Chapter 4. Managing national economic crises

Under this heading, we "[r]eview whether the objectives of the Central Banking Act 2000 give adequate priority to … managing national economic crisis (Section 7)" as well as "options around quantitative easing (QE) options during a declared emergency (focus on Section 55)."

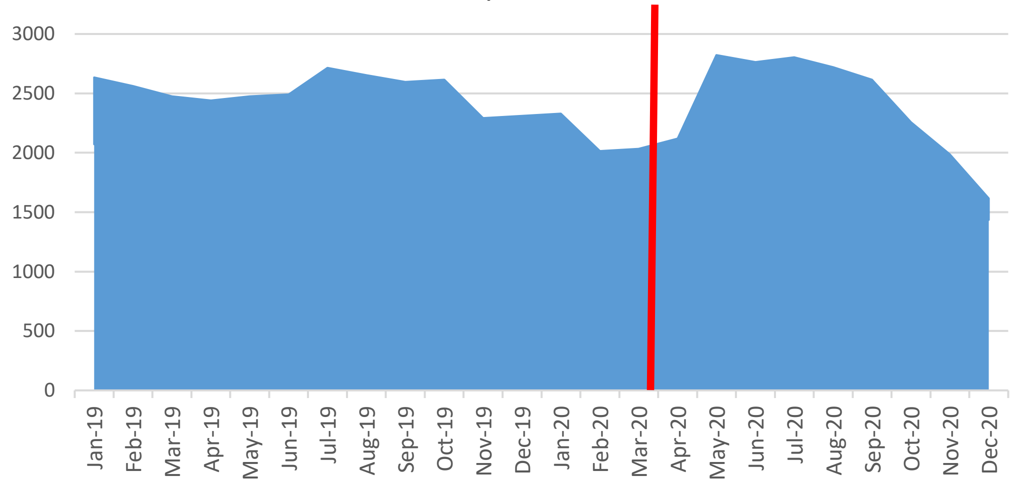
For ease of handling, we have rearranged the TOR to bring together the two items related to crisis management – objectives and QE. (QE or asset purchase programs involve the purchase of government securities.[38])

In Chapter 4.1, we assess BPNG's response to COVID-19, and in Chapter 4.2 we assess what legislative changes are needed for future crises.

4.1 BPNG response to COVID-19

With the onset of the COVID-19 pandemic, BPNG announced on 30 March 2020 that it would engage in the purchase of government securities (or QE) to inject liquidity. It did initially, but then, as the graph below shows, a few months later started selling government securities. As the figure also shows, the Bank in fact held less government debt at the end of 2020 than it did at the start of the pandemic. As discussed in Chapter 3.1, the sale of securities in the second half of the year was due to the Bank's concerns that the increase in the TAF would increase liquidity. However, again as discussed there, in fact Treasury has made little use of the TAF, at least up to the end of 2020. Moreover, other decisions made by BPNG in response to COVID-19 were designed to inject liquidity: not only the QE program, but a reduction in the Cash Reserve Requirement from 10% to 7%, and a cut in the Kina Facility Rate (KFR) from 5% to 3%.

Figure 20. Central bank holdings of government debt (Kina millions): before and during COVID-19, 2019 to 2020

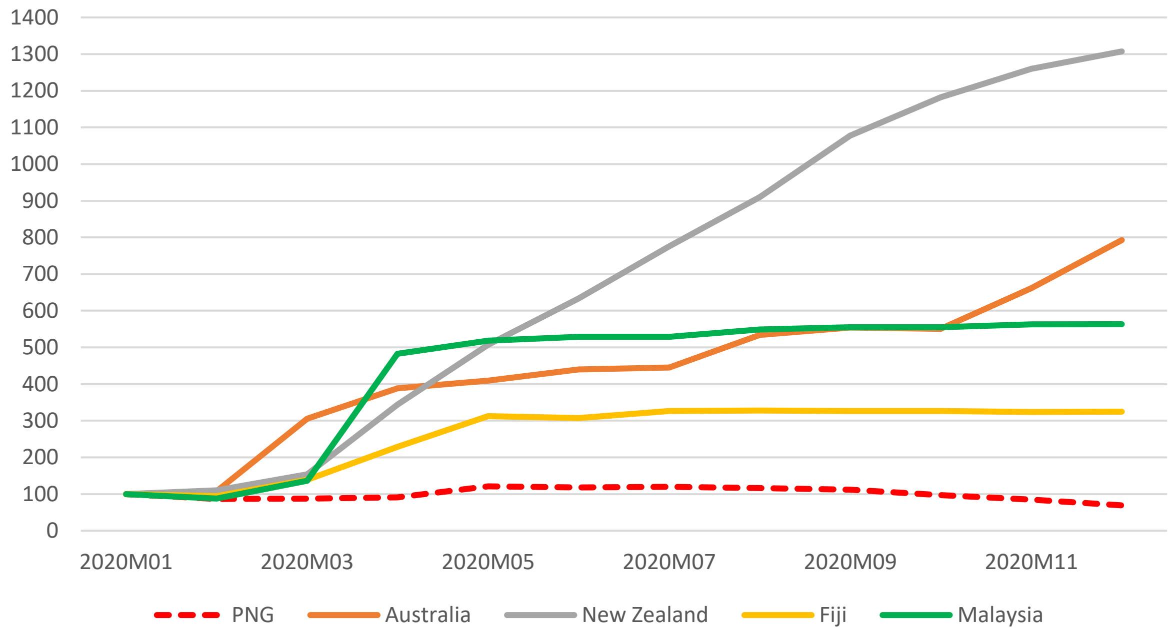


Source: QEB Table 2.3. Notes: The thick line marks the onset of the COVID-19 pandemic. Government debt includes Inscribed Stock and Treasury Bills.

