Keynote Speech at the ANU-UPNG hosted PNG Update 2023 Conference by Acting Assistant Governor, Mr Jeffrey Yabom on behalf of the Acting Governor, Ms Elizabeth Genia.

Theme: Resilient and Diverse Development

On behalf of the Board, A/Governor and Management of the Bank of Papua New Guinea, I thank the vice chancellor and pro-vice Chancellors of the University of Papua New Guinea (UPNG), the Executive Dean and faculty members of the School of Business and Public Policy of UPNG, and the Australian National University's Development Policy Center for hosting this important annual conference for 2023.

I am inspired by the spirit of collaboration among the best minds of today at this forum to discuss feasible development strategies to address contemporary socioeconomic issues, and chart the course for long-term economic development. The theme of the conference "Resilient and diverse development" well encapsulates the fundamentals for sustainable economic growth and development. This is an interesting theme that encompasses development issues from a wide range of perspectives in social science and science. I am supremely confident that the policy implications and lessons drawn from the series of research presentations and the corresponding discussions in this conference should be enlightening and impactful.

Excellences, Ladies and Gentlemen,

I now want to share a few thoughts on building a robust economy that is resilient and diverse for ourselves and the future generations, beginning from where we are now to where we envision to be. My views are strictly from the economics perspective.

Being a small-open economy, PNG heavily depends on international trade for national income, and imports for consumption of consumer and producer goods. Apart from the non-renewable resource sector, the agriculture sector has played the crucial role of supporting the economy since Independence in 1975. The large majority of the country's population depend on the agriculture sector for income and food. Unfortunately, this sector which was once the backbone of the economy has declined over the years. This is a grievous concern that requires cohesive structural policy approaches to revive the sector. PNG has the right climatic conditions, arable land mass, and abundant supply of labor that gives us a comparative advantage over our peers to boost the quality and quantity of production and exports of agricultural commodities. What we need are long-term investments to commercialize the sector.

I guess some might ask, why commercializing or promoting down-steam processing in the agriculture-fishery-forestry (AFF) sector should be the first step to achieving economic diversification and harnessing our comparative advantage?

Well the two possible answers are: first, since more than half of the population rely on the AFF sector, increase in production and income generation in this sector will boost spending which will support activity and diversification of businesses in other sectors. Second, higher household savings will raise national savings, thereby boosting capital accumulation in other productive economic sectors. Let us say for instance, a rough estimate of two (2) million households in PNG live in this sector depend on agriculture, forestry and fishery, and supposing everyone makes a minimum K2,000 per year purely from production and sales of cash crops and other export commodities. This would raise an estimated K4 billion or higher annually, increase private savings and improve living standards of our people as well as bring in export revenue to support our import needs. We have all being talking about this sector for so many years and sad to say that production in most of our major export commodities such as coffee, cocoa, copra have dropped significantly since the 1980s and are in desperate need for support. The AFF sector needs to be given priority because of its positive impact on the wider population and export earnings to support our import needs and provide the catalyst for diversification in other sectors.

Furthermore, economic diversification must also reflect local ownership of businesses promoting the theme, "Take-back-PNG". With more domestic savings, we can empower national entrepreneurs in down streaming businesses. The value-added gains generated should raise domestic savings and wealth that are essential for long term growth. Having a diversified economic base driven by import substitution and exports of finished products would enhance the country's resilience to both internal and external shocks – i.e., domestic wealth smoothens consumption and output during economic downturns.

However, as I stated at the outset, economic diversification can only be realized through cohesive policy reforms to address the inherent structural challenges, such as removing market impediments, strengthening institutions and governance, and improving public infrastructures. Against this backdrop, I want to highlight the main contributions of the Bank of PNG through the financial sector development towards economic diversification.

Financial sector development plays a pivotal role in effectively mobilizing savings and create investment opportunities, which leads to capital accumulation and technological progress. Over the years, the Bank of PNG has been delivering policy initiatives and financial infrastructures to address market inefficiencies in the financial sector. The notable contributions are financial inclusion, modernization of national payments system, and the current development of the secondary market for government securities. These measures aim at bring the unbanked population into the formal banking system to access financial products and services that can help them to hedge against business cycle risks – i.e., during economic downturns, people can use their savings or borrow to smoothen their consumption levels.

Moreover, the central bank took on extra tasks that are not directly related to its key mandates, such as establishing the Credit Guarantee Scheme (CGS) to support Micro, Small and Medium Enterprise businesses access formal credit, and Financial Intelligence Supervisory roles to enforce the Anti-Money Laundering and Counter Terrorism Financing Act 2015. In particular, when the CGS becomes fully operational, it will significantly empower the start-ups and existing businesses owned by local entrepreneurs to take off. On top of that, the Bank recently launched the country's inclusive Green Finance policy in June 2023, which recognizes the pathway in the financial sector to a greener economy for a resilient future.

