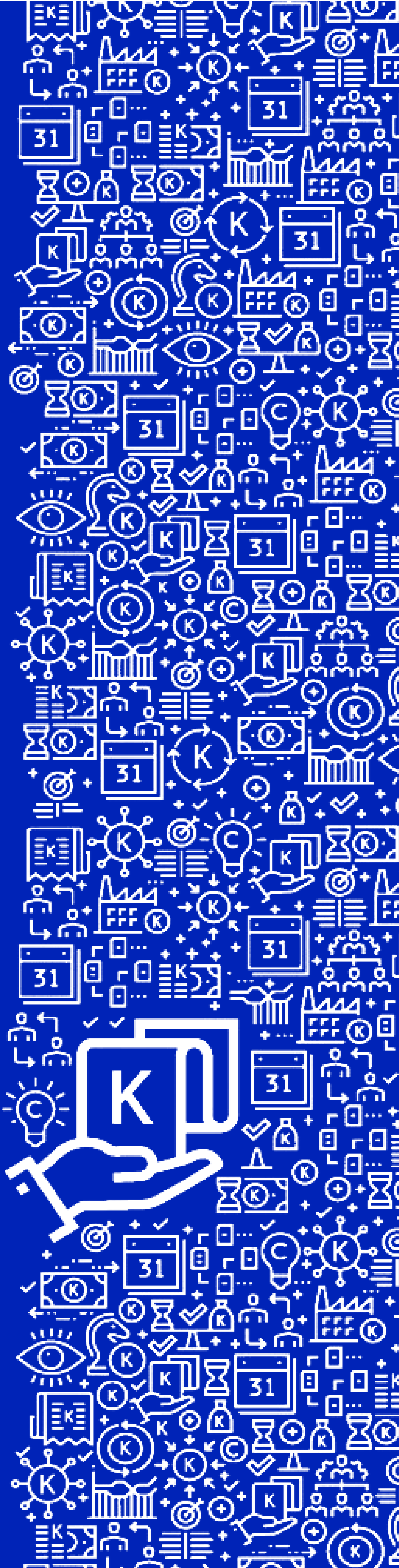
KPMG

Papua New Guinea Budget 2023

"Implementing the Vision"

A review of the Budget's major business implications



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"The 2023 Budget has support for economic growth as its top priority and sets the stage for fiscal consolidation over the medium term. This Budget is once again a high deficit budget. "

Executive summary

The 2023 Budget at a glance

The "Implementing the Vision" message this year under the existing main theme of "Take Back PNG", focuses on the need to consolidate the vision in times of crisis. In this regard the Treasurer's speech makes specific reference to the country having to sail through choppy international waters. On a positive note the 2023 Budget is described as a responsible and steady approach to debt and deficit levels, while paving the path for increased economic independence.

The K4.985bn deficit projected for 2023 is an improvement from the 2022 Budget and brings the deficit to GDP ratio to just under 5%. This deficit will increase the level of public debt (excluding valuation changes and outstanding arrears) to K59.143bn which is 52.3% of GDP.

Budget deficits appear set to continue through to 2026, but by then are not expected to exceed 2 percent of GDP. Unsurprisingly therefore, the Budget includes certain revenue raising measures.

On a percentage basis, the planned revenue growth exceeds the expenditure increase by around 10% and is on the backdrop of an improving global market and commodity prices and targeted increase in taxes to the non-resource sectors.

Highlights

On the revenue side, the K19.582bn budgeted is funded through mainly local tax collections of K14.900bn, international donor aid of K2.0254bn and K1.933bn in dividends from state-owned resource companies which have benefited from high commodity prices. On the tax collection front, a point to note is the expected lag in revenue which is highly dependent on the timing of the startup of resource projects.

On the expenditure side, total expenditure rises from K22.175bn to K24.675bn. Law and order, health and education are the focus areas, as in the past, with major increases expected in the recruitment of police, teachers, nurses and doctors. The public services wages bill, which is significant, continues to increase year on year. It is evident that a fundamental decision at the institutional level will have to be made on the size of the public service in the coming years.

The 2023 Budget, from 1 January 2023, increases the rate of tax payable by commercial banks from 30% to 45%. This measure will apply to the four commercial banks and is expected to raise K240m. Feedback from the market is that this unexpected tax, with minimal prior consultation, targets specific large corporations. Changes of this nature may have other unintended consequences, including deterring foreign investors.

As a reprieve, the Budget provides a household assistance package to provide relief for cost-of-living pressures. There was no mention of the re-write of the Income Tax Act which was expected to be legislated now but effective from 1 January 2024.

"This Budget continues the primary themes from last year's Budget, namely spend the money more wisely, raise revenues more fairly and finance debt more cheaply"

Zanie Theron
Managing Partner

"The theme of this years Budget is implementing the vision and is the largest in PNG's history with key priorities being law and order, infrastructure, education and health, agriculture and household assistance."

Key insights from the 2023 Budget

A summary of key elements of the 2023 Budget.

Economic Analysis

- The 2023 Budget continues with the 13 year plan set out in 2022.
- A significant increase in certain taxes should lead to an increase in revenue for GoPNG.
- Inflation continued to rise in 2022 creating pressure on the economy.
- The emphasis on rural economy and sustainable economic growth shows a direct effort to improve the non-resource economy.

Economic Assumptions

- For 2023 the mining sector will grow 13.5% without Porgera mine and 23.4% in 2023 when it re-opens.
- Overall growth of 4.6% in 2022 will moderate to 4.0% in 2023 with a projected decline in Oil & Gas sector.
- Inflation is high, at 6.6% in 2022 and is expected to moderate to 5.7% in 2023 and to 5.2% in the medium term. There are risks to this outlook.

Expenditure

- The total budget deficit to reduce by K1.0bn from K6.0bn to K5.0bn.
- Expenditure grew by 5.1% to K24.6bn, of which a budget deficit of K5.0bn will be financed through external borrowing and domestic disbursements.
- Debt to GDP would reach 52.3%.

2023 is PNG's largest budget in history

Fiscal strategy

- The overall debt has worsened from 50.2% in 2022 to 52.3% in 2023, before easing gradually to 46.8% in 2027.
- The cash deficit of K6bn in 2022 represents 5.6% of GDP and is projected to reduce by K1bn in each of 2023 and 2024, down to a negligible cash deficit in 2027.
- Revenue predictions are optimistic and represent a real risk to the achievement of the medium-term projections.

Revenue

- Resource-related revenue (including dividends) is expected to decline by almost 40.0% in 2023 on the back of lower projected global crude oil prices.
- Non-resource related revenue is projected to increase 16.4% in 2023 supported by an increase in CIT, PIT and GST, coupled with sustained trade and economic activities.

Tax

- The commercial banks bear the brunt with a 45% corporate tax rate from 1 January 2023.
- The general public fare better with an increase in the tax-free threshold to K20,000 and the extension of the excise duty exemptions for six months to 30 June 2023.
- Similar to prior years anti-social drinks and round logs suffer excise duty increases.

"The Budget is delivered in the context of a 'gloomy and uncertain' global outlook but, according to Treasury, amidst a much more positive domestic outlook"

Economic analysis

The 2023 budget continues with the 13- year plan GoPNG set out in 2022 to provide the 'fiscal spine' for the economic growth strategy. This budget maintains the effort to deliver on sustainable growth, particularly focusing on rural areas and the non -resource sector

Significant global challenges such as rising inflation and interest rates, along with falling growth and the war in Ukraine have had significant impacts on the global economy and PNG has not been immune. It has however fared better than most other countries recovering well in the non-resource economy post COVID-19. Inflation is expected to continue falling and employment increase. In addition, foreign exchange reserves continue to rise. PNG continues to strive for economic independence with a focus on getting the budget in surplus by 2027.

