

Papua New Guinea Economic Update

A Fine Balance

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The 2013 Pacific and PNG Update

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A Fine Balance

1. After the commodity price driven boom of the past decade...
2. ...the drivers of recent growth are waning
 - ▶ External conditions becoming a drag
 - ▶ Mixed signals on domestic demand
 - ▶ Fiscal expansion to provide some support
2. A mixed outlook
 - ▶ Managing policy at this point in the cycle is hard – as PNG's history shows
 - ▶ Potential upside potential centered on hard resources, but the weaker external environment is delaying when this might be realized
3. But with a change in focus these challenges can be met
 - ▶ Three seeds for sustainable and inclusive growth:
 - ▶ Centered on making more of PNG's greatest resources
 - ▶ Both in the private sector and by government

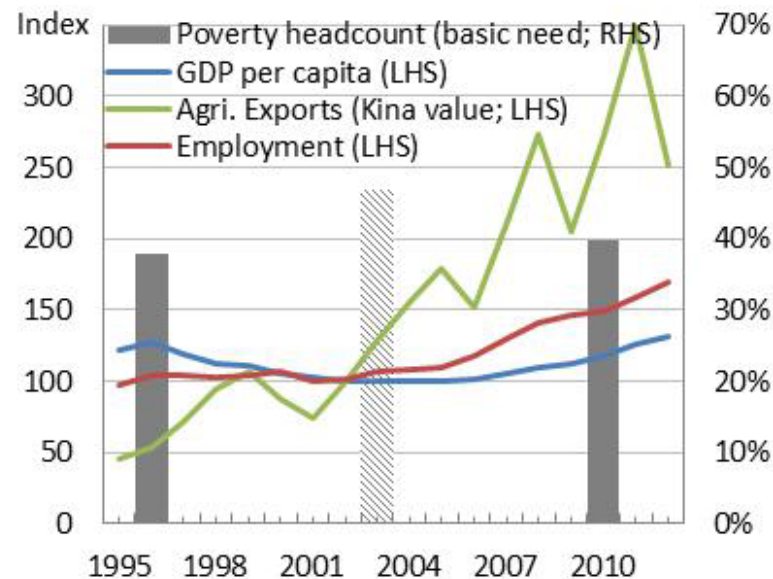
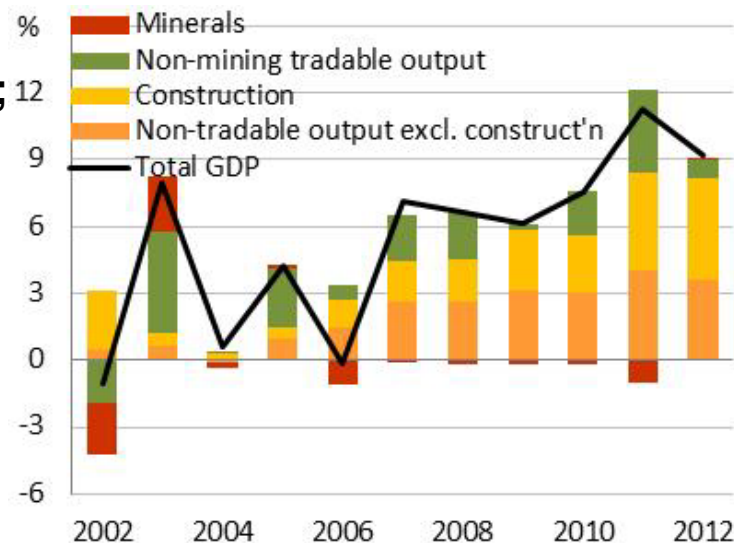


PNG's coming from a good decade....

PNG's coming from a good decade

Strong, broad growth, improving macroeconomic conditions, recovering living standards

- ▶ **2012- ~9% growth, 6th year of growth above 6%; GDP growth averaging 5.8% for a decade**
- ▶ More importantly for living standards, decade-average **non-resource GDP** growth of 7.1%
- ▶ **Government finances in improving shape**
 - ▶ Windfall revenues used to pay-down debt and contingent liabilities (until 2012)
 - ▶ ... and transferred to households across PNG by waiving fees for core public services
- ▶ **Inflation mostly tamed** (average 5% - although measured poorly and deteriorating)
- ▶ **Raising living standards:**
 - ▶ At least 70% more formal jobs in a decade
 - ▶ And broad recovery in living standards, at least compared with early 2000s



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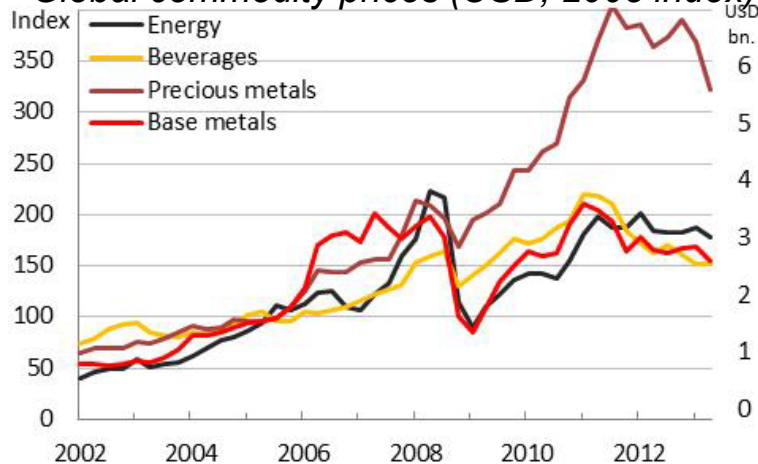
Sources: Treasury, BPNG, IMF, NSO, and World Bank staff

PNG's coming from a good decade

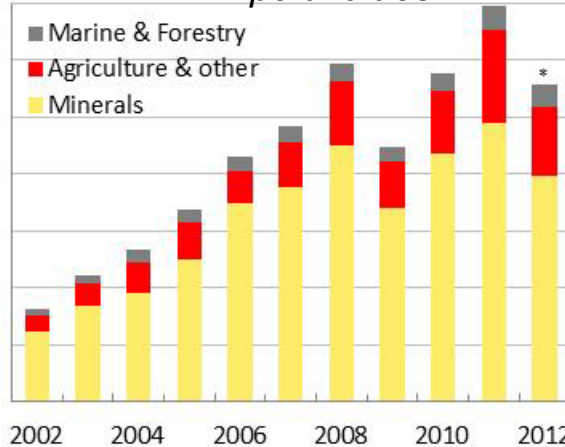
...due to highly supportive external conditions, well managed at a macro level

► Behind this is an unprecedented (and unexpected) surge in PNG's income

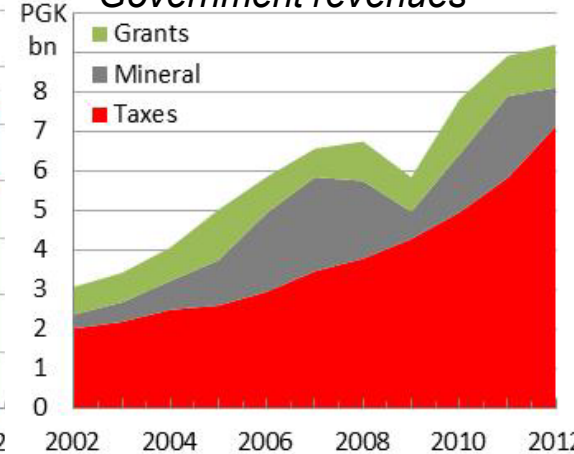
Global commodity prices (USD, 2005 index)



Export values



Government revenues



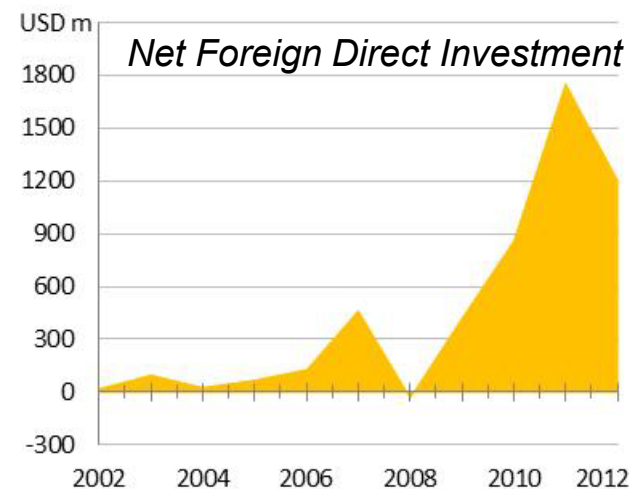
► Strong **soft** commodity prices have raised rural incomes and spending power

