



# **BANK OF PAPUA NEW GUINEA**

## **MONETARY POLICY STATEMENT BY THE GOVERNOR OF THE BANK OF PAPUA NEW GUINEA, MR. LOI M. BAKANI, CMG**

**PORT MORESBY**

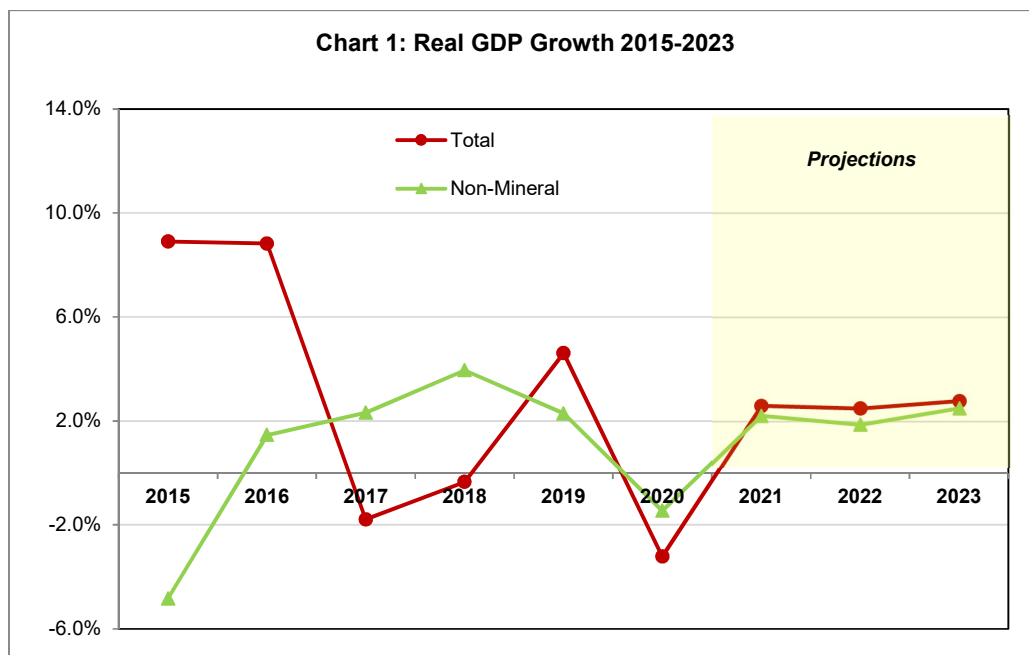
31<sup>st</sup> March 2021

Economic activity in Papua New Guinea (PNG), like the global economy declined in 2020 due to the Coronavirus Disease 2019 (COVID-19) pandemic and its containment measures. Such a health crisis is different from an economic and financial shock, and requires a combination of measures with unconventional policies to stimulate the economy. The PNG authorities responded with a large fiscal stimulus package and quantitative easing program, while financial institutions implemented a loans repayment moratorium and other initiatives aimed at ensuring liquidity is available to the public. The State of Emergency (SOE) containment measures restricted mobility of people, and disrupted supply chains and business operations which impacted on Government revenue and foreign exchange flows, as well as increased prices. Economic recovery is expected for 2021 with growth forecasted for both the non-mineral and mineral sectors. However, concerns remain given the heightened risks of the pandemic with rising infection cases as well as the impact of any further tightening of the containment measures. A full rollout of a vaccination program to the wider population would assist with the economic recovery process.

The global economy was estimated to have contracted by 3.5 percent in 2020, according to the International Monetary Fund's (IMF) *World Economic Outlook Update* of January 2021. This was the largest decline since the 1930's Great Depression and was largely due to the COVID-

19 pandemic. For 2021, the IMF forecasts a recovery of 5.5 percent, on the back of the rollout of COVID-19 vaccines, combined with additional fiscal stimulus packages and accommodative monetary policies.

In PNG, economic activity was estimated by the Bank of PNG to have contracted by around 3.0 percent in 2020 (See Chart 1). This was mainly due to the SOE measures. The sectors hardest hit were the transportation, accommodation (hotels) and food services, and other services. The closure of the Porgera Gold Mine in April, 2020 also impacted adversely on economic activity. The Bank projects GDP growth for PNG to recover in 2021, to around 2.5 percent, with higher activity in the Agriculture/Fisheries/Forestry and mineral sectors as well as a general pickup for most other businesses. The downside risk to this forecast is the rising infection rate of COVID-19 and further tightening of containment measures. However, this can be minimized depending on a successful vaccination program throughout the country.