Distinguished Participants,

I want to admit that the Bank has also faced numerous challenges that have limited its ability to effectively achieve its mandated objectives of price stability and supporting growth and employment in the non-mineral sector. The main issues are lack of monetary policy transmission, and persistent imbalance in the foreign exchange (FX) market that have been affecting economic activities in recent years. You will notice that the interest rate margin between lending and deposit rates has remained high around 7 – 8 percent for quite some time, implying that banks make more money from deposits without remunerating the depositors well. Our policy efforts to addressing this interest rate spread has been hindered by excessive liquidity in the banking system mainly driven by successive fiscal deficit spending. The spillover of this liquidity into imports in turn contributed to the persistently high demand for foreign currency more than offsetting its corresponding supply in the FX market. Since the economy is fully reliant on imports for consumer durables and intermediate inputs, the situation in the FX market bears heavily on domestic economic activities.

One point that I want to stress is, with the Project Development Agreement in place, the surplus trade balance arising mainly from the LNG exports has yet to translate into consistent foreign currency inflows. This has left the economy at the mercy of foreign currency inflows mainly from exports of agricultural commodities. That exemplifies the need for economic diversification drive by both export oriented and import substitution activities to provide lasting solutions to the FX issues we currently face. Meanwhile, the FX market has been running on a life support from Bank of PNG FX intervention. However, this life support is becoming unsustainable and drastic policy measures needs to be undertaken as soon as possible to put the economy back to the path of macroeconomic stability.

I will now turn to broadly touch on the two major reforms undertaken with respect to the Central Bank. First, by the Government in 2021 to modernize the Central Bank to reflect the changes in economic developments and adapt to international best practice. After two (2) decades, the Government amended the Central Banking Act 2001 with the aim to realign the Bank's operations to international best practices of present era. The main amendments included dual objectives of monetary policy (promote price stability, and growth and employment in the non-mineral sector), granting of full policy decision-making power to the Board, and an increase in direct financing of Government budget. Generally, the reforms undertaken were good to ensure dilution of power vested to the Governor, improve transparency and good governance, and improve the efficacy of policy design and implementation. The second phase on the reforms focused on the regulatory and supervisory roles of the Central Bank. The review of the functions of the Central Bank in this area as well as the financial sector are important to ensure the stability and development of the financial sector, and providing efficient services to the public. While the Bank fully supports these important reforms, it is also important to mention that maintaining Central Bank independence is paramount.

While the change had positive benefits, it created new challenges with regards to the efficiency of policy decision-making processes, and direct government financing. The second-phase of the review, which is in its final stage also attempts to address some issues in the first amendment, to empower the central bank to perform its functions effectively.

The second reform is the current IMF program to which the government has entered into in March 2023, mainly for budget support rather than the conventional arrangement for balance of payment crisis purposes. The program has stringent conditions in the form of structural benchmarks and quantitative targets that the Government and Bank of PNG must meet to qualify for each tranche of funds to be realised. A total of US$ 918 million is expected to fund the reforms. The important reform on the part of the Government is to move into Budget consolidation in the medium term to achieve a balanced budget and reduce budget deficits. On the part of the central bank, the program requires critical reforms to the monetary and exchange rate policy frameworks. The monetary policy reform focuses on linking the policy rate to the market interest rates to improve the transmission of monetary policy to domestic interest rates, including the lending and deposit rates. For instance, if the central bank reduces its policy interest rate, that should influence other market rate to decline to make borrowing cheaper for firms and households. The transmission of policy is important to support the broader objectives and policies of the Government including the diversification of the economy by influencing the borrowing cost of credit. With regards the exchange rate framework, the program requires the Bank to adopt an exchange rate arrangement that can restore flexibility in the exchange rate to address currency overvaluation. The expected depreciation of the kina determined by the market fundamentals of supply and demand will allow the exchange rate to fall from its current overvalued level to its market equilibrium level overtime. This will try to restore both internal and external balance. Such a depreciation of the exchange rate to bring about the balance and support growth in the export industries including the AFF sector – i.e., eliminating overvaluation should make PNG's exports more competitive, which should support economic diversification efforts. The weaker kina will of course have inflationary impact, however this process will be measured and carefully implemented to ensure that inflationary impact is contained – as imports become expensive and expenditure switching should lead to expansion in domestic output.

Looking back at the history shows that we must harness our comparative advantages and invest in the right sectors that will set the course for economic diversification to take place. In deed there are challenges, but, I believe that now is the opportunity to forge the pathway to take us from where we are to greater stability and prosperity.

Thank you!