



BANK OF PAPUA NEW GUINEA

MEDIA RELEASE

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Quarterly Economic Bulletin

June Quarter 2021

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

1. UPDATE ON DEVELOPMENTS SINCE JUNE 2021

The global economic growth is projected to recover by 5.9 percent in 2021 from the effects of the COVID-19 pandemic, as per the International Monetary Fund's (IMF) World Economic Outlook Update of October 2021. The recovery mainly reflects the impact of fiscal stimulus packages, accommodative monetary policies and vaccination rollout programs in the advanced economies. Lower infection rates, supported by the easing of containment measures have boosted international trade and travel and economic recovery in the United States (US), Japan and the euro area. Growth in most emerging market and developing countries, except China, remains low to negative. The on-going COVID-19 pandemic and emergence of new variants, and supply chain disruptions combined with labour shortages continue to weigh on growth, while increasing inflationary pressures. For 2022, the IMF forecasts global economic growth to be 4.9 percent.

Acting Governor Popoitai stated that to support economic recovery, most economies including PNG, through their respective Governments continue to provide various fiscal measures, while their monetary authorities maintained an accommodative monetary policy stance. Global trade and international commodity prices have increased, mainly reflecting the impact of the stimulus packages and vaccination programs in the advanced economies. He added that the pick-up in global growth and demand resulted in price improvements of PNG's export commodities.

According to the latest international commodity price data published by the World Bank in October, prices for all energy commodities continued to increase in the September quarter of 2021, compared to the June quarter, while the price of precious metals declined. Energy prices increased by 16.1 percent reflecting higher prices for natural gas, coal and oil due to higher demand. Non-energy prices stabilized during the quarter but varied across commodities, with price increases for coffee, cocoa, palm oil and tea, while the price of logs declined. Prices of precious metals declined by 3.0 percent, reflecting the fall in the prices of gold, platinum and silver. Given the improved prices, the Acting Governor encouraged domestic exporters to increase production and capitalise on these favourable international prices.

Global inflation has been increasing due to pandemic induced supply and demand mismatches associated with supply chain disruptions and higher commodity prices. At the same time, some major economies continue to provide fiscal support to sustain recovery efforts, while the emerging market and developing economies have reduced fiscal support as a direct result of rising public debt levels. Moreover, some central banks have opted to raise policy rates to curb the threat of rising inflation. Acting Governor Popoitai noted that whilst there have been improvements in the domestic supply chain, inflation remains a concern especially with the rise of Delta variant cases, and now the emergence of the new Omicron variant across the globe and its spill over effects into domestic prices.

The annual inflation outcome to the September quarter of 2021 was 4.3 percent as released by the National Statistical Office (NSO), following a lower increase of 3.3 percent in the June quarter. The Acting Governor cautioned that the increase in inflation reflected higher imported inflation mainly driven by high international oil

prices, as well as domestic supply chain disruptions. It was imperative to remain vigilant on the effect of the pandemic on the global and domestic supply chains, and its impact on domestic inflation. The September quarter inflation outcome reflected price increases in the 'Household Equipment' and 'Recreation' expenditure groups with 2.2 percent each and 'Transport', 'Housing', 'Miscellaneous', 'Food and Non-Alcoholic Beverages', 'Restaurants and Hotels' and 'Health', with 1.8 percent, 1.5 percent, 0.5 percent, 0.2 percent, 0.2 percent and 0.1 percent, respectively. These more than offset a decline in the 'Alcoholic Beverages, Tobacco and Betelnut' expenditure group of 6.7 percent.

In November 2021, the Government passed the 2022 National Budget with a projected expenditure of K22,174.8 million and a projected revenue of K16,190.2 million, giving a fiscal deficit of K5,984.7 million (5.9 percent of GDP). This will increase the level of public debt stock to K52,765.2 million (51.9 percent of GDP). The Government will finance the deficit through a combination of domestic and external financing. It plans to raise K3,744.7 million of the K5,984.7 million through external borrowing, while the remaining K2,240.0 million will be financed through domestic sources. Of the total expenditure, over 50.0 percent of the 2022 Budget is marked for operational expenditure, while 39.5 percent and 10.5 percent are for capital expenditure and loan service payments, respectively. Over the last three years, the Government's debt servicing for both domestic and external loans have been around 10.0 percent of its annual expenditure.

Also in November, Parliament passed several amendments to the Central Banking Act 2000. The notable changes include: expanding the objectives of the central bank to include promoting employment and growth as well as efficient banking services to the Government; reducing the terms of the Governor and Deputy Governor; changing the membership and functions of the Board; and increasing advances by the Central Bank to the Government and for emergency funding.

