

# WESTPAC PNG

## Economic Bulletin –

### May 2023

#### KEY HIGHLIGHTS

- The global economy is modestly rebounding as countries recover from the impacts of the COVID-19 pandemic and Russia's invasion of Ukraine.
- The Papua New Guinea (PNG) economy is well placed for continued recovery for the medium term.
- Real GDP growth in 2023 is projected to be 3.7 percent (by IMF) driven by the non-resource sector supported by growth in private sector credit and higher Government spending.
- The IMF has approved PNG's request for a Financing Program in Special Drawing Rights of SDR684.3 million, which is equivalent to US\$918.0 (K3,232.4) million under its Extended Credit Facility and Extended Fund Facility.
- Excess liquidity in the banking system remains high and the financial sector is stable.
- Externally, PNG's balance of payments position remained in surplus mainly driven by a record export receipt as a result of higher production and international prices of major export commodities, particularly crude oil and LNG.
- Nonetheless, public external debt burden as a proportion of total debt has increased.
- Inflation is currently high but is expected to ease going forward.
- Risk to the growth outlook remain.



## PNG economy on a solid footing for the medium term

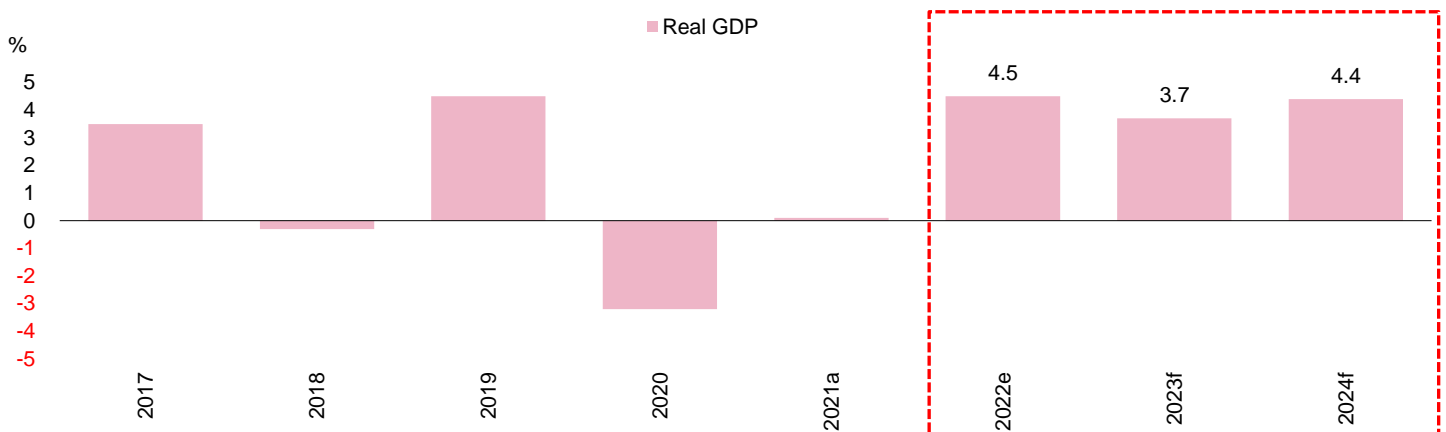
**Globally, the interest rate tightening cycle that began in 2022 is now at or very near its peak.** The US FOMC has established a conditional pause following this month's 25bp hike. The RBA has adopted a softer tightening bias, and it is expected the ECB, Bank of England and RBNZ to all follow suit after final 25bp hikes at their next meetings. In all cases, pausing is still highly conditional on the data-flow, the evolution of inflation in particular, but also how the growth and labour market conditions that feed into this unfold.

**As the year progresses, there will be more evidence of growth slowing materially in response to the rapid monetary tightening, and overlaid with some additional tightening in credit conditions associated with strains in the banking system.** In the case of the US, the slowing in both growth and inflation is expected to be relatively rapid, opening the door for rate cuts by December. That process is expected to be slower elsewhere, reflecting the absence of banking-related issues and a variety of other factors and considerations. Across most jurisdictions, prospects of more persistent high services inflation amid still tight labour markets and low productivity growth is the key consideration.

