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PACIFIC ECONOMIC AND MARKET INSIGHTS

September Quarter 2022

Key trends at a glance

GLOBAL ECONOMY SLOWS DOWN



- The World Bank estimates that global growth will slow from the 6.1% recovery in 2021 to 3.2% in 2022, then 2.9% in 2023. This is largely due to supply chain issues and inflation.
- Ongoing tensions in Europe pose headwinds globally, as Russia moves to formalise its annexation of four (4) Ukrainian territories.
- Increased money supply from COVID-era stimulus, coupled with current shortages of oil on the global market, sees inflation increasing globally.



COMMODITIES WEAKENED

- Tighter monetary conditions as well as reduced consumption and high inflation, are skewing risks towards a recession and causing oil prices to fall even though a global shortage persists. OPEC+ has agreed to a historic production cut of 2 million barrels per day to maintain higher prices.
- Gold prices lost momentum in Q3-22, due to the surging US dollar (which makes gold more expensive) and higher bond yields (which is a substitute investment).
- Coffee prices gained momentum in Q3-22 due to supply shocks, but prices were still lower compared to Q2-22. The threat of a global recession adds downward pressure on prices for the remainder of 2022.



PNG BOOSTED BY RESOURCE PRICES

- PNG's outlook has improved according to the ADB, with higher growth expected at 3.5% in 2022 and 4.9% in 2023. High import price and the Russia-Ukraine conflict are key headwinds to consider.
- Higher commodity prices and future prospects in mining and petroleum underpin the improved outlook. Other segments of the PNG economy are expected to make forward strides in 2023.
- The resources sector contributes 39% to PNG's domestic production, according to the Chamber of Mines and Petroleum. The sector beat revenue projections in 2022 due to high energy prices which enabled a spending increase by the Government in the Supplementary Budget.
- BPNG has tightened monetary policy in Q3-22, by raising the KFR to 3.25% and the CRR to 9.0%. This has the intended effect of limiting the financial system's ability to create credit, with the aim of dampening consumption to counter recent inflationary pressure.
- Agriculture was among the key contributors to the economic recovery. Strong results were particularly driven by higher export volumes of palm oil. This led to solid growth in agricultural export receipts (+50% YoY) – in particular receipts from the export of palm oil doubled.



ECONOMIC GROWTH FOR THE SOUTH PACIFIC

- Economic growth in the sub-region is expected to grow by 4.7% in 2022 and 5.5% in 2023, driven by rising visitor arrivals expected to support tourism-dependent Pacific economies.
- Given the high reliance on imported goods, the Pacific Island nations are particularly prone to high global inflation. Progression of national vaccination programs in most countries has also allowed for the reopening of the tourism industry whilst minimising health risks.

REAL GDP GROWTH

	2021	2022	2023
	-4.1%	+11.7%	+8.5%
	-0.5%	-4.2%	+3.0%
	-7.1%	-5.3%	+2.0%
	-2.7%	-2.0%	+3.7%
	+1.0%	+2.0%	+4.0%
	-29.1%	+10.5%	+11.2%

Source: ADB September 2022 Economic Forecasts.

BSP's economic and market views



Robin Fleming

Group Chief Executive Officer

What are your views on inflation, and what impact will this have on the PNG economy?

- *The National Statistics Office (NSO) estimates inflation at 5.5% at the end of June 2022. The Bank of Papua New Guinea further estimates that inflation for the year will end up at 6% in 2022.*
- *This is driven by higher prices for imports of fuel and household goods. Given PNG's reliance on imports and the lack of domestically produced substitutes, PNG remains highly exposed to global inflation.*

How has BSP responded to the increase of the Kina Facility Rate (KFR) by the Bank of Papua New Guinea?

