



BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

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Quarterly Economic Bulletin September Quarter 2020

Mr. Loi M. Bakani CMG, Governor of the Bank of Papua New Guinea (Bank of PNG), today released the September 2020 Quarterly Economic Bulletin (QEB). This statement provides an overview of the economic and financial developments during the September quarter of 2020 and some key developments since then.

1. UPDATE ON DEVELOPMENTS SINCE SEPTEMBER 2020

The global economy showed signs of recovery in the December quarter of 2020. However, the second wave of the Coronavirus Disease 2019 (COVID-19) pandemic with the new strain started to affect major economies, derailing the recovery. As a result, most countries have not completely opened up their borders to the movement of people. The development and trial of COVID-19 vaccines that continued into the last quarter of 2020 provided some level of confidence for the global market and the world economy. In its January 2021 World Economic Outlook (WEO) Update, the International Monetary Fund (IMF), projected the world economy to contract by 3.5 percent in 2020 from its earlier projection of a decline of 4.4 percent in the October WEO. For 2021, recovery has been upgraded with a growth rate of 5.5 percent, reflecting the trial and introduction of COVID-19 vaccines.

With the contraction in global activity in 2020, most central banks around the world introduced accommodative monetary policy with quantitative easing (QE) programs to support fiscal stimulus measures aimed at encouraging growth. Whilst the contraction in the global economy continues to affect domestic economic activity, Governor Bakani noted that the fall in global demand has assisted in dampening the impact of imported inflation on domestic prices. This, combined with the relative stability in the kina exchange rate in 2020, resulted in a low feed through to domestic prices. However, the annual headline inflation outcome for 2020 was 5.1 percent, mainly driven domestically by the impact of COVID-19 restrictions. Given the depressed state of the economy, the Bank of PNG maintained an accommodative stance of monetary policy after easing its policy rate, the Kina Facility Rate (KFR) at 3.0 percent in April 2020. The Cash Reserve Requirement (CRR) was also maintained at 7.0 percent since its reduction by 3.0 percent in March 2020.

As at 8th March 2021, the average daily kina exchange rate depreciated against all major currencies except the Japanese yen. The kina depreciated against the Australian dollar by 8.1 percent to A\$0.33695, the British pound sterling by 7.5 percent to £0.2060, the euro by 2.8 percent to €0.2392, and the US dollar by 0.9 percent to US\$0.2850, whilst it appreciated against the Japanese yen by 1.3 percent to ¥30.8900. These currency movements resulted in the Trade Weighted Index (TWI) declining by 4.8 percent to 26.9.

Governor Bakani stated that the level of foreign exchange reserves as at the end of December 2020 was K9,506.6 (US\$2,709.4) million. As of 05th March 2021, the level of foreign exchange reserves decreased to K8,464.9 (US\$2,412.5) million, reflecting debt service payments for the Government and intervention by the Central Bank in the foreign exchange market.

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

Economic indicators available to the Bank of Papua New Guinea (the Bank) indicate that domestic economic activity contracted significantly and remained depressed over the year to the September quarter of 2020, mainly reflecting the adverse impact

of the global COVID-19 pandemic. The domestic COVID-19 containment measures continued to affect business activity, although some of the restrictions were gradually eased. The significant fall mainly in the production of mineral export as well as the agricultural, forestry, marine export commodities, combined with a sharp fall in the prices of the agricultural and marine product exports resulted in this contraction. Consequently, total export receipts and imports declined significantly resulting in an overall balance of payments deficit. The domestic formal private sector employment declined in the September quarter of 2020 reflecting the depressed economic conditions. During the quarter, the kina depreciated against all major currencies which resulted in the Trade Weighted Index (TWI) falling by 5.1 percent. The annual headline inflation in the September quarter of 2020 was revised downward to 4.9 percent, with prices mainly driven domestically by the impact of the COVID-19 restrictions. With the contraction in economic activity, the Bank maintained a neutral monetary policy stance by keeping the KFR unchanged at 3.00 percent since April, 2020.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the formal private sector decreased by 18.3 percent in the June quarter of 2020, compared to a decline of 11.9 percent in the March quarter of 2020. Excluding the mineral sector, sales decreased by 9.4 percent in the June quarter, compared to a decline of 17.3 percent in the previous quarter. By sector, sales decreased in all sectors, except in the construction sector which increased. By region, sales declined in all regions except in the Momase region, which recorded an increase. Over the year to June 2020, total sales declined by 23.1 percent, compared to an increase of 8.2 percent over the corresponding period of 2019. Excluding the mineral sector, sales decreased by 24.3 percent over the year to June 2020, compared to an increase of 15.9 percent over the corresponding period of 2019. The reduction in overall sales mainly reflected the adverse impact of the global COVID-19 pandemic and its containment measures on domestic business activity.

