BANK OF PAPUA NEW GUINEA

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Quarterly Economic Bulletin
September Quarter 2019

Mr. Loi M. Bakani CMG, Governor of the Bank of Papua New Guinea (Bank of PNG), today released the September 2019 Quarterly Economic Bulletin (QEB). This statement provides an overview of the economic and financial developments during the September quarter of 2019 and some key developments since then.

1. UPDATE ON DEVELOPMENTS SINCE SEPTEMBER 2019

Global growth continues to remain weak reflecting the on-going trade dispute between the United States (US) and China. The slowdown is broad-based across the advanced economies, as well as the major emerging market and developing economies. This is exacerbated by policy uncertainty on global trade reflecting a further rise in trade protectionism and investment. In the US, a resilient service sector, and household income and consumption supported by employment growth continues to support activity. However, a slow fiscal impulse and weaker growth in its trading partners are weighing on confidence and activity. Growth in the United Kingdom (UK) remains weak as investment slowed reflecting uncertainties surrounding the Brexit, while growth in the euro area slowed mainly reflecting lower trade. The slowdown in activity is more pronounced in the emerging market and developing economies, with growth in China weakening further as the economy continues to rebalance from investment to consumption amid the on-going trade tensions with the US. The International Monetary Fund (IMF) in its October publication of the World Economic outlook (WEO) lowered its 2019 growth forecast to 3.0 percent from its earlier projection of 3.3 percent in the April WEO.

Weak global growth in 2019 and its downward impact on global inflation has prompted several major central banks during the course of the year to further ease monetary policy, while fiscal policy; especially in advanced economies, remains broadly neutral. The fall in global inflation continues to benefit Papua New Guinea (PNG) in terms of lower foreign inflation feeding through to domestic prices. Domestic inflation has been trending downwards resulting in the easing of domestic monetary policy to support growth. The Bank of PNG eased monetary policy by reducing the Kina Facility Rate (KFR) by 50 basis points from 5.50 percent in November to 5.00 percent in December 2019.

The latest international commodity price data published by the World Bank in October 2019 indicate a general fall in prices of PNG's main export commodities. Prices for copper and oil declined whilst gold prices picked up reflecting investors preference for gold as a safe haven investment. For non-mineral commodities, only cocoa prices increased while coffee, palm oil, logs and tea prices remained weak.

Governor Bakani expressed concern that lower international commodity prices will continue to affect PNG's export, tax revenue and foreign exchange inflows. He reiterated the importance of the Government's support for the fishing and agriculture sectors in terms of policy reforms and capital investments to increase production and improve export receipts, as well as encourage import substitution activities to reduce the country's import dependency.

In November, the Government introduced a supplementary budget projecting a higher deficit of K3,504 million, as total revenue was revised downward to K13,022.4 million and total expenditure was revised upward to K16,525.9 million against the 2019 Budget. The deficit was to be financed from external and domestic sources. External financing of K1.0 billion comprises loans of US$300 million from Australia and US$100 million from the Asian Development Bank (ADB). Both these financing were received before the end of 2019. The Governor encouraged the Government to improve revenue raising measures and monitor and maintain expenditure targets to avoid any slippages that would increase the debt level.

The IMF identified the ongoing challenging fiscal position of the Government during 2019 and recommended policy adjustments to achieve long-term fiscal sustainability and macroeconomic stability. They also highlighted the importance of improving good governance in Government processes to support long term development goals. The recommended policy adjustments include: achieving fiscal consolidation, strengthening the monetary policy framework and improving monetary transmission, and restoring the exchange rate setting mechanism through the interbank market. These recommendations were proposed in the Staff Monitoring Program (SMP) by the IMF. The SMP involves funding from the Australian Government and other multilateral agencies but not from the IMF. The IMF SMP is yet to be cleared by the Government and approved by the IMF Board.

Governor Bakani also mentioned that the economy requires a major boost to achieve higher economic growth over the coming years. On this basis the Governor is encouraged by the conclusion of the Papua Liquefied Natural Gas (LNG) project agreement and the commencement of negotiation for P'nyang LNG project between the State and the developer. He also encouraged the Government and project partners to progress the development of mineral and gas projects as they will have a significant impact on economic growth and support the foreign exchange market.

At the end of December 2019, the average daily kina exchange rate depreciated against the pound sterling by 4.3 percent to 0.2284 and the US dollar by 0.2 percent to US$0.2939, while it appreciated against the Japanese yen by 1.1 percent to ¥31.9474, euro by 0.3 percent to €0.2654 and the Australian dollar by 0.2 percent to A$0.4300. These currency movements resulted in the Trade Weighted Index (TWI) that depreciated by 0.1 percent to 29.7.

At the end December 2019, the level of foreign exchange reserves increased to K7,832.97 (US$2,338.14) million mainly reflecting the budget support loans from Australian and the ADB.

