



**The PNG economy: is a crisis inevitable?**

*Michael Cornish*



## Overview

- The PNG economy: a quick introduction
- Fiscal policy
  - Solutions?
- Monetary policy
  - Solutions?
- Conclusions for development partners





## The PNG economy: a quick introduction

- Commodity-based economy
  - Agricultural exports provide reasonable amounts of local employment, but fuels and mineral commodity exports do not
- PNG's share of total global exports: 0.03%

**PNG is also a high cost economy**



## Comparing POM prices to Canberra prices

Groceries	POM price	Vegetables	POM price
Dilmah 25 bags 50g Ceylon tea	544%	Broccoli	554%
Cadbury roses silver - 225g	241%	Lettuce	388%
Cadbury dairy milk choc - 200g	219%	Red onion	335%
Zafarelli spaghetti - 500g	205%	Oranges	334%
Fruit loops - 285g	200%	Grape tomato	287%
Napolitana pasta sauce - 500g	199%	Green capsicum	273%
Eggs - 650g	198%	Granny smith	200%
Arnotts milk arrowroot - 250g	198%	Red delicious apple	175%
Saxa iodised table salt - 750g	166%	Button mushroom	154%
White sugar - 1kg	165%	Capsicum (all varieties)	125%
Lowan Apple Cinnamon Oats -750g	154%	Brown onion	117%
Weet-Bix - 375g	128%	Potato	111%
Pringles original - 169g	109%	Cucumber	86%
Heinz baked beans - 420g	102%	Eggplant	35%
Coke - 2L	93%	Banana	29%
Bushells blue label 25 bags 50g	54%		
Mi goreng - 85g	23%		

**Source: Rohan Fox, ANU, August 2015**



## The PNG economy: a quick introduction

- Major merchandise exports (goods):
  - 23.8% agriculture
  - 41% fuels and mining
  - 6.2% manufacturing
  - 29% other

Source:  
WTO, 2014





## The PNG economy: a quick introduction

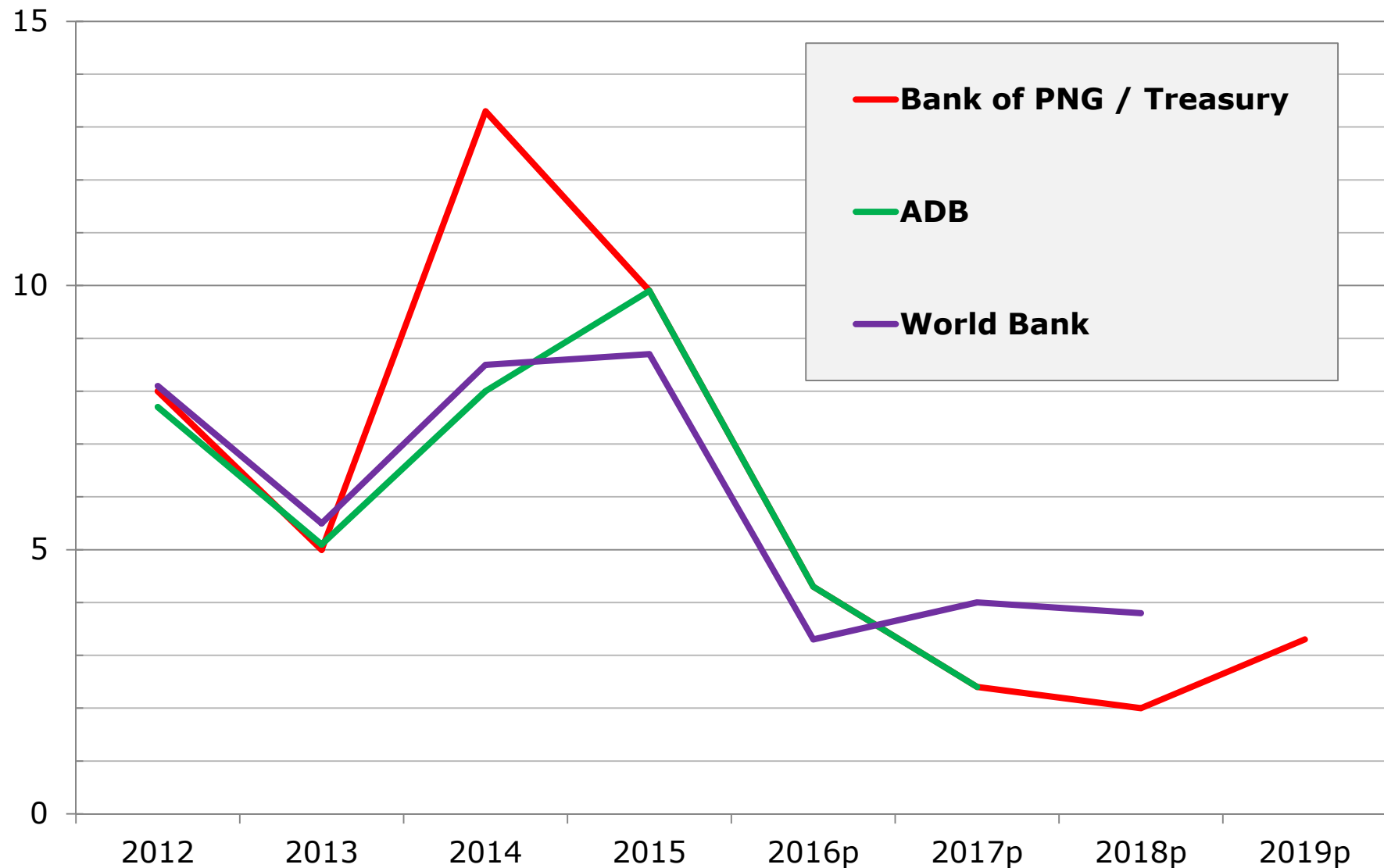
- Major merchandise imports (goods):
  - 11.4% agriculture
  - 17.8% fuels and mining
  - 69.4% manufacturing
  - 1.4% other

