PNG economic survey 2015-16

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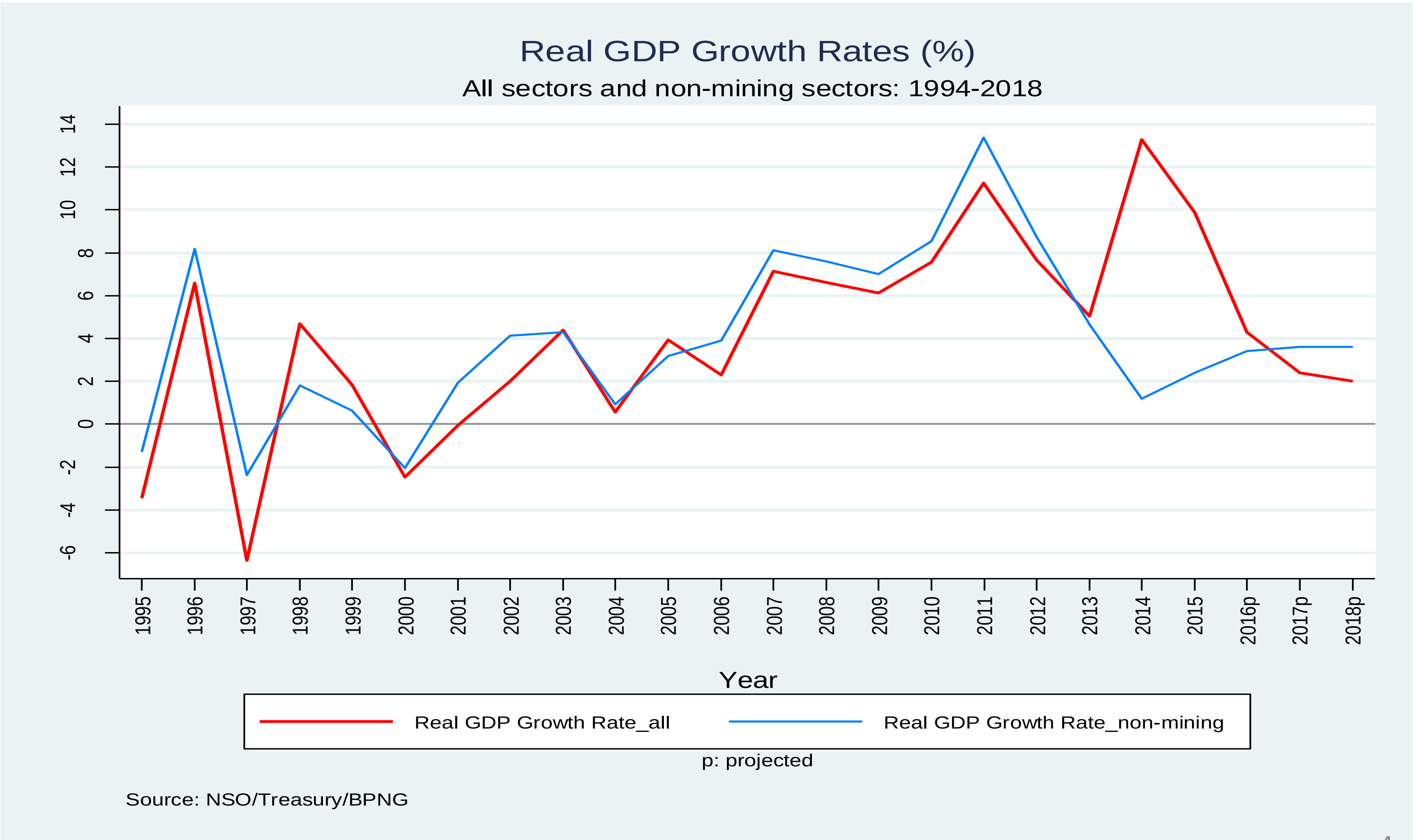
Introduction

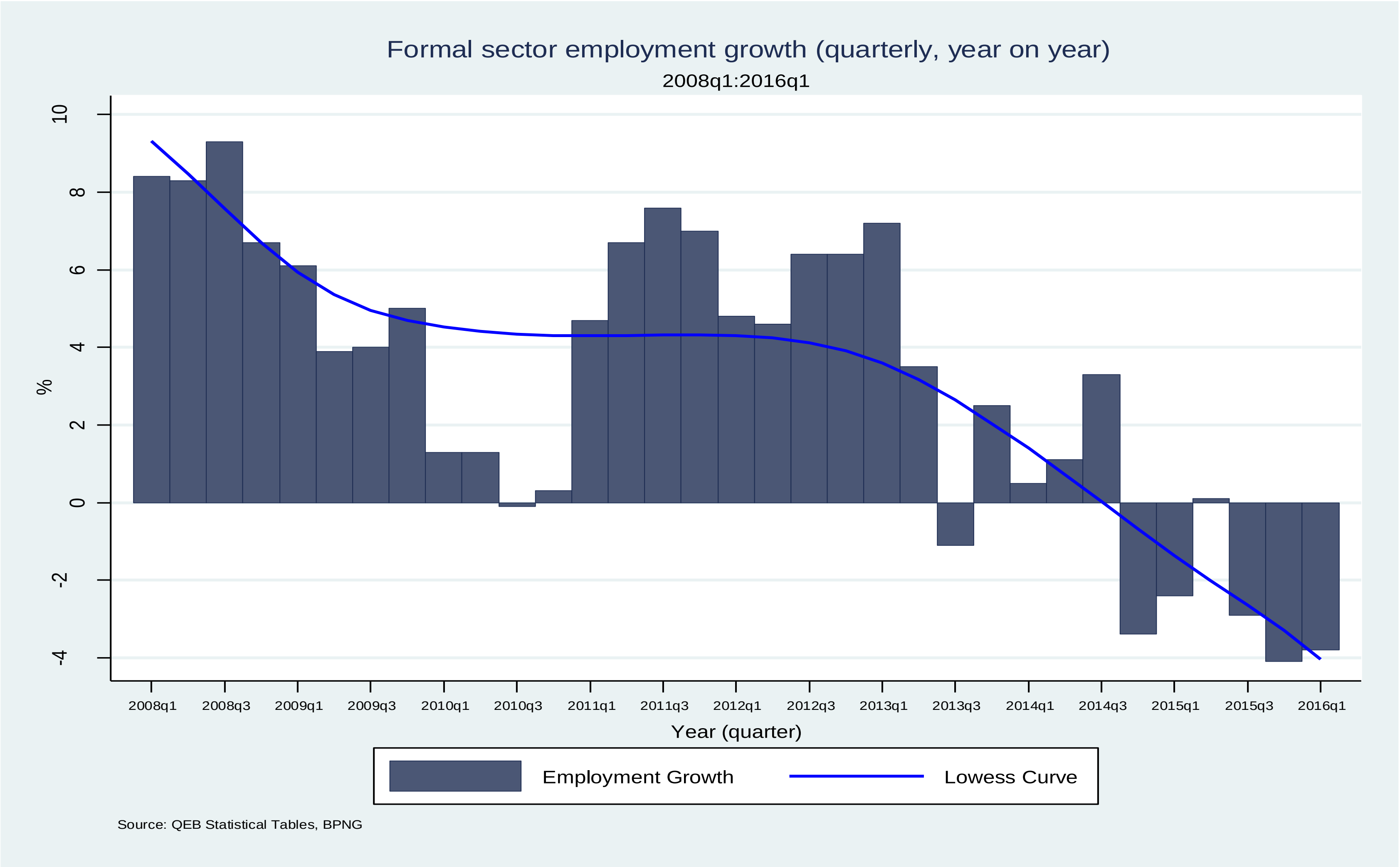
- Joint project of Division of Economics, School of Business and Public Policy, UPNG and Development Policy Centre, Crawford School of Public Policy, ANU
- Provides a survey of key economic developments
- Focus this year on economic growth, macroeconomic developments and structural policy response

