

ECONOMIC & MARKET INSIGHT



SEPTEMBER QUARTER 2018

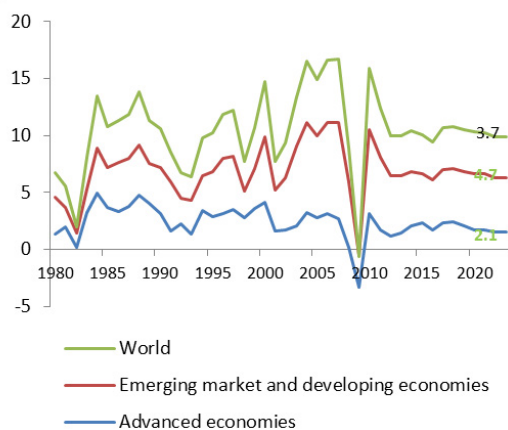
Contents

Global Economy	2
Commodities	2
Pacific Overview	2
Papua New Guinea	3
Consumer Price Index	3
PNG Exchange Rate	3
Fiscal Position	4
Fiji	4
Solomon Islands	4
Samoa	5
Tonga	5
Cook Islands	6
Vanuatu	6
Cambodia	6
Market Rates	7
Macro Data	7

Highlights

- The IMF has downgraded its global growth projection for 2018 to 3.7%, in its Oct-18 World Economic Outlook [WEO] update. Growth is becoming less vigorous and less balanced. Despite strong growth in U.S, the euro area and UK experienced lower growth. The ongoing US-China trade war is considered the biggest risk to global economic growth.
- The US economy is expected to grow by 2.9% in 2018. While the US experienced strong growth, the euro area and UK's growth over the first 9-months to Sept-18 was lower than expected. In China, GDP growth had eased slightly relative to a year earlier, with growth in some sectors expected to be weak.
- Commodity prices were mixed, with the World Bank's Energy Price Index increasing by 11% over the 9-months to Sept-18, while Non-Energy and Precious Metals Indices declined by 7% and 11% respectively. The increase in oil and natural gas prices towards the end of the Sept-18 were above expectations.
- The ADB downgraded 2018 growth in the Pacific region to 1.1% in Oct-18, compared to 2.2% projected in Apr-18. However, the forecast for 2019 was upgraded slightly to 3.1% [from 3.0% projected in Apr-18]. The APEC summit will provide opportunity for discussion on the China's growing influence, amongst other important trade and economic issues in the region.
- GDP growth in PNG is expected to be around 1.0% in 2018, before increasing to 2.8% in 2019. The PNG Government successfully issued US\$500m [K1.57bn] 10-year sovereign bond at 8.375% coupon with payment denominated in US dollars. The proceeds will go as planned towards refinancing existing public debt as well as the infrastructure spending. Investment into the development of domestic capital market is critical.

World Economic Outlook



Source: IMF World Economic Outlook, Oct-18



Global Economy

The global economy is becoming less vigorous and less balanced as observed by IMF in its Oct-18 WEO update. Global growth is projected at 3.7% for 2018 compared to an earlier projection of 3.9% [-0.2%]. The downward revision reflects moderation in major advanced economies, the negative effects of the trade measures implemented or approved between April and mid-September, as well as a weaker outlook for some key emerging market and developing economies.

Among advanced economies, growth was lower in the euro area and the United Kingdom [UK]. Growth in the United States [US] remains robust, supported by strong private spending, fiscal expansion and job creation. GDP growth is expected to expand around 2.8% during the fourth quarter, and remain around that pace at the end of 2018. However, recovery in the euro area and UK stalled somewhat in the early part of the year, prompting downward revisions to their 2018 growth projections. The IMF growth projections are presented below in table 1.

