

**FOR  
AGENDA**

SM/06/333

September 29, 2006

To: Members of the Executive Board

From: The Secretary

Subject: **Brunei Darussalam—Staff Report for the 2006 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2006 Article IV consultation with Brunei Darussalam, which is tentatively scheduled for discussion on **Monday, October 16, 2006**. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of Brunei Darussalam indicating that they do not consent to the Fund's publication of this paper.

Questions may be referred to Mr. Nakabayashi (ext. 38918) and Mr. Eskesen (ext. 34033), in APD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Tuesday, October 10, 2006; and to the Islamic Development Bank, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

BRUNEI DARUSSALAM

**Staff Report for the 2006 Article IV Consultation**

Prepared by the Staff Representatives for the 2006 Consultation with Brunei Darussalam

Approved by David T. Coe and Adrienne Cheasty

September 28, 2006

- The 2006 Article IV consultation discussions were held in Bandar Seri Begawan during July 1–13. The team comprised Messrs. Nakabayashi (Head) and Eskesen (both APD), and Mss. Asmundson (APD) and Gobat (MFD).
- Among others, the mission met with Minister of Finance II Abdul Rahman Ibrahim; Permanent Secretaries Ali Apong, Metassan Momin, and Kamis Tamin; and private sector representatives.
- The Fund has supported the authorities' exemplary commitment to prudent fiscal policies in recent years. At the same time, it has urged them to adopt a formalized medium-term fiscal framework and the authorities have now taken some initial steps in this direction, drawing up a Strategic Plan. The authorities have also taken steps to upgrade the regulatory and prudential framework to strengthen financial sector supervision, in line with Fund advice. While the Fund and the authorities have agreed on the importance of diversifying Brunei's economy, given the eventual depletion of natural resources, progress has been slower than hoped. Important improvements in the economic and financial database have been achieved, but it remains weak and data provision is irregular, hindering effective surveillance. Details on last year's Executive Board discussion can be found at <http://www.imf.org/external/np/sec/pn/2005/pn05137.htm>.
- Brunei joined the Fund in October 1995. It has accepted the obligations of Article VIII, Sections 2, 3, and 4. It maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. Brunei has a currency board arrangement with the Brunei dollar exchanged at par with the Singapore dollar.
- The public information notice has been issued since 2003 and the Statistical Appendix was published for the first time last year. However, Brunei has not published any Article IV staff reports.

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## EXECUTIVE SUMMARY

### Current Setting

**Economic growth has been modest in recent years but is expected to strengthen.** Staff projects a pickup in growth from ½ percent in 2005 to around 3¾ percent in 2006, primarily due to a rebound in oil and gas production as capacity is restored. Inflation is expected to remain subdued, partly due to government price controls. The external and fiscal positions are expected to remain strong, reflecting the continued high oil and gas prices. The main risks to the short term outlook stem from a global economic slowdown. GDP growth is projected to average around 2¾-3 percent over the medium term, assuming some productivity growth and further economic diversification.

### Policy Discussions

- **The government's prudent fiscal strategy is exemplary, but there is scope to strengthen fiscal management** to prepare further for the eventual depletion of hydrocarbon reserves. In this context, the mission recommended elaborating the government's Strategic Plan by developing a formal medium-term fiscal framework building on a sustainable savings path, expenditure and revenue reforms, and fiscal rules. Improving the governance framework for the two oil-related funds is another important step to strengthen fiscal management.
- **To support the monetary and financial system, the authorities are rightly focusing on building strong institutions.** The continued commitment to the currency board arrangement remains a key strength of the financial system. While the planned establishment of a new single monetary authority is welcome, the mission stressed the need for careful sequencing and prioritization. The mission commended the steps taken to fortify the financial sector regulatory and supervisory framework, noting that focus should now shift to implementation.
- **Plans to diversify the economy have been high on the agenda for a while, but progress has been slow.** To support the development of the private sector, the government should gradually withdraw from economic activities best carried out by the private sector, reduce administrative obstacles for business start-ups, better align skills with private sector demand, and further study options to increase value added in the energy sector.
- **Welcome steps have been taken to improve Brunei's statistical databases, although incomplete and slow data reporting hampers effective surveillance.** An important improvement was the recent upgrading of National Accounts data, which have been rebased to reference year 2000 and now also cover the expenditure side.