**Domestically, the Papua New Guinea (PNG) economy is well placed for continued recovery for the medium term supported in part by the approval of US\$918 million Under the Extended Credit Facility and Extended Fund Facility by the International Monetary Fund (IMF).** Having experienced multiple shocks over past several years with adverse impact on economic growth among other spillover effects, PNG has significant development need. Hence, the 38-month arrangement (March 2023 to March 2026) by the IMF will support PNG's reform agenda, which seeks to help protect the vulnerable and foster inclusive growth. In 2023, the first drawdown was SDR65.8 million equivalent to USD88.3 (K310.9) million. The reforms will focus on strengthening debt sustainability, alleviating FX shortages, and enhancing governance and operationalizing the anti-corruption.

**Additionally, with international borders reopened, recovery from the pandemic well underway and optimism surrounding the mining sector gives the economy an edge for better growth prospects in 2023 and beyond.** After making a rebound in 2021, the PNG economy is estimated to have grown further in 2022 with an estimated real GDP growth of around 4.5 percent, marginally higher than anticipated mainly led by performance in non-resource sectors. Growth in 2023 is projected to be 3.7 percent, also driven by the non-resource sector with agriculture<sup>1</sup> remaining as the key contributor to the economic recovery in 2023 supported by growth in private sector credit and higher Government spending. The other major sectors to drive growth in 2023 include public administration & defense, education, health & social activities, information & communication, accommodation & food services, finance & insurance activities, transport & storage and commerce sectors. Output in 2024 is expected to accelerate to 4.4 percent, on the back of the resumption and full production at the Porgera gold mine<sup>2</sup> (IMF, April 2023 World Economic Outlook). Growth will further increase if the Papua Liquefied Natural Gas (LNG) project commences and other resource projects in the pipeline come on stream. For the Papua LNG project, the Front End Engineering and Design is currently underway, with the Final Investment Decision expected to be concluded in the next 18 months.

Chart 1: PNG Real GDP

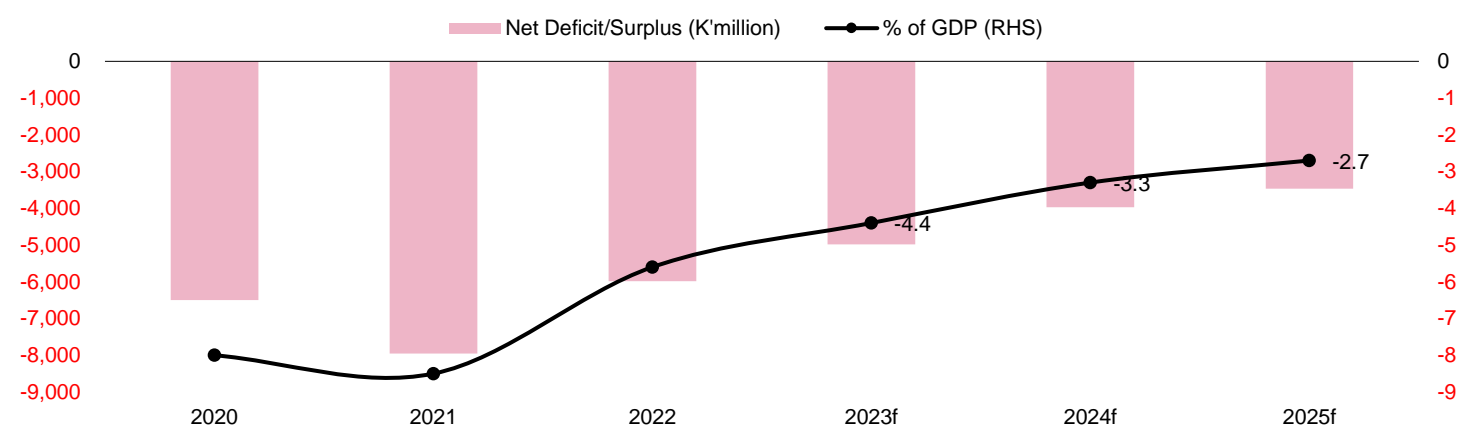


<sup>1</sup> The increase is reflective of the higher production of coffee, palm oil, copra and copra oil reflecting support from various Government's subsidies and assistance from development partners