As a result of significant increases in the cost of living due to inflation GoPNG has put in place measures to try and reduce the financial stress that households are facing and provide economic stimulus through a range of measures. The GoPNG has left the door open to potentially introducing more measures should inflation not reduce to below six per cent. GoPNG is acutely aware that there is a sensitive situation in relation to inflation and as such they are keeping a close eye on aggregate spending to ensure that they do not add inflationary pressures and to try and ensure stability in the medium term.

A focus on rural community shows GoPNG places importance on the sustainable development goals and inclusive growth for all. This is demonstrated through an increase in infrastructure spend, particularly in rural areas. The importance of Connect PNG still remains, aiming to ensure that the whole of PNG is linked, increasing access to markets and services, including health and education, and creating economic growth. In addition, the creation of new Agricultural Ministries cements the effort on rural industries and the non-resource economy.

The 2023 budget focusses on balancing the increasing spend forecast with an even more significant increase in revenue through increase tax and non-tax revenue. There remains a focus on micro-economic growth and foreign exchange issues to improve the domestic business environment. In addition, increased scrutiny on budget expenditure should lead to more efficient and effective outcomes for the people of PNG.

Key Insights

- A significant increase in certain taxes should lead to an increase in revenue for GoPNG.
- Inflation continued to rise in 2022 creating pressure on the economy, inflation needs to be watched closely with efforts to prevent it increasing further.
- The emphasis on rural economy and sustainable economic growth shows a direct effort to improve the non-resource economy.

"The PNG economy continues to reflect strong growth of 4.6% in 2022 and the non-resource sector is anticipated to underpin 2023 growth of 4.0% but FX imbalances remain"

Economic assumptions

The Budget estimates are based on a range of assumptions including revenue collections, economic growth, and commodity prices

Volatility in economic fundamentals presents significant risks for a comparatively narrowly based economy like PNG. Key assumptions underpinning the Budget are presented below.

Key Economic Assumptions	Comment	2022	2023
Total Real GDP Growth	In 2022 the domestic economy is projected to grow by 4.6%, down from the MYEFO estimate of 4.7% largely due to weaker oil & gas and AFF performance. In 2022 Mining and quarrying will grow 13.5% with recoveries in the operating mines excluding the still-shuttered Porgera. Porgera's reopening was to have boosted the sector 35.8% in 2022 according to the 2021 Budget. Resource sector growth of 2.0% is expected in 2023 with a forecast decline of 7.2% in the Oil & Gas sector as PNG production moderates. Mining and quarrying will grow 23.4% off the anticipated resumption of Porgera in H223. Over the medium-term overall growth is forecast to moderate at 3.8% underpinned by the non-resource sector offsetting stagnant resource sector activity.	4.6%	4.0%
Non-mining Real GDP Growth	Growth of 4.5% is expected in 2022 with 2.1% growth in AFF with lower coffee production due to election violence. 2023 growth is forecast at 4.6% for the non-resource sector – AFF up 4.0%, real estate up 3.5% with continued urbanisation and labour mobility; transport and storage to grow 3.3% and construction up 3.0%. GoPNG's Connect program and increased trade are key drivers for these latter sectors.	4.5%	4.0%
Real exchange rate index	The Kina held fairly steady (down 0.4%) against the US$ in 2022 and appreciated 12.0% against the AUD due to cross currency movements with AUD weakening against USD. The Trade Weighted Index rose by 11.0% in 2022 reflecting Kina appreciation against key trading partners and the Real effective exchange rate increased by 5.0% in 2022 – the highest level since 2015. FX inflows of K12.7bn to Aug22 were recorded against outflows of K14.6bn and FX imbalances in the local market remain. FX delays are attributed to new compliance measures and a move on the part of BPNG to hold greater FX reserves.		
Monetary Policy & Kina Facility Rate	Monetary policy tightened in July22 with a 25bp rise in the Kina Facility Rate to 3.25% as a policy response to inflation and liquidity. In H122 money supply increased 17.2% and is expected to be 13.7% in 2022 driven by increases in Net Foreign Assets (50.8%) and Net domestic Assets (8.6%).	3.0%	3.25%
Inflation	Projected to average 6.6% for 2022 pushed by food (cereal, fruit and vegetable prices), betel nut and transport prices. This is expected to moderate to 5.7% in 2023 with monetary policy tightening and a projected fall in oil prices. Medium term inflation is projected to average 5.2%.	6.6%	5.7%

Key Economic Assumptions		Comment	2022	2023
	Balance of Payments & International Reserves	A current account surplus of K15.2bn was recorded in H122 reflecting higher export receipts on the back of more production and high prices for export commodities. This is forecast to continue to K23.8bn at year end. The surplus is offset by the deficit in the financial account due to debt service payments for the LNG plant and FX held offshore by mineral companies. Commodity prices are expected to decline and impact the current account surplus. International reserves totalled US$3.3bn at Jun22 (9.2 months import cover) and is set to increase to US$4bn by Dec22.		K14bn
	Oil (US$/barrel)	Oil prices increased sharply in Q1 2022 as demand rises off the back of economic activity. Disruptions to the supply caused by geopolitical conflicts and the surge in inflation pushed prices to historical highs. Prices are expected to moderate into the first half of 2023.	95	83
	LNG (US$/MMBtu)	75% PNG LNG sales are on long term contracts linked to the crude oil price. LNG prices in 2022YTD have risen sharply as a result of peaks in crude oil prices. Prices are expected to continue to rise with supply side disruptions due to geopolitical uncertainty, rising demand and weather events in the short term with longer term stabilisation.	14.6	12.8
	Gold (US$/oz)	Prices have decreased mid 2022 due to interest rates conditioned to alleviate pressures from the rising inflation. Counteracting the decrease in price is the demand on Gold as a rising safe haven asset amidst geopolitical tensions.	1,816	1,812
	Copper (US$/tonne)	Post COVID-19 demand on copper resulted in prices performing well into H122 and declined following macro headwinds over the year. The fundamentals of demand and supply are anticipated to pick up giving rise to uncertainty in the 2023.	8,811	7,910
	Copra (US$/tonne)	Copra oil prices broadly stable following an increase in H122 driven by a pickup on the back of demand. Further decrease in prices were a result of broad-based inflation and an excess supply.	1,588	1,588
	Cocoa (US$/tonne)	Prices remain low from HI22 driven by increased supply from major productions due to improved weather conditions together with global inflation forcing a subsided demand. Priced are forecasted to further decrease in 2023.	2,383	2,285
	Coffee (US$/tonne)	Prices consecutively increased driven by the tight global supply and increasing demand. Brazil's decrease in crop reflecting the frost on its coffee producing regions coupled with the post COVID-19 surge in demand proved to be the main contributors to enduring price rises in the medium term.	5,804	5,445
	Palm Oil (US$/tonne)	Prices increased in H122 caused by a shortage in supply and increased demand. Production constraints in major global producers underpinned increasing prices. Production with major suppliers improved in the latter of	1,131	896

Key Economic Assumptions	Comment	2022	2023
	the year resulting in access supply and projected decrease in price for 2023.		

Source: Department of Treasury & KPMG Analysis

Key Insights

- Last year's Budget predicted a 35% growth in the mining sector on the back of the re-opening of Porgera mine. The sector will grow 13.5% without Porgera and 23.4% in 2023 when it re-opens.
- Overall growth of 4.6% in 2022 will moderate to 4.0% in 2023 with a decline in the Oil & Gas sector expected.
- Inflation is high, at 6.6% in 2022 and is expected to moderate to 5.7% in 2023 and to 5.2% in the medium term. There are risks to this outlook.

"The strategy centres on supporting economic growth and community services through strategic capital formation, expanding the tax base and improving essential service delivery"

Fiscal strategy

GoPNG remains guided by its thirteen-year plan incorporating a medium-term strategy to repair the financial position and support longer term economic growth

The main fiscal parameters of the 2023 Budget are:

- Budget deficit at 4.4% of GDP;
- FRA deficit (excluding concessional loans) at 6.3%;
- Non-resource primary balance at 6.3% of non-resource GDP; and
- Debt estimates of 52.3% of GDP.

