



BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

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Quarterly Economic Bulletin September 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 September 2021 Quarterly Economic Bulletin (QEB). The QEB also includes a section on the Financial Soundness Indicators for PNG, the first time the Bank has produced such an analysis. This Statement provides an overview of the economic and financial developments during the September quarter of 2021 and some key developments since then.

1. UPDATE ON DEVELOPMENTS SINCE SEPTEMBER 2021

The global economy continued to recover in 2021 after a sharp decline in 2020 as many countries relaxed restrictions related to the COVID-19 pandemic. However, the emergence of variants of the COVID-19 virus including Omicron, persistent supply disruptions and withdrawal of fiscal and monetary policy support by many economies weighed on economic activity, resulting in a slower recovery in 2021. In advanced economies, high vaccination rates and continued fiscal spending helped to cushion some of these challenges while recovery in most emerging market and developing economies declined due to waning fiscal support and tightening of financing conditions. The International Monetary Fund in its *January 2022 World Economic Outlook Update* estimated the world economy to have grown by 5.9 percent in 2021,

and forecast a lower growth of 4.4 percent in 2022. Inflation has increased and is expected to remain elevated due to rebound in economic activity, supply disruptions and higher energy and food prices. In the United States (US), economic activity grew at a slower pace as consumer and investment spending slowed down. In China, growth slowed due to disruptions from recent COVID-19 outbreaks, a decline in real estate investment and a faster than expected withdrawal of public investment. Growth in the larger emerging market economies remained weak largely due to a rise in the spread of the COVID-19 Delta variant, slower vaccination rates and withdrawal of fiscal support. Acting Governor Popoitai noted that new and ongoing impact of the Covid-19 pandemic poses unique policy challenges for many economies. Most emerging and developing economies have reduced their fiscal support as increased spending to stimulate their economies have resulted in record high levels of foreign and domestic debt.

According to the latest international commodity price data published by the World Bank in January 2021, prices for all energy commodities continued to increase in the December quarter of 2021, compared to the September quarter, while the price of precious metals declined. Energy prices increased by 16.5 percent, reflecting higher prices for natural gas, coal and oil due to the recovery from demand and supply constraints. Non-energy prices also increased by 3.1 percent, with price increases for coffee, palm oil and tea, while the price of logs and cocoa declined. Prices of precious metals declined by 0.4 percent, reflecting the fall in the prices of gold. The Acting Governor stated that the improvement in international commodity prices is beneficial to PNG commodity exporters. He urged the Government to continue to support and diversify the agricultural/forestry/fishing sector including downstream processing to increase value added production and improve foreign exchange inflows.

Global inflation continued to rise in the second half of 2021 due to higher global food and energy prices, persistent supply chain disruptions and recovery in demand. The rise in prices prompted some central banks to unwind their accommodative monetary policies to curb inflationary pressures. At the same time, some emerging market and developing countries reduced their fiscal support as high pandemic induced spending narrowed their fiscal space and flared up interest rates. The US recorded an inflation rate of 7.0 percent by the end of 2021, the highest in 40 years. In the following months

to March 2022, this prompted an increase in the US Federal Funds Reserve rate by 0.25 percentage points from zero percent, the first increase since December 2018 with expectations of six more increases in 2022. Acting Governor Popoitai warned that the increase in global inflation is already having a direct impact on domestic inflation, exacerbated by the current Russia-Ukraine War; which may derail the recovery in the domestic economy. Changes to the US Fed funds rate will affect PNG through its respective impact on the inflation levels of our major trading partners and the impact of the resulting appreciation of the USD on the PGK. Moreover, the current Russian-Ukrainian War has already put pressure on oil and food prices (wheat/grains and vegetable oil) prices given that these two countries are major producers of these items. In recent months, we have seen prices for these items, especially fuel prices, increase significantly.