Table 1: Real GDP projections [%]

	2016	2017	2018F	2019F
World	3.2	3.7	3.7	3.7
Advanced economies	1.7	2.4	2.4	2.1
US	1.5	2.3	2.9	2.5
Euro Area	1.8	2.4	2.0	1.9
Japan	1.0	1.7	1.1	0.9
Emerging market & developing economies	4.4	4.7	4.7	4.7
China	6.7	6.9	6.6	6.2
India	7.1	6.7	7.3	7.4
Australia	2.5	2.3	3.0	3.1
New Zealand	3.6	3.0	2.9	2.9

Source: IMF World Economic Outlook, Oct-18

China’s GDP growth has eased slightly relative to a year earlier and growth had been weaker than expected in a number of sectors, including infrastructure and construction. The Chinese authorities have tightened some regulations to reduce the build-up of financial stability risks, and introduced targeted fiscal stimulus and eased monetary policy to counter slowing growth in some sectors of the economy.

The latest national accounts confirmed that the Australian economy grew strongly, with GDP increasing by 3.4% in over the year to Jun-18. RBA expects growth to average around 3.0% in 2018 and 2019. Business conditions are positive and non-mining business investment is expected to increase.

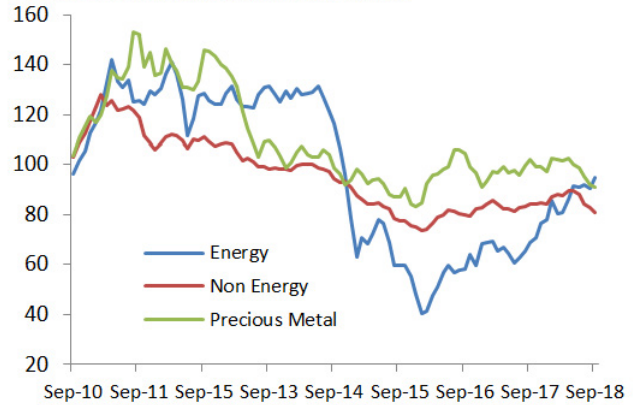
The biggest risk to the near-term global economic outlook is a continued movement toward a full-fledged trade war. In September, the US levied 10% tariffs on an additional US\$200bn worth of Chinese imports, to be raised to 25% in Jan-19, further stating that it considering an additional US\$267bn worth of goods. China responded with a 10% tariff on US\$60bn worth of US goods, also to be raised to 25% at year-end. Both sides are also tightening investment restrictions.



Commodities

Commodities were mixed during the September quarter and over the last 9-months. The World Bank’s Energy Price Index rose by 11% over the 9-months to Sept-18, while Non-Energy and Precious Metals Indices declined by 7% and 11% respectively.

Figure 1: World Bank Commodity Indices



Source: World Bank [Pink Sheet], BSP

Crude oil prices [average] increased by 5% and 14% to US\$75.36/ bbl. over the September quarter and 9-months respectively. Oil price has nearly doubled over the last 12-months, largely as a consequence of production cuts by OPEC and some non-OPEC countries that began in Jan-17. Current average crude oil prices are above the projected price of US\$65/bbl. for 2018. Similarly, the natural gas prices [Japan] is 24% above the projected price of US\$8.8 mmbtu. [circa: US\$10.9].

The non-energy index [comprises 64% agriculture] declined due to concerns around the US-China trade war and the flow-on effect on agricultural trade. It was noted in the Federal Open Market Committee [FOMC] meeting [31-Jul-18] that the, ‘agricultural sector had been adversely affected by significant declines in crop and livestock prices’ over the period. The impact on agriculture based economies will be mixed, with some upside on PNG given the increase in the price of natural gas.



Pacific Overview

The Pacific Island economies are expected to grow by 1.1% in 2018 [half the 2.2% projected in Apr-18], much lower than 2.9% in 2017. The downgrade was mainly due to weaker prospects for PNG following the Highlands earthquake. The aggregate forecast for 2019 is upgraded to 3.1% [from 3.0% projected in Apr-18], as expected recovery in PNG LNG production and reconstruction will improve growth in PNG.

The APEC summit in PNG is an important event for the region. The summit provides an opportunity for the leaders to discuss trade and economic issues in the region. Amidst the US-China trade war, the Pacific island countries through the Pacific Islands Forum [PIF], will likely discuss on China’s influence in the region.



