

BSP Treasury and Markets

PACIFIC QUARTERLY ECONOMIC & MARKET PULSE

September Quarter 2024

GLOBAL ECONOMY

Global core inflation has moderated as core consumer goods prices stabilize, with GDP growth in the region slightly exceeding the average for emerging and developing markets.

COMMODITY PRICE TRENDS

Cocoa prices remained high, Arabica coffee prices rose, LNG prices surged due to Asian demand, and gold prices increased ahead of a Federal Reserve rate cut.

PNG Q3-2024

Revised GDP growth projections for PNG revised due to lower-than-expected resource extraction output, with the suspension of mining operations in Pongara impacting the overall outlook.

PACIFIC MARKETS

Revised projections for the Pacific market show a mixed outlook, with improved estimates for Samoa and the Cook Islands compared to the ADB's April publication.

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BSP's Economic and Market views



Mark T. Robinson
Group Chief Executive Officer

BSP serves as the Anchor Partner of the Commonwealth Business Forum at the 2024 Commonwealth Heads of Government Meeting in Samoa.

- The Commonwealth Heads of Government Meeting (CHOGM) is a biennial summit that unites leaders from the 54 Commonwealth member states, established in 1971 to promote cooperation in areas such as democracy, human rights, and sustainable development. Leaders address key issues including economic development, financial inclusion, climate change, and security, engaging with civil society, youth, and business leaders through various forums.
- BSP, as the main bank in the South Pacific, plays a crucial role in regional economic development and financial stability. As the Anchor Partner of the Commonwealth Business Forum (CBF), BSP emphasizes collaboration among Commonwealth nations and the importance of financial services in achieving shared goals.
- CHOGM outcomes lead to significant initiatives, communicated through a communique outlining the commitments and priorities agreed upon by the leaders.

IMF Reaches Staff-Level Agreement with Papua New Guinea on Resilience and Sustainability Facility (RSF) Arrangement and Third Reviews Under the Extended Credit Facility and Extended Fund Facility

- The authorities of Papua New Guinea and the IMF team have reached a staff-level agreement regarding a request for approximately US\$265 million under the RSF to bolster resilience against climate change.
- Additionally, the authorities and the IMF team have finalized a staff-level agreement on the third reviews of the authorities' reform program, which is supported by the IMF's Extended Credit Facility and Extended Fund Facility, totaling about US\$918 million.
- The outlook for Papua New Guinea remains positive, with economic growth projected to increase to 4.5 percent in 2024. The authorities continue to make significant progress in implementing their homegrown economic reform program.

Key Global Trends Shaping the Economic Outlook for BSP's Pacific Markets

- **Tourism Impact:**
Fiji, Samoa, and the Cook Islands have experienced significant increases in growth forecasts due to higher-than-expected tourist arrivals, highlighting the critical role of the tourism sector in their economies.
- **Revised Growth Projections:**
Most regions have adjusted their growth forecasts upward or downward in response to recent data, reflecting a dynamic economic environment influenced by various factors, including the contributions of the service sector in the Solomon Islands and the liquidation of Air Vanuatu in Vanuatu.
- **Inflation Trends:**
Several countries, including Fiji, Samoa, and Tonga, are witnessing moderated inflation rates, suggesting a potential easing of economic pressures. However, regions such as Vanuatu continue to face inflationary challenges.
- **External Influences:**
Economic growth in these nations is significantly affected by external factors, including global tourism trends, agricultural impacts from climate events like El Niño in Tonga, and connectivity issues impacting Vanuatu's economy.

Source: ADB Asian Development Outlook-September 2024, BSP Pacific Market's Central Banks

BSP's Economic and Market Insights



Daniel Faunt

Group General Manager – Corporate Bank

What is the prevailing business sentiment for the third quarter of 2024?

- Delays in key projects such as Papua LNG and the Porgera mine are impacting the economy of Papua New Guinea, affecting both growth and employment. While the start of 2024 brought optimistic employment projections, those expectations have since stabilized as the year has progressed.
- Law and order issues are increasingly affecting businesses, with instability and tribal conflict in Enga Province leading to the temporary suspension of Porgera mine operations on multiple occasions in the third quarter. This creates some uncertainty regarding the mine's ability to achieve full production this year.
- Although some improvements have been noted, foreign exchange constraints continue to challenge many import-dependent businesses. Rising costs of imported goods, driven by persistent global inflation, are affecting profit margins and contributing to the increased cost of living for the general population.