Source:  
WTO, 2014





## Real GDP growth [and projections] (%)





## The PNG economy: a quick introduction

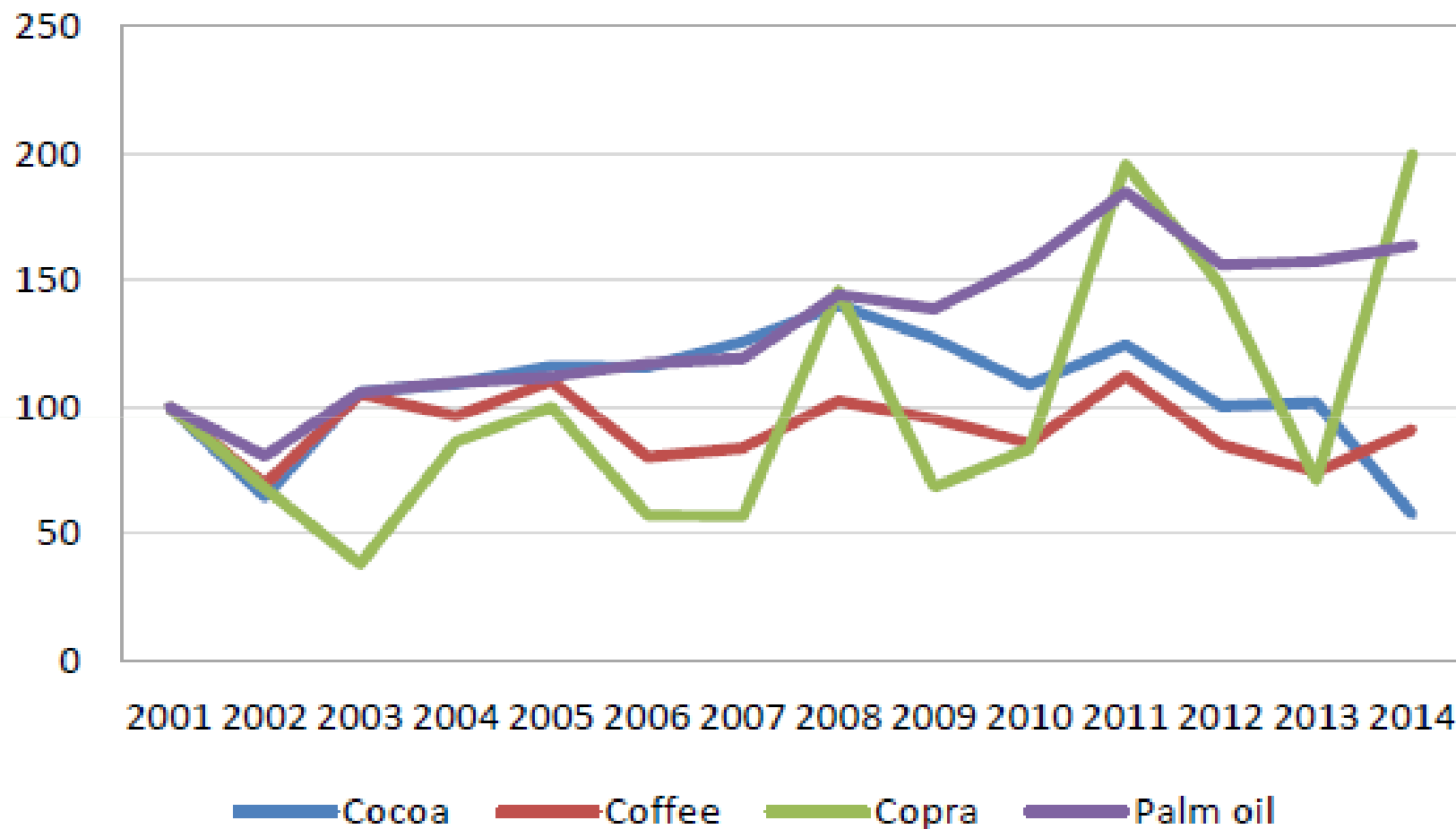
- In resource-dependent economies, **GDP can be a misleading indicator of welfare**
  - E.g., Most of the LNG project is owned offshore, so a significant proportion of its revenue will be of no benefit to PNG
- A better measure?
  - **Gross National Income (GNI)**







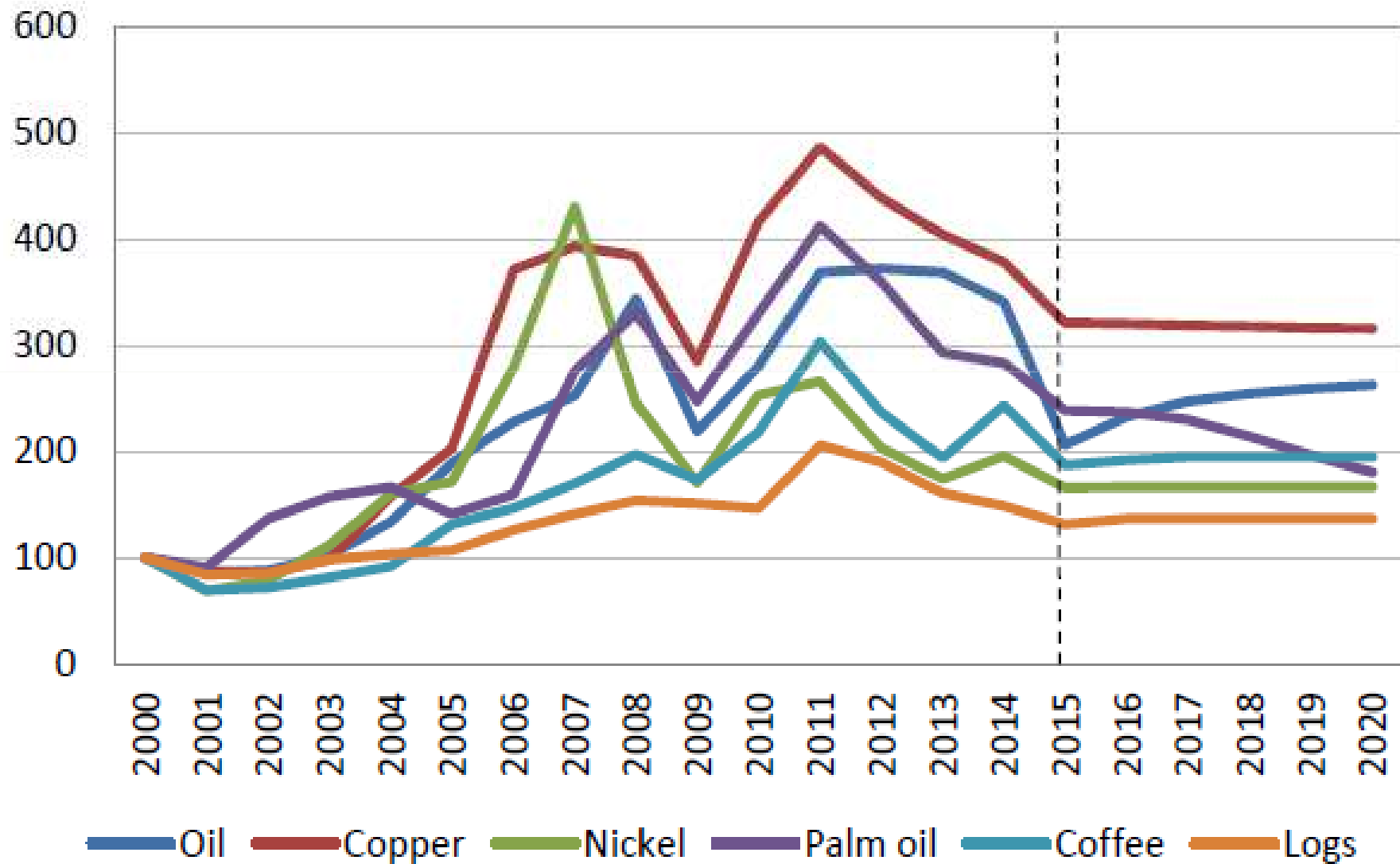
## Agricultural commodity production (volumes, 2001=100)



Source: BPNG (2015c) up to 2013; Treasury (2014) for 2014 estimate.

