

PACIFIC ECONOMIC & MARKET INSIGHTS



June Quarter 2015

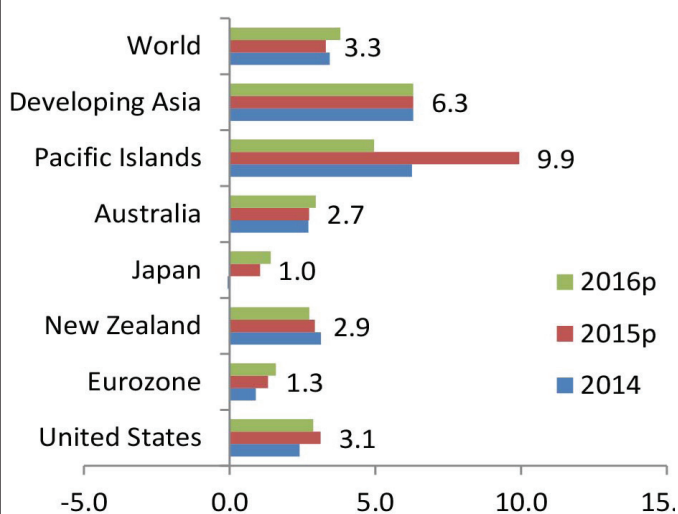
Contents

Global Economy	2
Commodities	2
Pacific Overview	3
Papua New Guinea	4
Fiji	5
Solomon Islands	5
Samoa	6
Tonga	7
Cook Islands	7
Market Rates	8
Macro Forecasts	8

Highlights

- Global economic growth forecasts for 2015 were lowered to 3.3% while 2016 growth was raised to 3.8% by the International Monetary Fund (IMF). The distribution of risks is skewed to the downside, with financial market volatility being a major near term risk.
- Commodities continued to remain at their lows, and susceptible to volatility. Most of PNG export commodity prices fell over the year to August 2015, with crude oil falling by 49% year on year.
- The Pacific region has enormous opportunities for growth given its proximity to one of the fastest growing regions of the world, Asia.
- All Pacific Islands economies are expected to grow in 2015 and 2016, except for Vanuatu and Cook Islands. The economic impact of the disasters is prolonged, though we see recovery in reconstruction. The key challenge remains to build resilience to natural disasters, while taking advantage of the Asian Century.
- PNG economic growth projections for 2015, have been downgraded to 11.0% from 15.5% projected in the 2015 Budget. Government revenue was revised downwards, with taxation revenue lower than expected.
- According to the Asian Development Bank (ADB), Pacific economies are among the most vulnerable to natural hazards in the world. Estimates indicate that an average cyclone reduces per capita income by 3.6% and a catastrophic cyclone by 7.4% to 15%.

GDP Growth (% , annual)

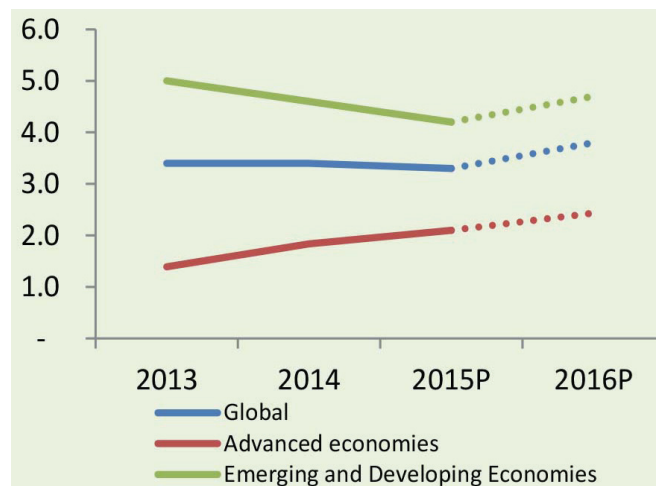


Source: ADB, BSP

Global Economy

Global growth is now projected to be 3.3% (down from 3.5% in April) in 2015, compared to 3.4% in 2014. The downward revision was due to a setback in economic activity, mostly in North America. The IMF commented in its April update that it was a temporary slowdown with recovery remaining on track.

Figure 1: Global GDP Growth (% annual)



Source: IMF Data, BSP.

Growth in advanced economies is expected to increase to 2.1% in 2015, from 1.8% in 2014. The underlying drivers for growth include eased financial conditions, more neutral fiscal policy in the euro area, lower fuel prices, and improving confidence and labour market conditions.

