

ECONOMIC & MARKET INSIGHTS



SEPTEMBER QUARTER 2015

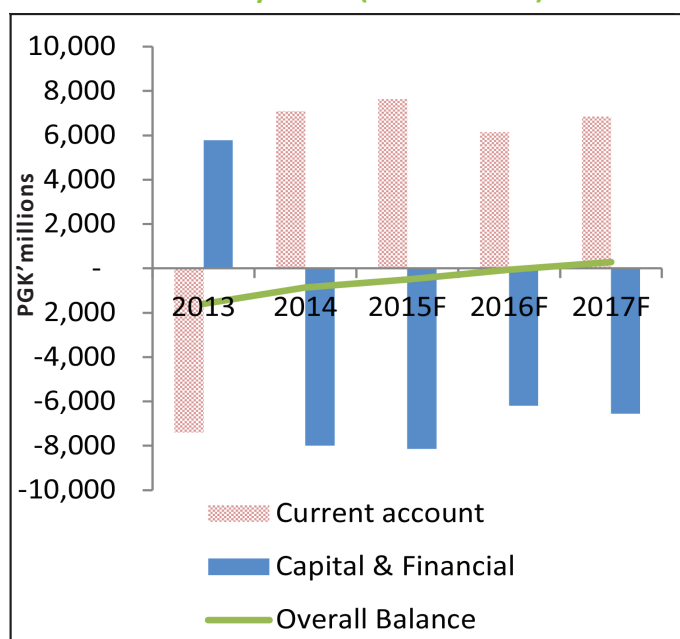
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Highlights

- The International Monetary Fund (IMF) revised global growth downwards by 0.2% to 3.1% for 2015. Economic growth prospects remain uneven, with activity in emerging and developing countries expected to remain low.
- Slow recovery in major industrial economies and moderating prospects in China and India, have prompted the Asian Development Bank (ADB) to lower developing Asia growth expectations to 5.8% in 2015 and 6.0% in 2016.
- Commodity prices continued to decline, driven by the fall in energy prices. There is consensus amongst analysts that commodity prices will remain low given ample supplies and weak prospects for global economic growth.
- All Pacific Islands economies are expected to grow in 2015, however given Papua New Guinea's (PNG) dominance and lowered growth prospects the Pacific region growth has subsequently been lowered to 6.6% and 3.9% in 2015 and 2016 respectively. The key challenge remains to build resilience to natural disaster, while taking advantage of the Asian Century.
- PNG's economic growth projections for 2015 have been revised downwards by ADB to 9% (incl. mining) and 3% (ex. mining) in 2016. The Government plans to reduce expenditure by K 1.4b and raise additional funds of K 1.1b. Downside risks remain high, affected by commodity prices remaining low and uncertainty around the El Nino phenomenon.
- According to Bank of PNG's Monetary Policy Statement (MPS) September, the overall Balance of Payments is expected to be in deficit of K505m at the end of 2015, compared to an earlier projection of K1,167m made in the March MPS. The current account surplus is expected to be lower resulting from lower than expected LNG related revenue inflows, temporary closure of the Ok Tedi mine and downward revisions of the international commodity prices.

PNG Balance of Payments (PGK millions)

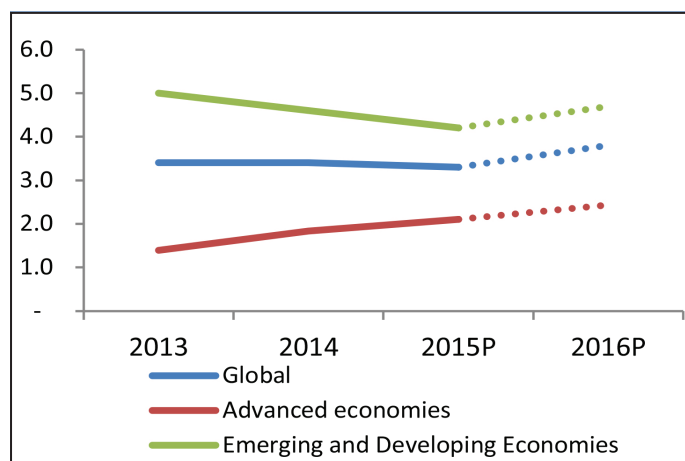


Source: Bank of PNG, BSP

Global Economy

IMF lowered global growth expectations to 3.1% (3.3% in July forecast) in 2015, compared to 3.4% in 2014. The downgrade was due to uneven prospects with emerging market and developing economies expected to feel the brunt of declining commodity prices on their external positions. Preliminary data suggest that global growth in the first half of 2015 was 2.9%, 0.3% lower than IMF prediction.