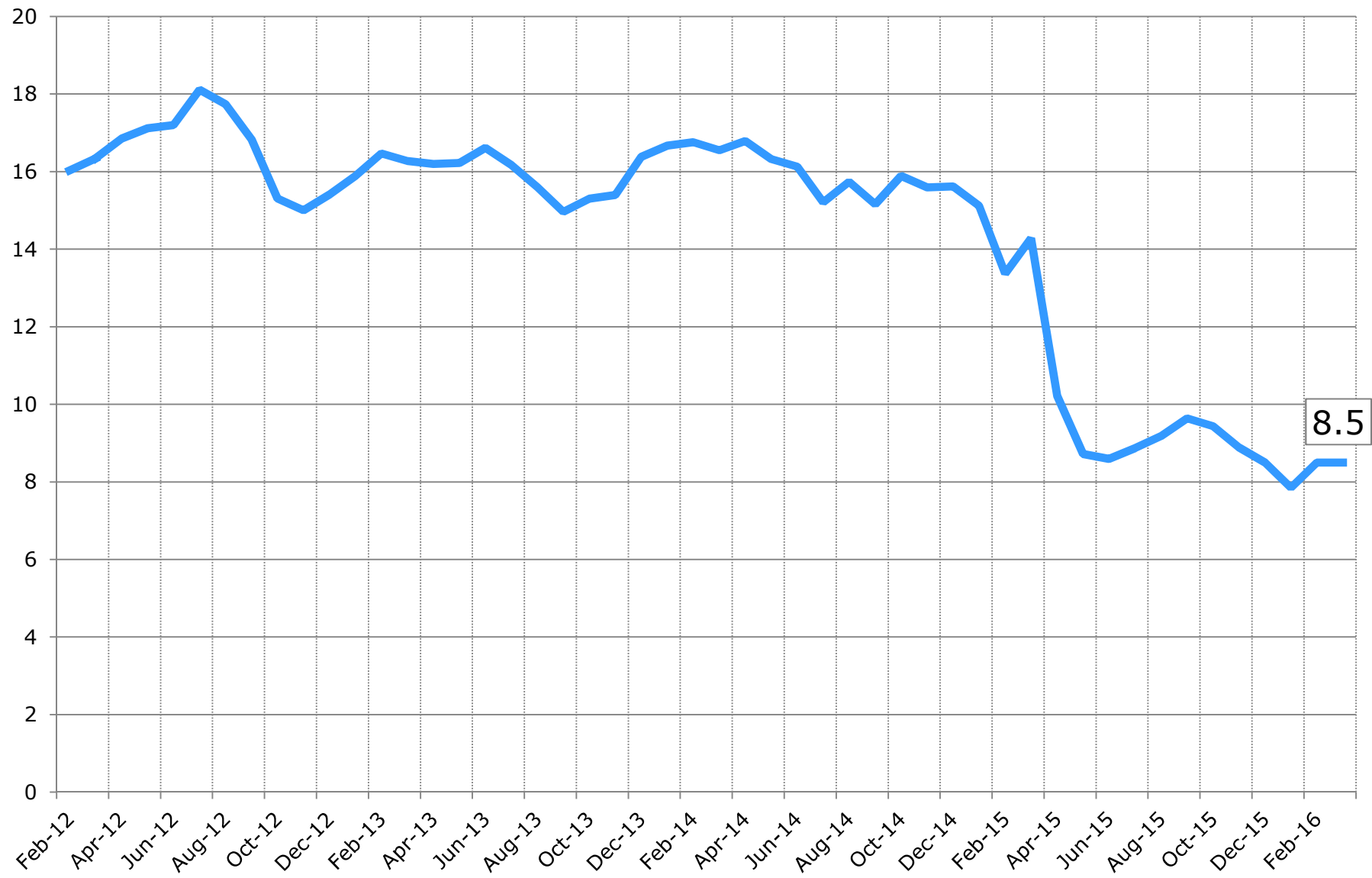


## Growth in commodity prices 2000-2020 (2000=100)



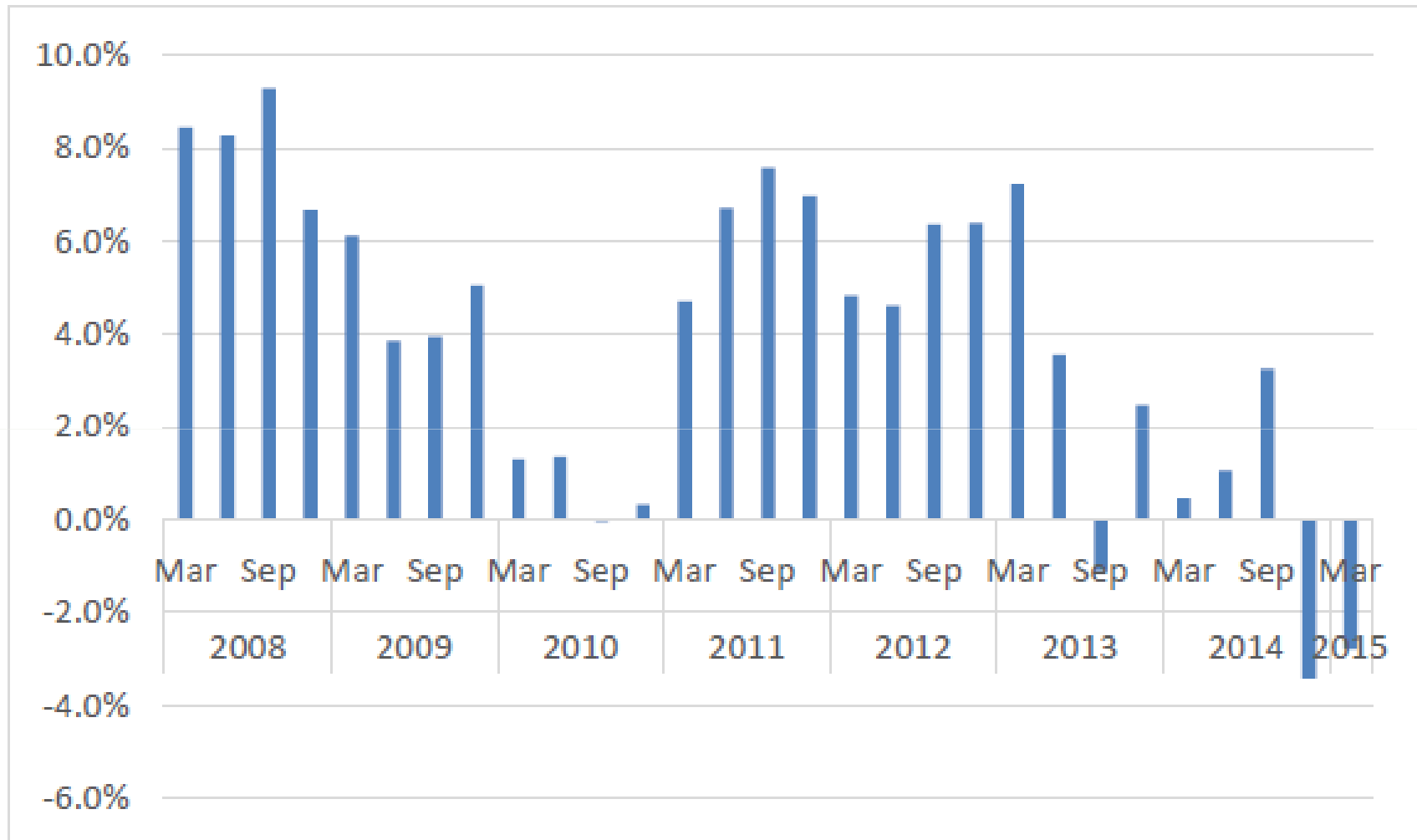


## Japanese LNG contract prices (USD/mmbtu)





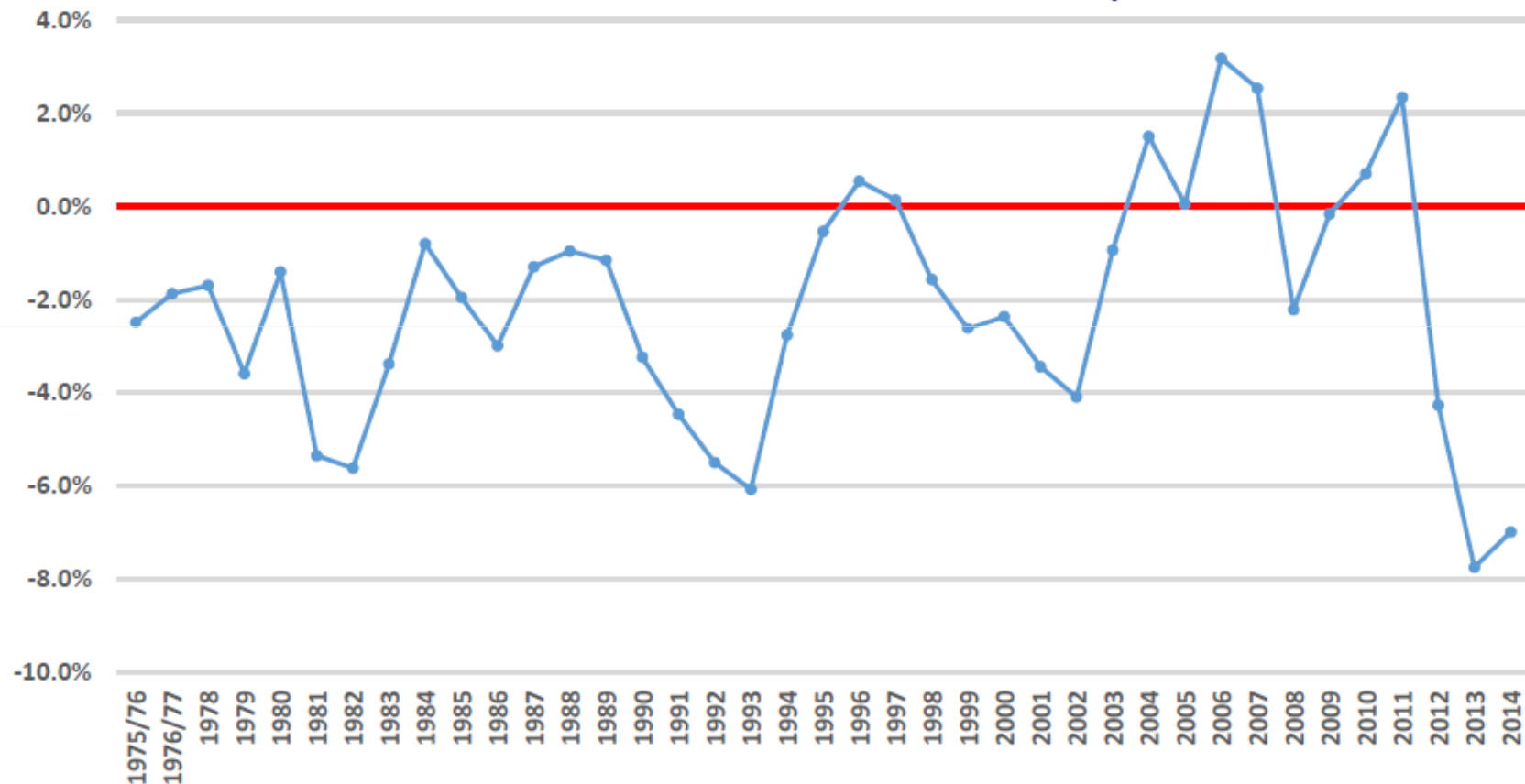
## Formal sector employment growth (quarterly, year on year)



Source: BPNG (2015).