- *To help control inflation, BPNG has increased the KFR from 3.00% to 3.25% in July. The KFR increase had the intended effect of increasing the cost of borrowing in order to cool down spending and reduce inflation.*
- *BSP adjusted its Indicator Lending Rate (ILR) with a 0.25% increase, in line with the KFR increase, enabling the transmission of policy rates into market rates. In addition, interest rates paid on customer deposits were increased to pass on the full benefit of the KFR increase to our customers.*

The 2022 Supplementary Budget was passed in September, what are your key takeaways from the Budget.

- *The Supplementary Budget increased government spending by K1.2 billion to K23.4 billion.*
- *PNG's oil, gas, and resource sector performed well, due to the supply shortages and the Russia-Ukraine conflict. The resources sector exceeded budgeted tax revenue by +300%, and dividends by 75% as a result.*
- *The new budget envelope means that Government spending will be equal to 21.2% of GDP. Spending of this magnitude by the government provides economic stimulus in the short term, but adds to inflationary pressures.*
- *The Fiscal Policy expansion seems at odds with BPNG's contractionary Monetary Policy stance. Greater coordination is needed between the two arms of government economic policy to maintain the soundness of the economy and the effectiveness of Monetary and Fiscal policy in the long-run.*

BSP's economic and market views



Peter Beswick

Group General Manager – Corporate Bank

Do you have any concerns regarding inflation?

- *BPNG's Monetary Policy Statement (MPS) issued on 30 September reconfirmed its stance to tighten Monetary Policy and counter the high domestic inflation. Headline CPI for June quarter 2022 tapered to 5.5%, against 6.9% in the prior quarter. This is a positive sign, however inflation remains a key concern impacting business costs and consumer purchasing power nationally.*
- *The key inflation drivers remain unchanged with elevated price levels ascribed to supply-chain disruptions, logistics costs, and fuel prices.*

What recent trends have you seen in business confidence?

- *The Prime Minister's 11th Parliament opening address "Restructuring Governance & Real Development Outcomes" was well received by the market, with its key focus on support of foreign direct investment and agricultural outputs that have high potential to be competitive across global markets.*
- *With the conclusion of the national election, we are seeing an uplift in consumer and business enquiries for investing and spending across all sectors. This is expected to build momentum ... leading into a strong 2023/24, initially driven by Barrick's reopening of the Porgera Gold Mine and then Papua LNG financial investment decision (FID).*
- *The continued increase in BPNG's foreign currency reserves to PGK12.7 billion, or USD3.6 billion, as at 31 August (reported in the MPS) is another positive indicator. Higher FX reserves should allow for increased business imports and will deliver strong economic and business activity.*



Rohan George

Group General Manager – Treasury

How was foreign exchange liquidity and the Kina in the Third Quarter of 2022?

- *FX market turnover in the September quarter fell by 6.4% from the June quarter 2022. However, year-to-date turnover increased by 15% compared to the prior year. This was supported by strong commodity prices, in particular Oil, Copper, Palm Oil, Coffee. Firmer commodity prices assisted to offset the lost FX inflows from the closure of the Porgera gold mine.*
- *Outstanding FX orders with BSP have doubled in the past quarter, affected by lower August and September FX inflows, large crude oil imports and pre Christmas stocking.*
- *BPNG FX intervention in the September quarter 2022 fell 25% compared to June quarter.*
- *The Kina mid-rate was stable against the U.S. dollar at 0.2840. Recessionary fears amid a tightening of monetary policy in Australia and widening unfavorable interest rate differentials weakened the Australian dollar and saw Kina rise 10.4% against the Australia dollar, cushioning imported inflation on Australian goods.*
- *BPNG raised the Cash Reserve Requirement (CRR) of commercial banks to 9% of total deposits, a tightening monetary policy to combat inflation. With the intent of seeing reduced liquidity, higher interest rates and reduced demand.*

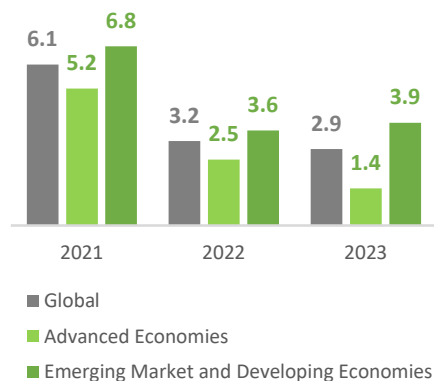
What's the outlook for FX inflows for the upcoming quarter and how should Corporate and Retail customers manage volatility in foreign currency inflows?

