L Wilson Kamit: Tackling extreme poverty in Papua New Guinea

Address by Mr L Wilson Kamit, CBE, Governor of the Bank of Papua New Guinea, to the Lowy Institute for International Policy Conference on “Tackling Extreme Poverty in Papua New Guinea”, Sydney, 14 May 2009.

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Distinguished guests,

Ladies and gentlemen

May I firstly thank the organizers of this conference, namely the Lowy Institute for International Policy, Care Australia and the Australian National University for the invitation to address this conference on tackling extreme poverty in PNG.

It is not very often that Governors of central banks are asked to comment on social issues or microeconomic matters. We tend to look at the macroeconomic level. Given the global financial crisis and its adverse effects that are being felt right across the globe, I am pleasantly surprised at the invitation to this conference. Recently, I have been asked to address different audiences on this subject at home and abroad.

I was asked to comment on the impact of the current global financial crisis on the PNG economy and its impact on poverty. I have some comments to make on the first part, which is the likely impact of the global financial crisis on PNG. I must however confess that there are others gathered here today who are better placed to comment on the second part of our discussions on the impact on poverty. I will therefore restrict myself to making some general remarks.

Ladies and gentlemen, much has been said and written about the causes of the current global financial crisis and its effects around the globe. I will therefore not dwell on them.

The maxim that “no nation is an island” is never more so true than now, where all countries, developed and developing, if they have not been so far, will be affected in one way or another by this crisis. Development through globalisation, international trade and global finance has meant that we, in PNG, will also be affected by activities and events taking place far away in the major financial centres and industrialized countries. As a small, open economy, PNG is a price taker for our exports and is vulnerable to the global economic and financial conditions.

Given this, the question for us, therefore, is in what ways is PNG likely to be affected by this financial crisis.

We are, to an extent, fortunate in PNG in that our banking system is shielded from the immediate effects of the crisis. Our banks and financial institutions are engaged in the traditional financial activities of raising funds from depositors and making loans to borrowers. Almost all the funds raised by our commercial banks are done so through deposit takings domestically. Deposits comprise over 80 percent of our commercial banks’ liabilities, much of it in kina. Foreign currency deposits are only a small component of the banks’ deposit base. As at the end of December 2008, foreign currency deposit was around 9 percent of total deposits.

The commercial banks are generally sound with high capital adequacy ratios. In 2008, their capital adequacy ratio was 25 percent, higher than our limit of 12 percent (see chart 1). The banks have no exposure to sophisticated financial products such as mortgage-backed securities that are linked to the demise of the sub-prime mortgage market. The high level of liquidity in the banking system also provided sufficient funds for commercial banks to operate without resorting to borrowing from the international financial system.

Despite the high level of liquidity, the commercial banks' lending is prudent with low levels of non-performing loans. In 2008, non-performing loans totaled K70 million, down from K277 million in 2001 (see chart 2). Lending also comprises a small share of the banks' assets, about 35 percent. The banks are well managed and closely regulated by the Bank of PNG. In addition, the two subsidiaries of Australian banks have in place guarantees from their parent banks (letters of comfort) for any lending in excess of prudential exposure limits set by the Bank of PNG, giving confidence to the stability of the financial system. Both these banks' parents have double "A" credit ratings by Standard and Poor's.

However, the financial institutions and companies most likely to be affected by the crisis are the superannuation funds and PNG dual-listed companies in overseas stock markets. The two major superannuation funds, the Nambawan Super Ltd and Nasfund Ltd, have some of their assets invested in offshore equities, while the rest are invested in commodity-based stocks that are dual-listed in PNG and overseas markets. They have reported positive returns in 2008 and remain positive and confident, though with lower returns projected for 2009.

Indeed, much credit must be given to the financial sector reforms introduced by the Government in 2000, which created an independent central bank and introduced improved supervision of the financial system. The reforms saw much needed changes done to strengthening our financial sector after the excesses and mismanagement of the 1990s (see chart 3). The reforms also meant we were in a better position to face the current financial crisis.

