

# ECONOMIC & MARKET INSIGHTS



DECEMBER QUARTER 2015

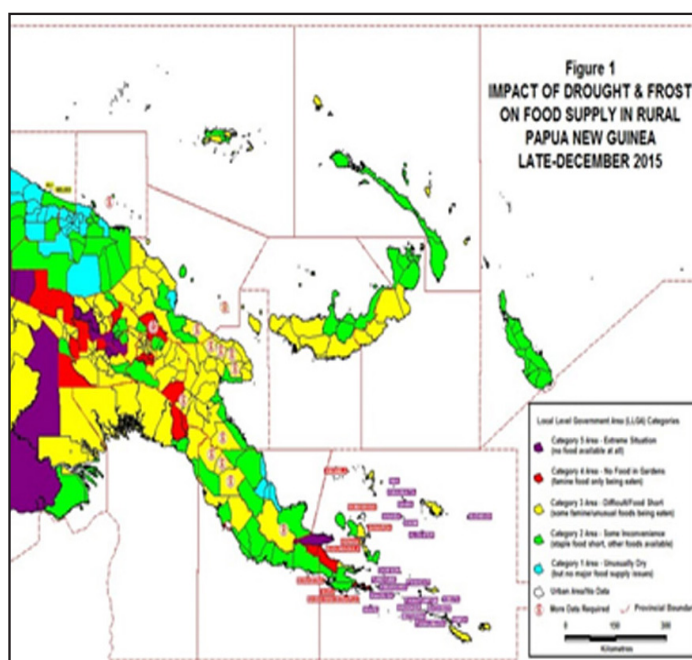
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## Highlights

- The global economy grew by 2.4% (3.1% by IMF) in 2015 - lower than projections due to deceleration in developing and emerging economies, though developed economies, especially the US showed some positive signs of recovery. World Bank expects global growth to increase to 2.9% in 2016, though risks are tilted on the downside.
- Activity in developing and emerging markets has grown by 4.3% in 2015 and is forecast to expand by 4.8% in 2016. The Chinese economy is expected to slow further, while Russia and Brazil are expected to remain in recession in 2016.
- Commodity prices continued to decline, with commodity price index down by 7.1% and 30.7% over the December quarter and 2015 respectively. There is consensus that commodity prices will remain depressed while production remains strong and the global growth outlook soft.
- Asian Development Bank (ADB) revised its economic growth projections for the Pacific region to 6.3% in its Pacific Economic Monitor (PEM) December, compared to its September estimate of 6.7%. The downgrade reflects the continued fall in commodity prices and its impact on economies in the region, especially Papua New Guinea (PNG). The uncertainty around the Chinese economy will impact other developing nations including the Pacific Island Countries.
- 2015 has been a challenging year for PNG with GDP projections lowered from 15.5% to around 10%. The government plans to reduce expenditure by K1.4b and raise addition funds to K1.1b via a Sovereign bond. Low commodity prices and uncertainty around the El Niño phenomenon, poses downside risks to the economy.
- The El Niño phenomenon has had a major impact on the livelihood of many people. The economic impact on inflation, agriculture production and real output is expected to be significant and severe.

## Impact of El Niño in PNG



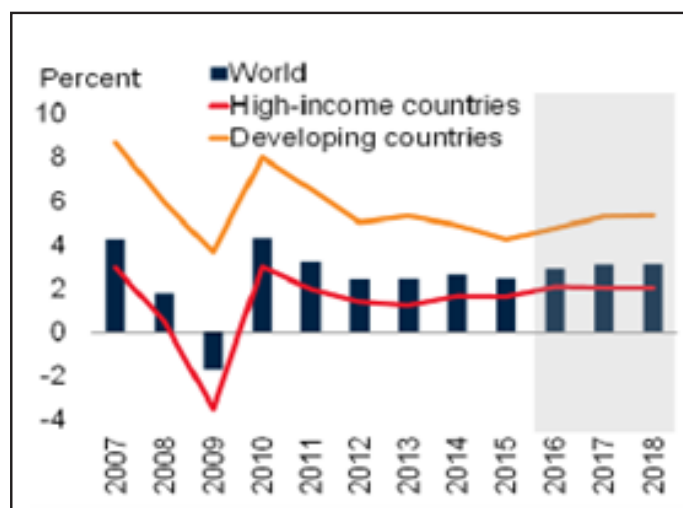
Source: Michael Bourke, Bryant Allen and Michael Lowe, Institute of National Affairs (INA)

## Global Economy

2016 has started on a rough note as global share markets fell on the back of geopolitical concerns, uncertainty regarding the pace of slowdown of the Chinese economy, wariness about the Fed raising interest rates and the impact of a rising US dollar and falling Chinese Renminbi. The Chinese economy grew by 6.9% in 2015, the weakest growth since the financial crisis.

Global growth fell short of projections, ending 2015 at 2.4% from 2.6% in 2014 according to the World Bank. IMF estimates growth to be 3.1% in 2015 and revised its projections for 2016 downwards by 0.2% to 3.4%. The lacklustre growth reflected the continued deceleration of growth in emerging and developing economies amid post-crisis lows in commodity prices, weaker capital flows and subdued global trade. According to World Bank's January 2016 Global Economic Prospects, global growth is projected to increase to 2.9% in 2016 and 3.1% in 2017-18.