- *After light FX inflows in the September quarter, we expect pre-Christmas import orders to increase in early in October and November, before end of year FX inflows satisfy the market's foreign currency appetite.*
- *BPNG enhanced exchange control compliance measures in the June quarter.*
- *To manage volatility in foreign currency flows, businesses should place FX orders (with correct documentation), as soon as possible, ensure orders are cash backed whilst awaiting execution, tax clearance certificates are current and reflect the expected FX order execution time.*

Global growth outlook

Global economic performance was resilient in the first half 2022, but has weakened significantly since the start of Q3-22 due to the impact of inflation, supply chain bottlenecks, and tighter monetary policy. The global economic outlook remains challenging with private consumption weakened, amid inflationary pressures, and the threat of a recession looming large over investment decisions.

GLOBAL GDP GROWTH



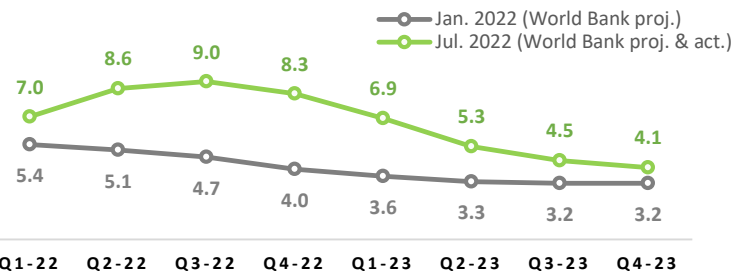
WORLD BANK ECONOMIC OUTLOOK – REAL GDP GROWTH						
Market	World Bank Prior Forecast [April - 22]		World Bank Current Forecast [July - 22]		World Bank-change	
	2021f	2022f	2021f	2022f	2021f	2022f
	USA	-1.40%	-1.00%	2.30%	1.00%	3.7%
China	-1.10%	-0.50%	3.30%	4.60%	4.4%	5.1%
East Asia Pacific	7.20%	4.40%	2.60%	5.30%	-4.6%	0.9%
Euro	-0.20%	-1.10%	2.60%	1.20%	2.8%	2.3%

- Global real GDP growth is expected to slow significantly from a strong recovery of 6.1% in 2021 to 3.2% in 2022 and 2.9% in 2023, according to World Bank forecasts.
- The advanced economies’ real GDP growth is expected to grow by 2.5% in 2022, a sharp decline from the 5.2% pace of 2021.
- The US and Eurozone economies are facing high stagflation risks but developing and emerging markets could be hit hard if the global economy enters a stagflation era.
- China’s economy is expected to slow down to 3.3% in 2022 due to lower consumption and disrupted activities as the country retains its zero-COVID policy. China’s economy is expected to grow to 4.6% in 2023.

RUSSIAN-UKRAINE WAR ECONOMIC IMPACT

- Russia has unilaterally declared its annexation of four (4) Ukrainian regions. The possibility of a retaliation by Ukraine and its Western allies has damped market sentiment across the globe. PNG is highly exposed to these effects through its reliance on imports.

INFLATION



- Rising inflation has spurred the withdrawal of monetary stimulus, and the risk of an inflationary spiral may prompt even more aggressive tightening.
- Inflation is projected to surge further in many key economies as a result of ongoing increases in food and energy prices, curbing real incomes and consumer spending and further dampening the global growth outlook. The risk of global stagflation remains significant.

