



BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

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Quarterly Economic Bulletin December Quarter 2021

Mr. Benny B M Popoitai, MBE, Acting Governor of the Bank of Papua New Guinea (Bank of PNG or the Bank), today released the December 2021 Quarterly Economic Bulletin (QEB). This statement provides an overview of the economic and financial developments during the December quarter of 2021 and some key developments since then.

1. UPDATE ON DEVELOPMENTS SINCE DECEMBER 2021

Global economic recovery from the COVID-19 pandemic indicated signs of slowdown in the first quarter of 2022 mainly reflecting the breakout of the Russia-Ukraine War in February. Its impact from the supply disruptions of crude oil and gas, food grains and other commodities has resulted in high commodity prices, and consequently, increasing global inflation and interest rates which has adversely weighed on consumer spending and business activity. In the United States (US), real gross domestic product (GDP) decreased at an annual rate of 1.6 percent in the first quarter of 2022, partly reflecting the on-going impact of the COVID-19 pandemic and a wider trade gap with lower exports. The widening trade gap reduced the first quarter GDP by 3.2 percentage points. Annual inflation in the US surged to 8.4 percent in March 2022, recording a 41-year high since December 1981. With higher energy prices and

broader inflation pressures, the Federal Reserve increased the Fed Funds rate by 25 basis points in March, and further raised the rate by 75 basis points to 1.50 - 1.75 percent target range in June 2022. In the Euro area, annual GDP increased by 5.1 percent in the first quarter of 2022 mainly reflecting the recovery from the COVID-19 pandemic, increased export performance and buildup of inventories. However, the economic recovery began to wane as the Russian-Ukraine War broke out in February causing supply disruptions to imports of crude oil and food grains, and exacerbated by increasing and broadening domestic price pressures to services and other goods. Headline inflation in the area reached record highs with annual inflation increasing significantly to 7.4 percent in March to a new all-time high of 8.6 percent in June 2022. In the United Kingdom (UK), economic growth expanded by 0.8 percent in the first quarter of 2022, reflecting increased activity in the service sector and higher household consumption. The annual inflation rate rose by 7.0 percent in March 2022, and further increased to 9.4 percent in June of 2022, the highest rate since 1982. This was mainly driven by high energy and food prices associated with the Russia-Ukraine War and the existing post-pandemic price pressures. In light of this, the Bank of England increased its Bank Rate by 0.25 percentage points to 0.75 percent. In Japan, economic growth declined by 0.5 percent in the March quarter of 2022, reflecting the resurgence of COVID-19 infections and a drop in business spending. The annual inflation rate was 2.3 percent in June of 2022, above its target rate of 2.0 percent. The Bank of Japan maintained its policy interest rate at negative 0.1 percent target for short-term rates to support growth. The annual core inflation increased by 0.8 percent in March 2022, and further increased to 2.2 percent in June, mainly driven by high prices of imported fuel and food associated with the Russia-Ukraine War, and exacerbated a sharply weakening yen. Among the emerging market economies, China's GDP expanded by 4.8 percent in the March quarter of 2022, a better than expected performance pointing to a strong industrial production, consumption growth, construction activity, fixed asset investment, and foreign direct investment. In India, the economic activity remained resilient on the back of improved business confidence with the easing of COVID-19 restrictions. In its *April 2022 World Economic Outlook (WEO) Update*, the IMF projected the world economy to slow down from an estimated 6.1 percent in 2021 to 3.6 percent in 2022.

According to the latest international commodity price data published by the World Bank in April 2022, prices for all commodities continued to increase in the March quarter of 2022, compared to the December quarter of 2021. Energy prices increased by 17.8 percent reflecting higher prices for natural gas, coal and crude oil due to the recovery from demand and supply constraints. This is further exacerbated by the Russian-Ukraine War, which adversely affected supplies of crude oil and gas, food grains, animal feed and fertilizers from these two countries. Non-energy prices also increased by 11.3 percent with price increases in agriculture, beverages and food products. For non-mineral products, prices increased for coffee, cocoa and palm oil, while logs and tea declined. Prices of precious metals increased by 3.7 percent, reflecting increases for gold, platinum and silver. As a result, prices of some of PNG's export commodities continued to increase in the first quarter of 2022.