The annual inflation outcome in the December quarter of 2021 was 5.7 percent as released by the National Statistical Office (NSO) following an increase of 4.3 percent in the September quarter. The Acting Governor cautioned that the increase in inflation reflected higher imported inflation driven by high energy prices including crude oil prices and pandemic induced supply disruptions. The December quarter inflation outcome reflected price increases in the 'Education, 'Alcoholic Beverages, Tobacco and Betelnut', 'Transportation', 'Food and Non-Alcoholic Beverages', 'Health' 'Miscellaneous', 'Housing', and 'Clothing and footwear' expenditure groups of 20.0 percent, 8.8 percent, 7.7 percent, 6.6 percent, 5.2 percent, 4.3 percent, 2.1 percent and 1.1 percent, respectively. These more than offset declines of 3.5 percent and 2.5 percent in the 'Restaurants and Hotels' and 'Communication' expenditure groups, respectively.

The Bank of PNG has maintained its accommodative monetary policy stance since the easing in March 2020 to support economic recovery. The Kina Facility Rate (KFR) and Cash Reserve Requirement (CRR) remained at 3.0 percent and 7.0 percent, respectively.

The Acting Governor noted that the average daily kina exchange rate appreciated against all the major currencies, except the United States dollar. Over the year to 31st March 2022, the kina appreciated against the Japanese yen by 2.1 percent to

¥34.5900, the euro by 1.8 percent to €0. 2543, the Australian dollar by 0.4 percent to A\$0.3796 and the British pound sterling by 0.3 percent to £0.2163. The US dollar, for the first time since 16 November 2020, dropped by 10 basis points to US\$0.2840. These currency movements led to an increase in the Trade Weighted Index (TWI) by 0.5 percent to 27.67 over the period.

Acting Governor Popoitai stated that the level of foreign exchange reserves as at 31st December 2021, was US\$3,290.35 (K11,346.02) million. As at 31st January 2022, the gross foreign exchange reserves fell to US\$3,233.24 (K11,149.11) million, mainly reflecting the Central Bank's interventions in the foreign exchange market and for repayments of Government loans. The Acting Governor noted that the Central Bank is responsible to manage the country's foreign exchange reserves prudently to ensure that current and future needs of the economy are met adequately. He reiterated that the export sector is the primary source of foreign exchange inflows and not the Central Bank. The Bank intervenes in the foreign exchange market to supply foreign currency when necessary. In fact, the Central Bank has been intervening consistently on a monthly basis of US\$50-US\$60 million since 2020 due to the shortage of foreign exchange. With the export sector not consistently providing sufficient foreign currency to meet the high import demand in the domestic market, a higher than sustainable intervention by the Central Bank will only deplete foreign exchange reserves. For this reason, the Central Bank will always be prudent and responsible in the management of the country's reserves.

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

Economic indicators available to the Bank continue to point to an improvement in the third quarter of 2021. The growth in the global economy associated with the fiscal stimulus and monetary expansion, and some easing of containment measures and supply chain disruptions continue to have a positive impact on domestic economic activity. The pick-up in global trade resulted in higher demand and prices for PNG's export commodities resulting in a higher export receipts and contributed to the overall balance of payments recording a surplus. The preliminary data on private sector

activity indicate that employment levels increased in the September quarter, as well as the total nominal value of sales by the private sector.

The average daily kina exchange rate appreciated against all major currencies except the US dollar, which remained stable. As a result, the Trade Weighted Index (TWI) increased by 2.1 percent to 27.31. Annual headline inflation was 4.3 percent in the September quarter 2021, higher than 3.3 percent in the June quarter mainly reflecting high energy prices. To support the economic recovery, the Bank maintained an accommodative monetary policy stance by keeping the Kina Facility Rate (KFR) unchanged at 3.00 percent.

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the formal private sector increased by 3.9 percent in the September quarter of 2021, compared to an increase of 14.5 percent in the previous quarter. Excluding the mineral sector, sales increased by 4.9 percent in the September quarter, compared to an increase of 10.1 percent in the previous quarter. By sector, sales increased in the transportation, wholesale, financial/business/other services, manufacturing, retail and mineral sectors, while it declined in the agriculture/forestry/fishing and construction sectors. By region, sales increased in the Highlands, Morobe, NCD and Islands regions whilst it declined in the Momase (excluding Morobe) and Southern (excluding NCD) regions. Over the year to September 2021, total sales increased by 24.5 percent, compared to a decline of 22.5 percent over the corresponding period of 2020. Excluding the mineral sector, sales increased by 20.6 percent over the year to September 2021, compared to a decline of 13.3 percent over the corresponding period of 2020.