Emerging and developing economies are projected to moderate to 4.2% in 2015, from 4.6% in the previous year. The slowdown reflects the dampening impact of lower commodity prices, tighter external financial conditions (particularly in Latin America and oil exporting countries), the re-balancing in China, and structural bottlenecks.

The Australian economy is estimated to grow by 2.7% in 2015, before improving to 3.0% in 2016. Growth in NZ is expected to grow by 2.9% in 2015 and by 3.1% in 2016 due to lower government spending and fixed capital formation despite the rise in private consumption and net exports.

Commodities

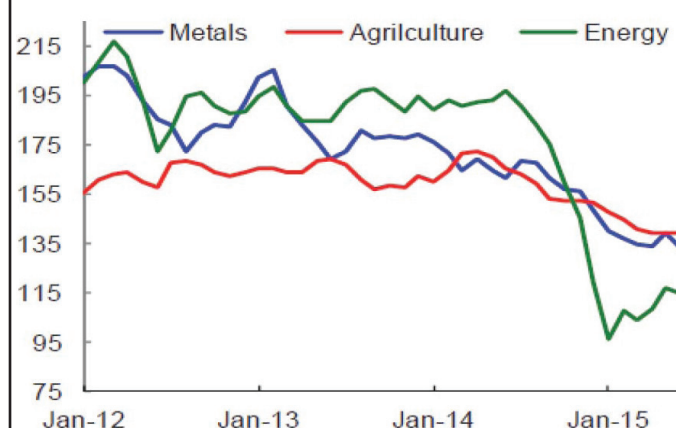
The IMF Commodity Market Monthly (16 June) reported that commodity prices fell by 1.6% in June, driven by price drops in metals and energy.

Crude oil prices fell 1.9% in June, averaging \$61.3 per barrel, due to strong OPEC production and possible suspension of sanctions against Iran. Crude oil price fell by 49% to \$49.2 per barrel (y-o-y) to August 2015.

Metal prices are expected to remain broadly unchanged owing to slowing demand in China and increases in new capacity, although there have been some supply disruptions.

Over the 12-months to August 2015, the gold price fell by 12% to US\$1,135. The Gold price is expected to increase by 3% to US\$1,231 at the end of 2016. Some analysts have forecast the gold price to average US\$1,220 an ounce in 2015.

Figure 2: Commodity Price Indices (2015=100)

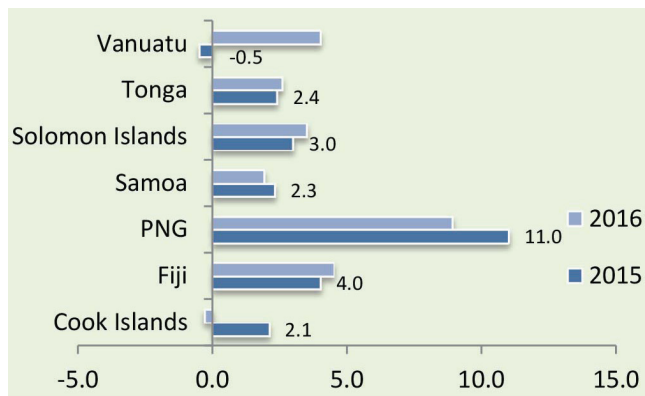


Source: IMF commodity market monthly, June 2015

Palm Oil declined by 5% over the 12 months to RM1,928 per metric ton as at August 2015. PNG commodities prices are forecast to fall in the short term, with crude oil expected to be hardest hit. Prices for PNG's main commodities were mostly down in 2015 YTD, driven by changes in the supply and demand fundamentals.

Pacific Overview

The Pacific region is expected to grow by 9.9% in 2015, compared to 6.1% in 2014. The downgrade in PNG growth expectations has lowered the Pacific regions' growth estimates from the 10.7% projected in March 2015 (ADB Pacific Economic Monitor, July 15).

Figure 3: Pacific GDP Growth (% annual)


Source: IMF Data, BSP.

According to the ADB, annual growth rates have been highly volatile in the smaller Pacific economies, but have generally averaged around 2%. Larger Pacific economies have performed better, with resource-rich PNG, Timor-Leste, and, to a lesser extent, Solomon Islands, all enjoying high growth since 2005. The natural disaster in Vanuatu is expected to dampen economic activity in the short term.