## PNG budget balance – 2013 and 2014 largest deficits in PNG's history

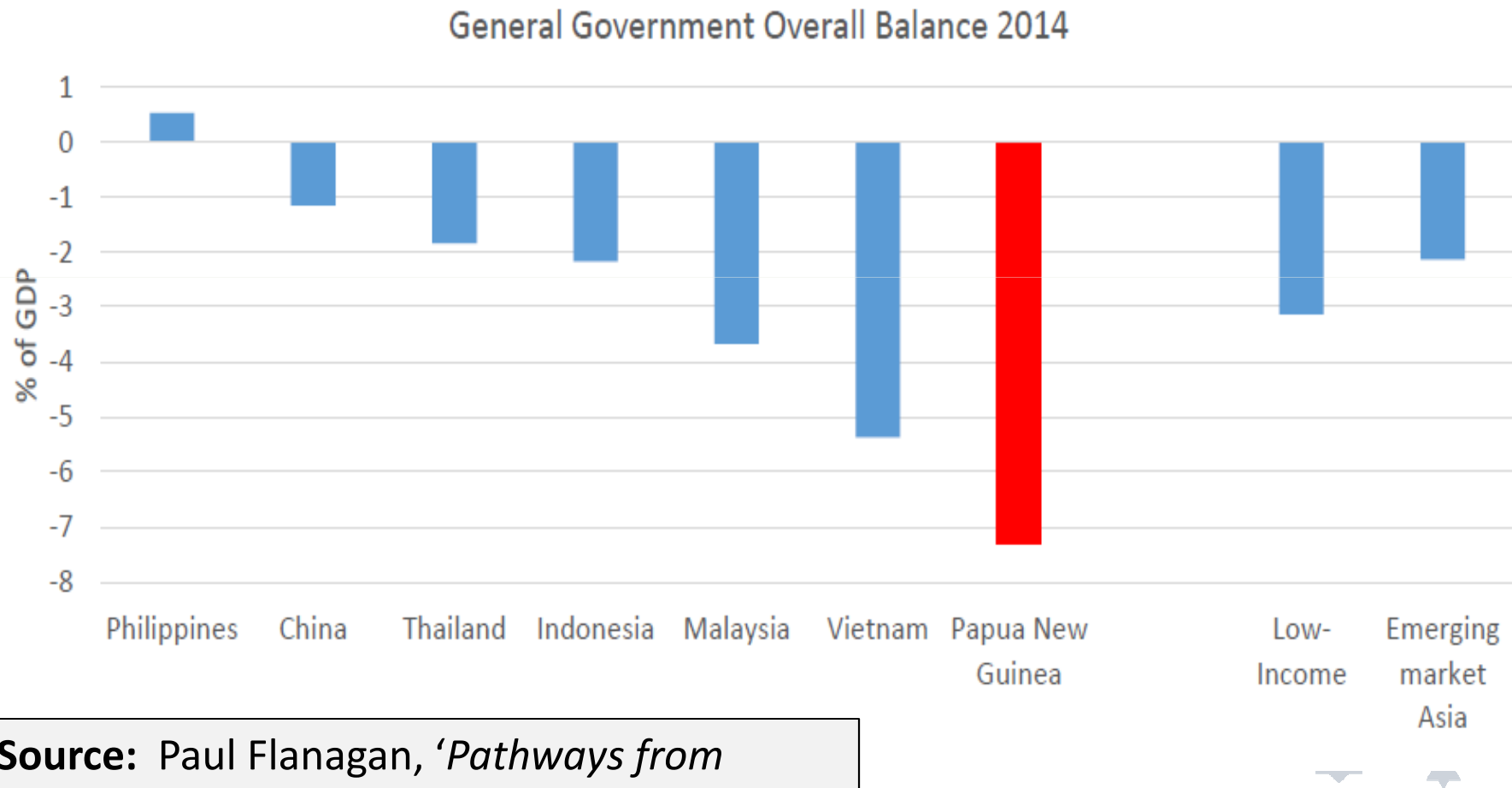


**Source:** Paul Flanagan, *'Pathways from potential crisis'*, ANU





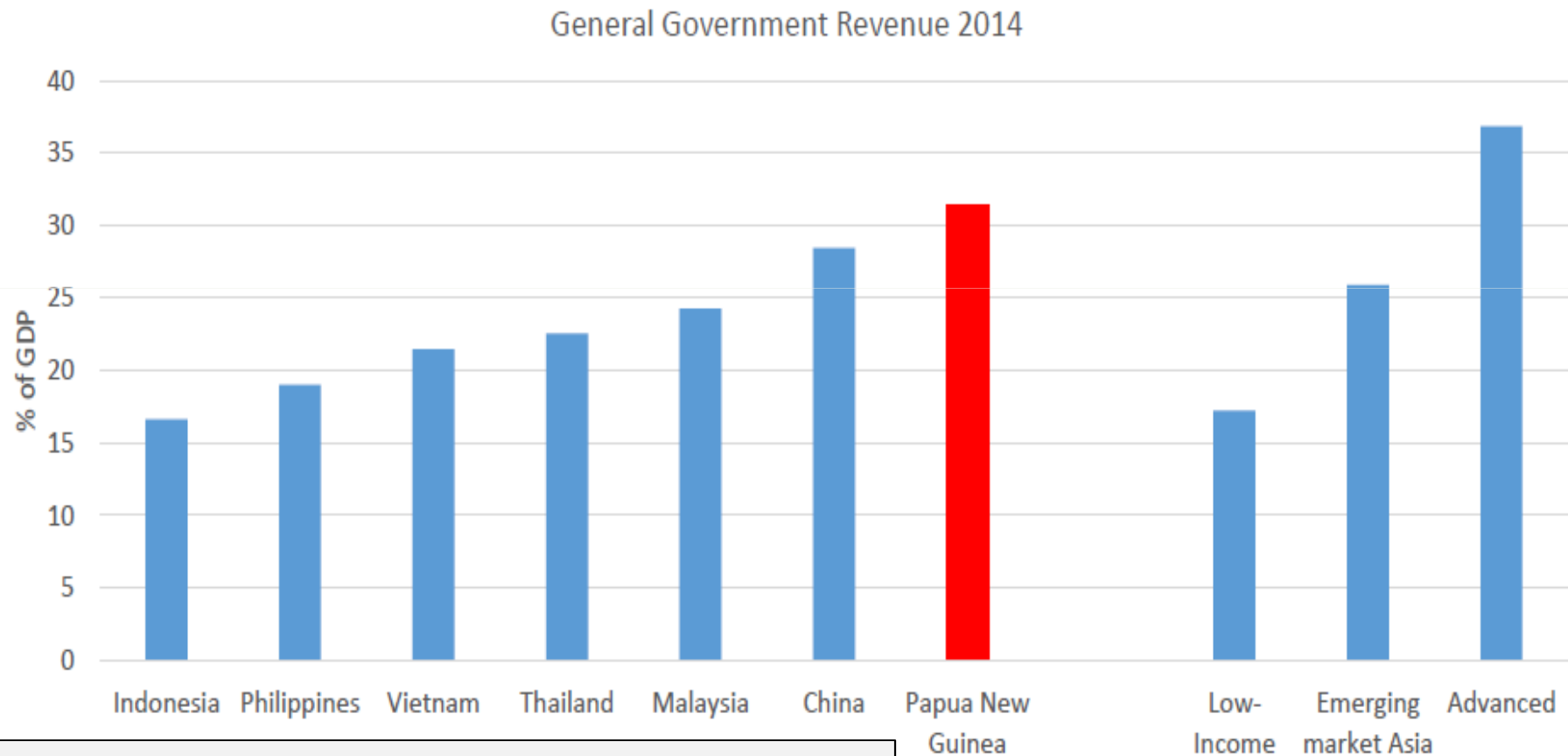
