BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

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Quarterly Economic Bulletin
March and June 2020 Quarters

Mr. Loi M. Bakani CMG, Governor of the Bank of Papua New Guinea (Bank of PNG), today released the March and June 2020 Quarterly Economic Bulletins (QEB). The late release of the QEBs was due to the slow submission of information from various sources due to the Coronavirus Disease 2019 (COVID-19) restrictions and relaxation given to financial institutions to provide reports to the Bank of PNG. This statement provides an overview of the economic and financial developments during the first two quarters of 2020 and some key developments since then.

1. UPDATE ON DEVELOPMENTS SINCE JUNE 2020

Global economic activity declined in 2020 as the COVID-19 pandemic impacted economies across the globe. The contraction was less severe than earlier forecasted, with most of the impact felt in the first quarter of 2020, as countries imposed domestic lockdowns and travelling restrictions. Activity has improved slowly, as restrictions were gradually eased, with countries reopening their borders and uplifting restrictions. China's quicker than expected recovery also boosted this recovery. In its October 2020 World Economic Outlook (WEO) publication, the International Monetary Fund (IMF), projected the world economy to contract by 4.4 percent in 2020 from its earlier projection of a decline of 5.2 percent in the June WEO. For 2021, the recovery has been downgraded with a growth rate of 5.2 percent, reflecting the second wave of COVID-19 infections and associated measures to contain the pandemic.

With the contraction in global activity in 2020, the Governor mentioned that global inflation is expected to remain subdued. Most of the major central banks have eased monetary policy and provided support to their respective Governments' fiscal stimulus measures to encourage growth. The contraction in global activity has adversely affected the Papua New Guinea economy and with the various containment measures imposed by the Government for the COVID-19 pandemic, domestic activity has also declined in 2020. Whilst the slowdown in global activity is affecting domestic economic activity, Governor Bakani mentioned that these developments have assisted dampen the impact of foreign inflation on domestic prices. He also pointed out that high headline inflation outcomes for 2020, are seasonally driven, with underlying inflation averaging below 2.0 percent. Given this environment and to support growth, the Bank of PNG eased monetary policy by reducing its policy rate, the Kina Facility Rate (KFR) from 5.0 percent to 3.0 percent in March 2020 where it has been maintained at for the rest of the year. The Governor also mentioned that the Cash Reserve Requirement (CRR) was maintained at 7.0 percent since its reduction by 3.0 percent in March 2020.

In September 2020, the Government introduced a supplementary budget with a deficit of K6,630.2 million for 2020 given the fall in revenue in light of the COVID-19 pandemic. Total revenue was substantially revised downward to K11,359.1 million against the original 2020 Budget, which more than offset the downward revision in total expenditure to K17,989.3 million. Of the total expenditure and net lending; recurrent and capital expenditures were estimated at K11,599.8 million and K6,389.5 million, respectively. The projected net decrease in expenditure of K737.2 million was mainly from reappropriation in the recurrent budget. The revised budget deficit was to be financed domestically, complemented with higher international funding support. External financing comprised of K1,258.3 million received from the IMF's Rapid Credit Facility, and projected inflows from the Australian Government of US$100 million for COVID-19 related spending and US$500 million from the Asian Development Bank (ADB). The Australian Government and ADB loans came in December 2020.

In December 2020, the Government passed the 2021 National Budget with a deficit of K6,612.8 million, relatively similar to the 2020 Supplementary Budget, and is 7.3 percent of the GDP. Revenue is projected at K12,995.0 million, while expenditure is at K19,607.8 million. The Governor cautioned the Government to maintain expenditure targets to avoid any slippages that would increase the debt level whilst at the same time improve revenue raising measures and compliance. He added that funds raised from both domestic and external sources for COVID-19 related expenses and the SME sector should be properly accounted for, audited and reported on to ensure transparency and accountability on their usage. In addition, he urged the Government to clear arrears or commitments for services rendered by the private sector which would assist those businesses to maintain their workforce, and contribute to the economic recovery.

