



Pacific economic and market insights

MARCH QUARTER 2020



Key trends at a glance



GLOBAL ECONOMY TO ENTER SHARP RECESSION

- IMF predicts a deep recession, V-shaped rebound.
- The global economy is projected to contract sharply by -3.0% in 2020 due to COVID-19 impacts ... far worse than during the 2008–09 financial crisis. While the global economy is expected to rebound in 2021 by +5.8%.
- PNG's key trading partners, such as China and AUS are expected to experience sharp falls in growth.



COMMODITY PRICES FALL IN Q1-20

- Earlier this year we reported that commodity prices improved in Q4-19. This positive trend was short-lived, with commodity prices hit hard by the COVID-19 outbreak ... particularly energy commodities.
- Oil was trading close to US\$20 toward the end of March. Both oil and LNG prices are expected to remain depressed for some time.
- Asian LNG spot prices fell below a record low of US\$3.00 mmbtu.
- With the exception of Oil, Gas and Nickel, during Q1-20 the prices of PNG's key commodities fared reasonably well in the face of the global economic downturn ... particularly gold. However, some of the commodities have fallen in more recent times.



PNG ECONOMY TO ALSO ENTER RECESSION

- In early April, PNG's government announced that the budget deficit will increase from a budgeted K4.6b to ~K6.6b, the biggest in the country's history, as a consequence of COVID-19 impacts.
- In response to the above and PNG's low growth outlook, the government is seeking additional support from the IMF, World Bank and others.
- PNG and IMF agreed to a Staff-Monitored Program ... incorporating K3.8b in funding that will be contingent on key reforms, such as a staged Kina devaluation over a three year period and expenditure reduction.
- In Apr-20, the IMF revised down its growth outlook for PNG to -1.0% in 2020, as a consequence of COVID-19 impacts ... with a return to growth of +2.9% in 2021 [assuming COVID-19 impacts peak in 1H-20 and social distancing and travel restrictions ease in 2H-20].
Recently, it was announced that Australia, IMF and World Bank are preparing a multi-year bailout package of about ~ K7b for PNG.
- The World Bank suggests that PNG would require a concessional loans package to help it through the COVID-19 crisis.



IMF



A CHALLENGING 2020 FOR THE SOUTH PACIFIC

- The region is also expecting a challenging 2020 ... particularly those economies heavily reliant on tourism. Consequently, Fiji, Vanuatu and Cook Islands are likely to experience a sharp decline in growth.
- While Solomon Islands is less reliant on tourism, it may also be impacted by the COVID-19 led slowdown in Chinese economic activity.

	GDP	
	2020	2021
	-5.8%	+7.0%
	-2.1%	+3.8%
	-1.2%	+1.2%
	-2.2%	+1.0%
	-3.7%	+0.5%
	-3.3%	+4.9%

Source: IMF, Apr-20, except Cook Islands, ADB Apr-20.

BSP's economic and market views



Robin Fleming

Group Chief Executive Officer

What COVID-19 impacts is BSP seeing in the counties it operates?

- *The economic impact on business, directly and indirectly, does continue to increase. Businesses are affected directly when measures taken by governments to minimise the risk of transmission of COVID-19, such as international travel bans, domestic travel restrictions and this results in business not being able to sell their products and services, and they are subsequently faced with lower revenue and less cash.*
- *Business is affected indirectly when government revenues reduce as a result of lower revenues associated with a particular sector, such as the tourism sector in Cook Islands, Fiji, Samoa, Tonga and Vanuatu ... or the oil and mining sector in PNG, which in turn can result in government spending less and businesses dependent on government contracts seeing revenue reduce.*
- *Many businesses are scaling back their operations as demand and sales reduce. Resorts in many countries have all but closed and staff either laid off or on extended leave without pay. Businesses that supported the resorts have seen sales reduce or evaporate and as a consequence have also laid off staff or in some cases closed their own operations. With fewer people in employment,*

there is less cash available for spending and retailers and supermarkets have also seen a reduction in sales.

- *Movement restrictions and restrictions of large gatherings of people also affect the informal sector as they are unable to get their produce and goods to the markets and generate less cash that they spend in various stores and supermarkets.*

What role is BSP playing to mitigate the economic effects of COVID-19 on the economies we operate in?

