2015 PNG Update

State of the Macro Economy and Issues & Challenges in the LNG Era

Bank of Papua New Guinea

at the 2015 PNG Update

Development Challenges in the LNG Era

University of PNG, Port Moresby, 18th June, 2015
Outline

• Current Macroeconomic Developments and Outlook
• Issues and challenges in the LNG Era
• Initiatives by BPNG
Sound Financial System

As At End of March 2015

- Total Assets K39.47 billion
  - Banking Sector K29.45 billion (74.61%)
  - Superannuation K 9.56 billion (24.25%)
  - Life Insurance K 0.45 billion (1.14)

- Total Loans K13.41 billion
- Non-performing Loans 2.0% of total Loans and 0.9% of total assets
- Capital adequacy ratio well above the minimum requirement of 12%.
Past Economic Growth

- The real GDP growth in the five years 2002 to 2006 in real GDP was moderate, at 2.8 percent per annum, lower the population growth rate, and therefore the average standard of living of the population remained stagnant or even declined slightly.

- In the seven years (from 2007 to 2012) the rate of real GDP growth was more than double the population growth rate at around 8.0 percent. On the average the per capita standard of living of the population increased, by around 5.1 percent per annum, or 35 percent during the seven years.

- For the thirteen year period the annual growth in real GDP was 6.0 percent. It is a very strong performance by all comparisons and standards. 2015 will be another year of economic growth, not as strong as around the year 2012.

- It is interesting that, in the seven years to 2012, non-mineral GDP grew at a rate of 8.8 percent, faster than total GDP. The main reason for the stronger growth in the non-mineral GDP was the commencement of the construction of the LNG project in 2010 and the spin-off effects to benefiting sectors such as building & construction, transportation, hoteling-catering-other services, and manufacturing.

- Information available from different sources indicate that the high mineral and petroleum commodity prices , were the driving forces behind the very high Government revenue and the increase in public consumption, an increase in the level of foreign exchange reserves, high liquidity in the financial system and very low deposit interest rates.
• GDP in 2014 is estimated by the Bank to have grown by higher than the 8.4% reported in the 2015 Budget.
• In 2015, projected GDP growth of around 9.0% reflects full year of LNG production and full capacity production for nickel & cobalt, as well as activity in the non-mineral sector.
• High economic growth & expansionary fiscal policy contributing to high import demand and depreciation of the Kina.
• Inflation is trending upwards.
• Financing of the Budget deficit will be a challenge.
• Declining oil and other commodity export prices have implications for Gov’t Budget and foreign exchange reserves.
Third expansionary fiscal budget with a deficit of K2.3 bn in 2015 or 4.4% of nominal GDP

Expenditure in priority areas; transport infrastructure, agriculture, law and order, education and health services and increased funding to provincial, district and local level Governments (LLGs).

Source: 2015 National Budget & Bank of PNG
Balance of Payments (K’mn)

Source: Bank of PNG

Note: 2014 to 2017 includes flows related to the PNG LNG project, compared to the actuals, which do not include LNG figures.

- Overall BOP projected to be in surplus in 2015 mainly due to LNG export inflows and higher holdings of foreign exchange by the Bank of PNG.
5.2 International Reserves (BPNG)

FX Reserves (US$'m)

- January 2014 to March 2015
The exchange rate has depreciated by 11.26% since the introduction of the exchange rate trading band from US$0.4130 to US$0.3665 as at 17th June 2015.

The continued depreciation was due to high economic growth that led to increased import demand, while foreign exchange inflows were lower.
USD/PGK Rate: Pre and Post-Exchange Rate Trading Band
Inflation is expected to be around 6.0% in 2015. Inflationary pressures are expected mainly due to continued economic growth that leads to high import demand.
Monetary Policy Management

- Monetary policy management has aimed at finding a balance between high liquidity levels, rising interest rates from budget financing, and high import demand resulting in the depreciation of the Kina.
- Advised caution in the 2014 September MPS on the high expectation of LNG revenue.
- In March 2015, LNG revenue were much lower, further aggravated by low oil and other commodity export prices.
Summary of Macroeconomic Performance

- Economic growth was boosted during the construction phase of the LNG project but inflation remained low.
- Growth continued, supported by the expansionary fiscal policy of the Gov’t with spending in priority areas.
- High growth contributed to increased import demand which led to the depreciation of the Kina.
- BPNG intervened to support the foreign exchange market.
- In many countries high economic growth is accompanied by high inflation. In the last 8 years, PNG managed to achieve a high growth at relatively moderate inflation rates of around 5 percent. Inflation has been manageable.
- Strong growth accompanied by low to moderate inflation macroeconomic stability, high business confidence – is commendable.
What is Not commendable?

Micro Level Update/Story - SAD

We all know it too well- poor accessibility to health services (deteriorating), churches and overseas volunteers are filling in a few gaps, poor transport infrastructure, education facilities run down in remote areas (enrolment increased under tuition free policy), etc, etc.
What Should Be Done?