Figure 1: Global GDP Growth (% annual)



Source: IMF Data, BSP

Growth in advanced economies is expected to improve modestly to 2.0% (-0.1% from July forecast) in 2015, from 1.8% in 2014. This reflects a strengthening of recovery in the euro area, positive growth in Japan and U.S, though underlying productivity remains weak in U.S. ADB observed in its Asian Development Outlook (ADO) September update that recovery in major industrial economies picked up after a slow start, with GDP projected at 1.9% and 2.3% in 2015 and 2016 respectively.

Emerging market and developing economies are projected to moderate to 4.0% (-0.2% from July forecast) in 2015, from 4.6% in the previous year. Economic growth in developing Asia was revised downwards to 5.8% in 2015. ADB noted that delayed recovery in the major industrial economies and moderating prospects for China and India is weighing on outlook, slackening the projected pace below the 2014 growth rate of 6.2%.

The Chinese economy has grown by 7.0% (yoy) in the first half of 2015, with ADB projecting growth to 6.8% in 2015 and 6.7% in 2016. The industrial sector has slowed sharply, though it was noted the services sector improved. The moderation in Chinese growth will be unfavourable for Australian exports and business. Given the trade relationship of most Pacific Island countries with Australia, Chinese prospects may pose a downward risk to economies.

Commodities

Commodity prices fell by 16% over the September quarter and by 10% over the year. The decrease was driven by price drops in energy, especially from crude oil, due to sustained oil production and financial market volatility. Growth concerns and financial market volatility in emerging markets, especially China, has impacted commodities over the quarter.

Agricultural prices decreased 6% in September quarter and by 11% over the year. Palm oil prices declined 25% YTD owing to weak import demand, mainly from India and China.

Crude oil prices fell 28% over the September quarter, averaging \$51.28/bbl, due to strong OPEC production and possible suspension of sanctions against Iran.

Figure 2: Crude Oil Price (\$/bbl., monthly average)



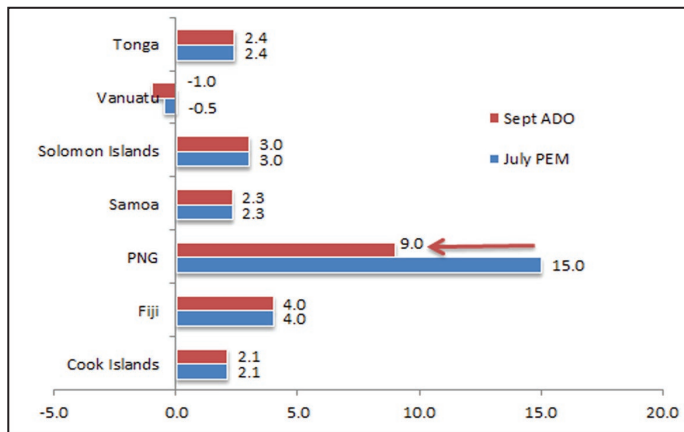
Source: IMF commodity market monthly, June 2015.

A recent IMF study suggest that a weak commodity price outlook is estimated to subtract almost 1.0% annually from the average rate of economic growth in commodity exporters over 2015-17 compared with 2012-14. Impact on energy exporters' growth is estimated to be larger (~2.15%) over the same period (IMF, WEO October 2015- Analytical Chapters). PNG as a net energy exporter will be impacted, evidenced by lower growth expectations.

Commodity prices are expected to remain low given ample supplies and weak prospects for global economic growth.

Pacific Overview

Economic growth in the Pacific region was revised downwards to 6.7% in 2015, compared to July projection of 9.9%. The downgrade reflects lower growth expectations in PNG (illustrated) which has been lowered by ADB to 9.0% in 2015, from 15.0% projected in the July Pacific Economic Monitor (PEM).

Figure 3: Pacific 2015 GDP Projections (% annual)

Source: IMF Data, BSP

The uncertainty and volatility surrounding international commodity prices has clouded the near-term outlook. According to ADB, PNG and Timor-Leste's outlook appear dimmer, though other smaller economies, including Fiji and Solomon Islands anticipate stronger growth in 2015. Smaller economies are net importers of oil, therefore the lower oil price is beneficial as it stimulates consumption.