What is the Current State of the PNG Coffee Export Industry?

- Management and board members of BSP recently conducted a visit to coffee exporters in the Highlands region.
- For the 2024 coffee season in Papua New Guinea, export volumes are projected to decline to between 600,000 and 700,000 bags, down from over 900,000 bags in 2023, despite a 33% increase in New York C Arabica prices since March 24. This decrease is primarily attributed to an off-year as coffee trees recover following three consecutive years of high yields.
- Additionally, the Coffee Berry Borer pest has become a significant concern, now affecting up to 20% of beans, a marked increase from 2% in 2022 and 6% in 2023.
- Furthermore, the forthcoming EU Regulation on Deforestation-Free Products, which will take effect on December 30, 2024, for larger operators and June 30, 2025, for smaller enterprises, will require all coffee to be traceable to its source, ensuring that no deforestation occurred during cultivation.



Rohan George

Group General Manager – Treasury & Markets

What was the status of foreign exchange liquidity and the Kina during the third quarter of 2024?

- In the third quarter, foreign exchange (FX) market turnover rose by 5% to a record K14.9 billion, driven by increased foreign currency inflows from exporters due to higher gold and palm oil prices, along with stable copper and cocoa prices.
- This led to a decreased reliance on Bank of Papua New Guinea (BPNG) interventions, which fell by K220 million, contributing 19.7% of FX inflows, down from 25.6% in the previous quarter.
- BSP customer outstanding FX orders peaked at K750 million in August but decreased to K240 million by the quarter's end.
- The PGK depreciated by 1.9% against the USD to 0.2552, and by 6.2% against the AUD to 0.3681, influenced by interest rate changes in the US, as well as steady Australian monetary policy.
- Domestic inflation in Australia has reduced the likelihood of rate cuts in early 2025, impacting interest rate differentials despite low domestic growth and disappointing developments in China.

What is the outlook for foreign exchange inflows in the upcoming quarter, and how should corporate and retail customers manage volatility in foreign currency inflows?

- With BPNG maintaining a monetary policy tightening bias and one-year Treasury bills rising to 7.62%, it is likely that the PGK will continue its gradual depreciation against the USD at an approximate rate of 0.7% per month, equating to 8% annually.
- We anticipate that foreign exchange inflows will reach record levels in the final quarter, driven by strong commodity prices and year-end dividends, which will help offset the seasonal surge in imports during the Christmas period. Consequently, outstanding market FX orders are expected to decline to their lowest level of 2024 by year-end.
- The availability of foreign currency remains volatile, with significant inflows anticipated in December. It is essential for customers to place their FX orders through BSP FX Online promptly and ensure all documentation is correct to avoid any unnecessary delays.

Global Economic Outlook

Global core inflation has moderated as core consumer goods prices stabilize, with GDP growth in the region slightly exceeding the average for emerging and developing markets.

World Growth



2024:	3.2%	3.2%	2.6%
2025:	3.2%	3.3%	2.7%

- > The OECD and World Bank revised their 2024 estimates, with 2025 projections unchanged. In contrast, the IMF's 2024 estimates remain unchanged, but their 2025 projections were adjusted from 3.2% to 3.3%.
- > Global activity and growth have stabilized throughout the year, and all projections indicate that global growth will remain positive, despite elevated political tensions and rising financing costs.