<sup>2</sup> The recovery in the resource sector has been impacted by delays in reopening of the Porgera gold mine and planned maintenance shutdown of LNG production

**The post-pandemic recovery has also been supported by higher Government spending.** The Government's preliminary fiscal budget outcome for the eleven months to November 2022 showed a deficit of K1,576.6 million, which was mostly financed by domestic sources (K2,019.7 million). The deficit was much lower than the corresponding period in 2021 (K3,398.1 million) due to windfall revenue totalling K3,804.9 million from LNG taxes due to substantial increases in international price of crude oil and LNG.<sup>3</sup> The 2023 Budget has planned expenditure of K24,566.9 million and revenue of K19,582.0 million, giving a deficit of K4,984.9 million, which equates to 4.4 percent of nominal GDP. The deficit will be financed from domestic sources totalling K1,465.7 million and external financing of K3,519.2 million. Of the net domestic financing, K525.7 million will be from new Treasury bill and K945.0 million from Treasury bond issuances, more than offsetting loan repayments of K5.0 million. In terms of debt, external debt burden as a proportion of total debt has increased significantly over the last five years. It was 27.1 percent in 2017, and has increased to an estimated 49.2 percent at the end of 2022. Although, external loan drawdowns have significantly contributed to increasing the country's foreign reserves, these debt-related inflows are temporary, as they would flow out as repayments in foreign currency to service the Government's foreign debt, which places PNG in high risk of debt distress. In the event of a large kina depreciation, debt burden will increase further.

