SPEECH ON THE MARCH 2024 MONETARY POLICY STATEMENT

DELIVERED BY THE GOVERNOR, MS. ELIZABETH GENIA, AAICD.

Daba Namona, Morning Tru and Good Morning All.

Firstly, let me acknowledge the owners of the land, the Motu and Koitabu people, and their elders past and present.

I also acknowledge the presence of our representatives of government, members of the diplomatic corps and our development partners.

On behalf of the Board, and the management of the Bank of Papua New Guinea, I extend a very warm welcome to you in joining us this morning to launch the Central Bank's Monetary Policy Statement.

I acknowledge our business leaders also this morning. The private sector is the driver of growth in Papua New Guinea, and your resilience through these challenging times is critical to PNG and to PNG's economic wellbeing.

The resilience of businesses and of households, in light of the significant economic challenges we are facing, is being tested. Some of these challenges are caused by external factors outside of our control. Those factors within our control are the focus of our work at the Bank of Papua New Guinea.

Over the next six months, we will need to make some tough policy decisions, and in doing so, we will feel some pain, in the short term, for what we are working towards in the longer term.

Many of the challenges we have faced in the past have been left unaddressed in the hope they would somehow resolve themselves without the need for difficult decisions.

Let me highlight from the outset that we cannot continue with the same approach going forward and expect a different result.

This morning I am going to present the highlights of the March 2024 Monetary Policy Statement, or MPS, which will reflect on where we are today before then pointing to the path forward in the coming months.

My speech broadly follows the structure of the MPS. I will present the Central Bank's assessment of broader macroeconomic developments along with our medium-term outlook and I will begin with a review of global developments and our domestic outlook

According to the IMF's most recent World Economic Outlook, real global GDP in 2023 is estimated to be 3.1 percent, slightly down from the 3.5 percent growth recorded in 2022.

This was primarily due to Central Banks tightening monetary policy to address higher inflation levels, the flow on effects of the Russia-Ukraine conflict and the withdrawal of COVID-related fiscal support.

Inflation globally, is estimated to have decreased from 8.7 percent in 2022 to 6.8 percent in 2023. With inflation trending lower, the IMF has projected global growth to remain relatively strong.

The global economy is expected to grow by 3.1 percent in 2024 and 3.2 percent in 2025, driven by a strong US economy and broad strength in several major emerging markets.

This is a relatively positive outlook. However, these growth projections are still below the pre-COVID average of 3.8 percent in 2019 and 2020. Headline inflation globally is forecasted lower, to 5.8 percent in 2024 and further declining to 4.4 percent in 2025.

Turning to domestic growth forecasts, the Bank of PNG estimates modest real GDP growth of 1.4 percent for 2023, a significant drop from the 5.2 percent recorded in 2022.

The Bank's estimate considers recent survey data in the formal sector, primarily based on employment and revenue data, and real GDP growth for the previous year.

The survey responses also highlight the enduring issues - ongoing foreign currency shortages, increased costs of transportation, structural challenges such as law enforcement and unreliable power sources, continue to be of major concern for businesses.

Faced with these ongoing challenges, companies are looking at cost-cutting measures while exploring cheaper alternatives, both domestically and abroad, to maintain their competitiveness.

For 2024, the Bank is forecasting a rebound in real GDP growth to around 3.0 percent, primarily driven by a strong performance in the mineral sector, underpinned by the resumption of production at the Porgera mine and higher output of gold, copper and silver from the broader mining sector.

The positive flow on effects from the commencement of operations at New Porgera and increased government spending are also expected to provide opportunities for the non-mineral sector.

It is a very difficult environment for business at the moment. The Bank's Business Sentiment Survey conducted in February 2024 indicated a decline in business confidence which is expected to persist over the coming months with the lingering effects of January’s civil unrest.

It is anticipated that revenues for businesses will remain under pressure. The consumer just does not have the discretionary income that was available to them previously and employment levels in the non-mineral private sector are expected to decline in the first half of 2024.

