



BANK OF PAPUA NEW GUINEA

MONETARY POLICY STATEMENT BY THE GOVERNOR OF THE BANK OF PAPUA NEW GUINEA, MR. LOI M. BAKANI, CMG

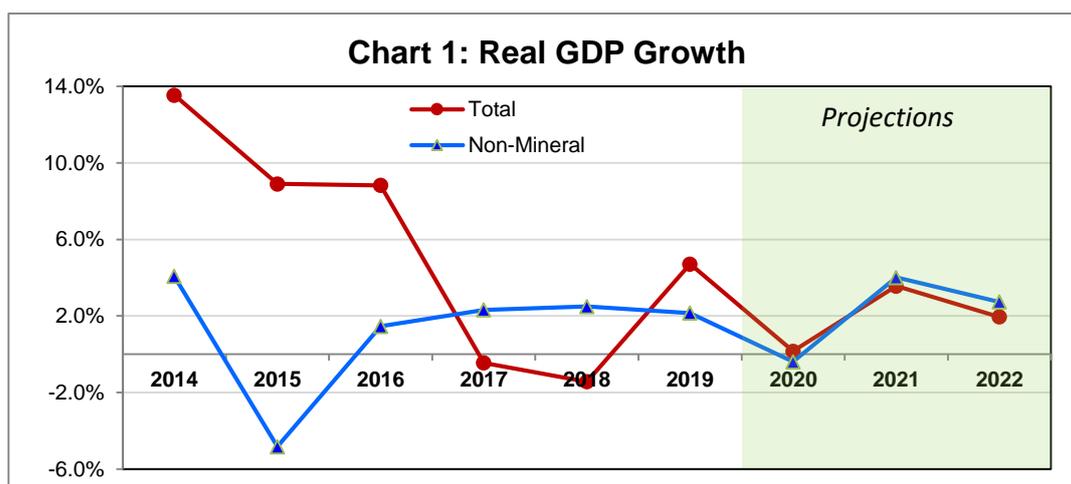
PORT MORESBY

30th April, 2020

The spread of Coronavirus, Covid-19, and its adverse impact through the disruption of production and supply chains, commodity and capital markets, international trade and investment, and global transport operations is having a significant negative impact on global economic activity. Papua New Guinea (PNG), like the rest of the world is also adversely affected and the containment measures by the Government are already affecting key sectors such as the trade, transport, tourism and hospitality, manufacturing and construction and adversely impacting domestic economic activity and growth. The Central Bank's projections for 2020 takes into account the impact of Covid-19 on key macroeconomic indicators. The Bank assumes that the spread and impact of Covid-19 will be contained in 2020, with minimal effect in the medium term (2021 to 2022).

Real GDP growth for 2019 estimated by the Central Bank is consistent with the Government's estimate of 5.0 percent in the 2020 National Budget (see Chart 1). The growth was mainly driven by a full year of production in the mining, and oil and gas sectors, following the recovery from the 2018 earthquake. For 2020, the Bank's forecast for real growth is about 0.3 percent, but can be a negative growth in a worse-case scenario if the impact of the Covid-19 pandemic is not effectively contained. Scaling down of business operations following the lockdown in March 2020 and the imposition of the nation-wide State of Emergency (SOE) immediately

thereafter, have seriously affected business activity in PNG. The decline in economic activity will further deteriorate growth from its potential output, as factors of production become underutilised. The Economic Stimulus Package (ESP) introduced by the Government is expected to stimulate economic activity, and lessen the adverse impact. In the medium term, growth is projected to recover as the economy normalises. During this period, if large resource projects come on stream that will further support the recovery.