The primary revenue risks would be posed from a reduction in mining and petroleum taxes or in corporate income taxes. The non-payment of dividends from the SOEs is a further risk. Risks on the expenditure side include rising global interest rates which would push up the debt interest repayments.

Total Revenue and Grants for 2023 is projected at K19.6bn (17.3% of GDP), K2.2bn (12.6%) higher than the 2022 Supplementary Budget estimate of K17.4bn. The medium-term revenue projections are shown in the table below which reflect optimistic tax and total revenue and grant growth, particularly in 2023 and 2026/7.

Revenue Projections (Km)	2022	2023	2024	2025	2026	2027
Tax Revenue	13,832	14,900	15,814	17,197	19,415	21,940
Donor Grants	1,825	2,025	2,075	2,125	2,175	2,225
Other Revenue (Non-Tax)	1,733	2,657	2,610	2,905	3,534	4,204
Total Revenue & Grants	**17,389**	**19,582**	**20,499**	**22,227**	**25,124**	**28,369**
% of GDP	16%	17%	17%	17%	18%	20%

Source: Department of Treasury & KPMG Analysis

Expenditure focuses on growing the economy, focusing on connecting PNG, supporting rural communities, supporting SMEs, providing responsible government, tuition fees, and strengthening SOEs through smarter and targeted reforms.

Key capital investment projects will continue focused on essential projects to stimulate economic activity and add value to those living in rural communities. These programs aim to reduce the cost of doing business and to connect and expand economic corridors to stimulate economic growth and employment opportunities in rural communities. The increased economic activity generated by these investments should eventfully lead to higher tax collections.

Total Expenditure & Net Lending is projected at K24.6bn, K1.2bn (5.1%) up on the Supplementary Budget estimate and is designed to strike a balance between economic stimulation and fiscal discipline. The CoE allocation is expected to increase to K6.9bn in 2023 primarily on the back of an increase in front line workers in essential industries to cost K406m in 2023. Over the next five years to 2027 the number of teachers and health workers are forecast to rise by 5% per annum; and police to rise from 5,000 currently to around 8,400 in 2027. The planned retirement of public servants over 65 will continue, as will efforts to clean up the GoPNG payroll.

Interest payments are budgeted to be K2.5bn in 2023 and over the medium term, interest payments are forecast to trend lower as GoPNG moves to a more concessional financing base.

Arrears repayments of K600m are projected in 2023, including arrears under Utilities, Rentals and Goods and Services. The Arrears Verification Committee (AVC) has cleared K962m of the starting K5.2bn as at June 2022, leaving K4.2bn to be dealt with in the ongoing process.

Total revenue of K19.6bn and total expenditure of K24.6bn leaves a deficit of a shade under K5bn or 4.4% of GDP, taking total debt to K59.1bn or 52% of GDP.

Medium term outlook

GoPNG's medium term focus is within the thirteen-year plan framework of maintaining fiscal support for economic recovery efforts, strengthening the revenue base, improve the quality of spending, and obtain cheap responsible financing within prudent risk levels. This is expected to ensure macroeconomic stability and form the basis for economic growth.

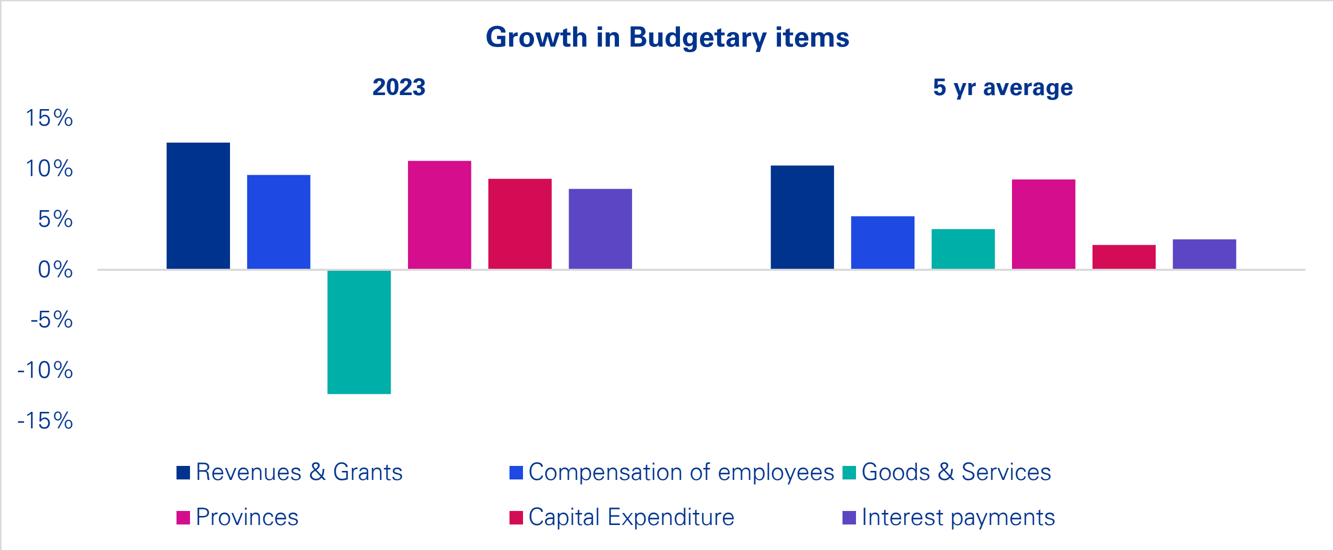
Revenue projections to 2027 show a 45% growth from 2023 against projected 15% rise in expenditure. This translates into a reducing budget deficit from 4.4% to a balanced budget in 2027 with debt to GDP down from 52.8% in 2023 to 47% in 2027.

2023 Budget strategy & medium-term fiscal outlook

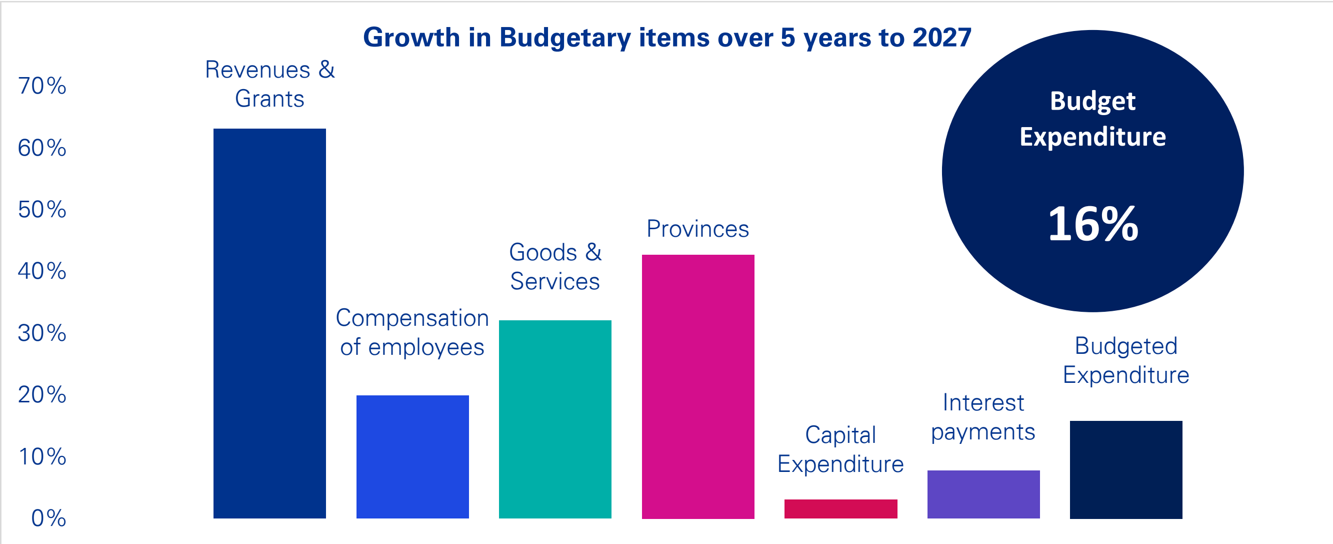
Budgetary item	2022 SB	2023	2024F	2025F	2026F	2027F
Revenues & Grants	17,389	19,582	20,499	22,227	25,124	28,369
Compensation of employees	6,346	6,942	7,161	7,598	7,900	8,206
Goods & Services	4,403	3,860	4,048	4,341	4,798	5,271
Provinces	1,316	1,458	1,572	1,702	1,851	2,020
Capital Expenditure	8,985	9,796	9,072	9,356	9,637	10,073
Interest payments	2,324	2,511	2,615	2,692	2,711	2,691
Budgeted Expenditure	23,374	24,567	24,468	25,689	26,898	28,262
Deficit	**-5,985**	**-4,985**	**-3,969**	**-3,462**	**-1,774**	**107**
Debt to GDP Ratio (excl arrears)	50.2%	52.3%	52.2%	51.3%	49.2%	46.8%