## I. INTRODUCTION

1. **Brunei continues to benefit from high prices for its large oil and gas resources.** The oil and gas sector accounts for around 50 percent of real GDP and generates more than 90 percent of total export earnings and government revenues.<sup>1</sup> The government has adopted a prudent fiscal strategy of saving the windfall from the recent increases in energy prices for future generations. Wealth from oil and gas provides Brunei's small population with a high standard of living, with GDP per capita estimated at US\$25,754 in 2005. However, economic growth has been modest, averaging 2¼ percent annually between 2000–05.
2. **Plans to develop the non-oil private sector have been high on the agenda for a while, but progress has been slow.**<sup>2</sup> Consequently, the non-oil private sector—mostly small and medium-sized enterprises providing approximately 90 percent of private-sector employment—remains dependent on government spending on construction and services.
3. **Important improvements have been made to Brunei's economic and financial statistics, although slow and irregular data reporting hampers effective surveillance.** Improvements include new national accounts data, rebased to 2000, based on new methodology, and now covering also the expenditure side. Moreover, the authorities this year for the first time provided data for a country page for the IFS.
4. **The Sultan, in power since 1967, has full executive authority and has ruled under a state of emergency since 1984.** The recent constitutional amendment to elect one third of the legislature by popular vote presages a gradual transition to a more democratic form of government, although no dates have been set for elections.

## II. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

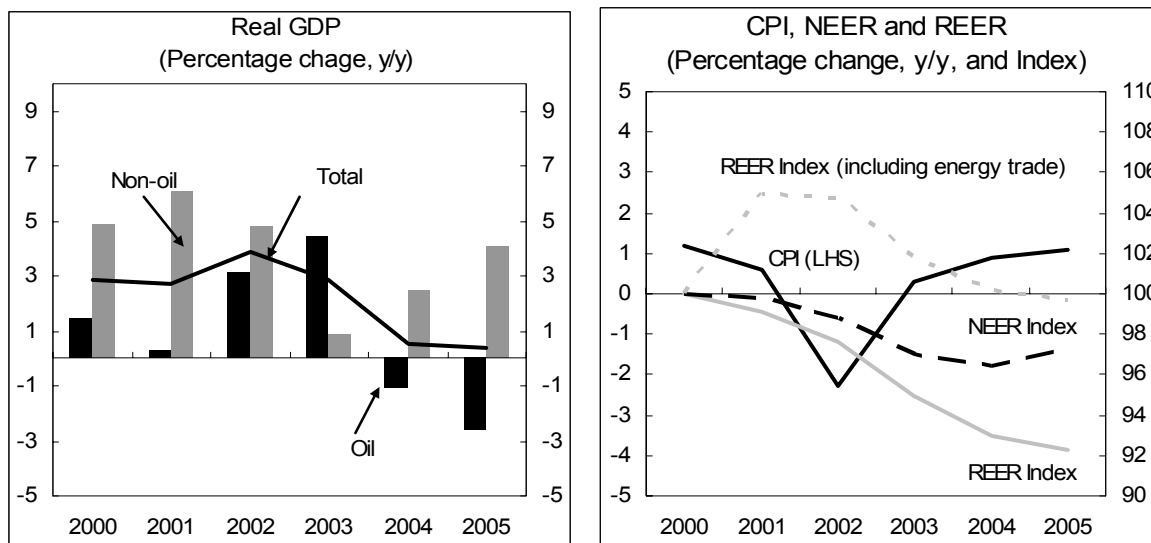
5. **Economic growth remained modest in 2005.** According to new national accounts data, the economy grew by ½ percent (year-on-year) in 2005, largely unchanged from 2004.<sup>3</sup> The modest overall expansion primarily reflected output declines in the oil and gas sector due to repairs and upgrades of production facilities. The private non-oil sector, benefiting from spillovers from higher oil prices, grew by around 4¾ percent year-on-year.

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<sup>1</sup> Brunei Shell Petroleum (BSP) is the major oil and gas producer; the Brunei government and Royal Dutch Shell Group are equal partners in the company.

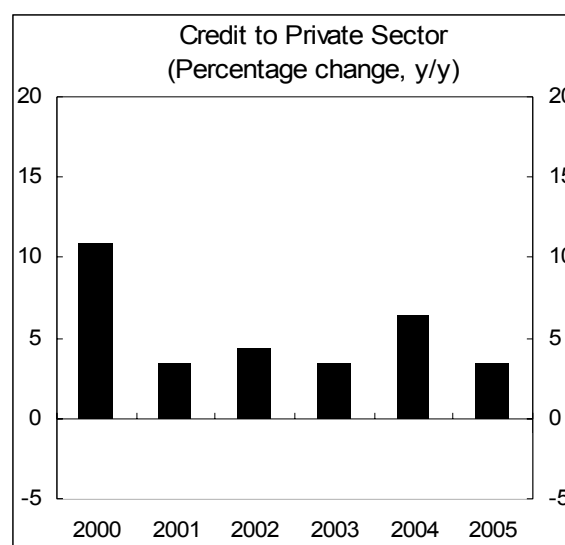
<sup>2</sup> Throughout this paper the term “non-oil” is defined to exclude the oil and gas sector.