Economic Growth

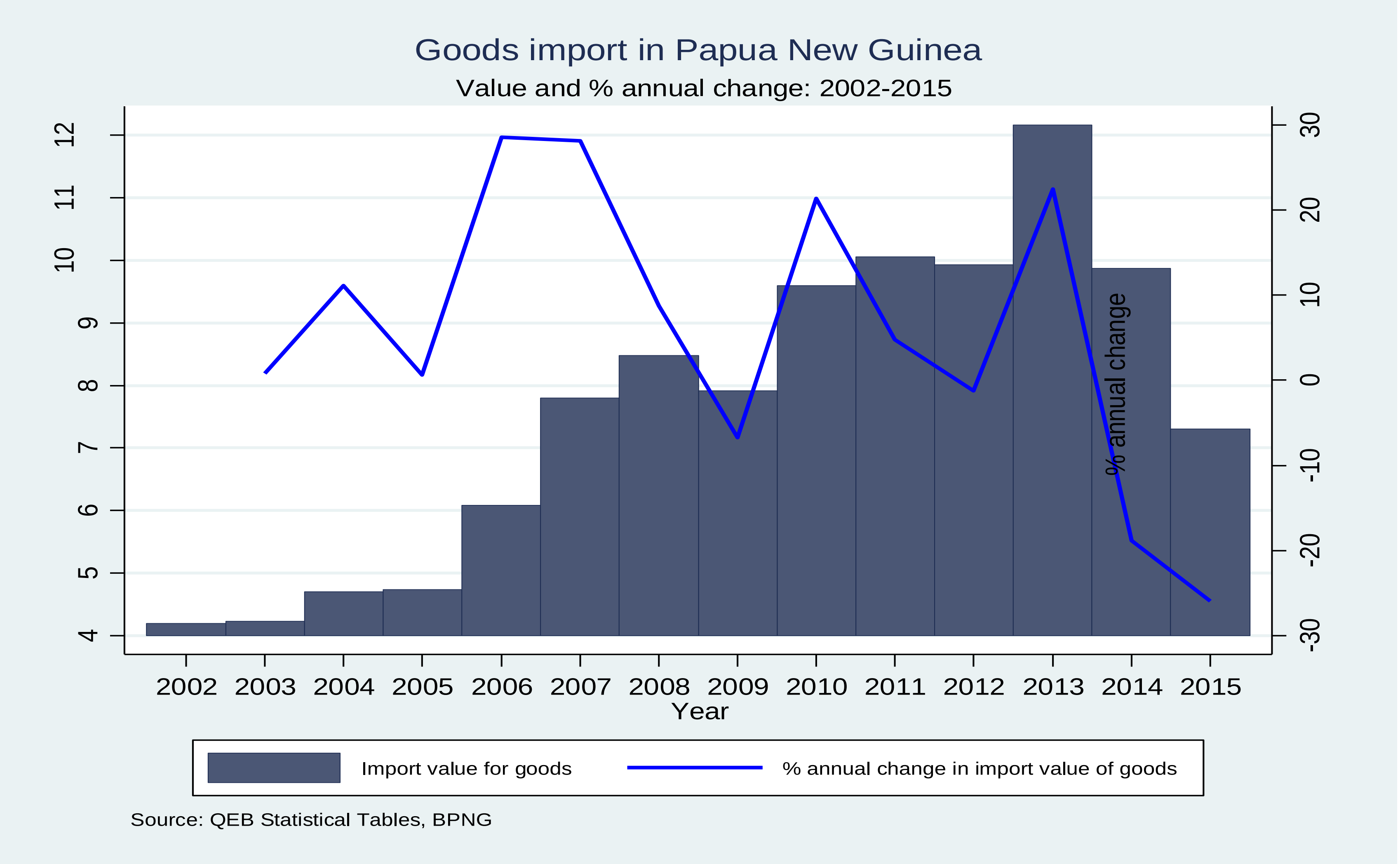
PNG's growth slowdown



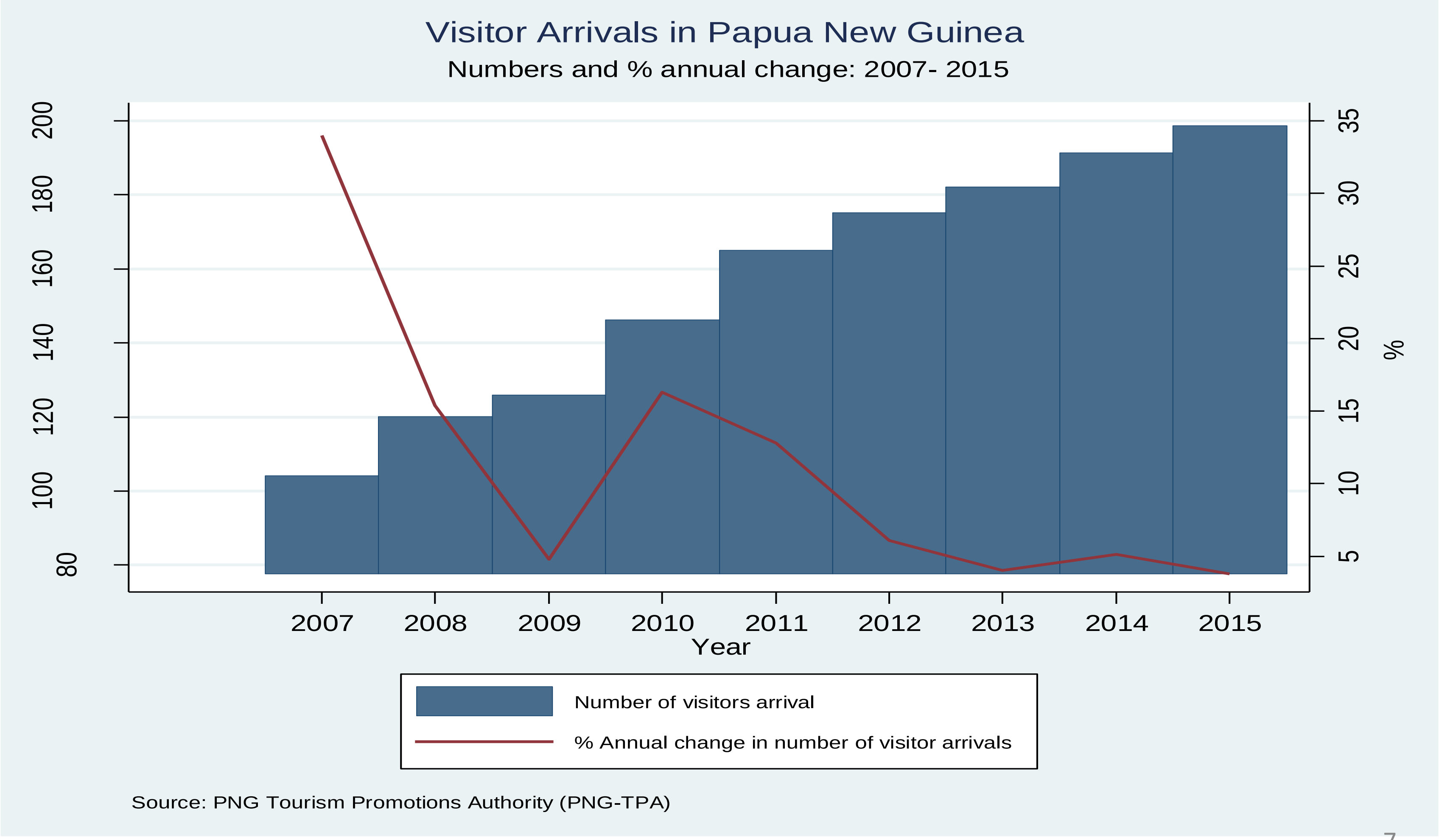
Employment growth negative since 2014 Q4



Imports down below 2007 levels



Visitor arrivals still growing, but slowly



Some indicators point to a recession

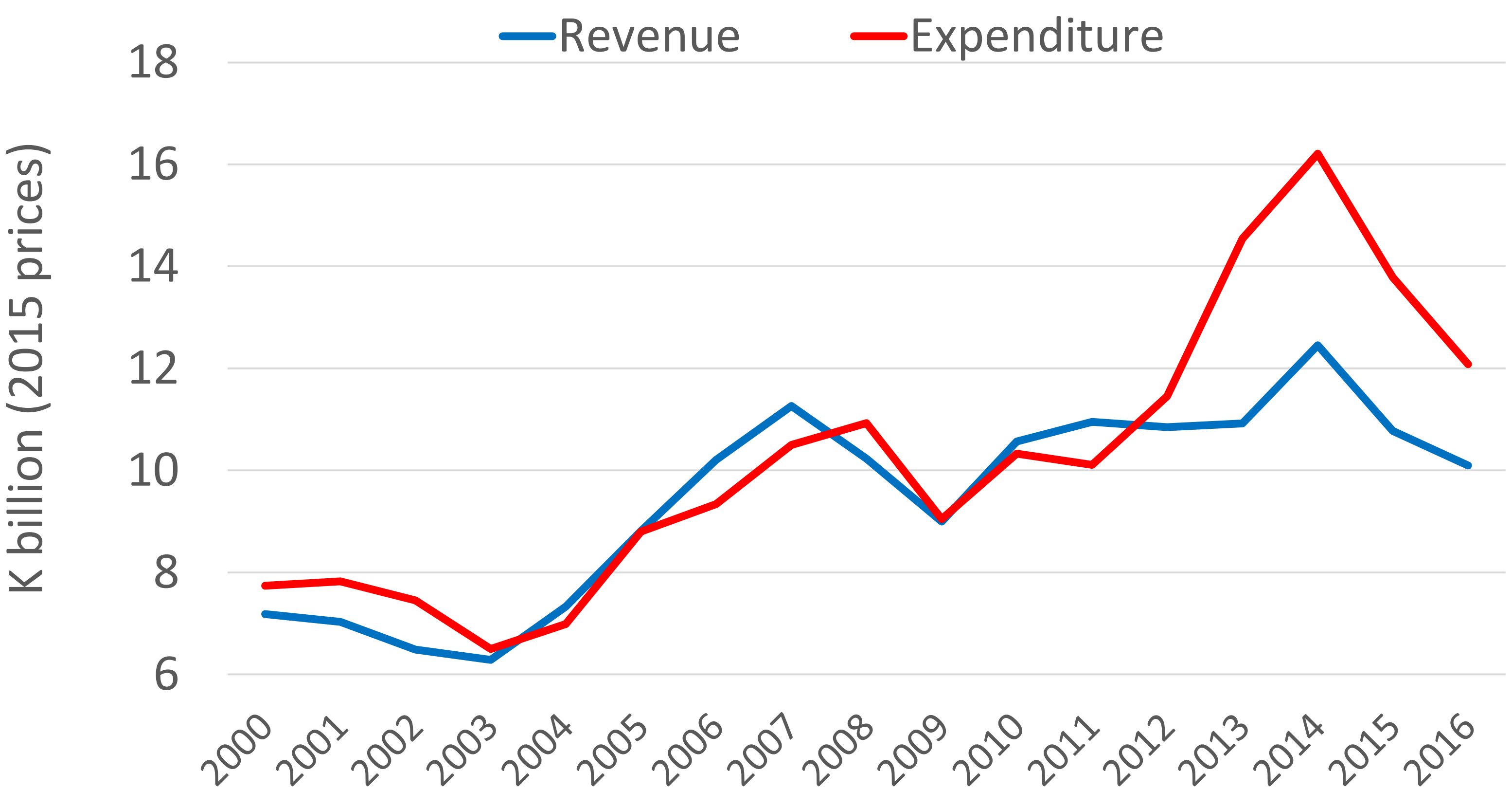
- Sharp decline in tax revenue (see fiscal section)
- 25% drop in coastal shipping over last year (Business Advantage, Oct. 2016)
- PNG Business Council report drops in sales of 35% in the first six months of 2016.