All economic indicators point to an economy moving from a low to a high growth economy, from a low to middle income country.

To support this
• Gov’t must address capacity constraints faced by implementing agencies, including the Districts and LLGs
• Infrastructure development in the short to medium term
• Utilize existing technical capacity that was built during the construction phase of the LNG project and other resource projects.
• Modernize and diversify agriculture sector, including downstream processing and food production.
• Open up rural PNG to the main urban centres, as well as international markets.
What Should be Done (cont)

Objective 1: to become self reliant in food production
Objective 2: to turn PNG into a main agricultural exporter
Objective 3: best way to withstand Dutch Disease
Development Issues and Challenges in the LNG Era

- The current Government’s development philosophy is to spend now in infrastructure, health and education to empower our people through transportation and market accessibility, and health and education services, this will lay the foundation for business opportunities and economic activity to prosper in the medium to long term. Hence, the expansionary fiscal policy in 2013 to 2015. With rise in business and economic activities, and diversification of production in such areas as manufacturing and export base of the country, economic growth can be sustained and the capacity of the country to repay its debt over time will improve.

- From 2012 to 2014, the Government invested heavily in infrastructure, health, education and law and order and the provinces with the increase in total Government Expenditure over this period at 18.0 per cent. This growth in expenditure has resulted in deficits of 4.4 per cent, 7.8 per cent and 7.3 percent in 2012, 2013 and 2014 respectively.

- The biggest challenge and obstacle to achieving this, is the capacity constraint in achieving quality and effective spending.
Development Issues and Challenges in the LNG Era

- While the Government is addressing the developmental needs of the country through the expansionary fiscal policy, it is mindful of the importance of macroeconomic stability. Therefore, the Government intends to consolidate its fiscal position and lower the budget deficits towards a balanced or surplus budget in 2017, consistent with its medium term fiscal strategy.
- The debt to GDP ratio for 2014 was just above 35 percent.
- Recognising that continued large deficits are not sustainable, the Government has adopted a plan to ease growth in expenditure to more sustainable levels. In 2015, the Government deficit will be reduced to 4.4 per cent of GDP. This will involve controlling expenditure, and be assisted by increased revenue flows and the full year impact of the PNG LNG production on GDP in 2015. Reducing the deficits to sustainable levels will also enable the Government to better respond to future external shocks such as the recent Global Financial Crisis. Debt to GDP will follow a similar profile, and is projected to remain under 30 per cent of GDP over the medium term.
- The fall in international oil prices and thus LNG price has changed the scenario for the 2015 National Budget.
What the Nation through the Government is doing is – borrowing against future Government revenue be it from LNG or other sources.
Effects on the PNG economy of the LNG project

Main Ideas

1. Project is important but benefits can be exaggerated. Total capital expenditure may be K35 billion and GDP may increase by 50%. But what is relevant here is expenditure on PNG factors of production (about K4.5 billion) and tax & dividends accruing to the PNG government (between 4 & 10 percent of GNP).

2. The resource is from our ground/soil but we do not own the exports, it is owned by the developer/s. The Govt only gets its share of export receipts but then this is/will be deposited through its vehicle – NPCP.

3. The means through which to spread the benefits to the rest of PNG is the Fiscal Policy/Budget.

4. Policy decision: how to spread the benefits to PNG through time: conservative; aggressive; and passive policy scenarios.

5. Project will have structural effects (Dutch Disease): reduction in traditional exports; increase in imports; reduction in unskilled wages; increase in skilled wages. Structural effects are easier to manage with conservative policy.
Effects on the PNG economy of the LNG project

- GDP growth includes payments or income accruing to foreign factors of production, including foreign labour. What is relevant for PNG is the growth in GNP - payments or income accruing to domestic factors of production and the consequent potential for increases in public and private consumption within PNG.

- The LNG project will generate enormous exports from PNG and have a corresponding enormous effect on GDP. From PNG standpoint, this is largely irrelevant. The LNG exports are owned by foreigners. What is relevant is taxes and dividends that will be paid to the Government.

- How can the rural majority of the PNG population benefit from the LNG project? The answer lies in efficient and effective implementation of fiscal policy - the national budget, year after year, subject to the capacity issues in the delivery service mechanism. The Government and its civil service machinery must deliver and redistribute the revenue gain to improve basic health, education and infrastructure services to empower the people to be partners and not spectators in the development process.

