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

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

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

- Bank of PNG / Treasury
- ADB
- World Bank

GDP growth projections from 2012 to 2019p, showing a decline post-peak in 2014.
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- 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)

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

- Oil
- Copper
- Nickel
- Palm oil
- Coffee
- Logs
Japanese LNG contract prices (USD/mmbtu)
Formal sector employment growth (quarterly, year on year)

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

Source: Paul Flanagan, ‘Pathways from potential crisis’, ANU
International - Very large deficit

General Government Overall Balance 2014

Source: Paul Flanagan, ‘Pathways from potential crisis’, ANU
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International – PNG high taxing

General Government Revenue 2014

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

General Government Gross Debt 2014

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
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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 (Kmillion)

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

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
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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

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