Global inflation increased significantly in the first half of 2022 due to rising fuel and gas prices, and food grains reflecting the impact of the Russian-Ukraine War. In 2022, the IMF has projected inflation to be around 5.7 percent for advanced economies and 8.7 percent for the emerging market and developing economies. Acting Governor Popoitai said the Russian-Ukraine war has brought on significant disruptions to the global supply of energy and food resulting in high commodity prices and inflation rising to record highs. He warned that developing economies like PNG would be adversely affected with high prices due to lack of social safety net programs and limited financial resources to minimize the impact, as economies are still recovering from the impact of the COVID-19 pandemic. Acting Governor Popoitai stated that the higher prices are expected to remain elevated as Russia continue to show no signs of ending the War in the near future. In light of this, the Government has introduced temporary relief measures, including raising the income tax threshold and providing tax exemptions on essential refined fuel products to relieve consumers of higher fuel prices.

Since 2010, the annual headline inflation was at a record high of 6.9 percent in the March quarter of 2022, compared to 5.7 percent in the December quarter of 2021. All expenditure groups recorded increases except the 'Restaurants and Hotels' expenditure group, which declined. There were increases in the 'Alcoholic Beverages, Tobacco and Betelnut' expenditure group with 13.2 percent, 'Transport' with 11.7 percent, 'Household Equipment' with 9.9 percent, 'Education' with 8.7 percent, 'Food

and Non-Alcoholic Beverages' with 6.2 percent, 'Miscellaneous' with 4.1 percent, 'Housing' with 2.9 percent, 'Recreation' with 2.4 percent, 'Health' with 1.8 percent, 'Clothing and Footwear' with 0.9 percent and 'Communication' with 0.1 percent. These more than offset a decline of 4.3 percent in the 'Restaurants and Hotels' expenditure group.

Acting Governor noted that with inflation driven by supply factors and not demand, the Bank maintained an accommodative stance of monetary policy by keeping the signaling rate, the Kina Facility Rate (KFR), unchanged at 3.0 percent during the first six months of 2022. The objective of the accommodative stance was to continue to support the economic recovery. However, if inflation remain elevated the Bank will consider tightening its policy at some point in the near future.

The average daily kina exchange rate appreciated against all the major currencies, except the US dollar. Over the year to 30th June 2022, the kina appreciated against the Japanese yen by 5.6 percent to ¥38.7300, British pound sterling by 3.2 percent to £0.2338, euro by 2.5 percent to €0.2716 and the Australian dollar by 0.5 percent to A\$0.4121. Against the US dollar, the kina depreciated by 0.1 percent to 0.2840 percent. These currency movements led to an increase in the Trade Weighted Index (TWI) by 1.1 percent to 28.3760 over the period.

Acting Governor Popoitai stated that the level of foreign exchange reserves as at 31st March 2022 was US\$3,080.90 (K10,660.50) million. As at 30th June 2022, the gross foreign exchange reserves fell to US\$3,052.79 (K10,563.30) million, mainly reflecting Government loan repayments and Central Bank interventions in the foreign exchange market. He urged the Government to invest more and improve production in the export sector, especially in the agriculture, forestry, fishery, and manufacturing sectors. Additional Government assistance to promote value-added exports, meet international export requirements and secure markets overseas would greatly assist growth in these sectors. The Government should focus more on export driven strategy to boost production and export in the non-mineral sector to increase PNG's export earnings to support the domestic foreign exchange market and improve income for the rural people. If these sectors are developed, any depreciation of the kina will have a positive impact on export revenue and growth, while minimising the impact of inflation. On the

other hand, if the current export capacity in the non-mineral sector is not improved to respond adequately to the depreciation of the kina, its impact will be more inflationary with a very small corresponding effect on growth and export revenue. Going forward, to address the on-going foreign exchange imbalance, any depreciation of the kina must be supported by relevant Government policies to address structural issues, especially to promote the export sector and minimise the impact on domestic inflation.

2. OVERVIEW OF THE DEVELOPMENTS IN THE DECEMBER QUARTER OF 2021

Economic indicators available to the Bank of Papua New Guinea (the Bank) point to a recovery in economic activity in 2021, especially in the non-mineral sector reflecting the easing of the COVID-19 pandemic restrictions and supply disruptions. The recovery also reflected higher government spending, and increased domestic production and international commodity prices, supported by improvements in global trade. As a result, the overall balance of payments recorded a surplus. Private sector nominal sales increased significantly in 2021, reflecting a rebound in business activity due to easing of COVID-19 pandemic restriction measures. Following the global recovery, inflation increased emanating from high international energy and food prices, and the on-going impact of the COVID-19 pandemic. Consequently, annual headline inflation increased to 5.7 percent in the December quarter of 2021. The average daily kina exchange rate appreciated against all major trading currencies except the US dollar, resulting in the Trade Weighted Index (TWI) increasing by 1.7 percent. To support the economic recovery, the Bank maintained an accommodative monetary policy stance by keeping the Kina Facility Rate (KFR) unchanged at 3.0 percent over the year.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the formal private sector increased by 19.7 percent in the December quarter of 2021, compared to an increase of 4.5 percent in the September quarter. Excluding the mineral sector, sales increased by 3.9 percent in the December quarter of 2021, compared to an increase of 4.4 percent in the previous quarter. By sector, sales increased in all sectors, except in the financial/business/other services sector, which declined. By region, sales increased in all regions, except in the Momase (excluding