Chart 2: Fiscal Performance and Projection 2023

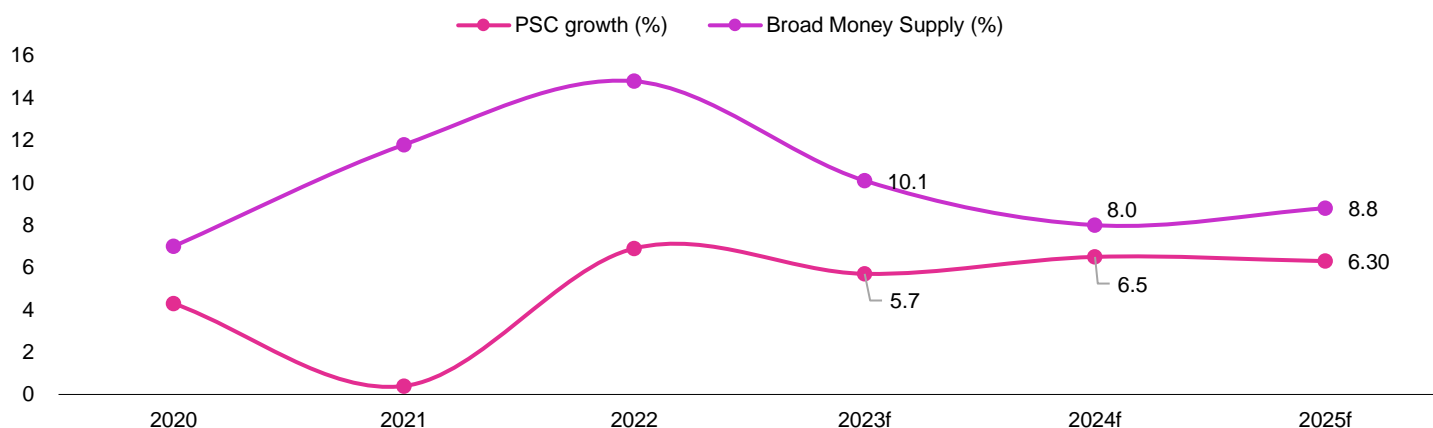


Source: Bank of Papua New Guinea

**The level of liquidity in the banking system increased further and was mainly used for investment in government debt securities by commercial banks, including funding of foreign exchange transactions.** Money supply increased by 14.8 percent in 2022, driven by Net Foreign Assets of 52.4 percent and Net Domestic Assets of 0.3 percent. The increase in NFA mainly reflected LNG tax revenue and external borrowing for the 2022 National Budget while the growth in domestic credit was attributed to higher net claims on Central Government, reflecting increase in holdings of Government's securities and an increase in private sector of 6.9 percent. Deposits at commercial banks have increased significantly driven mainly by increased Government spending. Going forward, according to Bank of PNG, money supply is expected to increase by 10.1 percent in 2023 led by increase in domestic credit which in turn reflects the growth anticipated in net claims on Central Government and PSC. The increase in net claims on Central Government reflects Government debt issuance and the growth in PSC is associated with an increase in economic activity in the non-mineral sector.

3 As a result, a Supplementary Budget<sup>17</sup> was passed in November 2022, in which K1,588.5 million was allocated to new expenditures and around K1,000.0 million was used to repay domestic debt.

**Chart 3: Money Supply**

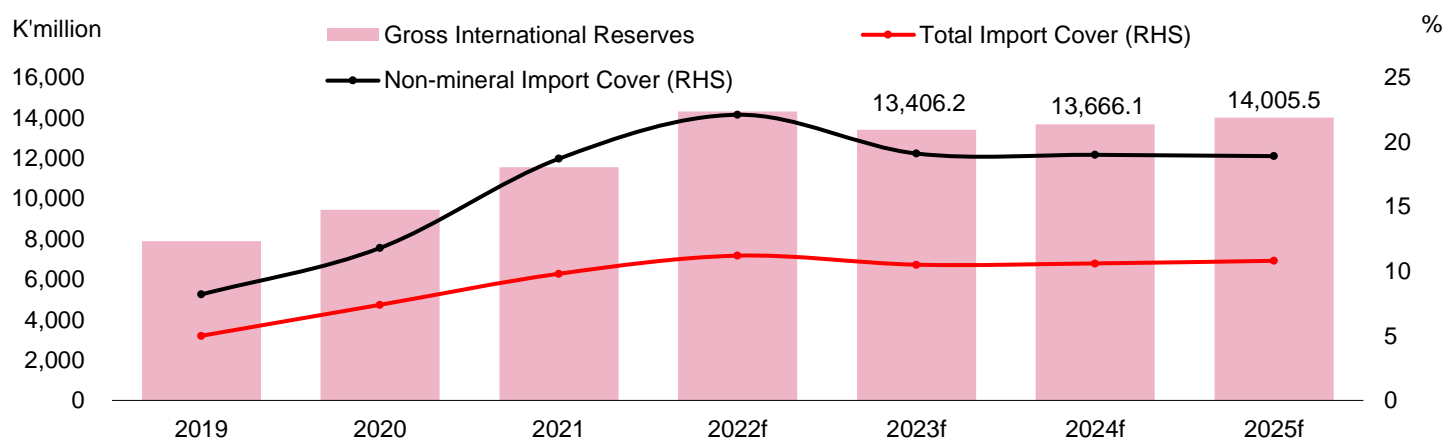


Source: Bank of Papua New Guinea

**Externally, PNG's balance of payments position remained in surplus mainly driven by a record export receipt as a result of higher production and international prices of major export commodities, particularly crude oil and LNG.** For 2023, the Bank of PNG projects an overall BOP deficit of K1,143.7 (US\$324.8) million, reflecting a deficit in the capital and financial account of K30,065.0 (US\$8,538.5) million, which more than offset a surplus in the current account of K28,921.4 (US\$8,213.7) million. This is reflective of a build-up in offshore foreign currency account balances of mineral companies including the LNG project partners and debt service payments.