Developing Asia



East Asia and Pacific

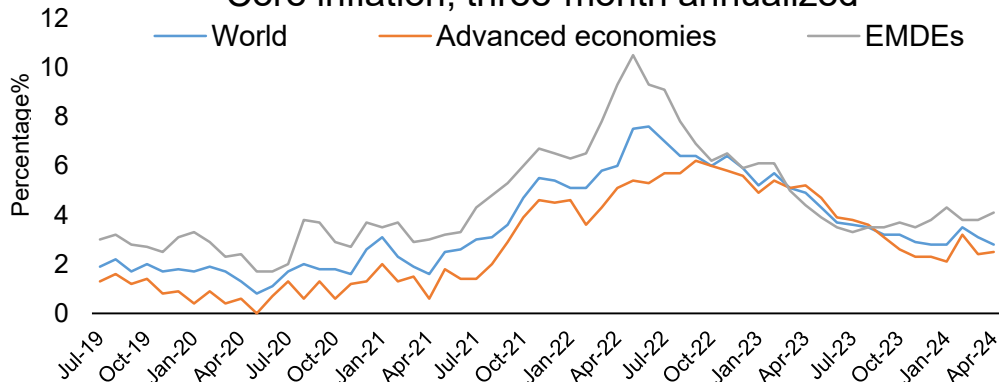
East Asia and Pacific (excluding China)



2024:	4.8%	4.4%
2025:	4.7%	4.9%

- > The World Bank's East Asia and Pacific Economic Update forecasts regional growth of approximately 4.8% in 2024, compared to an average estimated growth rate of 3.3% for emerging and developing markets.
- > Growth in the East Asia and Pacific (EAP) region is primarily driven by private consumption and service exports, with a projected growth rate of 4.7% for 2025.
- > Projections indicate that China's contribution to growth in 2024 is expected to be less substantial. The significance of excluding China's growth becomes more pronounced when comparing it to the 2025 forecasts. Although public investment is aiding China's growth in 2024, ongoing weaknesses in the property market, along with declines in private consumption and investor confidence, have significantly affected projections for China's growth in 2025.

Core inflation, three-month annualized



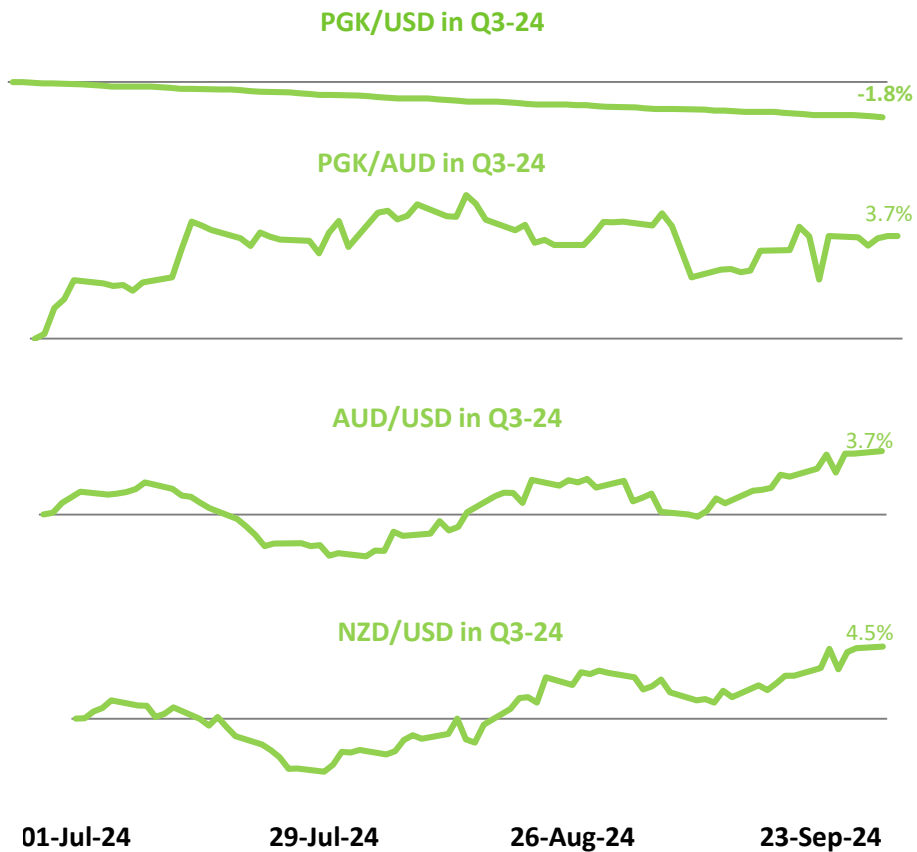
The rate of global inflation is decelerating as consumer prices stabilize, contrasting with the rapid disinflation observed in the aftermath of COVID-19. It is anticipated that global inflation will gradually decline, aligning with average inflation targets by 2026.

