

Fear of kina appreciation

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Last week, we discussed about fear of devaluation of Fiji dollar. This week our focus is on the fear of appreciation of Papua New Guinea (PNG)'s currency, the kina.

Under a fixed exchange rate regime, the Fiji dollar can be up-valued or devalued only by central bank. PNG has a floating exchange rate regime under which the value of kina is determined by free interplay of market forces of supply of and demand for kina. The supply of kina is influenced by imports and demand for kina by exports. If imports exceed exports, the value of kina goes down and if exports exceed imports the value of Kina goes up.

Countries under flexible exchange rate regimes, including the USA and Japan, do interfere with market forces for arresting, either the depreciation or appreciation of their currencies.

Depreciation renders imports more expensive but makes exports cheaper. It thus discourages imports and encourages exports, thereby reducing trade deficit.

As USA was going through recession, the only way for stepping up production and creation of jobs is to export more. The US central bank pumped in more than one trillion dollars during last five years, cheapening the currency. The US dollar depreciated against all currencies of the world.

The US simply allowed the dollar to have a free fall, known as "benign neglect". The USA has been doing it for last five years: all for creating employment.

The export- dependent Japan did not like the yen appreciating. Japan did not want its exports becoming uncompetitive. So it intervened, selling yen and purchasing dollars. Selling the yen for dollars depreciates its value.

This way of intervention in exchange market is called "dirty float".

Kina before Liquefied Natural Gas Project

During the past five years, the kina was depreciating against major currencies, because of fall in export earnings due to low international commodity prices following the world recession in 2008. That benefitted PNG farmers. But costs of imports rose. There was domestic inflation, since PNG heavily depends on food imports.

The central bank, Bank of PNG (BPNG) took various measures for stabilizing the kina. They included tight monetary policy stance with the benchmark interest rate at 6.25 percent. PNG grew in 2013 at a slower pace. In 2013, the kina came under downward pressure due to lower export receipts and higher import demand, and ongoing payments related to the PNG LNG project.

The kina depreciated by 12.6 percent against the US dollar between March 2013 and March 2014.

LNG project

The situation has changed with the completion of US\$19 billion liquefied natural gas (LNG) project (life of 30 years and nine trillion cubic metres of gas) last month. On May 27, PNG witnessed the first shipment of gas for Japan. Total income from LNG project will be US\$31 billion, with one-third expected to remain in PNG. Most of it will be as tax revenue, dividends, royalties and infrastructure tax credits to the national government, provincial governments and landowners. The government revenue will grow by around US\$ 3 billion to 4 billion in a full calendar year and the country will grow by a record 21 percent.

With massive export earnings, the kina is bound to appreciate. Although imports will become cheaper when the kina appreciates, the exporters of tree crops and all non mineral exporters would be experiencing losses, as their exports would become more expensive.

Further, with increases in export incomes, demand for non-traded goods will rise. These include house rents, water, electricity and domestic labour, contributing to inflation. The result will be a rise in real exchange rate, reducing competitiveness of agricultural exports further. The poorer sections of the community depend upon incomes from agricultural exports. This phenomenon is known as Dutch disease, a term which refers to the consequences of a similar natural resource discovery in the Netherlands.

Intervention

Can BPNG intervene and buy up incremental exports earnings for domestic currency?

That will be inflationary as more kina will be in the hands of the public. So, the so called sterilized intervention has to be resorted to, for offsetting the rise in money supply, by sale of kina bonds for absorbing excess kina from the public.

It is a sophisticated exercise. With observed limitations in the financial sector, that will only test the BPNG's capability.

The best option is to utilize the rising revenue by launching massive rural development programmes of electrification, roads and communication, education, and health. That will eventually improve quality of life in rural areas, and ensure equitable distribution of benefits from LNG project.