<sup>3</sup> The new national accounts data significantly revised upward nominal GDP and changed its composition, with the oil and gas sector now accounting for a much larger share.



6. **Inflation remains subdued, partly reflecting the currency board arrangement that fixes the exchange rate at par with the Singapore dollar.** CPI inflation amounted to 1.1 percent in 2005 compared with an average of 0.9 percent in 2004. However, inflation dropped during the first half of 2006, averaging around  $\frac{1}{4}$  percent over the same period last year. Lower prices on communication, computers, clothing, and food partly offset higher prices on energy-heavy categories such as transport. However, with price controls on fuels, the pass-through of higher energy prices has mostly been indirect and limited. This, together with the channeling abroad of prudent fiscal savings of energy windfall gains, has helped keep domestic inflation low relative to trading partners. The real effective exchange rate (REER) has, consequently, continued to depreciate.<sup>4</sup>

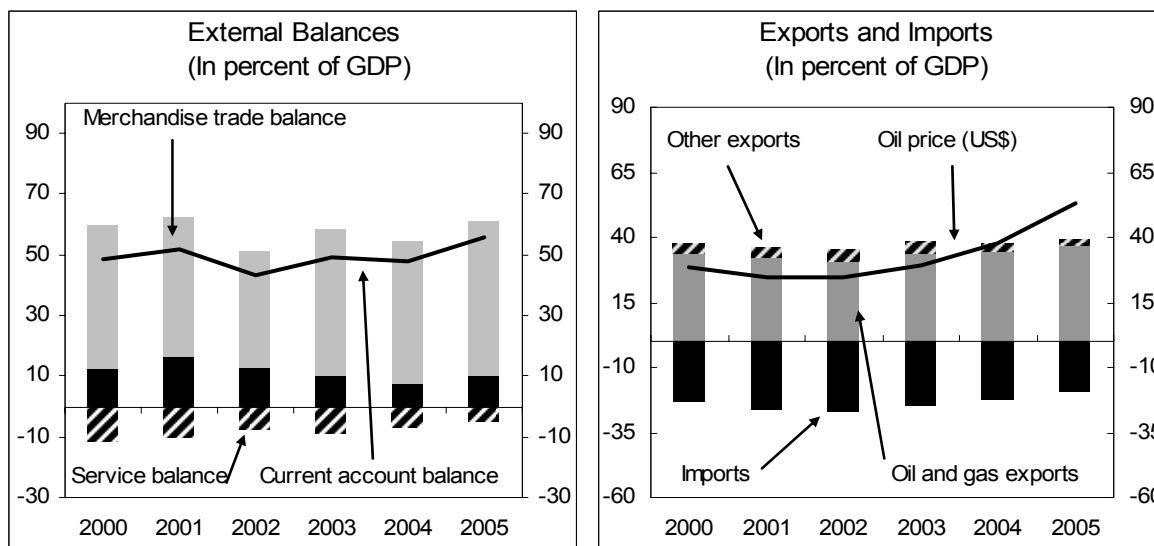
7. **Credit growth slowed in 2005 and asset quality has improved slightly.** Bank claims on the private sector have increased by 3½ percent in 2005, down from 6½ percent in 2004 because of slower growth in personal loans (mostly consumer loans), which account for more than 50 percent of total lending. This partly reflected the welcome introduction by the Ministry of Finance of a directive aimed at slowing personal loan growth, including by capping banks' loan limits for individuals to 12 times gross monthly salaries, limiting the debt service ratio to 22 percent of gross



<sup>4</sup> This is based on the standard practice of excluding energy trade when calculating trade-weighted REERs. Including energy trade, Brunei's REER initially appreciated and then reverted to the 2000 level.