Inflation eased in most Pacific Island countries, the result of falling international oil prices. Inflation is expected to increase to 4.7% in 2015 and slow slightly to 4.0% in 2016. This is projected to be driven by government spending and currency depreciation in PNG.

Tourism is an economic driver in the Pacific region, given a competitive advantage in tourism. Australia continued its dominance as the largest tourist source market (34.7%) followed by New Zealand (19%). Chinese tourists visiting Pacific Island Countries (PIC) has increased as well. Recent data from the ADB showed that departures from New Zealand to South Pacific countries rose by 7.9% in January - April 2015 compared with the same period last year. Pacific currencies have broadly weakened over the quarter reflecting a stronger USD, weaker commodity prices and softer AUD and NZD.

Papua New Guinea

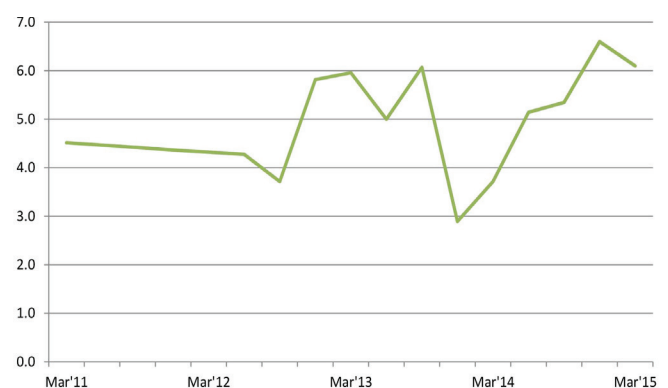
PNG economic growth projections for 2015 were lowered to 11.0% in the Mid Year Economic & Fiscal Outlook Report 2015 (MYEFO) compared to 15.5% estimated in the 2015 Budget. The fall in commodity prices, especially the oil price, will impact growth, with PNG Department of Treasury directed to furnish a mini-budget.

Total non-mining GDP is expected to grow at 4% in 2015, rebounding from the slower growth of 1.4% in 2014. The pick-up in the non-mining sector is due to the rebound in the construction sector, leading towards the Pacific Games 2015 and associated infrastructure spending.

On 18 May, Moody's credit ratings agency moved PNG's sovereign credit rating to a 'negative outlook'. The rating agency cited fiscal deterioration, a weakened external payments position and increased external vulnerability as the main factors for the move.

Consumer Price Index

Annual headline inflation increased by 6.1% in the March quarter of 2015, compared to 6.6% in December 2014. According to BPNG, retail price index (RPI) to June increased by 5.9%, compared to an increase of 2.7% in May 2015. This outcome was driven by increases in the 'food', and 'drink, tobacco and betelnut' expenditure groups, combined with increases in the 'non-durable goods' and 'medical and health care (exc. Hospital)' sub-groups.

Figure 4: Inflation (% quarterly)


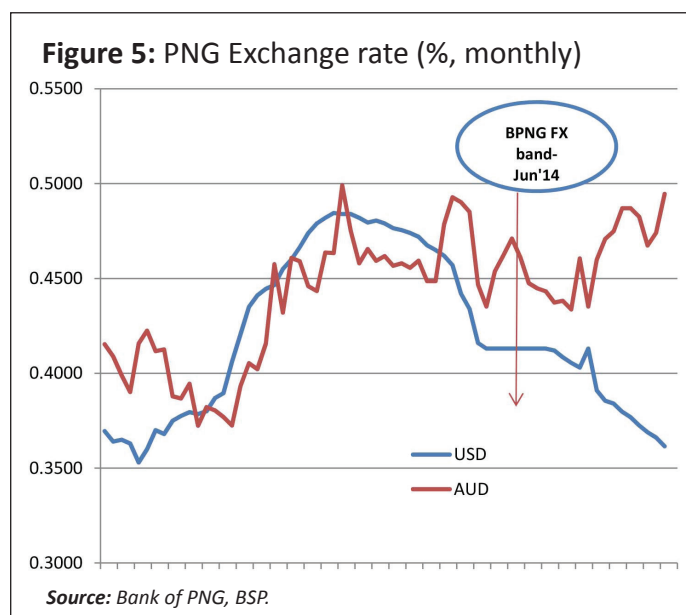
Source: Bank of PNG, BSP.