- The preconditions to the achievement of any development agenda is - having a healthy, educated and productive population.
Assets accumulated by PNG government from LNG project: per cent of baseline GNP
Real private and public consumption (percentage deviation from baseline)

Conservative expenditure policy

Aggressive expenditure policy

Passive expenditure policy
Fig 16. Output of the Construction sector (percentage deviation from baseline)
Fig 13. Output of Manufacturing (percentage deviation from baseline)
Fig 11. Output of the Export agriculture sector (percentage deviation from baseline)
What BPNG is Doing on its Part

*Developments in National Payment System*

- Since independence, banks (including BPNG) have been confined to exchanging funds between themselves using a manual clearing system and paper instruments, mainly cheques and warrants.
- Starting in 2013, PNG has been working on a modern national payment system as part of its 2010 – 2015 Strategic Plan. The national payment system will compliment other initiatives such as Automatic Teller Machines (ATMS), Electronic Funds Transfer at the Point of Sale (eftpos), credit cards, internet and mobile banking. The implementation of the national payment system, in particular will address the gap between the advancement of technology, the transformation of the domestic economy and the manual national payment system.
- The transformation of the national payment system involves a number of steps. This include the legal establishment of national payment system through an act of parliament (NPS Act 2013) that sets out the laws, standards, rules and procedures that define and govern the mechanics of the payment transfer process and the conduct of payment service markets.
- Under the project, the Bank has been working in partnership with commercial banks, Customs, Department of Finance and Internal Revenue commission. The national payment system is called the Kina Automated Transfer System (KATS) and has three (3) components;
What BPNG is Doing – National Payment System

Real Time Gross Settlement (RTGS)
RTGS is a system for large-value interbank funds transfers. It involves a continuous settlement of payments on individual banks without netting debits with credits across the books of the central bank. RTGS lessens the settlement risk because interbank settlement happens throughout the day, rather than just at the end of the day. RTGS was implemented in October 2013 and all commercial banks as well as BPNG are now fully connected electronically.

Cheque Truncation
Cheque truncation is an image-based clearing system that captures the image of a cheque and Magnetic Ink Character Recognition (MICR) and is transmitted electronically for clearing and settlement. Truncation means no physical exchange of cheques after it has been presented or deposited at a bank. MICR is an Encoded Cheque Format which is the Australian Payments Clearing Association (APCA) standard.
Under the new system, any cheque rejected and payment dishonoured in KATS, that cheque can no longer be represented. Instead, a new cheque will have to be raised by the customer. Cheques can be rejected and payment dishonoured for a number of reasons including non-compliance with the “MICR Encoded Format”, Insufficient Funds, Stopped Cheque, Account Closed and Fraudulent Cheque.
Cheque processing based on cheque images will speed up the processing of cheques - to as little as 4 business days clearing time and the Bank is committed to improving it further in the near future.
Cheque Truncation was implemented on 8 September 2014.

Direct Credit
The third phase of KATS involves Direct Credits and went Live early this year, 2015. Direct Credit is a simple, secure and reliable service that enables large and small organisations to make payments by electronic transfer directly into individual’s bank accounts. Examples of direct credit are payroll, supplier payments, employee expenses, insurance settlements and dividends.
Benefits include prompt payment, cleared funds on arrival - unlike cheques, funds paid by direct credit can be used straight away, on the day they are credited and is more secure.
What BPNG is Doing on its Part

• Payments System
  • KATS facilitates real time settlement of transactions.
  • Improves the financial infrastructure of the country, mitigates risks, increases efficiency, and reduces costs to both the Government and the private sector.
  • Strengthens consumer and business confidence and supports the creation of an enabling environment for economic growth.
Financial Inclusion and Literacy

- The National Strategy for Financial Inclusion & Financial Literacy 2014/2015 (*the strategy*) is centred on ensuring that the commitments of the Maya Declaration are achieved within the time frame of the strategy. As such most financial inclusion activities are focused on the Implementation Management component of the strategy that sets out the blueprint of achieving the Maya Declaration.

- **The Maya Declaration**

- During the 2013 AFI Global Policy Forum in Kuala Lumpur, Malaysia, The Bank of Papua New Guinea made several commitments under the Maya Declaration to create an enabling environment for building an inclusive financial sector in Papua New Guinea.
Financial Inclusion and Literacy

**Strategic Objective 1:** To reach 1.0 million more unbanked and underserved low-income people in Papua New Guinea by 2015. 50% of whom will be women:

- The following statistics show some achievements as at March 2015:
- Total new accounts opened to date since Dec 2014 (indication of banking the unbanked) was 500,000.
- New accounts for women as a percentage of total new accounts was 32%.
- The above information is based on quarterly returns received from banks and LFIs.
- This achievement was driven by the following activities:
  - June 2015: National Savings Campaign for Young Minds
  - To date 64 primary and secondary schools within NCD/central, West New Britain, Manus, Milne Bay, Mt Hagen and Madang Provinces were visited to promote the Young Minds Savings Campaign to approximately 50,000 students.
- Data for the December quarter 2014 indicated an overall total of 80,000 new students accounts opened with a total savings balance of K10,203,000.00 across the country.
Financial Inclusion and Literacy

• Other campaigns through FI Expositions

• The Bank and its partner financial institutions have organized 3 major financial inclusion expositions (Lae, Port Moresby and Kokopo) and 3 mini expositions (Goroka, Alotau and Madang) to allow the general public in these provinces to visit the stalls/booths of financial institutions with the view to familiarize themselves about the products offered and also open savings accounts. This strategy has worked well resulting in the opening of bank accounts by the unbanked.
Thank you