



Bank of Papua New Guinea

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### **Introduction**

In my presentation, I will briefly restate few key issues and challenges we face in PNG that has partly resulted in state of the economy that we have experienced over the 4-5 years, in particular the foreign exchange market. This should then set the stage for the way forward with an economic agenda for the Government, as well as setting the parameters and targets for the next five years.

### **State of Economy**

In the years since the commencement of construction of the PNG LNG project in 2010 and production in 2014, the Papua New Guinea economy went through a structural change. This change is reflected in:

- a. During the construction stage and the first two years of production from May 2014, to the end of the first year of full production in 2015, economic growth as measured by the growth in Gross Domestic Product (GDP) was very high, on the average 10% per annum and above. This

changed the structure of the Papua New Guinea economy from a "low income developing country" to a "medium income developing country".

b. The exceptionally high growth of the economy, combined with the very large increase in exports, resulted in a surplus in the current account.

## **Ongoing Structural Issues**

### *a. High Imports of Food*

Despite the significant growth rate of the economy and current account surplus, our imports of food products remain high. The surplus in the current account did not translate to increased revenue for Government and foreign exchange inflows, and we know the reasons. I'm particular about food imports because it constitutes the highest demand for foreign exchange and not matched by any foreign exchange revenue from food exports. This is an area of great potential for investment given the land mass and suitable land conditions we have, which can contribute to replacement of food imports and exports of the surpluses.

There are positive signs of large-scale investments in food production happening like in rice and vegetables, and more investments are encouraged.

### *b. Consumption behaviour*

We know it will take a long time to change consumption behaviour of our population, but some change need to happen to move away from high consumption of imported food to locally produced food. I guess, this is one consequence of the change in the economy structure from low income to middle income country.

### *c. Adjustments to Foreign Exchange Market Situation*

Some positive adjustments undertaken by companies to navigate their operations out of the foreign exchange situation were notable during the past few years. Examples include:

- divert to purchase of local products/inputs
- close off certain operations/business
- defer new investments or capital works
- borrow in foreign currency

### *d. Biggest Problem Remains-narrow export base of non-mineral sector*

Given the narrow export base of non-mineral sector and reliance on mineral projects and exports, the country has not reached a point of being Resilient to various shocks, both internal and external. The recent and past declines in oil and mineral prices have greatly affected both the Government budget and foreign exchange market. If we had a much more broader non-mineral export sector in place to provide alternative source and sustain both the Government revenue and foreign exchange market, the economic growth would have been sustained.

## **Future Prospects of Economy**

### ***a. Short Term-current situation to continue***

The story about the short-term prospects is often blurred by a lot of different views and comments. But as long as we have the same constraints and issues we currently face, and don't try to address them, the short-term problems can potentially evolve into longer-term issues and strain future prospects.

On a positive front, the Government has continuously acted to address some of these shortcomings through various ways such as:

- Supplementary budgets

- Legislative changes
- Consistent policies
- Inclusion of agriculture and tourism sector developments in its priority areas
- Measures in 100 day plan

Overall, the short term situation is expected to continue into 2018, and PNG has somewhat shown resilience in withstanding the slow down in the economy. So such forums like this to inform existing and potential investors and provide factual information to external analysts and commentators on the economic situation and how they are being managed, is important.

### ***b. Medium to Long Term-very positive***

The story about the medium to long-term prospects is a consistent one. From the Government and views from all sectors within the country, to international financial institutions, donors, international lenders and rating agencies, the positive prospects of the economy remains. Triggers for this view are many including the developments of the pipeline mineral and gas projects, the diversification of the economy slowly taking place and benefits of Government priority areas of education, health, infrastructure and law and order. The benefits from these priority development areas take time to be realised.

### ***c. Insight into Benefits from LNG project***

The population in the provinces, where the Gas is extracted from Hela and Southern Highlands, and the ones through which the pipeline is passing and the processing is done, will directly benefit from the development levies and royalties paid, as well as the dividend paid on the 2.25% equity held by MRDC for the landowners. They will also benefit from the 4.27% equity they are entitled to get from the 16.8%

held by Kumul Petroleum Holdings Limited (KPHL). The rest of the country will benefit from the dividend paid on the 12.53% held by KPHL, which is paid annually, even at the very low prices that prevail as of 2015.