**Figure 1: Global GDP Growth (% annual)**



Source: World Bank, GEP January 2016.

Growth in major high-income economies was estimated at 1.6% in 2015, driven by stronger demand, particularly in the US where employment conditions remain robust. Credit growth is picking up and unemployment is easing in the Euro area, while recover in Japan remains fragile despite policy stimulus. Economic activity in high-income economies is projected at 2.1% in 2016.

Developing and emerging economies are forecast to expand by 4.8% in 2016, up from 4.3% in 2015. Developing economies contribution to global growth from commodity exporting economies has declined substantially due to the declining commodity prices and moderation in China. Growth is expected to slow further in China, while Russia and Brazil are expected to remain in recession in 2016.

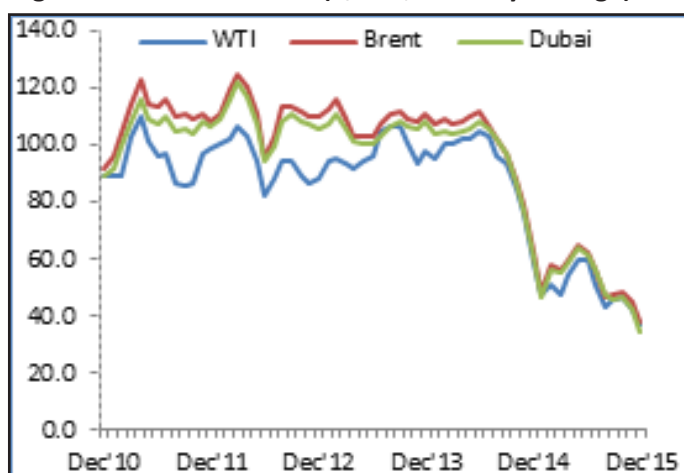
Risks to the global outlook remain tilted to the downside including the ongoing adjustments in the global economy: slowdown in emerging market economies, China's rebalancing, lower commodity prices, and the gradual exit from extraordinarily accommodative monetary conditions in the United States.

## Commodities

Commodity prices fell by 7.1% over the December quarter and by 30.7% over the year. The decrease was driven by price drops in energy, especially from crude oil, due to sustained oil production which outpaced global demand. International Monetary Fund (IMF) noted that the El Niño phenomenon has started to push up food prices like sugar.

Crude oil price dropped by 21% during the December quarter, reflecting the sustained oil production growth in OPEC members and subdued demand growth. The Syrian and Russia tension helped price rebound slightly, however returned to its declining trend.

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



Source: IMF commodity market monthly, December 2015.

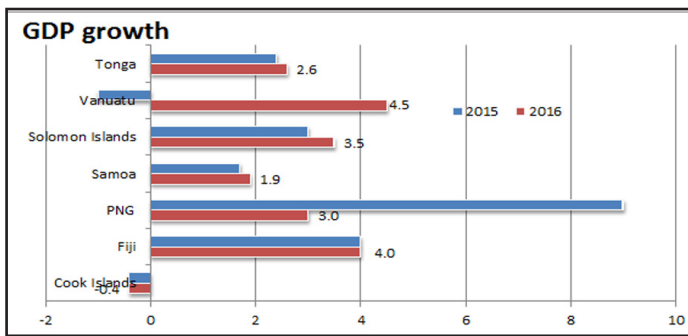
LNG<sup>1</sup> price has fallen 43% over the year to USD9.5 per million metric tonne as at the end of December.

Metal prices decreased by 12.9% over the December quarter and by 29.3% over 2015. Slowing demand in China and increase in new production capacity resulted in higher supply than demand.

Similarly, agriculture price was down with most of PNG's main commodities impacted over 2015. Commodity prices are expected to remain low given ample supplies and weak prospects for global economic growth.

## Pacific Overview

ADB revised its economic growth projections for the Pacific region to 6.3% in its December PEM report, compared to its September estimate of 6.7%. The downgrade reflects expected mainly the financial difficulty faced by PNG in financing its deficit budget.

**Figure 3: GDP Projections (% annual)**

Source: ADB data, BSP

PNG still contributes significantly to the region's GDP; however, economic activity is expected to wane in 2016. ADB noted that the Pacific region is going through the El Niño weather phenomena with effects expected to be more severe than experienced in 1997-1998. Impacts in PNG is expected to be more severe than other countries however; BSP feels that the worst period may be over.

Tourism in the Pacific region, continued to remain strong, with ADB data indicating continued departures from Australia and New Zealand to Fiji and other Pacific Island Countries. ADB projects foreign arrivals in the Pacific region to grow by 10.2% in 2015 and further grow by 6% to 7% per annum through 2019. ADB findings show the visitor flows are exogenous to the Pacific region, however specific countries need to improve transport connectivity and lower travel costs to attract tourists.

Inflation eased in most Pacific Island countries as a result of the falling international oil prices. Inflation is expected to increase to 4.1% in 2015 and increase slightly to 4.4% in 2016.