Over the medium term, the Bank anticipates a boost in economic activity. In 2025 real GDP growth is projected to reach 4.5 percent underpinned by a full-year of production at New Porgera, a recovery in the retail and wholesale sectors and some pickup in activities associated with pre-final investment decision spending by new resource projects.

In 2026, growth is projected to be around 3.6 percent, supported by increased activity in the mineral sector along with positive flow-on effects from increased exploration activities and capital investment.

The overall assessment of risks to the domestic economic growth outlook are considered to be balanced. Downside risks include a tighter than anticipated monetary policy stance from the Central Banks of the major economies, prolonged geo-political conflict in the Middle East and climate change related weather events.

Balance of Payments

I'd like to turn to our Balance of Payments position and structural FX issues and how they are linked as it is a question I am often asked.

PNG has experienced large current account surpluses over the last decade, mainly driven by the mineral sector and exports of LNG, Copper and Gold.

We had a substantial current account surplus of PGK 200m in 2023 mainly due to mineral exports (LNG, Copper and Gold). Non-mineral exports eased when compared to their historic levels but a recent increase in cocoa prices is encouraging and has boosted interest in cocoa exports.

Our current account surplus masks a structural issue we have with a deficit of foreign currency inflows into PNG's domestic FX market. Unfortunately, we are just not seeing enough of what we export come back on shore to PNG and it is something that is getting very close attention, both from the BPNG and from Treasury.

In 2023, commercial foreign currency inflows into PNG's domestic FX market amounted to USD 5.5 billion against outflows of USD 7.2 billion. The BPNG intervened in the market with USD 1.6 billion, a record level of intervention from the Central Bank.

Foreign reserves are adequate and the return of Barrick and New Porgera will help ease the pressure somewhat, on businesses and on PNG's international reserves this year, though for 2024 a current account deficit of 960m is expected due to higher net outflows in the financial and capital accounts exceeding the surplus in the current account.

Inflation

Annualised inflation in PNG remained below 2.2% over the March, June and September quarters of 2023, thanks mainly to a very strong US Dollar leading to an increase in the Kina's purchasing power against the non-USD major currencies for most of the year. The year ended however with a notable increase in the CPI to 3.9% in the December quarter, though underlying inflation was still trending lower.

Looking ahead to the remainder of 2024, the Bank expects inflationary pressures to increase, mainly due to the continued depreciation of the Kina against the US Dollar. The CPI is expected to increase to 5% this year and remain elevated throughout 2025 before easing in 2026.

Our medium term inflationary outlook also faces risks to the upside with supply side disruptions due to the conflict in the Middle East, any further escalation in the Russia - Ukraine war and domestic fuel security challenges, while any significant decrease in inflationary pressures in PNG's key trading partners and / or a broadly stronger US Dollar, could lead to lower domestic inflation than currently projected. We will be monitoring developments very closely for inflationary pressures continuing to build in the economy.

Broad Money

I also want to touch briefly on money supply and on the excess of liquidity in the banking system.

Broad money supply increased by 11.5% with increases in net foreign assets of 3.9% and net domestic assets of 22%. Private sector credit grew by almost 20%, mainly in the agriculture, petroleum and gas sectors.

PNG has long struggled with the issue of excess liquidity in the banking system, impeding as it does, on the effectiveness of the transmission of monetary policy. In response, the BPNG has introduced a Fixed Rate Full Allotment (or FRFA) 7-Day Central Bank Bill auction as a liquidity management instrument to support the monetary policy instrument, or policy rate, the Kina Facility Rate (KFR).

The FRFA auction's ability to influence domestic deposit rates has been somewhat effective and the BPNG will look at this more closely in the coming months to try to address the disparity between commercial bank lending rates and deposit rates.

It is very important for deposit rates, and lending rates, to converge to reasonable margins and for commercial banks and financial institutions to price their products with some reference to the policy rate as is done in other markets. The disparity between lending and deposit rates remains considerable.