Source: NSO (actuals to 2018), Department of Treasury (estimates for 2019 & 2020) and BPNG (projections for 2021-2023)

The fiscal operations of the Government were adversely impacted by the COVID-19 pandemic in 2020 with lower revenue, resulting in a Supplementary Budget introduced in September 2020. The preliminary fiscal outcomes for the eleven months to November 2020 showed a deficit of K5,638.4 million, compared to the deficit of K2,293.4 million in the corresponding

period of 2019. To finance the deficit, the Government raised K4,077.3 million from domestic sources and K1,561.0 million from external sources. The impact of these high expenditures in 2020 on economic activity has not been evident.

The 2021 National Budget has a planned expenditure of K19,607.8 million and revenue of K12,955.0 million, giving a deficit of K6,612.8 million. The deficit equates to 7.3 percent of nominal GDP. To finance it, the Government plans to raise K4,612.8 million from external sources and K2,000.0 million domestically. Of the total external financing, K2,319.6 million will be from other possible external sources. Given the recent cases of COVID-19 infections that could impact on revenue raising, this would pose additional financing challenges. It is important for the Government to step up its revenue collection efforts, which includes the new revenue raising measures. The Government is also cautioned to spend effectively on priority areas such as health and COVID-19 related expenses, education, law and order and settling arrears to service providers and exercise control in its expenditure. Given the high expenditure, there is a need for proper governance and auditing to ensure prudent spending.

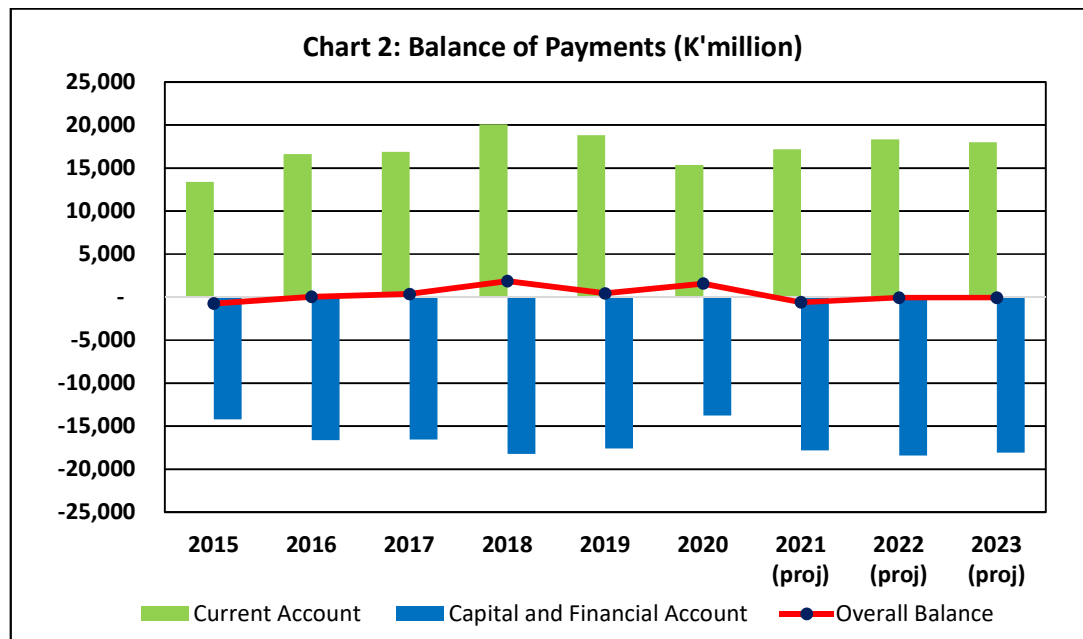
The revenue challenges and cash flow difficulties in 2020 resulted in the Government amending the Central Banking Act that increased advances from the Bank. The substantial increase in the Temporary Advance Facility (TAF) limit from K300.0 million to K1,500.0 million to finance the Government's cash flow mismatches poses a challenge to monetary policy management. The Central Bank undertook some trading in the secondary market by on-selling its stock of Government securities to diffuse part of the liquidity injected through the TAF. A large portion of the dishonored Government cheques funded by the TAF was as a result of not adhering to the due process of verification rather than the unavailability of funding. Therefore, the Government is encouraged to minimize the use of cheques and undertake electronic funds transfer for ease of payments.

