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PNG credit rating downgraded

T.K. JAYARAMAN

Just after we heard from the staff of UN ESCAP at their May 20 launch of 2015 Annual Economic and Social Survey in Suva, that PNG would grow at a stunning rate of 15 percent in 2015, we got the shocking news that Moody's Investors Services have downgraded Papua New Guinea (PNG)'s credit outlook rating: from stable to negative.

Although the same rating agency has re-affirmed PNG's B1 for foreign currency and local currency rating, the negative credit outlook does not bode well: there is a one-in-three chance that PNG would be downgraded to B2, if things become worse, which is just only one level a "poor quality" rating.

What are the factors that influenced latest Moody's credit outlook from stable to negative?
What are the "worsening" conditions feared by all, investors and policy makers alike?

Factors behind negative outlook

The first and foremost factor is deterioration in fiscal balance position. It is a negative 7.3 percent of GDP.

Mounting budget deficit is always accompanied by its twin: external deficit. The current account balance, which is the difference between exports of goods and services together with all factor earnings and imports of goods and services together with all factor payment, is also negative. The external deficit is 22.6 percent of GDP.

Moody's Investor Service research findings put the blame on government's fiscal spending on the assumption that completion of liquefied natural gas project's export earnings would sustain an ambitious expenditure planned. After a string of budget surpluses and near budget surpluses of 2004-2011, thanks to high commodity prices of both mineral and non-mineral exports, budget deficits since 2012 have bulged. It is reported that government debt will breach the ceiling of 35 percent, laid down by the Fiscal Responsibility Act of the Parliament. It will be 38 percent of GDP.

External deficit has already led to more than halving the country's foreign reserves: it has come down to 2 billion kina from 9 billion kina.

Worsening conditions

The fall in oil price and LNG prices are the reasons behind the country's current fiscal position. In fact, the central bank, Bank of PNG (BPNG)'s six monthly monetary policy statement issued in March has already revised downwards the growth rate forecast for 2015 to 9 percent. Incidentally, UN ESCAP 2015 Survey launched last week predicted the growth rate at 15 percent. It is yet another glaring lack of coordination between the international agency and a national government's forecast rate. Similar to what happened in the case of Fiji: Reserve Bank of Fiji revised the growth rate for Fiji in 2015 to 4.3 percent, the World Bank report said Fiji would grow at 2.5 percent.

The BPNG's monetary policy statement of March 2015 says that "lower net flows than earlier envisaged are expected from LNG exports".

The oil price is expected to fall in 2015 from US$ 103.7 per barrel to US$ 50.9 per barrel. The oil price and LNG price are highly correlated. It is predicted by ANZ bank's research department that LNG price would fall by 42 percent by June.

So the position is serious.

The central bank has warned government: "Cut non-essential expenditure, defer non-priority expenditure and refrain from undertaking any new commitments."

Already the kina is under pressure. Although PNG has adopted a floating exchange rate regime, there are heavy interventions. In June 2014, trading bands have been around a non-market exchange rate. That made the kina artificially kept up in value by raising its value by 17 percent.

Since June 2014, it has depreciated by 9 percent, still more than 5 percent higher than market rate. Allowing the exchange rate to depreciate will do a lot more good: it will reduce imports; and relieve the pressure on balance of payments.

Keeping the exchange rate overvalued is to lower prices of imports.. But the result has shown inflation is still up. It is still high at 6.6 percent. The only way to cut down inflation is through reducing aggregate demand by cutting down government expenditures and through austerity at all levels.

Moody's report is not all that gloomy.

It says LNG project presents bright prospects. Past decade of debt and fiscal consolidation by PNG has kept "the country with one of the lowest debt burdens among B1 rated countries".

The report makes it clear that there is no improvement in the grading likely, unless fiscal deficit and debt levels are kept down and foreign exchange reserves are increased.

What is now required is alertness on the part of the authorities: not to let the situation get out of hand.