Elizabeth Genia: Presentation of the March 2025 economic outlook

Keynote speech by Ms Elizabeth Genia, Governor of the Bank of Papua New Guinea, during the Breakfast Presentation to the Business Community on the March 2025 Economic Outlook, Port Moresby, 9 April 2025.

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Thank you to POMCCI for hosting us this morning and a very warm welcome to our distinguished guests: representatives from the Government, members of the Diplomatic Corps, representatives from the IMF, the World Bank, the Asian Development Bank, our valued development partners, officials from Treasury and other government departments, members of the banking community, ladies and gentlemen.

Papua New Guinea is a proudly inclusive society; we respectfully acknowledge the traditional custodians of the land on which we gather today - the Motu and Koitabu people - and we honour their enduring connection to this place.

On behalf of the newly established Monetary Policy Committee, as well as the Board and Management of the Bank of Papua New Guinea, I sincerely thank you for joining us for this morning's presentation which will also feature, in part, the Bank's Economic Outlook as at March, 2025.

Also, as many of you are aware, responsibility for monetary policy decisions have recently transitioned from the Bank's Board to the new Monetary Policy Committee (MPC), following the amendments to the Central Banking Act in December 2024. The MPC members were officially appointed in February 2025, and I take this opportunity to warmly acknowledge our new members:

- Mr. Scott Roger, previously of the IMF and the Monetary Authority of Singapore;
- Mr. Dairi Vele, a former Board member of the Bank; and
- Professor David Kavanamur, Managing Director of Kumul Consolidated Holdings and also a former Bank Board member.

Alongside Deputy Governor Yabom and myself, who serve ex-officio, we are grateful for the valuable contribution of our new MPC members during our first MPC meeting in March, and their ongoing commitment to responsibly formulating monetary policy and overseeing its implementation.

The establishment of the MPC was one of the key legislative reforms under the IMF Program, significantly strengthening the independence of Papua New Guinea's monetary policy framework, enhancing transparency in our decision making and accountability for monetary policy outcomes.

I would also like to sincerely thank our outgoing MPC members, Mr. Mark Baker and Mr. Michael Reddell, for their invaluable contributions, and dedicated service during their time on the Committee. We are fortunate that both continue to serve on our Board, ensuring we retain their experience and their expertise.

Six months ago, at the launch of the September 2024 Monetary Policy Statement, we gathered to discuss the ongoing reforms in monetary policy within the broader context of the IMF program, the prevailing inflation data, and the actions required to maintain price stability - the primary objective of the Bank - and now the mandate entrusted to the independent MPC.

Today, let me begin by reviewing the key monetary policy decisions taken over the past six months, providing an update on our current position, and then outlining how we see the path ahead. This morning's discussion will also offer some valuable insights, as we look forward to the next six months, and beyond.

In September of 2024, the Kina Facility Rate (KFR) was increased by 1.0 percentage point to 4.0%, following an earlier, 0.5 percentage point increase in August. You may recall that the KFR was briefly at a historic low of 2.0% in February of 2024 in response to the civil unrest in January of last year.

Although the KFR remained at 4.0% for the last quarter of 2024, monetary tightening continued through the adjustments that had been made to the Cash Reserve Requirement (CRR) earlier in the year. Each 1.0 percentage point increase in the CRR withdraws approximately PGK 330 million in commercial bank deposits from circulation. The CRR was increased from 10.0% to 11.0% in May, and again to 12.0% in June, removing just over PGK 660 million in available liquidity from the banking system.

These policy actions significantly impacted government borrowing costs, with 12-month Treasury Bill yields rising to over 8.0% by September 2024 while private-sector borrowing costs remained relatively stable.

By December 2024, the amendments to the Central Banking Act had been passed, legally establishing the MPC. However, with the MPC members yet to be appointed, the Board thought it prudent to defer further monetary policy decisions until the newly established MPC became operational.

The MPC's inaugural meeting was held on March 11th, within the requisite 30 days from the members' appointments on February 12th. At this meeting, the MPC decided to adjust the CRR to 11.0% following considerable discussion as to whether the previous increase to 12.0% had been one tightening too far.

Importantly, the MPC clarified that the decision to adjust the CRR did not signal an easing in monetary policy, it was a necessary step to address the uneven distribution of liquidity within the banking system.