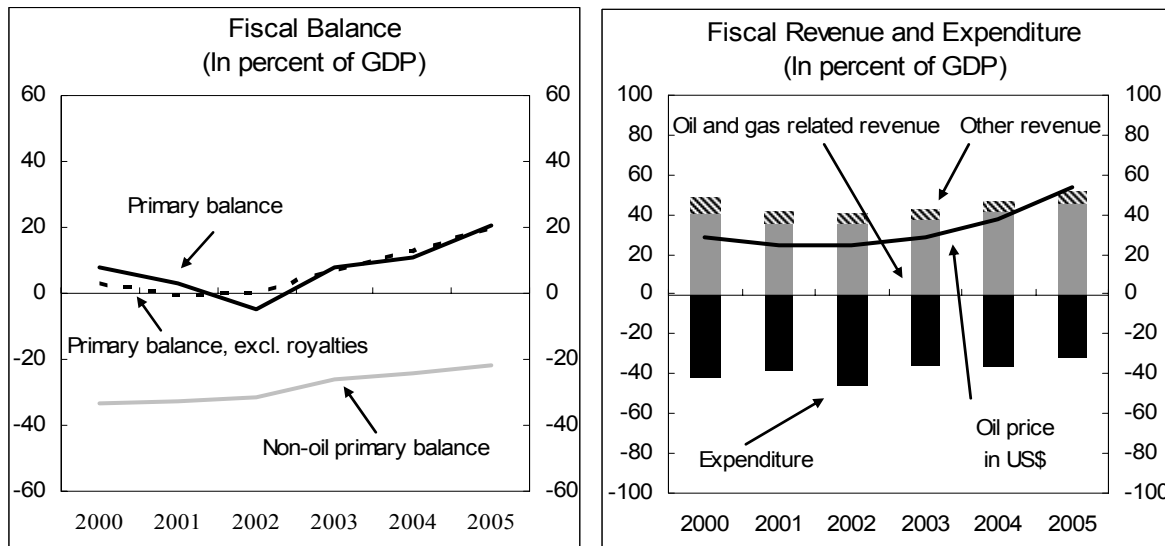
monthly salaries, limiting maturity to 6 years, and containing loan top-ups. Business lending strengthened, driven by the manufacturing, and general commerce and other service sectors. While non-performing loans (NPLs) as a share of total loans dropped to 12 percent at end-2005 from 13 percent at end-2004, they remain high. However, loan loss provisioning is adequate, reaching 93 percent of NPLs in 2005.

8. **On the external front, the massive current account surplus is estimated to have expanded even further in 2005 due to higher energy prices.** Although oil and gas production contracted during the year, nominal exports expanded by around 27 percent reflecting the hike in oil and gas prices. Exports of non-oil goods, however, contracted by around 16 percent (year-on-year) as textile exports dropped significantly following the expiration of the Multi-Fiber Agreement. For the full year, the current account surplus is estimated to have reached 56 percent of GDP compared with 48 percent in 2004. With the bulk of the energy-related income flows being placed abroad in non-reserve assets, gross official reserves have remained relatively stable at 2.2 months of imports (US\$494 million at end-December 2005).



9. **The fiscal surplus for FY 2005/06 was much larger than budgeted due to high energy prices and slow expenditure execution.** Energy-related revenues were in line with staff forecasts, but were more than double the budget projections, which were based on an average oil price of US\$25 per barrel. Moreover, actual expenditures (excluding royalties) were only around 95 percent of the full-year target, primarily due to slow execution of development spending. The primary budget surplus reached 20 percent of GDP compared with a budgeted deficit of around 5 percent and a surplus of 11 percent in FY 2004/05. The non-oil primary deficit dropped by around 2½ percentage points to 21¾ percent of GDP.





10. **The near term outlook is favorable, with oil and gas prices expected to stay at current high levels.** For 2006, the staff projects growth of around 3¾ percent and moderate inflation, despite some indirect pass-through of higher energy prices, as the appreciation of the Brunei dollar and price controls help keep inflation in check. Oil and gas production is projected to rebound in 2006 as capacity is restored. The private non-oil sector is expected to register solid growth, benefiting from a stable economic environment and large energy-related income spillovers. For 2007, the staff projects growth to moderate to around 2¾ percent as the oil and gas sector operate closer to capacity, while the private non-oil sector continues to benefit from high energy prices. The main risks to the short-term outlook stem from a global economic slowdown following a rise in interest rates or a disorderly unwinding of global economic imbalances, a downward correction in oil prices, an avian flu pandemic, or some combination of the three.

11. **The medium- and long-term outlook depends on progress on economic diversification and the fiscal strategy to handle the eventual depletion of hydrocarbon reserves.** GDP growth is expected to average around 2¾–3 percent over the medium term, allowing for further increases in per capita income. This assumes some productivity growth in the oil and gas sector, development of downstream industries, and stepped-up implementation of government development projects. The external position is projected to remain strong over the medium term with oil and gas prices expected to stay at high levels. The ability to maintain Brunei's high living standard depends on the government's fiscal strategy to improve the quality of public spending and handle the eventual depletion of the energy-related revenues. There is upside potential to the medium-term outlook related to the possibility of new hydrocarbon discoveries and a resolution of territorial disputes over oil and gas fields.

### III. POLICY DISCUSSIONS

12. Policy discussions focused on the enhancement of fiscal management in light of volatile oil prices and the eventual depletion of hydrocarbon reserves; monetary and financial sector policies, including the Brunei Currency and Monetary Board (BCMB), the establishment of a single monetary authority, and regulatory and supervisory issues; progress towards diversification of the economy; and the need to continue to improve the collection and dissemination of statistics.

