Prime Minister's Back to Business Breakfast
30 January 2020

Greg Pawson
2020 Business Outlook

Thank you Asi, and a very warm welcome to our Prime Minister, Ministers of Parliament, VIPs and guests here this morning.

It is indeed a pleasure to again sponsor this key event at the start of the 2020 business calendar. In fact for us it is the third year in a row and the first such event to be addressed by our Prime Minister. 2020 the start of a new decade.

2019 was a milestone year in our history at Kina Bank.

We completed the ANZ retail banking acquisition. We announced our strategic partnership with MiBank for the provision of financial and micro SME inclusion. And we welcomed AAA rated Asian Development Bank as our second largest shareholder, behind Perpetual Nominees - one of the largest fund managers in Australia.

We are proud to be PNG home-grown and now the second largest retail bank in the country. As a Group we reach over one million Papua New Guineans.

As the only dual listed financial services company in PNG, our stock is well supported by local and international investors. Our offshore investors in particular extend to Australia, NZ, the US, UK and Singapore – which in itself re-affirms positive perceptions of PNG and the opportunities that avail in this country, which I think is a good place to start!

So the 'Business Outlook for 2020'

- 2020 will be a difficult year:
    - The fiscal deficit: government expenses have been and remain high combined with revenue shortfalls.
    - Ongoing foreign exchange difficulties remain, even after some relief over the first half of 2019.
    - Delays to, in particular, the LNG projects are objectively a concern.

On the positive side, spending on infrastructure development and rehabilitation is a key driver in the 2020 budget. In addition we do see global economies regaining some growth momentum and that will underpin the resources sector. Lastly, the government settling over time up to K1.1 billion of arrears will provide some limited positive impetus.

Level 9, Kina Bank Haus
Douglas Street PO Box 1141
Port Moresby NCD 121
PAPUA NEW GUINEA

Telephone +675 308 3800
Facsimile +675 308 3899
Email Kina@kina.com.pg
Swift KINIPGPG
www.kina.com.pg

Clearly, the elephant in the room is the LNG projects. In addition to the delays around decisions, our concern is that the economics are changing rapidly as the LNG spot price has fallen heavily over 2019. This is not really discussed much, but we think it an important factor to be aware of in decision making: The fact there may be a multi-year oversupply of LNG, which could put PNG into a less favoured position in future, as buyers and developers of LNG projects reassess their needs in such a market environment.

Undeniably, delays have negatively impacted business confidence through the latter half of 2019. Businesses in resource adjacent industries have deferred capex, investment and employment intentions, as decisions are awaited.

Without the significant boost to the economy these resource projects provide, we think risks will remain to the downside, and investment in and meaningful growth of the broader economy will continue to be delayed.

Notwithstanding this, we recognise that getting the best outcome possible for PNG is a very important outcome, and commend the government for endeavouring to improve the terms. But in the end, the major multi-year inward investment of these projects is important for PNG's journey to economic prosperity.

And underlying growth of some businesses that we see remains good, but that reflects market share changes and also some businesses expanding into new regions. On an overall basis though business growth is muted, and most that we are aware of are preparing for a difficult year by ensuring they are running lean and not incurring unnecessary expenses and capex, until there is greater certainty on economic outcomes.

As we all know, the budget acted to "reset" expectations around our fiscal situation. Although the news was sombre, it was not unexpected. The recognition of the state of the country's fiscal affairs was in the end a positive - simply because it brings focus to potential solutions. That in itself is a positive but there will be an impact from some of the measures that need to be taken - such as getting public expenditures under control, a change to the TFF, and other measures such as better tax enforcement.

There is an intention in the budget to diversify the government's funding sources to include more offshore borrowing. There are pros and cons to this but on the up-side, overseas borrowing will bring in much needed foreign exchange, and reduce the cost of borrowing relative to the domestic market.

Availability of foreign exchange as we all know remains an issue. Freeing up foreign exchange will have a positive impact on business activity. We saw that last year with the drawdown of the US$500 million sovereign bond. More recently we have seen the USD300 million loan from Australia which we think is important in the near term as OK Tedi (our single largest FX earner) will halt production in the first quarter of 2020 due to dredging of the in-pit after the western wall collapse in 2019, potentially disrupting the supply of FX for a period of time.