Source: World Bank, IMF, OECD

Currency Trends

At the end of the quarter, the U.S. Federal Reserve cut interest rates in line with market expectations. Additionally, the prices of key commodity exports from Australia and New Zealand continue to support the strength of the Australian Dollar (AUD) and New Zealand Dollar (NZD).

Currency Movements



Commentary



USD – The strength of the U.S. dollar continued into the first two months of Q3-2024. After maintaining rates during H1-2024, the Federal Reserve implemented a 50 basis point cut. As a result, the USD Index closed 1.4% lower year-to-date, with the dollar weakening following the rate cut.



PGK – At the end of Q3-2024, the midrate for the Papua New Guinea kina stood at 0.2552 against the U.S. dollar. The Bank of Papua New Guinea's crawling peg strategy led to a 48-point decline, representing a 1.8% decrease from the previous quarter. The PGK/AUD exchange rate started strong but weakened as the Australian dollar strengthened against the U.S. dollar.



AUD – The Australian dollar concluded the quarter 3.7% higher. At the beginning of the quarter, it was slightly lower, underperforming amid ongoing concerns regarding the Chinese economic outlook. However, it gained momentum toward the end of the month as China, Australia's major trading partner, announced a fiscal stimulus for its economy, alongside the U.S. Federal Reserve's decision to cut interest rates.

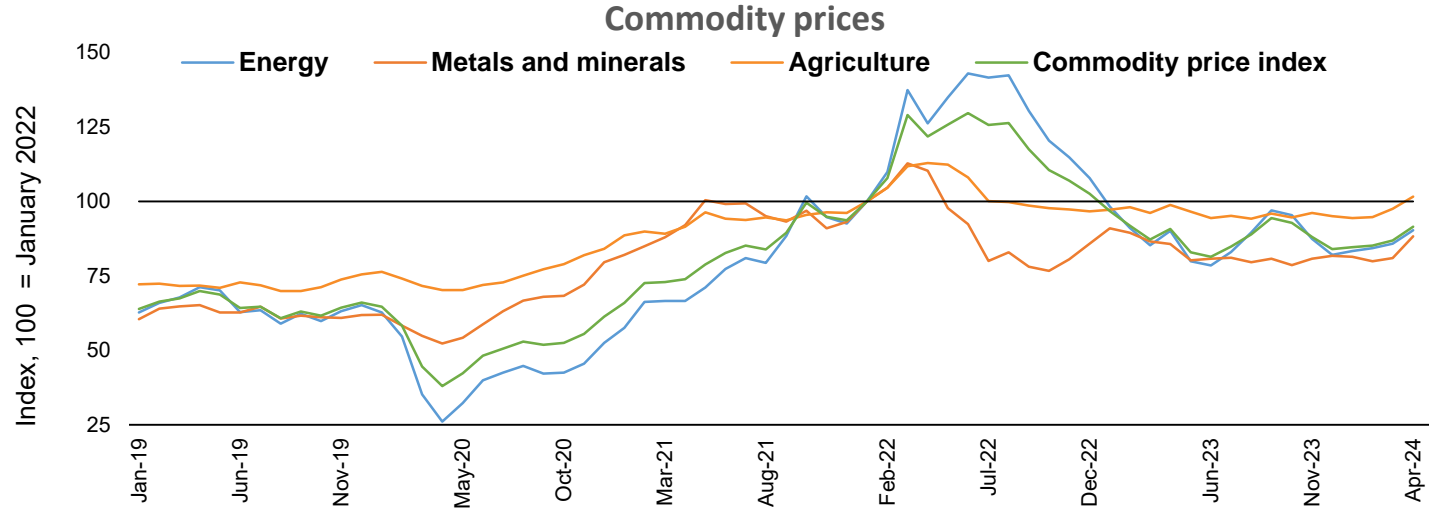


NZD – At the end of Q3-2024, the New Zealand dollar was 4.5% higher than the previous quarter, closing at 0.6349. After a weak start to the quarter, the NZ dollar gained strength, supported by higher prices for dairy and aluminum, despite lower prices for meat, forestry, and horticultural products.