► Strong **hard** commodity prices have attracted massive FDI

► Prompting spin-off investments

► All funded through ready access to **cheap international credit**

► And the Kina has remained a commodity currency



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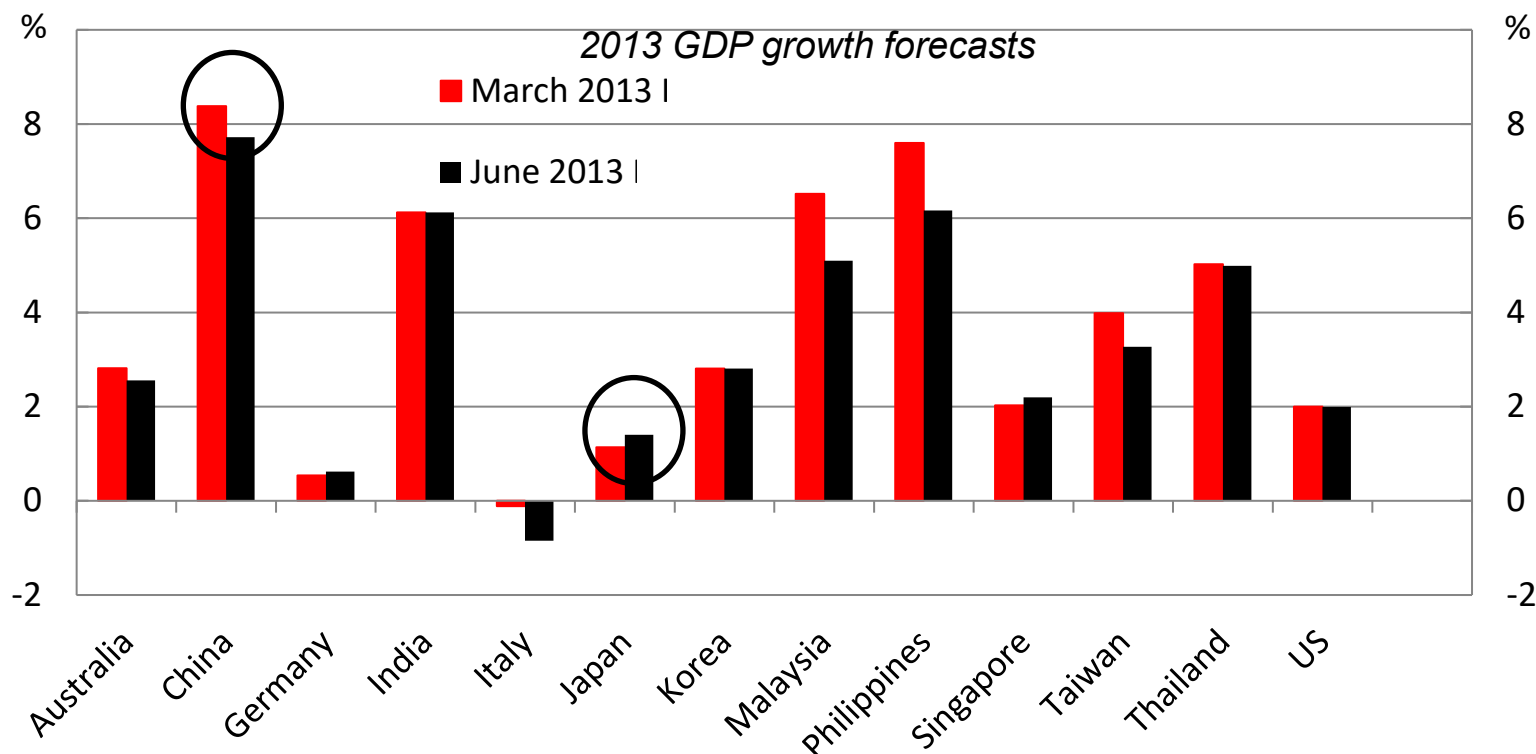
Sources: Treasury, IMF, BPNG and World Bank

Gloomier external conditions

Gloomier external conditions

The 2013 outlook is weakening for the economies that matter most to PNG

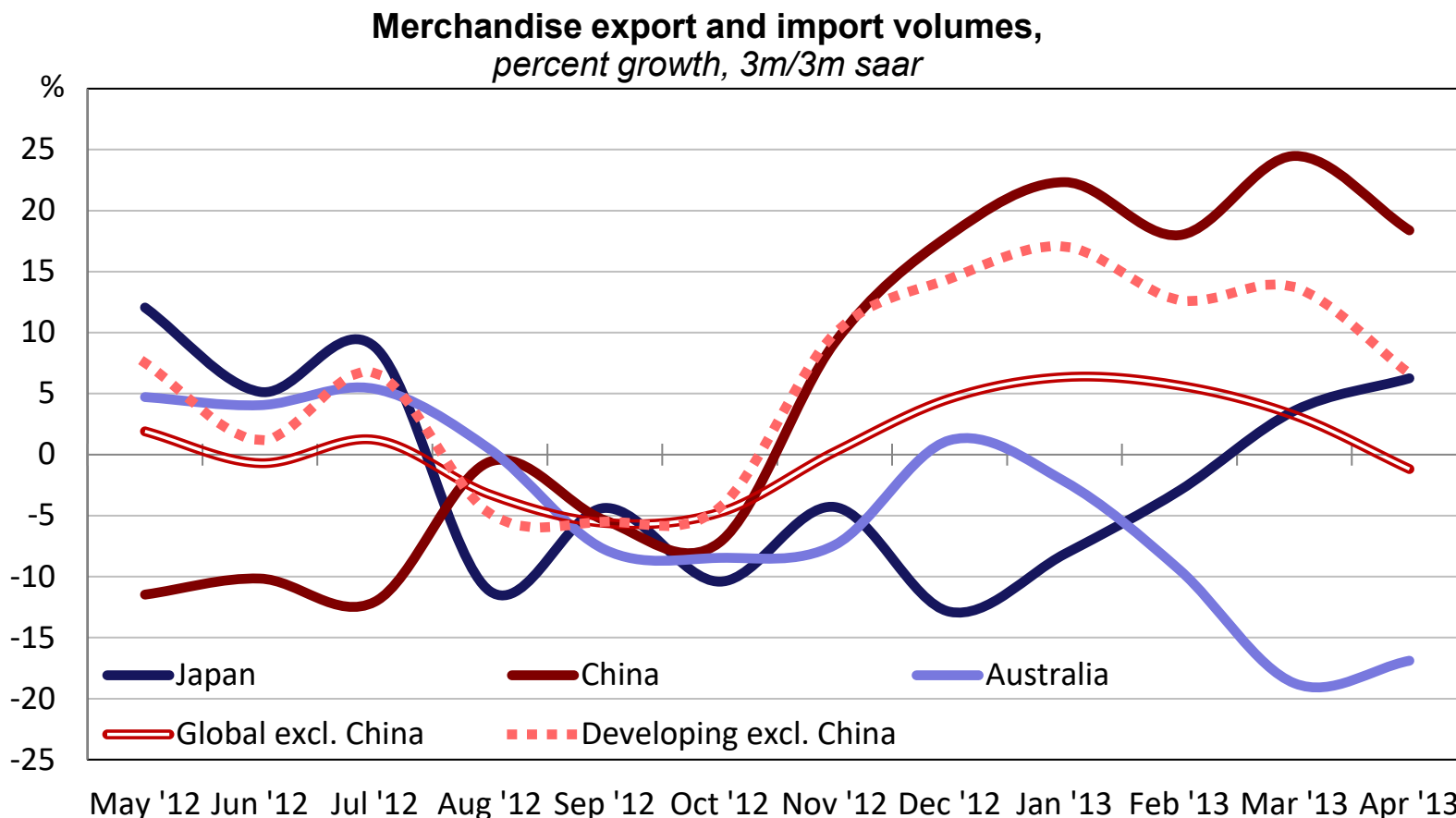
- ▶ 2013 outlook for developing economies is deteriorating; but is improving for advanced economies



Gloomier external conditions

...and trade flows are slowing

- ▶ Regional trade flows recovered earlier in 2013, although this recovery is also abating

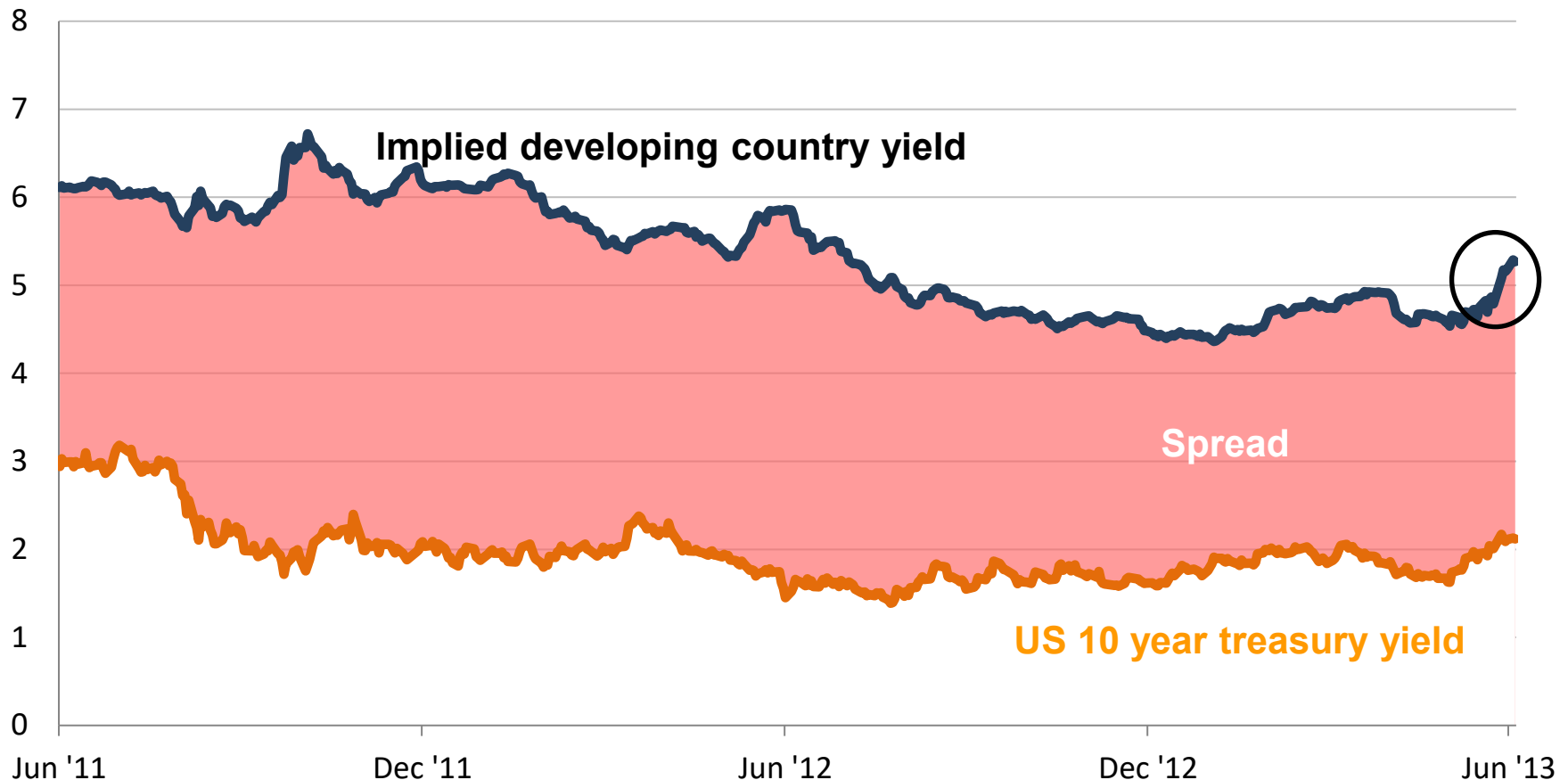


Gloomier external conditions

...and global financing is tightening as U.S. quantitative easing comes to an end