- *All governments have sought the support of BSP and all banks to provide repayment holidays and to reduce interest rates as part of each countries support arrangements. In every country we have agreed to repayment relief either for affected customers or in certain circumstances on a much broader basis.*
- *The types of support BSP offers will continue to change as circumstances change and we will try to have packages that are proportionate to the situations our customers experience. Reduced lending rates [refer to adjacent table] do of course come at some cost to the bank and the executive will continue to reassess the financial impacts.*

- *The table below summarises lending rate reductions to all variable rate loans, excluding the "First Home Owners Loan" that is fixed rate loan and already heavily discounted.*

BSP PNG – LOAN INTEREST RATES		
Product	Pre COVID-19	Post COVID-19
Indicator lending rate	11.10%	10.10%
All Corporate Bank loan products ^{1,2}	11.10%	10.10%
Standard home loan	6.50%	5.50%
First Home Owners Loan	4.00%	4.00%
Personal loans [secured]	11.10%	10.10%

PNG BANKS – INDICATOR LENDING RATE				
	BSP	KINA ³	ANZ ⁴	WBC
Post COVID-19	10.10%	11.65%	11.70%	10.75%
Pre COVID-19	11.10%	11.65%	11.70%	11.75%

Notes: ¹ Excluding insurance premium funding and leasing products
² Benchmarked off the ILR [+/- margin off the ILR]
³ Announced interest rates on overdrafts reduced by 200bps, interest rates on business loans unchanged
⁴ Announced all business loan interest rates reduced by 100bps, ILR unchanged

BSP's economic and market views



Peter Beswick

Group General Manager –
Corporate Bank

How will BSP work with its business customers to navigate through the COVID-19 period?

- Support packages launched for customers impacted by COVID-19
- Comprehensive COVID-19 business checklist provided
- Frequent contact with local decisioning, given a dynamic situation
- World class digital solutions to work remotely
- Experienced relationship managers, in country
- National branch network open for business.

Once the effects of COVID-19 pass, where do you see the best opportunities for PNG economic growth?

- Getting back-to-business is anticipated to be cautious, as commodity prices recover, global trade reactivates and international travel resumes. PNG's existing resources operations Ok Tedi, Harmony Hidden Valley, Newcrest Lihir, Exxon PNG LNG will continue to create opportunities.
- Medium term there are positive economic growth prospects underpinned by the resources sector projects, including Papua LNG, P'nyang, and Wafi-Golpu.
- Post COVID-19, Government and Aid Agency initiatives should deliver an uplift in activity in key sectors of transport, hotels and accommodation, mining services, infrastructure and agriculture.



Rohan George

Group General Manager –
Treasury

What are the emerging trends you're observing in PNG's FX market and trade on the back of COVID-19 and the decline of commodity prices?