Source: Department of Treasury & KPMG Analysis

The Medium-Term Fiscal outlook is reflected in the table above and relies upon revenue growth of 13% in 2023 and a five-year average annual growth to 2027 of 10%. Compensation of employees is only forecast to grow an annual 5% and goods and services expenditure is expected to decline 12% in 2023, pulling down an average annual growth to 5%. Capital expenditure growth of 9% in 2023, declines 7% in 2024 and only averages 2% annually over the five years. Put another way, revenues and grants are forecast to grow 63% over five years but expenditure only 16%.



Source: Department of Treasury & KPMG Analysis



Source: Department of Treasury & KPMG Analysis

Key Insights

- As expected, the overall debt has worsened from 50.1% of GDP in 2021, to 50.2% in 2022 and is expected to peak at 52.3% in 2023, before easing gradually to 46.8% in 2027.
- The cash deficit of K6bn in 2022 represents 5.6% of GDP and is projected to reduce by K1bn in each of 2023 and 2024, down to a negligible cash deficit in 2027.
- Revenue predictions are optimistic and represent a real risk to the achievement of the medium-term projections.

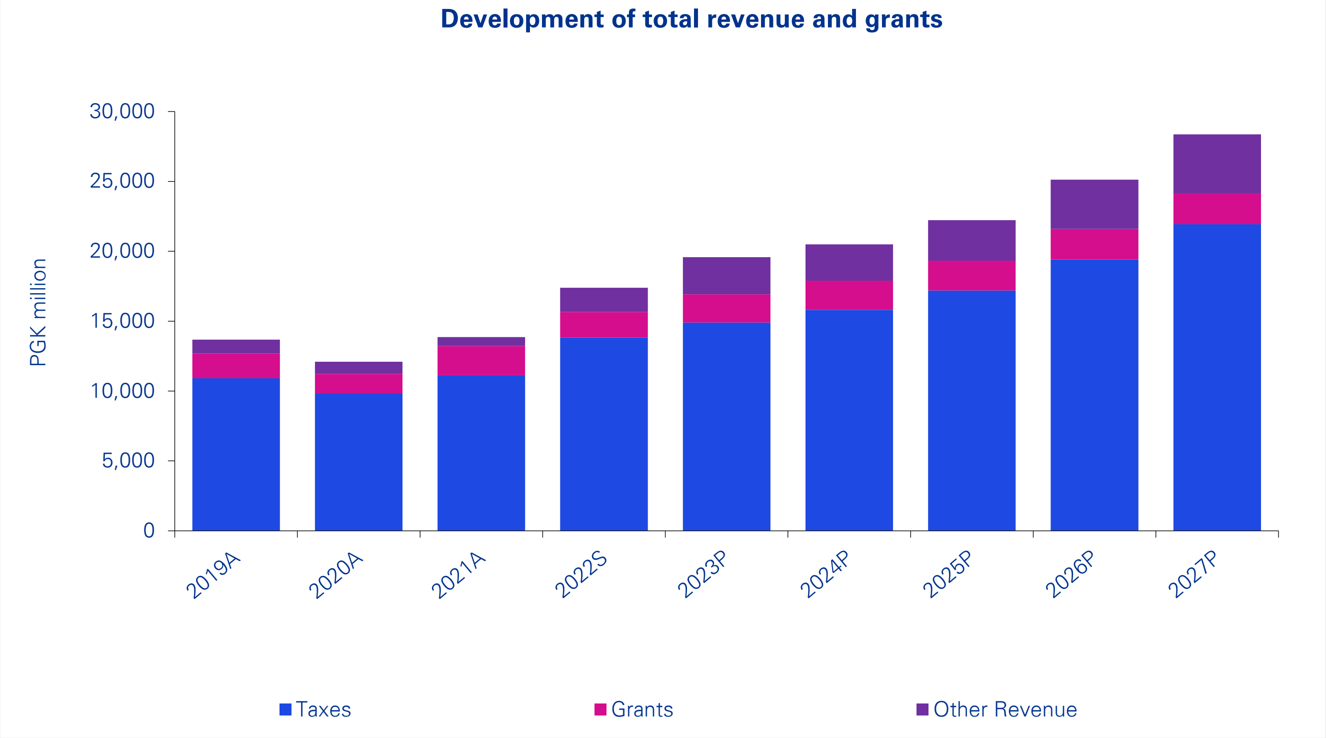
“PNG remains at high risk of debt distress and requires further fiscal consolidation and conservative financing strategies to continue to be sustainable”

Revenue

The 2023 revenue forecast is K19.6bn representing the most revenue in PNG’s history and an overall increase of 12.6% (K2.2bn) from the 2022 Supplementary Budget projection supported primarily by increased consumption and trade, as well as a 53.4% increase in non-tax revenues

Total revenue and grants

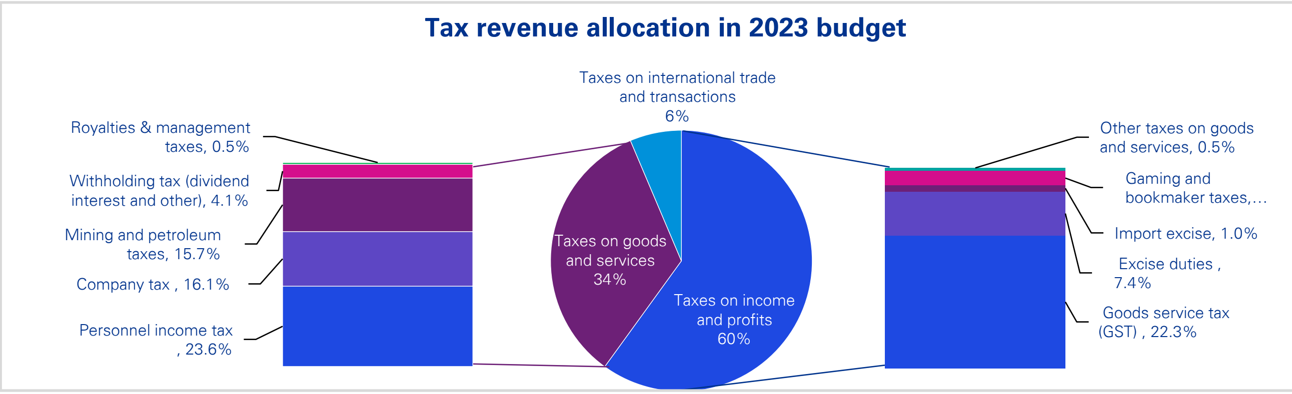
2023 revenue forecasts are supported by the continued post-Covid economic recovery in economic growth, increased consumption, growth in non-resource sector revenues and increases in non-tax revenues.



