Elizabeth Genia: The Papua New Guinea economy and managing FX demands in Papua New Guinea's domestic foreign exchange market

Speech by Ms Elizabeth Genia, Governor of the Bank of Papua New Guinea, at the Australia-PNG Business Forum, Gold Coast, Australia, 14 May 2024.

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Daba Namona, Morning Tru, and Good Morning Olgeta.

I would like to recognise the traditional owners of the land on which we meet, the Yugambeh [YUG-UM-BAY] people, and pay respect to their elders, past, present and emerging.

I extend this acknowledgement to all indigenous leaders here today, from Australia, Papua New Guinea and beyond.

I also thank the Australia PNG Business Council for your exceptional efforts in arranging this forum every year.

I am delighted to be part of this session and to be sharing the stage with Professor Chand for this discussion.

Let me start with a quick review of the economy and recent developments.

The latest estimates from the IMF and the World Bank anticipate growth for PNG of 4.6 percent and 4.8 percent respectively for 2024.

This growth is expected to be driven by agriculture prices and, importantly, by the re-opening of the Porgera Mine.

But the slow return of Porgera to pre-production levels and the civil unrest in January have moderated the otherwise positive expectations of growth.

Agricultural exports continue to receive a boost from the increase in global commodity prices in 2022.

While prices moderated in 2023, cocoa prices are experiencing significant increases this year following a drought in West Africa, a region that normally supplies up to 80% of global cocoa demand.

Coffee prices have also risen sharply, in part due to excessively dry conditions in Brazil impacting on coffee harvests and supply from that region.

The climate will continue to impact the prices of key food crops, and climate change will see changes in producing regions.

This is something PNG will need to monitor, as we will be affected just as surely as other growing regions, and this underscores the need for sustainable farming practices and green finance initiatives.

But for now, we are benefitting from negative climate outcomes in other regions.

We know that at least 80 percent of our population are directly affected by the performance of our agricultural sector, which in turn makes up 20 percent of Papua New Guinea's GDP.

Our agriculture exports are the lifeblood of our communities in the Highlands and Sepik regions, where the impact of improved production and crop development is demonstrated in improved livelihoods in the villages.

We see solar panels and water tanks being installed, children enrolled in school, and other positive flow-on economic benefits in those remote communities who already have plans in place for next year's harvest.

Cash crop exports were much higher as a percentage of GDP immediately post-Independence, and volumes have fallen from their peaks.

The Government is looking at very closely at opening new markets and creating incentives to increase agriculture production.

I note that a weaker kina results in greater wealth for our agriculture producers – and I'll return to a discussion on foreign exchange later.

Inflation peaked at 6.3 percent in September of 2022 before easing to 2.2 percent in September 2023.

The most recent data available shows inflation edging higher again, to 3.9 percent in the December quarter of last year.

In response to January's unrest, we eased our monetary policy signaling instrument, the Kina Facility Rate, half a percentage point to 2 percent to help provide support to businesses.

It was a calculated decision.

We knew inflation had increased in the December quarter but it was still relatively low and we decided that it was vitally important that we provide some relief to businesses and households.

We had hoped that by lowering the Kina Facility Rate we had enabled the commercial banks to likewise lower their rates and pass this benefit on to the business community.

Unfortunately, this did not happen.

This reinforced our ongoing concern that monetary policy is not being transmitted effectively through the economy.

I'll return to this later in the presentation.

I know a critical concern for you, as the business community, is the issue of foreign exchange management.

There are a number of structural imbalances in PNG's economy that are affecting our economic growth and our supply of foreign currency.

We record trade surpluses each year, with the value of our exports consistently exceeding the value of our imports, and this should be reflected in current account surpluses.

While we should be in surplus, the reality is that we have a persistent deficit of foreign currency inflows and as a result have been unable to meet the demand of our domestic market.

The reason for this simple.

Large quantities of our export proceeds are not repatriated to Papua New Guinea.