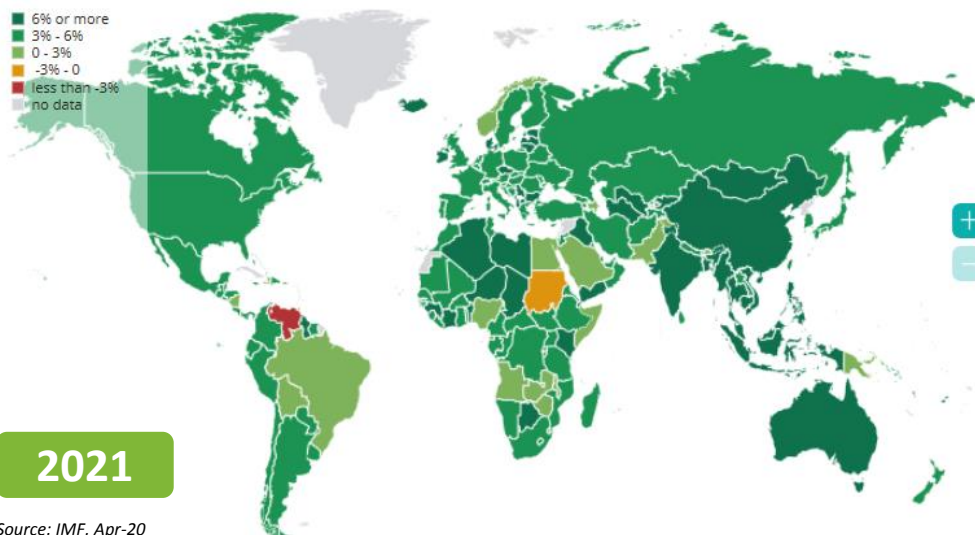
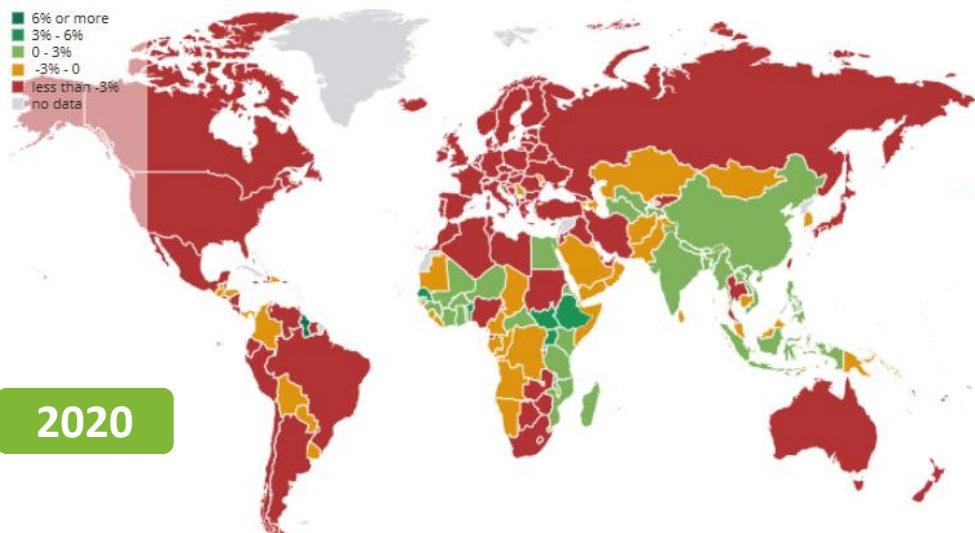
- Q1-20 foreign currency volumes from exporters have declined in 2020 by 12.5% from Q4 2019, due to seasonal factors, price, production and logistics.
- Outstanding importer FX orders tripled in volume in the March quarter, driven by New Year ordering, whilst exporter volumes fell.
- Importer FX requirements have only just started to decline, in response to COVID-19 disjointed supply chains, softer domestic economy and we expect reduced ongoing monthly import demand to reflect the contraction of the domestic economy.
- Central Bank intervention declined in the Q1-20, but is expected to increase in upcoming months with the release of COVID-19 response funds from IMF, World Bank, and ADB.

Do you expect the current slow, gradual, downward Kina devaluation of the Kina against the USD to persist in 2020?

- Assuming the PNG government doesn't adopt the IMF's devaluation recommendation, the current slow gradual downward pressure on the Kina is likely to persist in 2020, with commodity prices expected to remain subdued for the remainder of the year, as the ongoing impact of COVID-19 is felt by the global economy.
- In the current global environment a large devaluation of the Kina is unlikely, as it would push up the price of pharmaceuticals, medical equipment and foodstuffs, potentially leading to social unrest at a time when stability and certainty is required.

Global growth outlook

In April 2020, the IMF announced that the global economy is projected to contract sharply by -3.0% in 2020 due to COVID-19 impacts ... far worse than during the 2008–09 financial crisis. While the global economy is expected to rebound in 2021 by +5.8%, not all countries will experience an incremental increase ... with GDP below 2019 levels.