#### A. Fiscal Policies: Strengthening Fiscal Management

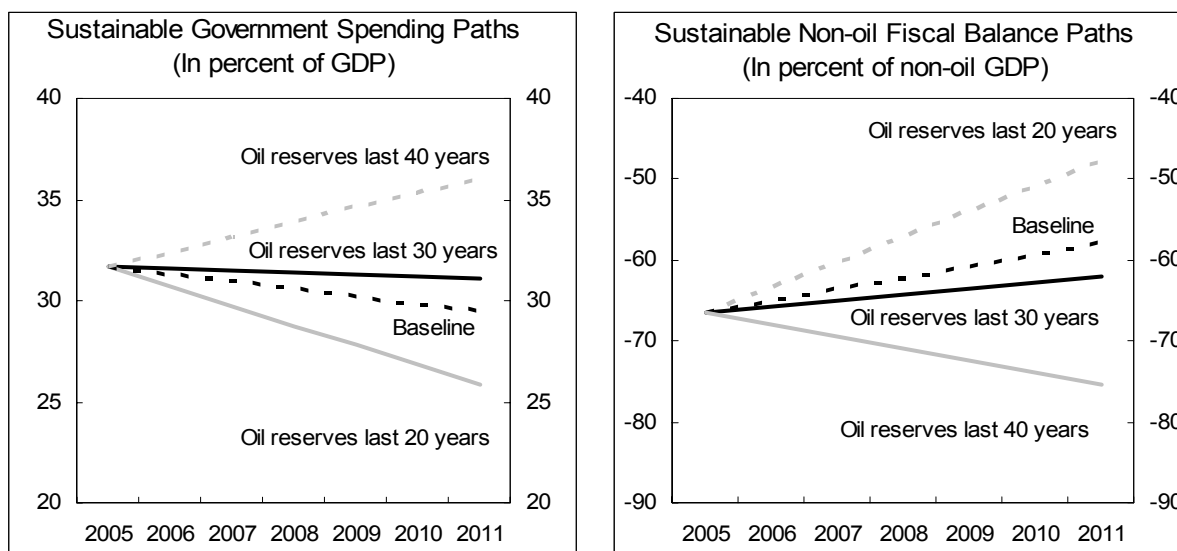
13. **The mission commended the authorities for their prudent fiscal policies in recent years and highlighted the need to strengthen implementation of development projects.**

The FY 2006/07 budget, presented for the first time to the legislative council, is again based on very conservative assumptions about oil and gas prices, suggesting another significant revenue windfall. Given the limited capacity to identify and implement high return programs over the short term, the mission supported the government's intention not to use the windfall for short-term pro-cyclical spending. Rather, the authorities have taken initiatives to step up implementation of economic development spending, which typically has fallen short of the budget allocation. These steps include improved project planning guidelines, better procedures for project site identification and release, and efforts to speed up payment processing. To further advance implementation, the authorities agreed with staff that better integration of the National Development Plan into the budget process and a change to a three-year budgetary framework could be useful. Staff also recommended integrating the extra-budgetary funds into the budget and publishing the consolidated fiscal accounts to improve fiscal planning and transparency.

14. **Despite the comfortable fiscal position, it is important to establish a forward-looking fiscal strategy consistent with long-term sustainability and fiscal priorities.** This is needed to better prepare for the depletion of hydrocarbon reserves, including by saving sufficiently for future generations and supporting economic growth and diversification. In this context, the mission welcomed the Ministry of Finance's recent Strategic Plan, which broadly outlines possible strategies to achieve long-term fiscal sustainability. The next step will be to elaborate on and implement the plan; to do this, the mission recommended the development of a formalized medium-term fiscal framework based on three main building blocks:

- **A medium-term fiscal goal consistent with long-term sustainability.** While staff analyses show that the high level of energy prices have lessened the need for fiscal savings over the medium term, the result is very sensitive to assumptions about long-term prospects for energy production, demographic and productivity trends, the rate

of return on government assets, and other factors.<sup>5, 6</sup> These uncertainties underline the importance of establishing a fiscal goal based on cautious assumptions and regularly updating the sustainability analysis.



