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

Real GDP Growth Rates (%)
All sectors and non-mining sectors: 1994-2018

Source: NSO/Treasury/BPNG
Employment growth negative since 2014 Q4

Formal sector employment growth (quarterly, year on year)
2008q1:2016q1

Source: QEB Statistical Tables, BPNG
Imports down below 2007 levels

Source: QEB Statistical Tables, BPNG
Visitor arrivals still growing, but slowly

Source: PNG Tourism Promotions Authority (PNG-TPA)
Growth summary

- Overall, the indicators suggest a sharp slowdown 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

Source: Treasury
Both mineral and economy-wide taxes have fallen

Source: Treasury
Harsh cuts to critical services, reprioritization, 2013 vs 2015

KINA BILLION (2015 PRICES)

Source: BPNG and Treasury
Fiscal deficits are very large

Source: Treasury
Debt is rising and borrowing difficult

Source: Treasury

- Debt/GDP - actuals
- Revised FRA limit
Fiscal Policy Reflections

- Cash flow problem due to (i) limited domestic appetite for further lending to the government and (ii) significant reduction in tax collections
- Expenditure cut in health and education not a solution
- Government needs to stimulate economy and examine the scope for tax increases to boost revenue, and reprioritize expenditures through cuts in the constituency spending
Exchange Rate
Recent modest nominal depreciation

Source: BPNG
Inflation remains at about 6%

Source: BPNG
Real exchange rate at a record high

Real Effective Exchange Rate

Modest depreciation + higher inflation as compared to trading partners

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

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

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

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 policy initiatives

- Ban on vegetable agricultural imports
  - Introduced last year, then lifted again, now reintroduced.
  - Also further discussions of rice import quotas

- SME policy
  - Goals of policy to increase employment, income per capita, SME contribution to GDP, local ownership
  - Foreign ownership of businesses in several areas (e.g. trade stores, tourism) to be restricted.

- Land policy
  - Ban of foreign ownership and leasing of land
  - Existing foreign leases have to be given up within 30 years
Commentary on the new policies

- All 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.
Conclusion
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- In the face of economic slowdown and severe government expenditure cuts, the government needs to stimulate the economy, but lacks borrowing capacity.

- The real exchange rate is at a record high. Rather than introducing protectionist measures, would be better to allow further currency depreciation.

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