It is also important that the authorities fast track the structural reforms to improve revenue collection and expenditure controls. Some of these are outlined under the IMF Staff Monitored Program that is scheduled to end in June 2021. The Central Bank is also considering technical assistance to reform and enhance its monetary policy management and foreign exchange market operations.

The overall balance of payments (BOP) recorded a surplus of K1,557.9 million in 2020 (See Chart 2). The outcome was due to a surplus in the current account which more than offset a deficit in the capital and financial account. The outcome in the current account was mainly driven by a surplus in the trade account due to export receipts. The net outflow in the capital and financial account was mainly due to external debt service payments.

For 2021, the Bank projects a BOP deficit of K604.2 million, with a higher net outflow in the capital and financial account more than offsetting a lower surplus in the current account. The capital and financial account is projected to have a deficit of K17,788.8 million. This mainly reflects debt servicing by the partners in the PNG LNG Project. The current account is projected to have a surplus of K17,184.3 million, due to higher prices and production of most export commodities. In the medium term, the Bank projects deficits in the overall BOP, with deficits in the capital and financial account more than offsetting surpluses in the current account. This outlook would however change if the Porgera mine resumes production and the other projects in the pipeline such as Papua LNG and Wafi-Golpu mine come on stream, combined with higher than expected prices of major export commodities.

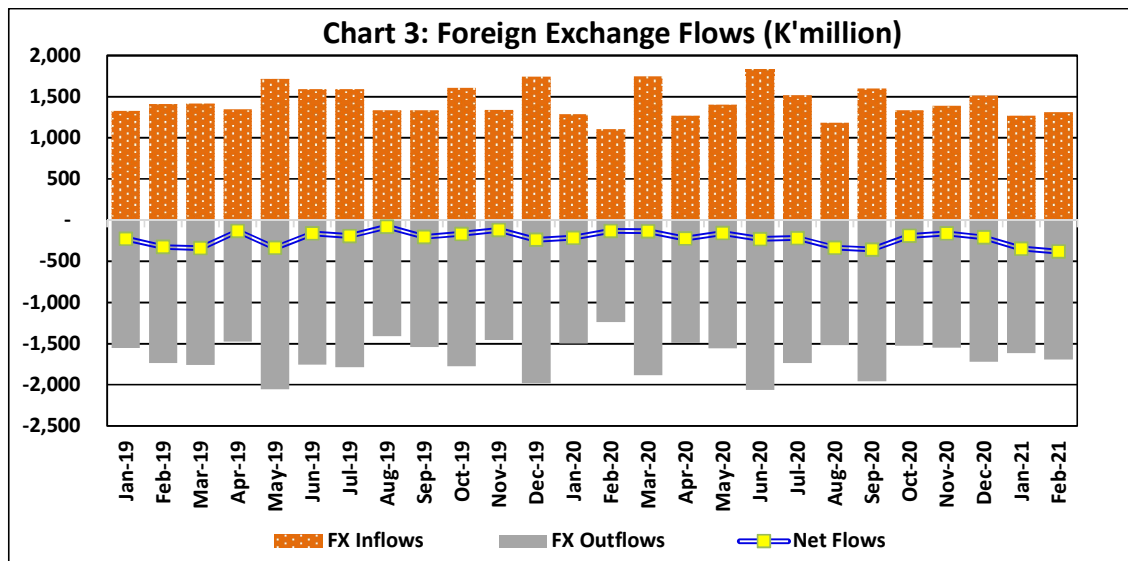
As at the end of December 2020, the gross international reserves was K9,393.2 (US\$2,709.4) million, sufficient for 8.7 months of total and 15.3 months of non-mineral import covers. The foreign exchange inflows in 2020 were mainly from mining and petroleum taxes, dividend receipts and external budget financing. The level of gross international reserve was US\$2,410.9 (K8,313.5) million as at 18<sup>th</sup> March 2021. The decline in reserves was due to the servicing of external Government debt and Central Bank interventions to support the foreign exchange market.