Source: Reuters, Bloomberg, BPNG, Western Aus. Treasury Corp., CNBC, ANZ Commodity Price Index, RBA Commodity Price Index

Commodity Price Trends

Commodity Prices on a Quarterly basis.



- » **Cocoa** prices, while lower at the end of the quarter, remained relatively high compared to the same periods in previous years. These elevated prices are primarily attributed to production challenges in key cocoa-producing regions, exacerbated by adverse weather conditions and ongoing agricultural issues, which have resulted in tighter supply. Prices are anticipated to remain high for the remainder of the year.
- » **Arabica** coffee prices experienced a significant increase, driven by a combination of adverse weather conditions and rising global demand. Key coffee-producing regions have faced challenges from drought and other climate-related issues, leading to reduced yields and heightened concerns regarding supply stability.
- » The increase in **LNG** prices was driven by robust global demand,

- particularly from Asia, as countries sought to secure energy supplies in response to geopolitical tensions and fluctuations in traditional energy markets.
- » **Gold** prices rose significantly, driven by initial expectations of a Federal Reserve rate cut. As geopolitical tensions and economic uncertainties persisted, gold remained a favored safe-haven asset. The announcement of the Fed's first rate cut in four years toward the end of the quarter further boosted demand, contributing to the increase in prices.
- » **Copper** prices fluctuated due to strong demand from electric vehicles and supply issues from labor strikes. Prices rose mid-quarter as inventories fell, reflecting ongoing demand-supply challenges.

Commodity	Q2-24 (Average price)	Q3-24 (Average price)	Change (%)
Crude Oil, Brent [US\$/bbl.]	81.85	77.31	(5.55%) ▼
LNG, Japan [US\$/MMBtu]	13.13	14.10	7.39% ▲
Gold [US\$/troy oz.]	2,402.86	2,511.49	4.52% ▲
Nickel [US\$/MT]	18,350.47	16,261.44	(11.38%) ▼
Copper [US\$/MT]	9,689.07	9,209.87	(4.95%) ▼
Iron Ore (US\$/mt)	112.53	101.14	(10.12%) ▼
Palm Oil [US\$/MT]	3,935.72	3,870.92	(1.65%) ▼
Arabica Coffee [US\$/kg]	220.27	245.73	11.56% ▲
Cocoa [US\$/kg]	7,725.81	7,272.70	(5.86%) ▼

Source: World Bank Commodity prices- July data, Bloomberg Closing Prices

PNG Economic Outlook

Revised GDP growth projections for Papua New Guinea have been reduced due to lower-than-expected resource extraction output.

ADB		2023	2024		2025	
			Apr	Sep	Apr	Sep
	GDP Growth	2.0	3.3	3.2	4.6	4.5
	Inflation	2.3	4.5	3.0	4.8	4.8

- > ADB's revised GDP growth projections in their September ADO for 2024 and 2025 are 0.1% lower than the April forecast, reflecting weaker-than-expected resource extraction.
- > Subdued inflationary pressures in the first half of 2024 have resulted in a significant reduction in projections for PNG's inflation, although an increase is anticipated in 2025.

Amendments to PNG's Central Banking Act (2000)

The most significant amendment to the Central Banking Act was the establishment of the Bank of Papua New Guinea's (BPNG) mandate to ensure price stability. These amendments aimed to enhance the BPNG's operational framework and governance by reinforcing its independence, clarifying its monetary policy objectives, and strengthening its role in financial stability and foreign exchange management. Increased transparency and reporting requirements were also introduced to improve public communication of policies and decisions.

BPNG's Monthly Economic Review - August

The August monthly review noted a 1% year-on-year increase in annual headline inflation, driven by rising costs in transportation, food and non-alcoholic beverages, and household expenditures. The kina's depreciation against the U.S. dollar is linked to a persistent imbalance in the foreign exchange market, while its decline against the Australian dollar resulted from cross-currency movements that strengthened the AUD against the USD.