2. OVERVIEW OF THE DEVELOPMENTS IN THE SEPTEMBER QUARTER OF 2019

Economic indicators available to the Bank of Papua New Guinea (the Bank) point to a lower growth in business activity in the September quarter of 2019. The growth was mainly driven by the mineral sector with higher production and export of mineral commodities. However, weak recovery in the global economy and its impact on international commodity prices continue to affect most of PNG’s major exports during the quarter. Consequently, most prices and production of agricultural commodities fell affecting foreign exchange inflows into the domestic market. It’s spill-over effect to the non-mineral sector was evident as import orders continue to remain high. With the shortfall in foreign exchange, coupled with Government’s cash flow constraints, the non-mineral sector showed signs of slowdown in the quarter as reflected by the decline in the level of non-mineral private sector employment. During the quarter, the kina exchange rate remained relatively stable, as indicated by the TWI which showed marginal appreciation. Annual headline inflation in the September quarter eased to 3.3 percent from 3.9 percent in the June quarter.

During the quarter, the kina appreciated against most trading currencies except the US dollar and the Japanese yen. These movements resulted in the TWI appreciating slightly by 0.47 percent to 29.716 in the quarter. With the continued downward trend in inflation outcomes and stability in the exchange rate and other macroeconomic indicators, as well as lower inflationary expectations, the Bank reduced the monthly KFR by 75 basis points to 5.5 percent in the September quarter, from 6.25 percent in the June quarter of 2019.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the formal private sector increased by 10.2 percent in the June quarter of 2019, compared to a decline of 13.6 percent in the March quarter of 2019. Excluding the mineral sector, sales increased by 16.9 percent in the June quarter, compared to a decline of 13.5 percent in the previous quarter. By sector, sales increased in the manufacturing, financial/business/other services, retail, wholesale and mineral sectors, while it declined in the construction, agriculture/forestry/fishing (AFF) and transportation sectors. By region, sales increased in the National Capital District (NCD), Momase (excluding Morobe) and the Southern (excluding NCD) regions, while it declined in the Islands, Highlands and Morobe regions. Over the year to June 2019, total sales increased by 13.5 percent, compared to a decline of 1.6 percent over the corresponding period of 2018. Excluding the mineral sector, sales increased by 29.9 percent over the year to June 2019, compared to a decline of 3.0 percent over the corresponding period of 2018.

The Bank's Employment Index shows that the total level of employment in the formal private sector declined by 2.6 percent in the September quarter of 2019, compared to a slight increase of 0.5 percent in the June quarter of 2019. Excluding the mineral sector, the level of employment declined by 2.8 percent. By sector, the level of employment declined in the financial/business and other services, AFF and mineral sectors while it increased in the wholesale, construction, manufacturing, retail and transportation sectors. By region, the level of employment declined in all centres. Over the year to September 2019, the total level of employment increased by 1.8 percent, compared to a decline of 2.0 percent in the corresponding period of 2018. Excluding the mineral sector, employment fell by 0.7 percent over the year to September 2019, compared to a decline of 2.3 percent in the corresponding period of 2018.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), increased by 0.7 percent in the September quarter of 2019, same as the June quarter of 2019. All expenditure groups increased except ‘Housing’ which declined, while ‘Restaurants and Hotels’, ‘Transport’ and ‘Communication’ expenditure groups recorded no price changes. By urban centre, prices increased in all the surveyed centres. Annual headline inflation was 3.3 percent in the September of 2019, compared to an increase of 3.9 percent in the June quarter.

In the September quarter of 2019, the average daily kina exchange rate appreciated against the pound sterling by 3.7 percent to 0.2388, the Australian dollar by 1.6 percent to 0.4293 and the euro by 0.5 percent to 0.2647, while it depreciated against the Japanese yen by 2.8 percent to 31.5928 and the US dollar by 0.5 percent to 0.2943. These currency movements resulted in the TWI increasing by 0.47 percent to 29.7163 in the September quarter of 2019.

The weighted average kina price of PNG's export commodities, excluding LNG, increased by 3.3 percent in the September quarter of 2019, compared to an increase of 7.2 percent in the corresponding quarter of 2018. There was an increase of 4.8 percent in the weighted average price of mineral exports compared to an increase of 16.0 percent in the corresponding quarter of 2018, reflecting higher kina prices for gold and nickel. For agricultural, logs and marine product exports, the weighted average kina price declined by 4.6 percent compared to a decline of 11.7 percent in the corresponding quarter of 2018. There were lower prices of all non-mineral export commodities, except for cocoa, tea and marine products. Excluding log exports, the weighted average kina price of agricultural and marine product exports declined by 6.3 percent in the quarter, compared to a decline of 15.4 percent in the corresponding quarter of 2018. The lower kina export price reflected a decline in international prices.