The Bank's Employment Index shows that the level of employment in the formal private sector increased by 0.9 percent in the September quarter of 2021, compared to an increase of 0.5 percent in the previous quarter. Excluding the mineral sector, the level of employment increased by 0.8 percent. By sector, the level of employment increased in the construction, financial/business and other services, transport, mineral, manufacturing, and wholesale sectors, while it declined in the retail and agriculture/forestry/fishing sectors. By region, the level of employment increased in the NCD, Highlands and Momase regions, while it declined in the Southern, Morobe and

Islands regions. Over the year to September 2021, the total level of employment increased by 1.8 percent, compared to a decline of 6.5 percent in the corresponding period of 2020. Excluding the mineral sector, the level of employment increased by 0.3 percent over the year to September 2021, compared to a decline of 2.7 percent in the corresponding period of 2020.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), increased by 0.3 percent in the September quarter of 2021, compared to an increase of 2.5 percent in the previous quarter. There were increases in the 'Household Equipment', 'Recreation', 'Transport', 'Housing', 'Miscellaneous', 'Food and Non-Alcoholic Beverages', 'Restaurants and Hotels', and 'Health' expenditure groups, which more than offset decreases in the 'Alcoholic Beverages, Tobacco and Betelnut', 'Clothing and Footwear', and 'Communication' expenditure groups. The 'Education' expenditure group recorded no price change in the quarter. By urban centre, prices increased in all the surveyed centres except Lae. Annual headline inflation was 4.3 percent in the September quarter, compared to an increase of 3.3 percent in the June quarter of 2021.

In the September quarter of 2021, the US dollar appreciated against all major currencies except the Japanese yen. It appreciated against the Australian dollar by 4.5 percent, the euro by 1.9 percent and the pound sterling by 1.4 percent, while it depreciated against the yen by 0.6 percent.

In the September quarter of 2021, the average daily kina exchange rate appreciated against all major currencies except the US dollar in which it remained constant. The kina appreciated against the Australian dollar by 4.7 percent to A\$0.3879, against the euro by 2.1 percent to €0.2417, against the pound sterling by 1.4 percent to £0.2068 and against the Japanese yen by 0.6 percent to ¥31.3862, while it remained unchanged against US dollar at US\$0.2850. These currency movements resulted in the TWI appreciating by 2.1 percent to 27.31.

The weighted average kina price of PNG's export commodities, excluding LNG, increased by 20.7 percent in the September quarter of 2021, compared to an increase of 2.5 percent in the corresponding quarter of 2020. There was an increase of 16.0

percent in the weighted average price of mineral exports, compared to an increase of 8.2 percent in the corresponding quarter of 2020, reflecting higher kina prices for copper, crude oil, nickel, cobalt and condensate, combined with the depreciation of the kina against the US dollar. For agricultural, logs and marine product exports, the weighted average kina price increased by 41.7 percent, compared to a decline of 18.7 percent in the corresponding quarter of 2020. There were higher prices of all non-mineral export commodities, except for tea, logs and marine products. Excluding log exports, the weighted average kina price of agricultural and marine product exports increased by 57.7 percent in the quarter, compared to a decline of 22.5 percent in the corresponding quarter of 2020. The overall increase in kina export price stemmed from higher international prices for most of PNG's export commodities.

There was an overall balance of payments surplus of K582 million for the nine months to September 2021, compared to a deficit of K650 million in the corresponding period of 2020. This was due to a surplus in the current account, which more than offset a deficit in the capital and financial account.

The current account recorded a surplus of K16,166 million for the nine months to September 2021, compared to a surplus of K11,442 million in the corresponding period of 2020. This was due to a higher trade account surplus and net transfer receipts, which more than offset higher net service and income payments.

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

The level of gross foreign exchange reserves at the end of September 2021 was K8,890.2 (US\$2,578.2) million, sufficient for 7.8 months of total and 13.6 months of non-mineral import covers.