[38] https://www.bankofengland.co.uk/faq/inflation-and-interest-rates

The September 2021 MPS reports purchases of government bonds of K431.5 million between December 2020 and June 2021, suggesting that the sale in the second half of 2020 was partly reversed. No explanation is provided. In any case, these purchases do not change the conclusion that, as shown in the next figure, the lack of sustained QE in PNG makes the country stand out in an international context when many other central banks increased their government bond holdings over the course of last year.

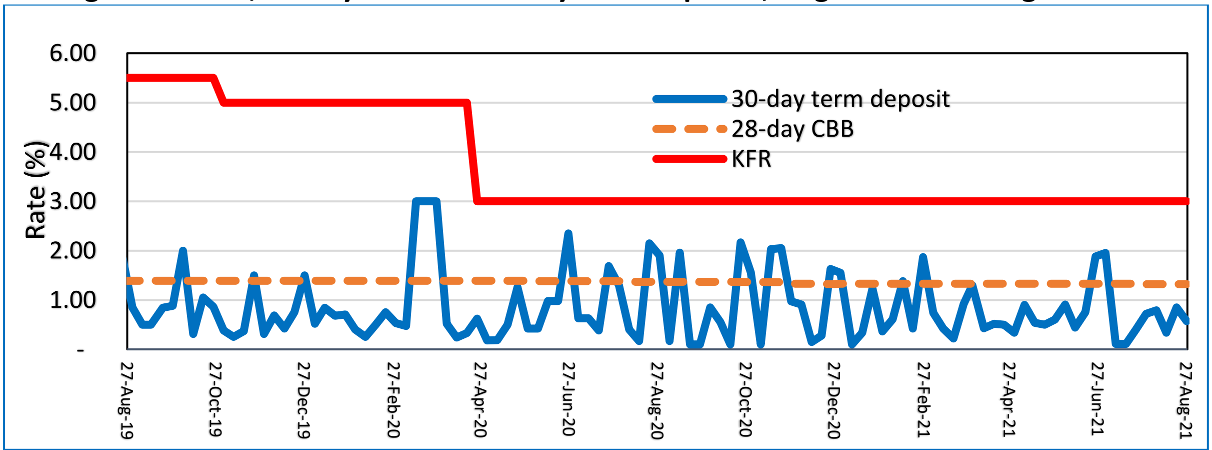
Figure 21. Central bank holdings of government securities in 2020 (Jan 2020=100)



Source: BPNG and IMF.

The June 2021 BPNG Monthly Economic Report shows that, despite the reduction in the Kina Facility Rate, the CBB and 30-day term deposit rates have not changed. This is in line with the general understanding that transmission of the KFR to bank rates is weak in PNG due to excess liquidity (as discussed in Chapters 3.2 and 5.2).

Figure 22. KFR, 28-day CBB and 30-day term deposits, August 2019 to August 2021



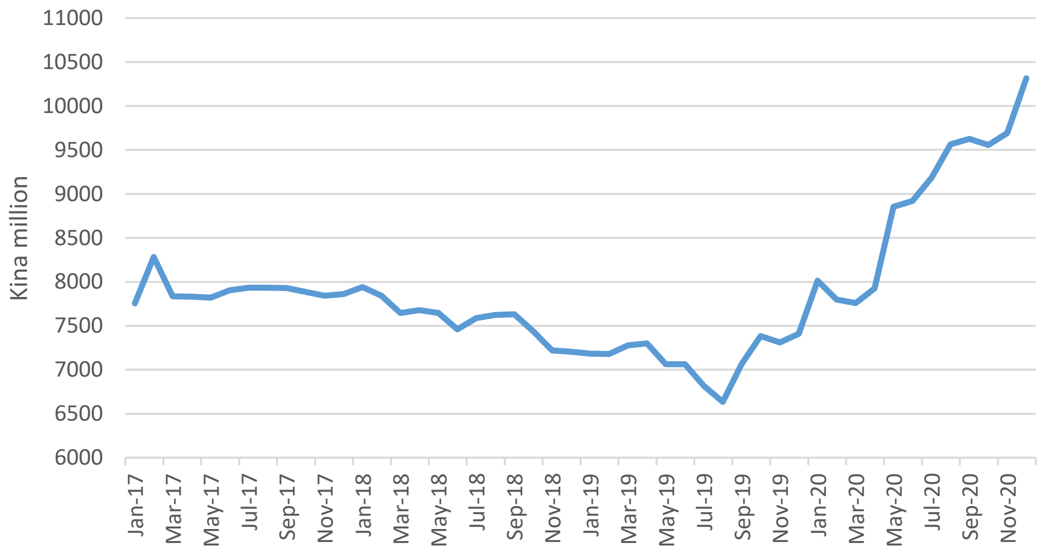
Source: BPNG Monthly Economic Review, June 2021. Note: The 30-day term deposit rate is volatile as it is a weighted average of wholesale and retail deposits, and the weights change over time.