Instead, they are held offshore, leading to the accumulation of unmet foreign exchange orders with our commercial banks and our Authorised Foreign Exchange Dealers.

In 2023, foreign currency inflows amounted to around 5.6 billion dollars in contrast to total export receipts of around 14 billion dollars.

Had even half of that 14 billion dollars been brought onshore, we would be in a far stronger position this year.

But this has been the pattern for over a decade.

Foreign currency shortages have been a persistent handbrake on growth, leading to lower investment, reduced competition in key sectors and ultimately higher prices.

I am not for one moment failing to acknowledge the lower Kina's impact on prices and the potential for inflationary pressure.

But we need to acknowledge that these structural imbalances are contributing to a higher cost of doing business in Papua New Guinea than should otherwise be the case.

The most critical factor affecting businesses, year after year, is limited access to foreign exchange and adjustments needed to be made.

The overvaluation of the Kina over the last decade, and the currency rationing we have had in place, has and continues to undermine growth.

The IMF has estimated Papua New Guinea's economy would be 3.0 billion dollars larger had we not introduced currency rationing in 2014.

In absolute terms, our economy would be ten percent larger today – with growth primarily driven by our non-resource sector – the sector that more than any other contributes to employment and boosts economic activity throughout PNG.

We have data-driven evidence illustrating the impact currency rationing has had on our economy through restricting essential inputs for domestic production and business operations.

This is why we have been working with the market since May of 2023 to make the necessary adjustments to the Kina.

These gradual, and measured adjustments, are being made to ensure inflation and price stability are maintained, to the best extent possible, ensuring that **the benefits to the economy in the medium term** more than offset the risks.

And this is what we are seeing in practice.

We were wrong to maintain an overvalued exchange rate when it was clearly not sustainable, and we did not have the reserves to support the Kina at an artificially high level.

We also found that our attempts to fix the value of the kina comprehensively failed in their objective to maintain medium term price stability.

There is no example of a country that has developed and diversified its economy with an overvalued exchange rate.

Papua New Guinea has been no different.

In summary: our overvalued currency has resulted in a decade of foreign exchange rationing, which in turn has negatively impacted on economic growth by up to 10 percent over that time, while also decreasing foreign investment, reducing employment and lowering incomes for our rural exporters.

To end the rationing of foreign currency, the Kina needs to adjust to its equilibrium level where the sensitivity of foreign currency inflows to the lower exchange rate can be tested.

And this is what we are doing – cautiously, with full transparency, and without the excessive volatility associated with moving immediately to a floating exchange rate.

There are so many moving parts in the economy – the policy settings are the only ones we, the BPNG, have control over – we don't have control over global coffee or cocoa prices but our farmers will thankfully see an even greater return in Kina this year that they otherwise would have.

We have also increased our support to the market to try to ease the foreign exchange shortage.

In 2023, foreign currency inflows in PNG's domestic FX market amounted to US 5.6 billion while total foreign exchange outflows were US 7.2 billion.

We intervened in the market with US 1.6 billion- a record level and one that was intended, but failed, to clear the backlog.

In the first four months of 2024, the Bank has intervened with just over 430 million US dollars.

We expect to see some improvement in foreign currency inflows with the return of Porgera, and with the commencement of construction for other major resource projects.

Despite these measures, outstanding orders remain at a monthly average of around 1.2 billion kina, or the equivalent of over 300 million US dollars.

We are on the right track, but there is more to do before we reach our destination.

This is a major focus for the Bank as we get the policy settings right for the governments growth agenda through to the end of the decade and beyond.

Another critical issue that may not be as visible as our foreign exchange interventions, but which is still extremely important, are the adjustments we are making to our Monetary Policy Framework.

We have been working closely with the IMF in undertaking a thorough review of the effectiveness of the transmission of monetary policy through the financial system.