While PNG may not be directly affected by the global financial crisis, we will be if and when the financial crisis turns into a recession. Already, the major industrialized countries are experiencing negative growth in economic activity. These countries include the United States (US), United Kingdom (UK), Germany, and Japan. There is lower growth here in Australia. Besides China, these are the major markets for many of our exports. A slowdown in these countries would mean less demand for our export commodities, resulting in lower export revenue, and a reduction in Government tax revenue. A lower reserve level means less funds available for the Central Bank to invest in and loss of income to the Government (see chart 10).

In the private sector, lower export demand would mean companies would hold back on any expansion plans, save costs by reducing employment and may have difficulties servicing their loans. Furthermore, foreign investors would delay any new investments in the country given the uncertainties. Generally speaking, economic activity in the country would be lower (see chart 4). For 2009, the Government forecasted a growth in economic activity (GDP) of 6 percent.

All this does not augur well for poverty reduction in PNG. Less Government revenue would mean the Government has to reduce its expenditure (see chart 5). This is the prudent fiscal response to a reduction in revenue. The alternative would be to borrow, domestically or externally, to make up for the revenue shortfall. This would however mean increasing the Government's indebtedness. So far, the Government has succeeded in reducing its debt. The Government's debt to GDP ratio declined from 71 percent in 2001 to around 30 percent in 2008 (see chart 6). A return to borrowing (deficit financing) would reverse this achievement, as well as passing on the burden of servicing the debt to future generations of Papua New Guineans. Tying down financial resources for debt servicing means there is less money available to fund the provision of much-needed goods and services to the populace.

If the Government decides to reduce expenditure, this may mean cutting back on essential social services of health and education, and important infrastructure projects that would improve the livelihood of our people. The Government has set aside the windfall gains from high commodity prices in 2007 and the first half of 2008 in various trust accounts for spending in the key priority areas of infrastructure, health, education, agriculture and law and order. However, with revenue forecasted to be lower than expected, this would put pressure on the Government to access these funds to maintain recurrent expenditure levels. This concern was raised at the recent PNG Economic Update forum series in Port Moresby.

The majority of our people still live in their villages, relying on subsistence farming and fishing and using the cash economy whenever the need arises. They also benefit from their extended family ties through the “wantok” (care for extended family) system. Fortunately, they are least affected by the workings of the Government and its agencies, much less by the global financial crisis.

Our own challenges in the Central Bank in relation to poverty alleviation involve the issues of financial inclusions and financial literacy. How do we get the vast majority of our people outside our financial system to participate fully within the system and benefit from the economic growth? Over the years, we have revitalized the savings and loan society movement, closing down dormant societies, improving on training for their staff and increasing supervision on their activities. We have also licensed two microfinance institutions to complement the activities of the commercial banks and other financial institutions. The savings and loan societies and microfinance companies are aimed at assisting low income earners and entrepreneurs to do businesses, improve their lifestyles and should assist in alleviating poverty. How can we ensure our people are financially literate so that they can make informed financial decisions as well as notice unscrupulous deals when they see one? Financial education and literacy programmes by the Government sector, private sector and non-government organizations are important. Financial literacy programmes lead to financial inclusion which improves the lifestyles or economic conditions of those engaged in it and help reduce poverty. However, to work effectively, both these two activities would have to be undertaken together, that is, microfinance development together with financial literacy. The on-going financial global crisis shows the importance of dealing with these issues, even in the industrialized countries.

The current global financial crisis is a concern. Some say it is the worse economic crisis since the Great Depression of the 1930s. If so, it presents a challenge to all of us here today. To those of us involved in the economic management of the country, as well as the technocrats, the politicians, the business community and civil society. We all have a part to play in ensuring that any adverse impact of the crisis is eliminated or minimize, especially on the most vulnerable members of our community.

In the 1990s, what some call the “lost decade”, when in spite of high earnings from our mineral wealth and steady economic growth, gross fiscal mismanagement, the closure of a major mining project and other external factors, we were deprived of the opportunity to set the stage for progress and growth. We hope we have learnt from this experience and not repeat the same mistakes.

Thank you again for the invitation and I look forward to the rest of the discussions at this important and timely conference.

Thank you.