The MPC maintained the KFR at 4.0%, acknowledging it remains relatively low, and indicating that normalisation of the policy rate will occur over time. Additionally, the Bank resumed its crawl-like exchange rate arrangement and retained the margins for overnight repos, and reverse repos, at 1.5% above and below the policy rate.

In an effort to improve monetary policy transmission, the MPC also looked at moving to indirect monetary policy instruments. Reducing the Cash Reserve Requirement, coincided with increased issuance of 28-day Central Bank Bills and maintenance of the interest rate corridor around the KFR.

You will notice the Monetary Policy Statement has a new format, reflecting recent legislative changes and demonstrating our commitment to transparency and accountability.

Section 11 of the amended Central Banking Act requires the Monetary Policy Committee to issue a statement within one day after each meeting, detailing all directions, decisions, and actions taken by the MPC, as well as clearly outlining how individual members voted and explaining the rationale behind their votes.

Transparency and accountability are at the heart of what the Monetary Policy Committee is aiming to achieve. We took an important step towards transparency in publishing the minutes of our inaugural MPC meeting as we wanted to provide the public with a deeper insight into how the MPC meetings are conducted.

We also wanted to highlight the extensive work, and attention to detail, required of our Monetary and Economic Policy Group (MEPG), to ensure the MPC members are fully equipped to make incisive and well-informed monetary policy decisions. Timing is also now an important factor for the MPC and issuing the Monetary Policy Statement within one day of the MPC meeting is a deadline that cannot be missed.

Last night, we published the Bank's Economic Outlook, these economic projections were previously included in the Monetary Policy Statement and are always presented during our MPC meetings. Following the amendments introduced under section 11 of the Central Banking Act, the MPC will discuss how best to incorporate these projections into future Statements.

I'd like to share some of the data from the Economic Outlook with you this morning.

The chart numbers on the following pages reference those in the Economic Outlook as of March 2025 https://www.bankpng.gov.pg/economic-outlook-March-2025 though they do not follow the same numerical sequence.

Tradable and non-tradable inflation

Chart 1 tells an interesting story, and clearly shows where non-tradable inflation was more than offsetting tradable inflation for quarters 2,3 and 4 of 2024.

Non-tradable, or domestic inflation, which shows the rate of change in the prices of domestic goods, has been decreasing. Non-tradable inflation has nothing to do with the exchange rate or a depreciating Kina.

On one hand, this is partly a good news story, with telecommunications prices falling due to increased competition following the entry of a new market participant. However, on the other hand, the trend signals weakening demand and highlights softness within the non-mineral and non-petroleum sectors of the economy and this was one of the contributing factors to the KFR remaining at 4.0% for now.

Every visit to the supermarket reminds us just how expensive our shopping basket has become. The left of chart 1 shows the persistently high levels of inflation during, and post Covid 19 with headline inflation averaging, at times, between 5.0% and 6.0%.

Looking towards the right-hand side of the Chart, price stability was reasonably well maintained throughout 2023 with only moderate price increases, though off a very high base due to the higher-than-average inflation from 2020 through to the third quarter of 2022.

All things considered, inflation was relatively well contained in 2023, particularly with the lower Kina, depreciating as it was, in a gradual and a measured way. However, weakening demand, and a softer domestic economy was the main contributing factor to the lower headline inflation number.

Core inflation measures

At the Central Bank, our main focus is on the underlying, or core measures of inflation. While chart 2 includes headline inflation, we concentrate on the trimmed mean, which we produce ourselves at the BPNG, and the exclusion-based inflation measure that is produced by the National Statistics Office (NSO).

The trimmed mean inflation measure is calculated by removing the most significant price increases, and price decreases, from the calculation of the CPI. Some prices of goods and services in the CPI basket may experience sharp swings in a particular quarter that do not necessarily reflect broader inflationary trends.

By 'trimming' these extreme movements in prices, we get a more stable, and reliable measure of underlying inflation. It provides us with a relatively accurate representation of persistent inflation, helping to avoid policy responses to temporary price spikes.

The exclusion-based inflation measure removes specific volatile subgroups from the CPI basket. These include 'Fruits and Vegetables', 'Alcoholic

Beverages and Tobacco', and excise and price-controlled items, such as 'Rents', 'Electricity', 'Water' and 'Fuel'. 'Medical Services', and 'Education Fees' are also excluded.