Consistent with the finding in Chapter 3.2 that BPNG decisions have a strong fiscal impact, BSP notes in its annual report that the lowering of the Cash Reserve Requirement enabled it to invest in the Government's COVID-19 bonds (see BSP 2021 Annual Report, p.12). This supports our earlier argument that banks are at or near their single-borrower exposure limits. Although they have excess liquidity, they are constrained from investing their excess deposits in bonds (even though this would be very profitable for them) because of those limits. Deposits needed to meet the CRR requirement are not counted in the asset base, the denominator used to calculate the single-borrower limit. Therefore, reducing the CRR means increasing the single-borrower denominator, and therefore enables more lending to government.

The next graph shows that after three years (2017, 2018 and 2019) in which commercial banks have had holdings of government securities of K8 billion or below, in 2020, they increased those holdings to K10 billion. In May alone – just a month after BPNG reduced the CRR – the commercial banks increased their holdings of government securities by K0.9 billion. Over the course of the year, commercial bank holdings of government debt increased by K2.9 billion, which was the net increase in government domestic debt holdings over the course of the year.[39]

Not all of this increase would have been due to the reduction of the CRR, but it would have helped. Negative domestic borrowing in 2018 (when PNG secured a large commercial foreign loan) also helped create room for additional domestic lending to government in 2020.

Figure 23. Commercial bank holdings of government securities, 2017 to 2020



Source: BPNG QEB Table 3.7

[39] As mentioned, there was an unexpected decline in holdings by BPNG of central government debt by K0.7 billion over the year. Superannuation fund holdings also increased by K1.3 billion, and other sources decreased holdings by K0.6 billion.

4.2 Legislative options

There are no crisis provisions in the CBA 2000. A few countries do include crisis provisions in their central bank legislation. For example, Section 19 of the Bank of England Act 1998 gives reserve powers to the UK Treasury over monetary policy "in extreme economic circumstances".

Section 19 of the PNG CBA 2000 requires the Governor to report to the Minister when conditions exist that "may be likely to affect adversely the achievement of the financial and economic policies of the Government." The Treasurer informs us that no such report was received in relation to COVID-19.

Many central banks have been very active in response to COVID-19 without the activation of emergency clauses, or the takeover of their powers by the government. However, some countries did amend legislation in response to the pandemic to support bond purchases (Indonesia and Brazil) and/or to increase the limit on such purchases.[40]

Recommending legislative provisions for monetary policy in PNG in the event of an emergency requires an understanding of how the PNG Constitution deals with emergencies, the subject of Part X of the Constitution. This provides for the declaration of emergencies by the National Executive Council (NEC). Emergencies can cover wars (or the imminent dangers of wars), natural disasters, including infectious disease outbreaks, and acts by persons that threaten life. Once an emergency has been declared, emergency regulations and then an Emergency Act can be put in place. An example of an Emergency Act is the Emergency Act 1979 imposed in response to unrest in the Highlands. The Emergency (General Provisions) (COVID-19) Act 2020 was passed in response to the current pandemic. The Emergency Law typically gives extraordinary powers to a designated Controller. Subject to some basic constitutional protections, the Emergency Law can amend any other law as required.

Many emergencies would not warrant overriding the provisions of the Central Banking Act. The range of measures undertaken by BPNG during the COVID-19 pandemic have been those undertaken by many banks: reduction in policy lending rate; reduction in the Cash Reserve Requirement; QE (though not sustained); and short-term credit facility for the second-tier financial institutions. This indicates that BPNG already has many of the powers it needs to respond to an emergency.

At the same time, it could be reasonably argued that during an emergency, BPNG should be able to play more of a role in relation to government financing. The Government already has the power to amend or suspend any part of the CBA through an Emergency Law. It is better though to attempt to provide some guidance to Government that it can use in an emergency. We propose therefore that the CBA be revised to foreshadow temporary increases in the Bank's financing role (as envisaged in Chapter 3.3) through an Emergency Act following a national emergency, if declared for the whole of Papua New Guinea.

One strength of current BPNG arrangements is that, with the concentration of powers in one

[40] See the IMF and BIS COVID-19 central bank response databases.

person, decisions can be made quickly in an emergency (by the Governor or by the Deputy Governor in the absence of the former). A Monetary Policy Committee might not be so nimble. The Reserve Bank of New Zealand Act that set up that country's MPC foreshadowed this problem, and laid down emergency procedures for the MPC, which we recommend also be adopted by PNG. These involve the Governor being satisfied that emergency circumstances exist, that urgent action is necessary, and that other members are unable to participate in the required decision making in a timely manner.