Inflation eased in most Pacific Island countries as a result of the falling international oil prices. Inflation is expected to increase to 4.2% in 2015 and increase slightly to 4.4% in 2016. The lower projection was mainly in response to downward revisions to international commodity prices, according to ADB.

Tourism is an economic driver in the Pacific region, given a competitive advantage in tourism. Chinese tourists visiting Pacific Island countries have increased, though Australia and New Zealand visitors are dominant. The cross-currency movements resulting from the appreciation of USD may affect tourism, and economic activities in the Pacific region.

Papua New Guinea

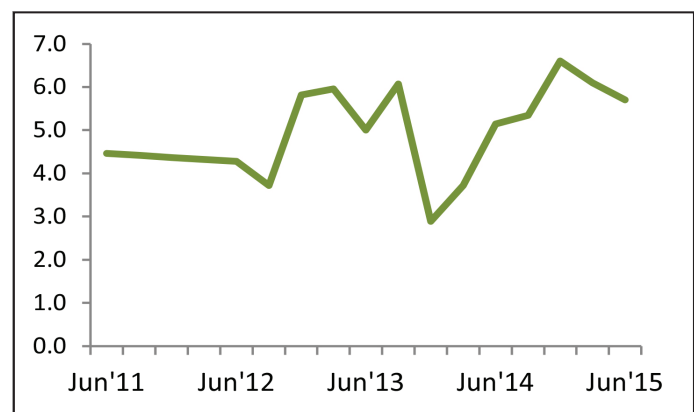
PNG economic growth is expected to be lower, with Bank of PNG projecting a real GDP of 9.0% in its September MPS. The downgrade was due to lower commodity prices and its likely impact on businesses, temporary closure of Ok Tedi mine, and lower government expenditure.

The National Executive Council (NEC) has approved K1.4b expenditure cuts and plans to raise K1.1b in additional revenue (*The Post Courier*). Government will likely defer non-essential spending to bring expenditure to K14.8b, with a notable economist, Paul Barker commenting that budget adjustments are necessary, however timing is a 'little too late' (*The National*).

Foreign exchange reserves were US\$1,972.3m (K5.6b) as at 28 September 2015, with Bank of PNG projecting reserves to fall slightly to US\$1,923.2m at the end of 2015. This is sufficient for 7.9 months of total and 15.6 months of non-mineral import cover.

Consumer Price Index

Annual headline inflation declined to 5.7% in the June quarter of 2015, compared to 6.1% in March quarter, according to National Statistics Office (NSO). This was attributed to increase in prices for food, rent and excise items, such as tobacco and alcohol. In light of this, the Bank of PNG has maintained the Kina Facility Rate (KFR) at 6.25% for September.

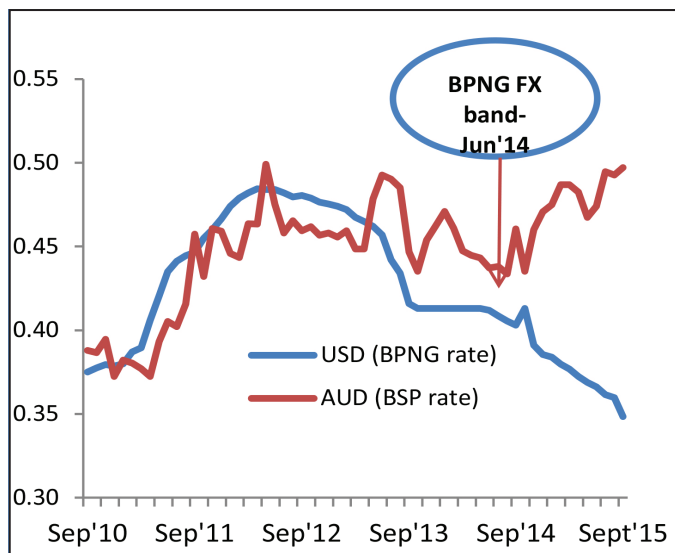
Figure 4: Inflation rate (% quarterly)

Source: Bank of PNG, BSP

BSP expects inflation to be higher than the projected 4.9% in MYEFO 2015, with El Nino phenomenon expected to exert upward pressure on inflation. Historical data indicates that inflation rose in the 1997/98 drought, hence with El Nino expected to last until 2016, inflationary impact will be felt, besides affecting the livelihood of 1.2m (est.) people in PNG.