# International - Very large deficit



**Source:** Paul Flanagan, *'Pathways from potential crisis'*, ANU



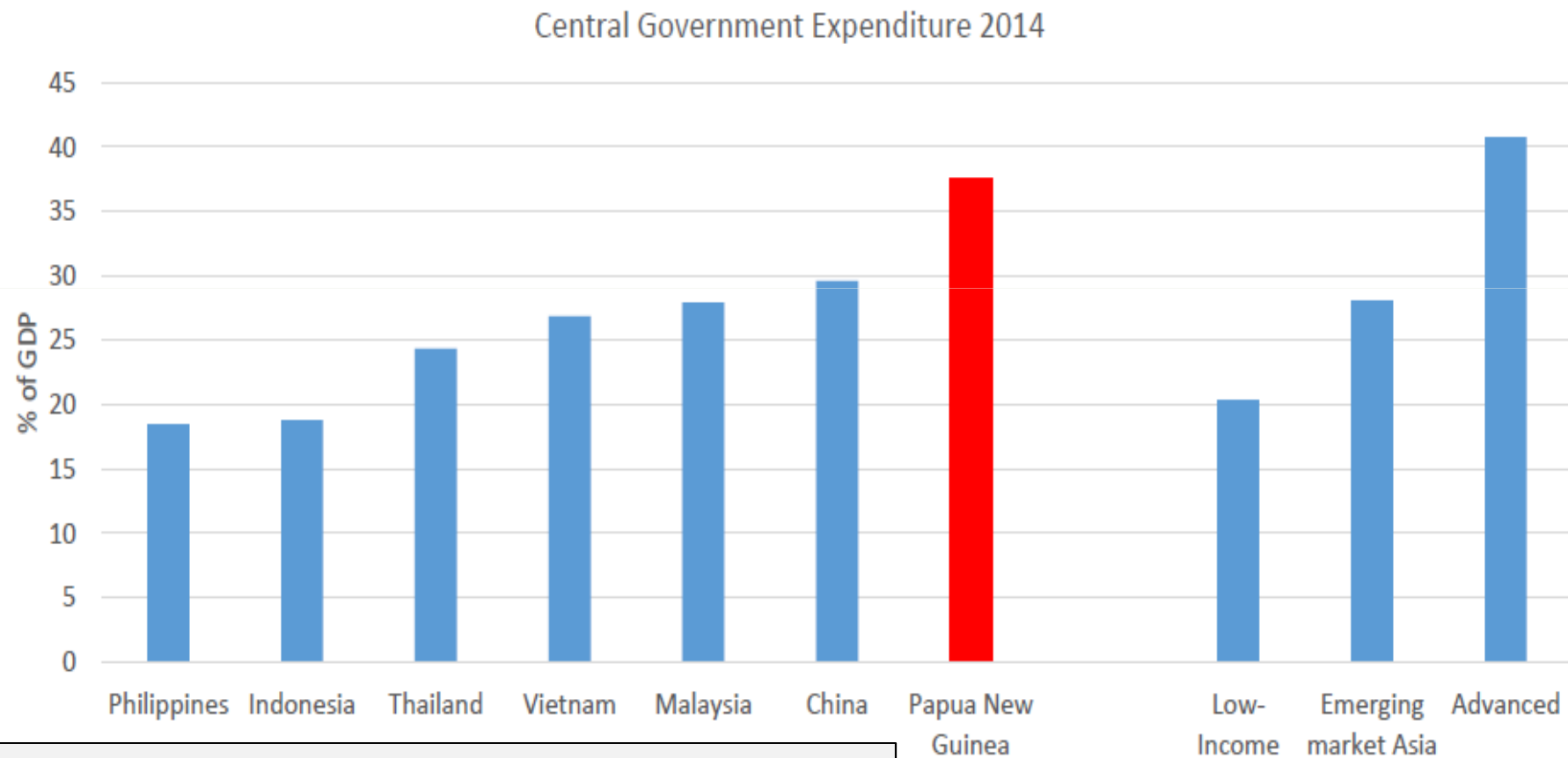
# International – PNG high taxing



**Source:** Paul Flanagan, '*Pathways from potential crisis*', ANU