Papua New Guinea

The government has projected 2018 GDP growth rate of 1.0% in light of the impact of the Highlands Earthquake. Bank of PNG noted in its Monetary Policy Statement [MPS, Sept-18] that, recovery in the post-earthquake period has been noteworthy; it may not fully offset the downside impact. The Bank of PNG expects a slightly higher growth supported by high government spending and APEC related activities.

ADB projects GDP growth of 1.8% [IMF:-1.1%] in 2018 and around 2.7% in 2019 in its updated ADB Outlook. ADB noted that, ‘confidence may be restored as PNG draws closer to the next round of gas investments, with two large projects [expansion of PNG LNG Project and Papuan LNG] are expected to commence in early 2020.’

The PNG government has successfully issued US\$500m [K1.57bn], 10-year sovereign bond during the quarter. Coupon interest was at 8.375% and payment will be denominated in USD. The successful bond issue indicates investor confidence in PNG. The proceeds are planned to go towards restructuring existing public debt as well as infrastructure and development projects in line with the 2018 budget. Allocation of funds to alleviate the foreign exchange back-log will be good for the business community.

BSP Group CEO stated that the bond raising is an ‘important milestone’ for the country with the focus on ‘budget support.’ Development of the bond secondary market as part of the capital market development should be a priority investment in the next few years. This should assist the government meet its debt repayment obligations whilst deepening investor base and providing liquidity in the domestic market.



Consumer Price Index

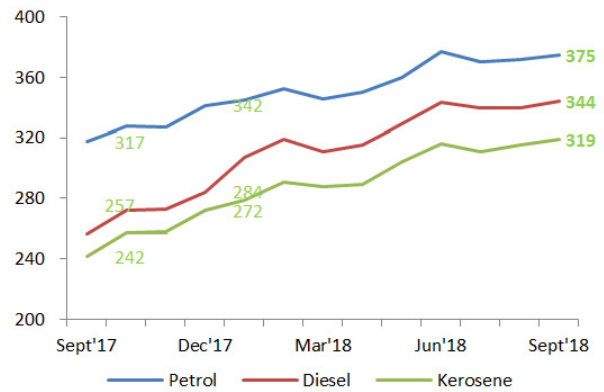
Headline Inflation remained stable at 4.5% over the 12-months to Jun-18. The Bank of PNG has lowered its inflation projection for this year to 4.5% compared to 5.0% projected in the Mar-18 MPS. The downgrade was due to lower prices of “seasonal items.” This is lower than the 5.9% projected in the Mid-Year Economic & Fiscal Outlook [MYEFO] 2018.

Available anecdotal indicator such as the average indicative retail price [IPP] of fuel in Port Moresby continued to increase as announced by Independent Consumer & Competition Commission [ICCC]. The increases in IPP have largely been due to the depreciation of the kina against the US dollar and the increases in crude oil prices in September.

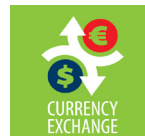
Over the September quarter, fuel price movement were mixed; with petrol slightly declining by 0.5% to K3.75 while diesel and Kerosene increased by 0.3% and 1.04% to K3.44 and K3.19 respectively. However, over the last 9-months the average indicative price for Petrol, Diesel and Kerosene increased by 9.7%, 21.1% and 17.2% respectively. BSP expects inflation to be around 5.0% in 2018, given the price increase over the 6-months of 2018, APEC related spending and continued depreciation of

the PGK.

Figure 2: Fuel Prices in POM [toea, average]



