

Monday 12 October 2020

2020 Mid-Year Economic and Fiscal Outlook Review

SUMMARY

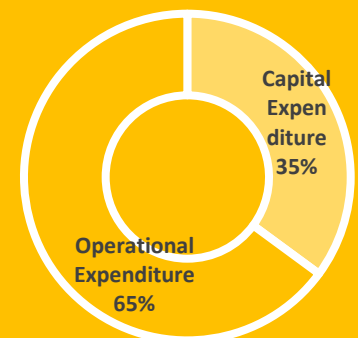
All things considered, PNG is in a reasonable relative position but investment from resource projects is a pre-requisite to medium term economic growth.

The International Monetary Fund estimates that the global economy will shrink by 4.9% in 2020. PNG by comparison is expecting a relatively modest 2% fall in real GDP in the MYEFO. Additional COVID-related expenditure was required and revenue losses were felt by the economy, which placed upward pressure on PNG's debt-to-GDP ratio. Initially projected at 40.3% of GDP, debt is expected to increase to 48.9% at the end of FY20 with a forecast medium term track of increasing debt-to-GDP in line with ongoing fiscal deficits. This 8.6% increase can be compared to the 19.3% increase in Australia's debt-to-GDP expected from FY20 to FY21, and the 32% increase in Fiji's within the same period.

Although an increasing debt-to-GDP track is not ideal, in the current circumstance of a recessed economy any major withdrawal of fiscal support will be negative. An increasing track is tolerable if there is a level of confidence that the resource deals that are currently under negotiation, which represent up to US\$31 billion in foreign direct investments, are agreed. This will lead to further investment in the country creating a large multi-year stimulus that will ultimately add to the longer term cash inflows for the country. The road to recovery post-COVID looks promising relative to some of PNG's neighbours, with the distinguishing local positive feature being the large potential investments to be made. We are quietly confident that the Government and project developers will confirm the US\$13 billion Papua LNG Project late this year or early next, with some progress being made in discussions.

FY20 Government Expenditure

K17.989 billion



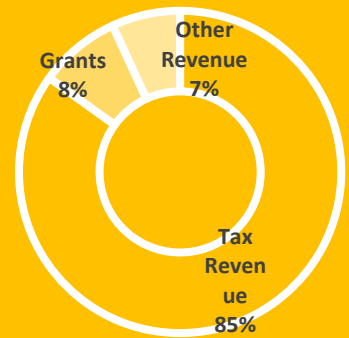
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In addition to the resources projects, there are many infrastructure projects scheduled to be implemented between 2020 to 2025 before the onset of COVID-19. The scheduled commission and associated Government expenditure of these projects fortuitously coincides with the current and medium term need for fiscal stimulus post-COVID, and provides a buffer to COVID-19 headwinds. These investments are across the board in areas such as a transnational highway network, telecommunication infrastructure, ports, roads, and runways, as well as electricity, and water supply and sanitation. All areas of positive economic and social impact over the medium and long term.

This major infrastructure spending will augment expected foreign direct investments and provide a foundation for economic development and stabilisation to the economy.

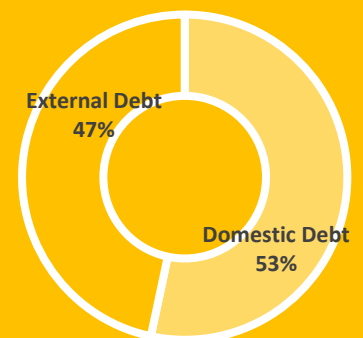
FY20 Government Revenue

K11.359 billion



National Debt Stock

K39.852 billion



REVENUE BREAKDOWN

Total Revenue in FY20 is expected to come in at K11.359 billion, down by K2.736 billion (19.4%) from the Budget of K14.095 billion. Revenue is captured under three main categories: Taxation Revenue, Donor Grants, and Other Revenue. Tax receipts are expected to fall short by 14.7%; Donor Grants remain unchanged; while Other Revenue will fall by 58.0%.

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Taxation

The MYEFO projects that Taxation Revenue will be K9.647 billion, down from K11.308 billion expected in the National Budget. The K1.661 billion (14.7%) loss in Revenue is due to lower collections from Company Tax, Mining & Petroleum Tax, Import Excise, Export Tax, and Goods & Services Tax (GST).