## Papua New Guinea

2015 has been a challenging year for PNG with commodity prices remaining at their lows, exacerbated by untimely policy responses on the domestic arena. Some of the business worries include the FX margin setting and its impact on availability of foreign currency, the temporary suspension of Ok Tedi Mining Ltd (OTML), mine site disruptions at Porgera and Hidden Valley, moderation in property valuations and slight decline in market yields. The end of the PNG LNG construction phase has impacted business spin-offs as well. On the positive side, BSP has acquired Westpac's Pacific operations at \$A125m, while Kina Group of Companies took over Maybank for \$A120.7m. Despite, business confidence and optimism in the beginning of the year, 2015 proved to be a challenging and tough year indeed.

The government faced mounting fiscal challenges in 2015, with the government responding well albeit late, to instil discipline. The Supplementary budget identifies expenditure cuts of about K1.4b and additional revenue of K1.1b, mainly from IRC and SOEs.

The 2016 National Budget was passed by Parliament on 3 November 2015. Total expenditure and revenue is projected at K14.8b and K12.7b respectively, leaving a net deficit of K2.1b. Financing is mostly expected to be domestic sources, with net borrowing expected to be 3.8% of GDP.

Lower commodity prices and a reduction in PNG LNG capital inflows have led to the depreciation of PGK by

**Table 1: Budget Estimates**

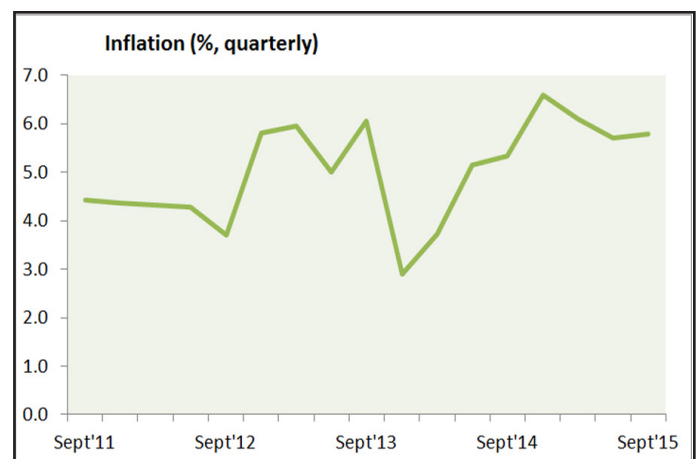
Economic Indicators	'14	'15F	'16F
Total GDP (%)	13.3	9.9	4.3
Non-mining GDP (%)	1.2	2.4	3.4
Inflation (average, %)	5.2	5.1	5.7
Budget Balance (% of GDP)	-8.3	-4.9	-3.8
Debt to GDP ratio (%)	35.5	34.7	35.8

Source: 2016 National Budget

13.7% and 2.2% against the USD and AUD respectively over the year. There have been calls for Bank of PNG to ensure that the exchange rate is market driven after the crawl-like arrangement. Inflation has stabilised despite liquidity concerns, coupled with the inflationary pressure from the depreciating Kina.

## Consumer Price Index

Annual Headline inflation increased slightly to 5.8% in September quarter, compared to 5.7% in June quarter 2015. According to National Statistics Office (NSO), there were increases in the 'housing, alcohol beverages, tobacco, bettlenut' and other expenditure groups which more than offset declines in 'recreation, miscellaneous and transport group.'

**Figure 4: Inflation rate (% quarterly)**

Source: Bank of PNG, BSP



Retail Price Index (RPI) increased to 6.9% as at October 2015, compared to 5.7% in the corresponding period of 2014. In consideration of inflation and RPI results, the Bank of PNG has maintained the Kina Facility Rate (KFR) at 6.25% over the December quarter.

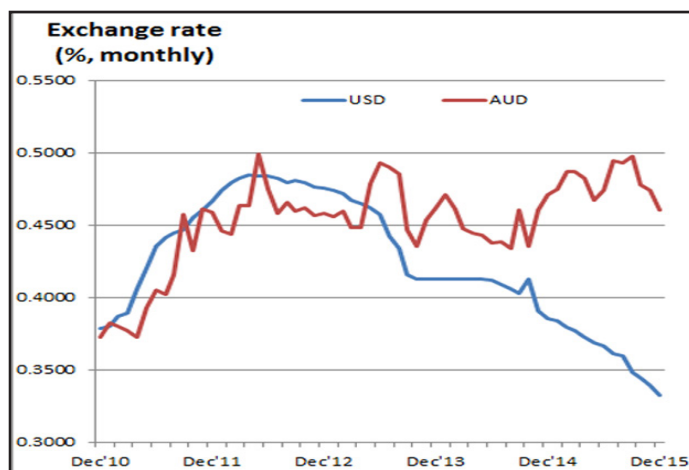
Headline inflation is estimated at 5.1% in 2015, a downward revision from the 2014 inflation outcome of 5.2% and slightly higher than the 2015 Mid-Year Economic & Fiscal Outlook (MYEFO) estimate of 4.9%. In 2016, inflation is expected to pick up to around 5.7% reflective of the expected improvement in global economy and the pickup in commodity prices. The El Niño phenomenon is expected to exert upward pressure on inflation.