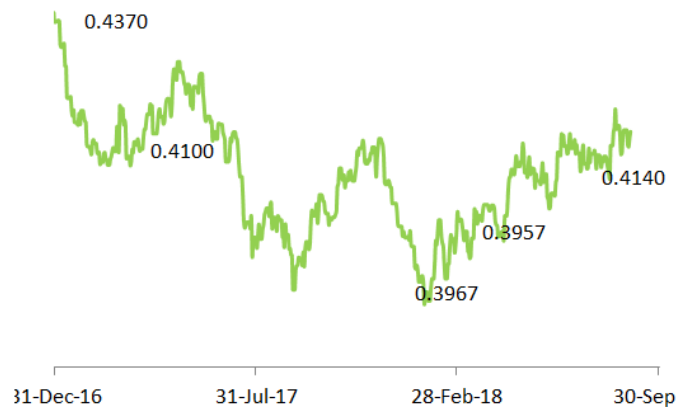
Source: ICCC, BSP



PNG Exchange Rate

Over the quarter, the PGK/USD depreciated by 1.6% to 0.299. Against the AUD, the kina strengthened by 0.6% to 0.414. Both moves were consistent with growing interest differentials between Australia and the U.S. Over the year to 28-Sept, PGK/USD has depreciated 4.3% while the PGK/AUD appreciated by 3.6% as shown in Figure 3.

Figure 3: Kina movement against AUD [daily]



Source: Bank of PNG, BSP

The proceeds from the bond issuance should bolster Bank of PNG’s reserves when converted and will likely result in some additional funding for importers via Bank of PNG support in the interbank market.

The market is expecting the PGK to depreciate against USD by around 10 points per month over the next 12-months. A reduction in the number of foreign exchange pending orders is dependent on the timing and volume of Bank of PNG’s conversion of sovereign bond and other foreign currency denominated borrowings.

Additionally, the market is expecting uplift in dividend and repatriation of intercompany expenses relating to management and royalty payments once market participants receive additional currency inflows.



Fiscal Position

The MYEFO'18 and Budget Strategy Paper 2019 were released by the Department of Treasury [DoT] towards the end of the Sept quarter. According to MYEFO'18, total revenue was K5.5bn [44% of planned for 2018] at the end of Jun-18, compared to spending of K5.9bn [40% of planned for 2018]. Total revenue and expenditure are expected to increase as tabled below.

Table 2: Preliminary estimates

Amounts in PGK'm	2017 Actual	2018 Budget	June Outturn	2018 MYEFO	Change [%]
Total revenue	11,525	12,731	5,553	12,944	1.7
Total expenses	13,320	14,718	5,878	14,931	1.5
Net Borrowing	- 1,795	- 1,987	- 325	- 1,987	0.0
% GDP	2.4	2.5	0.4	2.4	0.1

Source: MYEFO'18, BSP

Revenue and expenditure is projected to increase slightly by the end of 2018, due to higher petroleum taxes. According to the budget strategy, revenue reforms in the 2019 Budget will be aimed at growing the revenue base, broadening the tax base and improving tax payer and administration efficiencies through appropriate and effective investment in revenue raising agencies.

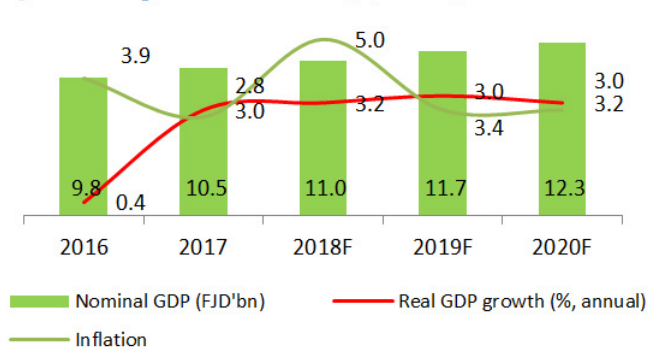
The government estimates that the net proceeds of US\$494m [after deduction of offering costs] will be used primarily for refinancing of existing public debt and also for works and services of the government, which includes the financing of infrastructure and development projects and operational funding for the APEC Summit. The 2019 Budget will likely be passed towards the end of Nov-18.



Fiji

Fiji's 2018 GDP forecast was revised downwards from 3.6% to 3.2% in May-18, due to the impact of tropical cyclones. Fiji's 2017 GDP was lowered to 3.0% compared to 4.2% estimated earlier.

Figure 4: GDP growth and inflation [%, annual]



Source: RBF, BSP

Economic indicators were mixed, with tourism, gold and timber remaining robust, while sugar production was poor. The Governor of Reserve Bank of Fiji [RBF] stated that, 'partial indicators for investment spending were mixed but are expected to improve towards the latter part of the year supported by the higher budgeted capital expenditure by government.'