Inflation expectations for 2015 are between 5.0% and 6.0%. Bank of PNG projects trimmed-mean inflation and the exclusion-based inflation to be 3.0% and 4.0%, respectively. High inflationary pressure is likely to be exerted from high import demand compounded by relatively lower supply of foreign exchange liquidity in the market.

PNG Exchange Rate

PNG Kina continued to depreciate against USD, due to high import demand resulting from high economic growth and low commodity prices. The average kina exchange rate depreciated against the USD by 7% to 0.3565, while it has appreciated against AUD by 5% to 0.4891 over the year to 31st August 2015.

Cross-currency movements impacted PGK/AUD.



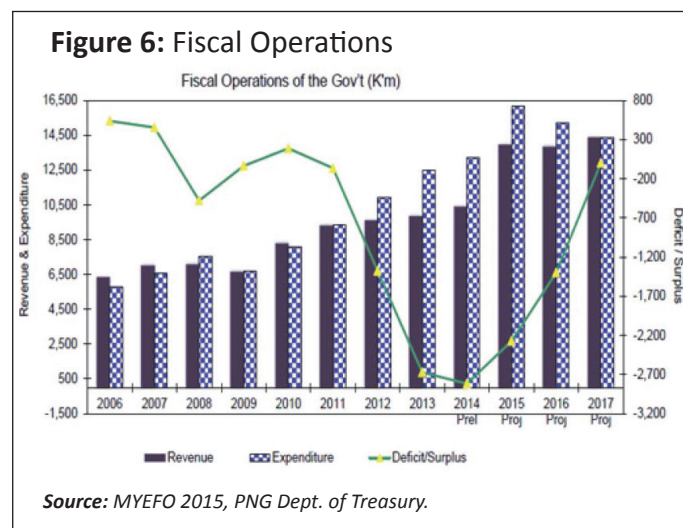
Since the introduction of the trading band in June 2014, the exchange rate has moved in line with the supply and demand for foreign currency. BPNG has intervened with US\$570.9m (PGK1.48b) to support kina in 2014. Since the FX band, PGK depreciated by 14% to USD0.3565. There were noted shortages of foreign currencies in the market.

The depreciation of Kina will impact PNG's external debt position, interest payments and foreign exchange reserves. Gross foreign exchange reserves were US\$2,058.8m at the end of May 2015 (sufficient for 9.0 months of total and 13.9 months of non-mineral import cover).

Fiscal Position

The government continued expansionary fiscal policy in 2015, with the deficit budget to be funded mainly from domestic sources. The government's revenue was impacted by the fall in oil price, with 2016 expected to be a challenging year.

According to MYEFO 2015, total government revenue was pressured by the continued fall in oil price and high expenditure plans. Revenue was estimated at PGK2.4b, while total expenditure was PGK5.5b at the end of March 2015. The debt financing requirement stood at PGK3.1b, which will mostly be raised on the domestic market.



Total expenditure for the first three months to March 2015 was PGK1.8b, 4.9% lower than in the corresponding period of 2014. This was due to lower recurrent expenditure, which more than offset an increase in development expenditure.

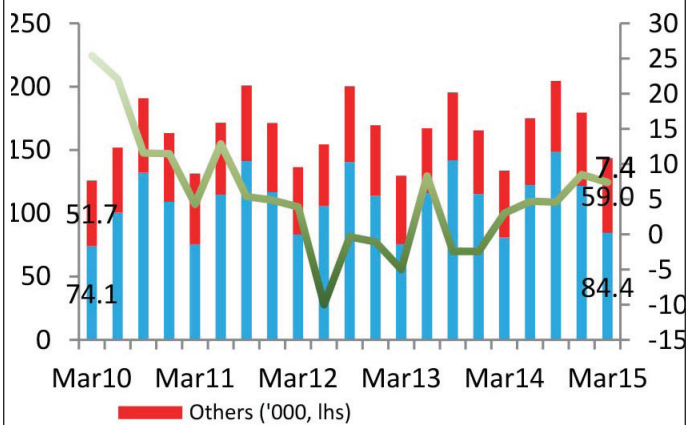
Fiji

According to Reserve Bank of Fiji (RBF), Fiji's economy is projected to grow by 4.3% (ADB: 4.0%, IMF: 3.3%) in 2015, with a slight acceleration to 4.5% expected in 2016. Growth is expected to be broad-based, with tourism and sugar sectors at the forefront.