### PNG Exchange Rate

PNG Kina depreciated against the USD by 4.6% to 0.3325 over the December quarter. The decline was due to lack of supply of foreign currency relatively to demand. PNG Kina declined by 7.4% against the AUD to 0.4604 over the quarter reflecting cross-currency movements. Over the year, PGK has depreciated by 13.7% and 2.2% against the USD and AUD respectively. IMF is of the view that further depreciation is needed to safeguard external buffers and eliminate imbalances in the FX market.

In spite of Bank of PNG's effort to support the market, lower commodity prices and the recent El Niño weather phenomenon continued to impact foreign currency inflows. Bank of PNG requested for follow-up IMF technical assistance regarding its participation in the FX market, and will work on clarifying its focus.

Figure 5: PNG Exchange rate (% , monthly)



Source: Bank of PNG, BSP

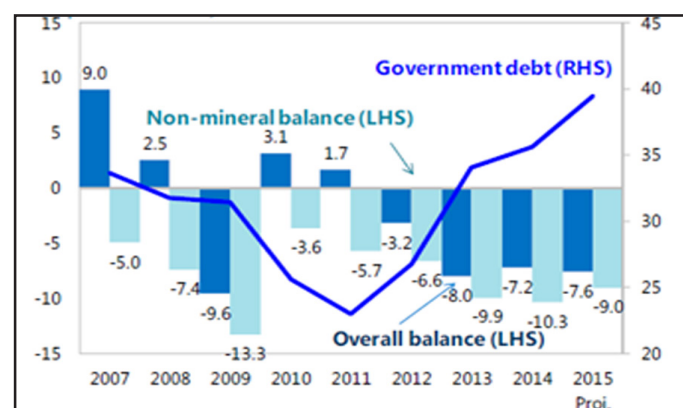
BSP Group CEO, Robin Fleming said that "for the short term a circuit breaker is required and the sovereign bond will assist with this." Mr. Fleming further noted that the bond would raise US dollars to retire kina denominated government debt, which would [help] reduce the prospect of government budget deficit funding crowding out lending activities. It would also provide a source of US dollars to replenish reserves and settle private sector

import payables. BSP understands that a roadshow will be held by government officials and its international lending advisers early 2016. Challenges influencing investor appetite for the sovereign bond issue remain high, given emerging markets debt margins, the PNG Sovereign credit rating downgrade and global market.

### Fiscal Position

The National Government's fiscal operation over the nine months to September 2015 show an overall deficit of K1,940.1m, compared to K1,510.1m in the previous corresponding period (pcp). The deficit was financed mainly from domestic sources, which totalled K2,076m at the end of September. With domestic appetite for short and long term fixed income securities drying-up, the government plans to look offshore for funding. BSP expects external funding to be challenging as well costly for the tax-payers.

Figure 6: Fiscal Operations



Source: IMF

According to Bank of PNG monthly economic review (November 2015), total revenue was 11.7% higher at K7,455.8m, compared to the corresponding period of 2014. The 2016 Budget documents show that, total revenue for 2015 is expected to be K12,637.9m (-10%) reflecting significant decline in commodity prices.

ADB commented that PNG will likely face difficulty financing its 2016 budget deficit with domestic commercial banks reaching their limits on treasury bill investments. BSP understands that Superfund's appetite for fixed interest investments has also dried out. The government's plan to issue sovereign bond of \$1.0 billion in 2016 will be challenging.

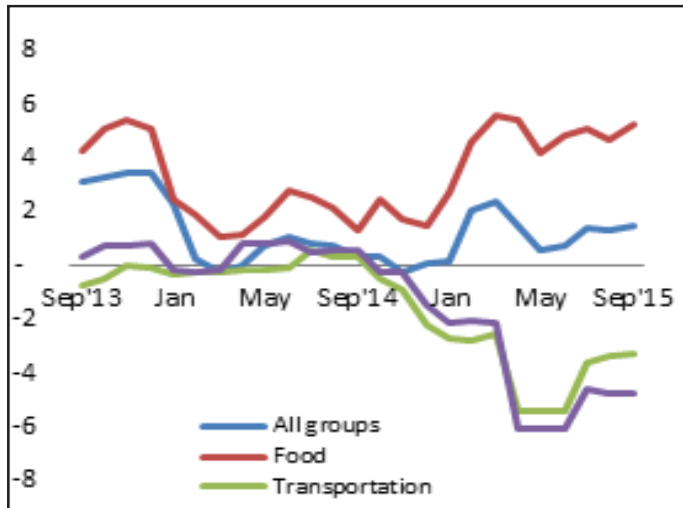
KPMG's PNG Taxation Review (November 2015) showed that, there will be no new taxes imposed in 2016, with capital gains tax expected in 2018. Corporate tax will be reduced in 2017 and 2018 to 20%, while Dividend Withholding Tax (DWT) reduced to 10% during the same period.