The RBF Business Expectations Survey [Jun-18] indicated that 80% of respondents expect overall economic conditions to be positive in the next 6 to 12 months. Similarly, the RBF Retail Sales Survey reported that, 8.3% expected increase in retail sales in 2018. Recruitment intentions are also positive as the number of jobs advertised rose by 6.3% [annual] in the year to Jul-18.

Headline inflation fell to 4.3% in August, from 4.7% in Jul-18; however, it was higher than the 1.9% in the previous corresponding period. Higher prices were noted for yaqona, alcoholic drinks & tobacco, vegetables and fuel items. The duty increase announced in the fiscal year (FY) 2018/19 budget will likely put an upward pressure on prices. The year-end inflation is now forecast at 5.0%.

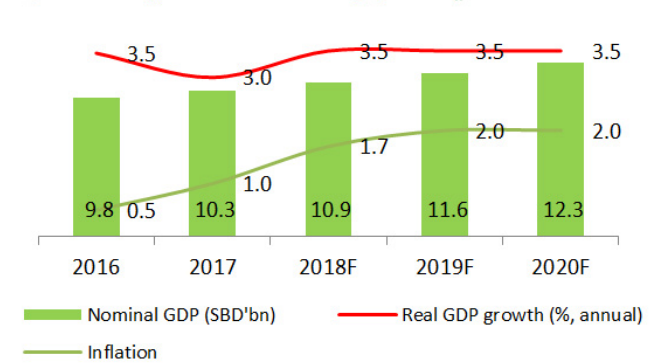
The 2018 Fiji National Elections is underway, with the date of voting set at 14 November. According to Fiji Sun polls, it will be a two-party race, between FijiFirst and Social Democratic Liberal Party [SODELPA]. In the 2014 General Election SODELPA secured 28.18% of the total votes casted [139,857 votes and 15 seats in Parliament]. The Prime Minister, Voreqe Bainimarama's Tailevu province will be one of the fierce battlegrounds in this election. Sitiveni Rabuka [PM between 1992 and 1999] is the leader of SODELPA.



Solomon Islands

GDP growth is expected to increase to 3.5% in 2018, compared to 3.0% in 2017. The Central Bank of Solomon Islands [CBSI] Production Index surged to 94 points, compared to 77 points in June.

Figure 5: GDP growth and inflation [%, annual]



Source: CBSI, BSP

Headline inflation moderated to 2.5% in June, from 2.8% in May-18, reflecting the continued fall in both imported and domestic inflation. The average price of fuel in Honiara fell marginally in July to SB\$9.52 per litre from SB\$9.57 per litre in Jun-18. Continued increase in global economic growth and commodity prices, will impact inflation. BSP expects inflation to rise to around 2.0% in 2018, compared to 1.0% in 2017.

On the fiscal budget, the preliminary estimates show a deficit of SB\$160m in July, against a deficit of SB\$65m in Jun-18. This was due to a fall in revenue collection, compounded by an increase in expenditure. A balanced budget is expected, with Deficit/GDP ratio projected at 5.0%.

The CBSI stated in its Financial Stability Report [2017] that,

financial institutions are profitable and building up their capital buffers. However, it raised concerns around de-risking and the rapid pace of credit expansion to the personal sector.

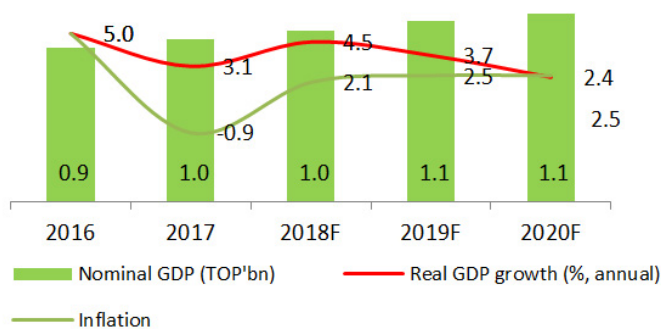
The Solomon Islands Electoral Commission expressed its readiness for the 2019 National General Elections. The voter registration process is underway with election expected towards the end of 2018.



