

Survey of the PNG economy

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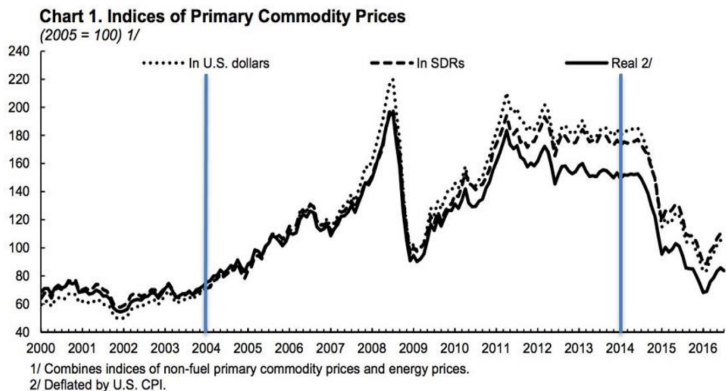
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August 1, 2017

PNG'S RESOURCE BOOM: 2004-2014

Figure: Commodity Prices, 2000-2016



Survey of Recent Developments:

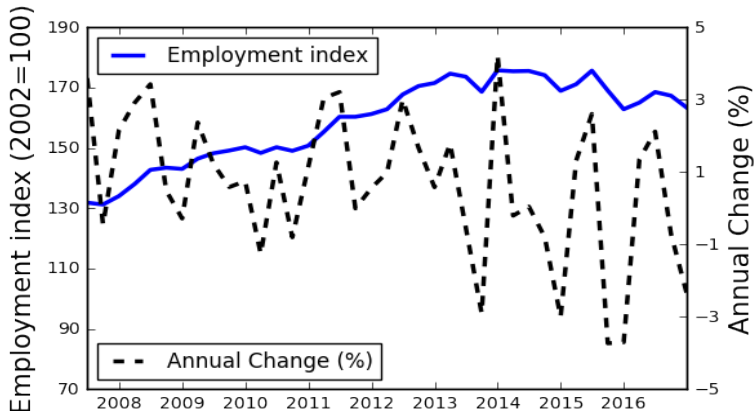
I. Economic Growth, Employment, and Inflation

