PNG’s Macroeconomic Outlook

Strategies for Exiting the Boom and Bust Cycle

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Strong Headwinds Affecting Growth

- **Economy slowing down.** Government revised 2016 GDP growth forecast to 2.2%. 2017 GDP growth expected to be 3.0%.

- **Inflationary pressure building up.** Inflation in 2016 revised up to 6.5%, and expected to rise to 7.5% in 2017.

- New mining projects in the medium-term provide upside risks.

(Source: Asian Development Outlook Update (2016).)
Weakened External Position

**BOP Accounts (3-mths moving average, USD millions) and USD/PGK**

- **Limited FX inflows** relative to exports from the mineral sector.
- **Loose fiscal policy had** contributed to the relatively strong demand for imports and hence foreign exchange.
- **FX trading band** led to an appreciation of the USD/kina exchange rate and an increase in the outstanding sell kina orders.

*Source: BPNG data; Estimates based on ADB, World Bank & BPNG joint analysis*
Weakened Fiscal Position

- Sustained fall in commodity prices drastically reduced public revenue. In 2015, overall revenue fell by PGK 2.5 billion (or 21% total revenue), with the largest reduction being in Mining and Petroleum Tax (91%).

- Expansionary fiscal policy started in 2012 led to a large structural fiscal deficit. The deficit increased from 0.3% of GDP in 2012 to 9.6% in 2013 and 8.3% in 2014, which was largely financed through domestic borrowing.

- Existing budget financing measures have reached their limit. Little market appetite for new government securities as financial institutions reach their technical limit on exposure to public debt.

- 2016 Revenue shortfall of PGK 1.9 billion (US$ 633 million).

Cyclical Factors

- Declining international commodity prices, which started in 2012, generated lower inflows from key export commodities such as copper, gold and oil.

- The El Niño weather phenomenon which began in 2015 reduced mining and agricultural exports and consequently FX inflows and reserves.

- Capital and financial inflows previously associated with PNG LNG construction phase have ceased.

*Source: BPNG data; Estimates based on ADB, World Bank & BPNG joint analysis*
Increasing reliance on resource exports has made the economy vulnerable to external shocks.

Low productivity in non-mining sector: agriculture, manufacturing and services.

Key constraint to economic diversification include:

- Limited infrastructure.
- High/inflated operating costs.
- Weak business environment.

Source: ADO (various years)
Historical Experiences

• **1997 to 1998 (Asian Financial Crisis and El Nino):**
  - Depreciation of the kina from PGK 0.75/USD to PGK 0.37/USD, but exports did not pick up.
  - FX reserves deteriorated from 2.6 months to 1.2 months of import cover (US$ 213 million).
  - Tax revenue fell by 4½% of GDP in 1998.
  - Despite cuts in capital spending, overall deficit widened (equivalent to 2.1% of GDP in 1998 form near balance in 1997).
  - The non-resource sector contracted by 2.3 percent (in real terms) in 2000.

• **2008 Global Financial Crisis:**
  - Strong fiscal buffers (built over much of 2000) and growth momentum helped PNG withstand the impact.
  - Swift recovery in global commodity prices.

*Source: Based on ADB and World Bank joint analysis*
Key Lessons

• Economy susceptible to external economic and natural shocks.
• Global commodity price key transmitter of external economic shock.
• Pro cyclical policy stance and reduced fiscal buffers.
• Investments in productive infrastructure and human development.
Improving Fiscal Stance

• Calibrated move to balanced budget by 2020/2021.
• Proactive measures taken to rein ballooning of the deficit.
• Introductions of revenue measures.
• Cutting of non-essential and non-productive expenditures.
• Going forward effective implementation of reforms identified by the Government will be key.
Public Finance Management Reforms

• **Planning and Monitoring Responsibility Act (2016)** aims to strengthen the link between annual budget and medium-term development plan.

• **National Budget Framework (2016)** will bind annual budget allocation (appropriations) to the national development priorities.

• **Public Finance Management Act Amendment (2016)**: Stronger controls on issuance of warrants and financial reporting, better monitoring of statutory authorities, controls on trust fund accounts, strengthening financial management at sub-national level.

• **Reform to Budget Process**: Unified budget (recurrent and capital expenditure), Multi-year budget, and two-stage budget process (design and cost approval for capital expenditure). The 2017 Budget will consider SDG priorities.

**Prognosis:**

• Fiscal consolidation is welcomed, but needs to be done prudently to safeguard development priorities.

• Execution of PFM reform and monitoring of outcomes will be important.
Central Bank’s Monetary Position

- Central Bank maintains neutral policy stance to support economic activity.
- Kina depreciating at a policy determined speed.
- Central Bank plans to purchase of 63 day Treasury Bills for monetary policy signaling rate.

Prognosis:
- The neutral policy stance may not be adequate to reduce the excess liquidity.
- Trading band around the exchange rate is not sustainable.
- Proposed reform to monetary policy signaling rate could reduce fiscal discipline and stoke inflationary pressures.

Source: BPNG data; Estimates based on ADB, World Bank & BPNG joint analysis
Economic Diversification Vital for Reducing Growth Volatility

• Weak institutions undermine structural economic transformation.

• Increasing reliance on resource exports has made the economy vulnerable to external shocks.

• Important to increase productivity in non-mining sector: agriculture, manufacturing and services.

• Key constraint to economic diversification include:
  • Limited infrastructure.
  • High/inflated operating costs.
  • Weak business environment leads to high mark ups resulting from high concentration ratios.

Source: Asian Development Outlook (2016)
Measures Needed to Avoid Boom and Bust Cycle

1. Sustain investment in infrastructure to support productive sectors.
2. Expand opportunities for private sector participation in non-mineral sector.
3. Invest in human development.
4. Improve performance of public expenditure and increase budget efficiency.

Source: Asian Development Outlook (2016)
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