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Debt Blow-outs – More Independent Views

"Yet another independent international source has given a thumbs down to the way the national government is mismanaging the economy. The international credit ratings firm Fitch has joined the other two big international credit ratings firms Moody's and S&P in giving a worrying view of the real state of the PNG economy. Presumably in providing comments on the foolish PNG Sovereign Bond offering, Fitch has sharply disagreed with the rosy view of the economy presented by Treasurer Charles Abel. Specifically, contrary to the Treasurer's claims that the budget deficit will be down to 1.2 per cent of GDP in 2022, Fitch says the budget deficit will average 4.4 per cent of GDP for the next decade! This is not showing much faith in Abel's budget strategy "said Ian Ling-Stuckey, Shadow Minister for Treasury and Finance.

"As I indicated in my Budget response nearly a year ago, and have been consistently arguing since, the national government has put forward a fake, rosy set of budget figures. These figures have consistently been looked through by international experts such as the credit ratings agencies. A Fitch figure of a 4.4% budget deficit in 2018 is equivalent to K3.6 billion, more than K1.6 billion greater than the 2018 figure used by the Treasurer as recently as his 2019 Budget Strategy.

"Larger on-going budget deficits would mean that PNG's public debt would also continue to increase. Indeed, using the Fitch figures on average budget deficits and even the PNC government's understated public debt figure of K23.8 billion in 2017, we would see public debt sky-rocket to K35.4 billion by 2020 – another K11.6 billion racked up in debt by the O'Neill-Abel government. By 2022, at the time of the next election, public debt would have soared to K45.3 billion, nearly another 10 billion again. The national government had admitted that public debt would continue growing – but the implications of the Fitch estimate is K14 billion more. This is simply irresponsible budget management" said the Shadow Treasurer.

"Sky-rocketing public debt also means sky-rocketing interest costs. Average interest costs on public debt were 8 per cent in 2017. Using the same figure (and not allowing for further increases from any expensive sovereign bond) would see interest costs increase from K1,885 million in 2017 to K3,622 million by 2022 – so essentially doubling yet again. This would be a massive share of our budget and would squeeze out vital health, education and infrastructure spending and force the government to severely reduce DSIP funding to members of parliament, which may not be such a bad thing! When the PNC took over in 2011, interest costs were only K416 million. So the people of PNG are facing nearly a ten times increase in interest costs, from K416 million in 2011 to K3,622 million in 2022 under the PNC government. Better policies are needed, a better government with the right mix of coalition partners with a proven track record of managing the economy is needed" said Mr Ling-Stuckey.

"I have only picked up one of the many worrying assessments made by the Fitch ratings agency. Future releases will cover other implications such as the exchange rate and proposed sovereign bond."

Hon.Ian Ling-Stuckey,CMG.MP
Shadow Minister for Treasury & Finance

20 September 2018

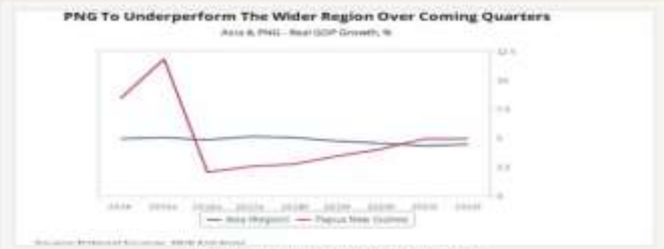
Detailed Information

The assessment by Fitch has been covered in a recent Business Advantage article of 18 September available at https://www.businessadvantagepng.com/analysts-fitch-forecasts-higher-economic-growth-for-papua-new-guinea-in-2019-but-kina-to-weaken/

Analysts Fitch forecasts higher economic growth for Papua New Guinea in 2019 but kina to weaken

18 Sep 2018 by David James | Leave a Comment

Financial analysts Fitch Solutions is forecasting higher economic growth for Papua New Guinea in 2019. But it says the kina is overvalued, which may pose problems in the future if the the Government's proposed sovereign bond issue is successful.



PNG's real GDP growth versus Asia. Source: Fitch

'We forecast real GDP growth to come in at 2.8 per cent in 2018 and 3.4 per cent in 2019, versus an estimated 2.5 per cent in 2017,' says ratings agency Fitch's latest assessment of PNG's economic outlook.

'While PNG has strong macroeconomic potential due to its vast resource wealth, the near-term growth outlook remains modest.

> *'We forecast the kina to depreciate by around 3 per cent per annum against the US dollar'*

'This (GDP growth) is likely to be below the regional average.'

Kina

The report says that since mid-April, the kina has 'only fallen by 2.2 per cent against the US dollar', despite higher inflation in PNG.

It says the expensive exchange rate has 'weighed on the competitiveness of PNG's non-resource exports' and it is 'one of the main reasons' for holding back the country's efforts at economic diversification.

'This is unsustainable over the long run and we forecast the kina to depreciate by around 3 per cent per annum against the US dollar.'

> *'The climate for international investment may not be conducive.'*

The report says a weaker kina would result in an increase in the government's external debt servicing costs.

'This would act as a long-term drag on its fiscal health.

'We forecast PNG's fiscal deficit as a share of GDP to average 4.4 per cent over the coming decade, versus 4.0 per cent in the 2010-2017 period.'

Debt servicing

The Fitch report says the proposed sovereign bond could increase financial stress on the PNG government in the future.

'While the dollar bond issuance, if successful, would plug the fiscal deficit in the near-term and shore up foreign exchange reserves, we believe that this would likely cause greater pain down the road for the government in the form of debt servicing costs.

> *'Global financial conditions and dollar liquidity have tightened considerably since April and May and there had been bouts of risk aversion.'*

The report says that the climate for international investment may not be conducive.

'As a whole, Asian currencies have weakened by more than 6.0 per cent since mid-April, suggesting that riskier assets are losing their appeal for the time being.

'We believe that PNG is slightly late to the game and will likely face a less conducive environment amid rising global interest rates and risk aversion.'

'Global financial conditions and dollar liquidity have tightened considerably since April and May and there had been bouts of risk aversion, resulting in capital flight from emerging and frontier markets.

'In our view, the main reasons for the fragile Emerging Market sentiment are likely due to escalating trade tensions between the US and its trade partners (particularly China), and rising interest rates in the US.

'Even economies in the region with a much stronger growth outlook than PNG, such as Vietnam, India, and Philippines, have borne the brunt of portfolio outflows.'

The following graphs show the implications of the Fitch assessment that PNG's budget deficits will average 4.4% over the coming decade, not the much lower rates included in the latest 2019 Budget Strategy and the plan to return to budget surplus. The figures use PNG Treasury GDP estimates and public debt figures for 2017 and then using the Fitch budget estimates. Interest costs are assumed to remain at the average level of 2017 of 8 percent of public debt.