Further changes may be required through the BPNG's Open Market Operations to absorb the excess of liquidity that is resulting in low deposit rates and we are examining these options carefully.

Monetary Policy Stance

Before I turn to our Monetary Policy Stance, I want to take a moment to briefly review the monetary policy adjustments that were made since the release of the September 2023 Monetary Policy Statement when the BPNG adopted a neutral Monetary Policy Stance and that was followed by two adjustments lower in the KFR, from 3.0% to 2.5% in November 2023 and lower again to 2.0% in February 2024.

The reduction to 2.5% was to align the KFR with the liquidity management instrument designed to support it, the Fixed Rate Full Allotment (FRFA) 7-day Central Bank Bill auction and the adjustment to 2.0% was intended to assist businesses after the civil unrest in January this year.

Importantly, the decision to lower the KFR to 2.0% was taken in exceptional circumstances after the events in January. While headline inflation turned higher in December 2023, it did so from very low levels and underlying inflation was still trending lower.

For the coming six months, inflationary pressures will be to the upside and the BPNG will adopt a tightening bias with its Open Market Operations to support the BPNG's Monetary Policy Stance. This will involve increases to the Cash Reserve Ratio (CRR) held on behalf of the commercial banks (currently 10% of deposits with the commercial banks are held in reserve), increases to the KFR (currently at 2.0%) and the possibility of a longer dated FRFA Central Bank Bill auction to support the KFR.

The exchange rate will continue lower and the BPNG will closely monitor the inflationary impact of the lower Kina and will take all necessary steps to keep inflation under control.

These are challenging times for the economy and the main challenge for the majority of businesses remains the issue of accessing foreign currency. That is no less the case this year, even though we had record intervention from the Central Bank in PNG's Foreign Exchange Market through 2023.

Our intervention in the FX market last year was just under USD 1.6 billion. This is very significant support and represents the Bank of Papua New Guinea's highest ever intervention program. In the first quarter of 2024, the BPNG has intervened with just over USD 300 million.

2024 will see some improvement in foreign currency inflows and we will continue to support the market in a similar manner to what we have been doing, though it is unlikely we will be able to exceed 2023's record level of intervention.

We are addressing the structural issues in Papua New Guinea's foreign exchange market, above and beyond the resource cycle and the boost to foreign direct investment that we experience approximately every 8 to 10 years. This will continue to be a major focus for the Central Bank, as I know it is for Treasury, and we will get the policy settings right for the government's growth agenda through to the end of the decade, and beyond.

In 2024, the Kina will continue to ease lower, the Kina needs to reflect the dynamics of supply, and of demand, and we will monitor the currency very carefully, assessing it at different levels, not only against the benchmark PGKUSD exchange rate, but also against the Kina cross rates.

We are continuing to work through the IMF Program along with the government and that is progressing well. The technical assistance we have received at the BPNG in working with the IMF has been of great benefit to us and we look forward to the IMF's next mission to PNG which is later this month

The government has already enacted a number of amendments to the Central Banking Act in December 2021 following on from the recommendations from Phase 1 of the Independent Advisory Group's report. Further amendments to the Central Banking Act are expected very soon following the release of the IAG's Phase 2 Report in late November last year.

We have some new Board appointments, very recently announced, and I am delighted to say we have a full Board with nine members now appointed. There is a wealth of experience being brought to the BPNG through those Board appointments and they will make a significant contribution to the BPNG and to PNG's economy.

In closing, there are some challenges ahead of us but nothing that can't be addressed and overcome. The measures we are introducing, with the exchange rate and the overall monetary policy framework will take time to achieve their desired outcomes.

The Central Bank will always be focused on smoothing out the extremes of the peaks and troughs of the investment cycle, to ensure a more stable environment for businesses to operate in and ultimately, to promote sustainable and longer term economic growth.

Ends.