Source: Bank of PNG

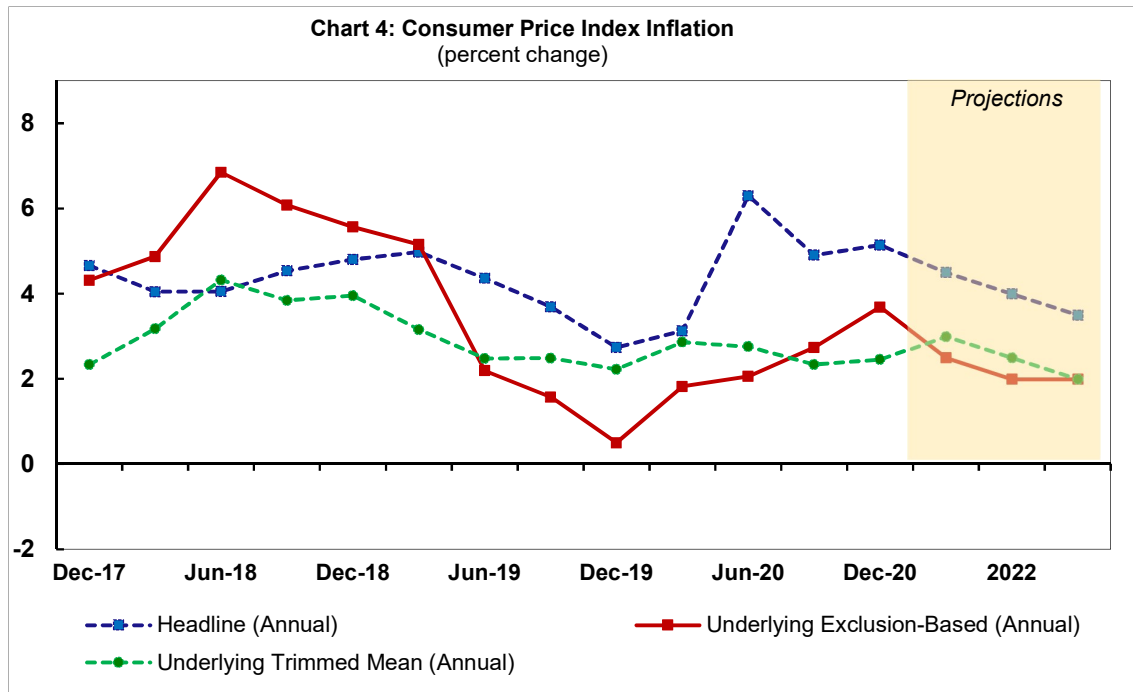
The kina exchange rate depreciated against the US and Australian dollars between the end of September 2020 and mid-March 2021. As at 18<sup>th</sup> March 2021, it depreciated against the US dollar from US\$0.2860 to US\$0.2850, reflecting continued high import demand. Against the Australian dollar, the kina depreciated to A\$0.3643 from A\$0.4026 over the same period mainly reflecting cross currency movements, with the AUD appreciating against the USD.

The supply of foreign exchange to the domestic market in 2020 stemmed mainly from the mining sector, while the demand for foreign currency was led by the retail sector. This trend is expected to continue into 2021 (See Chart 3).



Source: Bank of PNG

The annual headline inflation, as measured by the Consumer Price Index (CPI) and released by the National Statistical Office (NSO), trended upwards in the second half of 2020 (See Chart 4) due to the impact of the COVID-19 pandemic on the prices of seasonal produce and medical services. Annual headline inflation was 5.1 percent in the December quarter of 2020. The annual core measures of inflation also increased. For 2021, the Bank forecasts the annual headline inflation to be around 4.5 percent taking into account the declining feed-through from past inflation and relative stability in the exchange rate. The underlying inflation measures are projected to be low. The upside risks to these projections would include the impact of disruptions to domestic and external supply chains. Over the medium term, the headline inflation forecast is around 4.0 percent, reflecting the easing of containment measures.



Source: NSO and Bank of PNG

In 2020, broad money supply increased by 7.0 percent due to increases of 19.5 percent and 4.5 percent in Net Foreign Assets (NFA) and Net Domestic Assets (NDA), respectively. The increase in NFA mainly reflected external borrowings for the National Budget. The increase in deposits at commercial banks was mainly from liquidity injected by Government expenditure and monetary policy measures in response to the COVID-19 pandemic. The additional liquidity did not translate into increased private sector credit, which was instead reinvested in COVID-19 Treasury bonds and through secondary market trading with the Central Bank. Demand for credit by the private sector remains low due to the subdued economic conditions. Therefore, the Exchange Settlement Account levels of commercial banks and liquidity in the banking system remain high. To minimize the potential threat to price stability, in the meantime, the Central Bank is managing liquidity through secondary market trading and the TAP Facility for Government securities, which was also setup to encourage a savings culture.

For 2021, the Bank forecasts an increase of 6.2 percent in broad money supply. This is mainly due to an increase of 8.6 percent in NDA, which more than offset a decline in NFA of 4.5 percent. The increase in NDA is due to an increase in net claims on Central Government of 16.0 percent, which reflects Government debt issuance and an increase in Private Sector Credit

(PSC) of 6.0 percent. The increase in PSC is mainly driven by the expected economic recovery. In line with these developments, the monetary base is projected to increase by 3.9 percent.