The Governor mentioned that the latest international commodity price data published by the World Bank in September 2020, showed that prices for energy, non-energy and precious metals all increased. Energy prices rose by 33.9 percent, driven by cuts in crude oil production by members of the Organization of the Petroleum Exporting Countries. Non-energy prices increased by 9.6 percent, with higher prices for most agricultural commodities, including cocoa, coffee, tea and palm oil. Mineral prices increased, with those for copper and nickel driven by a pick-up in growth in China. Precious metal increased by 16.5 percent, with the price of gold reflecting its role as a safe haven investment during the COVID-19 pandemic and also due to global monetary easing. Given these unprecedented times, the Governor encouraged PNG exporters to capitalise on these favourable international prices.

As at 17th December 2020, the average daily kina exchange rate depreciated against all major currencies. The kina depreciated against the British pound sterling by 2.4 percent to £0.2173, the euro by 2.2 percent to €0.2623, and both the Australian dollar and the Japanese yen by 2.0 percent to A$0.3938 and ¥29.8679, respectively. Against the US dollar, it depreciated by 0.6 percent to US$0.2856. These currency movements resulted in the Trade Weighted Index (TWI) depreciating by 2.8 percent to 27.5.

Governor Bakani stated that the level of foreign exchange reserves as at the end of September 2020 was K7,135.6 (US$2,076.5) million. As of 24th December 2020, the level of foreign exchange reserves increased to K9,314.88 (US$2,701.31) million, reflecting inflows of loans from the Australian Government (US$100 million), ADB (US$500 million) and dividend payments to the Government from the Ok Tedi mine (US$113 million).

2. OVERVIEW OF THE DEVELOPMENTS IN THE JUNE QUARTER OF 2020

Economic indicators available to the Bank of Papua New Guinea (the Bank) indicate that domestic economic activity declined significantly in the second quarter of 2020. This was largely due to the introduction of the nation-wide State of Emergency (SOE) in April as part of the containment measures to address the COVID-19 pandemic. The decline in international commodity prices and exports, lower imports as well as a fall in annual private sector employment are all indicative of the slump in economic activity. During the quarter, the kina exchange rate depreciated at a slow pace against all major currencies except the pound sterling. The kina’s movement against these currencies resulted in a fall in the Trade Weighted Index (TWI) by 0.5 percent to 29.79. The annual headline inflation increased significantly to 6.0 percent in the June quarter of 2020 from 3.1 percent in the March quarter, mainly driven by the containment measures for COVID-19. The core measures remained relatively low due to the slow pace of kina depreciation and low imported inflation. With the significant fall in global and domestic demand, and expected low inflationary pressures, the Bank maintained its neutral monetary policy stance by keeping the monthly KFR at 3.00 percent over the June quarter of 2020.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the formal private sector declined by 11.5 percent in the March quarter of 2020, compared to an increase of 3.8 percent in the December quarter of 2019. Excluding the mineral sector, sales declined by 8.7 percent in the March quarter, compared to an increase of 3.4 percent in the December quarter of 2019. The decline was mainly due to the two-week lockdown in March imposed by the Government as measures were undertaken to close international borders, suspend domestic travels and scaled down business operations to ensure social distancing among workers and the general public to contain the spread of COVID-19. By sector, sales declined in all sectors except in the agriculture/forestry/fishing (AFF) and finance/business/other services sectors which increased. By region, sales declined in all the regions except the Islands region. Over the year to March 2020, total sales declined by 0.7 percent, compared to an increase of 7.9 percent in the corresponding period of 2019. Excluding the mineral sector, sales declined by 0.2 percent, compared to an increase of 10.0 percent in the corresponding period of 2019.