## Fiji

The Fijian economy remains vibrant, with all economic indicators suggesting that the 4.0% growth target for 2015 is achievable. Strong consumer demand and industrial activity continue to support growth.

Inflation rose to 1.8% in November from 1.4% in October, driven by food & non-alcoholic beverages and miscellaneous goods & services category. Low imported inflation (oil prices and trading partner inflation) have kept inflation at subdued levels. 2015 year end inflation is expected to be around 2%.

**Figure 7: Inflation (% , monthly)**



Source: Fiji Bureau of Statistics, BSP

Sectoral performance was mixed over the year to November 2015. Recent data on industrial production highlighted positive outcomes in gold (9.7%), electricity (3.5%) and cement (18.9%) production cumulative to November. Sugarcane and sugar production performed better than projected despite the prolonged drought conditions.

On the downside, mahogany logs and wood chip production declined by 8.5% and 9.7%, respectively in the year to November 2015.

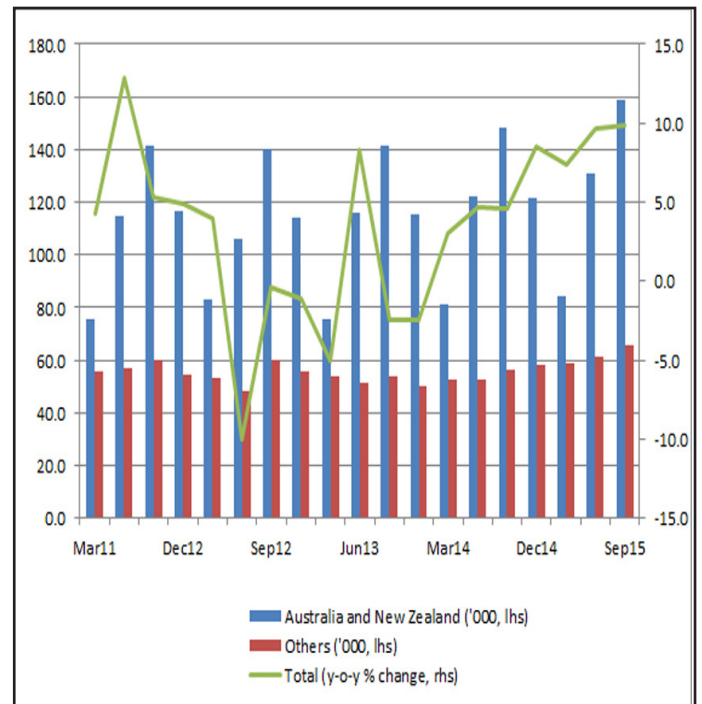
Similarly, industrial activity remained robust supported by the construction activity. Labour market indicators were positive, with the Reserve Bank's Job Advertisements Survey showing an 18.4% increase in advertised vacancies over the year to November.

Tourism performed well in 2015 YTD, after achieving its highest growth of 692,630 in 2014. This has been underpinned by expanding air links, and the shift from Vanuatu, following the wake of Cyclone Pam.

According to ADB's December PEM, visitor arrivals increased by 9.2% (y-o-y) over the first 3 quarters of 2015. Arrivals from Asia (particularly, China) continue to expand rapidly, now account for around 9% of total visitors to Fiji.

The number of visitors from the largest source markets—Australia and New Zealand—increased by 4.1% and 13.3% (y-o-y), respectively. RBF expects visitor arrivals to surpass the 8% growth projected in 2015.

**Figure 8: Fiji Tourism Arrivals (% , quarterly)**



Source: Fiji Bureau of Statistics, BSP

The banking sector continued to be positive with Banking Industry Quarter Condition Report (June 2015) showing the following:

- Total assets grew by 14.1% to \$7.7b on an annual basis, due to increase inflows of funds and lending activities. Total deposits also increased by 12% to \$6.5b at the end of June.
- Banks earnings was satisfactory, with banks' annualised return on assets (ROA) increased from 2.2% to 2.3% and the annualised return on equity (ROE) also rose from 21.5% to 21.9% at the end of June 2015.

Downside risks to the economy remain from slowing growth in the China leading to weaker trade in Asia and the Pacific region.

## Solomon Islands

Economic growth will be supported by strong growth from transport and communication, construction and the utilities sectors, as well as the fisheries sector. Based on preliminary estimates, the CBSI monthly production index improved by 28% to 104 points in November from 81 points in October. The increase reflected increase in log production and strong recovery in copra and cocoa output during the month.

On the international market, average prices for all export commodities fell, except for cocoa prices which increased by 5% and fish price which levelled off at the end of November.

The 2016 budget is still being prepared. The fiscal position narrowed to a deficit of \$8m in November from \$108m deficit recorded in October. This resulted from a 30% increase to \$288m in revenue collections whilst expenditure contracted by 10% to \$295m over the prior month.

The increase in revenue was due to a 14% increase in tax proceeds to \$245, coupled with grant of \$35m received in November. The debt-to-GDP ratio remained broadly unchanged at 11% as in the previous month. ADB noted that, the fiscal deficit target is expected to be similar to that in the 2015 budget (equivalent to about 5% of GDP), with continued focus on major infrastructure projects.