Morobe) region, which declined. In 2021, total nominal sales increased by 39.9 percent, compared to a decline of 19.3 percent in 2020. Excluding the mineral sector, sales increased by 16.5 percent, compared to a decline of 9.4 percent in 2020. The increase in nominal sales reflected the recovery from the COVID-19 pandemic, higher commodity prices and production and the Government's expansionary fiscal policy.

The Bank's Employment Index shows that the level of employment in the formal private sector increased by 1.8 percent in the December quarter of 2021, compared to a decline of 3.9 percent in the previous quarter. Excluding the mineral sector, the level of employment increased by 1.9 percent. By sector, the level of employment increased in the construction, financial/business and other services, manufacturing, transport, and mineral sectors, while it declined in the agriculture/forestry/fishing, retail, and wholesale sectors. By region, the level of employment increased in the National Capital District (NCD), Highlands, and Morobe regions, while it declined in the Islands, Southern (excluding NCD) and Momase (excluding Morobe) regions. In 2021, the total level of employment declined by 0.7 percent, compared to a decline of 5.5 percent in 2020. Excluding the mineral sector, the level of employment declined by 5.9 percent in 2021, compared to a decline of 1.6 percent in 2020.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), increased by 2.3 percent in the December quarter of 2021, compared to an increase of 0.3 percent in the previous quarter. There were increases in the 'Alcoholic Beverages, Tobacco and Betelnut', 'Health' 'Household Equipment', 'Housing', and 'Transport' expenditure groups, which more than offset decreases in the 'Clothing and Footwear', 'Restaurants and Hotels', 'Recreation' and 'Food and Non-Alcoholic Beverages' groups. The 'Miscellaneous', 'Communication' and 'Education' expenditure groups recorded no change in prices in the quarter. By urban centre, prices increased in all the surveyed centres. Annual headline inflation was 5.7 percent in the December quarter of 2021, compared to an increase of 5.1 percent in the corresponding quarter of 2020.

In the December quarter of 2021, the average daily kina exchange rate appreciated against all the major currencies, except the US dollar (USD). The kina appreciated against the Australian dollar (AUD) by 0.9 percent to A\$0.3915, euro by 3.1 percent to

€0.2492, British pound sterling by 2.3 percent to £0.2115, and the Japanese yen by 3.2 percent to ¥32.3959. It remained unchanged against the USD at US\$0.2850. These currency movements resulted in the Trade Weighted Index (TWI) increasing by 0.9 percent to 27.54. In 2021, the average daily kina exchange rate appreciated against all the major currencies, except the USD and the pound sterling.

The weighted average kina price of PNG's export commodities, excluding Liquefied Natural Gas (LNG), increased by 27.1 percent in 2021 from 2020. There was an increase of 25.3 percent in the weighted average price of mineral exports, reflecting higher kina prices for all mineral exports. For agricultural, log and marine product exports, the weighted average kina price increased by 33.9 percent due to higher prices of cocoa, coffee, copra, copra oil, palm oil, rubber and logs. Excluding log exports, the weighted average kina price of agricultural and marine product exports increased by 43.8 percent in 2021 from 2020. The higher kina export price reflected an increase in international prices for all of PNG's non-mineral export commodities, except tea and marine products.

The balance of payments recorded a surplus of K1,931 million in 2021, compared to a surplus of K1,557 million in 2020. A surplus in the current account more than offset a deficit in the capital and financial account.

The current account recorded a surplus of K19,681 million in 2021, compared to a surplus of K17,256 million in 2020. This was due to a surplus in the trade account and higher net transfer receipts, which more than offset higher net service and income payments.

The deficit in the capital and financial accounts was K17,750 million in 2021 compared to K15,710 in 2020, reflecting higher net outflows due to the build-up in offshore foreign currency accounts of mineral companies including the LNG companies. This outcome is also reflective of net Government and private sector loan repayments.

The level of gross foreign exchange reserves at the end of December 2021 was K11,368.7 (US\$3,240.1) million, sufficient for 8.2 months of total and 13.7 months of non-mineral import covers.

