BANK OF PAPUA NEW GUINEA

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Quarterly Economic Bulletin

December Quarter 2019

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

1. UPDATE ON DEVELOPMENTS SINCE DECEMBER 2019

The unprecedented scale and magnitude of the impact of 2019 coronavirus disease (COVID-19) pandemic has caused significant damage across the globe with loss of human life and falling global economic activity. The negative impact of the pandemic is expected to induce the worst economic crisis since the Great Depression of 1929 with countries across the world being faced with the dilemma of containing its spread whilst minimising the negative economic impact of lockdowns and restrictions on mobility. In 2020, economic growth in the advanced economies is projected to contract significantly by 6.1 percent and emerging market and developing economies by 1.0 percent. Growth in most of the emerging markets and developing economies are projected to decline, while China and India are projected to further weaken to a low growth of 1.2 percent and 1.9 percent, respectively. In its April 2020 publication of the World Economic outlook (WEO), the International Monetary Fund (IMF) projected the world economy to contract by 3.0 percent for 2020 from its earlier projection of a growth of 3.3 percent in the January WEO. It further projects a recovery in 2021 with a growth rate of 5.8 percent if the COVID-19 pandemic is effectively contained in 2020.

The Governor mentioned that the contraction in global growth in 2020 and its downward impact on global inflation has prompted many major central banks to ease monetary policy and support their Government's fiscal stimulus measures to encourage economic growth. The contraction in global growth is adversely affecting the Papua New Guinea's economy and growth is expected to be lower in 2020. Given this environment and the future low growth scenario, the Bank of Papua New Guinea announced policy and regulatory measures on 30th of March 2020 aimed at providing liquidity to the banking system to ensure maintenance of financial, payment and monetary stability amid the potential negative repercussions of the Covid-19. The measures comprised of:

- reduction of the Kina Facility Rate (KFR) by 2.0 percentage points from 5.0 percent to 3.0 percent to lower the cost of borrowing;
- reduction of the Cash Reserve Requirement (CRR) by 3.0 percentage points from 10.0 percent to 7.0 percent, injecting additional liquidity of over K600.0 million into the banking system;
- introduction of the Quantitative Easing (QE) Program that allowed BPNG to buy-back Government securities (Treasury bills and Inscribed Stocks) from the existing holders. The QE program will provide liquidity to the holders of these securities; and
- buy-back of Government securities under the Tap Facility for small investor to have access to their funds.

Governor also reiterated the Bank of PNG's commitment to continue to support the foreign exchange market by providing dollars to prioritise import orders related to COVID-19 as well as other health related imports of medical drugs and pharmaceutical products.

On the 2nd April, 2019, the Government announced the COVID-19 economic stimulus package of K5.6 billion, which consisted of K2.5 billion in Treasury Bond issuance (Covid-19 Bond) to be raised domestically and K1.5 billion in external financing mainly from the International Monetary Fund (IMF). In order to raise the K2.5 billion COVID-19 Bond funding, the Government issued K1.0 billion on the 1st May 2020 and K750 million on the 15th May 2020. The first auction was oversubscribed by K80.29 million, while the second auction was oversubscribed by K290 million with the Government accepting bids of K280 million. A total amount of K2.1 billion was raised at these two auctions.

Following the announcement of the policy measures by the Bank of PNG, the licensed financial institutions responded accordingly with their own relief packages to assist their clients with cash flow due to the impact of COVID-19. The commercial banks have reduced their interest rates for various loan products and services. They have also offered relief on principle and interest payments on case by case basis for borrowers affected by COVID-19. This relief also applies to fees and charges.

In consultation with BPNG on Government's economic stimulus, the members of the Authorised Superannuation Funds (ASFs) of PNG introduced measures to support their members who are directly affected by the impact of COVID-19. These measures include a tax-free one-off payment of up to 20 percent or maximum of K10,000 of members own contribution for those that have lost their jobs; work with the employers on a case by case basis to determine suitable payment options for the employee contribution payments, including deferment, if necessary; a waiver on penalty interest for late payments for employers who may be affected; and provide concession on rental payments for their clients renting their commercial properties.

