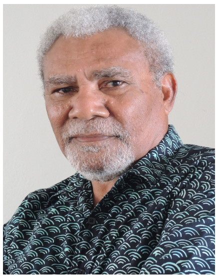
Public Statement by
Rt Hon Sir Mekere Morauta
Port Moresby, 20 June 2016

Bank of Papua New Guinea is being politicised



The O'Neill Government's political interference in the Bank of Papua New Guinea is threatening the stability of the nation's financial system and state finances, and increasing risks for bank depositors and investors in financial institutions, former Prime Minister Sir Mekere Morauta said today

The central bank, the nation's premier financial institution, is supposed to be the independent watchdog that supervises the system and ensures that risks are kept to a minimum, he said.

One of the reforms my Government introduced was to strengthen the independence and the watch-dog role of the Bank of Papua New Guinea, setting clear prudential guidelines and assigning it the additional role of supervising the superannuation industry as well as the financial intermediaries.

The transfer of the supervisory role of superannuation funds from the Minister for Treasury to the Central Bank was the result of the near-death experience of the National Provident Fund under the Skate regime.

But the Prime Minister is increasingly using the Bank of Papua New Guinea as a tool to prop up his Government's shaky cash position and to defend his mismanagement of the economy and state finances, Sir Mekere said.

"As a result, the central bank is failing in its duty to oversee the financial system effectively and transparently.

"The law gives the Bank of Papua New Guinea the authority to act independently, to protect the national economy and financial system. But it appears to have given in to political direction.

"This lessening of the central bank's independence, integrity and capacity is yet another sign that Papua New Guinea's important institutions of state are being compromised and weakened.

"It is yet another example of the destruction of systems and processes under the O'Neill Government to protect its own interests and make way for its cronies to benefit.

"There is hardly an institution left untouched by this Government - compromised, rendered ineffective, pillaged and looted or otherwise incapacitated."

Sir Mekere said the Bank of Papua New Guinea had become a de facto money-printing machine for the government by buying unwanted Treasury Bills and Inscribed Stock and failing to monitor and control commercial bank lending to State-Owned Enterprises.

The Bank of PNG's latest figures (up to December last year) show that Government domestic borrowings have hit K14.05 billion, more than double the K6.12 billion in 2012.

It is not as if the danger signs of such high levels of borrowing were not there. They were, and the central bank chose to ignore them.

Paul Flanagan, an economist specializing in PNG, wrote in DevPolicy Blog in Oct 2014 about the decision by the central bank to purchase from the Treasury any T-bills or Inscribed Stock that are not bought by the private sector.

> *"In theory, this sounds great," he wrote. "In reality, it is disastrous. There is now an imperceptibly fine line between what the bank is doing and the bank simply printing money to fund the growing budget deficit."*
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> *"So the central bank is now providing almost unlimited financing for any deficit. Once started, this near printing of money can be a very addictive habit for any government."*
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> *"This agreement by the central bank to purchase bills and stocks that the private sector doesn't want, despite very significant increases in interest rates, is an extremely worrying step down what can be a very slippery slope."*

The central bank has allowed the O'Neill Government to proceed further down the slope. Government debt held by the central bank, mainly through T-Bills and Inscribed Stock, has hit K2.34 billion, more than triple the K711 million held in 2012.

Banks and other deposit-taking institutions hold K7.67 billion in Government debt, up from K3.60 billion. Super funds, insurance companies and the National Development Bank hold K2.69 billion, double the K1.27 billion held in 2012.

Much of it is wasteful, unproductive lending.

For example, lending by domestic commercial financial institutions to State-Owned Enterprises – propping up the walking dead – has hit K2.3 billion. This is six times more than the K366 million in banking system loans to SOEs in 2012.

The level of loans to SOEs is especially disturbing, given that according to the Auditor-General they are notorious for waste and corruption and are mostly operating outside the various laws that govern them.

From its own published data, it would appear that the biggest lender to the sector is BSP, which is likely to have loans to SOEs to the value of about K1.2 billion (based on its market share).

The prudential limit set by the Central Bank for lending by a commercial bank to one group is 40 percent of prudential capital. BSP's prudential capital, according to the publicly available reports, is K1.9 billion, so the limit it should lend to any one group currently is around K760 million. K1.2 billion represents 63 percent, well above the 40 percent limit set by the Central Bank (treating the Government sector as one group, as BSP itself does in its official statements).

"The damage being inflicted on the institutions of government and the financial sector by O'Neill is deep and will be long-lasting. It will take a very strong and good Prime Minister to repair the damage and rebuild the institutions. This is the real hidden cost of O'Neill's survival actions that is not yet evident to the public eye," Sir Mekere said.