Growth summary

- Overall, the indicators suggest a sharp slow down in domestic economic activity.
- Even if GDP growth is still positive, many indicators are suggestive of an economic recession in PNG.
- A key challenge for the government is therefore how to stimulate the economy through its macroeconomic tools which is the subject of the next section.

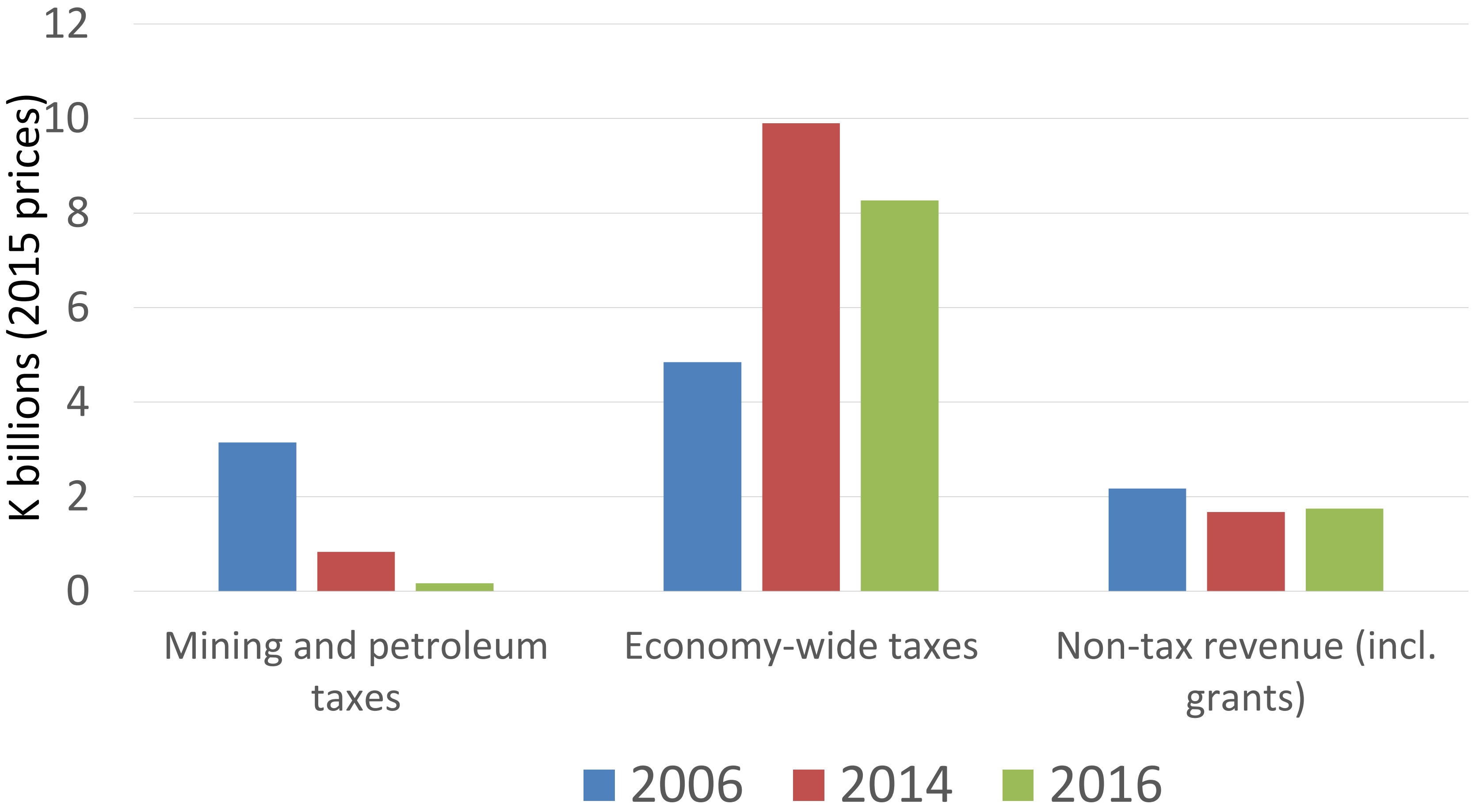
Fiscal Developments

Expenditure has outpaced revenue, but both are falling; revenue is back at 2006 levels