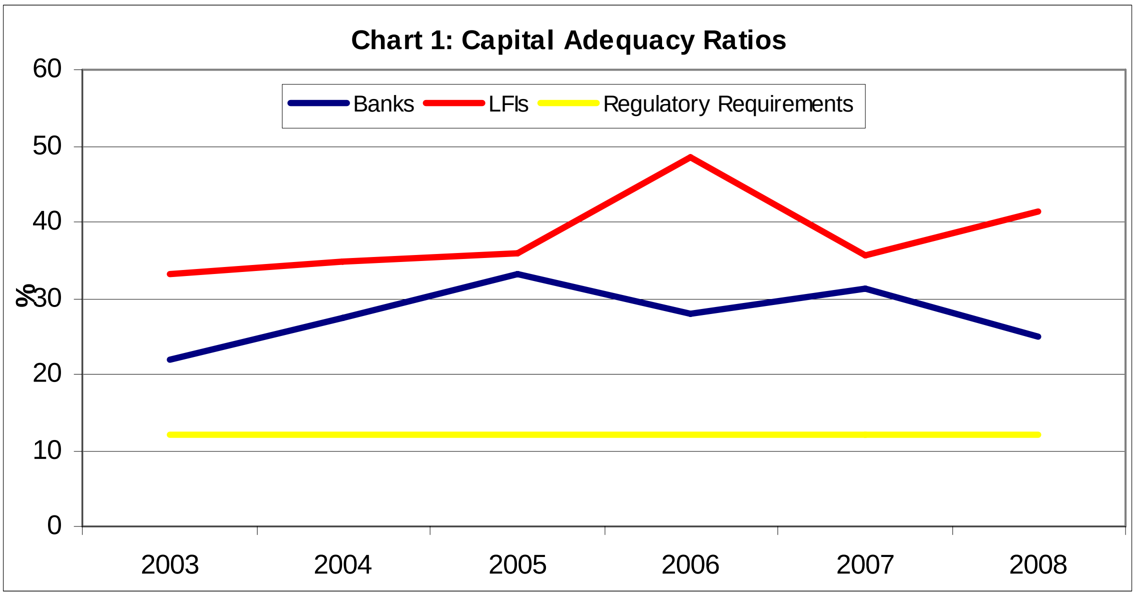


Chart 1: Capital Adequacy Ratios
Banks
LFIs
Regulatory Requirements
%
60
50
40
30
20
10
0
2003
2004
2005
2006
2007
2008