Governor Bakani expressed concern that the impact of the COVID-19 pandemic is negatively affecting PNG through a decline in global trade and growth, and causing international commodity prices to fall sharply. The latest international commodity price data published by the World Bank in April 2020 indicate a general fall in prices of PNG's main export commodities. Prices for Liquefied Natural Gas (LNG), copper and nickel declined whilst gold prices picked up reflecting investors' preference for a safe haven investment. Non-mineral commodity prices for cocoa, coffee and palm oil also increased bringing some relief to PNG exporters. He stated that the significant drop in some of the commodity prices has already affected PNG's export tax revenue and foreign exchange inflows, and will continue to put pressure on the foreign exchange market. He reiterated the importance of Government's support to increase local production and ensure its food security requirements are at a satisfactory level to sustain domestic consumption, while reducing the country's dependency on imports.

As at the 10th June 2020, the average daily kina exchange rate depreciated against all major currencies. It depreciated against the Australian dollar by 3.8 percent to A$0.4134, euro by 3.5 percent to €0.2560, Japanese yen by 2.2 percent to ¥31.2300, US dollar by 1.7 percent to US$0.2890 and pound sterling by 0.4 percent to £0.2274. These currency movements resulted in the Trade Weighted Index (TWI) depreciating by 2.5 percent to 28.96.

As at 5th June 2020, the level of foreign exchange reserves fell to K6,774.8(US$1,991.8) million mainly reflecting the outflow from government debt repayments and intervention in the foreign exchange market."

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

Economic indicators available to the Bank of Papua New Guinea (or the Central Bank) point to a recovery in economic activity in 2019, following disruptions especially to the mining operations from the earthquake in 2018. The improvement was mainly driven by higher production in the mineral sector, which more than offset lower international prices of most export commodities. However, the decline in the annual employment level in 2019 indicated a lower activity in the non-mineral sector. During the quarter, the kina depreciated against most trading currencies which resulted in the Trade Weighted Index (TWI) depreciating slightly by 0.1 percent to 29.689. With the downward trend in inflation and relative stability in the Kina exchange rate, the Central Bank further eased its stance of monetary policy in December 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 3.1 percent in the September quarter of 2019, compared to an increase of 5.1 percent in the June quarter. Excluding the mineral sector, sales decreased by 2.5 percent in the September quarter, compared to an increase of 8.1 percent in the previous quarter. By sector, sales increased in the agriculture/forestry/fishing, construction, mineral, retail, transportation, wholesale and financial/business/other services sectors, while it declined in the manufacturing sector. By region, sales increased in the Momase (excluding Morobe), Southern (excluding NCD), Highlands and Morobe regions, while it declined in the NCD and Islands regions. Over the year to September 2019, total sales increased by 8.2 percent, compared to an increase of 2.6 percent over the corresponding period in 2018. Excluding the mineral sector, sales increased by 7.6 percent over the year to September 2019, compared to an increase of 7.1 percent over the corresponding period in 2018.

The Bank’s Employment Index shows that the level of employment in the formal private sector declined by 2.4 percent in the December quarter of 2019, compared to a decline of 2.3 percent in the September quarter. Excluding the mineral sector, the level of employment fell by 2.5 percent. By sector, employment declined in the wholesale, construction, agriculture/forestry/fishing, manufacturing, financial/business and other services, and the retail sectors, while it increased in the transportation and mineral sectors. By region, employment declined in all regions, with the highest decline recorded in from Momase (excluding Morobe), followed by the Highlands, Islands, Morobe, Southern (excluding NCD) regions and National Capital District (NCD). In 2019, the total employment level declined by 2.2 percent, compared to an increase of 2.3 percent in 2018. Excluding the mineral sector, the level of employment declined by 2.7 percent in 2019, following a decline of 0.3 percent in 2018.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 0.8 percent in the December quarter of 2019, compared to 0.7 percent in the September quarter. All expenditure groups recorded price increases except ‘Education’ expenditure group which declined. The ‘Clothing and Footwear’ and ‘Communication’ expenditure groups recorded no price movements. By urban centre, prices increased in all the surveyed centres. Annual headline inflation was 2.9 percent in 2019, compared to 4.8 percent in 2018.