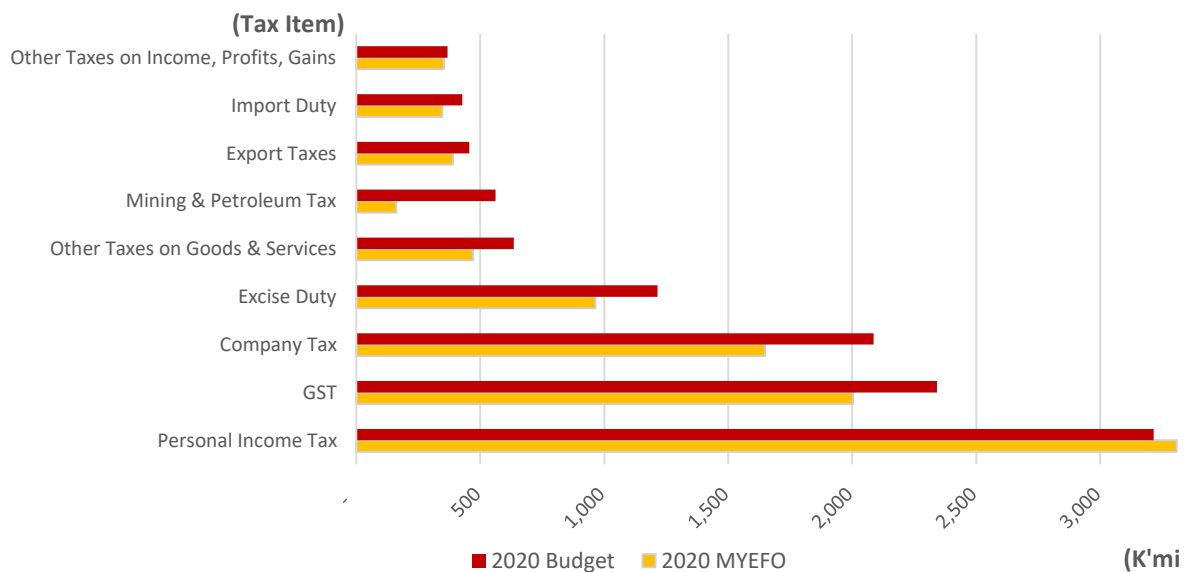
Company Tax and Mining & Petroleum Tax are responsible for 96% of the shortfall. Company tax receipts are lower because of the economic slowdown, additionally the Internal Revenue Commission (IRC) allowed for delays in lodgements and reductions in provisional payments to support cash flow.

Personal Income Tax (PIT) is expected to increase due to the ceasing of GST Credit Offsets for companies, this allows IRC to collect the full PIT liabilities. The increase in the public sector headcount also added to PIT, and mass layoffs in the services sector is expected to be below the tax-free threshold.

Tax Category/Item	2020 Budget*	2020 MYEFO*	Change (%)	
Taxes on Income, Profits & Capital Gains				
Personal Income Tax	K3,215.0	K3,308.0	2.9%	↑
Company Tax	K2,085.4	K1,648.6	-20.9%	↓
Mining & Petroleum Tax	K561.2	K161.2	-71.3%	↓
Royalties Tax	K29.6	K33.7	13.9%	↑
Management Tax	K19.8	K21.5	8.6%	↑
Div. Withholding Tax	K171.0	K171.0	0.0%	--
Non-Withholding Tax	K40.0	K5.0	-87.5%	↓
Interest Withholding Tax	K107.3	K121.4	13.1%	↑
Sundry & Income	K0.1	K0.2	100.0%	↑
Taxes on Goods & Services				
GST	K2,341.9	K2,002.9	-14.5%	↓
Stamp Duty	K55.5	K35.3	-36.4%	↓
Excise Duty	K1,215.0	K964.2	-20.6%	↓
Import Excise	K292.0	K273.7	-6.3%	↓
Bookmakers' Turnover	K18.2	K10.2	-44.0%	↓
Gaming Machine	K246.7	K140.2	-43.2%	↓
Departure Tax	K23.9	K6.6	-72.4%	↓
Motor Vehicle	K0.0	K2.3	--	--
Other taxes	-K0.4	K2.6	-750.0%	↓
Taxes on International Trade Transactions				
Import Duty	K427.8	K347.3	-18.8%	↓
Export Tax	K455.4	K390.0	-14.4%	↓
Tax on Payroll & Workforce				
Training Levy	K0.0	K1.4	--	--

*Amount in K'million

2020 Taxation Revenue: Budget vs MYEFO



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Grants

Grants from donor partners are expected as originally anticipated. There was K932.1 million projected in FY20: K766.2 million (82.2%) from foreign governments, and K165.9 million (17.8%) from international organisations. This amount is expected to be realised in full throughout the year.

Other Revenue

Other Revenue has been revised to less than half the National Budget estimate with an anticipated decline of K1.076 billion (fall of 58%) to a new estimated collection of K779.8 million.

Mining Petroleum & Gas Dividends and Dividends from State Owned Enterprises are expected to fall short of Budget by K450 million (56.3%) and K100 million (100%), respectively. Government Services Revenue is expected to be 26.8% lower than Budget, Penalties & Fines have been adjusted upwards by 125%, and Miscellaneous Transfers are expected to be 66.6% lower than Budget.

EXPENDITURE BREAKDOWN

Total Expenditure was reduced by 3.9% to K17.989 billion.

The Government has spent 36.9% of the 2020 National Budget envelope in H1'20. When broken down into expenditure categories, Operational and Capital Spending in H1'20 have reached 41.3% and 27.2% of their respective Budget allocations.