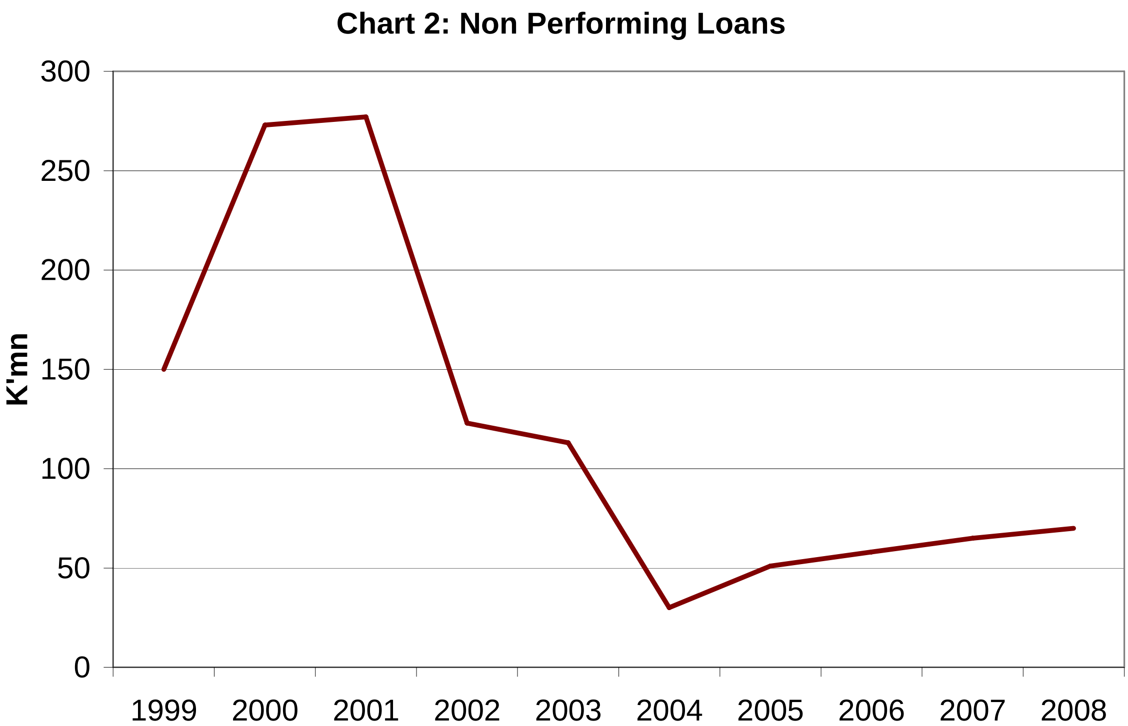


Chart 2: Non Performing Loans
K'mn
300
250
200
150
100
50
0
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008