Once the period of the accelerated depreciation will be exhausted, estimated to be around 2021-2022, the project will commence paying taxes, which the Government will use to build up balances in the Sovereign Wealth Fund, development expenditure and spread the benefits to the rest of the nation.

### **Potential Steady State Growth Rate**

The question that we policy makers have been deliberating is: "What is the potential of the Steady State Growth of the Papua New Guinea economy, excluding the mining and petroleum sectors". This question is relevant to address the challenge of ensuring we reach a point of economic development where the economy can be able to sustain itself and be resilient to various shocks.

Following some detailed comparative analysis by BPNG, with other similar countries, we concluded that it is around 6% to 7%. I will try to point out, what can and should be done to achieve this "Steady State Rate of Growth".

In 2012, the Government committed to priority areas of Free Education, Free Basic Health Services, Improving Law and Order and Infrastructure Development. These priorities have to be continued with some refocus into high impact efficient activities. In 2017, the Government should add: (1) Development of major agricultural projects to achieve self sufficiency in food production, import replacement and export of agricultural products; and (2) Pursue the development of the tourist

industry. As I already mentioned, it's positive that the Government has targeted these areas a priority. I will elaborate on those areas here:

Working toward those two objectives, will result in a continuous non-interrupted growth of the economy, at its Steady State Growth Potential of 6% to 7%. The mineral and petroleum developments will be the icing on the cake that will top it up, during the periods of construction and initial years of production. It will also result in an improvement in the standard of living of the 81% of the population living in the rural areas.

The objectives should specify:

- a. Replacement of rice imports with domestic production;
- b. Replacement of soya bean imports with domestic production;
- c. Replacement of stock feed imports with domestic production;
- d. Replacement of all other grain Imports (Wheat, Sorghum Maze) with domestic production.

In addition, the many other agriculture products should also be tested and introduced as part of diversification of products. Even the existing agriculture products like coffee and cocoa should be restructured and managed differently under different models.

These objectives can be achieved through deliberate actions, committed investments, landowner and local equity participation, and others. But two important success factors are the use of modern technology and new innovations in various stages of production and the type of model to be used. The model here refers to either a nuclear estate type or plantation type.

The diversification and import replacement in agriculture and food subsectors will result in many thousands of millions of US\$ production

for import replacement, open the potential for exporting of agricultural products on a large scale, to the main importing countries in the Pacific and Asian region.

In the Tourism industry, Papua New Guinea should concentrate its efforts and investments in the niche markets of diving, surfing, white water rafting, trekking, bird and wild life animal watching and the many attractions of its cultural, traditional and anthropological diversity, it is offering. The competition on mass tourism, sea side sun bathers, resort visitors and gambling in the region is very high from our close neighbours like Australia and Fiji and it will be difficult to match their prices, and the attractions they offer to those sectors of visitors.

### **Encouraging Other Sectors**

I have no doubt that there will be room for many small to medium size enterprise's (SME's) entrepreneurs, in both the agriculture and the tourism sectors and some new sectors like small/light industrial manufacturing.

This is where the Central Bank's efforts to develop an efficient country wide Payment System and Financial Inclusion is important in facilitating these developments. The operation of the Kina Automated Transfer System (KATS) is complete. The basic service the system provides to the Government, banks and financial institutions is operational, including the Banking Services System (BSS). The Bank of Papua New Guinea moves to the next level, to implement the Retail Electronic Payments System (REPS), which will allow payment to any account at any other connected institution, using a card, mobile phone, on line payment or any other electronic medium.

The challenge to bring financial services to our rural people remains. We continue to explore innovative ways and products to assist in this journey. Such innovations include blockchain technology, which we are studying to understand its benefits and implications as another tool to drive financial inclusion.

Thank you for listening.

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