GROWTH SLOWDOWN



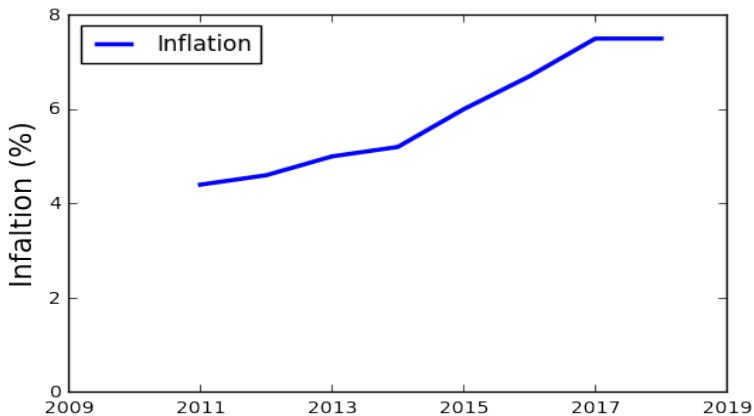
Source: Devpolicy PNG Budget Database

FORMAL SECTOR EMPLOYMENT IS SHRINKING



Source: BPNG

INFLATION IS INCREASING



Source: BPNG

OTHER INDICATORS

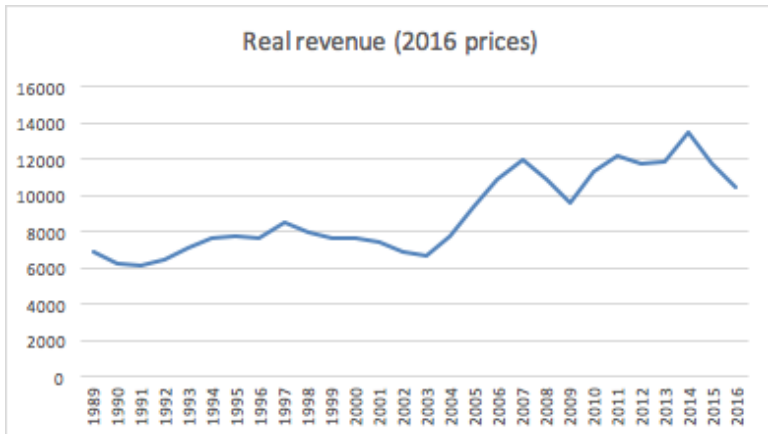
- Businesses uniformly report 20-35% drops in sales.
- But no recession according to official numbers (!).

- Due to good coffee harvest, 2016 slightly better than 2015.
- Harvest expected to be worse in 2017 (750-850k bags vs. 1.1M), so sales flat (at best).
- Election period will disrupt coffee production and other economic activities for at least 2 months.

- In any case, average living standards are falling given high population growth ($> 3\%$)