Chart 3: Assets of the Financial System

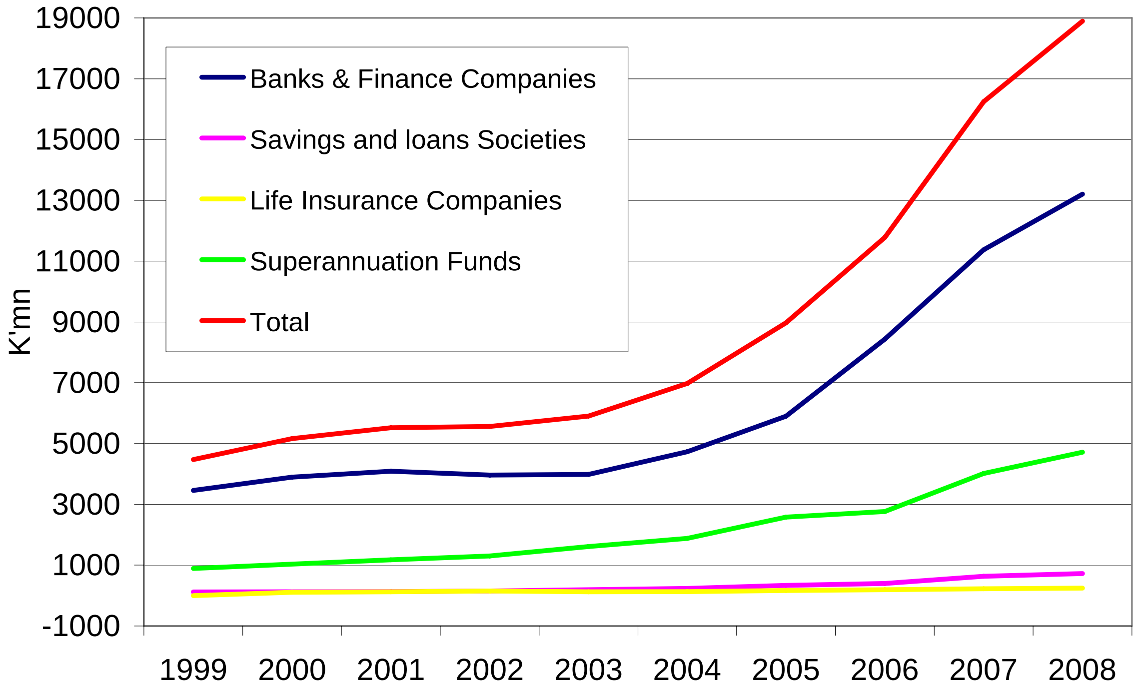


Chart 4: Real GDP

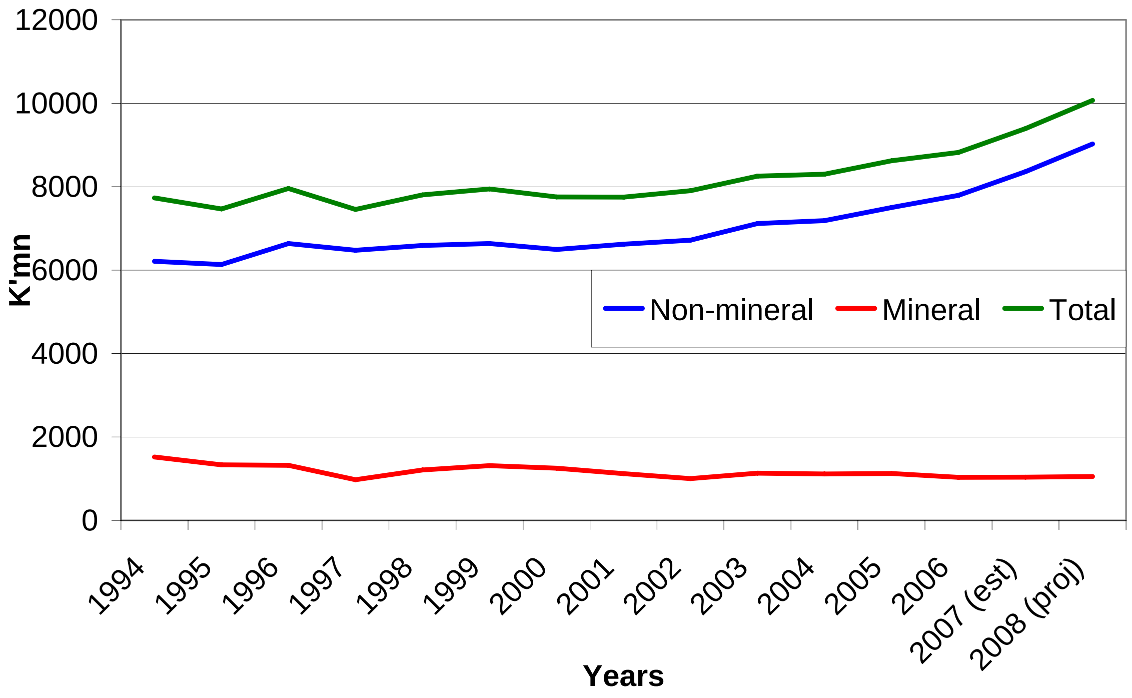


Chart 5: Fiscal Operations