MONETARY STANCE

- More aggressive tightening by the US Federal Reserve and other central banks, is denting global demand and rattling financial markets, according to the ADB.

Source: World Bank July GDP forecasts, Euromonitor Economic Outlook Q3-2022

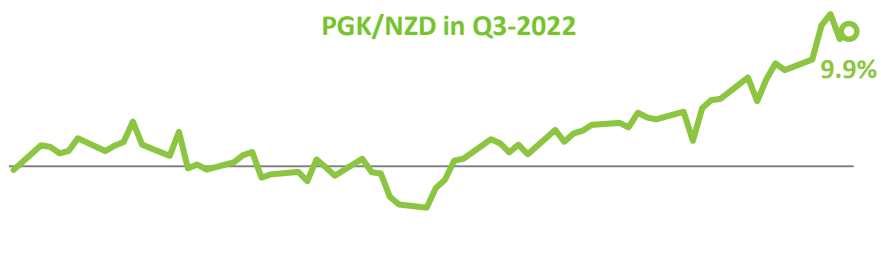
FX markets

The global economy is caught in an abnormal situation, where growth is contracting while inflation increases. Central banks are choosing to address inflation (at the cost of further suppressing growth) through rate hikes, causing shifts in currency markets and adding to the US dollar safe-haven appeal.

PGK/AUD in Q3-2022



PGK/NZD in Q3-2022



AUD/USD in Q3-2022



NOTES ON CURRENCY MOVEMENTS



- **PGK** – The PGK/USD reference mid-rate closed unchanged at 0.2840, at the end of Q3-22. The PGK is 5.5% stronger against the AUD, 9.9% against the NZD, and 7.8% against the Euro in Q3-22.



- **USD** – The US Federal Reserve has taken more aggressive steps to control domestic inflation relative to its peers. As a result, the USD surged against major currencies as investors and traders piled into the USD. The US dollar appreciated by 16% YTD.



- **AUD** – The prevailing pessimism in the global economy, especially in China, has impacted AUD rates. The commodity-dependent AUD, has seen a sharp depreciation towards the end of September as the US tightens monetary policy, and weakened against the USD by 5.5% in Q3-22.











- **NZD** – The NZD, similar to the AUD, is affected by the US Federal Reserve’s aggressive rate hikes. Inflation in New Zealand is not as rampant compared to the US, therefore similar rate hikes are not necessary. This leads to investment capital outflows chasing higher interest in US bonds and reducing the demand for NZD against the USD.

01-Jul-22 08-Jul-22 15-Jul-22 22-Jul-22 29-Jul-22 05-Aug-22 12-Aug-22 19-Aug-22 26-Aug-22 02-Sep-22 09-Sep-22 16-Sep-22 23-Sep-22 30-Sep-22

Source: Reuters, CNBC, Yahoo! Finance,

Commodity price trends

Commodity markets have been under pressure, due to worries about a global economic recession ... as central banks pursue aggressive monetary tightening amidst high inflation, further dampening global demand.