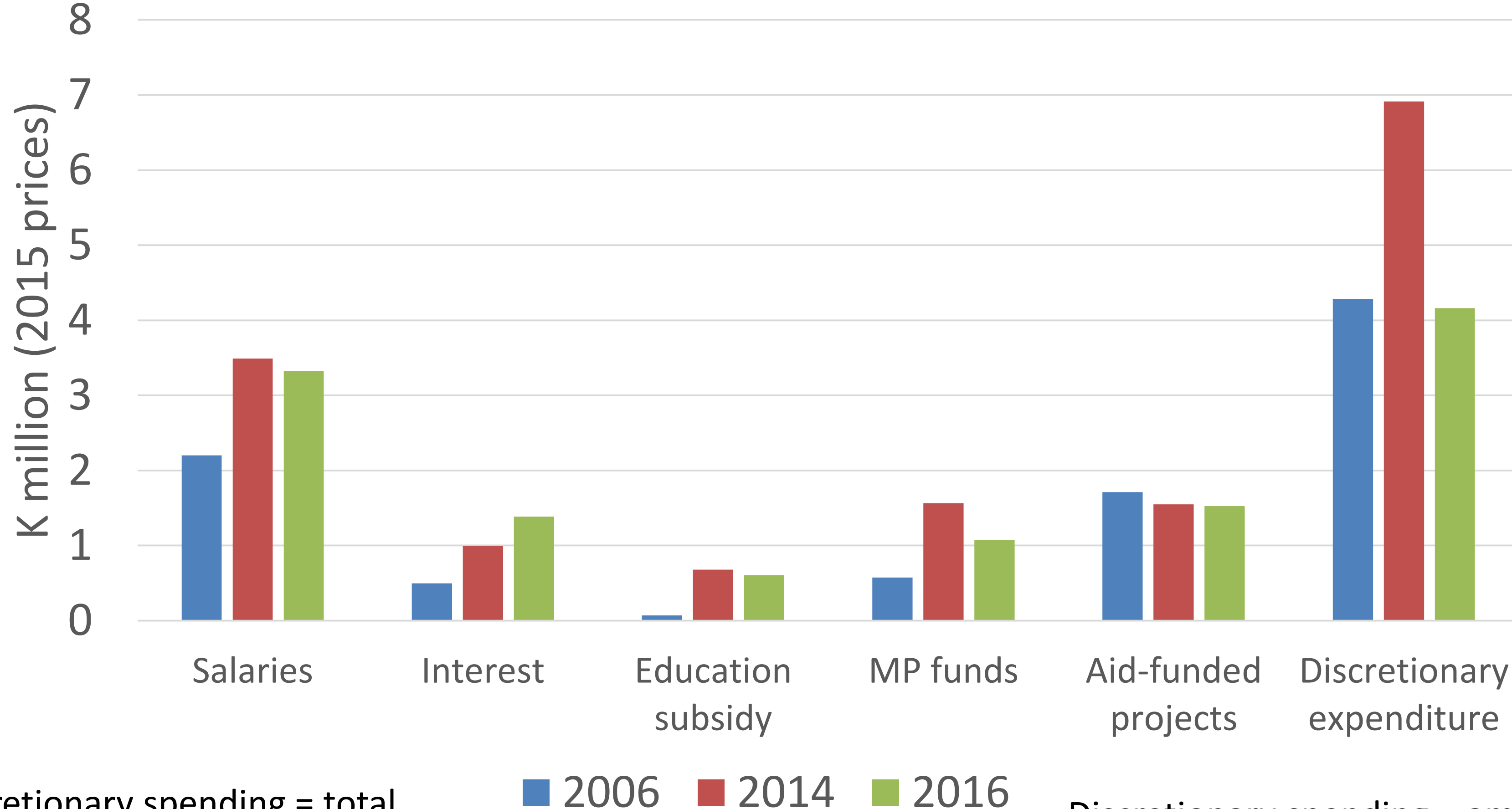
Source: Treasury

Economy-wide taxes have fallen; resource taxes have disappeared



Source: Treasury

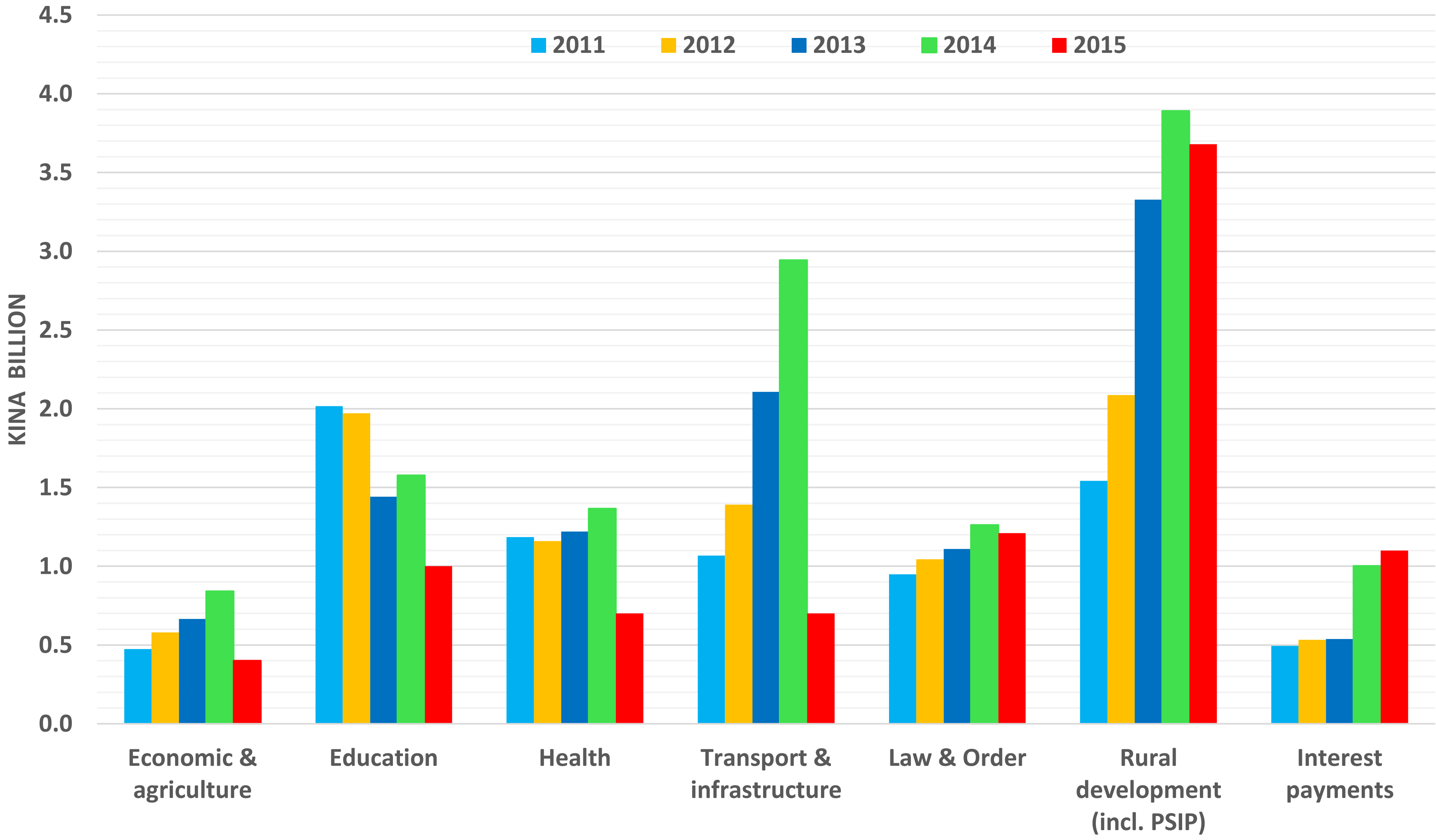
Increased spending in salaries, interest and political commitments have squeezed discretionary spending



Discretionary spending = total spending minus salaries minus interest minus political commitments minus aid.

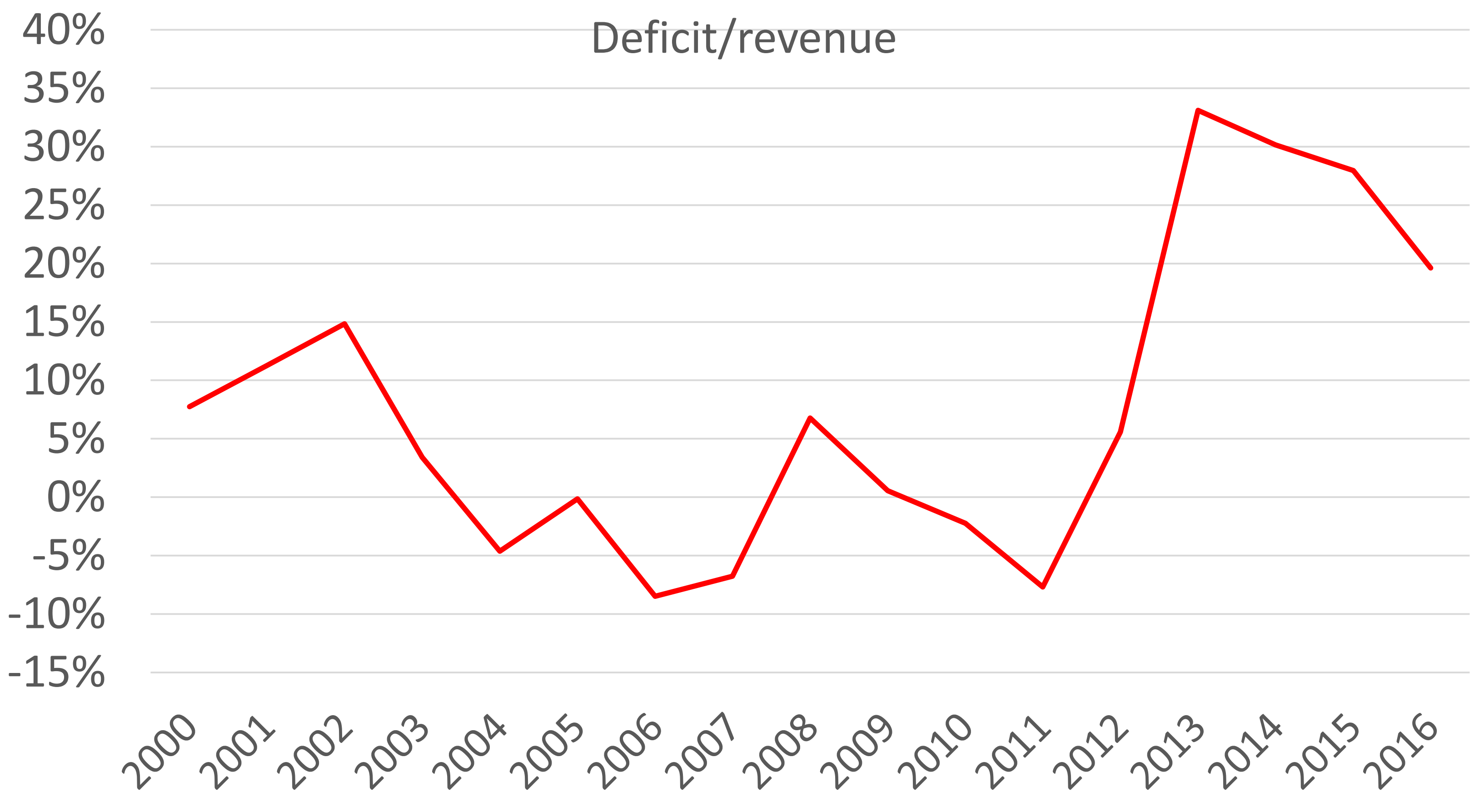
Discretionary spending = amount available for core government operations (running hospitals, universities; building major roads)