Samoa

Real GDP growth for 2018 is projected at 4.5%, supported mainly by the rehabilitation and scheduled activities. The National Reserve Bank of Tonga [NRBT] downgraded its estimated GDP growth in 2017 to 3.1%, from 4.0% due to the impact of Tropical Cyclone Gita.

Figure 7: GDP growth and inflation [% , annual]



Source: 2018/19 Budget, BSP

The private and public sector infrastructure and construction projects relating to the Pacific Games 2019 will support the 3.0% GDP growth projection for 2019.

Short term inflationary pressures continue to linger in the aftermath of Cyclone Gita in Feb-18, as well as recent hikes in petroleum prices. This has seen headline inflation rise to 3.7% at end Jun-18 given increases in both its domestic and imported components. Inflation is expected to remain within the CBS target of 3.0%.

The Samoan Parliament passed the Money Laundering Prevention Amendment Act 2018, aimed at strengthening its anti- money laundering framework [based on international standards that have been set by the Financial Action Task Force (FATF)]. Significant changes include;

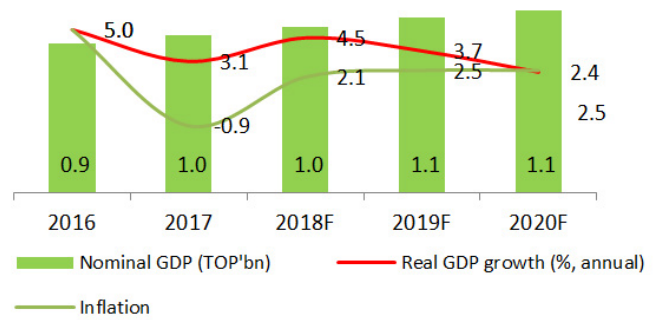
- Imprisonment term increased from 7 to 15 years, and
- All dealers or promoters in crypto-currency must first seek the approval or clearance from CBS.



Tonga

Real GDP growth for 2018 is projected at 4.5%, supported mainly by the rehabilitation and scheduled activities. The National Reserve Bank of Tonga [NRBT] downgraded its estimated GDP growth in 2017 to 3.1%, from 4.0% due to the impact of Tropical Cyclone Gita.

Figure 7: GDP growth and inflation [% , annual]



Source: 2018/19 Budget, BSP

Economic activity will also be supported by infrastructure rehabilitation, upgrade of the Fuaa domestic wharf [US\$30m], improved tourism, and continued recovery in remittances. The Liahona & Saineha school anniversaries, hosting of Miss Pacific Islands Pageant, annual church conferences, and family reunions are expected to support tourism and remittances. Like other PIC's, growth prospects are likely to be impacted by weather uncertainties.

The increase in general prices reflects the impact of Tropical Cyclone Gita on the domestic food supply. Other contributors include higher prices for transportation, tobacco, alcohol and kava-Tonga. Inflation is expected to level back to around 2.1% before the year ends.

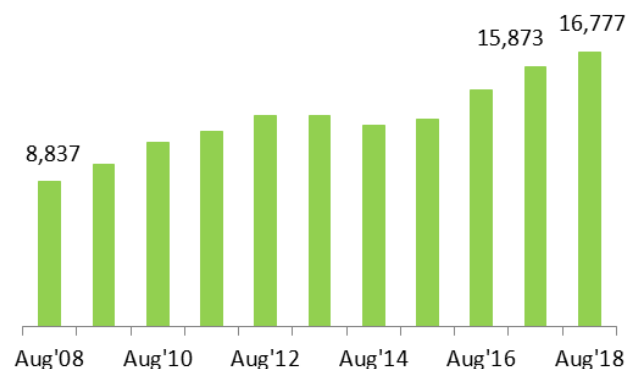
The NRBV reported that, individual housing loans increased over the month by 0.8% to WST1.5m. In the tertiary sector, international air arrivals rose by 10.9% coinciding with a 28.6% increase to a total WST12.2m of travel receipts.