# International – PNG very high spending

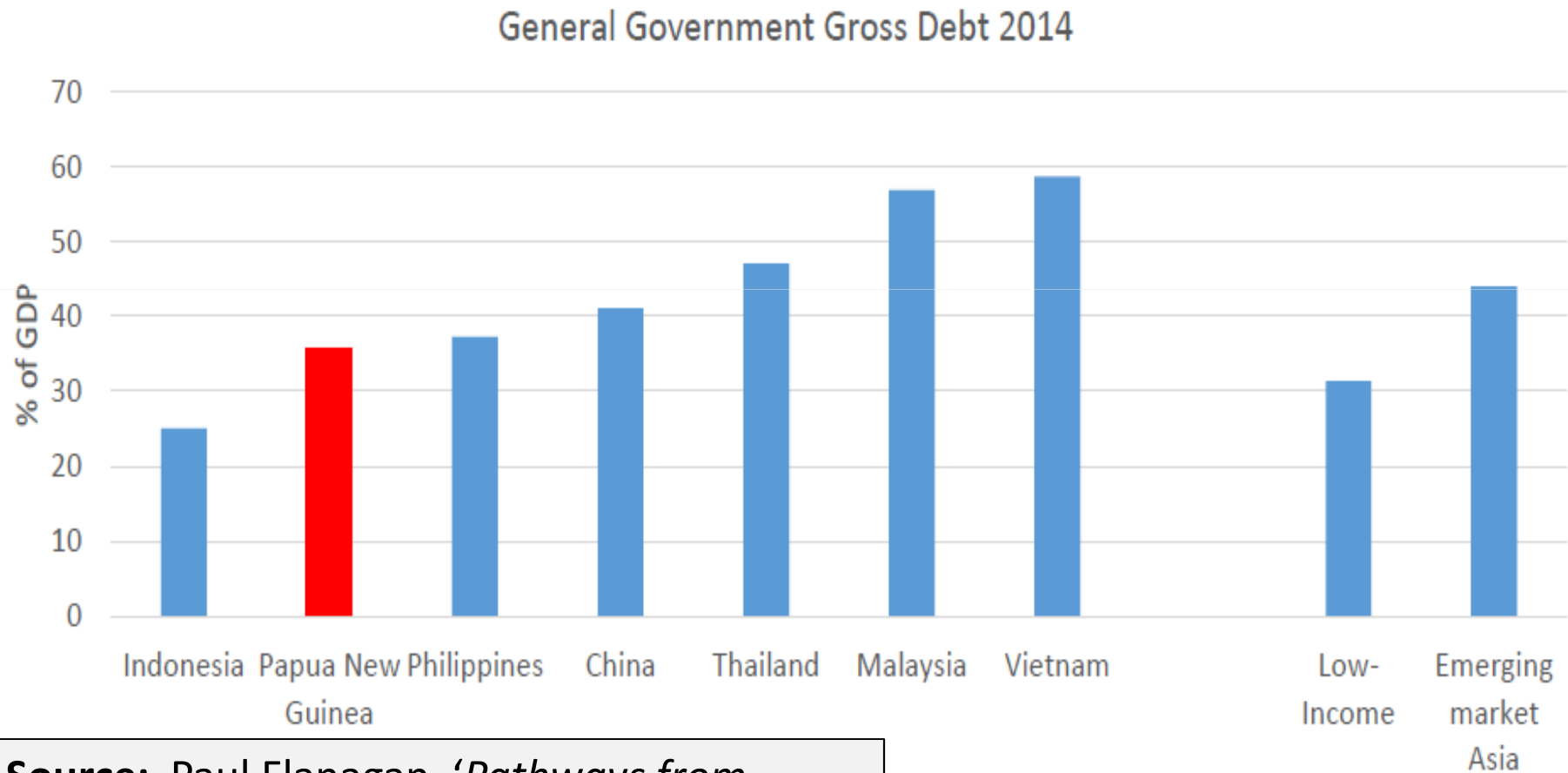


**Source:** Paul Flanagan, '*Pathways from potential crisis*', ANU





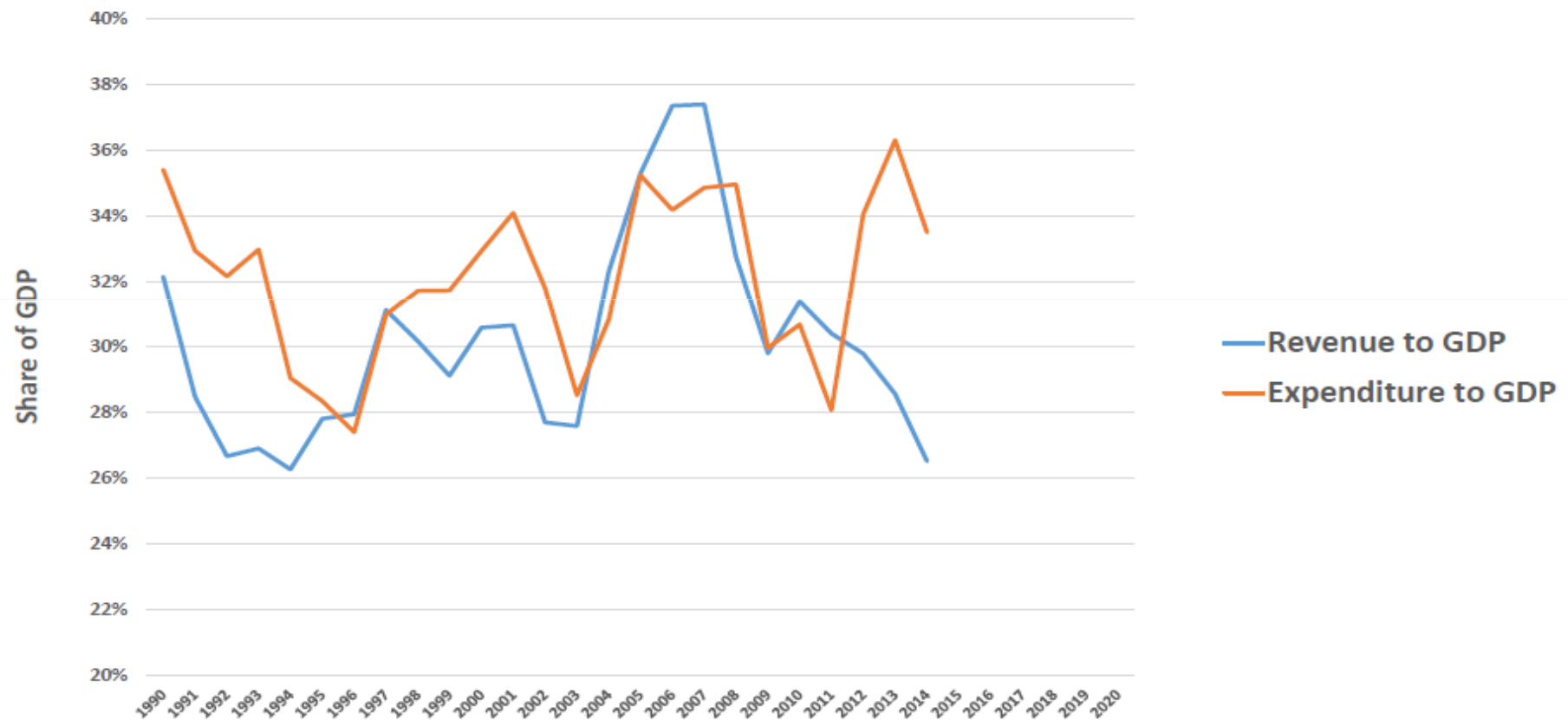
# International - Moderate public debt levels