Inflation was up by 2.5% over April, resulting from the increase in domestic and imported inflation. In annual terms, the inflation rate declined by 1.5% due to global energy prices being 25% lower than the previous year. Inflation is expected to continue remaining low between 0-3%.

Tourism remains the primary driver of growth, with visitor arrivals increasing by 7.5% (y-o-y) over the first 4 months of 2015 (ADB, PEM, July 2015). Fiji receives the highest number of visitors from Australia.

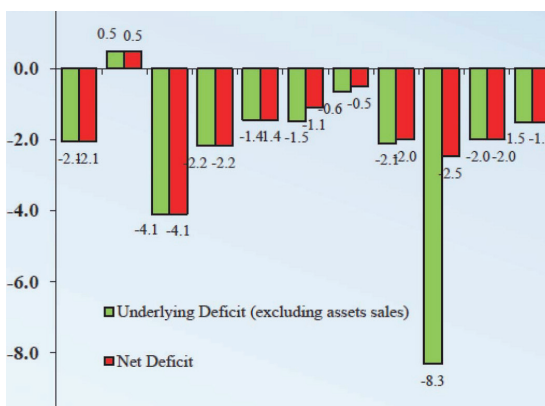
Figure 7: Visitor Arrivals (% quarterly)



Source: Fiji Bureau of Statistics, BSP.

The government's fiscal stimulus in the 2015 budget will increase public expenditure on transport, energy, and water supply and sanitation infrastructure. Whilst monetary policy remains accommodative, the fiscal stimulus will increase demand and economic activity. According to RBF, investment to GDP will remain above 25% while the deficit is expected to be around 2% of GDP in 2015.

Figure 8: Banking sector in Fiji



Source: RBF Deputy Governor's presentation, 15 July 2015.

The banking sector in Fiji continued to grow, with RBF data indicating an increase in new lending for consumption and investment purposes. According to the RBF Governor, new lending for investment purposes cumulative to April 2015 has grown by 75% from 2014 compared to annual growth of 11% last year (Governor's speech, 16 July, Launch of BSP Life). The commercial banks' weighted average outstanding lending rate increased to 5.78% in June 2015, from 5.72% in December 2014.

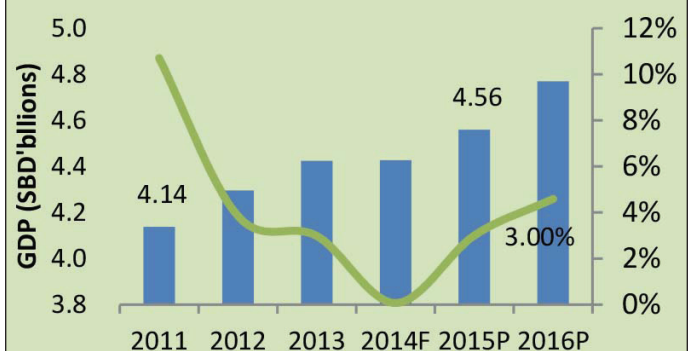
Credit conditions are expected to remain conducive for growth and investment this year. Fiji's interest rate spread is lower than most Pacific Island countries.

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.

Logging is still a significant and important part of the economy accounting for 15% of GDP and log exports account for around 14% of revenue.

Figure 9: GDP Growth (% annual)



Source: IMF data, BSP.

According to the Central Bank of Solomon Islands (CBSI), monthly production index declined by 9% in March 2015 to 75 points, compared to 21% surge in February. The decline was driven by falls in log output and fish catch, supported by the slowdown in copra output.

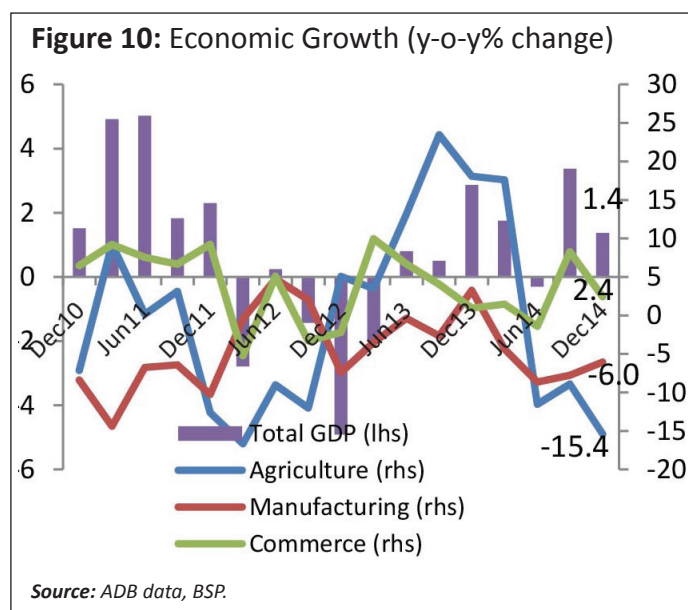
Log production, measured by export volumes reached a high of 2.1 billion cubic meters in 2014, a 12% increase from the previous year of 1.9 billion cubic meters. The IMF projects log price to increase in 2015, however there is concern on the depletion of logs.