We do expect and would definitely want to see in 2020 planned infrastructure spending take place. We think this is important to “hold the line” on the economy and there are businesses that will benefit from these initiatives. This is a huge plus to support growth in 2020 and a good investment to make for economic growth into future years. Key infrastructure areas of roads, ports, energy and telecommunications remain critical.

Inflation has been falling over the last two years and is expected to remain stable around the 4% level for 2020 and that’s palatable. Supporting that, we see limited scope for business to increase margins over 2020 due to the subdued economy that is expected, and that in turn will keep a lid on inflation.

Our exchange rate has been largely stable over the last two years against our major trading partners and we expect that to remain the case, which in turn will keep imported inflation in check.

Under our expectations we think that domestic interest rates will also remain stable but with a possible upward bias dependent on what progress is made in financing the fiscal deficit from offshore sources.

Our central theme remains that 2020 will be a good year for our resources sector and most companies supported by good pricing. Notwithstanding criticism of the Phase 1 trade deal between the USA and China, the fact remains that it has averted an escalation of their trade war and the momentum of expectation is now for resolution in the fullness of time.

We are keeping a very close eye on our view. The coronavirus has the potential to become embedded and lead in particular to a retrenchment of Chinese economic activity. However, we do not think that this will occur.

Cyclical growth in the major economies overseas will lead to increasing demand of some of our key commodity exports. Indeed pricing over 2019 has improved for all PNG major commodity exports (in USD) which sets up a good year for our resource businesses in 2020.

The one stand out commodity whose price has fallen as mentioned is the LNG price, which is down over the course of 2019 by over 40%. This is a concern, not for existing LNG projects that are contracted, but for the future projects under discussion.

Government focus on the agricultural sector is an area of the economy that needs to be developed. The Prime Minister talks often about becoming the bread basket for Asia, and this is totally feasible. The policy discussion and developments around value added processing are something that we hope to see broaden the manufacturing and export base over time. But we do not see any impact in 2020. This is an investment for the future.

Foreign exchange continues to be the proverbial hot topic. Although PNG enjoys a balance of payment surplus, most of PNG’s export revenues are held offshore resulting in the depletion of limited FX reserves and the Kina remaining under ongoing pressure. The arrangement between the State and resource developers is such that surpluses do not fully translate to increased foreign exchange inflows.

Though the Central Bank records large current account surpluses, this is not translating to increased foreign reserves and does little to alleviate our foreign exchange shortages. The shortage will continue to act as a handbrake on domestic economic activity through the year going forward. But we do believe there is an opportunity to bring back in country some of those FX balances held offshore.

One of the very first announcements that the Prime Minister made, was to revisit the privatisation agenda, to invite private sector discipline into some of the SOEs - to help improve their performance and also their general effectiveness. We of course endorse this as a large opportunity and one that should be pursued.

The Connect PNG initiative to open up economic corridors has the potential to improve the flow of goods and services and boost the agriculture sector. The government has correctly identified an area of focus to diversify and broaden the economic base of the country. Investments in this sector have a medium to long term horizon before their benefits can be felt.

Like agriculture, investments in the financial inclusion and SME sector are investments for the future. The special attention given to it by the government is commendable.

So in conclusion:

2020 will be a difficult year but we would also suggest it is a transition year given the government's initiatives.

In the immediate future a decline in discretionary spending and continuance of a two speed economy reflects the general weakness in the domestic economy. But we expect the resources export sector to remain buoyant. Discretionary spending has been muted and will remain so. Confidence to remain low.

Feedback from business is consistent with these themes - in particular companies involved in the provision of discretionary goods and services such as retailers. Key decisions will impact not only 2020 but future years, and what we transition to.

I will leave it there and a big thank you to the Kina Investment Management team for putting together this commentary. It's always a rather dry topic however I hope you have got some value out of it.

Thanks for listening. And now for the reason we are all here I will hand back to Asi.