To support economic recovery, the Bank of PNG has maintained its accommodative monetary policy stance since the easing in March 2020. 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 depreciated against all major currencies except the Japanese yen and the euro. Over the year to 08th December 2021, the kina depreciated against the British pound sterling by 4.4 percent to £0.2150, Australian dollar by 3.2 percent to A\$0.3999 and the US dollar by 0.2 percent to US\$0.2850. The kina appreciated against the Japanese yen by 4.7 percent to ¥32.36 and euro by 0.3 percent to €0.2524. These currency movements resulted in the Trade Weighted Index (TWI) declining by 1.4 percent to 27.46 over the period.

Acting Governor Popoitai stated that the level of foreign exchange reserves as at 30th June 2021, was US\$2,491.8 (K8,625.1) million. As at 07th December 2021, the gross foreign exchange reserves increased to US\$2,609.3 (K8,997.6) million, reflecting the inflow of the World Bank budget support loan, LNG tax receipts and funds from donor agencies. The Acting Governor stated that although fiscal support is invaluable during times of crisis, the Government should realign and regain prudent control and discipline in its expenditure, while putting more emphasis on growing and improving its revenue sources. He cautioned the Government not to depend too much on borrowings to fund its expenditure because PNG is already highly indebted but instead focus on growing the revenue base.

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

Data from the Bank's Business Liaison Survey (BLS) show that the total nominal value of sales in the formal private sector increased by 15.0 percent in the June quarter of 2021, compared to a decline of 3.1 percent in the previous quarter. Excluding the mineral sector, sales increased by 10.3 percent in the June quarter, compared to a decline of 3.3 percent in the previous quarter. By sector, sales increased in all sectors except in the transportation sector where it declined. By region, sales increased in all regions. Over the year to June 2021, total sales increased by 24.3 percent, compared to a decline of 22.8 percent over the corresponding period of 2020. Excluding the mineral sector, sales increased by 28.1 percent over the year to June 2021, compared to a decline of 23.8 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 0.5 percent in the June quarter of 2021, compared to an increase of 0.9 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 mineral, manufacturing, agriculture/forestry/fishing and the wholesale sectors while it declined in the construction, retail, financial/business and other services, and the transport sectors. By region, the level of employment increased in the Southern (excluding NCD) and Highlands regions, while it declined in the NCD, Momase (excluding Morobe), Islands and Morobe regions. Over the year to June 2021, the total level of employment declined by 4.1 percent, compared to a decline of 3.8 percent in the corresponding period of 2020. Excluding the mineral sector, the level of employment declined by 1.9 percent over the year to June 2021, compared to a decline of 3.8 percent in the corresponding period of 2020.

Quarterly headline inflation, as measured by the Consumer Price Index (CPI), increased by 2.5 percent in the June quarter of 2021, compared to an increase of 0.6 percent in the previous quarter. There were increases in the 'Food and Non-Alcoholic Beverages', 'Clothing and Footwear', 'Miscellaneous', 'Transport', 'Alcoholic Beverages, Tobacco and Betelnut', 'Household Equipment', 'Housing' and 'Education' expenditure groups, which more than offset decreases in the 'Health', 'Recreation', and 'Communication' expenditure groups. The 'Restaurants and Hotels' expenditure group recorded no price change in the quarter. By urban centre, prices increased in all the surveyed centres. Annual headline inflation was 3.3 percent in the June quarter, compared to an increase of 4.6 percent in the March quarter of 2021.

In the June quarter of 2021, the average daily kina exchange rate appreciated against the Japanese yen by 3.3 percent to ¥31.1979, the Australian dollar by 0.4 percent to A\$0.3704 and the euro by 0.1 percent to €0.2367, while it depreciated against the pound sterling by 1.4 percent to £0.2040. The kina remained flat against the US dollar at US\$0.2850 during the June quarter of 2021. These currency movements resulted in the appreciation of the TWI by 0.1 percent to 26.7385 in the June quarter of 2021. The weighted average kina price of PNG's exports, excluding Liquefied Natural Gas (LNG), increased by 24.7 percent in the June quarter of 2021, compared to the corresponding quarter of 2020. The weighted average kina price of mineral exports

was 26.0 percent higher, reflecting higher kina prices for all mineral commodities, whilst gold declined. For agricultural, logs and marine product exports, the weighted average kina price increased by 42.9 percent, due to higher kina prices for all non-mineral commodities, except for copra. Excluding logs, the weighted average kina price of agricultural and marine product exports increased by 52.0 percent in the June quarter of 2021, compared to the corresponding quarter of 2020. Higher international prices accounted for this increase.