- Expenditure and revenue reforms necessary to support economic diversification, strengthen growth, and meet the medium-term fiscal goal.** On the expenditure side, staff encouraged the government to reduce the wage bill by containing wages and reducing staff, partly through natural attrition. It also suggested cutting the generous fringe benefits, extending the defined-contribution pension system to the entire government, and reducing distortionary fuel subsidies. The savings could create room for higher outlays on education, targeted social assistance, and productive capital expenditure needed to support diversification and economic growth. While the authorities agreed with the thrust of the expenditure measures, they said wages had been kept unchanged since 1984 and were only just increased this year in connection with the Sultan's 60<sup>th</sup> birthday. On the revenue side, a gradual broadening of the revenue base is needed over the medium term to prepare for the eventual depletion of energy-related revenues. The authorities concurred that options include broadening the corporate income tax base, introducing a personal income tax and a general sales

<sup>5</sup> Staff's sustainability analyses involve, under different assumptions about key variables, determining a path for government savings over the medium term consistent with a sustainable level of real per capita government spending (in line with the permanent income hypothesis). For further details on the methodology applied, see 2003 Brunei Selected Issues paper (SM/03/114).

<sup>6</sup> Staff's medium-term baseline scenario, presented in text charts and Table 5, assumes that hydrocarbon reserves will last for 30 years. The implied fiscal saving over the medium term in the baseline is larger than strictly needed to achieve the sustainable path. This reflects the need to contain current spending to support diversification and competitiveness, but also some constraints on development spending implementation, despite an assumed strengthening in the capacity to identify and execute these programs.

& service tax, raising utility charges to reflect underlying costs, and strengthening tax administration. However, they stressed that the social and economic impact of such reforms would first have to be carefully assessed.

- **Fiscal rules to help safeguard the medium-term fiscal goal.** Fiscal rules can help insulate policy from popular pressures for additional spending. Such rules should aim to decouple expenditures from the short-run vagaries of oil prices. From a stabilization perspective, the mission proposed a fiscal rule targeting the ratio of the structural non-oil primary balance to non-oil GDP. The size of the permissible balance should be consistent with long-term sustainability. At the same time, the mission noted that a necessary precondition is a sound fiscal framework and that a fiscal rule is only as strong as the political will to abide by it. The authorities noted that they informally follow a rule by formulating the budget based on conservative assumptions about international energy prices, but that they would be interested in looking further into a formal and transparent rule consistent with long term fiscal sustainability.

15. **The authorities' establishment of the two oil-related funds has helped signal the objective of fiscal stabilization and savings.** However, strengthening the framework governing the two funds, the Consolidated Fund (CF) and the General Reserve Fund (GRF), could help further strengthen fiscal management.<sup>7</sup> A formal and explicit definition of their purpose and use, rules-based mechanisms for transfers to and from the funds, and integration of the funds into the budget would improve transparency and accountability and provide a stronger institutional base to build up wealth for future generations. In this context, staff pointed out that it is important to establish a mechanism that ensures an efficient allocation of the fiscal surplus between the two funds, taking into account trade-offs between liquidity risk and financial return. The CF currently holds assets in excess of 50 percent of GDP, mostly in liquid low-yielding assets such as bank deposits. Considering this and the large fiscal surplus expected in coming years, the authorities agreed that there is scope to reallocate funds from the CF to higher-yielding assets placed under the GRF.

## **B. Monetary and Financial Sector Policies: Building Institutions**

16. **The currency board arrangement remains a key element of Brunei's macroeconomic management, contributing to price and financial stability.** To further strengthen the credibility of the Brunei Currency and Monetary Board (BCMB), the mission urged the authorities to publish the audited BCMB accounts for 1999–2001 and finalize the auditing of subsequent years. The mission commended the authorities for maintaining the

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<sup>7</sup> CF is a general purpose fund to which budgetary receivables accrue and from which budget allocations are made. The GRF is a savings fund for future generations managed by the Brunei Investment Agency (BIA), a separate government entity. These funds are discussed in detail in Box 3 of the 2004 Article IV Staff Report (SM/04/161).

foreign exchange coverage around 100 percent, but suggested increasing the minimum statutory coverage from the current 70 percent to 100 percent, in line with international best practice. To build a sufficient excess margin of foreign assets to provide some scope for monetary operations, the authorities and staff agreed that an option would be to raise the reserve ceiling for retained BCMB profits.

**17. The mission supported the plans to establish a new monetary authority by end-2008.** The existing currency board arrangement would be retained, recognizing that it has played a central role in preserving price stability and safeguarding confidence in Brunei's financial system. However, the government plans to carve out all the functions currently residing with the Ministry of Finance that are related to the management of the monetary and financial system. Given a clear mandate, independence, and strengthened supervisory capabilities, the new monetary authority could help promote the stability of the financial system.<sup>8</sup> Staff, however, stressed the need for careful sequencing and prioritization in order to preserve the integrity of the currency board arrangement going ahead and safeguard the financial system more broadly.<sup>9</sup> Staff suggested the initial focus should be on establishing the objective and scope of the new monetary authority, its governance and organizational structure, and the legal framework. The mission supported the broader set of roles envisaged, including providing settlement banking services, setting up government accounts, and developing the capacity for carrying out monetary operations. Before taking on these new roles, the payment system should be modernized, the capacity for monitoring and forecasting liquidity conditions strengthened, and the appropriate instruments for liquidity management developed. Moreover, the mission stressed the need to establish international best practice to govern the role as lender of last resort, including ensuring bank solvency and collateralized support at a penal rate. Finally, the mission cautioned that efforts to promote the off-shore center should be consistent with a strong supervisory framework.