The Central Bank maintained a neutral monetary policy stance during the December quarter of 2021, by keeping the KFR at 3.00 percent. A low interest rate environment was aimed at encouraging private sector activity to support the economic recovery from the impact of the COVID-19 pandemic. The dealing margins for the Repurchase Agreement (Repo) Facility were maintained at 100 basis points on both sides of the KFR. The Cash Reserve Requirement (CRR) for the commercial banks was maintained at 7.0 percent during the quarter.

The Bank implemented its monetary policy by utilizing its Open Market Operation (OMO) instruments to manage liquidity in the banking system. In the December quarter of 2021, there were two inter-bank borrowing and seven Repo deals conducted. The inter-bank borrowing totalled K140.0 million all done at 5.00 percent interest rate, while borrowing under the Repo Facility totalled K392.0 million at 4.00 percent. Liquidity in the banking system remained high over the quarter despite some diffusions mainly through the Central Bank's issuance of Central Bank Bills (CBBs) and interventions in the foreign exchange market. There was a net issuance of K1,006.5 million in CBBs in the December quarter of 2021. The Bank significantly increased its CBB issuance to sterilize excess liquidity in the banking system. There was a net retirement of Government securities totalling K194.4 million, mainly from a net retirement of K357.6 million in Treasury bonds (Inscribed Stock) more than offsetting net issuance of K163.2 million in Treasury bills.

The average level of broad money supply (M3*) increased by 2.9 percent in the December quarter of 2021, compared to an increase of 2.1 percent in the previous quarter. This was mainly driven by an increase in average net foreign assets (NFA) of the Central Bank, which reflected inflows of external budget financing. The average net domestic claims, excluding net claims on Central Government, increased by 1.1 percent in the December quarter of 2021, compared to a decline of 0.5 percent in the previous quarter. This reflected an increase in average net claims on public non-financial corporations, which more than offset declines in average net claims on other financial corporations and the private sector.

The average level of monetary base (reserve money) increased by 3.7 percent in the December quarter of 2021, following an increase of 4.5 percent in the previous quarter. This was due to increases in average levels of both currency in circulation and liabilities to other depository corporations (ODCs) at the Central Bank, particularly deposits of commercial banks.

The NFA of FCs, comprising DCs and other financial corporations (OFCs), increased by 30.5 percent to K10,886.6 million in the December quarter of 2021, compared to a decline of 19.9 percent in the previous quarter. This was mainly driven by an increase in the NFA of the Central Bank, which more than offset a decline in the NFA of ODCs. The increase in Central Bank's NFA reflected higher inflow of Government's external budget financing, mainly reflecting the Australian Government's Budget Support and funding by the Asian Development Bank (ADB) for State Owned Enterprises (SOE) Reforms in December 2021.

Net claims on the Central Government by FCs declined by 8.9 percent to K17,312.8 million in the December quarter of 2021, compared to an increase of 4.0 percent in the previous quarter. This mainly reflected higher Government deposits at the Central Bank associated with the inflows of external budget financing, combined with a net retirement of Government securities.

In the December quarter of 2021, total domestic credit extended by FCs to the private sector, public non-financial corporations and 'Provincial and Local Level Governments (P & LLGs)' decreased by 0.2 percent to K17,725.0 million, compared to an increase of 0.9 percent in the previous quarter. Lending to the private sector and public non-financial corporations decreased by K205.1 million and K53.5 million to K15,669.8 million and K1,830.7 million, respectively. The increase in lending to the 'P & LLGs' of K224.5 million reflects a reclassification of a loan during the quarter.

Fiscal operations of the National Government in 2021 showed a deficit of K6,270.3 million, compared to a deficit of K6,612.8 million in the corresponding period of 2020. This represents 6.7 percent of nominal GDP.

Total revenue and grants in 2021 was K13,860.4 million, 14.6 percent higher than in 2020 and is 101.4 percent of the 2021 Supplementary Budget amount. The outcome reflected higher than projected grants from development partners and tax revenue collections, which more than offset lower collections in Other Revenues (Dividends, Statutory Transfers, and Fees & Charges).

Total expenditure in 2021 was K20,130.7 million, 3.8 percent higher than the 2020 outcome, and 0.8 percent lower than the Supplementary Budget appropriation.

As a result of these developments in revenue and expenditure, the budget deficit was K6,270.3

million which was financed from domestic and external sources totalling K2,601.0 million and K3,669.3 million, respectively.

Total public (Government) debt outstanding as at the end of 2021 fiscal year was K48,173.1 million, 51.6 percent of GDP. The current outstanding debt is comprised of K25,257.6 million from domestic sources and K22,915.5 million from external sources.

Total Government deposits at depository corporations increased by K1,371.4 million to K5,252.9 million, mainly between November and December of 2021. This increase reflected drawdowns of external budget support as well as financing from domestic sources.