Source: IMF, Apr-20



IMF ECONOMIC OUTLOOK – REAL GDP GROWTH

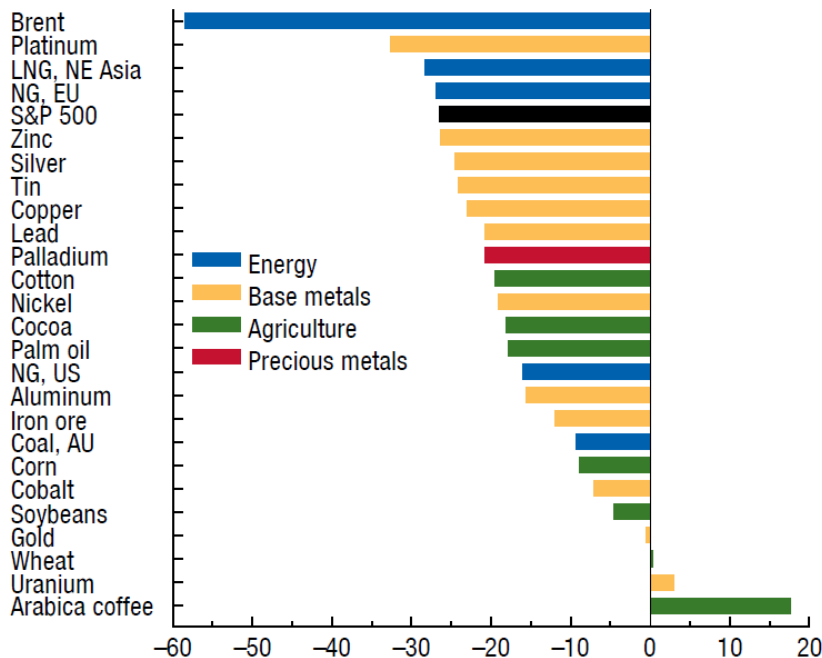
Market	IMF Prior Forecast [Oct-19]		IMF Current Forecast [Apr-20]		IMF – change	
	2020f	2021f	2020f	2021f	2020f	2021f
USA	2.1%	1.7%	-5.9%	4.7%	-8.0%	3.0%
China	5.8%	5.9%	1.2%	9.2%	-4.6%	3.3%
Australia	2.3%	2.6%	-6.7%	6.1%	-8.9%	3.5%
PNG	5.0%	2.6%	-1.0%	2.9%	-6.0%	0.4%
Fiji	2.7%	3.0%	-5.8%	7.0%	-8.5%	4.0%
Solomon Islands	2.7%	2.9%	-2.1%	3.8%	-4.8%	0.9%
Samoa	3.4%	4.4%	-3.7%	0.5%	-7.1%	-3.9%
Tonga	3.5%	3.7%	-1.2%	1.2%	-4.7%	-2.5%
Vanuatu	3.8%	4.4%	-3.3%	4.9%	-7.1%	0.5%
Cook Islands	N/A	N/A	N/A	N/A	N/A	N/A
Cambodia	6.8%	6.8%	-1.6%	6.1%	-8.4%	-0.7%
Lao	6.5%	6.5%	0.7%	5.6%	-5.8%	-0.9%

Source: IMF, Oct-19 and Apr-20

COVID-19 commodity price impacts

Commodity prices have been hit hard by the COVID-19 outbreak ... particularly energy commodities. Energy prices further declined in March as the OPEC+ coalition broke down ... with oil trading close to US\$20 towards the end of March. Both oil and LNG prices are expected to remain depressed for some time. Not all commodities were negatively impacted, with gold [“safe haven” asset] and Arabica coffee prices strengthening.

COVID-19 OUTBREAK IMPACT ON COMMODITY PRICES



Source: IMF, Apr-20

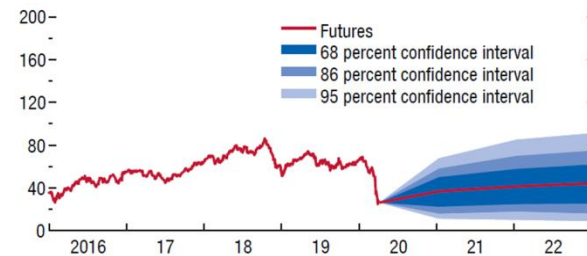
Sources: Argus; Bloomberg L.P.; Thomson Reuters Datastream; URSA Space Systems; and IMF staff calculations.

Note: Figure represents selected commodity price movements between January 17, 2020 (pre-outbreak), and February 7, 2020. Coal, AU = coal, Australia; LNG, NE Asia = liquefied natural gas, northeast Asia; NG, EU = natural gas, Europe; NG, US = natural gas, United States.

ENERGY PRICES

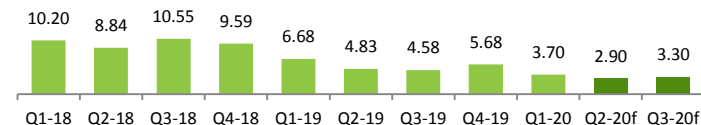
Brent prices:

- The IMF [Apr-20] reports that oil futures contracts indicate rising Brent prices close to US\$45 over the next five [5] years.
- Brent futures prices suggest an average annual prices of US\$34.80 a barrel in 2020 [a decrease of 43.3% from the 2019 average of US\$61.38] and US\$36.40 a barrel in 2021.