PNG Exchange Rate

The Kina exchange rate depreciated against the USD by 3% to 0.3485, while it has moved in the opposite direction against the AUD to 0.4971 (3%) over the September quarter of 2015. The depreciation against USD was due to strengthening of the USD and lack of supply of foreign currency, while cross-currency movements impacted PGK/AUD. The gap between the exchange rates continues to widen.

Figure 5: PNG Exchange rate (% , monthly)

Source: Bank of PNG, BSP

BPNG noted that the market has embraced the foreign exchange trading band introduced in June 2014. Subsequently, the Bank has commissioned an audit, the purpose of which is to ascertain compliance with current regulations and the use of foreign currency accounts. The Bank also noted that demand for foreign currency may be exacerbated by excess orders not supported by proper documentation.

Given the shortage of foreign exchange in the market, BPNG continued to intervene with K652m of foreign currency added over the September quarter and K1.55b YTD to support the Kina. Since the foreign currency band, PGK depreciated by 16% to USD 0.3485. The depreciation of Kina has impacted inflation, PNG's external debt position, interest payments and foreign exchange reserves.

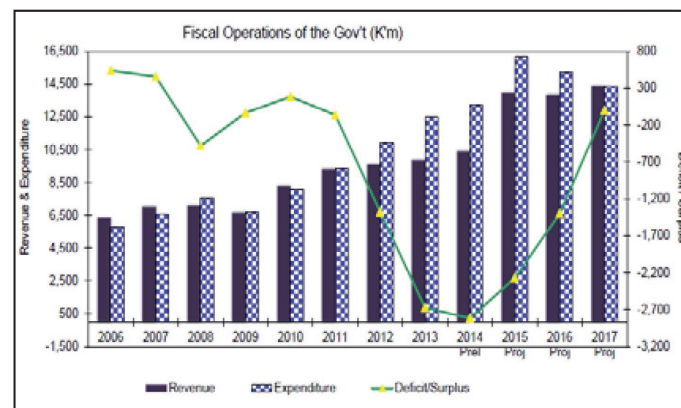
Fiscal Position

Bank of PNG preliminary estimates of the government's fiscal operations showed a deficit of K942m YTD to June, compared to K563.6m in the previous corresponding period (pcp). The government is expected to introduce a supplementary budget in October.

Infrastructure development is one of the Government's key priorities, therefore it is critical that it remains committed on 'value for money' projects. Bank of PNG urges the Government to focus on inclusive policies and invest in the non-mineral sector.

Beside expected revenue from National Petroleum Co of PNG (NPCP), Internal Revenue Commission and Customs, funding will be mainly sourced from domestic sources with plans in progress to issue a sovereign bond. Since the bond will be denominated in a foreign currency (likely in USD), it is expected to somewhat alleviate the foreign currency shortage in the market. Current developments in emerging credit markets suggest that any sovereign

issue may be challenging, and may require a higher coupon in order to attract foreign investment.

Figure 6: Fiscal Operations

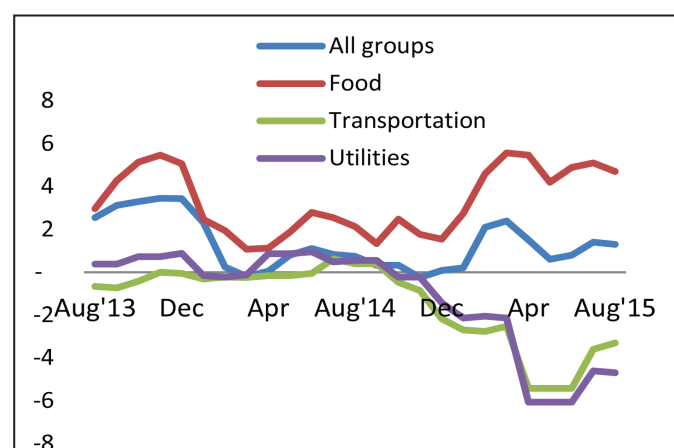
Source: MYEFO 2015, PNG Dept. of Treasury

Institute of National Affairs (INA) executive director, Paul Barker stated that it would be helpful if adjustments were made earlier. The late budget cut diminishes the options and prospects for effective action (*The National*).