Non-Extractive Industry

2024 Coffee Season

Yield Forecast: The anticipated yield for 2024 is significantly lower than in 2023, with expected export volumes of 600,000 to 700,000 bags, down from over 900,000 bags.

Yield Drivers: The decline is due to crop conditions rather than pricing. Despite a 33% increase in New York C Arabica prices since March 24, export volumes have decreased.

Historical Context: After strong yields over the past three seasons, 2024 is classified as an off-year as coffee trees recover.

Coffee Berry Borer (CBB)

Prevalence Concern: CBB incidence has risen in some cases up to 20%, up from 2% and 6% in 2022 and 2023.

Management Challenges: The lack of coordinated management suggests further crop damage may be likely.

Regulation and Market Impact

The EU Regulation on Deforestation-Free Products, effective December 30, 2024, for medium and large operators, and June 30, 2025, for micro and small enterprises, poses a significant threat to PNG's coffee industry by requiring traceability to ensure no deforestation occurred during cultivation.

Extractive Industries

New Porgera Suspends Operations

The Porgera mine, which resumed operations in February after a temporary closure, suspended operations a second time as of October 14 due to escalating violence in the area. Recent unrest led to security personnel shooting six individuals, one fatally, and the arrest of numerous illegal miners in a crackdown on lawlessness in the highlands region.

The shutdown was exacerbated by fuel shortages resulting from an illegal roadblock along the Highlands Highway, near a significant landslide in Mulitaka. Additionally, ongoing law and order issues pose challenges for the mine. Papua New Guinea risks substantial revenue losses if production does not resume, as Porgera contributes approximately 10 percent of the country's total annual exports.



OTML Celebrates 40 Years of Resilience and Excellence

Ok Tedi Mining Limited (OTML) marks its 40th anniversary, celebrating four decades in Papua New Guinea's mining industry. Founded in August 1984 by Broken Hill Property Limited (BHP) as a gold mine, OTML transitioned to copper-gold in 1987

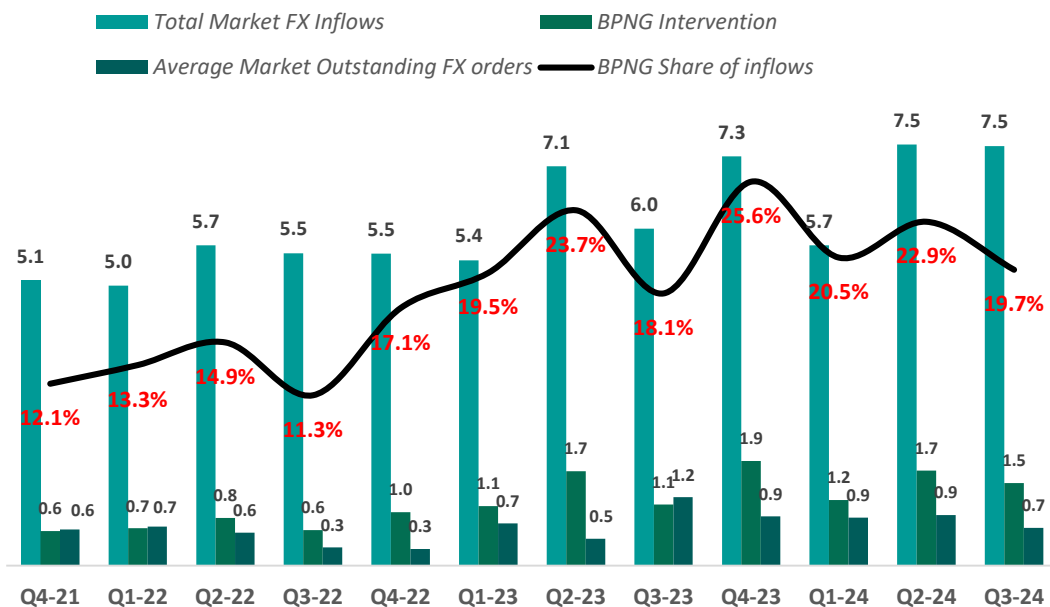
and has been fully owned by Papua New Guinea since 2015. The company has overcome significant challenges and looks forward to the future, with its Special Mine Lease renewed until 2042 and plans to extend the mine's life to 2050.