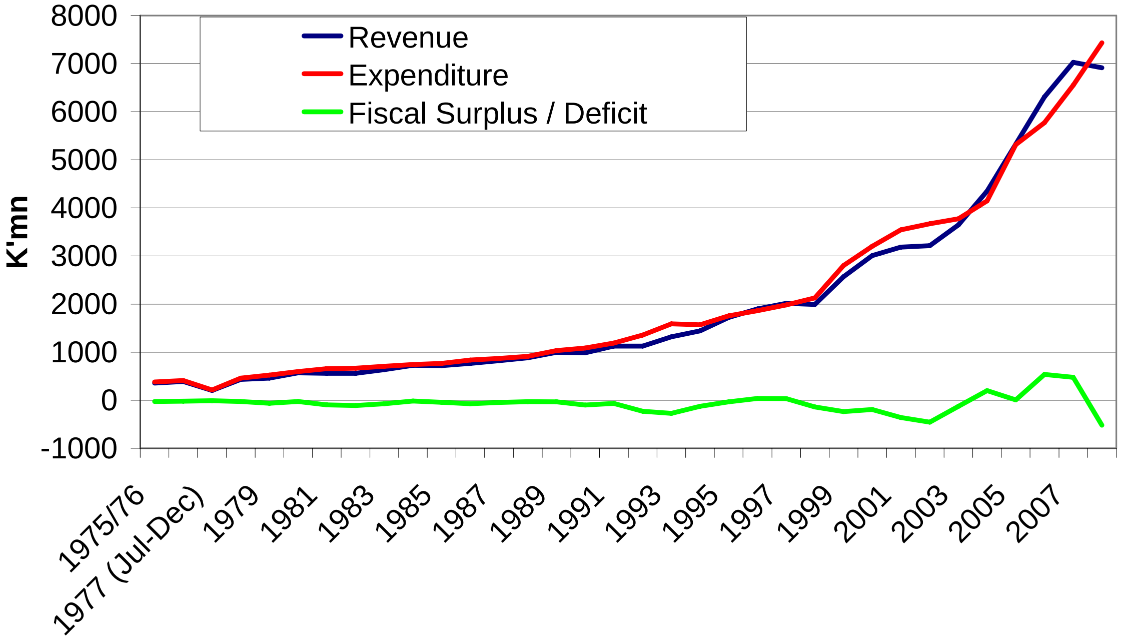


Chart 6: Government Debt

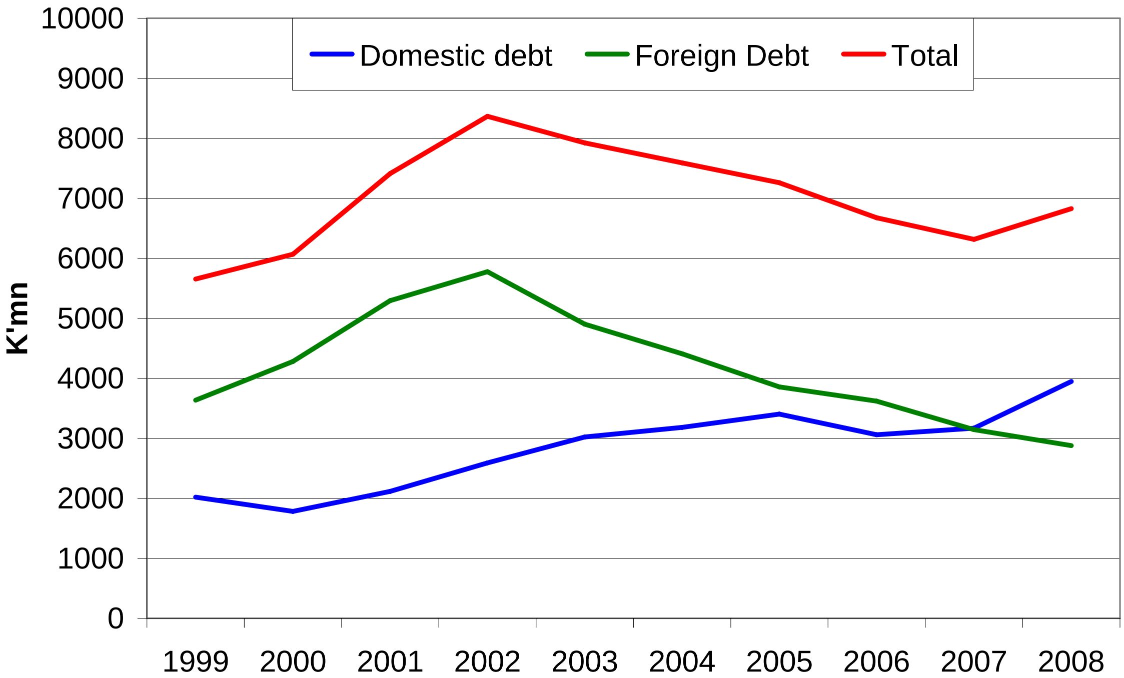


Chart 7: Inflation