LNG prices:

- China’s COVID-19 containment policies strongly reduced demand for natural gas, leading some Chinese liquefied natural gas (LNG) buyers to halt their LNG imports as storage tanks filled. As a result, Asian LNG spot prices fell below a record low of US\$3.00 mmbtu.
- Prices recovered slightly in March as Chinese activity slowly resumed.



PNG's economic outlook

In early April, PNG's government announced that the budget deficit will increase from a budgeted K4.6b to ~ K6.6b, the biggest in the country's history, as a consequence of COVID-19 impacts.

In response to the above and PNG's low growth outlook [in the absence of new resource projects], the government is seeking additional support from the IMF, World Bank and others.

COVID-19 IMPACTS

PNG's Treasurer announced in early April that a stimulus package will be introduced in response to COVID-19's material impact on the economy. However, the package will need funding support from the IMF, World Bank and others.

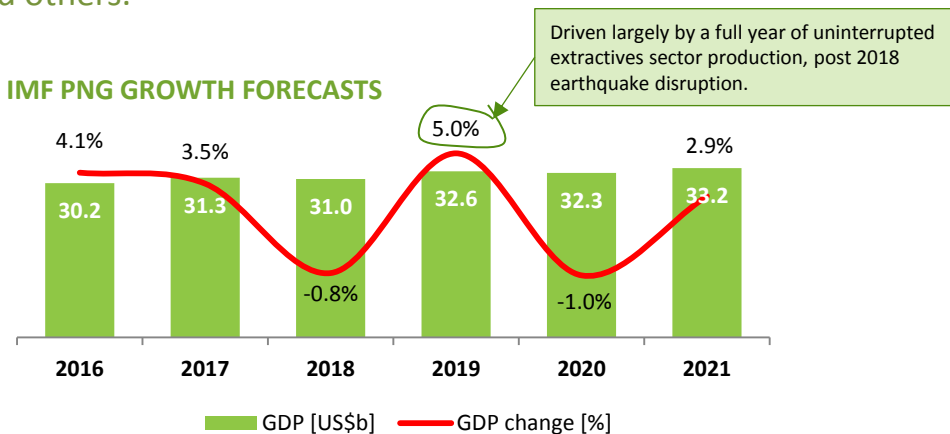
The package is in response to the domestic disruption triggered by positive COVID-19 cases that resulted in a State of Emergency and the international trade impacts on PNG export values that are estimated to fall by more than 13% [or > K5.0b].

The PNG government also announced a K2.5b issuance of COVID-19 Treasury bonds to raise cash to fund urgent priorities, such as:

- K500m in additional spending for health, security and affected economic sectors.
 - K250m for the health and security response – K175m for Health, K50m for Police and K25m for Defence; and
 - K250m was to support the rural sector, jobs, micro, small and medium-sized enterprises and families.

The government intends to provide more detail of the above and other support measures in coming weeks. Further, a supplementary budget is being prepared, given the significant change to the 2020 budget as a consequence of COVID-19 economic impacts ... that the government hopes to table in June.

IMF PNG GROWTH FORECASTS



Source: IMF, Apr-20

In Jan-20, the IMF forecast PNG's real GDP to grow by 2.0% in 2020 and average 3.0% over the medium term. These projections were based on the assumption of no major new resource projects, and growth would be largely driven by the non-resource sector.

In Apr-20, the IMF revised down its growth outlook for PNG to -1.0% in 2020 as a consequence of COVID-19 impacts ... with a return to growth of +2.9% in 2021 [assuming COVID-19 impacts peak in 1H-20 and social distancing and travel restrictions ease in 2H-20].

PNG's IMF Staff-Monitored Program

The PNG government applied for and was granted an IMF Staff-Monitored Program [SMP] ... incorporating K3.8b in funding that will be contingent on key reforms, such as an accelerated Kina devaluation and expenditure reduction. More recently [Apr-20], it was announced that Australia, IMF and World Bank are preparing a multi-year funding package of ~ K7b for PNG.