The balance of payments recorded an overall deficit of K813 million for the first six months of 2021, compared to a deficit of K97 million in the corresponding period of 2020. A deficit in the capital and financial account more than offset a surplus in the current account.

The surplus in the current account was due to a trade surplus and net transfer receipts, which more than offset net service and income payments.

The deficit in the capital and financial account was due to net outflows from direct and other investments reflecting related party transactions and build-up in offshore foreign currency account balances of mineral companies, including those allowed under the various Project Development Agreements (PDAs), respectively. These combined with net outflows in Government and private sector loan repayments also contributed to the deficit.

The level of gross foreign exchange reserves at the end of June 2021 was K8,586.0 (US\$2,490.0) million, sufficient for 8.6 months of total and 16.2 months of non-mineral import covers.

The Central Bank maintained a neutral monetary policy stance in the June quarter of 2021, keeping the KFR unchanged at 3.00 percent. This was to encourage private sector activity and support the economic recovery. The Repurchase Agreement (Repo) Facility dealing margins were also maintained at 100 basis points on both sides of the KFR.

The Bank utilized its Open Market Operation (OMO) instruments in the conduct of monetary policy to manage liquidity. Liquidity in the banking system remained high during the quarter resulting in inactivity in both the inter-bank market and Repo transactions. There was a net issuance of K13.5 million in CBBs in the June quarter of 2021. There was an overall net issuance of K1,855.40 million of Government securities. The Government's total net issuance consisted of K1,710.1 million in Treasury bonds (Inscribed stock) and K145.3 million in Treasury bills. The CRR for the commercial banks remained at 7.00 percent during the quarter.

The average level of broad money supply (M3*) increased by 2.8 percent in the June quarter of 2021, compared to an increase of 4.0 percent in the March quarter of 2021. This was due to an increase in the average net foreign assets (NFA) of the banking system, and the average domestic claims. Average net domestic claims, excluding net claims on the Central Government, decreased by 2.4 percent in the June quarter of 2021, compared to a decline of 0.5 percent in the March quarter of 2021. The decrease was due to declines in the average net claims on the public non-financial corporations, other financial corporations and the private sector.

Net claims on the Central Government by FCs increased by 17.4 percent to K18,262.7 million in the June quarter of 2021, compared to an increase of 8.1 percent in the previous quarter. This reflected increased holdings of Government securities, especially by the commercial banks and drawdown of Government deposits.

In the June quarter of 2021, total domestic credit extended by FCs to the private sector, public non-financial corporations and 'Provincial and Local Level Governments' declined by 1.8 percent to K17,605.3 million, following an increase of 0.2 percent in the previous quarter. Credit to the private sector and the public non-financial corporations declined by K267.6 million to K15,703.6 million and K55.5 million to K1,901.6 million, respectively.

The fiscal operations of the National Government over the six months to June 2021 showed a deficit of K2,690.5 million, compared to a deficit of K2,085.8 million in the corresponding period of 2020. The higher deficit reflected increased expenditure.

Total revenue and grants over the six months to June was K5,506.4 million, 14.4 percent higher than in the corresponding period of 2020 and represents 42.4 percent of the 2021 Budgeted amount. The outcome was due to large inflows from bilateral partners. Total expenditure for the six months to June 2021 was K8,196.9 million, 18.8 percent higher than in the corresponding period of 2020 and represents 41.8 percent of the Budget appropriation. This was due to higher capital expenditure.

The developments in revenue and expenditure resulted in the Government recording a deficit of K2,690.5 million in the first half of the year. The deficit was financed from domestic and external sources of K1,937.1 million and K753.4, respectively. Net domestic financing comprised of K431.0 million, K1,589.7 million, K291.4 million, and K34.2 million from BPNG, ODCs, OFCs and Public non-financial corporations, respectively. This more than offset a net retirement of Government securities totalling K409.2 million from other resident sectors. External borrowing comprised of K219.8 million and K949.5 million from concessional and extraordinary sources, respectively, which more than offset external loan repayments of K415.9 million to commercial sources.

Total public (Government) debt outstanding as at the end of June 2021 was K43,238.0 million or 47.7 percent of the GDP. This comprised of K24,531.7 million in domestic debt and K18,706.3 million in external debt. This is an increase of K2,812.9 million from the previous quarter, reflecting net borrowing during the quarter. Total Government deposits at depository corporations decreased by K789.9 million to K4,096.6 million in the June quarter of 2021 and reflected drawdown of Government deposits to meet expenditures given low revenue.