**Source:** Paul Flanagan, *'Pathways from potential crisis'*, ANU



## PNG Budget over 30 Years Expenditure and Revenue as shares of the Economy

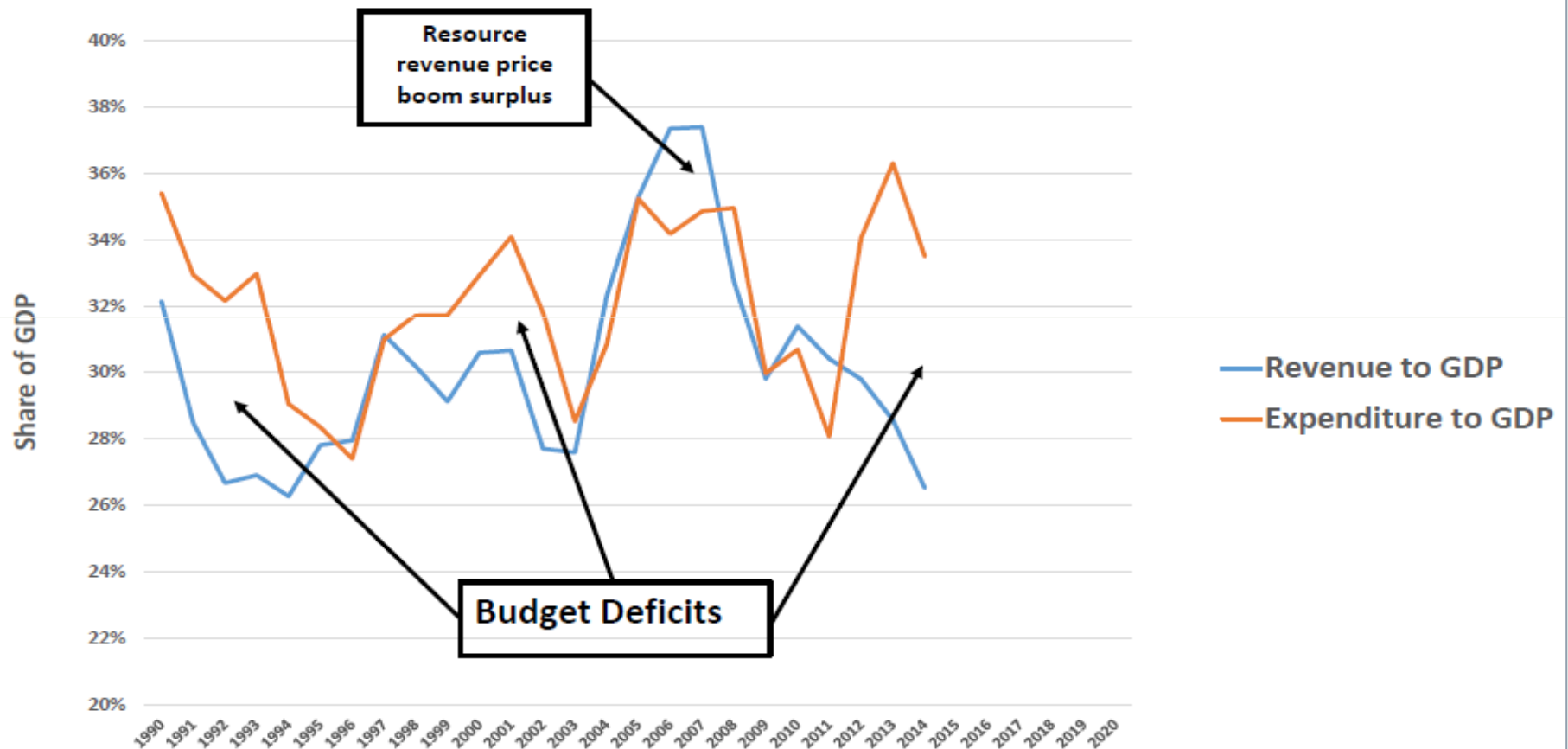


**Source:** Paul Flanagan, '*Pathways from potential crisis*', ANU





## PNG Budget over 30 Years Expenditure and Revenue as shares of the Economy



**Source:** Paul Flanagan, *'Pathways from potential crisis'*, ANU





## Fiscal policy: where are we now?

- Collapse in government revenues of 20% (relative to the 2015 budget)
- Expenditure reductions in 2015 (against budget):
  - 37% cut in health
  - 36% cut in infrastructure
  - 30% cut in education





**Comparison of 2015 budgeted and final sectoral  
expenditure figures for 2015 (K million)**

<b>Sector</b>	<b>2015 Original</b>	<b>2015 Outcome</b>	<b>Variance</b>	<b>% change</b>
Health	1,104.57	694.80	-409.77	-37.1%
Transport and Infrastructure	1,124.99	720.53	-404.46	-36.0%
Education	1,402.78	977.36	-425.42	-30.3%
Economic and Agriculture	453.78	359.05	-94.73	-20.9%
Miscellaneous	1,196.01	954.67	-241.34	-20.2%
Administration	2,157.08	1,923.66	-233.42	-10.8%
Law and Justice	1,348.78	1,212.37	-136.41	-10.1%
Community and Culture	77.46	70.07	-7.39	-9.5%
Utilities	101.65	92.99	-8.66	-8.5%
Interest	1,130.10	1,074.70	-55.40	-4.9%

*Note: Based on Table 18 in the 2015 FBO.*

**Source:** *2015 Final Budget Outcome document*, Government of PNG; and Paul Flanagan, *PNG's frightening Final Budget Outcome*, Australian National University





## Fiscal policy: where are we now?

- Note: these are areas the government said would be protected
- The combined budget deficits over the last three years are **24% of GDP**
  - The largest deficits over a three year period in PNG's history!