Both the trimmed mean and exclusion-based measures are useful, and are viewed together, noting the reasons for the underlying movements in each, when considering monetary policy.

At this point, we are expecting inflation to remain relatively well contained, but the caveat of course is the recent introduction of tariffs in the US and I will come to that a little bit later.

The impact of tightening measures on government borrowing costs

I have included chart 3 to highlight the impact of the tightening measures taken last year that were primarily due to the increases in the Cash Reserve Requirement.

In June 2024, the yield on the 12-month TBILL was just under 5.0%. After removing liquidity from the banking system (approximately 660 million in total) the amount of liquidity available to participate in the weekly TBILL auctions, and monthly GIS auctions, was significantly reduced and with less credit available to Government, resulted in the upward pressure on Government borrowing costs.

By December 2024, the yield on the 12- month TBILL was at 8.7% and has since eased to just above 8.0% after the recent adjustment in the CRR to 11.0%

The impact of tightening measures on private sector borrowing

Chart 4 shows that even though there was less liquidity available in the banking system, the impact of the increases in the CRR on private sector credit was much less pronounced. There was very little correlation also between movements in the KFR and movements in either deposit rates or lending rates. This will be an area the newly established MPC will be looking at closely - that is - how to improve the monetary policy transmission mechanism through to private sector lending rates and weighted average deposit rates.

The Kina - USD exchange rate and the trade weighted index

Chart 5 shows both the depreciating Kina against the US Dollar, as shown with the PGKUSD exchange rate measured against the vertical axis on the right-hand side of the chart, and also the Kina's depreciation against the Trade Weighted Index, on the left-hand side of the chart.

The Kina has been depreciating based on its relative overvaluation. We have our estimate of the Kina's overvaluation at the BPNG and the IMF have their estimate of its overvaluation, and I'm happy to say that both estimates agree when we perform this calculation every 6 months.

Ironically, the Kina's level of overvaluation, which is in the single digits, isn't of primary importance. What is important is that we are using this as a mechanism to allow the Kina lower, in a measured, and in a gradual way, until we see some improvement, or what economists call 'equilibrium' in the market.

Are we there yet? No. How much lower do we have to go? We don't know. What we do know, is that we need to continue to test the sensitivity of foreign currency inflows to the lower exchange rate, until we see signs of that 'equilibrium' in the market.

The Kina - USD exchange rate and the trade weighted index

Are we seeing signs of improvement? Yes, and the next chart, chart 6, shows the improvement in the backlog of FX orders in recent months.

In August 2024, the backlog of 'essential orders' was just over 1 billion Kina, and the waiting time to have an order filled could be up to six weeks, sometimes even longer. We have seen a significant improvement in the last 6 months. Essential orders, which we classify as orders for imported goods and services, have decreased to just over 100 million Kina and less than 20% of overall orders in the market.

'Non-essential' orders comprise mainly of dividends, which are of course essential but we use this classification system from the perspective of what businesses need to maintain their operations, pay salaries, and repay loans to their banks and protect the stability of the financial system. The reduction in the backlog of FX orders is very encouraging, and while we are of course, mindful of weakening demand, which we saw evidence of earlier, this is nonetheless a very positive trend which we will continue to monitor carefully as the year progresses.

Sectoral contributions to real GDP growth

The Bank forecasts the economy will grow by 4.0% in 2025, up from an estimated 3.0% in 2024. Growth is expected to be primarily driven by higher production in the mineral sector due to improved mining operations, better ore grades, expanded processing capacity, and increased output from the Porgera gold mine and PNG LNG Project.

Early works related to the Papua LNG Project will further support growth as it approaches a Final Investment Decision in late 2025.

Agriculture, fisheries, and forestry are expected to contribute strongly, and despite expectations of moderating global commodity prices, the depreciation of the Kina is anticipated to boost export earnings, and incentivise production across export sectors. Growth in telecommunications, transportation, accommodation, and food services – is also expected - aided by government spending on infrastructure.

Over the medium term, economic growth is projected at around 5.0% - 6.0%, underpinned by near-full capacity at the Porgera mine and commencement of the Papua LNG construction phase in 2026, while the agriculture and non-mineral sector is expected to benefit from increased competitiveness.