The Bank's Employment Index shows that the level of employment in the formal private sector declined by 5.5 percent in the September quarter of 2020, compared to an increase of 1.3 percent in the June quarter of 2020. Excluding the mineral sector, the level of employment fell by 1.4 percent. By sector, the level of

employment dropped in all the sectors except the financial/business and other services, and the wholesale sectors. By region, the level of employment fell in the Highlands, Momase (excluding Morobe) and Southern excluding National Capital District (NCD) and NCD, while it increased in Morobe. The level of employment remained unchanged in the Islands region. Over the year to September 2020, the total level of employment fell by 7.0 percent, compared to an increase of 2.1 percent in the corresponding period of 2019. Excluding the mineral sector, the level of employment fell by 2.7 percent over the year to September 2020, compared to a decline of 0.4 percent in the corresponding period of 2019.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI) and released by the National Statistical Office (NSO), declined by 0.6 percent in the September quarter of 2020, compared to an increase of 3.8 percent in the June quarter of 2020. There were declines in the 'Alcoholic Beverages, Tobacco and Betelnut', 'Transport', 'Miscellaneous', 'Food and Non-Alcoholic Beverages', 'Household Equipment' and 'Housing' expenditure groups, which more than offset increases in the 'Health', 'Restaurants and Hotels', 'Clothing and Footwear', and 'Recreation' expenditure groups, whilst the 'Education' and 'Communication' expenditure groups recorded no price change. By urban centre, prices increased in all the surveyed centres. Annual headline inflation was revised downward to 4.9 percent in the September quarter of 2020, compared to 6.3 percent in the June quarter of 2020.

In the September quarter of 2020, the US dollar depreciated against all major currencies. The US dollar depreciated against the Australian dollar by 9.0 percent, the euro by 6.2 percent, the pound sterling by 4.0 percent, and the Japanese yen by 1.6 percent.

In the September quarter of 2020, the average daily kina exchange rate depreciated against all major currencies. It depreciated against the Australian dollar by 9.2 percent to A\$0.4021, the euro by 6.7 percent to €0.2460, the sterling by 4.8 percent to £0.2227, the yen by 2.2 percent to ¥30.5051, and against the US dollar by 0.9 percent to US\$0.2874. These currency movements resulted in the decline of the TWI by 5.1 percent to 28.27 in the September quarter of 2020.

The weighted average kina price of PNG's export commodities, excluding LNG, increased by 2.5 percent in the September quarter of 2020, compared to an increase of 3.3 percent in the corresponding quarter of 2019. There was an increase of 8.2 percent in the weighted average price of mineral exports, compared to a decline in the corresponding quarter of 2019, reflecting higher kina prices for gold, copper and cobalt. For agricultural, logs and marine product exports, the weighted average kina price declined by 18.7 percent, compared to a decline of 4.6 percent in the corresponding quarter of 2019. There were lower prices of all non-mineral export commodities, except for coffee, tea, copra and palm oil. Excluding log exports, the weighted average kina price of agricultural and marine product exports declined by 22.5 percent in the quarter, compared to a decline of 6.3 percent in the corresponding quarter of 2019. The overall increase in kina export price stemmed from higher international prices for some of PNG's export commodities.

There was an overall balance of payments deficit of K650 million for the nine months to September 2020, compared to a deficit of K999 million in the corresponding period of 2019. This was due to a deficit in the capital and financial account, which more than offset a surplus in the current account.

The current account recorded a surplus of K12,728 million for the nine months to September 2020, compared to a surplus of K14,932 million in the corresponding period of 2019. This was due to a lower trade account surplus and net transfer receipts, which more than offset lower net service and income payments.

The deficit in the capital and financial account was due to outflows of direct and other investments reflecting a build-up in foreign currency account balances of mining, oil and LNG companies, combined with Government loan repayments.

The level of gross foreign exchange reserves at the end of September 2020 was K7,135.6 (US\$2,076.5) million, sufficient for 5.3 months of total and 8.6 months of non-mineral import cover.