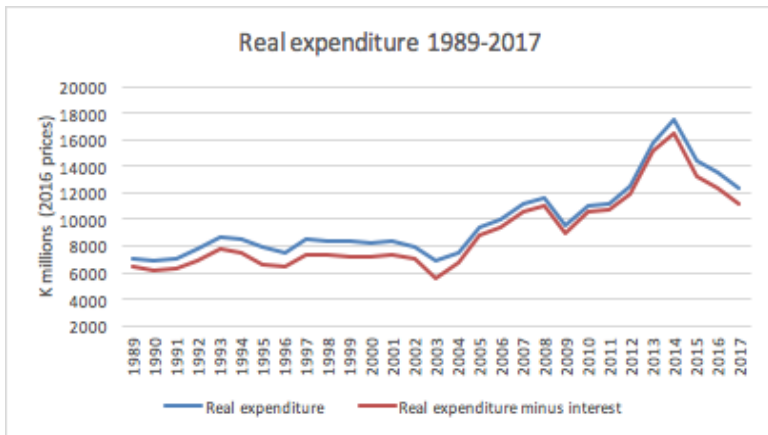
II. Fiscal Policy

REVENUE IS DOWN



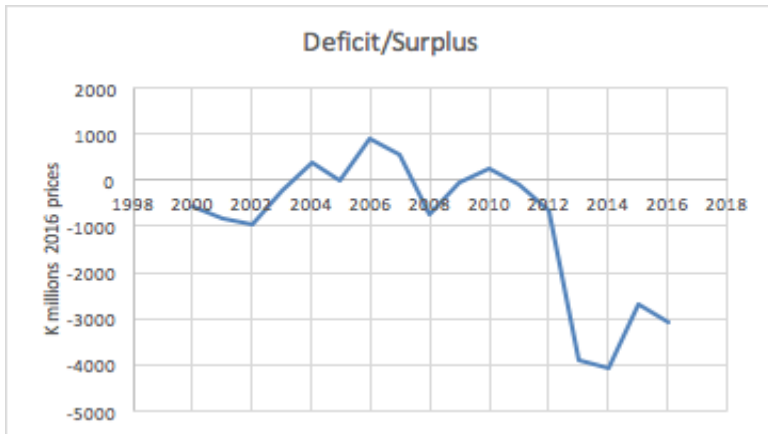
Source: Devpolicy PNG Budget Database

EXPENDITURE BACK AT PRE-BOOM LEVEL



Source: Devpolicy PNG Budget Database

RECORD-HIGH DEFICITS



Source: Devpolicy PNG Budget Database

DEBT INCREASING RAPIDLY

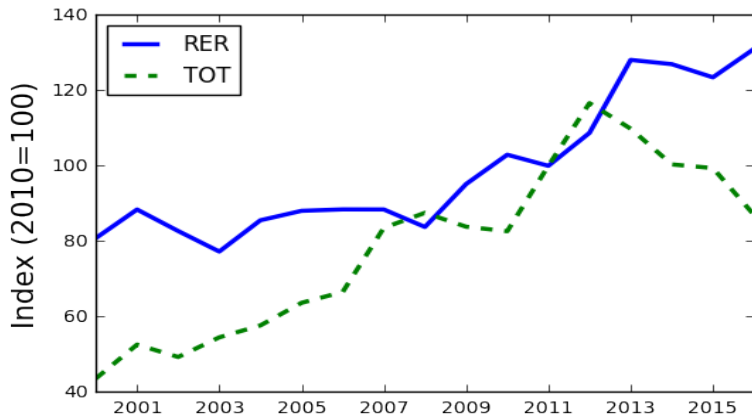


Source: Devpolicy PNG Budget Database

III. The Real Exchange Rate (RER)

BACKGROUND

Figure: Real Exchange Rate (RER) and Terms of Trade (TOT), 1999-2016



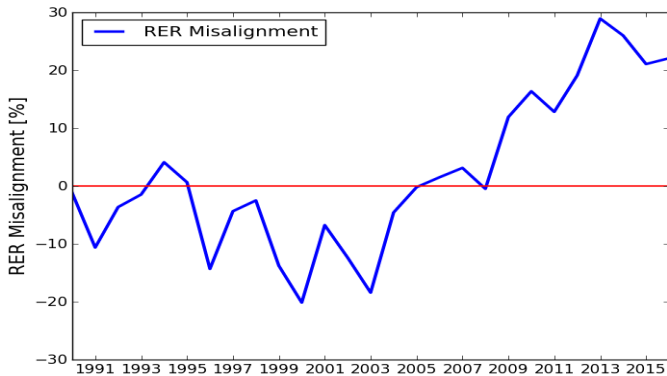
PGK/USD EXCHANGE RATE, 2013-2017



- Theory: Sharp RER appreciation during resource boom and decline of tradable sector ("Dutch Disease").
- After the boom, RER depreciation needed to restore internal and external balance.
- In PNG, RER continued to appreciate even after the boom (see previous Figure)
- Reserves declined from US\$ 4B in 6/2012 to US\$ 1.7B in 12/2016.
- FX restrictions since 2014 (US\$ 300M-1B excess demand).
- Fox & Schröder (2017): kina overvaluation = 20%.
- Black market premium (AUD): about 15% (reportedly).

EXTENT OF KINA OVERVALUATION

Figure: RER misalignment (%), 1990-2015.



Note: Positive values indicate RER overvaluation.

CONSEQUENCES OF FX RESTRICTIONS

- FX has become number 1 issue for PNG businesses.
- Processing time of FX-orders: Currently 8-14 weeks.
- Invoices outstanding now 60-180 days vs. 14d credit line.
- "Dollarized" debt piles up while kina is pressured to depreciate.
- Overseas suppliers may lose/have lost their patience.
- MNEs cannot repatriate profits.
- Administrative burden to manage FX-crisis increases costs.

- Macroeconomic adjustment to end of resource boom postponed for years.
- RER overvaluation leads to resource misallocation → lower growth.
- PNG gov't strategy: bank on new resource project(s) within 12-24 months.
- "Fear of depreciation" based on bitter memories of the 90s.
- "Elasticity pessimism" (despite empirical evidence against).

IV. Outlook

OUTLOOK

- General expectation that economy has reached the bottom.
- Next resource project unlikely before end of 2019.
- No clear alternative gov't strategy visible.
- FX-restrictions put economy into a straitjacket.
- FX-restrictions not sustainable in long run → BOP crisis (?).
- No quick recovery in sight at least until 2019.

- Agribusiness around Lae/Morobe province has great potential.
- Investments in Highlands Highway underway.