2017 PNG Economic Survey

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Introduction

• New government, new plan
• Short-term challenges: recession, falling government revenue, foreign exchange shortages
• Long term challenges: low growth of economy and of government revenue
The long-term view of the economy

Non-resource GDP per capita (adjusted for inflation; 1980=1)
The long-term view of government

Revenue and expenditure per person (adjusted for inflation)

Introduction – Growth – Fiscal – Macro – Conclusion
This survey

• How can PNG respond to current economic difficulties AND get on a higher growth path?

• Section 2 – Growth

• Section 3 – Fiscal

• Section 4 – Macro (exchange rate and inflation)

• Conclusion
Economic growth
The growth slowdown

Real GDP and non-resource GDP growth (%)
Has there been a recession?

- Views of business: Drop in output and sales of 20-35% from the peak.
- Negative growth in *economy-wide* tax revenue every year since 2014 (25% after inflation for GST, income tax and non-resource corporate tax).
- Sharp contraction in imports since 2014.
- Small fall in number of formal workers, and of foreign workers, both since 2013.
- Some evidence that the recession is now bottoming out.
- Confidence going forward from future resource projects, but nothing in the next year (or two?), and mistake to wait for the next project.
Fiscal
Falling revenue; back to 2005 levels

Government revenue, adjusted for inflation
Since 2014, falls in economy-wide taxes

Tax revenue by source (adjusted for inflation)
Sharp falls in expenditure, but after a steep increase

Government expenditure, adjusted for inflation

Kina billion (2017 prices)

Rising salary and interest bill

Salaries and interest bill, adjusted for inflation

Real salaries
Real interest

Kina billions (2015 prices)
Discretionary spending back at 2007 levels

Discretionary expenditure (total minus salaries and interest), adjusted for inflation

Kina billions (2015 prices)

Non-salary non-interest exp. (discretionary exp.)
Growth in provincial spending (DSIP etc) has also crowded out other sectors

Budget expenditure by sector, adjusted for inflation

K billions (2017 prices)
Big increase in deficits (borrowing) in recent years

Government expenditure minus revenue (borrowing)

Kina billions (2015 prices)

Exp-Rev (real; 2015 prices)
Leading to rapid growth in debt

Government debt (not adjusted for inflation)

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Debt-to-revenue back at pre-boom levels

Debt to revenue ratio

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Macro and the Real Exchange Rate (RER)
Background - RER and TOT (terms of trade), 2000-16

Source: BPNG and WDI
PGK/USD Exchange Rate, 08/2012-08/2017
Theory: Sharp RER appreciation during resource boom and decline of tradable sector ("Dutch Disease").

After the boom, RER depreciation needed to restore internal and external balance.

In PNG, RER continued to appreciate even after the boom (see previous Figure).


FX restrictions since 2014: US$ 300M-1B excess demand.


We update their estimate to 2016: kina still 20% overvalued.

2017: RER appreciation projected $ overvaluation likely to increase
Macro-level consequences of FX restrictions

• Macroeconomic adjustment to end of resource boom postponed for years.
• RER overvaluation leads to resource misallocation → lower output and productivity growth, and investment.
• Businesses have great difficulty to source intermediate and capital goods from the rest of the world.
  → Imports have collapsed to historically low levels.
PNG Imports – 1980-2016

Source: BPNG and WDI
Micro-level consequences

• FX has become number 1 issue for PNG businesses.
• Processing time of FX-orders: Currently 8-16 weeks.
• Invoices outstanding now 60-180 days vs. 14-30d credit lines.
• "Dollarized" debt piles up while kina is pressured to depreciate.
• Overseas suppliers may lose have lost their patience.
• MNEs cannot repatriate profits.
• Administrative burden of FX-crisis increases costs → Inflation.
Inflation

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Why is inflation high and accelerating?

- Inflationary expectations?
- Optimism about the future?
- Excess liquidity?
- FX rationing
  - Reduces competition
  - Excess demand
  - Increases supply costs
Policy options

• Why does BPNG not devalue?
  • ”Fear of depreciation” (Inflation, loss in urban real income).
  • “Elasticity pessimism”.
  • ”Sit out the crisis: Next resource project just around the corner?

• Current situation has very limited benefits, only significant costs.

• Our policy recommendation: Depreciate the exchange rate. One option is to introduce a dual exchange rate for a limited time (up to 24 months)
  • Apply current appreciated rate for essential imports (rice, pharmaceuticals)
  • Depreciate kina by 20% and apply that rate to all other transactions.
Conclusion
Building consensus for reform

• New Treasurer has admitted there is a problem. Need to build consensus on this, and the need for tough decisions.

• Twin reform goals needed:
  • Stimulating economic growth
  • Restoring fiscal sustainability while protecting basic services
Reforms to stimulate economic growth

• Interest rate: BPNG has limited influence on market interest rates
• Exchange rate: Case for depreciation already discussed
• Structural policy: Need to rebuild business confidence
Reforms for fiscal sustainability

• Borrowing: Government already borrowing as much as it can; deficits need to fall as the economy recovers.

• Taxation: Focus on compliance – IRC funding and performance

• Expenditure: Protection of key services (health, education) will require salary restraint and cuts to MP funds (DSIP etc).
Tenkyu tru!

PNG Budget Database (devpolicy.anu.edu.au & look for PNG Project)