US tariffs

The above paints a relatively rosy picture, and of course, the question has to be asked - how will the recent tariffs introduced by the US impact PNG? The real question is how will the tariffs impact globally, and what is the likelihood of a global recession?

For answers, we need to look at the two most recent significant global events - Covid 19 and the GFC in 2008/9. Papua New Guinea emerged relatively unscathed from the GFC, largely insulated from global banking contagion due to the absence of any exposure to leveraged credit or sub-prime mortgage-backed securities.

However, the COVID-19 pandemic and subsequent outbreak of the Russia-Ukraine conflict, presented a different challenge. These events led to sharp increases in global energy prices, triggering significant inflation and directly impacting PNG's economy.

If equity markets continue to sell-off and we see increased margin calls, we could see vulnerabilities emerge in global banking, and while we should be largely insulated from that, as we were in 2008, the impact of such an event on funding for Papua LNG is an unknown.

Regarding the tariffs themselves, any impact on LNG prices is likely to be limited, given that most of PNG's LNG is contracted forward and with gold prices currently above USD 3,000 per ounce, we may see heightened interest in PNG's gold deposits.

That said, we really don't know precisely what the outcome would be. We will be watching events closely, and like everyone else, hoping that a global recession can be avoided.

Potential grey listing

I want to finish this morning by turning briefly to the Financial Action Task Forces' Mutual Evaluation Report for PNG. The Financial Action Task Force (or FATF) are a global body who have developed a set of guidelines to help countries around the world develop and implement an effective Anti-Money Laundering Framework.

The FATF completed their Mutual Evaluation Report in October of 2024 and the results were not flattering. We were assessed in two critical areas: - our technical compliance with our AML framework, and our effectiveness in enforcing it.

PNG scored extremely low ratings on both our effectiveness and technical compliance, indicating substantial shortcomings with enforcing anti-money laundering measures. The Mutual Evaluation Report identified that our biggest challenge lies with co-ordination across Government Agencies, prosecutions and recovery of assets.

In response, we formed a National Co-ordination Committee comprising of all government agencies and over recent months, have been working on increased co-ordination and cooperation, and we have until October of this year to fully address the issues raised in the Mutual Evaluation.

I don't want to let the banking community off the hook entirely by giving them a clean bill of health here this morning but I will say that as the regulator responsible for the integrity of Papua New Guinea's financial system, one thing I can confidently attest to is that PNG's commercial banks adhere to the highest international standards of AML compliance. They have to - it is essential for them to maintain their correspondent banking relationships - and to ensure their ongoing access to international financial networks.

However, it is important to recognise that banks' adherence to the highest AML standards is only one component of an effective AML framework. FATF's Mutual Evaluation Report makes it clear that our greatest challenges lie in enforcement, specifically with the relatively low number of successful prosecutions, and minimal recovery of assets.

On paper, we have the appropriate legislation in place with our AML/CTF Act and Proceeds of Crime laws, but we are struggling to enforce them. Law enforcement needs to have the resources necessary to effectively combat corruption and white-collar crime within our borders.

Individuals can at times exploit corporate structures, hiding behind the corporate veil to move money illegally and it is encouraging to see our anti-corruption agency, ICAC, is now fully operational and is also working with FASU to target and dismantle these hidden networks and enforce accountability.

Where assets do end up overseas, it is important for the FATF to see tangible evidence of PNG cooperating effectively with our overseas financial intelligence counterparts - so that we can work with them to trace these assets and ensure we get them back.

If we don't address these problems - and address them quickly - we will end up on the grey list, and that is a place where no country wants to find itself. Once grey listed, it will take years of dedicated effort to be removed from it.

It will damage our reputation internationally, transactions to facilitate trade flows will attract more scrutiny, it will lead to increased costs of doing businesses and it will discourage foreign investment.

We need to urgently build capacity and adequately resource our law enforcement agencies - particularly the Police and prosecutors - by providing them with the resources, skills and tools necessary to effectively prosecute white collar crime.

ICAC needs to be fully supported, and we need to continue to improve on the coordination between our Government agencies, so that together, we can tackle the scourge of corruption.

The cost of ending up on the grey list will be a high one for Papua New Guinea. Let's address these challenges and take action now while we can. In a few short months, it will be too late.

Thank You