The Central Bank continued to maintain an accommodative stance of monetary policy during the September quarter of 2021, by keeping the Kina Facility Rate (KFR) unchanged at 3.00 percent. The stance was to support the economic recovery from

the COVID-19 pandemic. The Repurchase Agreement (Repo) Facility dealing margins were maintained at 100 basis points on both sides of the KFR.

The average level of broad money supply (M3*) increased by 2.1 percent in the September quarter of 2021, compared to an increase of 2.8 percent in the quarter. This was due to an increase in the average net domestic claims of the banking system, which more than offset a decline in the average net foreign assets (NFA). The average net domestic claims, excluding net claims on the Central Government, declined by 0.5 percent in the September quarter of 2021, compared to a decline of 2.4 percent in the previous quarter. The decline was driven by decreases in the average net claims by the other financial corporations and public non-financial corporations, which more than offset an increase by the private sector.

The average level of monetary base (reserve money) increased by 4.5 percent in the September quarter of 2021, compared to an increase of 0.1 percent in the previous quarter. This was due to increases in the average level of liabilities to other depository corporations (ODCs) at the Central Bank, especially deposits of commercial banks, and currency in circulation.

The NFA of the Financial Corporations (FCs), comprising DCs and other financial corporations (OFCs), declined by 19.9 percent to K8,340.3 million in the September quarter of 2021, compared to an increase of 7.4 percent in the previous quarter. This was due to a decline in the NFA of the DCs, which more than offset an increase in the OFCs. For DCs, there was a decline in NFA of the Central Bank due to a decrease in foreign reserves reflecting external loan repayments, including the final Credit Suisse loan, and intervention in the foreign exchange market, while the increase in ODCs' NFA resulted from an increase in the holdings of foreign assets.

Net claims on the Central Government by FCs increased by 4.1 percent to K19,002.0 million in the September quarter of 2021, compared to an increase of 17.4 percent in the previous quarter. This reflected increased holding of Government securities, especially by the commercial banks and drawdown of its deposits by the Government.

In the September quarter of 2021, total domestic credit extended by FCs to the private sector, public non-financial corporations and 'Provincial and Local Level Governments' increased by 0.9 percent to K17,759.1 million, following a decline of 1.8 percent in the previous quarter. Credit to the private sector increased by K171.3 million to K15,874.9 million, while to non-financial corporations it declined by K17.4 million to K1,884.2 million.

Fiscal operations of the National Government over the nine months to September 2021 showed a deficit of K3,335.0 million, compared to a deficit of K3,259.2 million in the corresponding period of 2020.

Total revenue and grants over the nine months to September 2021 was K8,747.6 million, 15.6 percent higher than in the corresponding period of 2020 and is 67.3 percent of the 2021 budgeted amount, compared to the nine months to September 2020. The higher outcome reflected grants received from development partners and higher collections in other direct taxes and goods & services tax (GST).

Total expenditure for the nine months to September 2021 was K12,082.6 million, 11.6 percent higher than in the corresponding period of 2020 and is 61.6 percent of the Budget appropriation. The higher outcome was due to increased capital investment on both national and provincial projects, compared to the same period in 2020.

The developments in revenue and expenditure resulted in the Government recording a deficit of K3,335.0 million in the first nine months of the year. The deficit was financed from both domestic and external sources of K3,019.3 million and K315.7 million, respectively. Net domestic financing comprised of K726.3 million, K1,629.2 million, K408.5 million, K19.3 million and K236.0 million from BPNG, ODCs, OFCs, Public non-financial corporations and other resident sectors, respectively. External borrowing comprised of K228.5 million and K949.5 million from concessional and extraordinary sources, respectively, which more than offset external loan repayments of K862.3 million to commercial sources, including the final payment of the Credit Suisse loan.

Total public (Government) debt outstanding as at the end of September 2021 was K44,393.5 million, an increase of K1,155.5 million from the previous quarter, and is

48.5 percent of the GDP. The current outstanding debt is comprised of K26,124.9 million from domestic sources and K18,268.6 million in external debt. Total Government deposits at depository corporations decreased by K110.0 million to K3,986.6 million in the September quarter of 2021. This reflected drawdown of Government's deposits.