**18. The mission welcomed progress made since last year's consultation in strengthening the supervisory and regulatory framework.** In particular, the enactment of the new Banking, Insurance, and Finance Company Orders brings the regulatory framework closer in line with international standards. The mission also welcomed plans to introduce a credit-registry by end-2006, publish the core financial indicators on a quarterly basis, bring accounting and reporting requirements in line with international standards, and strengthen the AML/CFT framework through the introduction of a Financial Intelligence Unit. Plans to harmonize Islamic banking regulation with conventional banking regulation by end-2006 are encouraging and will help ensure a level playing field. Going forward, the mission stressed

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<sup>8</sup> An MFD TA mission on the establishment of a new monetary authority took place in January 2006 and a follow-up TA mission took place in August 2006, with the latter focusing on establishing a governance structure for the new monetary authority and reviewing regulatory and supervisory standards.

<sup>9</sup> See accompanying Selected Issues paper for further discussion of the authorities' monetary and financial system reforms.

the need to strengthen banking supervision, in particular the capacity to conduct on-site supervision, and enforce the new regulatory framework. In line with MFD TA recommendations, the mission recommended that the onshore and offshore banking supervision divisions within the Ministry of Finance be merged to enhance efficiency. Given the critical role of foreign branches, the mission also encouraged the supervisors to establish formal relationships with the home-country supervisors, noting that this could also help them improve on-site supervision skills.

### C. Structural Policies: Stepping up Diversification

19. **Given the high energy dependence, economic diversification is key to Brunei's medium-term growth prospects.** The various National Development Plans (NDPs) have appropriately aimed to promote diversification and strengthen economic growth. However, economic diversification is a lengthy and difficult undertaking. While the 8<sup>th</sup> NDP, covering 2001–05, presented ambitious goals, progress has been slower than hoped, with only a quarter of the planned allocation actually executed. Looking ahead, the government should focus on key strategies to support diversification and growth of the private sector (Box 1). In particular the government should gradually withdraw from economic activities best carried out by the private sector and strengthen the business environment:

- **Reducing the role of the government in the economy.** This could be achieved through outsourcing, privatizations, and deregulation. In this context, the mission welcomed the corporatization of Telekom Brunei as a first important step. Furthermore, corporatization and privatization could help develop domestic capital markets, complementing the steps already taken by the government through the issuance earlier in the year of Islamic treasury bills. A reduction in government employment and a scaled back civil servant wage and benefit package relative to what is offered in the private sector is key to encourage private sector employment and strengthen competitiveness. Efforts should also be made to scale back price controls, including on utilities, which distort economic decisions and are costly.
- **Reducing the cost of doing business.** This could be done by streamlining procedures for getting a business license and land allocation, and by removing restrictions on foreign ownership of domestic-oriented businesses. Staff welcomed plans to establish a one-stop electronic portal for application of business licenses for domestic and foreign companies.
- **Increasing value-added in the energy sector.** The mission also recommended further study of options to vertically diversify the energy sector by promoting downstream activities, including oil and gas refining. It is, however, important that steps taken in this direction do not impede the development of the private non-oil sector.

### **Box 1. Cross-Country Lessons on Economic Diversification**

**Diversification has long been a priority in Brunei.** Given the country's heavy dependence on hydrocarbon revenues and their eventual depletion, sustaining a high standard of living requires other sources of growth. Possibilities include tourism, finance, transportation, and halal foods. The experiences of other hydrocarbon-dependent countries such as Bahrain and the United Arab Emirates (UAE) offer some lessons for Brunei.

**Bahrain and the UAE have very open and efficient business environments.**

Bahrain has emphasized finance as a source of future growth, while the city states of the UAE have diversified in areas such as petrochemicals and fertilizers, transportation, finance, and tourism. Both countries have low tariff barriers, liberal expatriate employment policies, and low administrative burdens on business. For Bahrain, a prudent regulatory environment, well-developed telecommunications, a highly trained labor force, and an early-mover advantage meant it was able to take advantage of the shift away from Lebanon as a regional financial center beginning in the 1970s. More recently, it has responded well to competition by offering new products, including Islamic financial instruments. For the UAE, a commitment to efficient trading across borders has made it a regional hub for trans-shipment and attracted tourists. This led to a reduction in oil dependency from 90 percent in 1980 to about 50 percent in 2004.