Source: Department of Treasury & KPMG Analysis

Revenue assumptions for 2023 assume a rise in tax revenue of 7.7% to K14.9bn. Total Revenue and Grants for 2022 is projected to grow by 25.5% to K17.4m million (16.1% of GDP), from 2021. This growth is driven by favourable commodity prices and strong domestic economic recovery leading to higher tax revenues and higher mining and petroleum dividends.

The total forecasted revenue in 2022 is expected to significantly exceed the 2019 (pre-pandemic) revenue by 27.1%, through increased tax revenue and increased dividend income. Tax revenue comprises 76.1% of the overall revenue budget and 13.2% of GDP. The composition of the total revenue and grants for the 2023 Budget is presented in the chart below:



Source: Department of Treasury & KPMG Analysis

The forecast assumes global commodity price moderation and dissipation of pent-up global demand.

Personal income tax (PIT) is projected to increase by K201.6m (6.4%) to K3.5bn underpinned by the forecasted economic growth that will lead to both employment opportunities and an increase in nominal wages. This growth in PIT will be offset by the raising of the income tax-free threshold to K20,000 for 2023.

Company Income Tax (CIT) is expected to grow by 35.8% to K2.4bn representing 16.1% of total tax revenues. The increase in CIT is driven by non-resource sector earnings growth and a new tax rate applicable to the commercial banks of 45%. This new tax measure is expected to bring in an additional K240.0m in base revenues.

Mineral and Petroleum Tax (MPT) is expected to contract by 21.9%to K2.3bn in 2023, driven by the anticipated moderation in oil price in 2023 and the tax credit arising from the over-assessment of MPT in 2022. Treasury estimates that for every dollar increase in the oil price MPT is expected to increase by c. USD44m given a certain level of production volume.

The 2023 Budget growth forecast assumes that the resumption of the Porgera mine will occur in the first quarter of 2023, with production commencing in the second quarter. Any further delay will have a downward effect on the growth forecast. The resumption of production in 2023 is projected to contribute 1.2 percentage points to the overall real GDP growth.

Taxes on Goods and Services (including GST and excise duty) is projected to increase significantly from the 2022 Supplementary Budget (21.4% or K884.6m). This reflects the anticipated steady consumption due to improved economic conditions and trade growth. GST collections will also be boosted by GoPNG’s decision to cease the GST relief provided during 2022 for retail fuel.

We note the projected increase in excise duty (K376.0m or 51.5%) driven by increasing consumption and spending patterns on excisable items. GoPNG will also introduce tougher excise regime measures on anti-social drinking, with a one-off 493%increase in the excise tariff rate, which is expected to raise an additional K30.0m in revenue.

Taxes on International Trade and Transactions is projected to increase by 10.5% to K949.9m supported by 20.0% higher export duty on round log exports and overall stronger custom’s compliance efforts.

Under other revenue, dividends from mining, petroleum and gas areas (specifically K1.3bn from Kumul Petroleum Holdings and K382.5m from the OKTedi mine) represent the major revenue source contributing 87% of total dividend revenue. A further K459.3m of revenues are projected from the Non-Tax Revenue Administration Bill (NTRA) which is expected to be tabled with the 2023 Budget.

At 1.8% of GDP it is clear that, although welcome, GoPNG does not expect to increase its dependency on grant funding the way it may have in the past. Development partners, such as the Asian Development Bank (ADB), European Union (EU), Australian Aid and others may look to increase funding in PNG, to support its post pandemic economic recovery.

GoPNG's revenue target, excluding grants, is to reach 16.5% of nominal GDP by 2026, above the 13.9% target for 2023 in the current MTRS. The higher revenue growth rate compared with the nominal GDP growth rate reflects expected improvements in efficiency in the tax collection system with a greater share of the revenue coming from resource and non-resource sectors.

We note that GoPNG revised its growth strategy compared to the 2022 Budget and increased the revenue projection by 10.7% for 2023 and 4.8% for 2024. This reflects the continued recovery of the economy in short-term.

Key Insights

- Resource-related revenue (including dividends) is expected to decline by almost 40.0% in 2023 on the back of lower projected global crude oil prices.
- Non-resource related revenue is projected to increase 16.4% in 2023 supported by an increase in CIT, PIT and GST, coupled with sustained trade and economic activities.
- Significant risks to the execution of the 2023 Budget will be a reduction in mining and petroleum taxes, reductions in oil price, delays to resumption of Porgera mine, a reduction in corporate income taxes and/or the non-payment of dividends by SOEs.
- GoPNG's new Medium Term Revenue Strategy (MTRS) will aim to improve PNG's revenue framework through strengthening the existing tax policies, updating tax legislation, and improving administrative capacity.

"GoPNG continues to fund service priorities in the health, education, law & order, and infrastructure sectors, as well will continuing the implementation of some of the key capital investment projects which began in prior years."

Expenditure

The 2023 budget is framed by GoPNG's updated 13-year fiscal plan with total expenditure in 2023 budgeted at K24.6bn

The 2023 Budget is framed by GoPNG's updated 13-year fiscal plan. Total expenditure in 2023 is budgeted at K24.6bn. The total deficit financing required is K6.0bn although there has been a significant growth in revenue over expenditure, expected to result in a decline of K1.0bn from the budget deficit. The remaining budget deficit of K5.0bn in the 2023 budget is planned to be financed through external borrowing (K3.5bn) and domestic disbursements (K1.5bn). The 2023 Budget represents expenditure funded from GoPNG of K21.4bn and donor funded expenditure of a total of K3.2bn. In the budget components, the operational budget is K14.7bn and the capital investment is budgeted at K8.8bn.

The operational budget has increased by 7.0% driven mainly by:

- The 18% increase in the Goods and Services budget which considers the GoPNG's arrears (utility bills, rentals, superannuation, and retirement costs) and interest costs.
- The increase in Compensation of employees (CoE) by 5% to cater for the 10% increase in core public services, increased salaries, and cost reductions in non-core services.

2023 capital expenditure budget increased by 3% from the 2022 budget to ensure:

- On-going financing of provincial and district level projects, including the financing of 7 new districts established in 2022.
- Maintaining the funding of fixed commitments of key policies and priorities, such as the Support Improvement Programs (SIPS) and Connect PNG Policy.

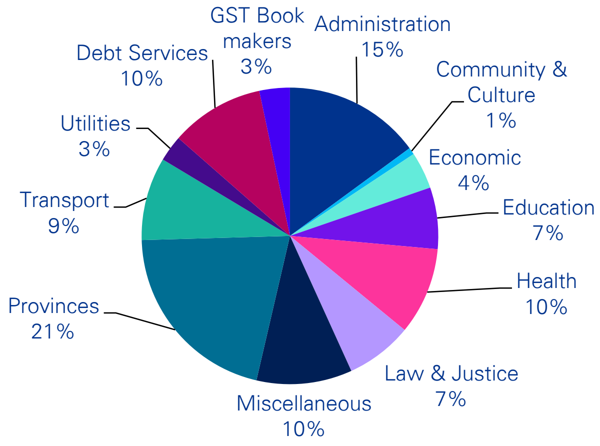
Budget Components (Km)	2022 Budget	2023 Budget	Change in 2023	% of total
Operational	**14,389**	**14,771**	**3%**	**60%**
Compensation of Employees	6,346	6,942	9%	28%
Goods and Services	4,403	3,860	-12%	16%
Debt Interest Payment	2,324	2,511	8%	10%
Provincial Functional grants	594	642	8%	3%
GST & Book Makers Transfers	722	816	13%	3%
Capital	**8,985**	**9,796**	**9%**	**40%**
GoPNG	6,092	6,615	9%	27%
Concessional Loans	1,318	1,156	-12%	5%
Donor Grants	1,575	2,025	29%	8%
Total Expenditure	**23,374**	**24,567**	**5%**	**100%**

Source: Department of Treasury & KPMG Analysis

The GoPNG budget repair strategy focuses on three key principles: 1) Spending money wisely, 2) raising revenue fairly and 3) financing debt cheaply. Under these principles, GoPNG implements the following efficiency measures:

- the Organisational Staffing Personal Emoluments Audit Committee in managing and controlling the personnel and wage bill
- continuing the retirement exercise and reduce GoPNG liabilities
- the identification and payment of arrears and liabilities by the Arrears Verification Committee (AVC)
- the issue and implementation of Non-Financial Instructions (NFI); and
- a Public Expenditure Review.