The Central Bank maintained a neutral monetary policy stance during the September quarter of 2020, by keeping the KFR unchanged at 3.00 percent. The Bank did not undertake any additional change to its policy or instruments, following the measures it undertook in the first two quarters to support the economy from the adverse effects of the COVID-19 pandemic. The Repurchase Agreement (Repo) Facility's dealing margin remained at 100 basis points on both sides of the KFR.

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, given the additional liquidity injected under the Bank's QE program implemented in the March quarter. During the September quarter, there was a net retirement in Central Bank Bills (CBBs) of K197.2 million to support the easing stance. On the other hand, Government's domestic debt increased by K732.2 million, resulting from net issuance of K850.9 million in Treasury bills, which more than offset a net retirement of K90.9 million in Treasury bonds. The Central Bank's intervention in the foreign exchange market also assisted in diffusing some of the kina liquidity. The CRR for the commercial banks remained at 7.00 percent during the quarter.

The average level of broad money supply (M3*) increased by 2.5 percent in the September quarter of 2020, compared to an increase of 0.8 percent in the June quarter of 2020. This 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, declined by 0.1 percent in the September quarter of 2020, following an increase of 0.7 percent in the June quarter of 2020. This reflected decreases in average net claims on the private sector and public non-financial corporations, which more than offset an increase in other financial corporations (OFCs).

The average level of monetary base (reserve money) increased by 1.9 percent during the September quarter of 2020, compared to an increase of 0.3 percent in the previous quarter. This reflected an increase in the average level of currency in circulation, which more than offset a decline in commercial bank deposits held at the Central Bank.

The NFA of the Financial Corporations (FCs), comprising Depository Corporations (DCs) and OFCs, declined by 7.3 percent to K8,663.0 million in the September quarter of 2020, compared to an increase of 13.1 percent in the previous quarter. This reflected a decline in NFA of the Central Bank, which more than offset a increase in NFA of the Other Depository Corporations (ODCs) and OFCs. The decline in NFA of the Central Bank was mainly due to foreign currency intervention and repayment of Government external loans. The increase in NFA of both the ODCs and OFCs was due to an increase in investments abroad.

Net claims on the Central Government by FCs increased by 12.8 percent to K15,361.1 million in the September quarter of 2020, compared to a decline of 1.5 percent in the previous quarter. This resulted from a net issuance of Government securities and a decline in Government deposits held with the Central Bank.

In the September quarter of 2020, total domestic credit extended by FCs to the private sector, public non-financial corporations and 'Provincial and Local Level Governments' increased by 0.3 percent to K18,116.8 million, compared to the previous quarter. This reflected an increase of K89.1 million in credit to the private sector, which more than offset a decline of K29.5 million in claims by the public non-financial corporations. The marginal increase in credit to the private sector was due to advances by ODCs (mainly commercial banks) to the 'Mining & Quarrying', 'Household (housing loans)', 'Manufacturing' and 'Electricity Gas and Water Supply' sectors, while the decline in the public non-financial corporations reflected repayments by the state-owned enterprises.

The fiscal operations of the National Government over the nine months to September 2020 recorded a deficit of K3,259.2 million, compared to a deficit of K1,613.1 million in the corresponding period of 2019. The significantly higher deficit was mainly due to lower revenue collections.

Total revenue and grants over the nine months to September was K7,568.8 million, 17.9 percent lower than in the same period of 2019, and represents 66.6 percent of the amount in the Supplementary Budget. Both the tax and non-tax receipts

underperformed due to the effect of the COVID-19 pandemic on economic activity, while foreign grants were also low.

Total expenditure for the period was K10,828.0 million, marginally lower than in the corresponding period of 2019, and represents 60.2 percent of the Supplementary Budget.

As a result of these developments in revenue and expenditure, the Government recorded a budget deficit of K3,259.2 million. The deficit was financed from domestic and external sources totalling K2,252.2 million and K1,007.0 million, respectively. Net domestic financing comprised K388.4 million, K2,035.8 million, and K629.7 million from the Bank of PNG, ODC's and OFCs, respectively. These more than offset net retirement of Government securities of K752.0 million by other resident sectors and K49.7 million from the public non-financial corporations. The net external financing was mainly from the drawdown of the IMF's Rapid Credit Facility (RCF) of K1,240.6 million and K650.6 million from concessional sources, which more than offset a repayment of K884.2 million to commercial sources.