BPNG proposes that the government looks at amending the tax concession policies, including tax holidays given to resource owners. Meanwhile, the Tax Review Committee has flagged possibilities that include the income tax threshold be raised to K15,000, corporate income tax reduced to 25.0% and GST raised to 15.0%. Most citizens and politicians responded unfavourably with PM stating that there will be no new taxes (*The National*).

Fiji

While announcing Fiji's monetary policy stance for September, the Fiji Reserve Bank (FRB) Governor stated that, "positive sectoral outcomes and strong demand conditions in the year to date are in line with the 4.3% economic growth projection for this year. In particular, increased consumption and investment demand continue to be supported by favourable financial and labor market conditions." (27 August 2015). RBF reported that the economy grew by 5.3% in 2014.

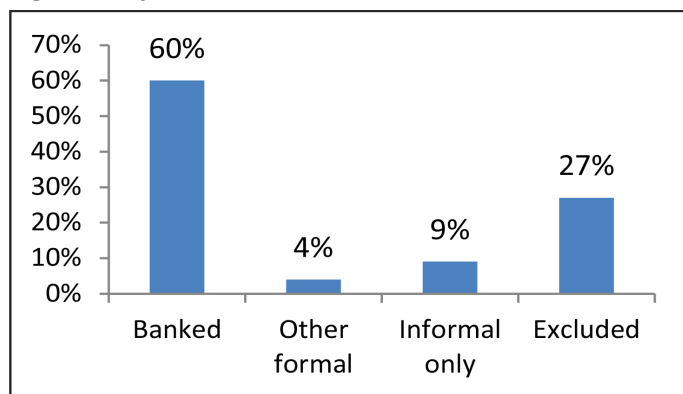
Figure 7: Inflation (% , monthly)

Source: Fiji Bureau of Statistics, BSP

Inflation rose to 1.3% in August, from 1.4% in July due to higher food & non-alcoholic beverages and tobacco prices. However, lower domestic fuel prices in the transport and housing, water, electricity, gas & other fuels contributed negatively to this inflation outcome. 2015 year-end inflation is expected to be around 3%.

The banking sector in Fiji remained robust. Commercial banks' lending, increasing by 14.2% over the year to August, underpinned by 13.7% growth in private sector credit. The RBF's August review showed that elevated disposable incomes as reflected by higher Pay as You Earn tax supported private consumption and remittance.

Figure 8: Fiji Financial Inclusion Strand 2015



Source: RBF, Financial Services Demand Side Survey, BSP

A demand side survey (September 2015), undertaken by the RBF revealed interesting insight into the financial sector in Fiji. Main findings show that;

- **60% of Fijians** have bank accounts, and another 4% use other formal financial services, including microfinance, credit unions, and insurance.
- Despite high mobile usage, **less than 11% of Fijian adults own a mobile money account.**
- There is a **strong savings culture among Fijians, with 71.2%** of the respondents saying that they had saved money with any source in the past year.
- **Most Fijians see the Post Office as their best option for domestic remittances**, rather than mobile money or bank transfers. Further research is required here.
- **Use of insurance is minimal among the poor with only 12%** of respondents having any type of insurance.

The commercial banks' weighted average outstanding lending rate increased to 5.85% in August 2015, from 5.72% in December 2014. Credit conditions are expected to remain conducive for growth and investment this year.

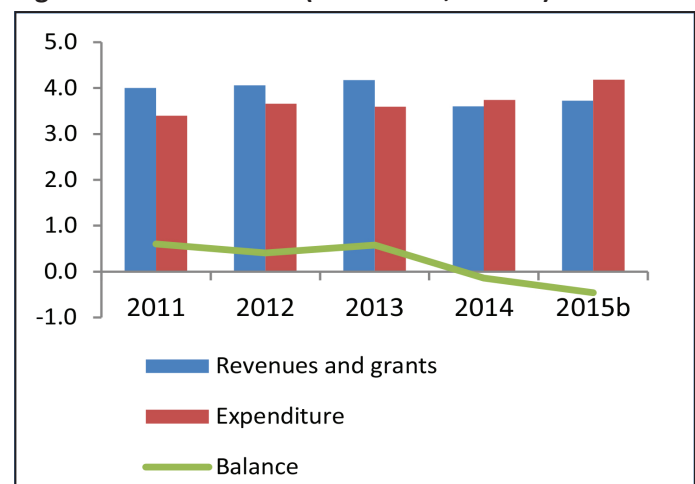
Solomon Islands

Economic growth is expected to remain at 3.0% in 2015 supported by foreign direct investment, resumption in mining, donor or government investment and major infrastructure following severe floods in April 2014.