Inflationary pressures remained subdued over the first six months of the year, owing in part to low global fuel and food prices. Headline inflation has begun to rebound from the deflationary trough of minus 4.8% reached in June, with latest data showing inflation of 1.2% in October. Core inflation remained positive over the first half of the year, ending October at 1.0%. Inflation is expected to be within the lower end of the March MPS forecasted range of 3-5% within the next 6 months.

Following the Board of Directors meeting on 1 Oct, the Governor stated that CBSI monetary policy stance will remain accommodative for the next 6-months. BSP notes that downside risks remains high with the El Niño conditions likely to hurt agricultural production and exports, while underspending of the budget would exert further downward pressure on the economy.

## Samoa

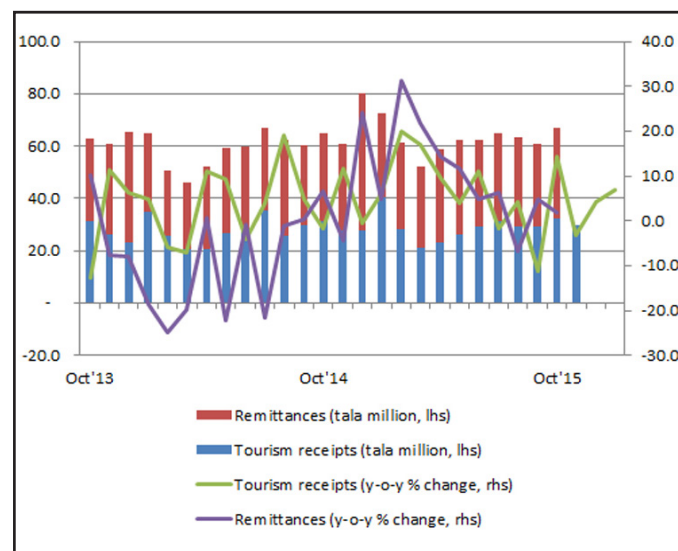
GDP grew by 1.7% in 2015 compared to 1.2% in 2014. The growth in tourism, transport, electricity and water, and fishing offsetted declines in non-food manufacturing, agriculture, and construction.

According to ADB, low fuel prices helped reduce operating costs in the transport and energy sectors. Construction activity, which had been stimulated by disaster response and preparations for hosting international events, has now wound down. ADB projects growth to remain moderate at 1.9% in the absence of new large infrastructure projects and growth in Australia and New Zealand.

Tourism remains the primary driver of growth, with visitor arrivals increasing by 11% (y-o-y) as at October 2015. Visitor arrivals purposes continued to be for 'holidays' with tourism receipts recorded at WST30m at the end of October 2015, having risen by 6% (y-o-y). According to IMF, remittance also increased by 6.7% (y-o-y) during the year due to higher inflows from Australia and New Zealand.

The Government of Samoa approved another expansionary fiscal policy for 2015/16. Fiscal deficit is forecasted at 3.1% of GDP and will be financed by concessionary loans.

**Figure 8: Key Sources of External Income (monthly)**



Source: Central Bank of Samoa, BSP

Grants are expected to drop by 28.0% (y-o-y), leading to a 5.8% decline in overall fiscal inflows. ADB stated that Samoa is reclassified as a country at “medium” risk of debt distress according to the July 2015 International Monetary Fund–World Bank debt sustainability analysis. This follows the completion of post disaster reconstruction and rehabilitation projects, as well as reduced grant assistance.

According to the Financial Inclusion Report (June 2015) released by the Central Bank of Samoa (CBS) and its partners

- **39% of Samoan adults currently have a bank account, while 12% use other formal services** such as credit unions, microfinance, insurance, or finance companies. 34% of respondents are excluded from both formal and informal financial services,
- **56% of adults** reported receiving money from relatives or acquaintances in Samoa or abroad (remittance),
- **69% of adults in Samoa have life insurance**, followed by about one-third (31%) with accident coverage.

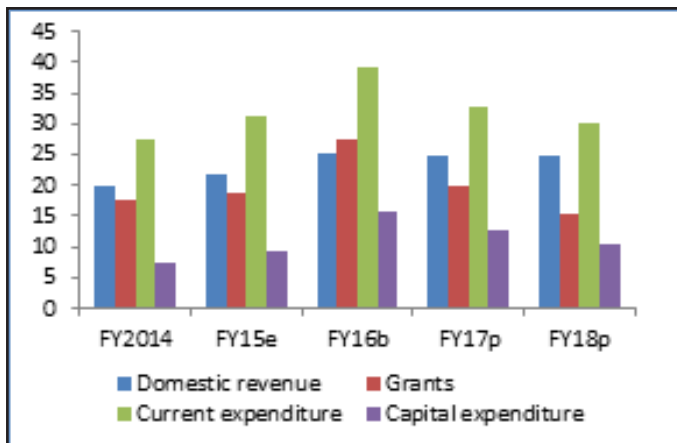
Insurance coverage is relatively high in Samoa compared to Fiji and Solomon Islands. Insurance ownership in Samoa is influenced by ownership of life insurance. The higher proportion of life insurance ownership could be driven by the fact that the main provider of life insurance in Samoa (the Samoa Life Assurance Corporation) is state owned, with the objective of providing affordable insurance to all Samoans.