One of the main barriers to the transmission mechanism has been the excess of deposits, or excess liquidity, in the banking system.

If the Central Bank cannot sufficiently influence the cost of money – in other words, the cost of loans and deposits – then our Monetary Policy Framework will struggle to ensure price stability, much less keep inflation under control.

To address this, in August 2023 we introduced a fixed rate, 7-day Central Bank Bill auction with no pre-determined limit on a bid amount in an effort to absorb some of this excess.

The auction was also opened up to the Super Funds, who hold a lot of the excess liquidity in the banking system.

Though not conventional monetary policy practice, given the importance of Superannuation in PNG it is encouraging that Super Fund members can now benefit directly from the policy rate rather than receive wholesale deposit rates from the banking sector, which are often much lower.

We are also introducing a Central Securities Depository portal which will enable the commercial banks and other investors to trade intra-day and lend overnight at a rate referenced to the Kina Facility Rate.

These measures will strengthen our Monetary Policy Framework and lay the foundations for more efficient financial markets and increased competition in the banking sector.

We continue to pursue measures to strengthen our financial markets and provide competition in our banking sector.

We do this to provide the best outcomes for business and to improve the lives of our citizens.

To this end, we are working with Credit Corp, TISA and PMBL to upgrade their operations to provide full banking services, and we are also working closely with the Bank of China.

We have a profitable banking sector and, as the third largest economy in the Pacific, it is important we have a strong, reputable financial system.

International banks like the Bank of China establishing a presence in PNG would be a very positive development, and we are looking to China and other partners to enter our market and provide services to our citizens.

In June, the National Payments Council will end the use of private sector cheques, and work is underway to move Government expenditure to digital transactions.

Fraudulent cheques are a major issue for financial institutions.

Digital transactions are much more secure and less costly and we would expect the cost of banking to lower once these changes are fully embedded into core banking systems at the end of next month.

Digital banking will drive efficiencies, and PNG needs a modern, responsive and inclusive financial system that supports our country's growth and our people's development.

There is more we can do to promote financial inclusion and bring more people into the formal banking system.

We understand the role **digital transformation** will play in our economic growth and **financial inclusion** but one of the key challenges we face are those of secure identity for our remote citizens.

As a PNG citizen, I know how difficult, costly and time-consuming it can be to secure identity documents and this becomes an insurmountable challenge when you come from a rural village with little access to our formal sector.

We worked with the ADB and a private company, Digizen, to develop the first digital I.D. product made specifically for Papua New Guinea.

Through this process we better understood what we, as the regulator, need to consider for the adoption of digital identities for banking.

To strengthen our systems and encourage the use of digital IDs, the Financial Analysis and Supervision Unit, FASU, responsible for overseeing the Anti-Money Laundering and Counter Terrorism Financing Act, has issued a guidance document for digital identity that is currently under review by regulated financial institutions.

All going well, it should be launched shortly and it will provide direction to our financial institutions on digital identity requirements.

We are also working to identify policies and practices that, in the past, would have deterred people from opening and using bank services.

These include, but are not limited to, the high cost of transaction fees and account charges.

As we identify key barriers, we will implement more initiatives to promote the use of the formal financial system and significantly lower our people's reliance on cash.

We also want to introduce more products that help our rural communities.

Our Regulatory Sandbox has commenced testing of another new product, pinBox, which will work with insurance and pension providers for all Papua New Guineans to have the option to save for their retirement through high-quality products from reputable providers – no matter where they are located or what their incomes are.

The Bank of Papua New Guinea is taking steps to ensure a modern and inclusive financial system that delivers the best outcomes for our people.

We cannot continue to do the same things and expect a different result.

We need to adopt policies consistent with a modern, international and growing economy.

This may sometimes require bold – and perhaps unpopular – decisions, but we know they are the right ones to build the foundation for the future success of Papua New Guinea.

Thank you for inviting me to present today.

I look forward to the remainder of this session and the discussion to follow.