- Yields on international benchmark debt likely to rise as QE is withdrawn in the US

Sovereign 10 year bond yields, and spreads, basis points



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Sources: World Bank, Datastream, JP Morgan.

Gloomier external conditions

Commodity prices are key for PNG – so is this super-cycle over?

- ▶ ‘Hard’ commodity prices have risen faster than most prices over the past century
 - ▶ But around the long-run trend are medium-run “super cycles”
 - ▶ Generally **last 20 years** from bottom to peak
 - ▶ These are linked to industrializations and urbanizations
 - ▶ Higher prices induce more supply and better use of the resources available
 - ▶ ...and **then prices return to trend**
- ▶ **Current ‘super cycle’ started in the mid- late-1990s**
 - ▶ As China rebalances from investment-heavy growth to a larger consumer economy, commodity prices pressure **may shift from ‘hard’ commodities to ‘soft’**

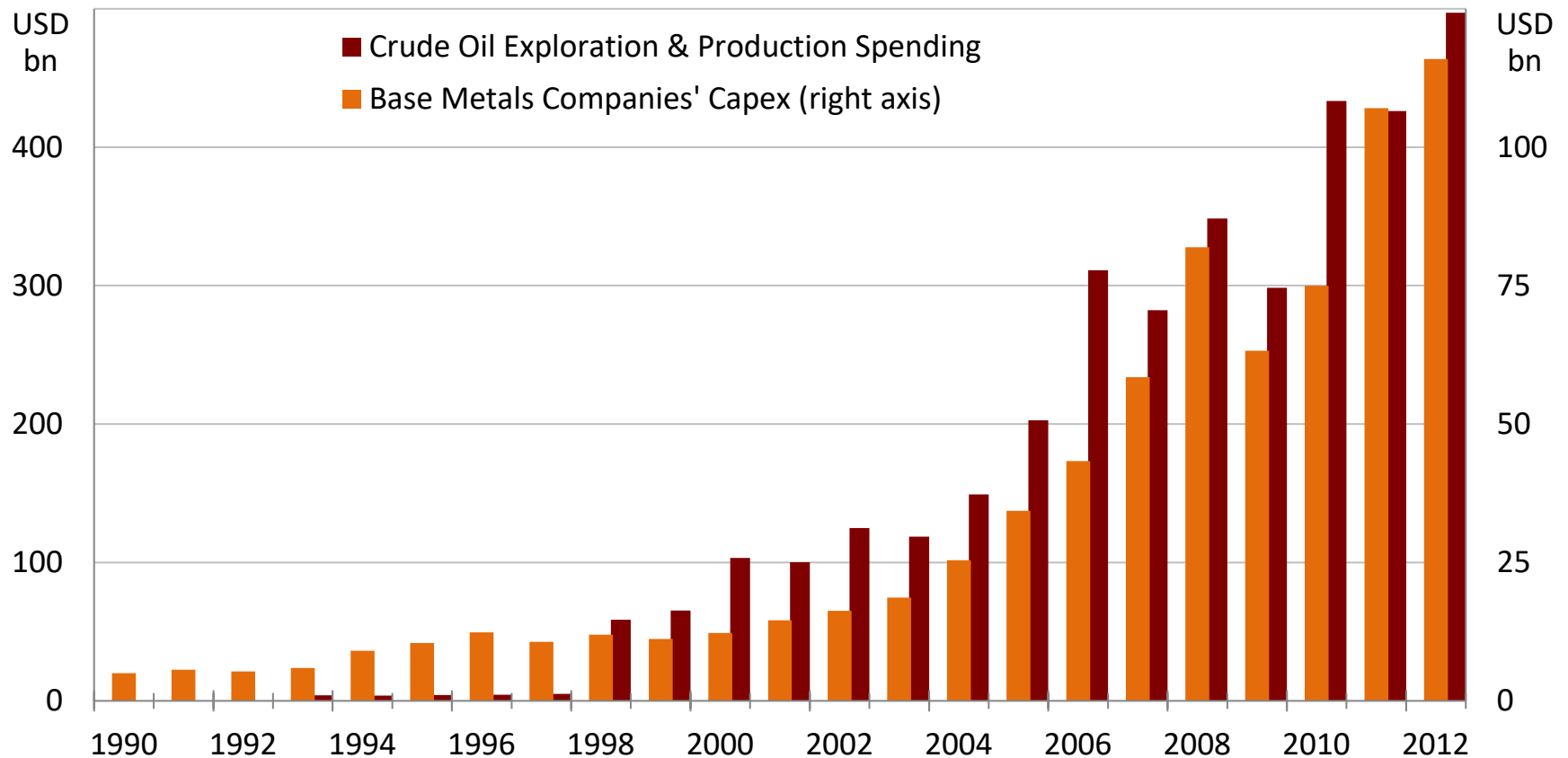
D. Jacks, NBER 2013, ‘From Boom to Bust: A typology of commodity prices in the long-run’:
- ▶ **PNG is well placed to benefit from both cycles**
 - ▶ But managing the volatility around the short- and long-run cycles is hard
 - ▶ The Kina remains a commodity currency – which can absorb shocks but generates its own challenges – eg, allowing the currency to weaken with commodity prices, without accelerating living costs
 - ▶ Supporting ‘soft’ commodity production demands **more from the public sector**



Gloomier external conditions

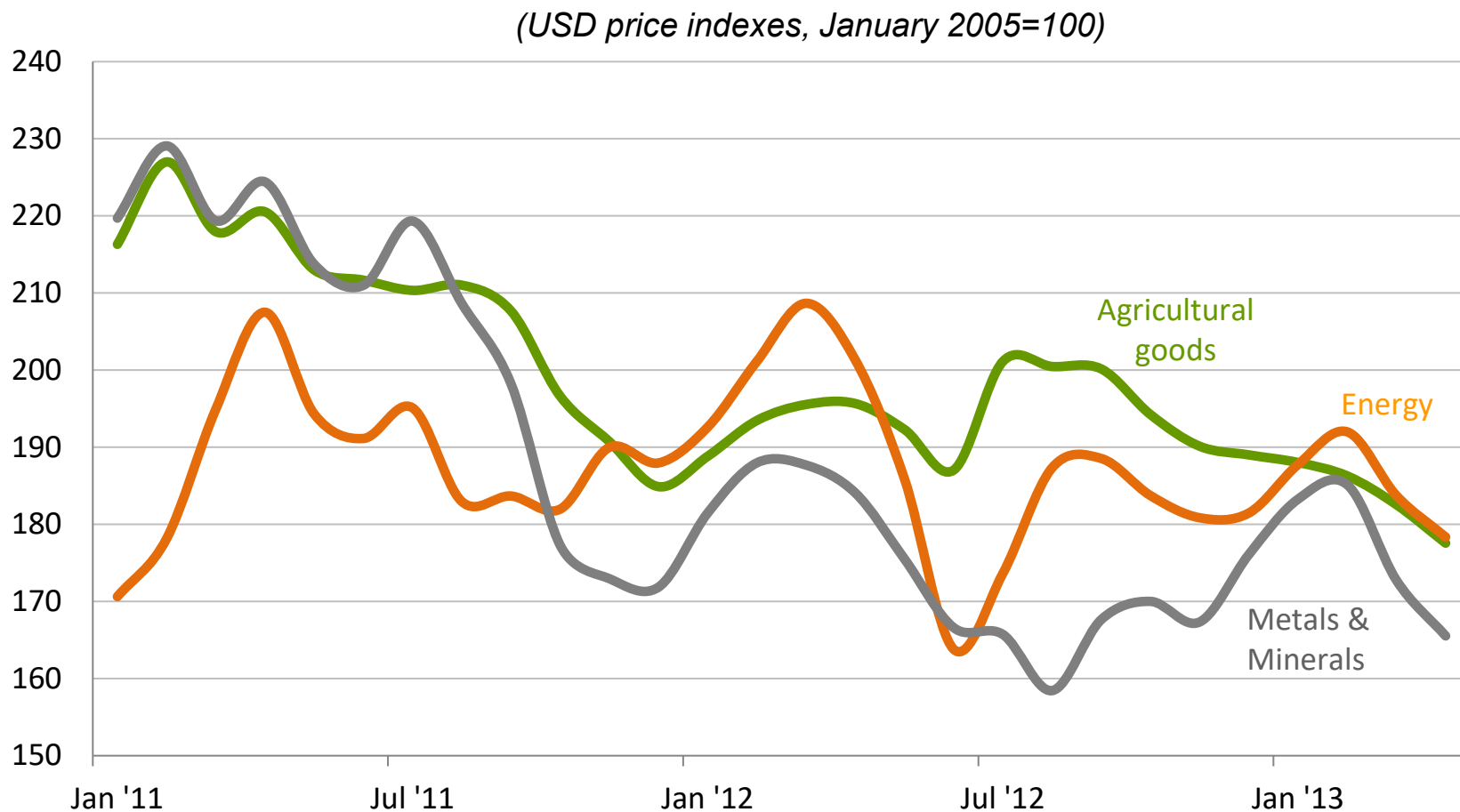
As global demand growth slows, massive investment in new supply comes on-line