Cook Islands

Real GDP is expected to expand between 1.6% and 3.5% in 2018, compared to 3.2% in 2017. Tourism and donor support will continue to support growth with some uncertainty around the latter. The decision by Economic Co-operation and Development [OECD] on whether to graduate Cook Islands to a 'developed nation status' will impact activities. The OECD agreed and allowed the nation to develop Gross National Income [GNI] data, with decision likely to be made this year.

Figure 8: Visitor arrivals [yearly]



Source: MF&EM statistics, BSP

Visitor arrivals increased by 5.7% to 16,777 in Aug-18, compared 15,873 arrivals in Aug-17. Arrivals from New Zealand and Australia are dominating. The increase in tourism will support growth in retail, hotels, restaurants, and transport and communications industries

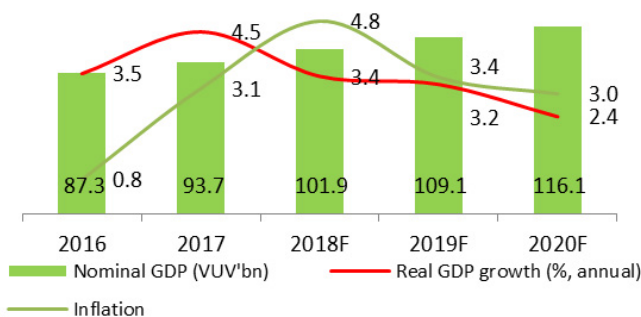
In the nine months to Mar-18, the net operating balance was a surplus of NZ\$26.2m, higher than what was projected in the budget. This was driven by higher revenue collection [NZ\$17.7m], followed by a NZ\$6.7m saving in overall operating expenditure. The overall fiscal balance for the reporting period was NZ\$17.7m - savings of NZ\$51.3m resulting from the deferral of capital/infrastructure implementation. These surpluses will be required to fund capital projects.



Vanuatu

Economic growth in Vanuatu is expected to moderate down to around 3.4% in 2018, from 4.5% in 2017. Economic activity will be supported by recovery in tourism and agriculture, and scaling up of infrastructure projects.

Figure 9: GDP growth and inflation [%, annual]



Source: VNSO, BSP

Infrastructure projects such as the road upgrade in Port Vila [US\$45m], regional road upgrade [US\$10m] and airport upgrades [US\$55m] will support economic growth.

RBV launched its National Financial Inclusion Strategy [NFIS]: 2018 – 2023. The NFIS will provide an important road map of the financial inclusion journey with the ultimate aim of improving access to and usage of appropriate financial services by the underserved adult population and Micro, Small and Medium Enterprises (MSME) in Vanuatu.



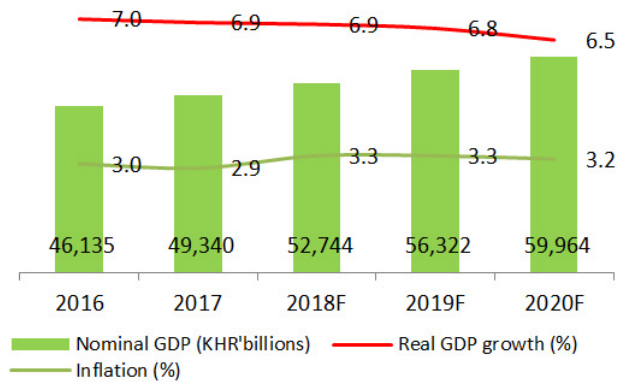
Cambodia

Cambodia’s economy is expected to grow by 7.0% in 2018, supported by higher public spending and robust construction and tourism activity.

There has been fierce criticism from around the world, following the sixth [6th] post-Khmer Rouge-run election in Cambodia in Jul’18. The White House Press Secretary Sarah Sanders declared the election a step backwards, stating that, ‘genuine democracies tolerate opposing political views, foster competition through elections, and promote and protect the

free exchange of ideas.’

Figure 10: GDP growth and Inflation [%, annual]



Source: ADB Outlook, April 2018

Hun Sen, who has ruled Cambodia for 33 years was re-elected with an estimated 80% of the vote, with his party, the Cambodia Peoples Party [CPP], taking at least 100 of 125 parliamentary seats. Defying international consensus, Hun Sen maintained that he had won in a free and fair election.