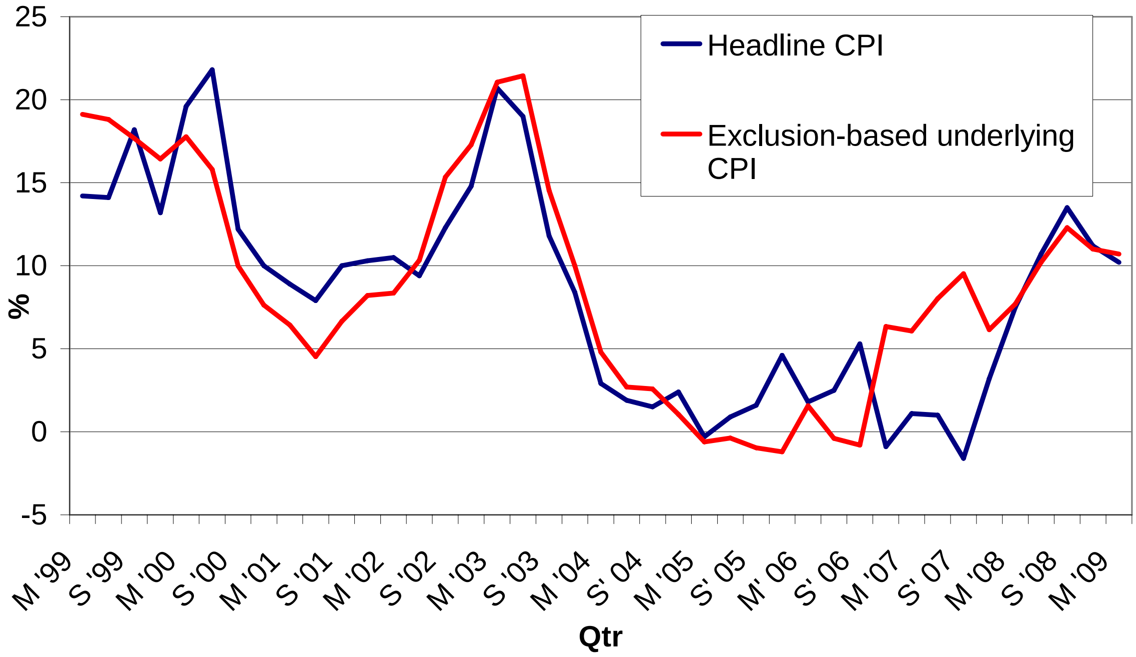


Chart 8: Quarterly Kina exchange rate against AUD, USD, TWI and REER

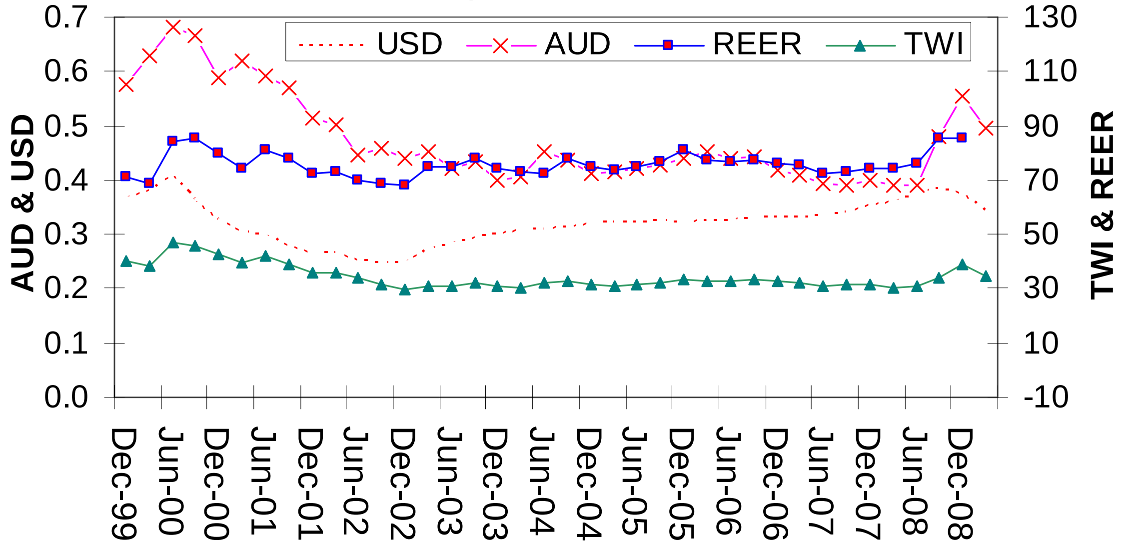


Chart 9: Interest rates