There was an overall balance of payments deficit of K999 million for the nine months to September 2019, compared to a surplus of K529 million in the corresponding nine months of 2018. A deficit in the capital and financial account more than offset a surplus in the current account.

The current account recorded a surplus of K16,272 million for the nine months to September 2019, compared to a surplus of K12,610 million in the corresponding period of 2018. This was due to a higher trade account surplus, net income and transfer receipts, combined with lower net service payments.

The capital and financial account recorded a deficit of K17,268 million in nine months to September 2019, compared to K12,070.7 million in the corresponding nine months of 2018. This resulted from outflows reflecting repayments of intercompany loans and build-up in foreign currency account balances of mining, oil and LNG companies, combined with Government loan repayments, respectively.

The level of gross foreign exchange reserves at the end of September 2019 was K6,509.4 (US$1,946.3) million, sufficient for 4.7 months of total and 8.6 months of non-mineral import covers.

With the downward trend in inflation and stability in the exchange rate, the Bank eased its stance of monetary policy by reducing the monthly KFR by 25 basis points to 6.00 percent in July 2019, and then by a further 50 basis points to 5.50 percent in August 2019. The dealing margin for the Repo Facility was maintained at 75 basis points on both sides of the KFR, from April 2019.

The Bank utilised its Open Market Operation (OMO) instruments in the conduct of monetary policy to manage liquidity. Liquidity remained high and unevenly distributed among the banks, and resulted in frequent borrowing in the inter-bank market and from the Repo Facility during the quarter. There was a net retirement in Central Bank Bills (CBBs) of K944.3 million, while there was a net issuance in Treasury bills and Treasury bonds of K205.2 million and K200.0 million respectively, in the September quarter of 2019. The Central Bank support in the foreign exchange market also assisted in diffusing kina liquidity during the period. The Cash Reserve Requirement (CRR) for the commercial banks was maintained at 10.0 percent during the quarter.

The average level of broad money supply (M3*) increased by 1.4 percent in the September quarter, following a decrease of 0.9 percent in the June quarter of 2019. This outcome was due to an increase in the average net domestic assets of the banking system, which more than offset a decline in average net foreign assets (NFA). Average net domestic claims outstanding, excluding net claims on the Central Government, increased by 2.3 percent in the September quarter, following an increase of 1.8 percent in the June quarter of 2019.

The NFA of the Financial Corporations (FCs), comprising Depository Corporations (DCs) and Other Financial Corporations (OFCs), decreased by 3.4 percent to K7,951.7 million in the September quarter of 2019, compared to an increase of 0.8 percent in the previous quarter. This reflected decreases in NFA of the Central Bank, ODCs and OFCs. The decline in NFA of the Central Bank reflected its intervention in the foreign exchange market combined with Government debt service payments.

Net claims on the Central Government by FCs increased by K288.3 million to K12,864.4 million in the September quarter of 2019, following an increase of K152.6 million in the previous quarter. This resulted from increased issuance of Government securities.

In the September quarter of 2019, total domestic credit extended by FCs to the private sector, public non-financial corporations and 'Provincial and Local Level Governments' increased by K262.4 million to K18,052.8 million, following an increase of K247.7 million in the previous quarter. This was attributed to increases of K204.5 million and K58.0 million in lending to the public non-financial corporations and private sector, respectively. The increase in private sector credit was broad-based across sectors, with notable increase in the agriculture, wholesale/retail, petroleum and gas, and the household sectors.

The fiscal operations of the National Government over the nine months to September 2019 show a higher deficit of K1,248.8 million, compared to a deficit of K1,006.5 million in the corresponding period of 2018. The deficit represents 1.4 percent of nominal GDP.

Total revenue and grants over the nine months to September was K9,274.8 million, 2.5 percent higher than in the same period of 2018 and represents 65.0 percent of the 2019 Budget. Total expenditure for the period was K10,523.6 million, 4.6 percent higher than in the corresponding period of 2018 and represents 65.2 percent of the 2019 Budget.

The developments in revenue and expenditure resulted in a deficit of K1,248.8 million over the nine months to September 2019. The deficit was financed from both domestic and external sources of K655.9 million and K592.9 million, respectively. Net domestic financing comprised of K1,724.2 million (of which K1,276.1 million was from trust account balances), K710.4 million and K56.5 million from the other resident sectors, OFCs and public non-financial corporations, respectively. During the period there were net retirements of K1,105.6 million and K729.6 million of domestic debt by BPNG and ODCs, respectively. The external financing was mainly from concessional sources.

Total public (Government) debt outstanding as at the end of September 2019 was K28,070.4 million, an increase of K548.0 million from the June quarter, reflecting increase in both external and domestic debt during the quarter.

Total Government deposits at DCs increased by K124.0 million to K3,056.0 million at the end of September compared to the level at the end June, 2019.