- ▶ Global supply is responding to a 5-fold increase in resource investments
- ▶ Although much of this investment has been inflated into higher production costs



Gloomier external conditions

...and global commodity prices are responding to the new supply

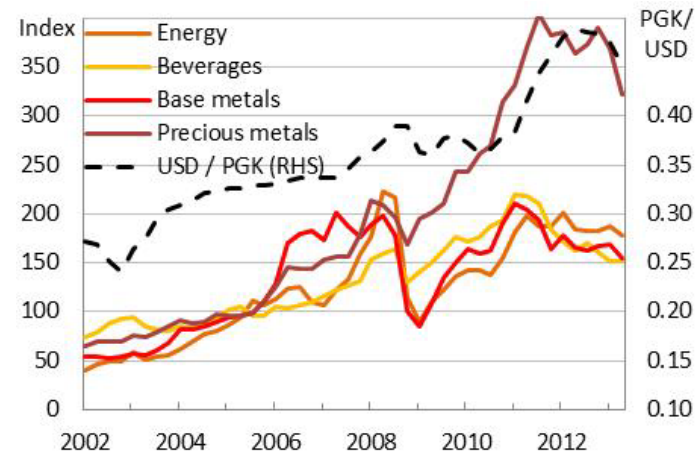
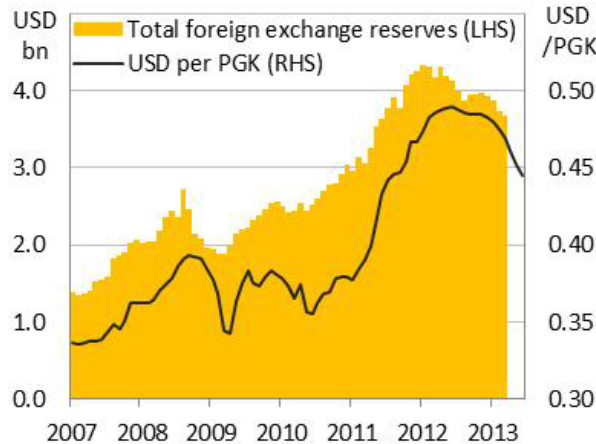


Transmitting into the domestic economy - 2013

What all this means for PNG

External drivers weakening...

- ▶ **Already external balances appear to be weakening**
 - ▶ In 6 months to June, against US\$: Kina 8.5% weaker (AU\$↓10.4%; IDR↓2.3%); and real effective exchange rate stabilized, though at historical highs
 - ▶ Total reserves: US\$ 3665m in March, ↓ US\$ 300m in 6 mths; ↓ US\$ 650 m in 12 mths

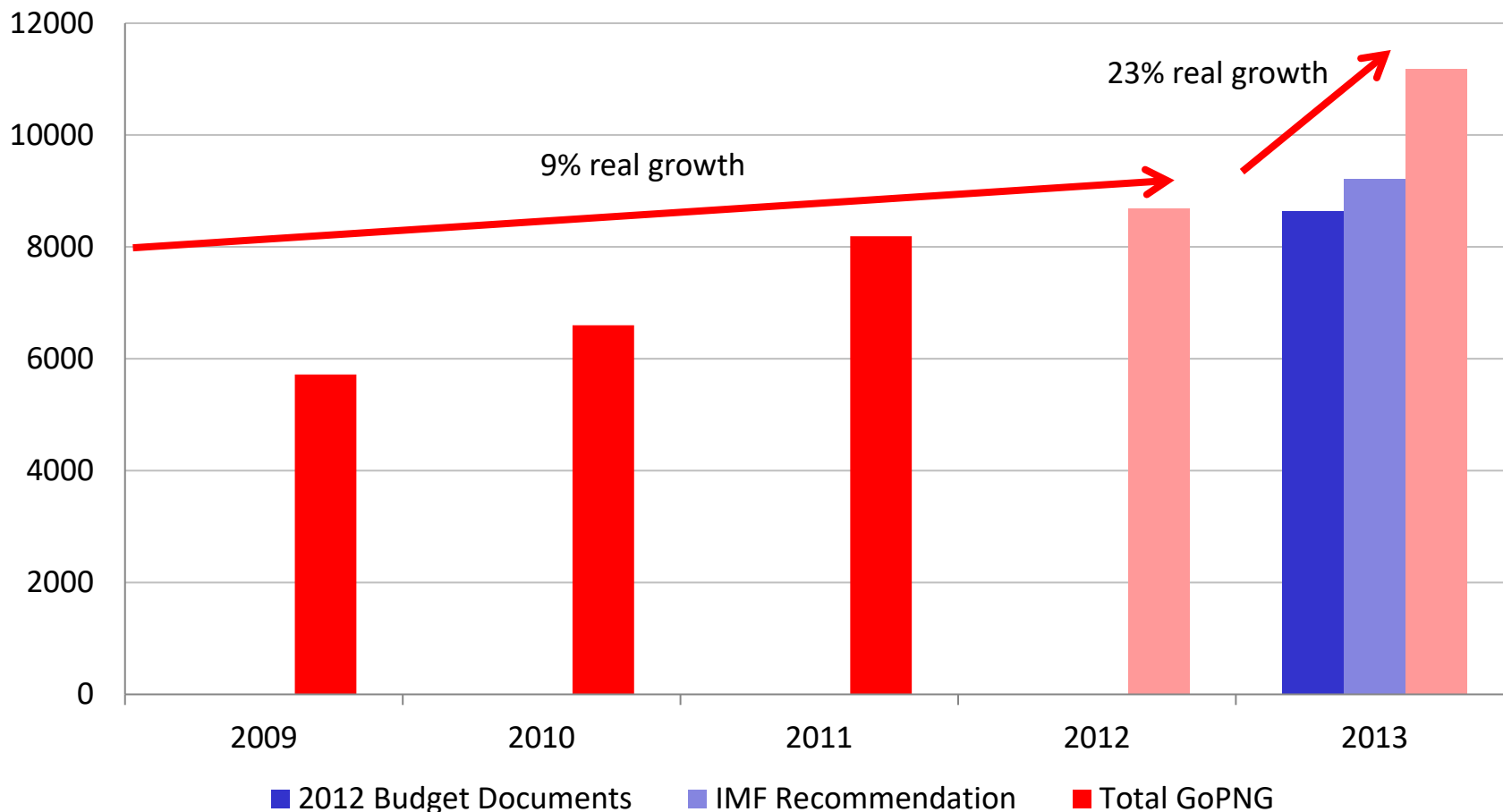


- ▶ **Why this might be happening:**
 - ▶ **Weakening export receipts, slowing FDI inflows**
 - ▶ **While imports remain strong**, funded by more government spending and redistribution, and retained earnings from the earlier boom
 - ▶ **Kina remains a commodity currency**
 - ▶ Trade-off between limiting imported goods inflation, while supporting rural incomes and defending a sustainable exchange rate

What all this means for PNG

Some support for domestic demand from government spending?

► Government has great spending ambitions for 2013



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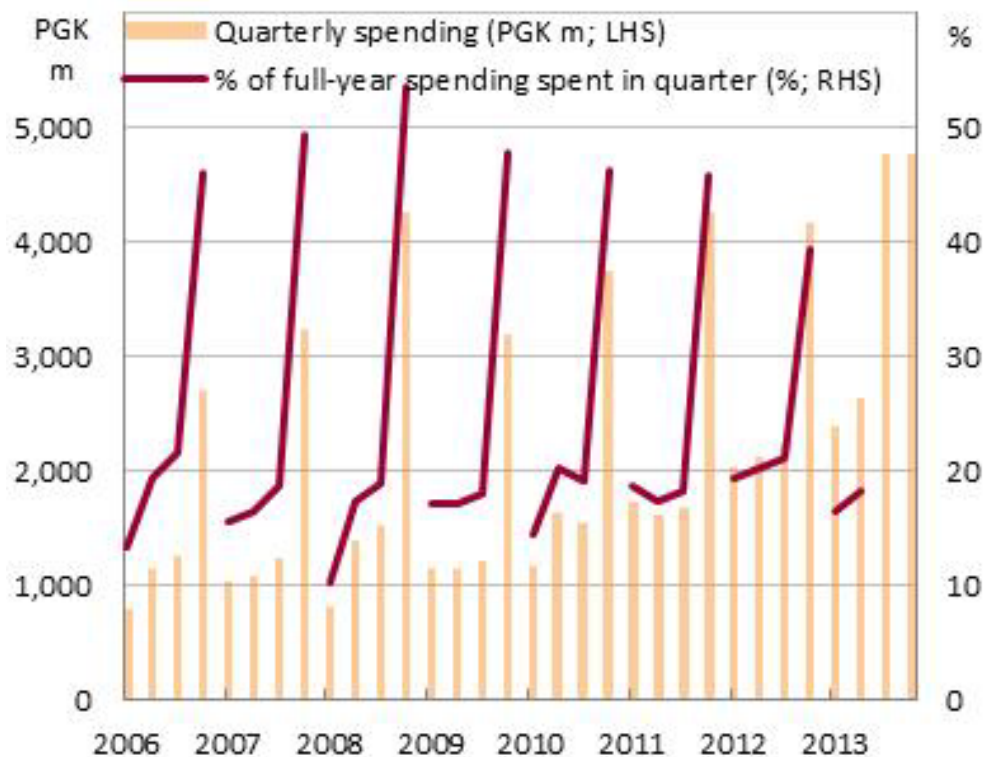
Source: Budget documents, AusAID Staff calculations

What all this means for PNG

Some support for domestic demand from government spending?