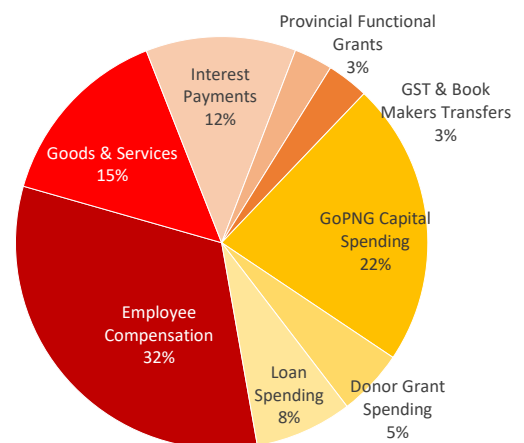
The lower-than-expected expenditure is due to cash flow constraints faced by the Government and operational restrictions from COVID-19 lockdowns. The government has reprioritized its main Capital Expenditures for FY20 to deal with the COVID-19 pandemic. Some Operational Expenditures have also been diverted to the COVID-19 pandemic response.

Operational Expenditure

The Operational component of the Budget has been lowered by K1.128 billion (8.8%) to K11.618 billion. The lower outcome is due to the slowdown of non-essential operational activities during the lockdown. Delays in programmed external financing have also caused fiscal distress and prompted a tightening of spending.

Salaries for Public Servants are expected to make up 49.6% of Operational Expenditure, and 32% of Total Expenditure. Functional Grants to provinces will be maintained, while Goods & Services purchased will be cut 30.9% for a K1.171 billion saving. Interest payments for debt

2020 MYEFO Expenditure



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servicing amounted to K1.012 billion for H1'20, with 76.3% paid to internal borrowing and 23.7% paid externally.

The right-sizing exercise for the public service has progressed slower than expected, but the MYEFO expects the retirement exercise and associated expenditure to quicken towards the end of the third quarter. K12 million is expected to be spent to retire 133 personnel in the third quarter, with an associated K36 million paid to the superannuation providers, Nambawan Super. Exit payments to Nambawan Super have been revised downwards from by K60 million while K145.8 million was shown in the June outturn for State share contribution to Nambawan Super.

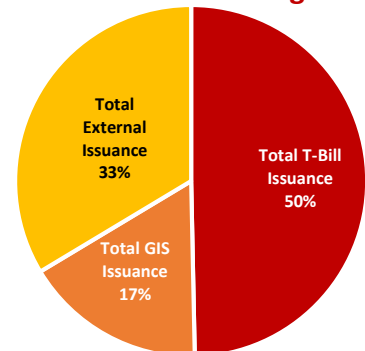
Capital Expenditure

27% of Capital investments was expended in H1'20, with K2.873 billion in Capital Spending planned for the second half of 2020. All Capital Expenditure is expected to remain as Budgeted, with the only change occurring in the Transport Sector. The Transport Sector will see K300 million added to its spending for FY20 to support the repayment of arrears for capital works from contractors.

FINANCING BREAKDOWN

The Fiscal Deficit for FY20 will be increased from K4.631 billion to K6.630 billion, a 43.2% increase. Outstanding Treasury Bill issuance is K3.723 billion and will be auctioned in the second half of 2020. There is K2.652 billion expected in H2'20 from external sources. Of these external funds, sources for K1.983 billion are yet to be confirmed at the time of the MYEFO but there is a high degree of confidence that these funds will be secured. The MYEFO also suggested that Government may offer securities domestically above the budgeted amount to support cash flow until international funds are received late in the year.

2020 Gross Financing



Internal Financing

The MYEFO projects that gross borrowing in the domestic market for FY20 will be K12.833 billion, and net borrowing at K1.923 billion. It is expected that domestic net borrowing in excess of the MYEFO amount will be needed to support government cash flow until concessionary and international financing comes through in late 2020, which has already occurred with the K457 billion bond issuance in August. The remaining year's issuances will focus on rolling over debt and net redemptions.

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Domestic Issuance

Total T-Bill Issuance	K9,600.30
T-Bills Issued (30 June 2020)	K5,877.80
Outstanding T-Bills (30 June 2020)	K3,722.50

(K'million; as at 30 June 2020)

BPNG's temporary advance facility is currently at K300 million, which the Government thinks is too small out of step with internationally-accepted levels. This has prompted a re-evaluation of the Central Bank Act to see how BPNG can

greater support the Government's short-term fiscal requirements.

External Financing

Gross External Borrowing has increased by 6.4% due to a K1.856 billion increase in Exceptional Financing. Net External Borrowing has been revised upwards by K887.8 million (26.3%) to K4.262 billion.

The MYEFO expects K4.635 billion inflows from External borrowing over H2'20, primarily driven by K3.871 billion in receipts from Exceptional Financing. The unprogrammed receipt of the K1.258 billion from the IMF of COVID support was significant unprogrammed boost to Exceptional Financing in H1'20.

External Issuance

Total Financing	K6,494.7
External Financing Received	K1,859.40
External Financing Outstanding	K4,635.3

(K'million; as at 30 June 2020)

Trust Account Drawdowns

The IMF Rapid Credit Facility provided K1.258 billion to the PNG Government for fiscal support during the height of the COVID-19 pandemic. These funds were kept in a trust account and K445.6 million is expected to be drawn down to support Government cash flow.

Ends.

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