2023 Budget expenditure by sector - K24.6bn



Source: Department of Treasury & KPMG Analysis

Expenditure by Sector (Km)	Operational	Capital	Total	% of total	Comment & major projects
Administration	968	2,699	3,667	15%	From the operational budget, K709m is allocated to CoE and K259m is allocated to Goods & Services. From the capital budget, K2,699m will fund GoPNG activities, grants and loans
Community & Culture	69	119	187	1%	Operational expenditure allocated will cover CoE and G&S expenses. The capital expenditure will cover major programs and projects
Economic & Infrastructure	274	715	989	4%	Promote sustainable and inclusive board based economic growth
Education	1,383	267	1,650	7%	Focus on improving infrastructure and training quality for FODE and TVET and improving accessibility and retention rates through the Government Tuition Fee Subsidy Policy
Health	1,674	662	2,335	10%	Budgeted capital expenditure to support ongoing activities and operational expenditure will cover sectoral challenges
Law & Justice	1,385	402	1,787	7%	Focus on growing key agencies in the sector driving a 10% growth in CoE per year over the medium term
Miscellaneous	2,561	-	2,561	10%	No comment in Budget
Provinces	2,927	2,212	5,139	21%	The capital expenditure has a continued focus on service delivery whilst the operational expenditure covers CoE and G&S expenses
Transport	167	2,059	2,226	9%	Key priority capital expenditures include major projects: Connect PNG, CADIP Program, Nadzab Airport Terminal Redevelopment, PNG Ports Infrastructure Investment Program amongst others

	Expenditure by Sector (Km)	Operational	Capital	Total	% of total	Comment & major projects
	Utilities	38	661	699	3%	Continue funding major programs and projects: Digital governance infrastructure development, NBC Rehabilitation and Modernisation Program, Provincial and District Water Supply Project amongst others
	Total expenditure	**14,771**	**9,796**	**24,567**		
	GST & BMT	**816**	**-**	**816**		

Source: Department of Treasury & KPMG Analysis

Key Insights

- A significant reduction in the budget deficit of K1.0bn is expected to reduce the total budget deficit from K6.0bn to K5.0bn.
- Expenditure overall grew by 5.1% to K24.6bn, of which budget deficit of K5.0bn will be financed through external borrowing and domestic disbursements.
- In the 2023 Budget, it is expected that Debt to GDP would reach 53.3%, which is 2.1% higher than the Debt to GDP for the 2022 budget at 50.2%.

"PNG remains at high risk of debt distress and requires further fiscal consolidation and conservative financing strategies to continue to be sustainable"

Budget financing

The focus continues to be on debt sustainability with concessional external financing sources and domestic debt to fund the K6bn 2022 deficit

GoPNG's financing and debt management strategy is focused on debt sustainability through exploring cheaper concessional sources of external financing and use of domestic debt. The 2022 Budget deficit of K6bn is proposed to be financed through a net external borrowing in the form of budget support loans and project loan disbursements from PNG's multilateral and bilateral partners of K3.8bn and net domestic borrowing of K2.2bn. There was no external financing support in the first three quarters of 2022 with all financing from domestic issuance but K800m from the ADB SOE Reform Program loan and K1.7bn from the Australian Government is anticipated prior to year-end.

Financial requirements for 2023

K5bn will be financed under similar strategies employed by GoPNG - external financing will comprise budget support loans from our multilateral and bilateral creditors, drawdowns from concessional loans, and a new commercial loan for project implementation. The domestic financing will include Treasury Bonds and Treasury Bills issuances, including a recently approved new commercial borrowing from local commercial bank earmarked for infrastructure development such as the Regional Road program.

GoPNG plans to drawdown K1.1bn from concessional loans earmarked for planned projects and K20m from commercial financing for other infrastructure projects.

Amortisation commitments for 2023 include: K125m for domestic commercial loans and K296m for extraordinary loans. GoPNG plans to amortise K640m in external concessional liabilities to reduce interest obligations. Accordingly, GoPNG's exposure to the domestic securities market for 2023 is estimated to be a net addition of K1.5bn which includes net issuance of K945min TBonds and K526m in T-bills, with a net repayment of K5m on domestic loans.

GoPNG debt of K59.1bn in 2023, at 52.3% of GDP, is within the current band of 45-60% set by the Fiscal Responsibility Act (FRA) with domestic debt comprising 49.8% and concessional external financing of 23.2%.

Domestic market conditions

Net GoPNG borrowing rose in 2022 to fund cash requirements, settle bond coupons and maturities in the absence of external budget finance support. Primary domestic borrowers in the weekly auctions are the four commercial banks, the superfunds and corporate and individual investors. Demand for short term T-bills was stronger in the first quarter with longer term T-bonds issued from Q2 onwards. Coupon rates for both short- and long-term debt declined over the year as liquidity remained high - yield on 182-day T-bills declined from 4.25% to 1.21%; that on 273 day securities dropped from 5.9% to 2.7%; and 365 day T-bills down from 7.2% to 4.3%. T-bond yields dropped below 6% in the last auction of 2022.

Overall objective of 2023-2027 Medium Term Debt Strategy

The next Medium Term Debt Strategy (MTDS) for the period 2023-2027 focuses on maintaining fiscal support for economic recovery and foster fiscal consolidation over the medium term and managing the risk exposure embedded in the debt portfolio.

Deficit Financing (Km)	2021	2022SB	2023	2024	2025	2026	2027
Domestic							
Treasury Bills	13,297	13,557	14,082	13,575	12,748	12,059	10,865
Treasury Bonds	10,833	12,583	13,528	14,588	15,088	15,611	15,749
Domestic Loans	1,128	1357.5	1,353	1,328	1,203	1,078	953
Total Domestic	**25,258**	**27,498**	**28,963**	**29,490**	**29,038**	**28,748**	**27,567**
International							
External Debt Securities	1,750	1,750	1,750	1,750	1,750	1,750	1,750
Monetary Gold & SDRs	-	1,244	1,244	1,244	1,244	1,244	1,244
Concessional loans	10,940	11,648	12,164	12,703	13,291	13,871	14,441
External Commercial loans	231	211.7	196.4	181	166	150	135
Extraordinary loans	8,750	11,806	14,825	17,743	21,084	22,585	23,104
Total External	**21,671**	**26,660**	**30,179**	**33,621**	**37,535**	**39,600**	**40,674**
Combined total	46,929	54,158	59,143	63,111	66,574	68,348	68,241
% of GDP (ex arrears)	**51.5%**	**51.5%**	**52.3%**	**52.2%**	**51.3%**	**49.2%**	**46.8%**