In the December quarter of 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 0.2939. It appreciated against the Japanese yen by 1.1 percent to 31.9468, euro by 0.3 percent to 0.2654 and the Australian dollar by 0.2 percent to 0.4299. These currency movements resulted in the TWI decreasing slightly by 0.09 percent to 29.6892 in the December quarter of 2019.

The weighted average kina price of Papua New Guinea's export commodities, excluding LNG, increased by 1.0 percent in 2019, from 2018. There was an increase of 1.9 percent in the weighted average price of mineral exports, reflecting higher kina prices for gold and nickel. For agricultural, logs and marine product exports, the weighted average kina price decreased by 2.7 percent due to lower prices of coffee, copra, copra oil, palm oil and marine products. Excluding log exports, the weighted average kina price of agricultural and marine product exports decreased by 5.3 percent in 2019, from 2018. The lower kina export price reflected a decline in international prices for some of PNG's non-mineral export commodities, except cocoa, tea, rubber and logs.

The overall balance of payments recorded a surplus of K423 million in 2019, compared to a surplus of K1,849 million in 2018. The lower surplus was due to a higher deficit in the capital and financial account, significantly offsetting the surplus in the current account.

The current account recorded a surplus of K18,856 million in 2019, compared to a surplus of K18,207 million in 2018. This was due to a higher trade account surplus, which more than offset net service and income payments.

The capital and financial account recorded a deficit of K18,435 million in 2019, compared to K16,393 million in 2018. This outcome resulted from a net outflow reflecting equity withdrawal and build up in offshore foreign currency accounts of mineral companies including the LNG companies covered under the Project Development Agreements, respectively. Foreign currency loan repayments by Government also contributed to the net outflows.

The level of gross foreign exchange reserves at the end of December 2019 was K7,833.0 (US$2,338.1) million, equivalent for 5.4 months of total and 9.3 months of non-mineral import covers.

In view of the downward trend in inflation and relative stability in the kina exchange rate, the Central Bank further eased its stance of monetary policy by reducing the monthly Kina Facility Rate (KFR) by 50 basis points to 5.00 percent in December 2019. In 2019, the Bank has reduced the KFR by a total of 125 basis points. However, the Bank has yet to see appropriate responses to the easing in policy interest rate by adjusting downward their market interest rates, especially the lending rates, to support lending and economic activity. The dealing margin for the Repurchase Agreement (Repo) Facility was maintained at 75 basis points on both sides of the KFR.

The average level of broad money supply (M3*) increased by 2.4 percent in the December quarter, compared to a 1.4 percent increase in the September quarter of 2019. This outcome was due to increases in the average net foreign assets (NFA) and net domestic assets of the banking system. Average net domestic claims outstanding, excluding net claims on the Central Government, increased by 0.9 percent in the December quarter, following an increase of 2.3 percent in the September quarter of 2019. This reflected an increase in average net claims on private sector, which more than offset decreases in public non-financial corporations and other financial corporations (OFCs).

The NFA of the Financial Corporations (FCs), comprising Deposit Corporations (DCs) and OFCs, increased by 20.7 percent to K9,595.9 million in the December quarter of 2019, compared to a decline of 3.4 percent in the previous quarter. This reflected increases in NFA of the Central Bank, ODCs and OFCs. The increase in NFA of the Central Bank and ODCs mainly reflected external loan proceeds from the Australian Government, Asian Development Bank, while the increase for OFCs reflected increase in holdings of foreign assets abroad.

Net claims on the Central Government by FCs increased by 3.6 percent to K13,327.9 million in the December quarter of 2019, following an increase of 2.3 percent in the previous quarter. This resulted from increased issuance of securities by the Government for budgetary financing.

In the December quarter of 2019, total domestic credit extended by FCs to the private sector, public non-financial corporations and 'Provincial and Local Level Governments' declined by K71.2 million to K17,981.6 million, compared to an increase of K262.5 million in the previous quarter. This was attributed to a decline of K152.7 million in lending to the public non-financial corporations, which more than offset an increase of K81.5 million in lending to private sector. The decline in the public non-financial corporations reflected loan repayments by the state-owned enterprises. The increase in private sector credit was broad based, with notable increase to the agriculture (mainly forestry and other), retail trade, petroleum and natural gas, electricity gas and water, real estate renting and business services, and the household (personal advances) sectors.