BACKGROUND

PNG's Treasurer, Ian Ling-Stuckey, announced on February 20, 2020 that the PNG government had applied for a SMP with the IMF. The SMP application letter was signed by the Prime Minister, Bank of PNG Governor, and Treasurer. The Treasurer indicated that the application had the potential to provide PNG with an **additional K3.8b in international financing** for building and transforming PNG's economy.

The Treasurer announced that without the funding, PNG's 2020 budget could not be delivered ... and the SMP would demonstrate that PNG was committed to economic reform and build international confidence in PNG. According to the Treasurer, the SMP has:

- A total of **31 performance criteria**; and
- **11 quantitative criteria** that are focussed on delivering the 2020 budget, and PNG is on track to meet at least 10 of the 11 criteria.

SMP DETAILS

The IMF reports that the SMP is designed to support the government's reform agenda. Salient points disclosed by the IMF are presented below:

- The **SMP will be monitored on a bi-annual basis** and is intended to assist the government in building a track record of implementation of a coherent set of economic policies.

- **Economic policies** under the SMP emphasise the restoration of macroeconomic and financial sector stability through:
 - Key reforms to **bring expenditure under control** while **expanding government revenue**;
 - **Restoring the convertibility of the currency** and clearing the backlog of foreign exchange in the economy; and
 - **Structural reforms** to support stronger, more sustainable and inclusive growth.



FX support for retail and SME customers

Given BSP's market leading commitment to retail and small and medium-sized enterprise customers in PNG, a substantial percentage [42.3%] of our FX supply is allocated to these critical customer segments.

BSP will continue to provide these essential FX services to PNG's retail customers and SMEs.

BACKGROUND

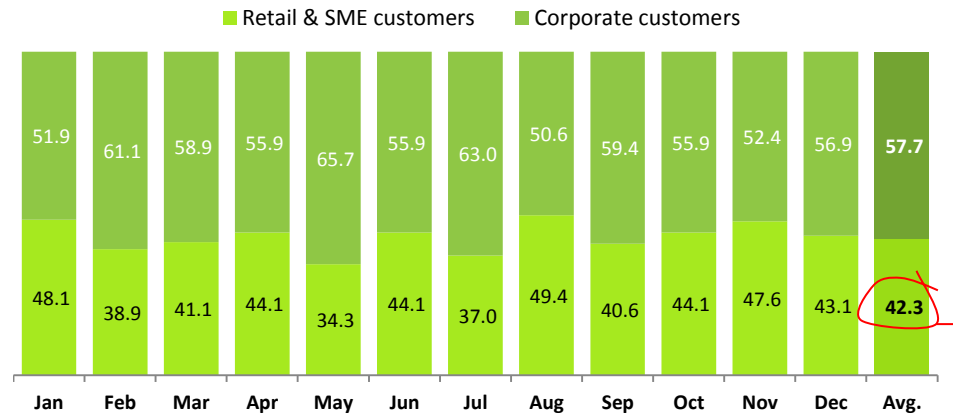
In 2019, 42.3% of BSP's critical FX supply was made available to the retail and SME customer segments.

Through the K25,000 daily limit, BSP ensured that there was sufficient FX liquidity to support personal remittances and lower value trade payments. Through this channel individual retail, sole trader and partnership customers remitted K1.6b in 2019, which was equal to 20.6% of BSP's total available FX.

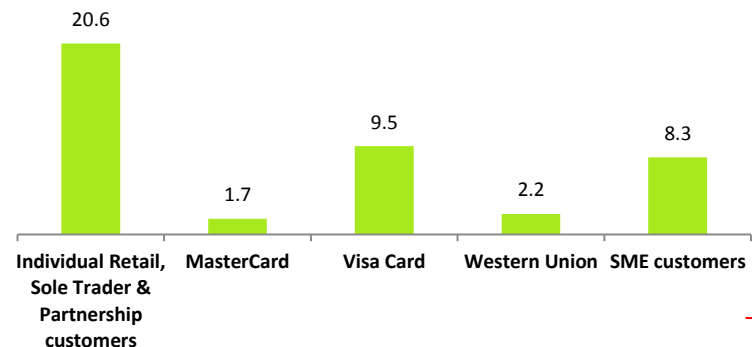
FX supply was also provisioned to ensure the smooth running of international payment channels such as Visa, MasterCard and Western Union. These services collectively accounted for K1.0b or 13.4% of the Bank's available FX supply.