Given the importance of the Micro Small and Medium Enterprises (MSME) sector, the Bank and the Government are working on establishing a MSME Credit Guarantee Corporation. The Government has also allocated K200 million to support this sector but its utilization has been dismal to date. The financial institutions have also rolled out various products for this sector.

Considering the macroeconomic developments in 2020 and projections for 2021, the Bank will maintain an accommodative stance of monetary policy in the next six months. It will closely monitor the developments on inflation and other macroeconomic and financial indicators, and will take necessary measures to ensure macroeconomic stability. The Central Bank will closely work with the Government on any new measures to support economic growth.

Monetary policy is implemented through the reserve money framework with the aim of influencing domestic market interest rates to align with the policy rate, the Kina Facility Rate (KFR). This involves managing liquidity in the banking system through Open Market Operations to influence interest rates to achieve and maintain price stability. The Monetary Policy Statement provides the overall policy stance for the next six months, while the monthly KFR signals this stance through public announcements by the Bank.



## Appendix

Table 1: Monetary and Credit Aggregates (annual % changes)						
INDICATORS	2018 (Actual)	2019 (Actual)	Actual to Dec 2020	2021 (Proj)	2022 (Proj)	2023 (Proj)
Broad Money Supply	-4.0	4.4	7.0	6.2	5.0	2.6
Monetary Base	-2.1	12.7	2.2	3.9	2.1	6.0
Claims on Private Sector	7.0	4.0	4.3	6.0	4.0	6.0
Net Claims on Government	-30.1	6.4	7.3	16.0	16.0	11.1
Net Foreign Assets	27.9	9.3	19.5	-4.5	-1.7	-0.8
Table 2: Summary of Other Macroeconomic Indicators						
CONSUMER PRICE INDEX (CPI) (annual % changes)						
Headline	4.8	2.7	5.1	4.5	4.0	3.5
Trimmed mean	4.0	2.2	2.5	2.5	2.0	2.0
Exclusion-based	5.6	0.5	3.7	3.0	2.5	2.0
BALANCE OF PAYMENTS (kina millions)						
Current Account	18,206.84	18,855.55	15,356.50	17,184.30	18,317.00	18,005.10
Capital & Financial Account	-16,393.09	-18,434.78	-13,148.90	-17,788.75	-18,387.25	-18,075.41
Overall Balance	1,849.10	423.32	1,557.90	-604.20	-70.20	-70.20
Gross International Reserves	7,457.14	7,880.02	9,393.2	8,966.10	8,895.96	8,825.79
IMPORT COVER (months)						
Total	6.70	5.40	8.10	6.7	6.0	5.7
Non-mineral	14.90	9.30	15.30	12.2	11.2	10.4
Crude Oil (US\$/barrel)	69.00	62.10	38.70	49.88	48.67	48.67
Gold (US\$/ounce)	1,225.66	1,332.48	1,670.20	1,800.00	1,710.00	1,539.00
Copper (US\$/pound)	291.50	269.00	255.90	292.97	287.12	289.13
Nickel (US\$/tonne)	12,650.00	14,229.30	12,214.90	13,924.96	13,699.38	13,599.37
Cobalt (US\$/tonne)	58,937.80	31,999.70	28,968.00	32,154.48	31,633.58	31,402.65
LNG (US\$/mmbtu)	10.40	10.40	8.80	9.23	9.01	9.01
Condensate (US\$/barrel)	70.40	61.80	37.50	48.40	47.22	47.22
FISCAL OPERATIONS OF THE GOVERNMENT*						
Surplus/Deficit (K'million)	-2,049.2	-4,172.1	-6,630.2	-6,612.8	-5,295.1	-3,325.5
% of GDP	-2.6	5.0	-8.1	-7.3	-5.3	-3.2
REAL GROSS DOMESTIC PRODUCT (annual % growth)**						
Total GDP	-0.3	5.9	-3.8	2.5	4.2	2.4
Non-mineral GDP	4.0	2.4	-1.1	2.2	3.7	3.5
Source: Bank of PNG, NSO and Department of Treasury						
* Actuals up to 2019 from 2020 Supplementary Budget. Figures for 2020 to 2023 are from the 2021 National Budget.						
** GDP figures for 2018 are from NSO, 2021 from BPNG and the rest from Treasury in the 2021 National Budget.						