According to Central Bank of Solomon Islands (CBSI), the monthly production index declined by 15% in July 2015 to 86 points, compared to a 25% decline in June. The rebound was due to improved performances in log exports, fish catch, cocoa and crude palm oil produced during the month.

On the international market, the average price for all export commodities weakened, except for cocoa and log prices which increased by 3% and 0.3% respectively.

Figure 9: Fiscal Position (SBD billion, annual)



Source: Solomon Islands Budget Papers, BSP

The government recorded a preliminary deficit of \$42m in June driven by an 11% increase in total expenditure to \$361m against the previous month. Total revenue declined by 24% to \$214m over the month of June.

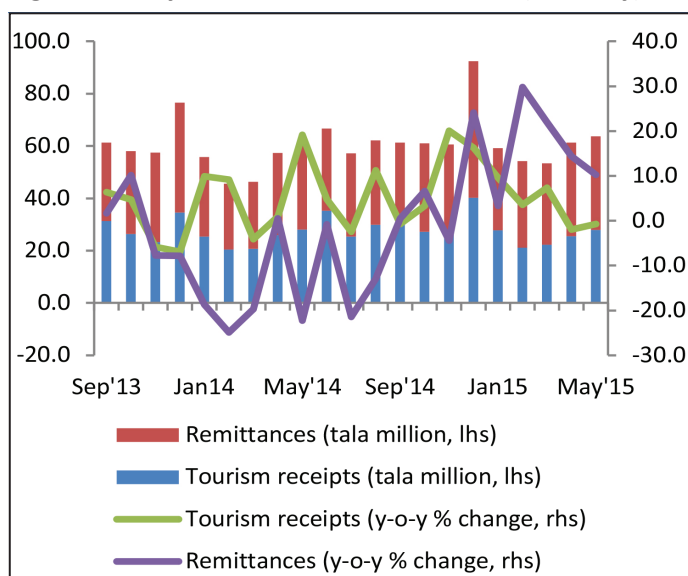
Headline inflation was negative 4.8% in June, from -4.2% registered in May. Imported and domestic inflation fell, though we note that domestic inflation fell significantly. The fall in food, housing and utilities prices were the main contributors to the 4.8% deflation.

Samoa

According to Central Bank of Samoa (CBS) the economy grew by 1.4% over the twelve months to March 2015, down from 1.9% in the same period to the end of September 2014. Economic activity is expected to grow by 2.3% in 2015, driven by higher tourism earnings and remittance related spending.

In the recent CBS meeting (5 August 2015), the Board noted that macro-economic conditions are lower in Australia and New Zealand than initially assessed. The Board maintained its 'easing monetary stance', taking into account the current sluggish growth in the Samoan economy as well as the decline in gross official reserves in 2014/15.

Figure 10: Key Sources of External Income (monthly)



Source: Central Bank of Samoa, BSP

Tourism remains the primary driver of growth, with visitor arrivals increasing by 6.1% (y-o-y) over the first three quarters of 2015. Visitor arrivals purposes continued to be for 'holidays' with tourism receipts recorded at WST22m at the end of March 2015, having risen by 7.7% (y-o-y).

ADB projects growth in Samoa to moderate to 1.9% in 2016, driven by weak agriculture and non-food manufacturing output. In addition, the Government plans to reduce overall expenditure by about 2% in response to lower external grants and higher external debt service payments as large bilateral loans come due.

Inflation remains stable at 1.9% at the end of June 2015. It is expected to rise to 2.2% in 2015/16 due to a gradual pickup in domestic inflation. Samoa has recovered from deflation experienced in the previous years as international commodity prices and domestic food prices fell. Inflation is projected to remain at 2.0% in 2016.