The Bank's Employment Index show that the level of employment in the formal private sector increased by 1.6 percent in the June quarter of 2020, compared to a decline of 1.3 percent in the March quarter. Excluding the mineral sector, the level of employment increased by 2.9 percent. The increase in employment reflected the easing of the SOE measures as businesses began to slowly revamp or increase their operations. By sector, the level of employment increased in the AFF and retail sectors, while it fell in the wholesale, financial/business and other services, construction, mineral, transportation and manufacturing sectors. By region, the level of employment increased in the Momase (excluding Morobe), Southern (excluding NCD), Islands and Highlands regions, while it declined in Morobe and NCD. Over the year to June 2020, the total level of employment declined by 3.5 percent, compared to an increase 4.3 percent in the corresponding period of 2019. Excluding the mineral sector, the level of employment fell by 3.0 percent over the year to June 2020, compared to an increase of 1.9 percent over the year to June 2019.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), was 3.4 percent in the June quarter of 2020, compared to 1.1 percent in the March quarter of 2020. There were increases in the 'Alcoholic Beverages, Tobacco and Betelnut', 'Health', 'Transport', 'Restaurants and Hotels', 'Housing', 'Food and Non-Alcoholic Beverages', 'Recreation', 'Clothing and Footwear', and 'Education' expenditure groups, which more than offset declines in the 'Household Equipment', 'Communication', and 'Miscellaneous' expenditure groups. By urban centre, prices increased in all the surveyed centres. Annual headline inflation was 6.0 percent in the June quarter of 2020, compared to 3.1 percent in the March quarter of 2020.

In the June quarter of 2020, the US dollar appreciated against all major currencies except the yen. The US dollar appreciated against the pound sterling by 3.0 percent, the Australian dollar by 0.5 percent and the euro by 0.3 percent. Against the yen, it depreciated by 1.2 percent.

In the June quarter of 2020, the average daily kina exchange rate depreciated against the yen by 2.3 percent to ¥31.2046, the US dollar by 1.0 percent to US$0.2860, the euro by 0.8 percent to €0.2637 and the Australian dollar by 0.6 percent to A$0.4430. Against the pound sterling, it appreciated by 2.1 percent to £0.2338. These currency movements resulted in the depreciation of the TWI by 0.5 percent to 29.79 in the June quarter of 2020.

The weighted average kina price of PNG's exports, excluding LNG, decreased by 5.0 percent in the June quarter of 2020, compared to the corresponding quarter of 2019. The weighted average kina price of mineral exports increased by 0.1 percent, reflecting higher kina prices for all mineral commodities. For agricultural, logs and marine product exports, the weighted average kina price decreased by 22.8 percent, due to lower kina prices for copra oil, rubber, logs and marine products. Excluding logs, the weighted average kina price of agricultural and marine product exports decreased by 27.7 percent in the June quarter of 2020, compared to the corresponding quarter of 2019. Lower international prices accounted for the decline.

The balance of payments recorded an overall surplus of K43 million for the first six months of 2020, compared to a deficit of K388 million in the corresponding period of 2019. A surplus in the current account more than offset a deficit in the capital and financial account.

The surplus in the current account was due to a trade surplus and higher net transfer receipts, combined with lower net service and income payments.

The deficit in the capital and financial account was attributed to a net outflow from direct and other investments reflecting related party transactions and build-up in offshore foreign currency account balances of mineral companies, respectively. The net Government and private sector loan repayments also contributed to the outflows.

The level of gross foreign exchange reserves at the end of June 2020 was K7,854.2 (US$ 2,309.1) million, sufficient for 5.4 months of total and 9.1 months of non-mineral import covers.

The Central Bank maintained a neutral stance of monetary policy during the June quarter of 2020. The monthly policy rate, the KFR was maintained at 3.00 percent, after it was reduced from 5.00 percent in the first quarter of the year to counter the adverse effects of the COVID-19 pandemic on the economy.

