There have been two recent, positive economic policy developments in Papua New Guinea. First, on 20 May, the Treasury Secretary Mr Dairi Vele announced that a budget review is underway. The review comes after dramatic falls in world commodity prices that have affected government revenue and PNG’s international credit rating. The likely budget cuts will of course be difficult but there is little option if PNG wishes to maintain its macroeconomic stability and growth.

The second positive development was hidden away in a monthly statistical update [pdf] released on 11 May by PNG’s central bank, BPNG. This stated that “The temporary arrangement with the Treasury Department for the Bank to purchase the under-subscriptions (slack) in Treasury bill and Inscribed stock auctions ceased at the end of the March 2015.” Sounds technical and boring but it is a major development that reverses the approach taken back in September. Essentially, it means that BPNG will not simply print money to fund PNG’s growing budget deficits (see below).

This is a very constructive step and BPNG are to be congratulated for such a stance, which is consistent with its charter as an independent central bank. The previous policy led to significant inflationary risks – and PNG’s headline inflation rate had already moved to 9.5 per cent in March 2015.

These two positive economic policy developments occurred against a backdrop of some very worrying economic news for PNG. On 18 May, Moody’s credit ratings agency moved PNG’s sovereign credit rating to a negative outlook. This is a significant blow, and lowers the chances of PNG being able to borrow abroad to fund its large fiscal deficits. PNG retains its “B1” rating but these grades are very different from school grades – a “B1” is in fact four ratings below investment grade (the “junk bond cut-off”) and 13 ratings below the top grade for countries such as Australia and Singapore. PNG joins 13 other countries in the world on a negative rating outlook. The two other countries with B1 negative outlook ratings are Lebanon and Montenegro – not great company. The successful commencement of the PNG
LNG project should have been an opportunity for PNG to lift its credit rating.

Moody’s credit analysis gave two reasons for the shift to a negative outlook. First, the widening of fiscal deficits since 2012 have already breached the ceiling of 35% of GDP public debt, as prescribed by the (amended) Fiscal Responsibility Act. Moody’s analysis states:

*Government revenue will fall short of the medium-term projections in the 2015 budget due to the impact of lower prices for petroleum, natural gas, and other commodities on royalties, dividends, and the profitability of associated companies. However, the government has not formulated a policy response that would realign expenditures to conform to the planned glide path to a balanced budget by 2017.*

Earlier blog posts touched on these issues and the risks they pose for PNG’s credibility in international financial markets. Backing up these concerns was some very worrying news in the latest monthly statistical bulletin from BPNG. During the first quarter of 2015, government expenditure exceeded government revenues by K2,088.8m – 92% of its expected deficit for 2015. At the same time in 2014 there was a surplus of K105.2m, in 2013 a deficit of K403.9m, and over the previous decade, an average deficit of K23m. This is an extremely worrying start to 2015 and shows why a supplementary budget is so important for rebuilding confidence and credibility.

The second reason given for Moody’s shift to a negative outlook was PNG’s weakened external payments position and increased external vulnerability. Foreign currency reserves have halved over the last two years. Moody’s estimates “that the stock of short-term external debt by residual maturity – incorporating both private and public sector debt – now surpasses the level of foreign currency reserves”. The start of 2015 (so with PNG LNG shipments well underway) has been very worrying – there were balance of payments deficits of K319m in January and a K266m in February.

Moody’s also sets out a series of positive factors that balanced the above elements for a continued “B1” rating. These included strong growth, the successful commencement of the PNG LNG project, future prospects for the natural resource base, previous fiscal discipline having lowered debt burdens, and local financing of public debt.

With the knock to investor confidence from Moody’s credit rating shift to a negative outlook, the extraordinary blowout in the fiscal deficit in the first quarter of 2015, the continuing large balance of payments deficits even after the commencement of PNG LNG exports, and pressures on the inflationary front, no more time should be lost before PNG begins on the
path of economic adjustment. Hence the importance of the budget review announcement. A Supplementary Budget will be very important for re-establishing credibility. It will need to deal with the immediate revenue shortfalls, as well as map out a path over 2016 and 2017 on how key government programs can continue without damaging deficit levels. Politically, this will be difficult but necessary.

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**About the author/s**

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Paul Flanagan has a longstanding interest in public policy issues in Australia, PNG and more broadly. His 35-year public service career was evenly shared between Treasury/Finance and AusAID. He headed up Treasury’s International Finance and Development Division from 2008-2011 before being seconded to a senior advisor position in the PNG Treasury until August 2013. He is Director of Indo-Pacific Public Policy and Economics, a leading commentator on economic developments in PNG, and a frequent contributor to the Devpolicy Blog.

Link: https://devpolicy.org/credit-rating-a-dark-cloud-for-png-policy-corrections-a-possible-silver-lining-20150528/
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