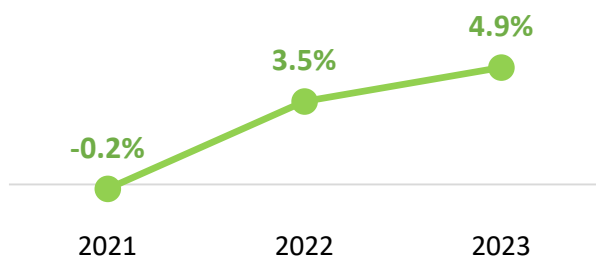
COMMODITY	Q2-2022 (Average price)	Q3-2022 (Average price)	CHANGE (%)	TREND	COMMENTS
Crude Oil, Brent [\$/bbl.]	112.7	99.2	(12.0)		Brent prices declined sharply in the Q3-22, amid concerns about a global economic recession and weak crude demand from the continued interest-rate hikes by global central banks. As the Q4-22 commences, OPEC+ has agreed to steep production cuts in November, in an attempt to improve oil prices.
LNG, Japan [\$/MMBtu]	16.7	20.6	23.5		LNG prices surged to record levels in Q3-22, on an expected pick-up in demand from China and ongoing concerns over curtailed Russian supply to Europe.
Gold [\$/troy oz.]	1,874	1,726	(7.9)		Gold prices fell in Q3-22, although tailwinds that usually propel gold higher were in place, the metal was overshadowed by the US dollar, which has been at its strongest since 2002. The longer-term outlook is bearish for gold given the picture around rates and Fed policy.
Nickel [\$/MT]	28,951	22,132.4	(23.6)		Nickel prices plunged in Q3-22 on the back of weaker demand in China from lockdowns and concerns around slowing economic growth outweighing supply disruptions.
Copper [\$/MT]	9,521	7,759.6	(18.5)		Like other base metals, copper prices fell in Q3-22 as fears of a global slowdown, weaker demand, a higher dollar and climbing stocks in London Metal Exchange (LME) registered warehouses sparked a sell-off.
Palm Oil [\$/MT]	1,634	997.3	(39.0)		Palm Oil prices plunged in Q3-22, as production and inventories outpaced demand. Demand from top consumer China is expected to pick up after it relaxes its COVID-19 restrictions.
Arabica Coffee [\$/kg]	5.9	5.8	(1.0)		Arabica coffee Q3-22 prices have been largely falling, driven by an expected rebound in production by the world's top producer and concerns a recession could dent demand.
Cocoa [\$/kg]	2.4	2.3	(4.0)		Despite a reduction in supply, cocoa trended downward in Q3. The downward price trend was attributed to concerns that rising prices of energy in Europe, together with a steady climb in the inflation rates could curb cocoa demand.

Source: capital, dailyfx, icco, reuters, spgglobal, World Bank September 2022.

PNG's economic outlook

Despite many challenges, Papua New Guinea's economy has weathered the pandemic well, relative to its neighbours. Real GDP in 2022 is projected at 3.5% by the ADB. The medium-term outlook is positive, supported by investment and higher revenues from the resource sector.

PNG'S GDP GROWTH OUTLOOK [ADB estimate]



- According to the ADB, Papua New Guinea's economy is projected to grow by 3.5% in 2022, driven largely by growth in the extractives sector.

MONETARY POLICY AND PRICE DEVELOPMENTS

- BPNG has tightened monetary policy in July 2022, by raising the KFR from 3.00% to 3.25% along with an increase in the CRR to 9.0% to counter recent inflationary pressure.
- PNG joins a long list of commodity-exporting countries that responded to the increasing trend in inflation by raising policy rates.

KEY MACRO FISCAL INDICATORS

- Available data for the first half of 2022 suggests that revenue collections are strongly outperforming forecasts built into the 2022 budget.

Indicator	2017	2018	2019	2020	2021	2022	2023	2024
						Est.	Projections	
Extractive Sector	8.1	-9.2	11.3	-8.4	-6.2	5.3	6.2	3.8
Non-Extractive Economy	0.5	4.1	1.4	-1.1	4.2	3.5	3.3	2.7
Overall Fiscal Deficit (% of GDP)	-2.5	-2.6	-5	-8.8	-6.8	-5.4	-4.6	-3.7
Public Debt, Net (% of GDP)	32.5	36.7	39.7	48.9	52.3	50.3	50.8	50.6
Current Account balance (% of GDP)	23.5	22.9	21.9	21	22	23.7	21.9	20.9

PNG'S TRADE STATUS

- Apart from global risks, regional risks, such as a structural slowdown in China and rising food prices, are likely to impact PNG directly and indirectly. Trade is the direct impact channel reducing export receipts. High energy and food prices are likely to have an impact on businesses and constrain private consumption. On the upside, elevated commodity prices are likely to increase PNG's exports.