## Fiscal policy: where are we now?

- Despite the cuts, government is starting to run out of money
  - Problems already emerging in the payment of subcontractors and some public servants





## Fiscal policy: what can they do?

- Cut more government expenditure
- Sell government assets
- Seek domestic finance
  - Insufficient domestic appetite
- Seek international finance
  - Sovereign bond issue? Failed
  - Chinese loan? Unlikely
  - IMF loan? More and more likely







## Fiscal policy: what *are* they doing?

### Short-term measures:

- Deferring and delaying expenditure, especially with government suppliers and subcontractors
- Seeking bigger dividends from SOEs
  - Unconfirmed reports that SOEs are now borrowing from BSP





## PGK v. USD

June 2014 intervention  
and appreciation





## Monetary policy: what can they do?

- Since June 2014, the Kina ceased to be a floating exchange rate
  - IMF's description: 'a de facto crawling peg'
- As a result, the Kina has been overvalued ever since



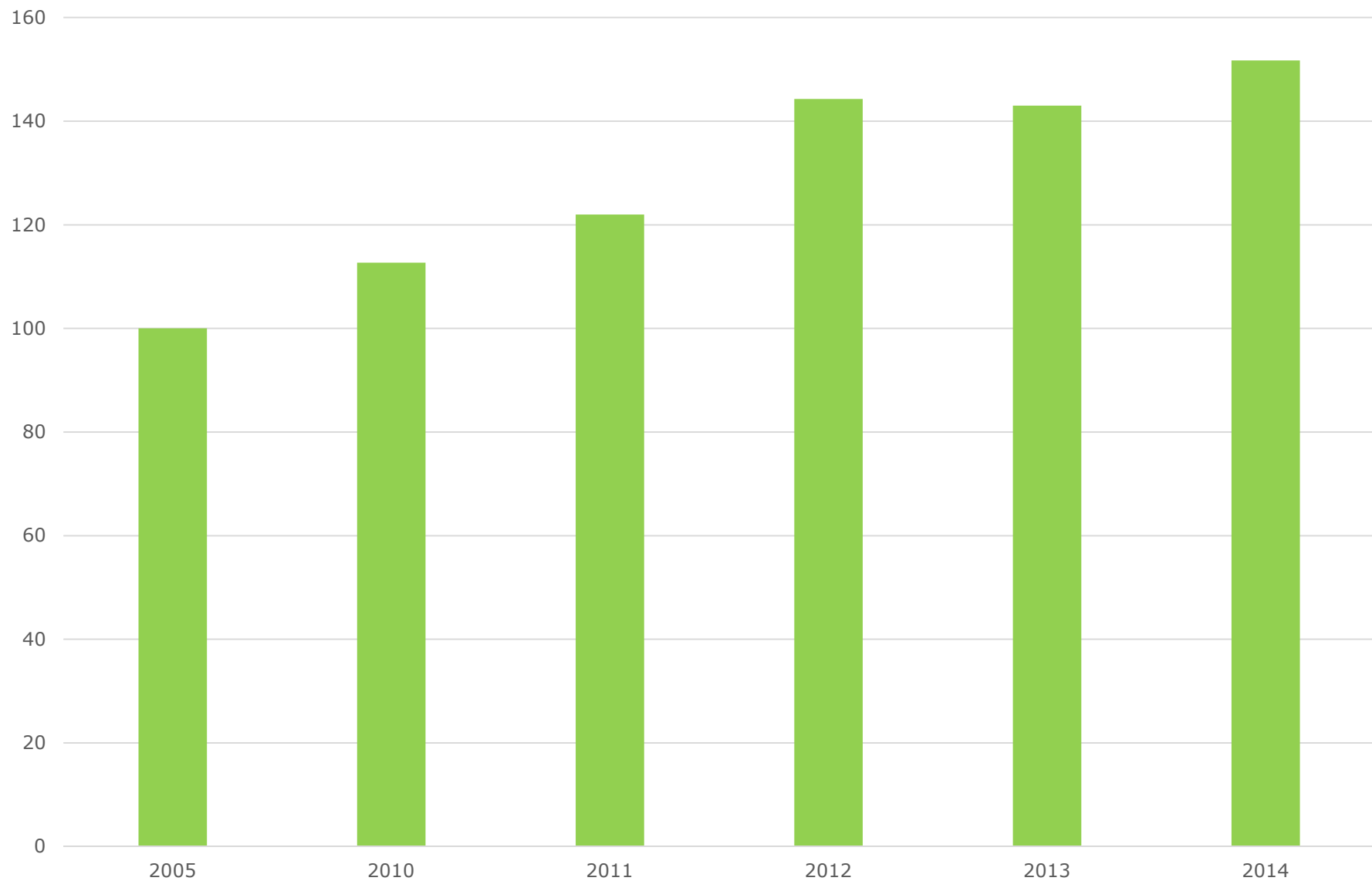


**Fifteen most resource-dependent economies with floating exchange rates, and PNG**

Country	%Δ exchange rate 1 Jun 2014-30 Jun 2015	Natural resource rents as % of GDP	Largest export categories as % of GDP
Brazil	-40.15	6.5	Iron ore, oil
Madagascar	-33.37	9.8	Textiles, cloves
Ghana	-32.88	17.8	Gold, oil
Uganda	-28.54	13	Coffee, oil
Norway	-27.26	10.9	Oil, LPG
Mexico	-21.91	7.7	Automobiles, electronics
Australia	-21.77	7.2	Iron ore, coal
Mozambique	-21.37	14	Aluminium, coal
S Africa	-15.89	6.8	Gold, coal
Chile	-15.72	16	Copper, sulphates
Peru	-13.82	9.7	Gold, copper
Indonesia	-14.40	6.6	Coal, LPG, oil
Zambia	-8.54	19.4	Copper, corn
Solomon Islands	-7.21	33.3	Timber, gold
Mongolia	-7.20	28	Coal, copper
PNG	3.55	31.6	LNG, gold



## Real exchange rate (2005=100)





## Monetary policy

- An overvalued exchange rate is:
  - Good for importers
  - Bad for exporters
- This overvaluation has created an ever-increasing **shortage of FOREX** in PNG
- The government has addressed the shortage with **FOREX rationing**





## Monetary policy

- Lack of FOREX has been slowly strangling the formal private sector in PNG
  - Hard for companies to pay foreign suppliers
  - Currently the **top concern** with PNG business leaders [*ANZ Business Survey*]
- Business activity has been in year-on-year decline since the first quarter of 2015





## Monetary policy: what are they doing?

- Government is seeking a USD 250 million loan from the International Finance Corporation (IFC) for the commercial banks, to help them clear the backlog
  - But estimated backlog is much bigger;  
**PGK 3bn** (USD approx. 950 million)







## Monetary policy: what can they do?

- Ultimately the exchange rate *must* be devalued to clear the market
  - BUT they must be careful – urban poor need time to respond to increased price of imported rice





## Conclusions for development partners

### Very tough times ahead

- Massive government budget cuts already underway
- Government partners will have less project funding capacity





## Conclusions for development partners

### **Very tough times ahead**

- Education, health, and infrastructure have faced very big government spending cuts already
- Other sectors have fared better thus far, but have still faced large government spending cuts





## Conclusions for development partners

### Very tough times ahead

- Potential cuts in public servant numbers?
- Exporters will benefit over time as exchange rate devalues
- But urban poor will face increasing pressures as the cost of rice increases