Source: Post-Courier & National Newspaper, PNG Business News, ADB Asian Development Outlook- July 2024, IMF WEO-April 2024

FX Market Inflows vs BPNG Intervention

Despite a decrease in interventions by the BPNG, foreign exchange inflows from exporters, driven by firmer commodity prices in Q3 2024, contributed to a reduction in the volume of outstanding market orders.

Total FX Market Inflows vs BPNG FX Intervention (Kb)



Q3-24 FX Market Inflow

K7.45b

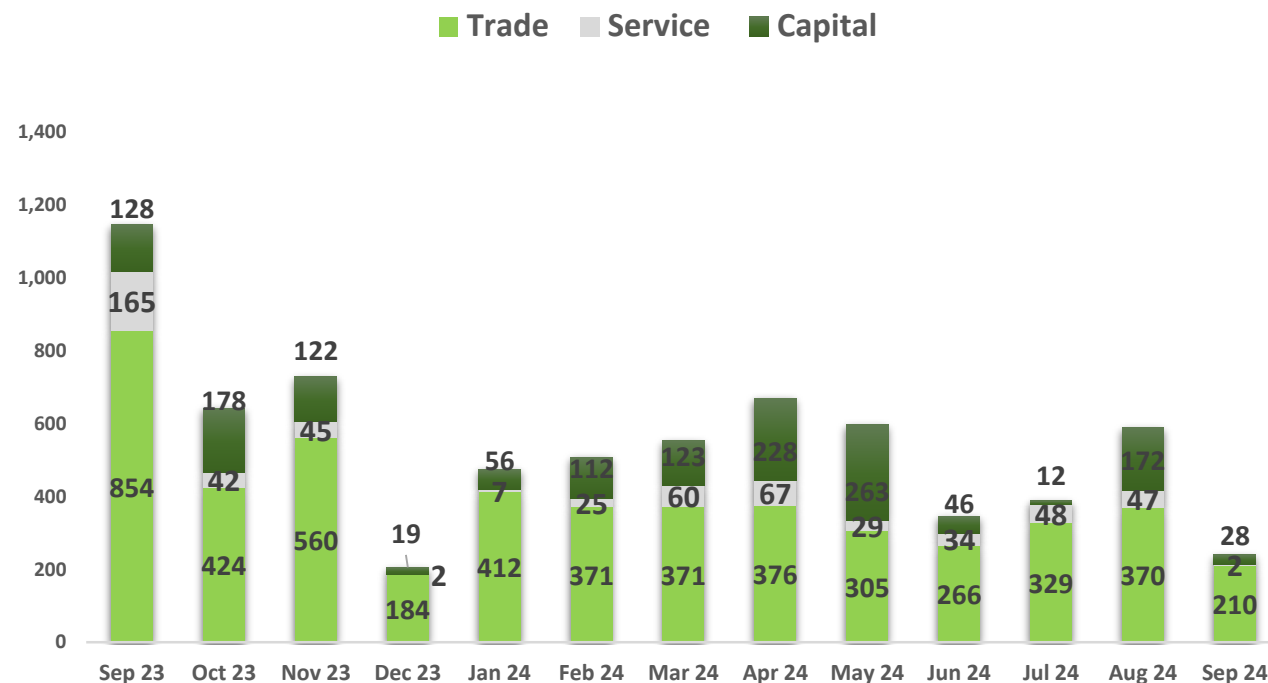
↓0.4% against Q2-24

Q3-24 BPNG FX Intervention

K1.47b

↓13.0% against Q2-24

Volume of Outstanding BSP FX Orders (Km)