- ▶ But disbursement rates so far have been little improved from historical levels

Budget spending over the course of the year



Q2 projected from April spending; total 2013 spending based on total appropriation



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Source: BPNG, Treasury and World Bank staff calculations

What all this means for PNG

Overall all this suggests a slowing economy in 2013

- ▶ **Challenge of assessing in time where we are, without timely macroeconomic data**
 - ▶ Rely on a few partial indicators – and anecdotes – and discount the noise
- ▶ **Slower growth or weakening in externally-reliant & foreign investment-reliant sectors**
 - ▶ Eg, industrial suppliers report slowing, even lower demand
 - ▶ Supply constraints no longer the issue of 2010, 2011
- ▶ **Domestically-focused consumption sectors generally continuing to do well**
 - ▶ Firms supplying domestic consumers continue to invest in new capacity to meet booming demand, with some upstream spin-offs
 - ▶ But other indicators mixed – eg, financial transactions reportedly slower
- ▶ **So 2013 growth forecasts ~4% remain likely**
 - ▶ Treasury expects 6%; BPNG's liaison suggest slower; private sector weaker still
 - ▶ Remember to distinguish historically high levels of activity from further changes in level of activity
 - ▶ Remember to distinguish real volume of activity from value
 - ▶ Eg, US\$4 bn increase in PNG-LNG cost doesn't change the volume of construction

Transmitting into the domestic economy – the outlook

The outlook

PNG is already unusually reliant on external debt to fund investment

- ▶ **PNG foreign direct investments unusually reliant on external debt financing**
 - ▶ Exposed to higher cost of international finance as QE withdrawn
 - ▶ Combines with lower prices and cost inflation
 - ▶ Delay final investment decision and profitability of major projects (Eg- Warfi; Lihir)

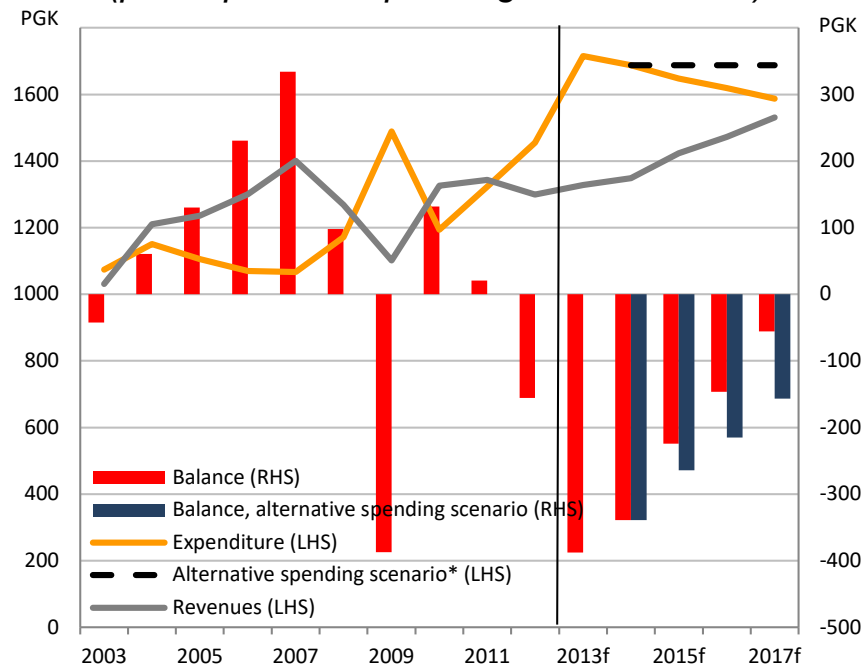


The outlook

MTFS and MTDS require government spending to slow

- ▶ **MTFS requires spending per capita to *decline* for the next four years**
 - ▶ Based on optimistic revenue and commodity price projections
 - ▶ Gold : 2014 US\$ 1605 / oz Today: US\$ 1200 / oz
 - ▶ Copper : 2014 US\$ 7866 / tonne Today: US\$ 6700/ tonne
 - ▶ Slower revenue growth would require sharper spending correction to return budget to balance by 2017 – yet expectations are for stronger spending

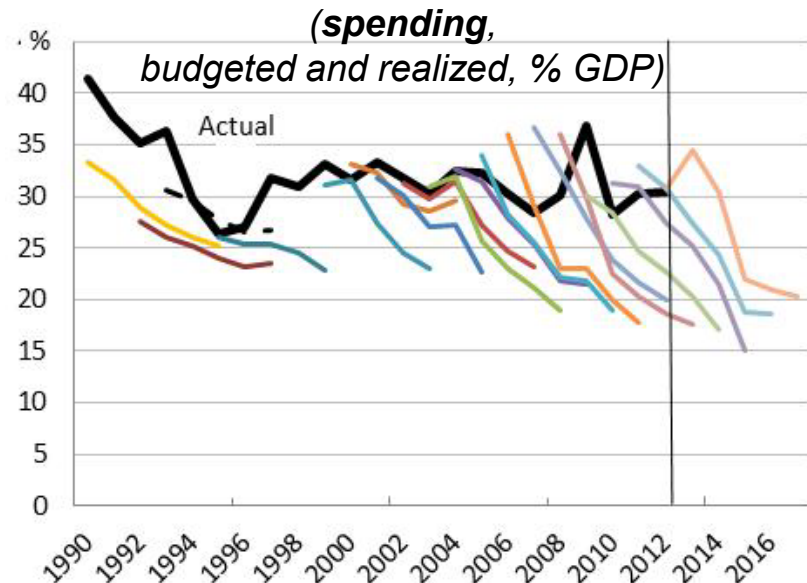
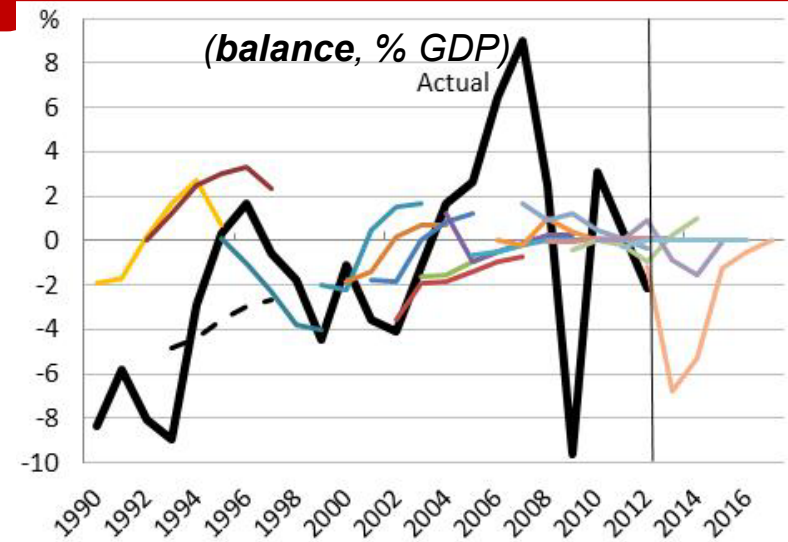
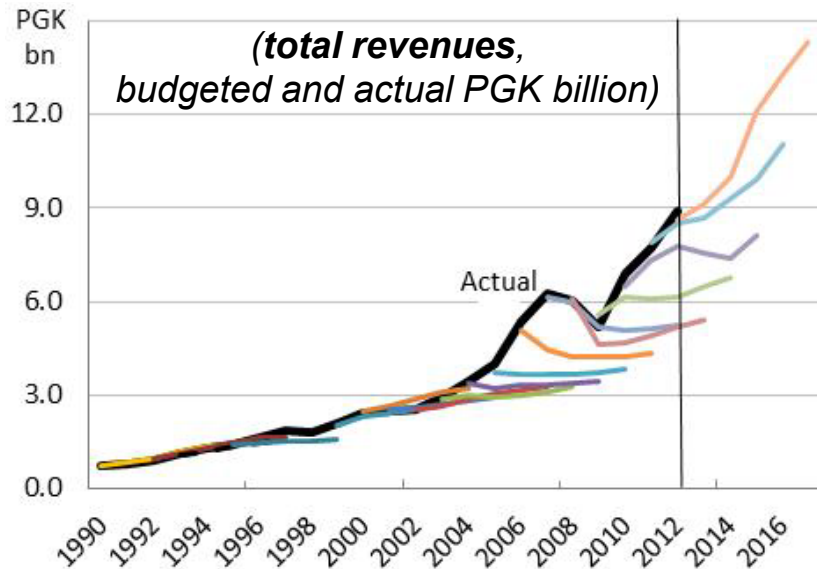
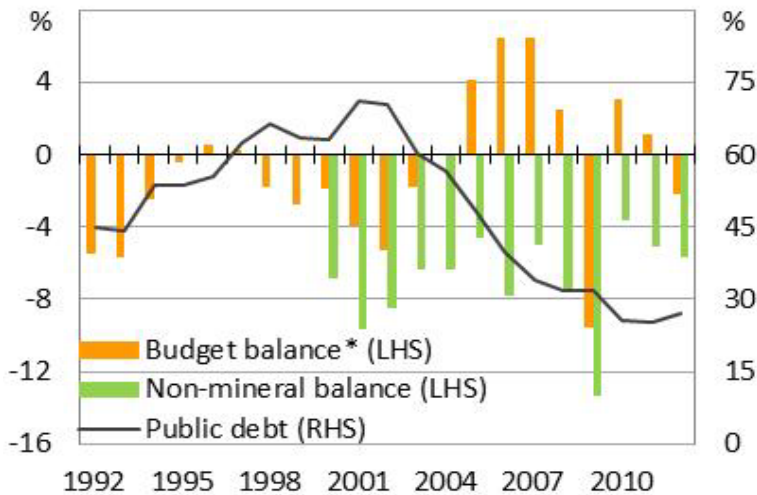
(per capita real spending and revenues)



The outlook

..otherwise PNG risks repeating its own history

► Risk of PNG repeating its own history?