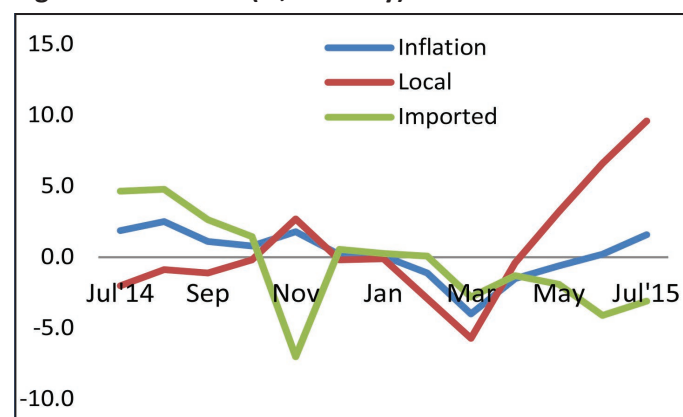
The Government of Samoa approved another expansionary fiscal policy for 2015/16. Government spending is likely to be lower, following more than 20% decline in external grant inflows. CBS stated that the Government's budget deficit is approximately 4.7% of GDP.

Tonga

National Reserve Bank of Tonga (NRBT) reported in its July review that the domestic economy slowed down over the month, due to the end of coronation celebrations and festivities. It was also noted that economic activity among its development partners remained mixed. Lower commodity prices will also be positive for the economy.

Headline inflation rose 1.3% over the month of July and by 1.6% over the year. Both domestic and imported prices rose, with domestic food prices being the main driver due to recent unfavourable weather conditions affecting supply.

Figure 11: Inflation (% , monthly)



Source: Tonga Department of Statistics, BSP

The end of the coronation has seen imports decreasing with payments lower at \$21.3m in July, compared to the preceding two months. Total export receipts were also 30% less than last month, driven by lower proceeds for marine exports, which more than outweighed the increase in agricultural exports.

Travel receipts rose by 35% to \$9.3m in July, according to NRBT. Although air arrivals decreased, departures increased and may explain the rise in travel receipts, as visitors pay for accommodation, gifts, souvenirs and other spending prior to departing.

Total remittance receipts increased by \$3.6m to \$19.9m in May, representing 37.4% of the Total Overseas Exchange Transaction (OET) Receipts. Remittances continued to be from US (34%), Australia (33%) and NZ (26%) with little change over the month and May YTD.

NRBT (June 2015) reported that total lending increased slightly by 0.5% over June, due to increased lending to households, with \$0.6m being approved from the government's managed funds loan scheme. Over the year, total bank lending rose by 11.7%, reflecting higher business and household lending.

Weighted average interest rate spread widened from 5.88% to 5.95% in July 2015. This was due to a 0.3 basis points increase in weighted average lending rate to 8.23%, and a 6.4 basis points drop in weighted average deposit rate.

Cook Islands

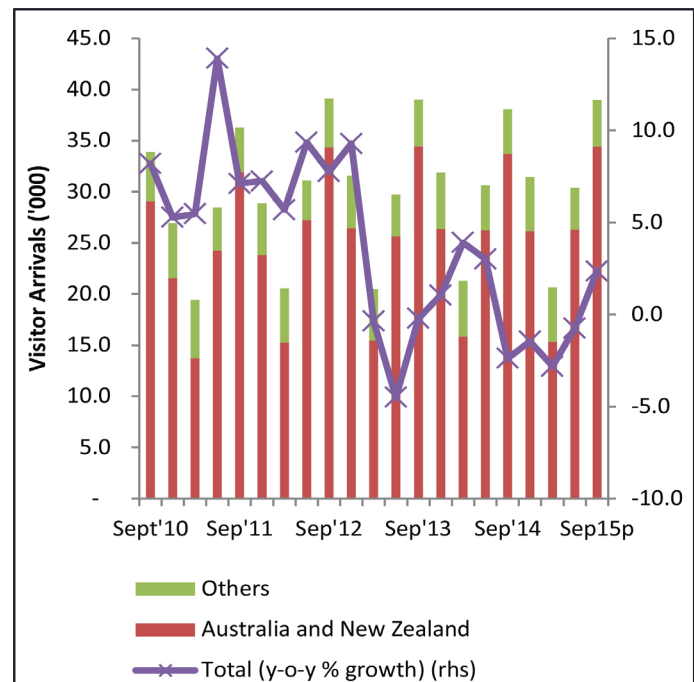
Real GDP is forecast to grow by 1.4% in 2015/16, driven largely by shifts in public spending especially the Te Mato Vai and the Southern Group Renewable Energy Project. This is expected to offset the weak growth in tourism.