The remaining 8.3% of FX was made available to BSP SME customers. BSP continues to be a strong supporter of the PNG Government's economic policy to grow the number and capacity of PNG's SMEs.

BSP – FX CUSTOMER OUTFLOW MIX [2019, %]



BSP – RETAIL AND SME CUSTOMER FX MIX [2019, %]



South Pacific's economic outlook

South Pacific countries are also expecting a challenging 2020 ... particularly those with economies heavily reliant on tourism. Consequently, Fiji, Vanuatu and Cook Islands are likely to experience a sharp decline in growth. A strong rebound in growth is expected in 2021, assuming COVID-19 impacts peak in 1H-20 and social distancing and travel restrictions ease in 2H-20.

COVID-19 IMPACTS

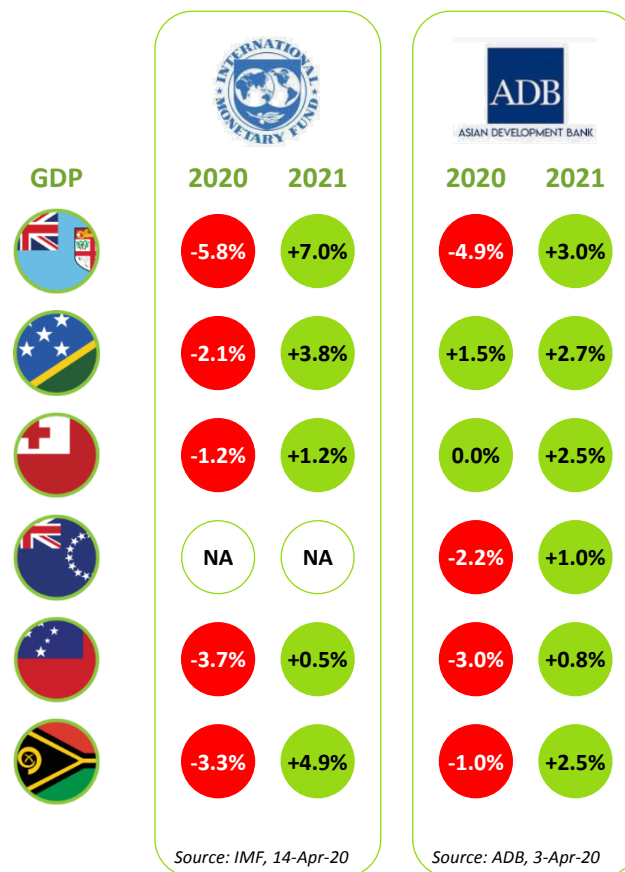
The region's countries are taking advantage of their relative isolation by applying travel bans to prevent the spread of COVID-19. However, tourism is crucial for many countries in the South Pacific:

- Contributing ~ US\$2.0b to Fiji's economy, representing ~ **40%** of GDP.
- Representing ~ **48%** of Vanuatu's GDP, ~US\$400m.
- Accounts for ~ **70%** of the Cook Islands' GDP.
- Samoa's tourism earnings are estimated at SAT\$494m, or **23%** of GDP.
- Representing ~ **20%** of Tonga's GDP, ~US\$100m.
- Accounts for ~ **13%** of the Solomon Islands' GDP, ~ US\$200m.

For example, in Fiji the national carrier has grounded 95% of flights amid travel restrictions and border closures around the world. Further, its Hotel and Tourism Association recently reported that 279 hotels and resorts have closed since the outbreak reached Fiji, causing more than 25,000 to lose their jobs.

In response, Fiji's minister of economy and attorney-general Aiyaz Sayed-Khaiyum announced a FJ\$1bn economic stimulus budget.

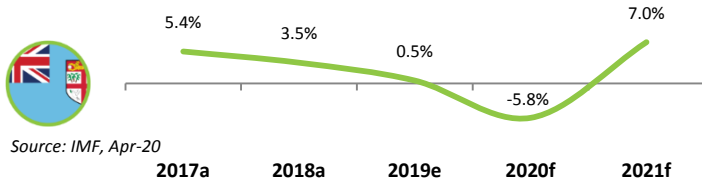
Other countries less reliant on tourism, such as the Solomon Islands may also be impacted by the COVID-19 led slowdown in Chinese economic activity ... with World Bank figures showing China has established itself as one of the main trading partners for the region, accounting for 67% of Solomon Islands' exports ... representing a significant economic dependence.