Harsh cuts to critical services

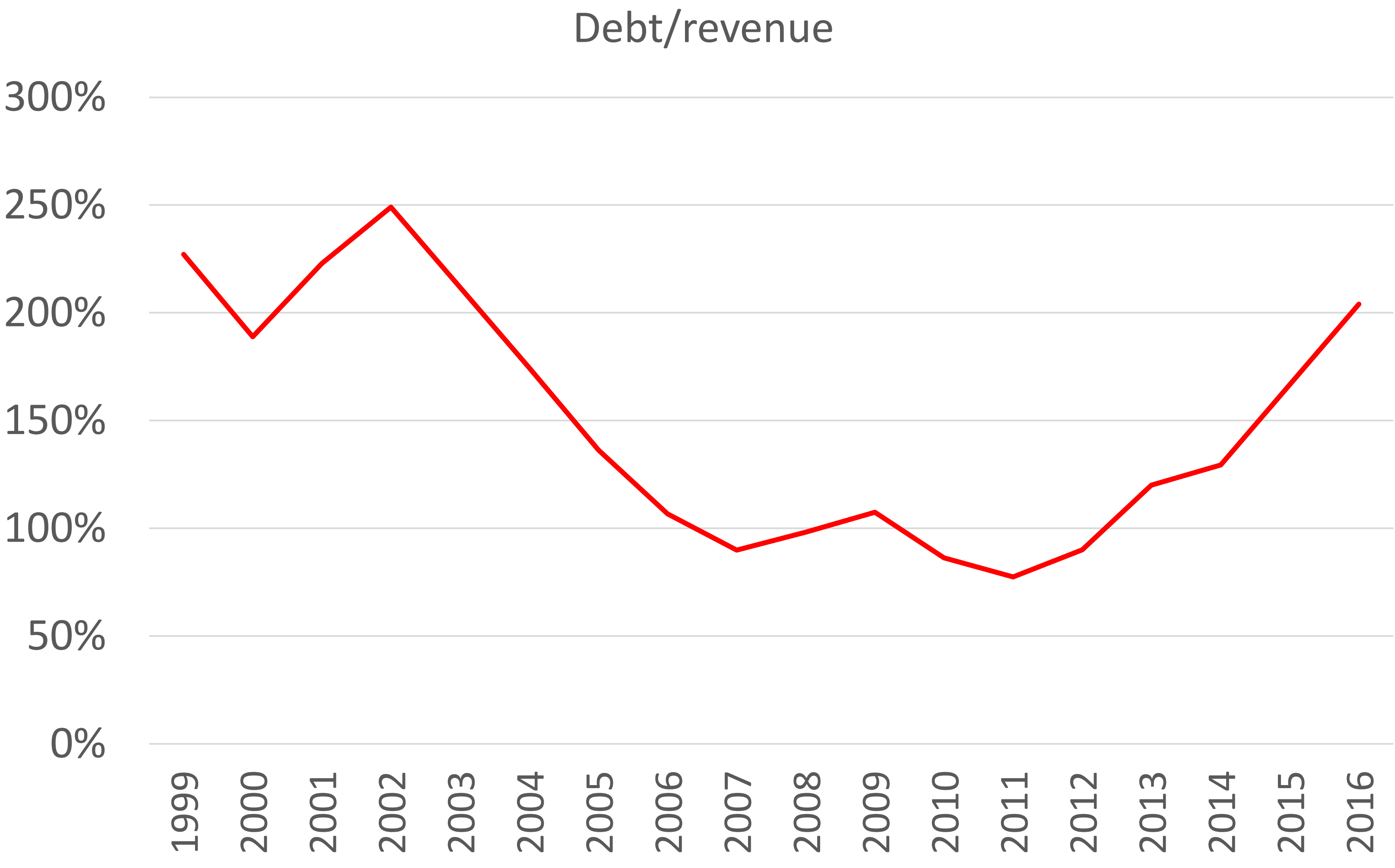


Source: BPNG and Treasury

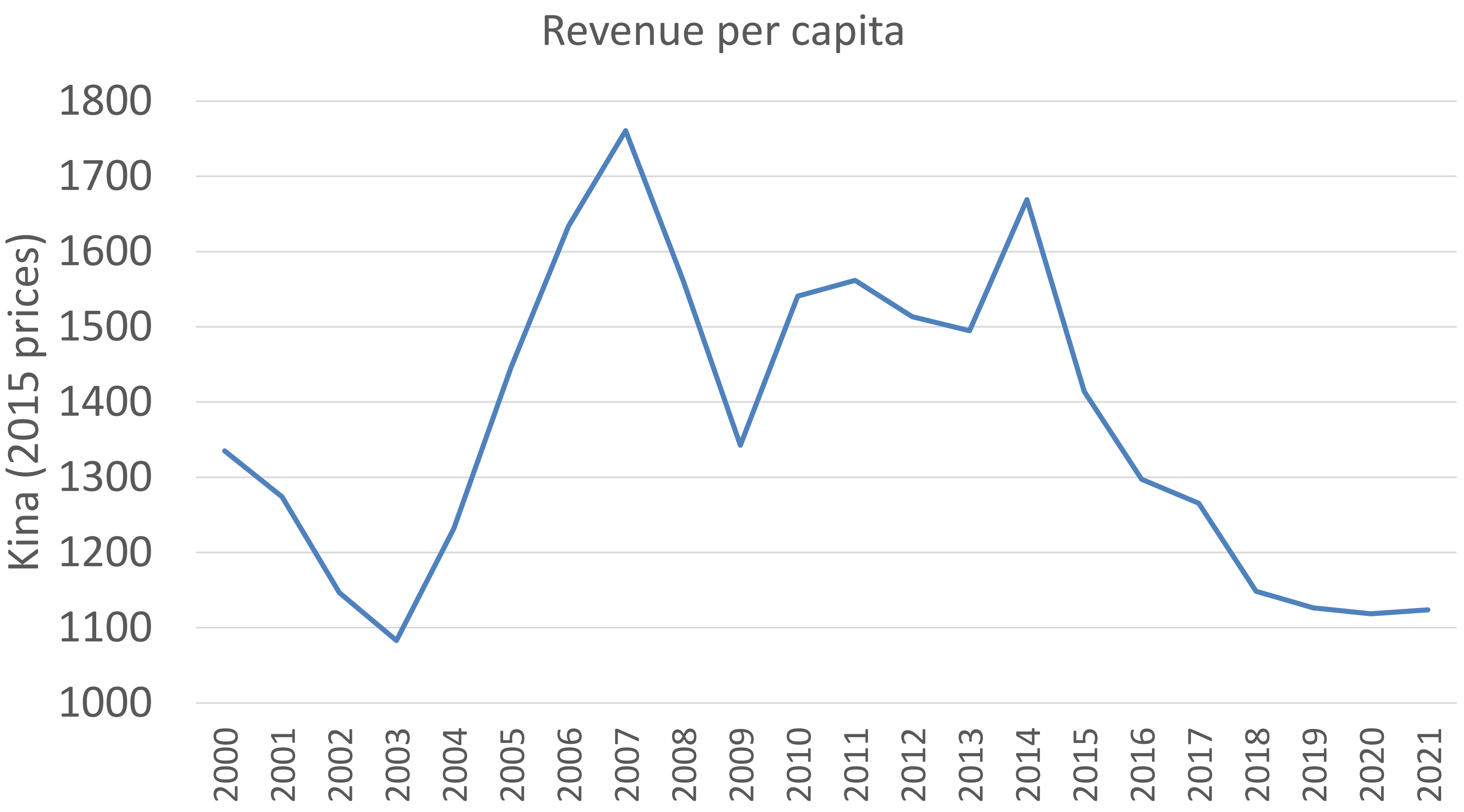
Deficit/revenue ratios reached an all-time high near the end of the boom



As a result, debt/revenue is now back at pre-boom levels



A gloomy revenue outlook



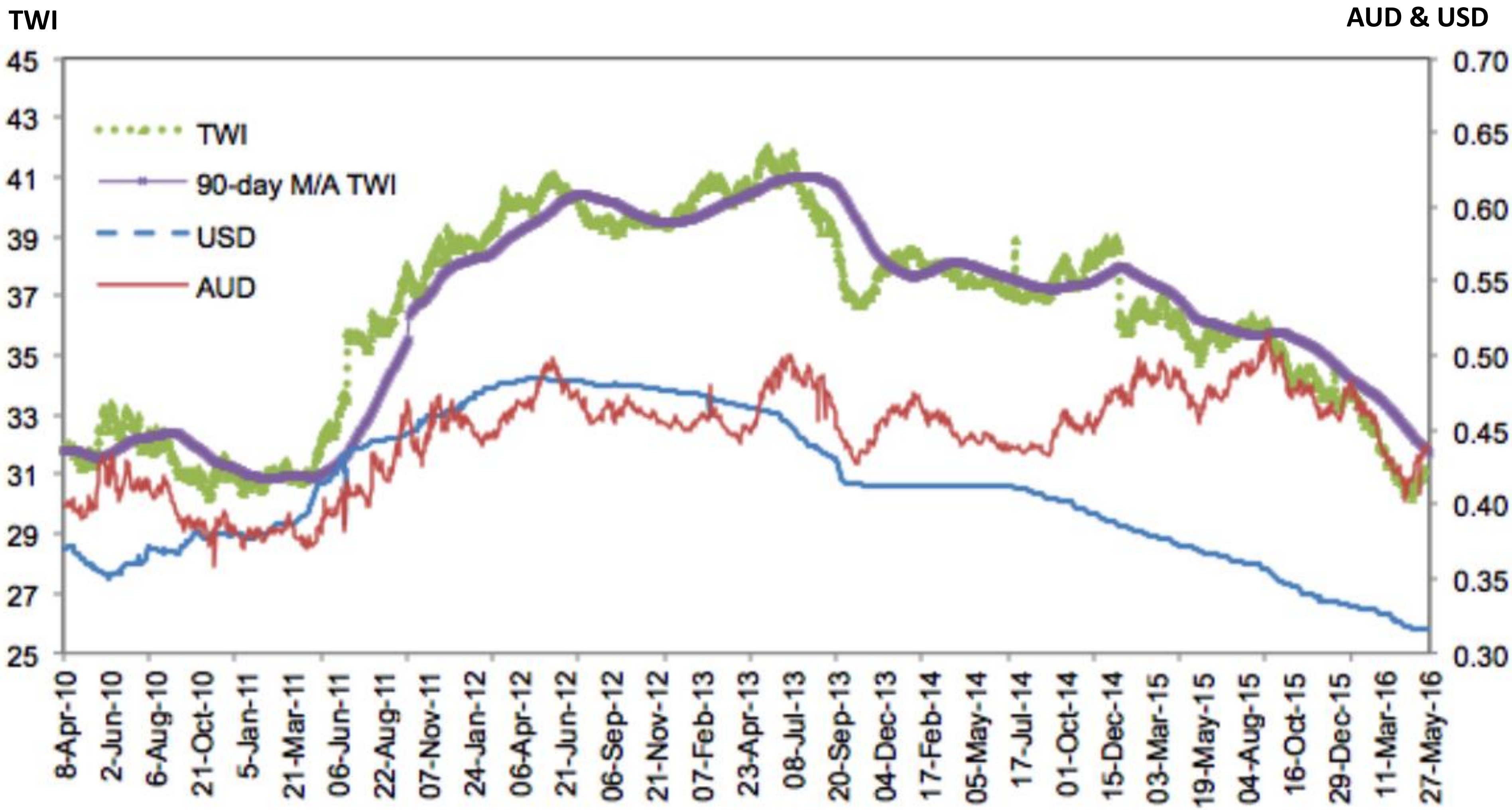
Note: 2017 onwards projections from 2017 budget

Fiscal policy reflections

- Government has been hit by a massive fiscal shock with the end of the boom.
- Expenditure cuts and cash-flow problems due to:
  - significant fall in tax collections
  - limited borrowing options
  - need to finance "boom legacy" expenditures (higher salary and interest bill, and new policy commitments).
- To avoid further cuts in health, education and infrastructure, government needs to:
  - continue to borrow
  - stimulate the economy
  - reprioritize expenditures through cuts in constituency spending and salary restraint.