The Bank utilised its Open Market Operation (OMO) instruments in the conduct of monetary policy to manage liquidity. Liquidity in the banking system remained high from the Quantitative Easing (QE) liquidity injection in the March quarter, coupled with lower demand for private sector lending. In the June quarter, there was a net retirement in CBBs of K441.5 million to support the easing stance. On the other hand, the Government made a net issuance of K51.8 million and K1,733.8 million in Treasury bills and Treasury bonds (known as COVID-Bonds), respectively. The Central Bank's intervention in the foreign exchange market also assisted in diffusing some of the kina liquidity during the period. The Cash Reserve Requirement (CRR) for the commercial banks remained at 7.00 percent in the June quarter, after being reduced from 10.0 percent in the previous quarter.

The average level of broad money supply (M3*) slightly increased by 0.8 percent in the June quarter of 2020, compared to an increase of 2.4 percent in the March quarter. This outcome was due to increases in the average net foreign assets (NFA) and net domestic assets (NDA) of the banking system. Average net domestic claims outstanding, excluding net claims on the Central Government, increased by 0.7 percent in the June quarter of 2020, following an increase of 1.1 percent in the previous quarter. This reflected an increase in average net claims on the private sector, which more than offset decreases in public non-financial corporations and other financial corporations (OFCs).

The average level of monetary base (reserve money) increased by 0.3 percent during the June quarter of 2020, compared to a decline of 1.1 percent in the previous quarter.

This reflected an increase in the average level of commercial bank deposits held at the Central Bank, which more than offset a decline in currency in circulation.

The NFA of the Financial Corporations (FCs), comprising Deposit Corporations (DCs) and OFCs, increased by 13.1 percent to K9,349.7 million in the June quarter of 2020, compared to a decline of 13.9 percent in the previous quarter. This reflected increases in NFA of the DCs including both the Central Bank and Other Depository Corporations (ODCs), and OFCs.

Net claims on the Central Government by FCs declined by 1.5 percent to K13,620.1 million in the June quarter of 2020, following an increase of 3.7 percent in the previous quarter. This resulted from a net retirement of Government securities and an increase in Government deposits partly reflecting the draw down from the IMF's Rapid Credit Facility.

In the June quarter of 2020, total domestic credit extended by FCs to the private sector, public non-financial corporations and 'Provincial and Local Level Governments' declined by 0.8 percent to K18,057.2 million, compared to an increase of 1.3 percent in the previous quarter. This reflected a decline of K175.5 million in claims by public non-financial corporations, which more than offset an increase of K23.4 million in credit to the private sector. The decline in the public non-financial corporations reflected repayments by the State Owned Enterprises (SOEs), while the increase in credit to the private sector by ODCs (mainly commercial banks) reflected advances to the 'Real estate, Renting & Business Services', 'Transport and Communication', 'Building & Construction', 'Electricity Gas & Water Supply' and 'Wholesale Trade' sectors.

The fiscal operations of the National Government over the six months to June 2020 show a deficit of K2,085.8 million, compared to a deficit of K1,667.4 million in the corresponding period of 2019. The significantly higher deficit reflected lower Government revenue receipts.

Total revenue and grants over the six months to June was K4,814.6 million, 17.1 percent lower than in the same period of 2019 and represents 42.4 percent of the revised 2020 Budget. This reflected declines in non-tax revenues.

Total expenditure for the six months to June 2020 was K6,900.4 million, 7.7 percent lower than in the corresponding period of 2019, and represents 38.4 percent of the revised 2020 Budget.

As a result of these developments in revenue and expenditure, the Government recorded a budget deficit of K2,085.8 million. The deficit was financed from external and domestic sources of K1,183.5 million and K902.3 million, respectively. Net external financing was mainly from extraordinary financing of K1,240.6 million from the IMF's RCF and K385.4 million from concessional sources, which more than offset a net repayment of K442.5 million to commercial sources. Net domestic financing was K482.7 million, comprising of K1,371.2 million, K254.3 million and K0.3 million from BPNG, ODCs, OFCs and public non-financial corporations, respectively. These more than offset a net retirement of Government securities of K1,206.2 million by other resident sectors.