forces at work, such as competition between banks, which has delayed the pass-through of these increases - see next chart.

### 7. Treasury Bill rates rise sharply; lending rates to follow gradually

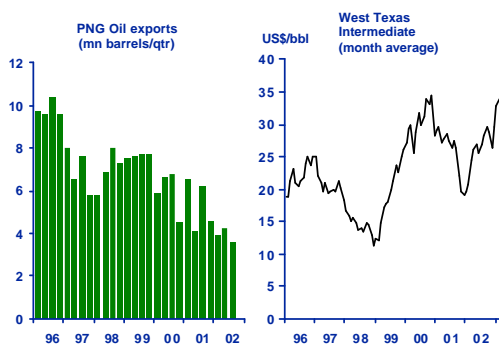


Sources: International Financial Statistics, Bank of Papua New Guinea

The benchmark 182-day Treasury Bill yield has been on a rising trend since February 2002. This reflects the widening budget deficit in the first half of last year and investor reluctance to lend to the government. Also, BPNG has encouraged the rise by increasing its Kina Facility Rate (see previous chart).

In contrast, lending rates declined throughout 2002 reflecting weak private demand for credit and competition between the banks. However, although not yet reflected in available data, the decline in lending rates has ended. Tight liquidity and the hikes in official rates forced some banks to raise their benchmark Indicator Lending Rates in December.

### 9. Oil production on a declining trend, but prices are strong



Source: Bank of Papua New Guinea

Source: Datastream

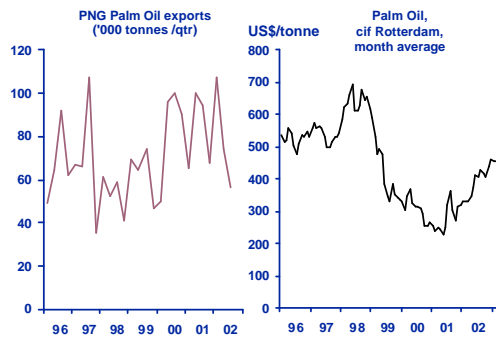
The volume of oil exports has been volatile in recent quarters, but the trend is downwards.

There are a number of potential new oil wells in the Highlands, but appraisal is expensive and risky. Drilling has recently been concentrated on development of the existing Moran and SE-Gobe fields.

In addition, some targets in the East Papuan Basin are about to be drilled. Proximity to the oil refinery which is under construction will bestow a cost advantage if usable quantities of oil can be produced.

Higher oil prices in recent months are benefiting producing countries. However, the outlook is particularly uncertain, with global and Middle Eastern politics, OPEC cohesion and the strength of world demand all playing a role.

### 10. Palm oil exports on a rising trend, and receiving good world prices



Source: Bank of Papua New Guinea

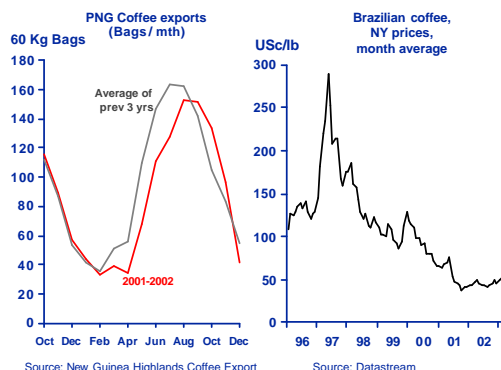
Source: Datastream

Palm oil is one of the success stories of recent years.

Export revenue from palm oil overtook that of coffee in 2000, despite the low prices prevailing in that year. Since then, palm oil prices have recovered strongly while coffee prices have languished. Volume shipped is also on a rising trend, although there is considerable quarter-to-quarter volatility.

The industry is currently investing in an expansion of plantation and smallholder acreage as well as in infrastructure and oil production capacity. These developments should drive further growth in export revenue from palm oil in coming years.

## 10. Coffee exports lagged in 2002



Last year, coffee exports were delayed first by late ripening and then because buying and transport of coffee were held up by the election. However, as the left hand chart shows, the seasonal cycle was merely delayed, and the final result was a reasonable one, with 1.02 million bags shipped in the year to September.

After declining for five years, there were some signs last year that prices were bottoming, but no meaningful rally occurred. Industry opinion is that global over-production could be reduced this year, but that excess stocks will need to be worked down before prices will recover.

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