## Tonga

According to National Reserve Bank of Tonga (NRBT) GDP for 2014/15 was estimated at 2.5%. This was mainly due to improved growth in the secondary and tertiary sectors driven by major events in mid-2015 such as the coronation, school reunions and church conferences. These more than outweighed the continued negative growth in the primary sector.

NRBT anticipates strong growth of 3.3% for 2015/16, an upward revision from the estimated growth of 3.2% in the February 2015 MPS. The outlook upgrade was supported by the rebound in primary production, particularly the agricultural and fisheries sectors. The growth estimate is supported by positive spill over effects from the declining global oil prices and low inflation.

**Figure 9: Government revenue and expenditure (% of GDP, annual)**



Source: Tonga Department of Statistics, BSP

According to ADB PEM (December 2015), the government recorded a fiscal surplus equivalent to 0.2% of GDP in 2015. Total revenue inclusive of grants was 12% higher with domestically sourced revenue remaining higher. Total expenditure was increased by 13% with non-wage operational spending growing by 17% and capital spending rising by 31%. Spending on public wages grew by 7% from 2014, driven by new government hiring, but remained below the budgeted allocation.

Government receipts are expected to increase in the near term from budget support, issuance of government bonds and other new revenue streams.

These are to finance the overall net borrowing requirement of \$20.7m for the 2015/16 fiscal year, as reflected in the Ministry of Finance and National Planning's 2015/16 Budget Statement. NRBT has announced the issue of 5-year bonds at 3.0%.

Headline inflation fell to 2.1% and 1.9% over the month of September and y-o-y respectively. The monthly decline was mainly caused by domestic inflation, which fell by 4.3% due to lower prices within the food & household operation

components.

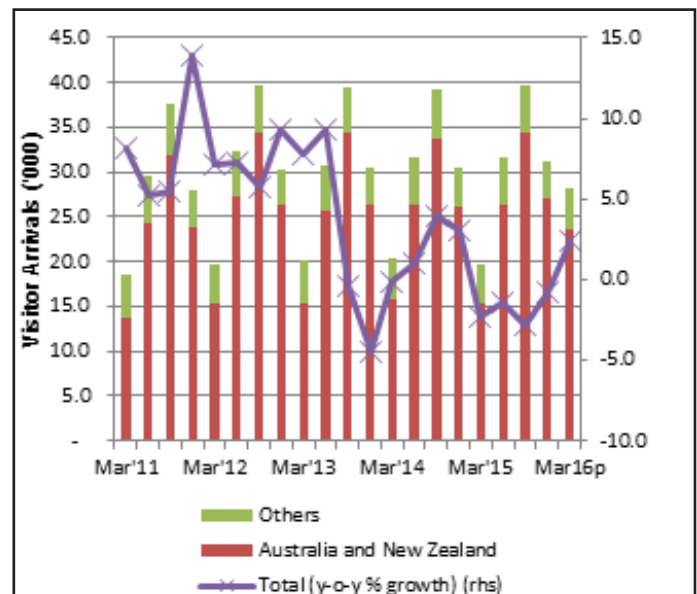
Gross official foreign reserves reached a record high of \$310.9m at the end of Aug'15. This is in line with a surplus of \$26.9m in the balance of Overseas Exchange Transactions (OET) over the year to Aug'15. The NRBT expects the high level of foreign reserves to be maintained in the near term.

## Cook Islands

Cook Islands economy is expected to grow over the next two years, however at a slower rate than in the previous two years. According to the Budget Policy statement 2014/2015, real GDP growth was revised to 2.1% due mainly to the expected fall in aid commitments. Grants/ Official Assistance (ODA) comprises 31% of revenue, while 62% is from general taxation.

The government projects a fiscal deficit equivalent to 10.5% of GDP for FY2016. This largely results from planned capital investments equivalent to 21.4% of GDP on projects including investments in renewable energy, water and sanitation, and education infrastructure.

**Figure 8: Key Sources of External Income (monthly)**



Source: Central Bank of Samoa, BSP

According to ADB, tourist arrivals declined slightly in 2015, reflecting accommodation shortages in peak periods. Investments in accommodation facilities are constrained by issues related to land tenure and the cost of meeting sanitation requirements.