HEADLINE INFLATION

- Higher food and energy prices prevailing in the international markets and inflationary pressures in the major trading partners imply that headline inflation will remain elevated in 2022 before settling down in 2023.
- The fiscal measures to mitigate the impact of higher fuel prices on domestic inflation, introduced by the 2022 budget amendments provide some relief.
- Accordingly, the BPNG should closely monitor external developments and adjust its stance monetary policy accordingly. The tightening of government spending can also ease inflation.

Source: BPNG Monetary Statement Sept, 2022, PNG National Control Centre 31/03/2022 report. World Bank-PNG Economic Update Sept 2022, EIU Website.

Resource sector updates

The resources sector is contributing 39% to PNG's GDP growth, according to the Chamber of Mines and Petroleum. PNG's oil, gas, and resource sector performed really well due to the supply shortages and the Russia-Ukraine conflict. The resources sector exceeded tax revenue projections by +300%, and dividend projections by 75%.

EXTRACTIVE RESOURCE SECTOR



POGERA MINE

- The shareholder agreement between Barrick Niugini Limited, the PNG Government, and various landowner groups was signed in September. This is an important step toward recommencing operations.
- The Managing Director of the Mineral Resources Authority, Mr. Jerry Garry, told media agencies that Porgera is set to reopen in the first quarter of 2023, if matters progress smoothly.

WAFI-GOLPU MINE

- Mr. Jerry Garry said the State and the project's developers of Wafi-Golpu, Newcrest Mining and Harmony Gold, were in the final stages of negotiations for a mining development contract.
- Accordingly, the Wafi-Golpu would sustain PNG's copper production in the event that the Ok Tedi mine in Western Province reaches its end-of-life in 2030.

OIL & GAS

- Kumul Petroleum has submitted a binding conditional offer to Santos for an additional 5% interest in the PNG LNG project for \$1.4 billion on 28 September 2022.
- Completion will be subject to customary conditions, including necessary regulatory approvals and on Kumul securing the finance.
- Santos chief executive, Kevin Gallagher, said the potential sale of the 5% interest represented an opportunity to build strategic alignment for the future development of PNG's natural gas resources, including via the PNG LNG infrastructure.

NON-EXTRACTIVE RESOURCE SECTOR









AGRIBUSINESS

- Agriculture was among the key contributors to the economic recovery. Strong results were driven by higher export volumes of palm oil. This led to solid growth in agricultural export receipts (+50% YoY) – in particular, receipts from the export of palm oil doubled.

Source: World Bank PNG Report, Business Advantage PNG, IMF, 2022 Supplementary Budget

South Pacific economic outlook

Economic growth in the sub-region is expected to grow by 4.7% in 2022 and 5.5% in 2023, driven by rising visitor arrivals in tourism-dependent economies, such as the Cook Islands and Fiji. Meanwhile, contractions are expected in 2022, given Tonga's major volcanic eruption in January, and in Samoa and Solomon Islands due to mobility restrictions in response to local outbreaks of COVID-19 in the first quarter.