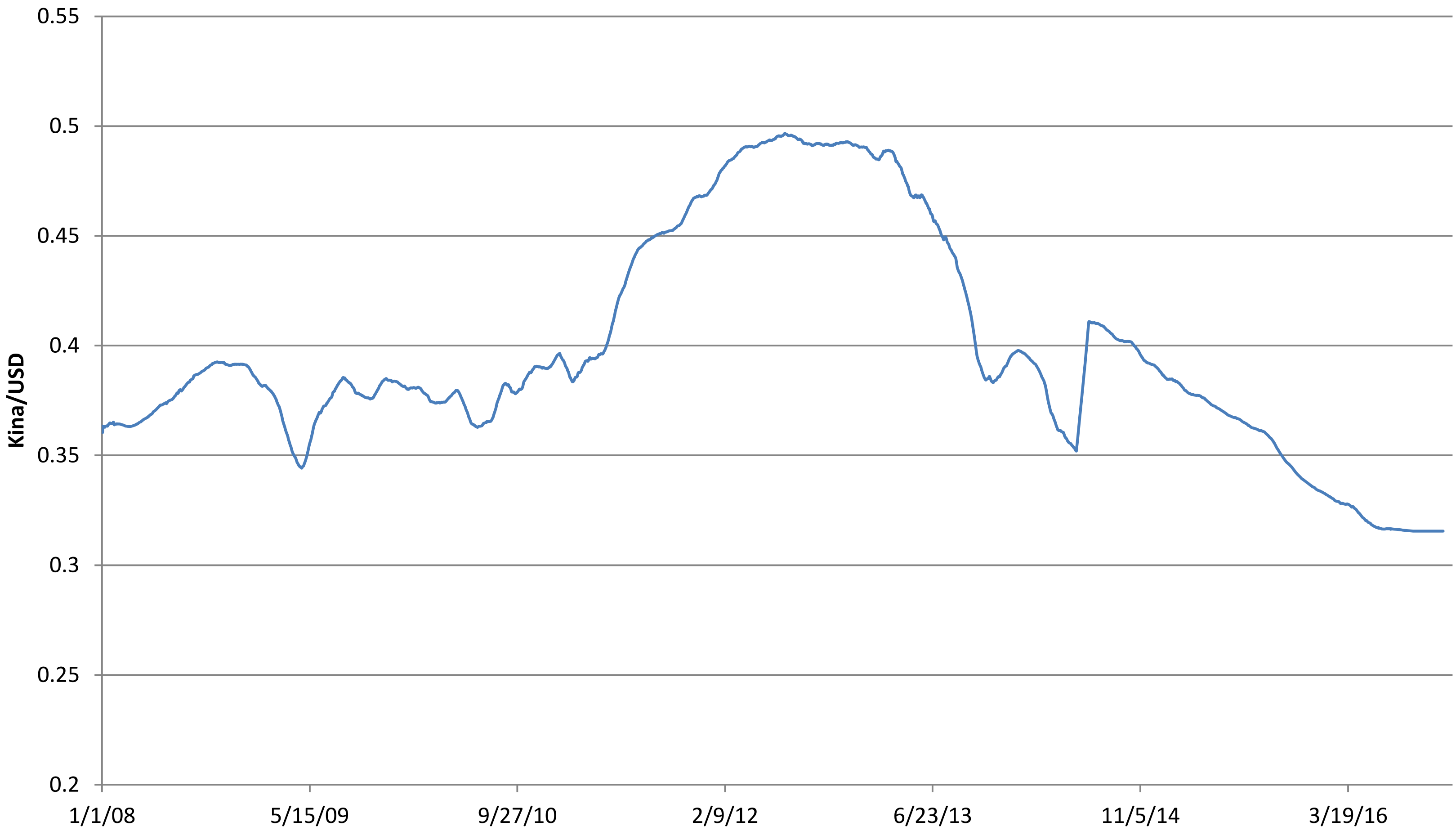
Exchange Rate

Recent modest nominal depreciation

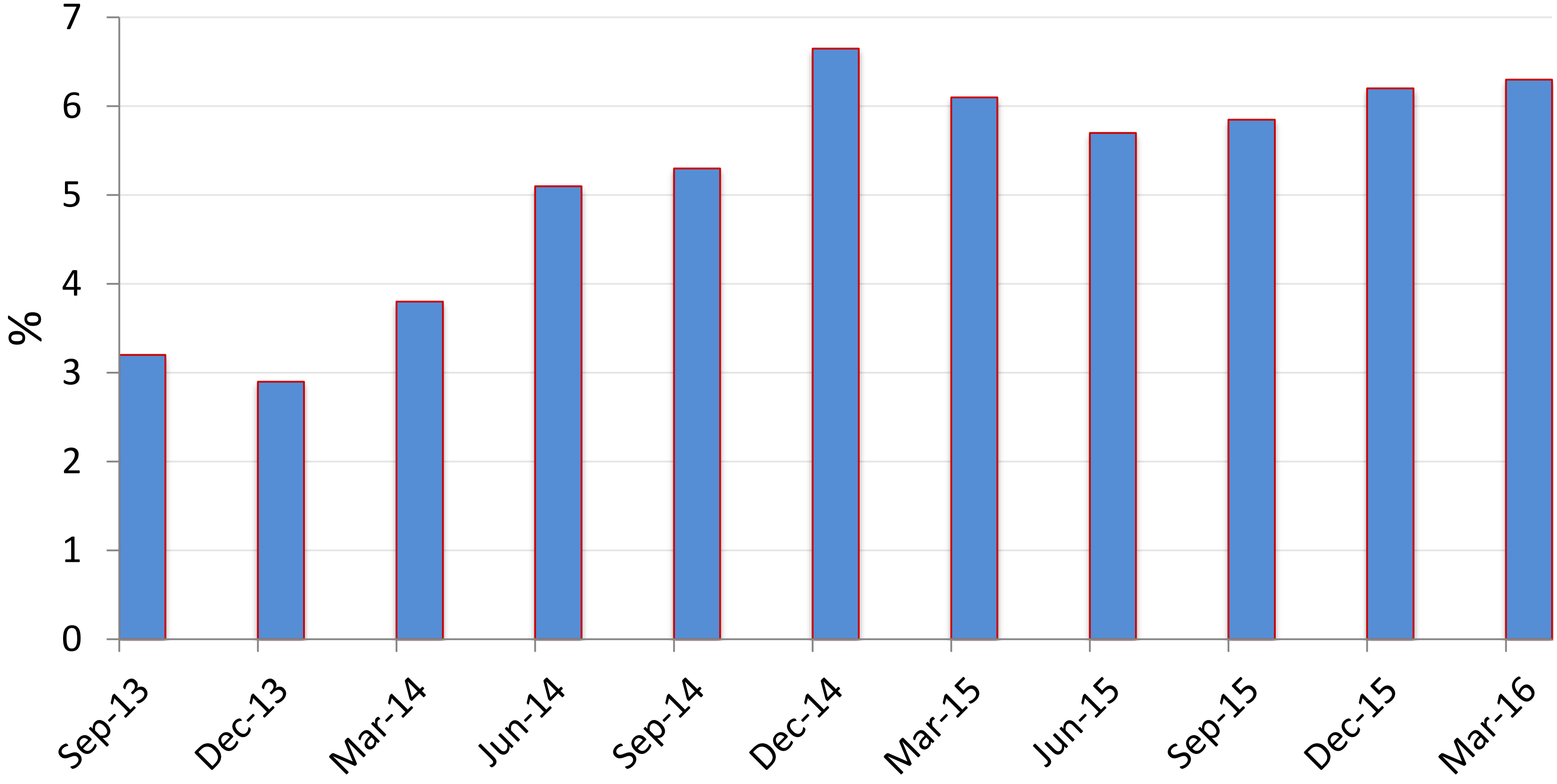


Source: BPNG

Exchange rate has not depreciated against the US dollar since May 2016