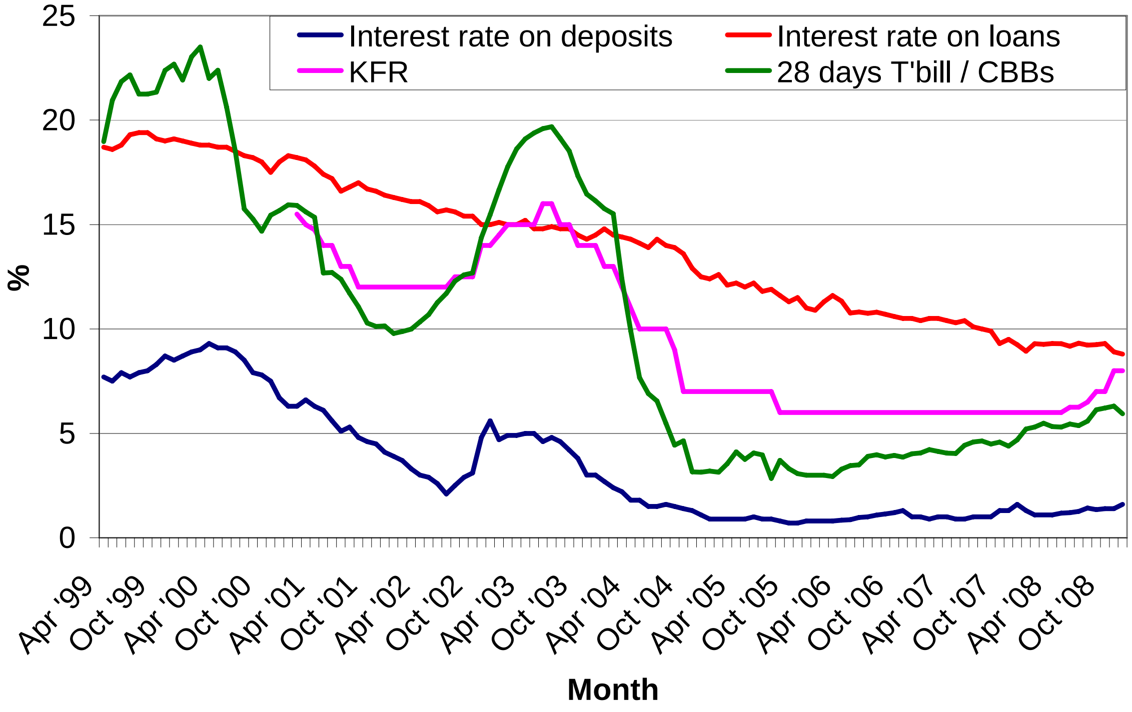
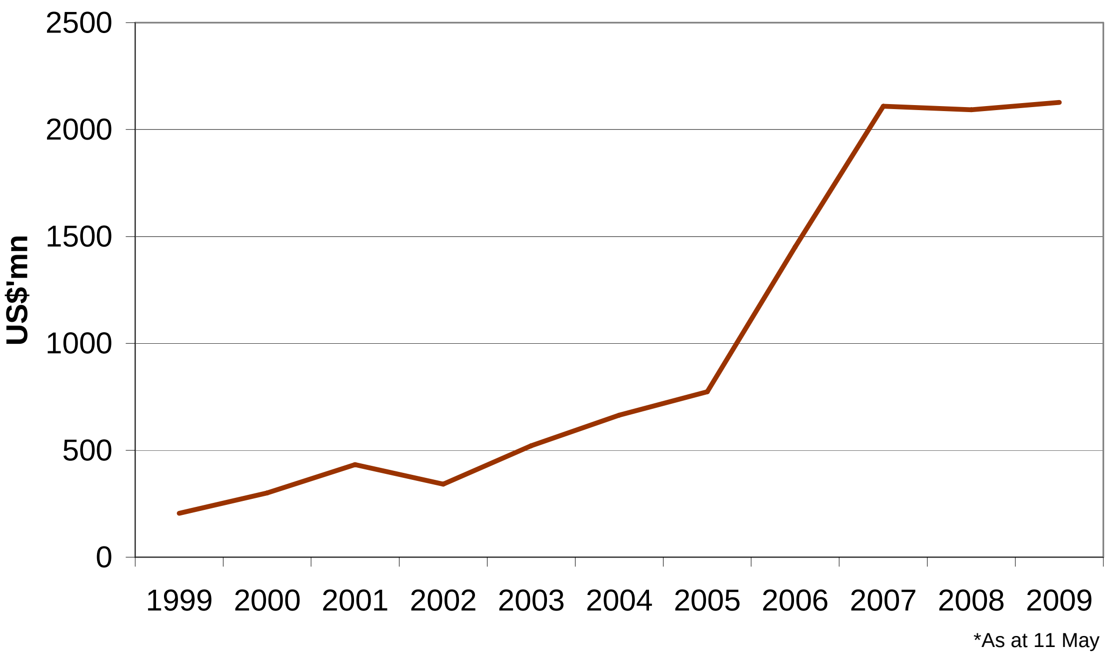


Chart 10: Foreign Reserves



*As at 11 May

Chart 11: Monetary Aggregates