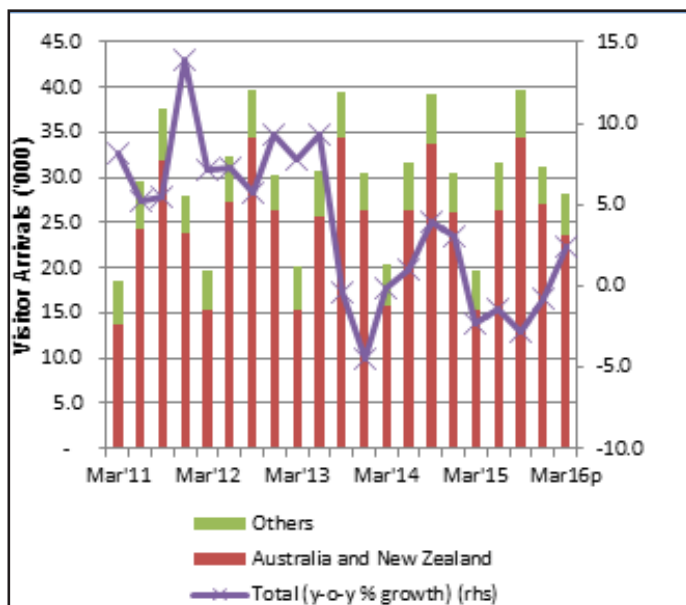
Continued efforts have been made to boost the tourism industry, with the Prime Minister, Honourable Henry Puna, announcing the streamlining of department document requirement, effective 1 Aug'15. Tourism remains the largest industry accounting for 60% of the economy.



This indicates that most of the items driving the CPI down are those considered to be highly volatile, subject to significant seasonal fluctuations, or largely affected by policy decisions

ADB commented that, Cook Islands faces challenges to achieve economies of scale and vulnerability to natural disaster and external shocks. The greatest challenge is to raise the long term rate of economic growth, which is slightly above zero (ADB mission conclusions, October 2015).

**Figure 8: Key Sources of External Income (monthly)**



Source: Central Bank of Samoa, BSP

## KEY CONTACTS

**Robin Fleming** - Group CEO  
[rfleming@bsp.com.pg](mailto:rfleming@bsp.com.pg)

**Peter Beswick** - Group GM Corporate  
[pbeswick@bsp.com.pg](mailto:pbeswick@bsp.com.pg)

**Paul Thornton** - Group GM Retail  
[pthornton@bsp.com.pg](mailto:pthornton@bsp.com.pg)

**Rohan George** - GM Treasury  
[rgeorge@bsp.com.pg](mailto:rgeorge@bsp.com.pg)

**Richard Borysiewicz** - GM BSP Capital  
[rborysiewicz@bsp.com.pg](mailto:rborysiewicz@bsp.com.pg)

**Aho Baliki** - GM Paramount  
[abaliki@bsp.com.pg](mailto:abaliki@bsp.com.pg)

**Christophe Michaud** - GM BSP Finance  
[cmichaud@bsp.com.pg](mailto:cmichaud@bsp.com.pg)

**Malakai Naiyaga** - MD, BSP Life, Fiji  
[mnaiyaga@bsp.com.fj](mailto:mnaiyaga@bsp.com.fj)

**Mathew Hasu** - Snr Mgr Corp Strategy  
[mhasu@bsp.com.pg](mailto:mhasu@bsp.com.pg)

**Jotam Sinopane** - Analyst  
[jsinopane@bsp.com.pg](mailto:jsinopane@bsp.com.pg)

## COUNTRY MANAGERS

**Kevin McCarthy** - Fiji  
[kmcCarthy@bsp.com.fj](mailto:kmcCarthy@bsp.com.fj)

**David Street** - Cooks Island  
[dstreet@bsp.cpm.pg](mailto:dstreet@bsp.cpm.pg)

**Maryann Lameko Vaai** - Samoa  
[mlameko-vaii@bsp.com.pg](mailto:mlameko-vaii@bsp.com.pg)

**David Anderson** - Solomon Islands  
[danderson@bsp.com.sb](mailto:danderson@bsp.com.sb)

**Daniel Henson** - Tonga  
[dhenson@bsp.com.pg](mailto:dhenson@bsp.com.pg)



## MARKET RATES

FOREIGN EXCHANGE			
	OCTOBER	NOVEMBER	DECEMBER
PGK/USD	0.3425	0.3375	0.3325
FJD/USD	0.4733	0.4643	0.4711
SBD/USD	0.1266	0.1237	0.1241
WST/USD	0.3874	0.3793	0.3793
TOP/USD	0.4608	0.4489	0.4489
NZD/USD	0.6696	0.6530	0.6840

COMMODITIES			
	OCTOBER	NOVEMBER	DECEMBER
Oil (US\$ per barrel WTI)	48	43	37
Gold (US\$ per ounce)	1,142	1,065	1,060
Copper (US\$ per metric ton)	5,112	4,586	4,705
Nickel (US\$ per metric ton)	10,046	8,865	8,780
Palm Oil (MYR per metric ton)	2,428	2,385	2,485
Coffee (US\$ per LB)	124	120	127
Cocoa (US\$ per metric ton)	3,263	3,339	3,211
Sugar (US\$ per metric ton)	395	403	422
Lumber (US\$ per 1,000 feet)	257	247	256

## MACRO DATA

Real GDP Growth (% annual)				
	2013	2014	2015F	2016F
PNG	5.0	8.4	9.9	4.3
Fiji	4.6	4.5	4.0	4.0
Solomon Islands	3.2	1.0	3.0	3.5
Samoa	0	1.9	1.7	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	5.2	5.1	5.7
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	-4.9	-3.8
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	1,920	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

## Economic Data Sources:

**Commodities & FX:** Bloomberg  
**PNG:** 2016 Budget, Department of Treasury, Bank of PNG, 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

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