The 2015 budget plans for a further ramping up of road funding to \$332m, and more than double allocations for the water utility to provide free services. Free education, which was introduced at the primary and secondary levels last year, will be extended to preschool.

Tourism remains the largest industry in the Cook Islands, accounting for around 60% of the economy.

According to ADB (*PEM, July 2015*) visitor arrivals dropped by 2.2% in the first 3 quarters of 2015 (ended 30 June) from the same period a year earlier. According to 2014/15 budget estimates, growth in tourist arrivals is forecast to slow to 1.7% in 2014/15 and 1.9% in 2015/16, reflecting the ongoing softness in key markets.

Figure 12: Tourism Growth



Source: Cook Islands Statistics office, BSP

Quarterly inflation increased by 1.3% in June quarter 2015, and by 3.04% on an annual basis. Inflation in the Cook Islands is projected to remain low at 2.5% in 2014 and 2015 as major imports are sourced from New Zealand and fuel prices stay stable. With the exception of the one-off increase in the VAT, inflation is expected to adjust towards its long-term trend.

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MARKET RATES

FOREIGN EXCHANGE			
	JULY	AUGUST	SEPTEMBER
PGK/USD	0.3605	0.3565	0.3485
FJD/USD	0.4686	0.4634	0.4629
SBD/USD	0.1290	0.1255	0.1300
WST/USD	0.3902	0.3891	0.3752
TOP/USD	0.4855	0.4851	0.4532
NZD/USD	0.6609	0.6454	0.6354

COMMODITIES			
	JULY	AUGUST	SEPTEMBER
Oil (US\$ per barrel WTI)	48	45	45
Gold (US\$ per ounce)	1,088	1,133	1,115
Copper (US\$ per metric ton)	5,262	5,130	5,160
Nickel (US\$ per metric ton)	11,055	10,025	10,400
Palm Oil (MYR per metric ton)	2,110	1,876	2,375
Coffee (US\$ per LB)	128	124	121
Cocoa (US\$ per metric ton)	2,158	2,101	2,179
Sugar (US\$ per metric ton)	349	340	370
Lumber (US\$ per 1,000 feet)	254	234	229

MACRO DATA

Real GDP Growth (% annual)				
	2013	2014	2015F	2016F
PNG	5.0	8.4	11.0	5.0
Fiji	4.6	4.5	4.0	4.5
Solomon Islands	3.2	1.0	3.0	3.5
Samoa	0	1.9	2.3	1.9
Tonga	0.8	2.4	2.4	2.6
Cook Islands	1.2	2.1	2.1	-0.3

Inflation (%)				
	2013	2014	2015F	2016F
PNG	4.7	6.6	6**	7.0
Fiji	3.4	0.1	2.5	3.0
Solomon Islands	5.8	4.8	3.0	5.5
Samoa	-0.2	-1.2	2.0	2.0
Tonga	1.0	1.5	0.4	1.0
Cook Islands	1.9	2.1	2.4	1.4

** Bank PNG MPS

Fiscal Balance (% of GDP)				
	2013	2014	2015F	2016F
PNG	-7.8	-6.9	-9.4	2.5
Fiji	-0.5	-2.0	-2.5	-2.0
Solomon Islands	2.3	-1.3	-3.5	3.0
Samoa	-6.1	-4.8	-4.2	-3.9
Tonga	-1.1	-0.2	-0.1	-0.2
Cook Islands	na	-5.4	-7.4	-6.1

Foreign Exchange Reserves (USD m)				
	2013	2014	2015F	2016F
PNG	2,750	2,296	2,059*	3,373
Fiji	937	913	872	780
Solomon Islands	515	530	550	550
Samoa	137	155	156	160
Tonga	140	138	140	140
Cook Islands	na	na	na	na

* MYEFO 2015

Economic Data Sources:

PNG: BPNG MPS, MYEFO 2015, Department of Treasury, Asian Development Bank (ADB), BSP

Fiji: Reserve Bank of Fiji, ADB, IMF, BSP

Solomon Islands: Central Bank of Solomon Islands, ADB, IMF, BSP

Samoa: Samoa Bureau of Statistics, ADB, IMF, BSP

Cook Islands: Financial Supervisory Commission, ADB, IMF, BSP

Tonga: Tonga Department of Statistics, IMF, ADB, BSP

Commodity Prices: Bloomberg

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