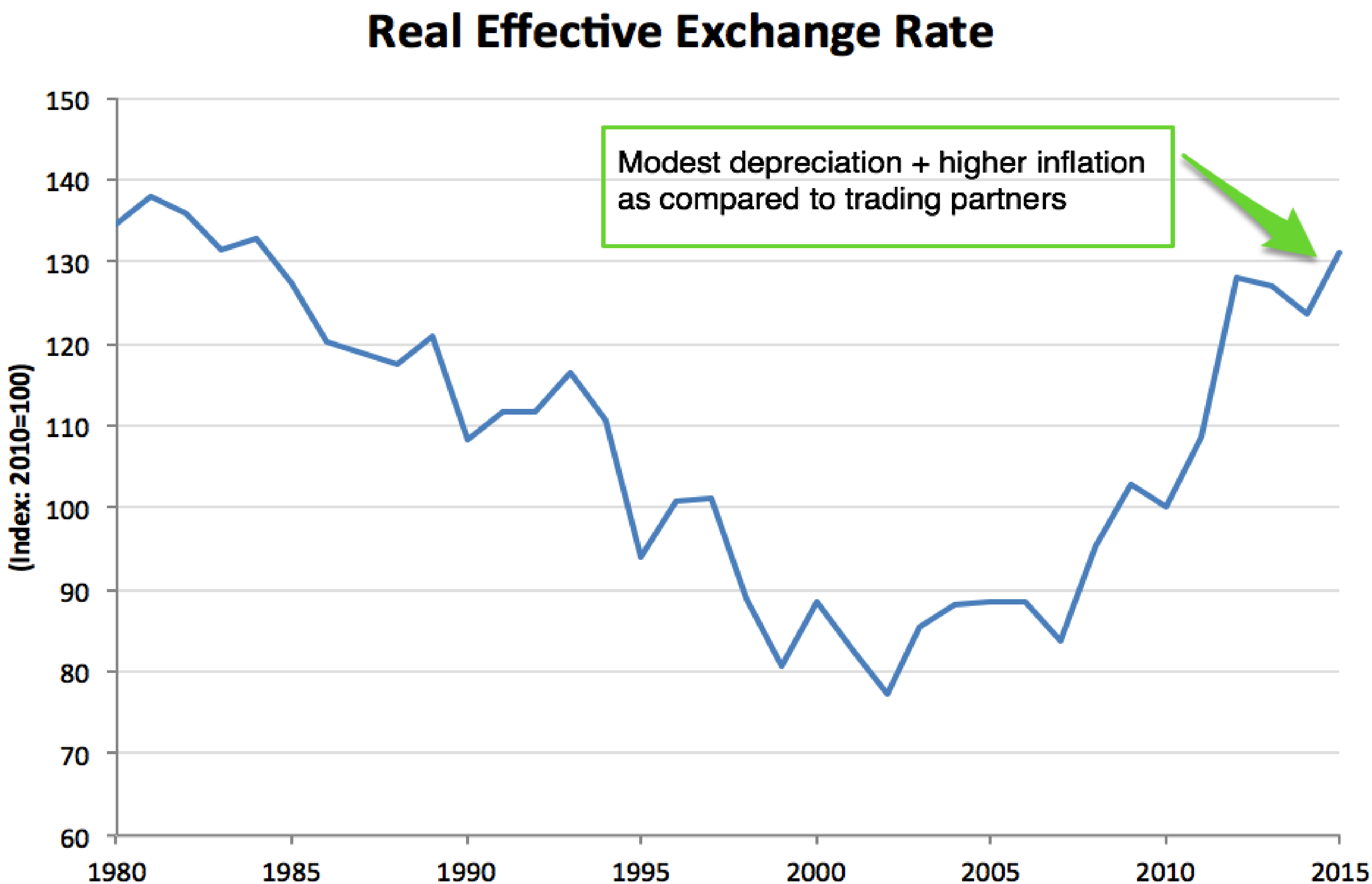


Inflation at around 6%



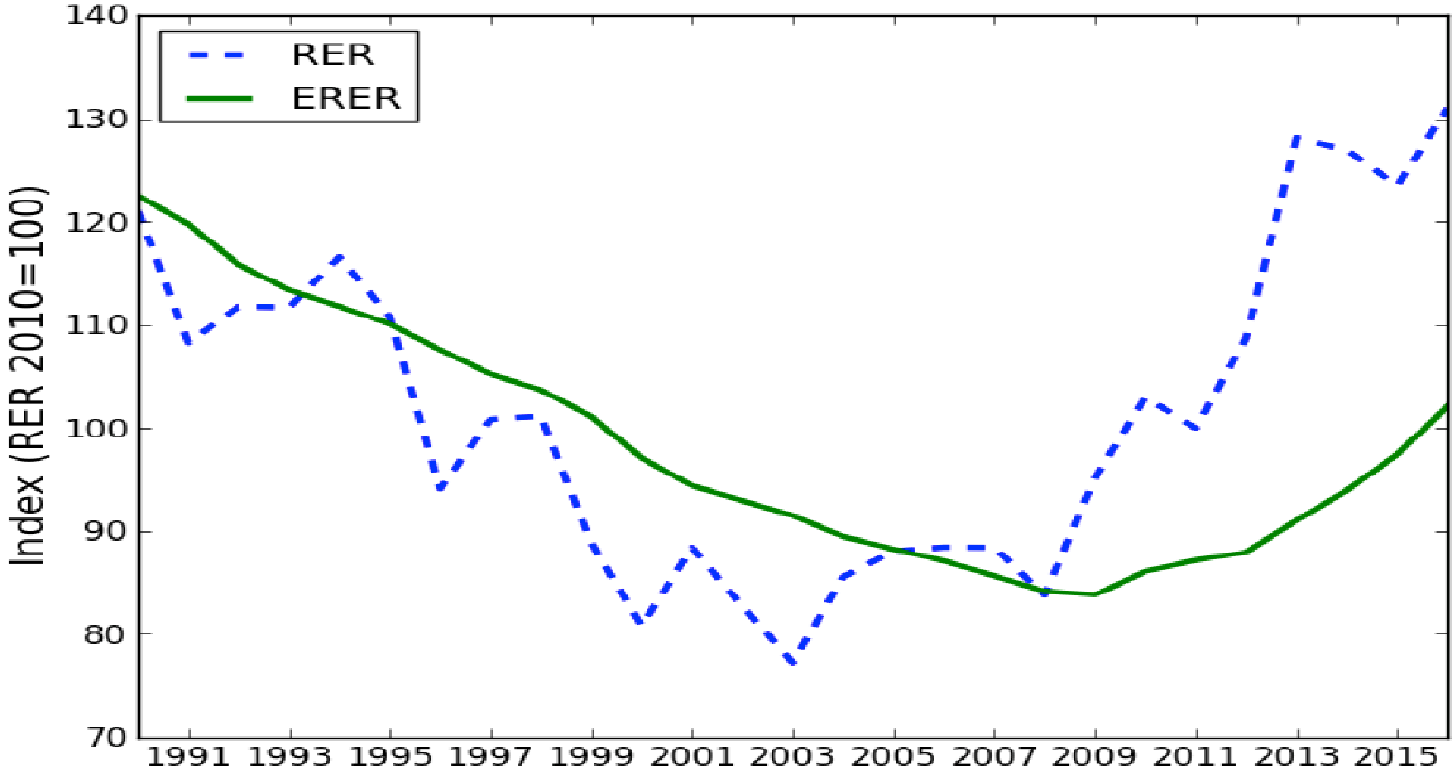
Source: BPNG

High Real exchange rate



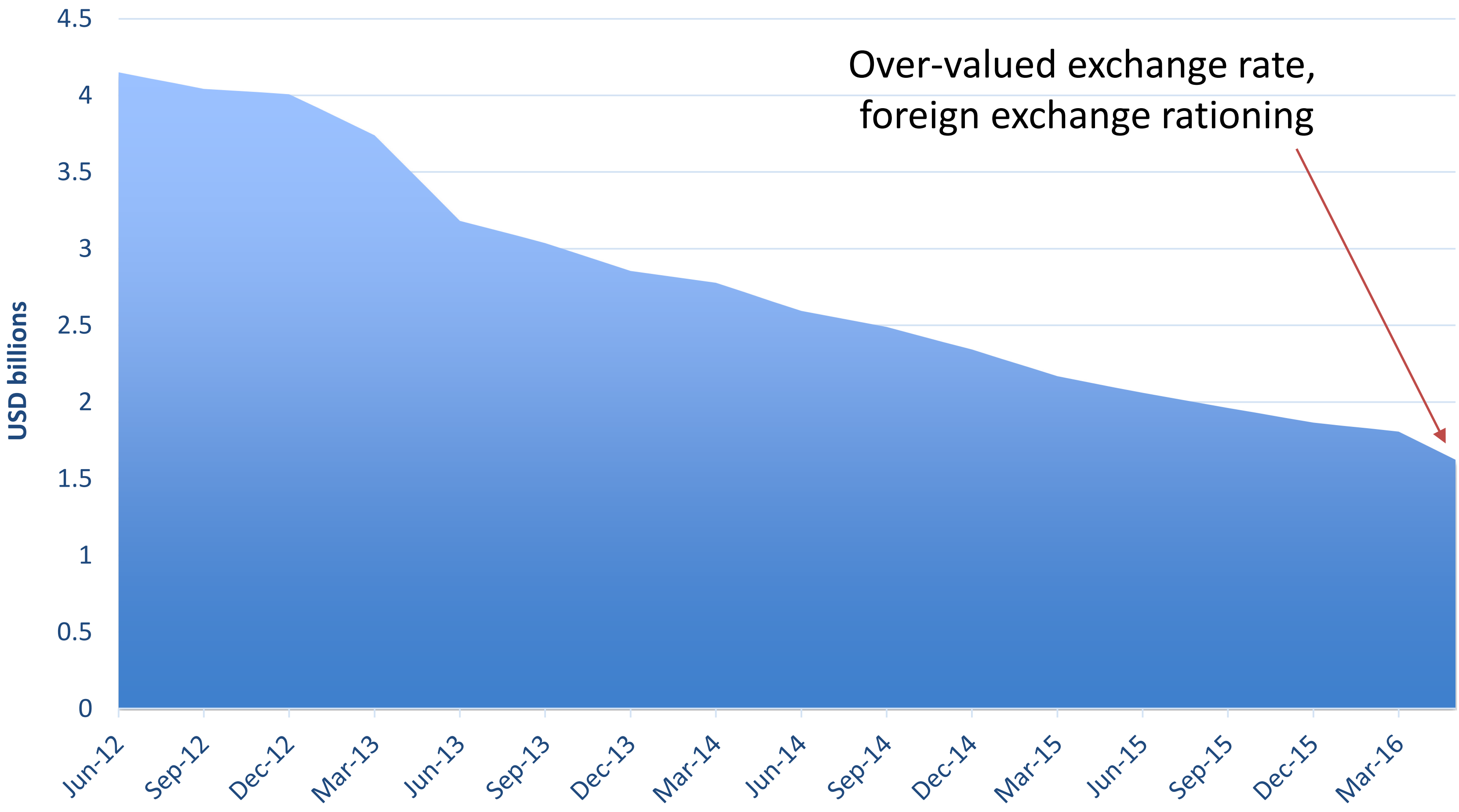
Source: World Bank (2016)

Figure: RER and ERER, 1990-2015.