MARKET RATES

FOREIGN EXCHANGE			
	JUL	AUG	SEPT
PGK/USD	0.3030	0.3010	0.2990
FJD/USD	0.4759	0.4705	0.4682
SBD/USD	0.1251	0.1241	0.1236
WST/USD	0.3962	0.3962	0.3962
TOP/USD	0.4416	0.4377	0.4390
NZD/USD	0.6826	0.4377	0.4390
USD/VUV	111.15	111.15	111.15
USD/KHR	4,057	4,030	4,131

COMMODITIES			
	JUL	AUG	SEPT
Oil (US\$ per barrel WTI)	67.27	69.37	73.25
Gold (US\$ per troy ounce)	1,224	1,201	1,191
Copper (US\$ per metric ton)	6,300	5,975	6,258
Nickel (US\$ per metric ton)	14,030	12,800	12,600
Palm Oil (MYR per metric ton)	2,194	2,248	2,174
Coffee (US\$ per LB)	113.10	101.80	102.45
Cocoa (US\$ per metric ton)	2,220	2,336	2,057
Sugar (US\$ per LB)	11.48	11.42	11.20
Lumber (US\$ per 1,000 feet)	455.40	437.60	344.40

MACRO DATA

Real GDP Growth (% annual)				
	2016	2017	2018f	2019f
PNG	2.0	2.2	1.0	2.8
Fiji	0.4	3.0	3.2	3.4
Solomon Islands	3.5	3.0	3.5	3.5
Samoa	7.1	2.5	1.0	3.0
Tonga	5.0	3.1	4.5	3.7
Cook Islands	8.8	3.5	3.5	3.0
Vanuatu	3.5	4.2	3.8	3.5
Cambodia	7.0	6.9	6.9	6.8

Inflation (%)				
	2016	2017	2018f	2019f
PNG	6.6	4.7	5.0	5.0
Fiji	3.9	3.8	3.3	3.0
Solomon Islands	0.5	1.0	1.7	2.0
Samoa	1.3	1.8	1.9	3.0
Tonga	5.0	-0.9	2.1	2.5
Cook Islands	1.6	1.6	1.1	1.3
Vanuatu	0.8	3.1	4.8	3.4
Cambodia	3.0	2.9	3.3	3.3

Fiscal Balance (% of GDP)				
	2016	2017	2018f	2019f
PNG	-4.6	-2.5	-2.5	-2.2
Fiji	-5.7	-4.9	-4.5	-3.5
Solomon Islands	-4.5	-3.4	1.3	-3.9
Samoa	-0.4	1.3	-1.0	-2.5
Tonga	-1.0	-3.2	-4.8	-7.5
Cook Islands	3.8	1.5	-6.2	-4.1
Vanuatu	-6.1	-7.5	-8.0	-4.3
Cambodia	-1.7	-3.6	-4.7	-4.8

Foreign Exchange Reserves (USD m)				
	2016	2017	2018f	2019f
PNG	1,678	1,700	1,900	na
Fiji	972	960	1,156	na
Solomon Islands	514	520	542	561
Samoa	113	125	132	na
Tonga	140	na	na	na
Cook Islands	na	na	na	na
Vanuatu	na	na	na	na
Cambodia	na	na	na	na

Economic Data Sources:

Commodities & FX: Bloomberg, WB

PNG: 2017 Supplementary Budget, Department of Treasury, Bank of PNG, ADB, BSP

Fiji: Reserve Bank of Fiji, ADB, IMF, BSP

Solomon Islands: Central Bank of Solomon Islands, ADB, IMF, BSP

Samoa: Samoa Bureau of Statistics, ABD, IMF, BSP

Cook Islands: Financial Supervisory Commission, ADB, IMF, BSP

Tonga: Tonga Department of Statistics, IMF, ADB, BSP

Vanuatu: ADB, IMF, Reserve Bank of Vanuatu, BSP

Cambodia: ADB, IMF, National Bank of Cambodia, BSP

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