Fiji Sun
Paper | Online | Mobile
Saturday, August 22, 2015

Is PNG facing a crisis?

T.K. JAYARAMAN

The last week column had to quickly analyze China's sudden devaluation of its currency, not one but three in a row. Consequently, we were forced to shift our attention from the so called "brink of a Greek-style fiscal crisis", hitting the headlines. That referred to the fast growing, resource rich Papua New Guinea.

The rest of the world has finally come to terms with the Chinese excuse of a flexible exchange rate regime which was designed to depreciate its currency for promoting exports and growth at the expense of others. So, we can now turn to PNG.

Does PNG have a real crisis looming large?

The real crisis is marked by some indicators.
Three of them are critical ones:

- level of international reserves held by the country to pay for its imports of food and fuel
- levels of external debt and servicing costs having exceeded danger levels; and whether the international reserves are adequate to cover servicing costs
- inflation: whether the country has been experiencing a runaway inflation at double digit level

Fears about the impending crisis are triggered by some facts and some forecasts.

Let us review them first before evaluating whether PNG is on the "brink of a Greek-style crisis".
The facts are:

- fall in commodity prices of PNG's exports, which include oil, gold and copper. The fall in oil price is about 50%, which has affected export earnings from liquefied natural gas (LNG).
- partial closure of Ok Tedi mining, which at one time contributed nearly 6% of GDP;
- slow disposal of public assets, which were slated for sale for realizing revenues.

The forecasts

Facts are relied upon for drawing some inferences leading to forecasts. The forecasts are based on the estimates released early this month by the mid-year *Economic and Fiscal Economic Outlook Report.*

These are:

- Growth forecast for 2015, reduced to 11%, from 15.5%
- Revenue forecast, lowered to K11,381 million, down from K13,927 million
- Budget deficit forecast for 2015, revised upwards to 9.4% of GDP from 4.4%
- Debt to GDP ratio forecast, raised to 41.3% of GDP from 33.5%

It is the forecasts, which have rung the alarm bells.

The reasons are not without foundations.

First and foremost, the revised 2015 forecast of budget deficit is the highest in PNG history, which is worse than the last economic crisis at the end of 1990s.

The second fearful forecast is the debt level. Presently it is around 33.5% of GDP, below the legislated debt limit of 35% of GDP under the Fiscal Responsibility of the Act.

These two forecasts have created panic.

Should these forecasts really mean PNG is facing the “Greek-style crisis?”

Policy formulators at the highest level and the bureaucracy are aware and are looking for the conventional, fire fighting solutions. These would include expenditure cuts and revision of priorities.

Presence of favourable factors

Panic creators should recognize them too.

The inflation is now around 4%. The inflation forecast for 2015, made in the official report is 4.9%, as against the earlier forecasted figure of 5.5%. That is one factor of comfort.

Further, the level of foreign reserves held by authorities is high enough to cover nine months of imports against the usual level of four months of import cover in many island countries. The debt level is currently well below the legislated level and it is yet to breach the limit.

Another aspect is most of the public debt, reported to be two-third, held domestically. Only one third of the total debt held externally. Most of the external debt is on concessional terms. Hence, servicing cost in terms of foreign exchange is not likely to be sizeable.

Deficit financing through public borrowing will be, if at all, confined only to domestic borrowing as authorities are encouraged by liquidity in the financial institutions. Thus, incurring additional external debt, which poses greater dangers, would be avoided.

The current situation is not so alarming. The signals have done the job.

Authorities have woken up.

“Lost Decade”

The policy makers cannot afford to forget the 1990s.

In the 1990s, things were grim. The closure of the Bougainville copper mine, fiscal excesses and a rundown on foreign exchange reserves, all led to the balance of payments crisis and ultimate abandonment of the Hard Kina Strategy in 1994. That was followed by yet another episode of fiscal mismanagement and a break-down in good governance combined with the El Niño drought of 1997/98 and Asian Financial Crisis, all brought PNG to the brink of financial collapse at the end of the 1990s.

That was the “Lost Decade”, so aptly called by a former central bank governor Sir Wilson Kamit in one of his 2008 public addresses.

Nobody wants a repeat of it.

Professor Jayaraman teaches at Fiji National University, Nasinu campus. This article appeared in Fiji Sun, Saturday August 22, 2015. His website is: www.tkjayaraman.com