South Pacific's economic outlook

While all of the below South Pacific economies are expected to contract in 2020, some are expected to rebound strongly in 2021 ... Fiji, Vanuatu and the Solomon Islands.

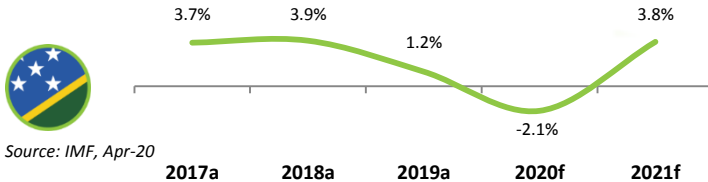
FIJI



Source: IMF, Apr-20

- Given its material reliance on tourism, Fiji is forecast to enter into a recession in 2020, with -5.8% growth. Fiji's visitor arrivals were up 2.5% in early 2020 ... prior to the introduction of COVID-19 travel restrictions.

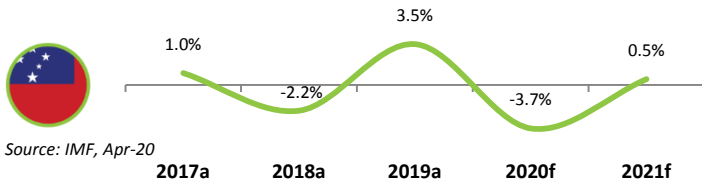
SOLOMON ISLANDS



Source: IMF, Apr-20

- While the Solomon Islands economy is also expected to enter into a recession in 2020, it will be less severe with -2.1% growth ... due in part to its economy being less reliant on the tourism sector.

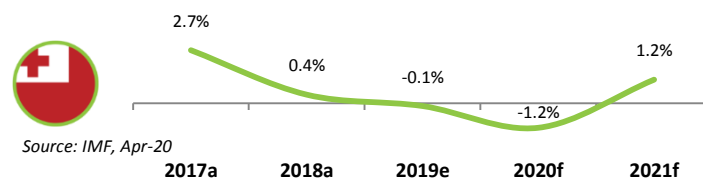
SAMOA



Source: IMF, Apr-20

- Samoa's economic performance has been inconsistent in recent years. Samoa's 2019 growth of +3.5% will largely be eroded by the impacts of COVID-19, with -3.7% growth forecast in 2020.

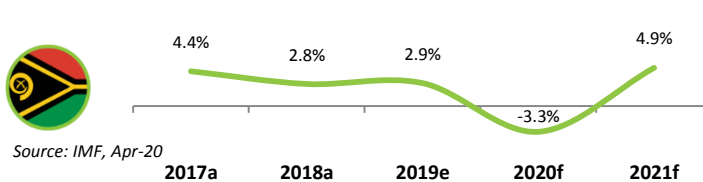
TONGA



Source: IMF, Apr-20

- Tonga had a difficult 2019 with an estimated growth of -0.1%. Unfortunately, this trend is likely to continue in 2020 with a second consecutive year of negative growth [-1.2%] forecast.

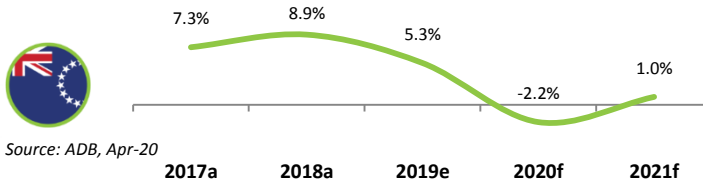
VANUATU



Source: IMF, Apr-20

- As raised earlier in this report, Vanuatu's economy is heavily reliant on tourism. Accordingly, its economy is forecast to experience a -3.3% reduction in economic activity in 2020 due to travel restrictions.

COOK ISLANDS



Source: ADB, Apr-20

- The Cook Islands economy is heavily reliant on the tourism sector, as illustrated by the small decline in 2019 GDP coinciding with a small decline in visitor arrivals. Accordingly, Cook Islands' economy is forecast to shrink by -2.2% in 2020.

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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