Note: An increase in RER denotes appreciation. Therefore, RER>ERER indicates RER overvaluation.

Foreign exchange reserves are falling



Source: BPNG

Foreign exchange rationing

- Overvalued currency leads to excess market demand
- To cater, BPNG needs to provide foreign currency to the market but not enough reserves available. Result: forex rationing
- Wait list is as high as 1 billion USD
- Imports are compressed
- Business deferring investment in lack of forex

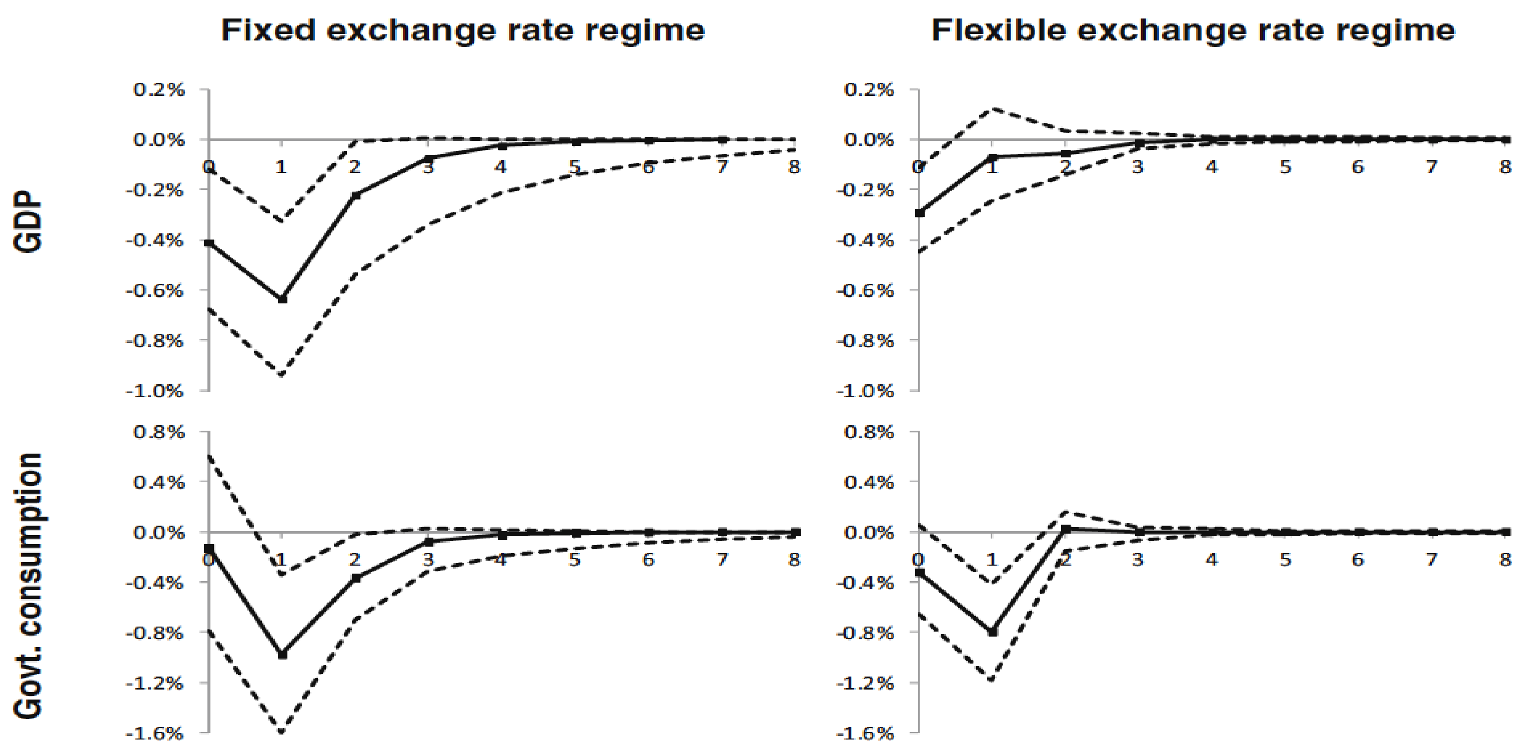
Kina depreciation modest by international comparisons

Country	%Δ exchange rate 1 June 2014 – 1 June 2016	Natural resource rents as % of GDP
Mozambique	-45.8	13.6
Brazil	-37.3	5
Zambia	-34.8	16.1
South Africa	-32.5	7.6
Mexico	-30.5	6.3
Norway	-28.3	9.1
Madagascar	-26.6	10.9
Uganda	-24	11.3
PNG (interbank rate)	-23.5	29.6
Australia	-22	7.1
Ghana	-21.9	21.1
Chile	-20.5	16.2
Peru	-18	8.7
Indonesia	-14.5	6.3
Mongolia	-9.2	22.1
PNG (market rate)	-8.7	29.6
Solomon Islands	-8.7	41

Source: World Bank

Lessons from cross-country research

Oil exporters with more flexible exchange rate regimes have a smaller GDP and government spending shock when oil prices fall



Source: Koh (2015) "Oil prices shocks and macroeconomic adjustments in oil-exporting countries" *International Economics and Economic Policy*

Lesson from international experience

- Several oil-exporting economies have moved to more flexible exchange rates in response to commodity price falls
- Examples include Azerbaijan, Colombia, Kazakhstan, Malaysia, Nigeria and Venezuela.
- PNG has done the opposite.
- Needs to stimulate growth through more flexible exchange rate

Structural policy

New Select Policy initiatives

- SME Policy initiatives
- Land Policy initiatives
- Agricultural Import Policy initiatives

1. SME Policy initiatives

Goals	Current	2030 Target	Changes in 15 years
Number of SMEs (in 000s)	*49.5*	*500*	10.1 times
Employment Creation (in mn)	*0.3*	*2.0*	6.9 times
Ownership of the formal Economy	*10%*	*70%*	60% point
% Contribution to GDP	*6%*	*50%*	44% point
Per Capita GDP (K'000)	*2.0*	*9.6*	4.8 times
Unemployment	*84%*	*49%*	-35% point
Below the Poverty Line	*40%*	*30%*	-10% point
Unbanked	*86%*	*40%*	-46% point

1. SME Policy initiatives

Some restricted provisions: e.g.,

- Foreign ownership of businesses in several areas (e.g. trade stores, tourism) to be restricted.

- Imposition of export taxes for all Agriculture commodities that are currently being exported in their raw form to encourage downstream processing <u>and</u> imposition of complete ban on the exports of round logs by 2020.

2. Land Policy initiatives

Key objectives of the ***Proposed Land (Amendment) Act 2013*** **(draft)** are

a. To improve land administration system

b. To improve land dispute settlement system process

c. To develop a framework for maximizing the development potential of land held under customary tenure

2. Land Policy initiatives

Proposed amendment is restrictive in nature for foreign ownership because it has provisions to

- Impose ban on foreign ownership and leasing of land

- Existing foreign leases have to be given up within 30 years

3. Agricultural Import Policy initiatives

- **Ban on Vegetable Agricultural imports:**
  Introduced last year, then lifted again, reintroduced in early 2016 and lifted again.

- **Discussions on proposed Rice Import Quotas** (*under 2015 proposed National Rice Import Quota System)*

Commentary on the new policies

- Some of the new policy proposals are sensible, but all are protectionist in nature, limiting trade and investment.

- Limiting trade will increase domestic output, but push up higher prices.

- Limiting foreign investment will reduce output.

- Unclear if policies will be implemented, but the announcement effect may further scare off foreign investment, already deterred by foreign exchange rationing.

Conclusions

Conclusions

- Economy is in crisis in the face of economic slowdown and fiscal deficit with severe government expenditure cuts—even in essential services.
- On fiscal measures, the government needs to stimulate the economy. However, PNG lacks borrowing capacity and cannot wait until next resource project and commodity prices to pick up.
- On structural policy measures, objective is right. However, it is very costly and can push up prices while scaring-off foreign investments that PNG needs.

Conclusions

- The real exchange rate is high for now. Rather than introducing protectionist measures, it would be better to allow further currency depreciation.

- That would make local businesses more competitive, and would help all the businesses engaged in export or import substitution.

- This would have an immediate impact, and would not scare off foreign investors.

Thank you!