**As at end of 2022, the level of gross foreign reserves was US\$4,132.2 (K14,298.4) million, compared to US\$3,290.3 (K11,346.0) million at the end of December 2021.** This is sufficient to cover 11.2 months of total imports and 22.1 months of non-mineral imports. As at March 2023, the gross foreign reserves declined to US\$3,981.8 (K13,778.0) million, reflecting Government debt repayments and foreign exchange interventions by the Central Bank. The country's foreign reserves are projected to improve in the outer years as the Porgera gold mine reopens and the Papua LNG project construction commences. The inflow of IMF funding of US\$918.2 million over the next three years for Government budget support will have a minimal net effect on the BPNG's international reserves due to increase in intervention and Government debt repayments. To ensure a sustainable level of international reserves it may require policy trade-offs to allow the kina to find its market clearing rate. This may exert a downward pressure on the exchange rate to depreciate, which would be inflationary.

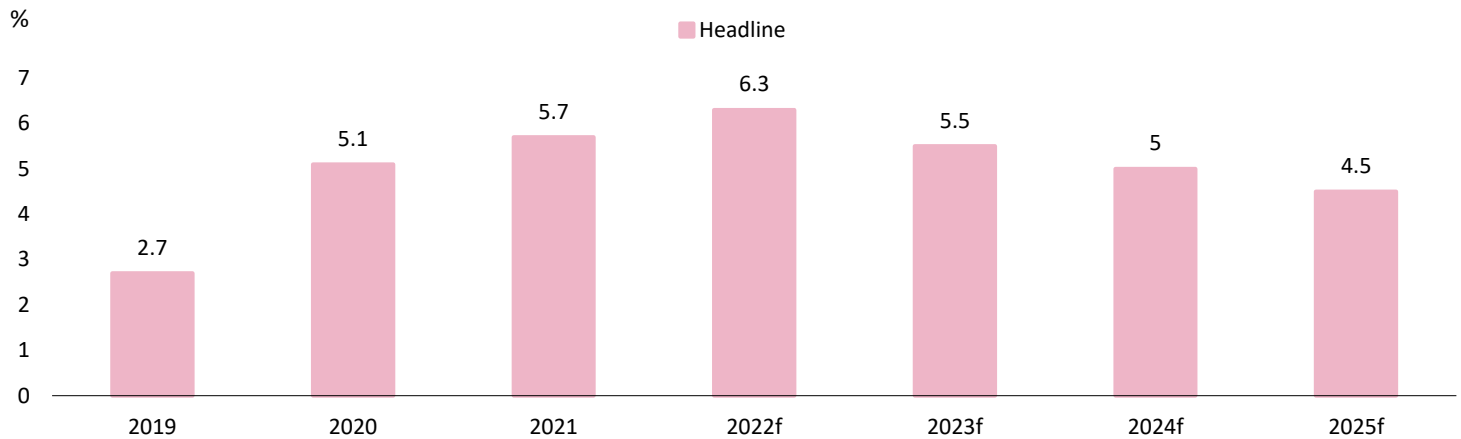
**Chart 4: Foreign Reserves**



Source: Bank of PNG

**Inflation remains a challenge although expected to ease this year.** Annual headline inflation was 6.3 percent in the September quarter of 2022, led by higher imported inflation from PNG's trading partner economies, which pushed up domestic prices for alcoholic beverages, tobacco & betelnut, household equipment, transport, food & non-alcoholic beverages & health. The Bank of PNG forecasts annual headline inflation to be around 5.5 percent in 2023, mainly driven by expectations that foreign inflation would ease following progressive increases in policy interest rates by the central banks in the advanced economies. In response to high inflation, the Bank continued with its tightening stance of monetary policy by further increasing the Cash Reserve Requirement of commercial banks from 9.00 percent to 10.00 percent in December 2022. In January 2023, the Bank further tightened by increasing the Kina Facility Rate (KFR) by 0.25 percentage points to 3.50 percent.