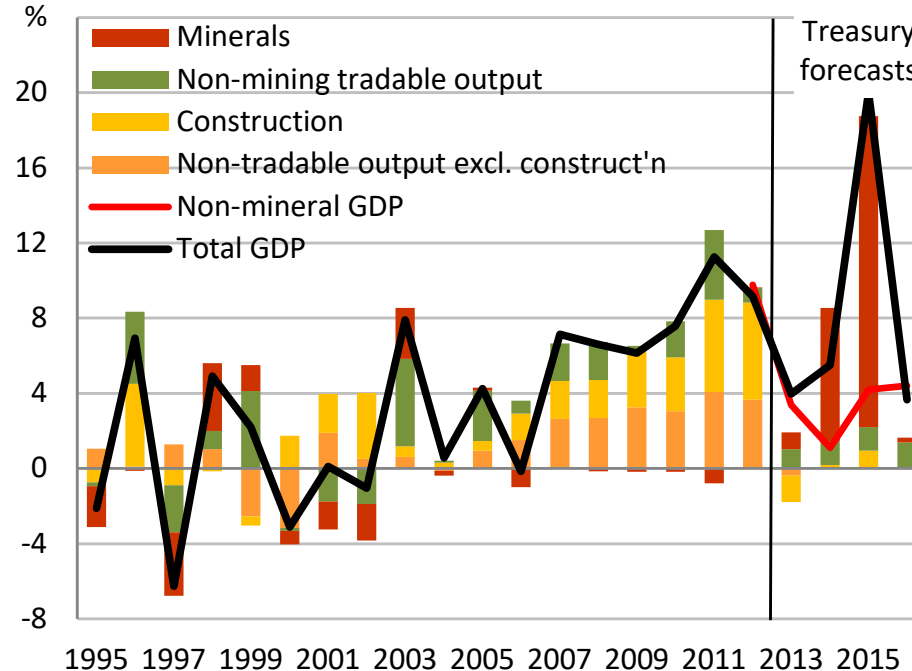


Sources: Treasury, IMF, World Bank

The outlook

GDP growth is set to slow markedly - abstracting from the start of LNG

- ▶ Together, these factors suggest markedly slower growth over the coming years
 - ▶ Excluding the impact of PNG-LNG on the headline GDP statistics
 - ▶ PNG-LNG real increase may be much larger than earlier forecasts, for technical reasons (mostly to do with how btu of gas are added to kilos of coffee and tonnes of copper ore)
 - ▶ This does not change nominal GDP, or ratios to nominal GDP (eg, MTDS)
(year-on-year output growth and contributions)



Generating sustained growth for all Papua New Guineans

Three opportunities

Seeds for lasting growth:

Three opportunities

1. Tackle what really makes it hard to do business in PNG

- ▶ If PNG joins the NRL it's not to ask the other teams to forfeit each game until Team PNG is up to grade, but to excel in what it does well and address the weaknesses holding it back

2. Informality and urbanization as an opportunity

- ▶ Informal activity is the fall back when people loose formal sector work
- ▶ Don't create hurdles to formalization; blur the line to make it easier for informal enterprises to develop, grow and formalize

3. Provide the complementary public goods and services

- ▶ Education, health and infrastructure are businesses' biggest concern
 - ▶ (not the stronger Kina or tax rates)
- ▶ Issues are as much as with implementation as resourcing
 - ▶ Not a call for more resources *per se*, but using the resources available more effectively – particularly given the fiscal risks



Seeds for lasting growth:

1. Support business by tackling what makes it hard to do business

While PNG ranks relatively well on a few indicators, in most areas regulation is holding PNG businesses back

(ranking of PNG, out of 185 countries)

Starting a business	Dealing with construct'n permits	Getting electricity	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency
91	159	23	88	83	49	106	120	166	125

- ▶ Small and medium enterprises are the largest source of employment and incomes across the world
- ▶ Closing markets to competition and providing subsidies is not a long-term solution to encouraging locally owned businesses in PNG.
 - ▶ Rather than working to reduce competition, policy makers' efforts would more effectively bring sustained improvements in living standards by working to improve -owned businesses ability to compete.
- ▶ The kinds of reform that will reduce costs for PNG businesses and increase their competitiveness are not expensive, and they are not difficult.
 - ▶ Some key reforms are already underway
- ▶ Business-enabling reforms provide an environment that will **increase the impact of the government's wider reforms**, and help PNG-owned businesses to can make the most of the spin-off opportunities presented by large investment projects



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Note: Describes conditions for businesses in the capital city of each country.

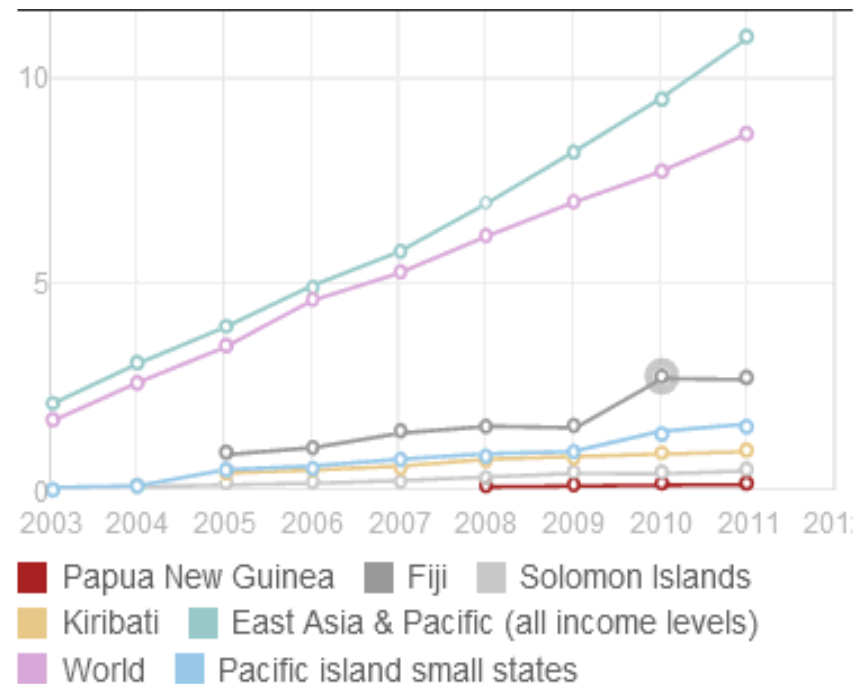
Source: 2013 Doing Business Survey

Seeds for lasting growth:

1. Support business by tackling what makes it hard to do business

- ▶ **Good example of recent reforms in telecommunications and ISP regulation**
 - ▶ Minister for Communications and IT's the international submarine cable transmission capacity and gateway are wholesale services
 - ▶ Breaks Telikom's monopoly
- ▶ **Simple change in the regulation allows firms to grow and new firms to enter**
 - ▶ Reduces costs for all other business and households in PNG
- ▶ **Similarly, cost of trade and logistics:**
 - ▶ PNG ranks low...
 - ▶ Because of hard infrastructure or soft processes (or both)?
 - ▶ Which is cheaper to address?

(broadband internet subscribers per 100 population)

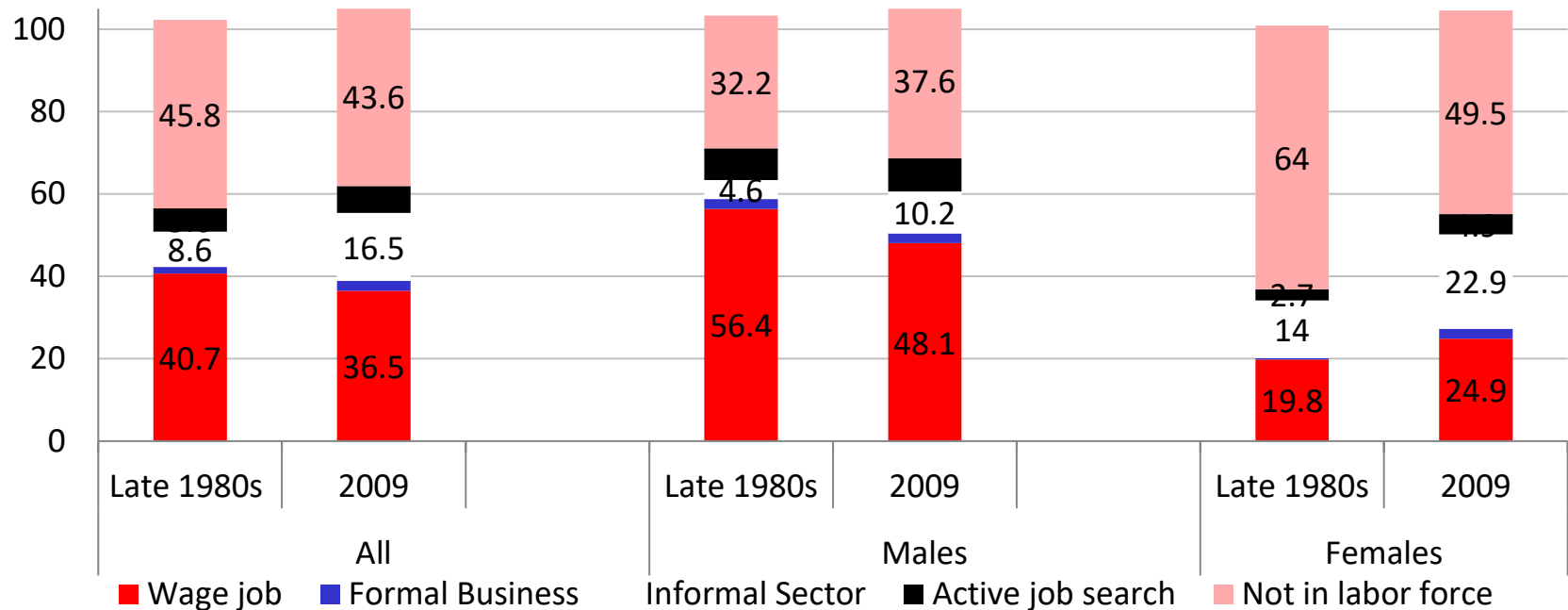


Seeds for lasting growth:

2. The opportunities in informality

► Informal sector has an expanding role in PNG's urban areas between 1980s & 2010

(Percentage of working aged population: NCD)



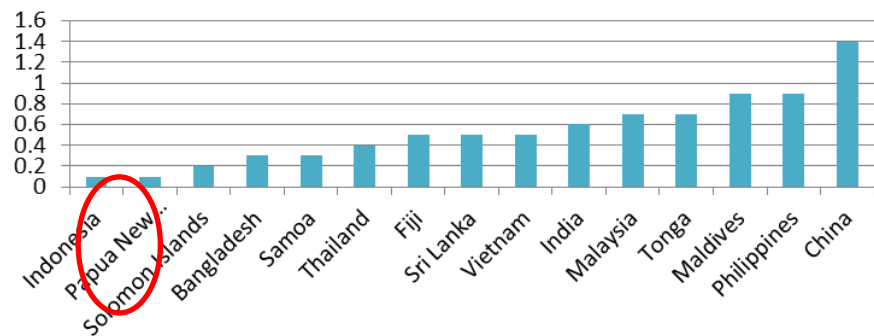
- Seems to be an inevitable part of urbanization and rising aggregate incomes – informal sector is a driver of urbanization
- Manage this through **integration** between formal and informal, **intervention** to supply services to the informal sector, and **institutions** that support the informal sector and make it easier to transition towards formality

Seeds for lasting growth:

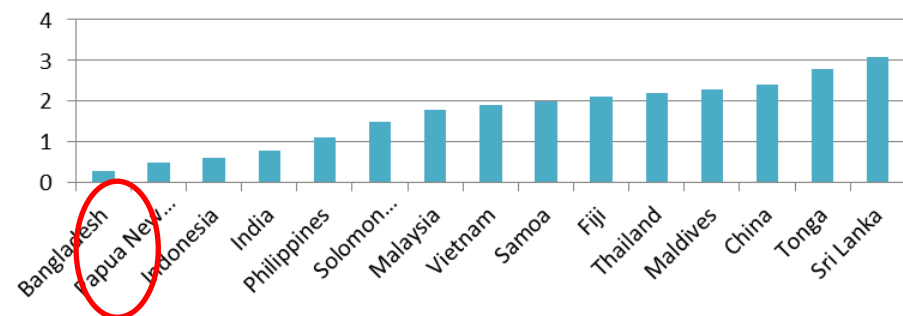
3. Provide the complementary public services & goods (recurrent health, education)

- ▶ Eg, health care: Low inputs per capita
- ▶ Poor outcomes relative to income

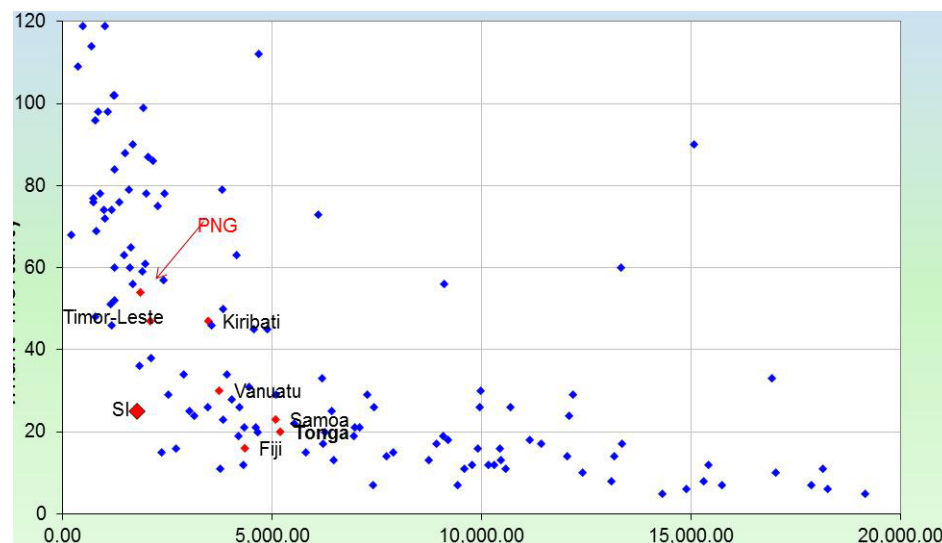
Doctors per 1000 population



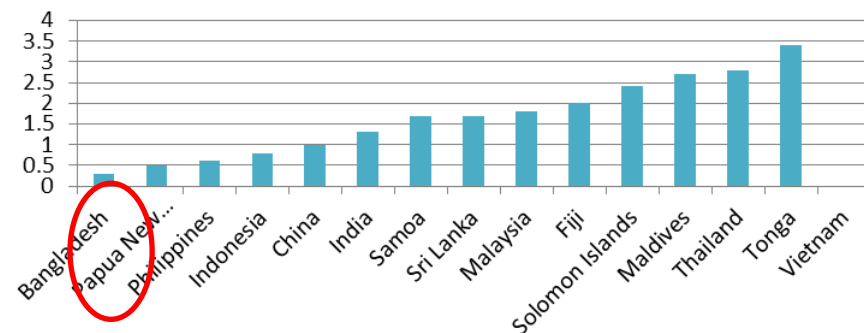
Health facility beds per capita



(infant mortality and income per capita)



Nurses and midwives per 1000 population



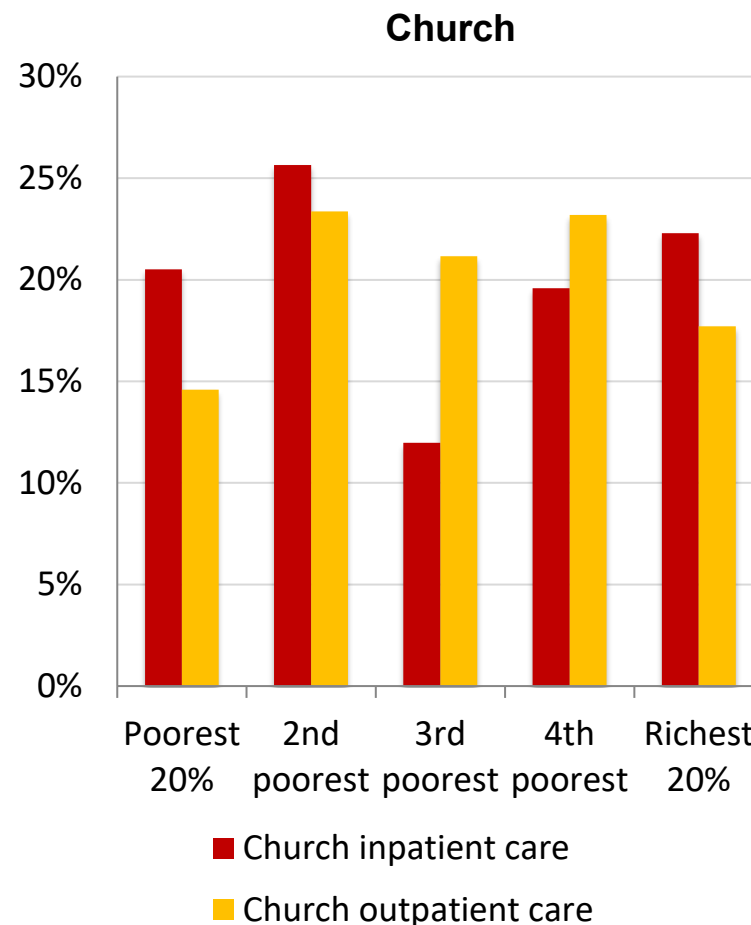
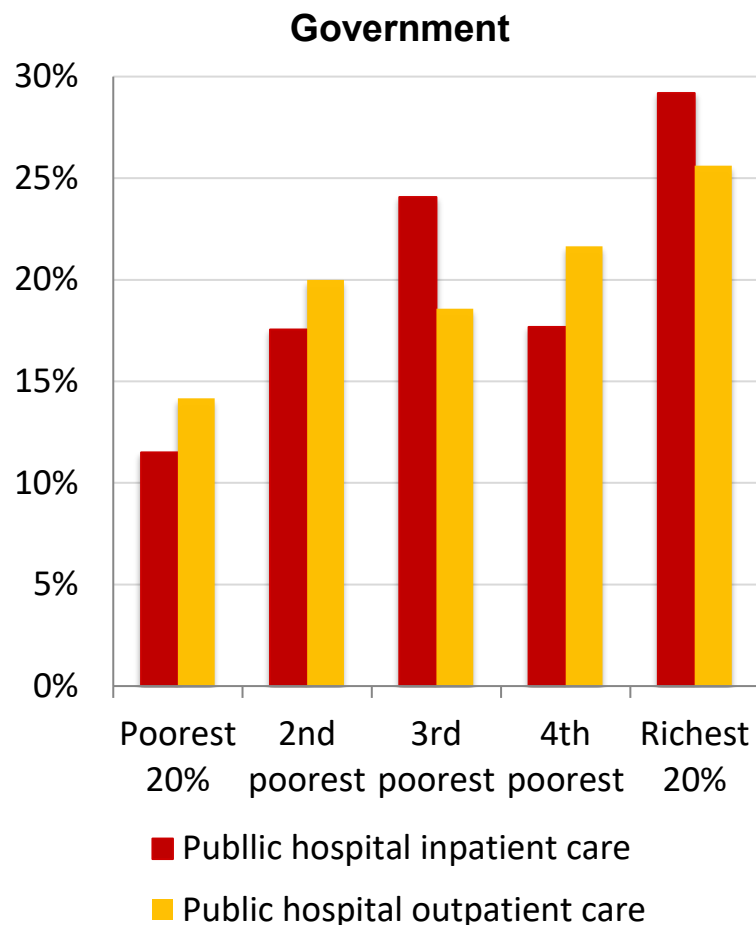
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Sources: World Development Indicators, World Bank staff