Source: National Statistical Office (Actuals to 2017), Department of Treasury (Estimates for 2018-2019) and BPNG (Projections for 2020-2022)

The 2020 National Budget has a planned expenditure of K18,726.5 million and revenue of K14,095.4 million, giving a deficit of K4,631.1 million. The deficit equates to 5.0 percent of nominal GDP. To finance it, the Government plans to raise K3,873.8 million from external sources and K757.2 million domestically. However, due to the impact of the Covid-19, tax revenue to the Government will be significantly reduced in 2020 reflecting a sharp fall in PNG's export receipts and slowdown in domestic business operations. In response to that, the Government introduced the ESP of K5.6 billion, of which the major components consist of K1.5 billion in external financing mainly from the International Monetary Fund (IMF) and K2.5 billion in Treasury bond issuance (Covid-19 bond). Further increase in external and domestic debt financing relating to Covid-19 expenditures will contribute to a higher debt level. This will result in a higher deficit compared to the 2020 budget. The Government intends to introduce a Supplementary Budget that will incorporate the effects of Covid-19 on Government revenue and expenditure, and the financing requirements.

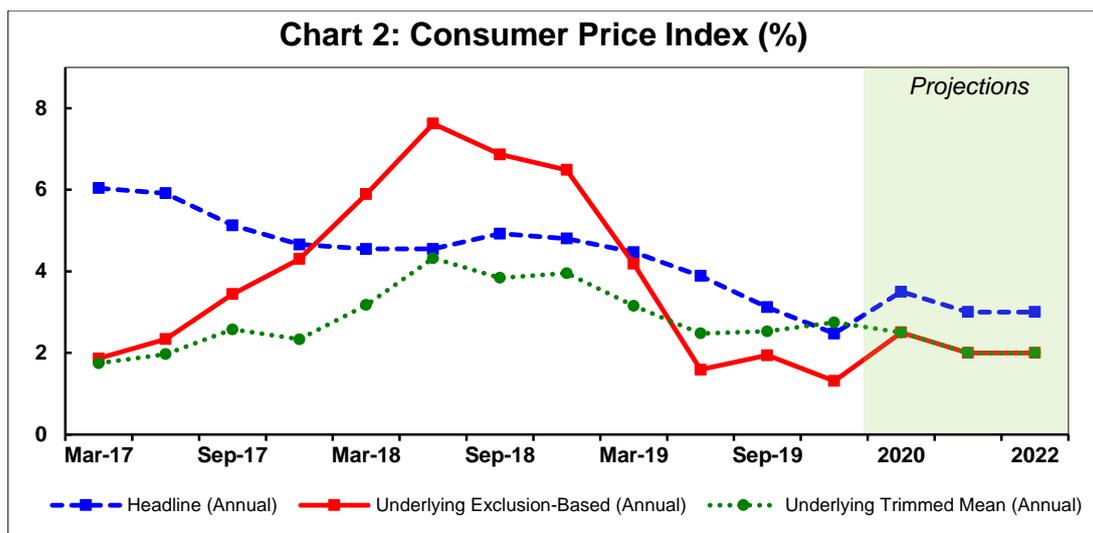
PNG recorded a surplus of K423 million in the overall balance of payments in 2019, stemming from a higher surplus in the current account. This outcome resulted from higher LNG and gold export receipts, which outweighed the lower prices and production of other export

commodities. For 2020, the Bank projects a deficit of K1,295 million in the overall balance of payments driven by a deficit in the capital and financial account. As at December 2019, gross international reserve level was USD2,312.8 (K7,880.0) million, sufficient for 5.4 months of total and 9.3 months of non-mineral import covers. The level of gross reserves was USD2,034.6 (K6,873.8) million as at 30th April 2020.

Foreign exchange inflows improved in 2019 reflecting increased export receipts and external budget financing. These inflows, together with Central Bank's intervention significantly reduced backlog of foreign exchange orders. However, new orders continue to remain high. The inflows also supported demand for credit by the private sector. Projected inflow of external budget financing in 2020, together with additional external support under the ESP will assist the foreign exchange market.

Given the ongoing macroeconomic management issues and challenges, the Government is engaged with the International Monetary Fund in a three-year Staff Monitored Program (SMP). This program entails reforms and adjustments to be undertaken through fiscal, monetary, and exchange rate policies and structural reforms, to stabilise the economy and support growth going forward. In light of the adverse impact on the economy and heightened risks emanating from the Covid-19 outbreak, achieving the measured policy outcomes under the SMP, while necessary, will be challenging.

