BPNG changes tack, but will it follow through?

By Stephen Howes
8 September 2023

Less than two years ago, the Bank of Papua New Guinea (BPNG) was insisting – in its September 2021 monetary policy statement, for example – that the kina was floating and that there was no rationing of foreign exchange. These statements made no sense at the time and damaged the central bank’s credibility. In surveys, businesses have repeatedly said that foreign exchange shortages are their number one concern, and the inter-bank kina-US dollar rate was unchanged from February 2022 to May 2023, a complete impossibility in a floating regime.

Fortunately, things have improved this year, with three speeches from BPNG providing a much more credible and honest account of the reality on the ground, and, for the first time, setting out its plans to reform its economic management.

The first of these three speeches was by the Chair of the BPNG Board, Mr David Toua, on 24 May this year. The second was by Acting Governor Elizabeth Genia at the PNG Business Advantage Forum in Brisbane on 10 August, and the third was delivered on the Governor’s behalf by Acting Assistant Governor Jeffrey Yabom at the PNG Update the following week on 17 August.

Taken together, these speeches mark a complete break with the past. I’d highlight four points.

First, there was a frank admission of the problem of rationing. Toua said, “BPNG is well aware of the issues faced by business in accessing foreign exchange”.

Second, there was, for the first time, an acceptance that the exchange rate was not floating, but rather, as Toua put it, that BPNG was “maintain[ing]” the currency “at a certain level”.

Third, whereas Toua restricted himself to stating the problem, Genia and Yabom went further, starting to sketch out the possible solution.
Genia stated that rationing cannot continue. She talked about “necessary adjustments need to realign the kina supply with demand” but “ruled out a sharp devaluation”.

Yabom went further, explicitly stating that the exchange rate was overvalued, and saying that depreciation was required:

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 over time.

In his spoken comments, Yabom distinguished between devaluation and depreciation, ruling out the former as the Governor did (meaning no large, sudden drop in the value of the kina) while allowing for the latter (that is, a gradual fall over time). This may not reflect the conventional usages of these terms, but is a useful way to communicate the bank’s intentions.

Fourth, Yabom for the first time injected some urgency into the discussion by saying that the foreign exchange market was “on life support” and talking about the need for “drastic policy measures” (and not only in relation to the foreign exchange market).

It is very welcome to see this change of tack by BPNG, and a much more transparent and honest approach. But is this new approach only rhetorical, or is it also being matched by action? BPNG has this year been releasing more foreign exchange into the market. But ruling out a large devaluation is inconsistent with the idea that drastic measures are needed. It is significant that, after holding the kina steady against the US dollar for so long, BPNG has devalued the former by 2.1% against the latter since May. However, the kina has actually appreciated against the Australian dollar by 2.7% over the same period, simply because the latter has weakened against the US dollar. So, on a trade-weighted basis, the local currency may actually be appreciating.

It is encouraging that BPNG has, at last, admitted that there is foreign exchange rationing and that this needs to end. But words need to be matched by action, and to judge whether the actions are adequate there needs to be a clear target, which is currently missing. No one knows what the equilibrium exchange rate is, and floating the kina is out of the question given the pent-up demand for dollars. The logical next step would be to announce a deadline for the elimination of foreign exchange rationing. Once that target is in place, BPNG could deploy the two instruments it has – the release of foreign exchange reserves and the depreciation of the kina – to achieve it.

*Correction (7/9): The second last paragraph has now been corrected to say that the*
Australian dollar has recently **weakened** against the US dollar not **strengthened**, as erroneously stated in the original.

**Disclosure**

*The author is a member of the [Independent Advisory Group on the Central Banking Act 2000](https://devpolicy.org/bpng-changes-tack-but-will-it-follow-through-20230908/). These represent his personal views.*

**About the author/s**

**Stephen Howes**

Stephen Howes is Director of the Development Policy Centre and Professor of Economics at the Crawford School of Public Policy at The Australian National University.

Link: https://devpolicy.org/bpng-changes-tack-but-will-it-follow-through-20230908/

Date downloaded: 27 February 2024