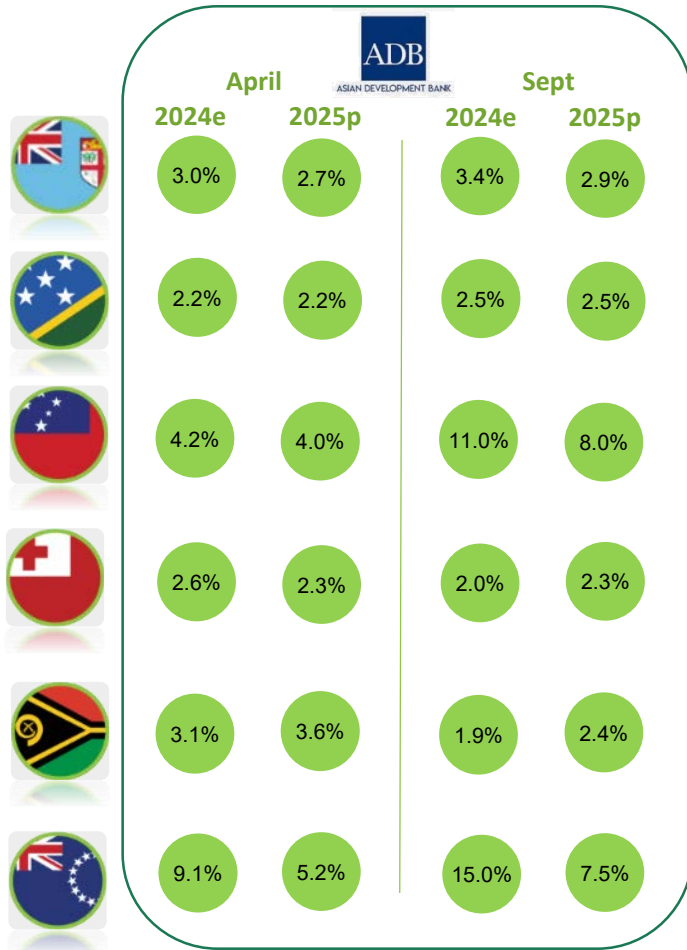
- BSP customer outstanding foreign exchange orders reached a peak of K750 million in August but declined to K240 million by the end of the quarter, driven by increased foreign exchange inflows from exporters.

Source: BSP Treasury and Markets

Pacific Markets Economic Update

Revised projections for the Pacific market present a mixed outlook, with estimates for Samoa and the Cook Islands showing improvement compared to the April publication of the Asian Development Bank's (ADB) Asian Development Outlook (ADO).

GDP Growth



Commentary

Fiji

The ADB has revised its ADO to forecast growth of 3.4% for this year, up from 3.0%. This increase is attributed to higher-than-expected tourist arrivals and a contractionary fiscal policy. Visitor arrivals rose by 6.75% in the first seven months of 2024, and key exports, gold and sugar, bolstered the economy. Additionally, the Reserve Bank of Fiji (RBF) reported a decrease in annual headline inflation to 5.4% in Q3 2024, down from 6.8%, due to lower crude oil and food prices.

Solomon Islands

Revisions to the Solomon Islands' GDP growth projections have been slightly increased to account for the previously underestimated contributions of the services and industry sectors. Recent data from the Solomon Islands National Statistics Office revealed that these sectors significantly contributed to GDP growth in 2021 and 2022.

Samoa

Growth forecasts have been significantly increased since April, driven by a 40.9% year-on-year rise in visitor arrivals. Revised inflation estimates indicate a moderation in inflation rates, partly due to Samoa hosting the Commonwealth Heads of Government meeting this year.

Tonga

The ADB's revised growth projections indicate a deceleration due to the effects of El Niño on agriculture and volcanic activity in June that disrupted internet connectivity. The country's growth will primarily depend on government-led construction and development efforts, while inflation is projected to remain moderate.

Vanuatu

Revised projections show a decrease of over 1% from the April estimates for both 2024 and 2025, primarily due to the liquidation of Air Vanuatu. The airline was crucial for connecting Port Vila, the capital, to various tourist destinations, with around 75% of passengers relying on Air Vanuatu in 2023. Its significant impact on travel patterns has influenced the updated projections.

Cook Islands

Growth forecasts from April have been revised upward due to higher-than-expected tourist arrivals linked to improved connectivity with the Cook Islands' source markets. Estimates for 2025 suggest a moderation in growth. Increased government revenue from higher tax receipts supports the 2024 projections, although inflation estimates have risen due to price increases from weather disruptions and supply chain issues.

Source: ADB Asian Development Outlook-September 2024, BSP Pacific Market's Central Banks

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