The annual headline inflation, as measured by the Consumer Price Index (CPI), has trended downwards since December 2018 from 4.8 percent to 2.9 percent in December 2019 (see Chart 2). The trend is a result of the slow pace of depreciation of the kina exchange rate, fall in prices of seasonal produce, increased domestic competition and low imported inflation. The annual core measures of inflation have also trended downwards. For 2020, the Bank forecasts the annual headline inflation to be around 3.5 percent considering some depreciation in kina exchange rate. The underlying inflation measures are projected to be low. The upside risks to these projections would include the impact of disruptions to domestic and external supply chains and further exchange rate depreciation which can result in higher cost of goods and services. Over the medium term, the headline inflation forecast is around 3.0 percent.



Source: National Statistical Office & Bank of PNG

In 2019, broad money supply increased by 4.4 percent due to increases of 6.9 percent and 3.0 percent in Net Foreign Assets (NFA) and Net Domestic Assets (NDA), respectively. For 2020, the Bank forecasts an increase of 5.4 percent in broad money supply. This is mainly due to an increase of 6.5 percent in NDA, which more than offset a decline in NFA. The increase in NDA is due to an increase in net claims on Central Government of 14.6 percent, which includes borrowing under the ESP, and an increase in Private Sector Credit (PSC) of 4.0 percent. The projected increase in PSC is expected to support growth as inflows from the external sources for budget support and funding under the stimulus package will stimulate economic activity. Monetary base is projected to increase by 8.2 percent, influenced by the increase in NDA. Given the low economic growth, the increase in lending to the private sector is important to support economic activity in the non-mineral private sector. This is consistent with the easing stance of monetary policy, and the introduction of Quantitative Easing (QE) program by the Central Bank to stimulate growth.

In view of lower inflation outcomes and relative stability of the kina exchange rate, and lower global economic growth, the Central Bank progressively eased its stance of monetary policy in the second half of 2019 to support lending to the private sector. The policy rate, the Kina Facility Rate (KFR), was reduced from 6.25 percent in June to 5.00 percent by December, 2019. As part of the Central Bank's policy response to the effects of Covid-19 on the economy, the KFR was further reduced to 3.0 percent and the Cash Reserve Requirement (CRR) lowered from 10.0 percent to 7.0 percent on 30th March 2020. The Central Bank also implemented the QE program through buy-back of government securities before maturity from the holders. The

reduction in CRR and implementation of QE are intended to provide additional liquidity to the banking system.

Considering the recent fiscal and monetary policy measures undertaken and projections for 2020, the Bank will maintain its stance of policy in the next five months. It will closely monitor the impact of Covid-19 on the economy, particularly on domestic inflation, and will take further policy measures to ensure macroeconomic stability.

Monetary policy is implemented through the reserve money framework with the aim of influencing domestic market interest rates to align with the policy rate. This involves managing liquidity in the banking system through Open Market Operations (OMO) to influence interest rates to achieve and maintain price stability. Given the depressed state of the economy and the low inflation environment, the Bank progressively eased its policy stance and introduced a QE program to support economic activity and growth. This MPS provides the overall policy stance for the next five months, while the monthly policy rate, the KFR, signals this stance or any changes through an announcement by the Bank.

The immediate focus of fiscal and monetary policies is to steer the economy out of the negative impact of Covid-19 pandemic. At the same time, the Government should not lose focus on its medium term fiscal objectives, particularly fiscal consolidation for sound macroeconomic management. In this regard, the Government is undertaking some of the reform measures and adjustments to fiscal and other structural policies under the SMP with the IMF. These includes key reforms in improving revenue generation and expenditure controls, as well as restructuring State-Owned Enterprises (SOEs) to be more efficient. The Central Bank is also undertaking adjustments in monetary and exchange rate policies to complement what the Government is doing for macroeconomic stability and growth.