Chart 5: Inflation in PNG



Source: National Statistics Office and BPNG

**Overall**, economic activity in PNG recovered strongly in 2022, compared to 2021 in spite of the slowdown in the global economy. PNG's real GDP has rebounded. This growth was driven by increases in production and sales in both the mineral and non-mineral sector as a result of the lifting of COVID-19 restrictions, increases in international commodity prices and Government's expansionary fiscal policy. Strong business activity reflecting higher sales by the private sector and an increase in employment level supported by growth in private sector credit contributed to the recovery in economic activity. Having said that, the downside risks to growth remain which includes a further slowdown in global growth, further tightening of financial conditions and uncertainties in the global financial markets, and the prolonging of the Russia-Ukraine war.

## Economic & Financial Statistics/Forecasts

### Economic Statistics

PNG	2019	2020	2021	2022f	2023f	2024f	2025f
Money Supply (%)	4.4	7.0	11.8	14.8	10.1	8.0	8.8
Private Sector Credit (%)	4.0	4.3	0.4	6.9	5.7	6.5	6.3
Current Account (K millions)	18,522.2	17,281.4	20,151.0	31,746.6	28,921.4	26,633.8	29,275.4
Gross International Reserves (K millions)	7,880.0	9,437.9	11,544.9	14,298.4	13,406.2	13,666.1	14,005.5
Total Import Cover (months)	5.0	7.4	9.8	11.2	10.5	10.6	10.8
Non-mineral Import Cover (months)	8.2	11.8	18.7	22.1	19.1	19.0	18.9
Headline Inflation	2.7	5.1	5.7	6.3	5.5	5.0	4.5
Fiscal Surplus/Deficit (K Million)	-4,172.1	-6,501.50	-7,955.50	-5,984.70	-4,984.90	-3,968.70	-3,462.40
Deficit % of GDP	-5.0	-8	-8.5	-5.6	-4.4	-3.3	-2.7

Source: Bank of PNG, International Monetary Fund and National Statistics Office

### Interest Rate Forecast

Australia	Latest	Jun-23	Sept-23	Dec-23	Mar-24	Jun-24	Sept-24	Dec-24
Cash	4.10	4.10	4.35	4.35	4.10	3.85	3.60	3.35
10 Year Bond	3.64	3.40	3.30	3.20	3.00	2.80	2.70	2.50
US								
Fed Funds	5.125	5.125	5.125	4.875	4.375	3.875	3.375	2.875
US 10 Year Bond	3.61	3.50	3.40	3.30	3.10	2.90	2.80	2.60
New Zealand								
Cash	5.50	5.50	5.75	5.75	5.75	5.75	5.25	4.75
10 Year Bond	4.30	4.20	4.15	4.10	3.95	3.80	3.75	3.70

Source: Westpac Economics

## Global & Trading Partner Growth Forecast

	2019	2020e	2021f	2022f	2023f	2024f
World Economy	2.8	-3.1	6.0	3.4	2.8	3.0
US	2.2	-3.4	5.7	2.1	1.6	1.1
Eurozone	1.3	-6.4	5.2	3.5	0.8	1.4
Australia	2.0	-2.1	4.9	3.7	1.6	1.7
New Zealand	2.9	-2.1	5.6	2.4	1.1	0.8
Japan	0.3	-4.5	1.7	1.1	1.3	1.0
China	6.0	2.2	8.1	3.0	5.2	4.5
India	4.2	-6.6	8.7	6.8	5.9	6.3

Source: International Monetary Fund, World Economic Outlook



## For queries; contact

**Krishal Prasad**  
**Senior Economist**

[krishalprasad@westpac.com.au](mailto:krishalprasad@westpac.com.au)

Ph: +679 9995 184

### IMPORTANT DISCLAIMER

*The information in this article is general information only, it does not constitute any recommendation or advice; it has been prepared without taking into account your personal objectives, financial situation or needs and you should consider its appropriateness with regard to these factors before acting on it. Any taxation position described is a general statement and should only be used as a guide. It does not constitute tax advice and is based on current tax laws and our interpretation. Your individual situation may differ and you should seek independent professional tax advice. You should also consider obtaining personalised advice from a professional financial adviser before making any financial decisions in relation to the matters discussed.*