Headline inflation decelerated to negative 3% in April, from -0.3% in the prior month. This was attributed to domestic inflation falling below zero to -3.3%, while imported inflation remained negative at minus 1.8%. The fall in food, drinks and tobacco prices were the main contributors. CBSI reported that the average fuel price in Honiara eased in May to \$8.50 per litre, following an increase in the previous month.

On the foreign exchange market, the Solomon Islands dollar (SBD) appreciated against the USD by 2% and 4.8% to 0.1255 over the month and year to July respectively. It has depreciated against the AUD by 2% (mom) and 6.4%(ytd) to 0.1689 at the end of July. The government recorded a preliminary deficit of \$40m in May driven by a 24% increase in total expenditure to \$240m against the previous month. Total revenue collection remained broadly unchanged at \$200m.

Samoa

Economic growth is expected to grown by 2.3% in 2015, driven by higher tourism earnings and remittance-related spending's. The tsunami in 2009 and Cyclone Evan in 2012 caused estimated damage and losses equivalent to 25% to 30% of GDP, and led to sharp contractions of the economy. Recovery is underway supported by development partner funded reconstruction.



ADB (PEM, July 2015) projects growth in Samoa to moderate to 1.9% in 2016, driven by weak agriculture and non-food manufacturing output in recent months. In addition, the government plan 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.

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 Mar'15, having risen by 7.7% (y-o-y).

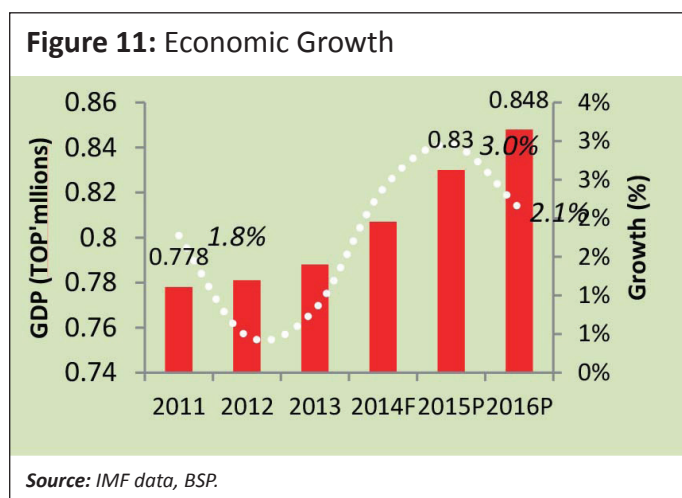
Inflation was up by 2.2% in the first 10-months of 2015, mainly from imported inflation.

Inflation is projected to remain at 2.0% in 2016. According to the Central Bank of Samoa (CBS), total commercial bank lending increased by WST136m or 18% to WST905m over the 12 months to May 2015. CBS (March 2015) noted that the increase was due entirely to expansions of credit directed to the private sector and public institutions.

On market interest rates, the weighted average deposit rate also declined to 2.47% in June 2015, down from 3.11% in May 2015. Likewise, the weighted average lending rate dropped to 9.43% from 10.32% in May 2015.

Tonga

The Tongan economy remains stable, with all economic indicators reflecting positive growth. Tonga's external position also strengthened, as grants and remittance inflows bolstered international reserves to TOP287m at the end of January 2015.



Inflation fell by 0.7% in Jun'15, and by 0.6% YTD as a result of low imported and domestic prices. Both imported and domestic prices dropped by 1.0% and 0.2% respectively, with low food prices being the dominant driver. The fall in global commodity prices has also impacted inflation. The total remittances receipt for the month of April was \$16.3m, representing 44.5% of the Total Overseas Exchange Transaction (OET) Receipts. Remittances continued to be originated mainly from NZ followed closely by Australia.