REAL GDP GROWTH [%]				
	2021e	2022	2023	COMMENTARIES
	-4.1%	+11.7%	+8.5%	Forecasts for Fiji and the North Pacific economies are adjusted upward, because of lingering impacts from high international prices. The rate of economic recovery projected for 2022 is driven by visitor arrivals from traditional source markets of Australia, New Zealand, and North America and aided by streamlined entry requirements into Fiji.
	-0.5%	-4.2%	+3.0%	Solomon Islands GDP growth is expected to contract in 2022, due to the economic fallout from measures to contain COVID-19 community transmission in the first quarter that has been severe. However, as production continued to suffer through the second quarter, recovery is now possible only in the second half of the year, buoyed by the lifting of restrictions.
	-7.1%	-5.3%	+2.0%	According to the ADB's revised GDP data released in early September 2022, Samoa's GDP growth is forecast to contract in by 5.3% in 2022 as the border reopening delayed until late September this year, which means that a second full fiscal year without tourism is expected. The GDP growth estimate for 2022 is thus revised down, despite countercyclical government programs.
	-2.7%	-2.0%	+3.7%	The delayed reopening of borders in Tonga is likely to slow long-term tourism recovery. ADB's 2022 projects a 2.0% contraction in Tonga's economy in 2022 and a return to positive growth of 3.7% in 2023, assuming borders remain open.
	+1.0%	+2.0%	+4.0%	Vanuatu's GDP growth is forecast to improve in 2022, as international borders reopened on 1 July, paving the way for activity in tourism and related enterprises to resume. Consumption is expected to be further boosted by remittances from seasonal workers in Australia and New Zealand.
	-29.1%	+10.5%	+11.2%	Growth in 2022 is forecast to recover as a result of quicker-than-expected recovery in tourism, with tourist arrivals exceeding the government's projection by 37.5%. The vaccination program supported by development partners that has administered two doses of COVID-19 vaccine to 99% of the population aged 12 years and above and a booster shot to 76% of the population aged 16 years and above. The growth forecast for 2023 is 11.2%, assuming smooth recovery in tourism.

Source: World Bank June Global outlook 2022; ADB Asian Development Outlook September 2022; OECD June Global outlook;

Recovery in the Pacific

Following an extended pause in international tourism since April 2020, increasing 2022 visitor arrivals are expected to support tourism-dependent economies in some Pacific destinations. The current accounts of the Pacific sub region are also projected to remain in surplus, due to improved exports pick after being disrupted by widespread Covid-19.

ECONOMIC RECOVERY 2022

- The economic outlook for the Pacific is expected to recover after more than 2 years of negative growth, caused by COVID-19. However, significant risks to this recovery remain,“ according to the ADB Director General for the Pacific Leah Gutierrez.
- It is vital that development partners, stakeholders, and policymakers work closely together to ensure the continued recovery.”



TOURISM

- A revival in tourism is expected to boost 2022 and 2023 economic growth in the Pacific. However, other risks to the Pacific’s recovery still remain such as vulnerability to climate change and disasters.



SUB REGION’S TRADE BALANCE

- The current account surplus in the Pacific sub-region will increase slightly, due mainly to a stronger rebound in PNG’s commodity exports, higher tourism receipts in Fiji, and stronger exports from Vanuatu. This will outweigh the worsening forecasts for the current account balances of the smaller economies, keeping the sub region in surplus.



STRONGER REMITTANCES

- Remittances in Fiji, Tonga, and Vanuatu account for 8%, 39%, and 11% of their GDP, respectively, some of the highest in the world and, in the case of Tonga, the highest, according to the August report from the SDG Knowledge Hub.



RUSSIA-UKRAINE WAR SUPPLY CONSTRAINTS

- Russia–Ukraine war also poses a risk to the sub region through rising import and transport costs, accelerating inflation, and increasing trade and fiscal deficits across the Pacific.



INFLATION

- Inflation in the Pacific is projected to rise sharply to 5.9% in 2022, before easing to 4.7% in 2023. High inflation poses a risk to recovery, by potentially constraining economic growth through reduced purchasing power and consumption spending.



Source: ADB, Worldometer, covidvax.live, <https://pacificvaccination.lowyinstitute.org/>, : ADB PEM Report August 2022, World Bank September Report 2022

Contacts

- **BSP Financial Group Limited**

BSP Waigani Head Office | Section 34. Allotment 6&7, Klinki Street, Waigani Drive PO BOX 78, Port Moresby, NCD, Papua New Guinea
Phone: (+675) 320 1212 | 7030 1212
Email: servicebsp@bsp.com.pg

- **Public Relations**

Email: pr@bsp.com.pg

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