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BSP Rating for 2017

Standard & Poors Global (S&P) in its ratings assessment of the Bank of South Pacific Limited (BSP) released on 30 April 2018, maintained BSP's stand-alone credit profile of 'b+', which is an endorsement of BSP's strong underlying performance. However, as a consequence of S&P's lowering of Papua New Guinea's (PNG) sovereign rating to 'B', BSP's overall credit rating was also lowered to 'B'. S&P's rationale for BSP's overall 'B' rating reflects its view that BSP is exposed to PNG's economic and operating conditions, with S&P's rating for PNG being 'B'.

S&P reiterated that the lowering of BSP's overall rating to 'B' is not a reflection of BSP's underlying performance, but as a consequence of its exposure to PNG (which represents 65% of total operations). S&P's rationale for the lowering of PNG's credit rating was due to existing government debt levels, higher debt service costs, exacerbated by lower than expected revenues and weaker economic growth compared to its peers.

S&P's 2018 review noted the economic risks faced by banks operating in PNG remain high by global standards and based on the lower sovereign rating BSP's rating has been downgraded to align with the PNG sovereign. S&P ratings take into account BSP's dominant market position as the largest commercial and retail bank in PNG. S&P believe that BSP has a number of structural advantages over its competitors, including an extensive distribution model and affinity with customers as PNG's largest domestically owned bank, which positions the Bank to defend its market share as business growth slows in the short term in a response to a slowdown in economic growth following the fall in global energy prices. S&P expects the Bank's profitability to remain strong over the medium term, despite the expectations of slower lending growth.

The PNG government has challenged the lower credit rating with Treasury Secretary Dairi Vele stating that it was misconceived as it was based on "outdated data and failed to comprehend fully the more positive fiscal out turn in 2017 and early 2018". Further, contrary to S&P's assertion the fiscal debt in 2017 of K1.79 billion was lower than the supplementary budget estimate of K1.88 billion and lower than the 2016 level of K3.09 billion. PNG's fiscal deficits are contracting not widening as a percentage of GDP, and the PNG government is on course to achieve its declining debt to GDP trends projected in its

Medium Term Fiscal Strategy. PNG government remains confident that in the medium term there was a high probability that the current trends will continue and a positive re-rating achieved over the next 12 months. Business confidence is increasing and the recommencement of operations by Oil Search and Exxon will ensure higher revenue receipts on top of the improving trend of metal, oil and commodity prices. In addition the World Bank and Asian Development Bank are accelerating plans to provide substantial low interest budget support loans over the three year period amounting to USD600 million. This funding along with the proceeds of the upcoming bond issuance, PNG will be in a position to shift its debt portfolio away from high cost domestic issuance, ameliorate the foreign exchange imbalance and extinguish the payments outstanding to a number of domestic companies that will result in higher economic growth rates and both debt and debt servicing as a percentage of GDP will be placed on a declining trend.

In summary, BSP's overall lower rating ('B') largely reflects the Bank's operating environment. However S&P gave due consideration to the positive aspects, such as BSP's strong domestic market position, extensive distribution model, significant investment in information technology and sustainable profitability to support our stand-alone credit profile rating of 'b+'.