Seeds of an ongoing boom:

3. Provide the complementary public services & goods (recurrent health, education)

- Eg, health care: large inequalities in the access and use of the public system

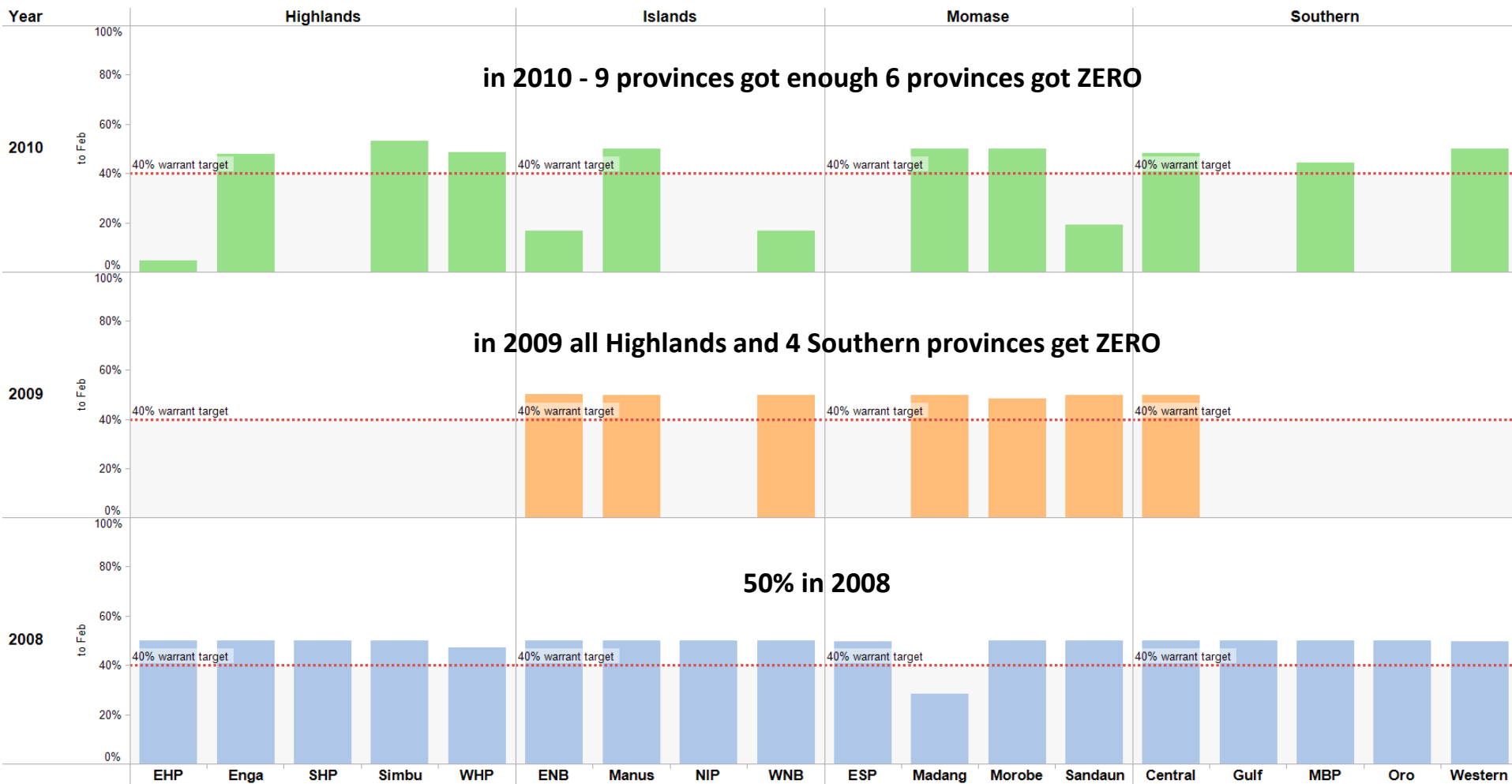


Seeds of an ongoing boom:

3. Provide the complementary public services & goods (recurrent health, education)

► A lot of the issues are with how things are done, not with resources

► Eg, Release of Health Function Grants funds is inconsistent and not timely

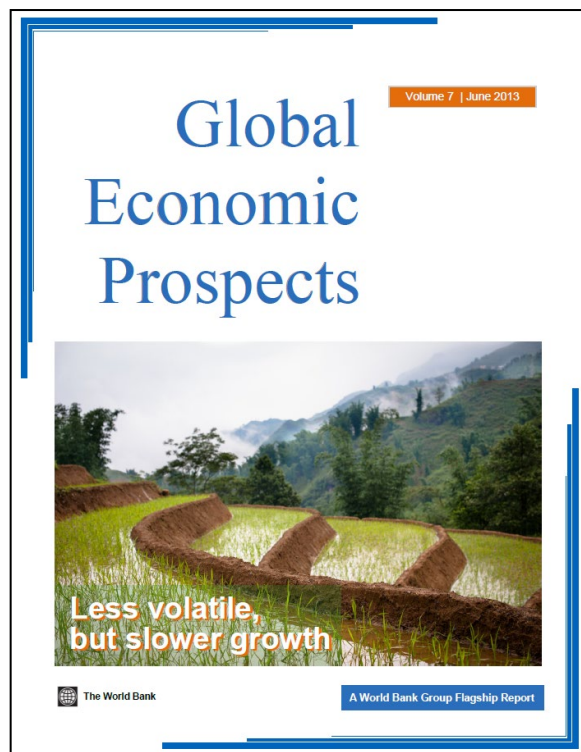


Source: Alan Cairns, 2013, 'Below the Glass Floor'

Papua New Guinea Economic Update

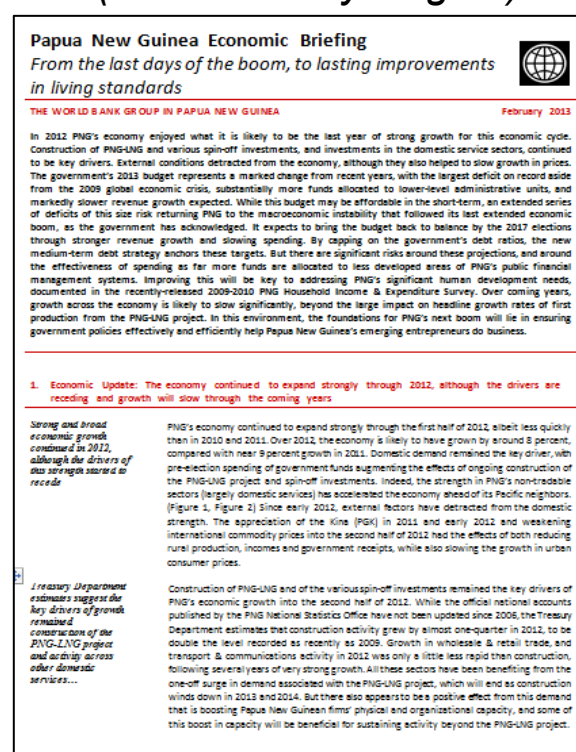
Linking PNG to global developments

Global Economic Prospects June 2013



www.worldbank.org/gep

PNG Economic Briefing (next due July/August)



www.worldbank.org/png

And most of the data here can be found at www.worldbank.org



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Features of the 2013 budget

...addressing weaknesses in the current system?

- ▶ Various initiatives in the 2013 Budget to start addressing these issues:
 - ▶ Better costing of projects, including publishing **5-year forward estimates** of spending and revenues
 - ▶ **Expanding the chart of accounts** (by which spending is classified) through Provincial to District authorities
 - ▶ Shift to funding well-formed national, provincial and district **plans** rather than public investment plans (PIP).
 - ▶ New **guidelines for the use of DSIP funds**
 - ▶ **Integrate the development and recurrent budgets** into a single national budget from 2014
 - ▶ Invest in **rolling out the new Integrated Financial Information System** across national departments and to subnational governments
 - ▶ **Increase transparency** around spending through decentralizing the responsibility of spending.
 - ▶ Develop subordinate legislation, policies and processes around the PNG Sovereign Wealth Fund (**PNG SWF**).