Source: Department of Treasury & KPMG Analysis

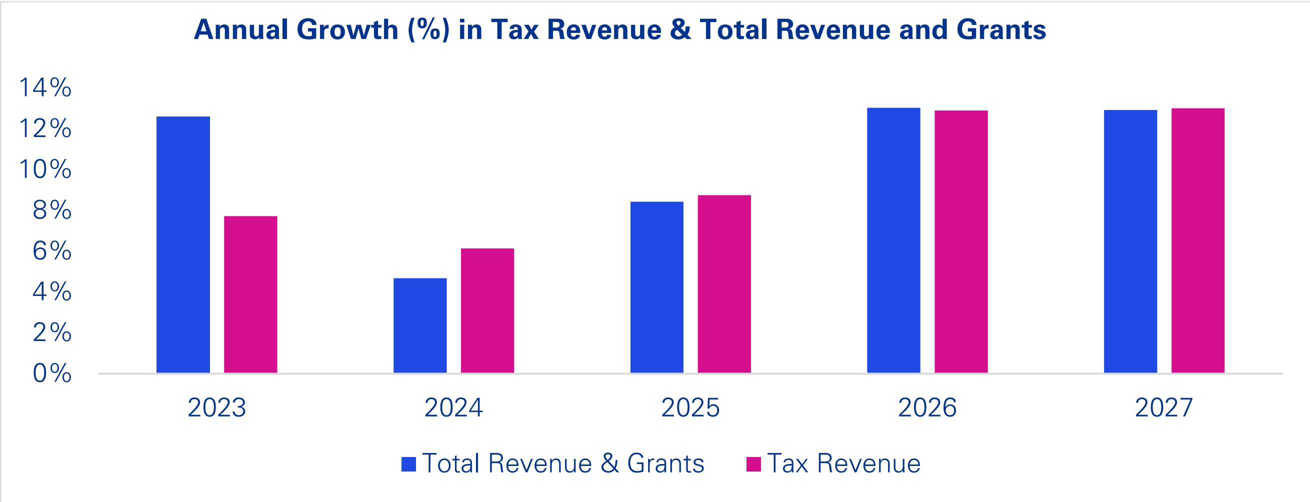
Cost and risk of current debt portfolio

Based on the IMF and World Bank, PNG remains at high risk of debt distress and requires further fiscal consolidation and conservative financing strategies to continue to be sustainable. Foreign exchange risk is high with foreign currency debt around 25% of GDP with the short-term component is 7% of international reserves. Refinancing risk is also high with 29.1% of total debt maturing in one year and being 14.6% of GDP. 50% of the total debt portfolio is exposed to interest rate changes. The average cost of domestic debt is 6.9%; external debt 2.7%; and overall, 4.9%. This is relatively expensive.

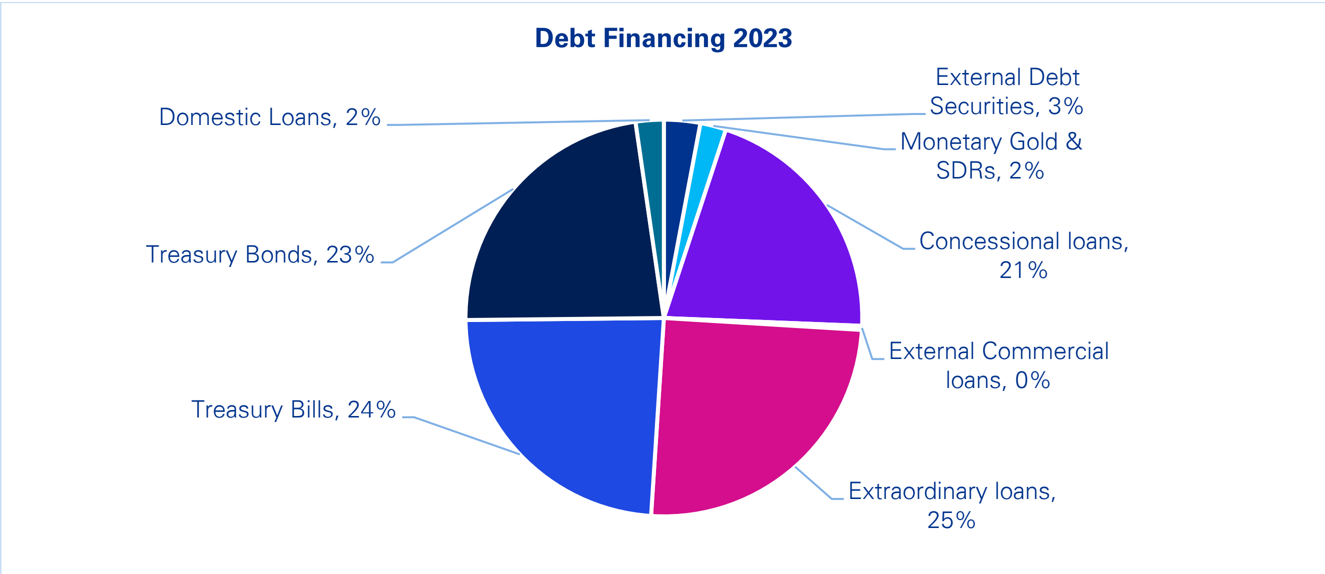
Debt strategy operations

GoPNG's debt policy is aimed to lessen reliance on T-bills to mitigate risk of refinancing; reduce variable interest rate borrowing; reduce commercial borrowing; prioritise concessional financing from external sources in order to secure the necessary financing for development objectives; and develop the domestic debt market to improve its depth, liquidity and efficiency.

This will be done by reference to key medium-term targets to be contained in an updated MTDS, being developed in conjunction with bilateral and multilateral partners.



Source: Department of Treasury & KPMG Analysis



Source: Department of Treasury & KPMG Analysis

Key Insights

- The K6bn budget deficit in 2022 is forecast to be financed through net external borrowings of K3.8bn and domestic borrowings of K2.2bn. The K5bn deficit forecast for 2023 is lower deficit but the gap between the proposed financing instruments and the deficit is concerning.
- PNG remains at high risk of debt distress and requires further fiscal consolidation and conservative financing strategies to continue to be sustainable.
- Refinancing and foreign exchange risk are high and debt, at 4.9% average, is relatively expensive.

"If anyone can be described as a winner in this Budget it would be the public while the losers are the commercial banks"

Tax - general

Major blow to the commercial banks

45% tax rate for banks

While there have been few taxation changes impacting the 2023 calendar year the commercial banks will feel the pinch. Although it may not come as a shock to the banking sector, as it had been foreshadowed in recent weeks, the increase in the corporate income tax rate from 30% to 45% will nevertheless be a significant burden on the sector. The new rate will apply to all commercial banks licensed under the Banks and Financial Institutions Act 2000 and will be effective from 1 January 2023. It comes at a time when some financial institutions are exploring the possibility of a banking licence so it remains to be seen whether it will dissuade new players to the banking market.

The rationale for the higher tax rate is to spread the tax burden more evenly across all of the commercial banks due to perceived high profitability levels compared to international norms. The 45% tax rate is expected to collect K240.0m in 2023.

As the 45% tax rate applies from 1 January 2023 the question arises as to how the rate will be applied to banks with substitute accounting periods for FY23. Also, while GoPNG have said they will consult closely with the banking industry during the first half of 2023, to consider if a different type of tax, such as the additional profits tax, may be more appropriate from 2024 onwards, we hope Treasury will in fact engage in meaningful consultations as promised.

A sunset clause has been introduced to the Additional Company Tax which impacted BSP bank. The tax was very controversial and while GoPNG have decided to replace it with a more broad-reaching tax on the banking industry as a whole, the sunset clause includes transitional provisions to enable the government to continue to pursue the assessed funds from the Additional Company Tax that they say are still outstanding.

Market concentration levy

Provisions have been introduced to correct an oversight whereby the Market Concentration Levy introduced last year, effectively targeting Digicel and BSP, was not formally repealed when the Additional Company Tax was introduced.

Revised dividend policy to increase revenue from SOEs

A large portion of GoPNG revenues are collected from State Owned Enterprises (SOEs). GoPNG is considering a revised dividend policy to increase revenue from SOEs due to expenditure pressures on GoPNG. Once finalised the revised dividend policy will be submitted for NEC's deliberation.