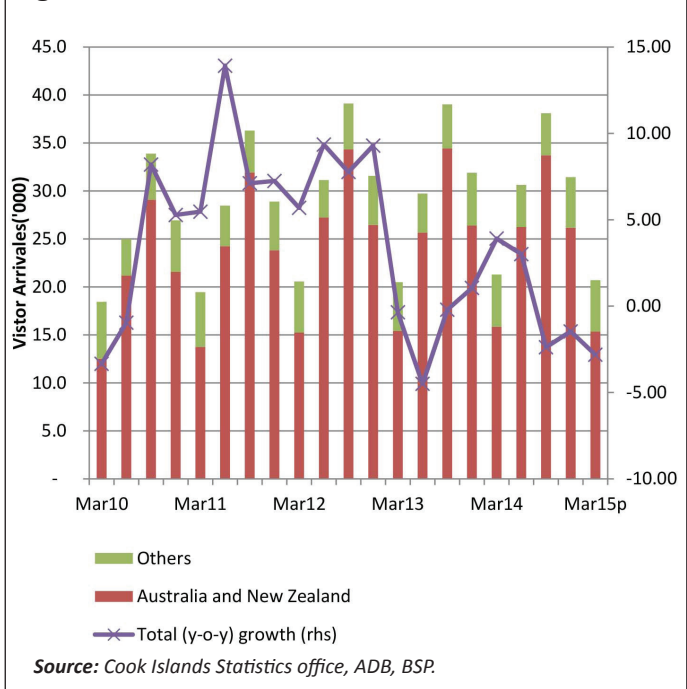
National Reserve Bank of Tonga reported (May 2015) that total lending increased slightly over May by 0.9%, driven mainly by a 1.1% rise in household loans. The increase in household loans was largely attributed to a rise in other personal loans, which was supported by lending activities.

Weighted average interest rate spread widened in May from 5.92% to 6.27%, reflecting a 5.3 basis points increase in weighted lending rate to 8.32%, and a 2.7 basis points rise in weighted deposit rate. The increase was due to a significant increase in business loans interest, whilst increases in savings and term deposit rates drove the rise in weighted average deposit rates.

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. 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 FY2015 (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



Continued efforts have been made to boost the tourism industry, with the Prime Minister, Honourable Henry Puna, announcing streamlining of department document requirement, effective 1 Aug'15. This is expected to boost tourism in the economy. Inflation increased by 1.3% in June quarter 2015, and by 3.04% on an annual basis. Transport group and apparels showed the highest increase in March, with the former caused by an increase in International airfares (up by 8.5%). To discourage smokers, the government raised the excise tax on tobacco by 33.0% in July 2014, which will positively impact government revenue.

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MARKET RATES

FOREIGN EXCHANGE				
	APRIL	MAY	JUNE	LATEST (31/08/15)
PGK/USD	0.3715	0.3675	0.3645	0.3565
FJD/USD	0.4874	0.4893	0.4809	0.4634
SBD/USD	0.1319	0.1294	0.1292	0.1255
WST/USD	0.4045	0.3993	0.4025	0.3891
TOP/USD	0.5072	0.5072	0.4777	0.4851
NZD/USD	0.7602	0.7309	0.689	0.6454

COMMODITIES				
	APRIL	MAY	JUNE	LATEST (31/08/15)
Oil (US\$ per barrel WTI)	59.6	60.3	59.5	49
Gold (US\$ per ounce)	1,184	1,190	1,172	1,135
Copper (US\$ per metric ton)	6,335	6,015	5,765	5,135
Nickel (US\$ per metric ton)	13,915	12,588	11,932	10,033
Palm Oil (MYR per metric ton)	2,070	2,170	2,224	1,928
Coffee (US\$ per LB)	144	132	136	124
Cocoa (US\$ per metric ton)	2,914	3,066	3,262	3,099
Sugar (US\$ per metric ton)	375	349	365	341
Lumber (US\$ per 1,000 feet)	256	274	288	223

MACRO FORECASTS

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	4.9*	6.0
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

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	-	-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: Department of Treasury, Bank of PNG, Asia Development Bank (ADB), BSP

Fiji: Reserve Bank of Fiji

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

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

Cook Is: Financial Supervisory Commission, ADB, IMF BSP

Commodity Prices: Bloomberg

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