In approving the revenue measures for the 2023 Budget, the NEC approved for the state Dividend Policy to be amended such that 85% of planned dividends from Ok Tedi Mining Limited (OTML) would be remitted into the Consolidated Revenue Fund (CRF), with the balance of 15% diverted to Kumul Minerals Holdings Ltd. The dividend to the CRF from OTML is expected to increase from K90.0m to K382.5m in 2023. In addition, the NEC also approved for Kumul Petroleum Holding's 2023 Annual Operating Plan to be amended to increase its dividend to Government from K300.0m to K1.3bn including K300.0m held over from 2022.

Employee tax free threshold

As a temporary measure to assist employees with the rise in worldwide inflation and living costs, the salary or wages tax free threshold will increase from K17,500 to K20,000 for the period 1 January to 31 December 2023. This change is said to increase take home pay by K63 per fortnight for employees earning more than K20,000 pa in 2023. This measure is projected to cost the Government K280.0m.

It appears however that there may be some flaws in the SWT tax tables accompanying the legislation.

Non-tax revenue measures

The new Non-Tax Revenue Administration (NTRA) Act will mobilise non-tax revenue by bringing all non-tax revenue collections into the Consolidated Revenue Fund (CRF) to support the Budget and allow all government agencies to be funded through the normal budget process. The NTRA aims to rectify the technical errors of the Public Money Management Regularisation (PMMR) Act 2017 that the courts ruled as unconstitutional in May 2020.

The implementation of this Act is expected to collect K555.0 in 2023 and forms a crucial pillar in the revenue mobilisation plan for 2023.

Key Insights

- There are fewer tax measures implemented and/or flagged in the 2023 Budget than recent years.
- GoPNG attempts to spread the tax burden more equitably across the commercial banking sector while simultaneously trying to protect their position on the Additional Company Tax pending the outcome of legal action from BSP bank regarding this tax.
- Measures such as the employee tax threshold and the excise duties on petrol, diesel and fuel, are aimed at easing the cost-of-living burden for individuals while perceived high profit earners such as the commercial banks are specifically penalised.
- There has been no mention of the proposed re-write of the Income Tax Act which was due to be passed with the 2023 National Budget but expected to be effective from 1 January 2024. We wait in anticipation of the new Act which commenced a consultation process almost three years ago.
- The Commissioner General, Mr Sam Koim, mentioned during the Budget press lock-up that the aim is to apply "the right tax, not more tax" by 2024.

International trade and customs

Alcohol producers to experience excise hikes while the public enjoy extension of fuel excise reliefs

Harmonised system update

The Harmonised System (HS) is a general term used for commodity description and coding for customs tariff purposes. The World Customs Organisation has responsibility for managing, reviewing, and updating the HS every five years. The last HS update was done in 2017. The 2019 review recommended for 351 sets of updates relating to a variety of products and product groups from various sectors including Agriculture, Machinery, Chemical etc. Amendments are proposed to the Customs Tariff Act to capture these recommended changes. The key factors driving the HS 2022 amendment include advancement in technology, changing trade patterns and facilitating the implementation of various international conventions amongst others. PNG as a contracting party to the HS Convention is required to adopt the HS 2022 amendment.

This measure is expected to be revenue neutral and is to be retrospective from 1 January 2022.

Round log duty rates

GoPNG in its bid to establish PNG's credibility in financing for protected areas is proposing to increase the log export duty rate by 20% in addition to the existing 50% introduced in 2020. This is aimed at discouraging the export of unprocessed logs and to encourage downstream processing by 2025. The proposal is expected to generate an additional K30.0m in 2023. GoPNG has earmarked the additional revenue from this proposal to support the newly established biodiversity and climate trust fund created by the United Nations for PNG.

Excise duty on fuel products

The Budget seeks to ease the inflationary pressures on individuals, families, and businesses by extending the temporary exemption of excise duties on diesel, petrol and zoom products purchased by the public at retail outlets. The extension will be for six months from 1 January 2023. The GST exemption will cease on the basis international oil prices have fallen substantially from its peak.

The proposal whilst leading to a reduction in the retail price of these fuel products is estimated to cost GoPNG K150.0m in reduced revenue for the first six months of 2023. This exemption does not apply to sales to specified resource entities, international freight operators and a power producer listed in the Bill to be passed into law.

Alcohol products

In line with GoPNG's priority to combat social and health issues caused by anti-social drinking, GoPNG is imposing an additional one-off increase of 493.0% excise on anti-social drinks (ready to drink). The measure is targeted to high alcohol and mixed drinks and is expected to raise K 30.0m in revenue in 2023. This is expected to come into effect from 1 December 2022 to 31 May 2023 with a 2.5% indexation rate to be applied bi-annually from that time.

The excise rate for mixed drinks of a strength of more than 3% alcohol content, not for medicinal purposes, will be increased to K664.63 per litre of alcohol from 1 December 2022 to 31 May 2023 and will increase to K681.24

per litre of alcohol from 1 June 2023 onwards. For mixed drinks of a strength of more than 3% and not more than 10% alcohol by volume, not for medicinal purposes, the excise rate will be increased to K813.95 per litre of alcohol from 1 December 2022 to 31 May 2023 and increase to K834.30 per litre of alcohol from 1 June 2023 onwards. There seems to be a flaw in the wording for these product tariff codes due to an overlap for products with a 3% to 10% alcohol content so further clarification may be necessary. The excise duty rate will increase by 2.5% at six monthly intervals on 31 May and 30 November each year.

Key Insights

- Customs brokers and importers should be aware of changes to product descriptions and codes as part of the Harmonised System update.
- GoPNG continues to target social and health issues through the increase of excise duties on anti-social drinks such as mixed alcohol drinks.
- GoPNG tries to ease the cost-of-living burden on the public through the extension of the excise duty exemption on certain fuel products.
- GoPNG seeks to establish PNG's credibility in the financing of protected areas with the increase in round log duty rates.

Announced measures not yet enacted

The government has flagged further measures

New policy development areas not yet implemented	
1	The last consultation for the re-write of the Income Tax Act took place in September 2022 at which stage we were advised the new Act would be legislated with the 2023 National Budget but would not be effective until 1 January 2024. This would have given time for further consideration and tax planning. However, no mention was made of the re-write of the Income Tax Act so it remains to be seen when the final Act may be passed.
2	Government is considering a revised dividend policy to increase revenue from State Owned Enterprises due to expenditure pressures on GoPNG. Once finalised the revised dividend policy will be submitted for NEC's deliberation.

Compliance measures announced	
1	The Budget Papers promise a consultation process with the banking sector during the first half of 2023 to discuss whether an alternative tax such as an additional profits tax should apply for 2024.

CFO / Head of Tax checklist

Leaders within finance and tax functions should consider the impact of the following measures as a priority

	Detail	Checklist
1	**New Income Tax Act - 2024** • Although not yet finalised keep a watch on developments with the new Income Tax Act. This new Act will include some key policy changes. Consider, as a priority, any tax planning which may need to be done in advance of its introduction.	☐
2	**Banking sector** • Consider the impact of the 45% tax rate on 2023 budget and profit forecasts. • For banks with substitute accounting periods ascertain whether a split 30%/45% tax rate will apply for FY23. • Ensure Treasury engage the commercial banks in the consultation process for 2023. • If intending to obtain a commercial banking licence, consider whether the 45% tax rate impacts the feasibility of the project.	☐
3	**Vendors of petrol, diesel and zoom** • Plan for the extension of the temporary exemptions of excise duties for the period 1 January to 30 June 2023.	☐
4	**Employers** • Payroll systems should be updated with the new tax exemption thresholds with effect from 1 January 2023. Follow up with payroll provider for the software update.	☐
5	**IRC records** • All taxpayers should bring their tax records up to date in preparation for the move to the new ITAS system.	☐
6	**Importers and customs brokers** • Be aware of the 351 updates to product descriptions and tariff codes to align with the World Customs Organisation Harmonised System 2022.	☐
7	**Vendors of anti-social drinks** • Plan for the increase in excise duty rates.	☐
8	**Logging industry** • Plan for the increase in round log duty rates.	☐

Turning insight into action: How KPMG can help

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