**Although improvements are needed, Brunei is in a good position to diversify.** It has a very stable and safe environment and an educated population. English is widely spoken, and it is close to many dynamic regional economies. Given the examples of Bahrain and the UAE, if the efficiency of the business environment can be improved, there is hope that Brunei can begin to realize more diversified growth.

- **Aligning skills with private sector demand.** The government should strive to better align education and training with the demands of a diversified private sector, including by focusing more on business and IT-related programs and vocational training. While the initiatives to promote employment of native Bruneians are understandable, it is important that these do not impede the efficient allocation of skills.

## **IV. STATISTICAL AND OTHER ISSUES**

20. **Important steps have been taken to improve Brunei's statistical databases, but incomplete and slow data dissemination hampers effective surveillance.** National accounts data have been improved, including by the rebasing to reference year 2000 and the

introduction of the expenditure side. Improvements also include the publication in May 2006 of a Brunei page in IMF's *International Financial Statistics (IFS)*. However, the late dissemination to staff of data on the FY 2006/07 budget, the new national accounts, and the IIP hampered policy discussions during the mission. The mission urged the authorities to address existing data deficiencies and provide data to the IMF on a regular basis, including monthly IFS data as agreed with the STA TA mission in January 2006. Moreover, the authorities were urged to improve public access to economic and financial data, including by creating a central statistics web page.

21. **Staff encouraged the authorities to publish this year's staff report and statistical appendix.** This is important to promote transparency and would also help create awareness among foreign investors about the economy and the government's economic policy agenda.

## V. STAFF APPRAISAL

22. **Economic growth has been modest in recent years but is expected to strengthen.** Staff expects growth to pick up in the near term as capacity utilization in the energy sector is increased and the non-oil sector continues to benefit from a stable macroeconomic environment and high energy-related income flows. The main risks to the short term outlook stem from a global economic slowdown. GDP growth is projected to average around 2<sup>3</sup>/<sub>4</sub>-3 percent over the medium term, assuming some productivity growth in the oil and gas sector, development of downstream industries in the energy-sector, and stepped-up implementation of government development projects.

23. **The government's prudent fiscal strategy is exemplary and has left room to step up implementation of economic development spending.** The intentional saving of energy-related revenue windfalls has helped to stabilize the economic cycle and provide a healthy fiscal cushion. Although there is limited capacity to identify and implement high-return projects over the short term, staff welcome measures to step up implementation of economic development projects already in the pipeline, which will help support domestic demand in a sustainable fashion while avoiding wasteful spending.

24. **Despite the comfortable fiscal position, the authorities need to take steps to further strengthen fiscal management.** This is important to accommodate short-term revenue volatility due to oil and gas price changes and prepare for the depletion of hydrocarbon reserves. In this context, the mission welcomes the Ministry of Finance's recently drawn-up Strategic Plan, which broadly outlines possible strategies to achieve long-term fiscal sustainability. The mission recommends to elaborate the plan through the development of a formalized medium-term fiscal framework based on three main building blocks: (i) a medium-term fiscal goal consistent with long-term sustainability; (ii) detailed revenue and expenditure reforms necessary to meet the fiscal goal and support economic growth and diversification; and (iii) a fiscal rule to help safeguard the medium-term fiscal



goals. Improving the governance framework for the two oil-related funds is another important step towards strengthening fiscal management.

25. **The currency board arrangement remains a key element of Brunei's macroeconomic management, having helped promote price and financial stability.** To further strengthen the credibility of the currency board arrangement, the mission urges the authorities to publish the audited BCMB accounts for 1999–2001 and increase the minimum statutory foreign exchange coverage from the current 70 percent to 100 percent, in line with international best practice and the actual current coverage. To help build a sufficient excess margin, the authorities could raise the reserve ceiling for retained profits.

26. **The mission supports the plans to establish a new monetary authority, but stresses the need for careful sequencing and prioritization.** As initial steps, the focus should be on establishing the objective and scope of the new monetary authority, its governance and organizational structure, and the legal framework. The mission supports a broader set of roles, including providing settlement banking services and carrying out open-market operations. Taking on these new roles, however, should be preceded by modernizing the payment system, strengthening capacity for monitoring and forecasting liquidity conditions, and developing the appropriate instruments for liquidity management. A lender of last resort role should build on international best practice and efforts to promote the off-shore center should be consistent with a strong supervisory framework.

27. **The mission welcomes progress made since last year's consultation in strengthening the supervisory and regulatory framework.** In particular, the enactment of the new Banking, Insurance, and Finance Company Orders brings the regulatory framework closer in line with international standards. Plans to harmonize Islamic banking regulation with conventional banking regulation by end-2006 are encouraging and will help ensure a level playing field. Going forward, the focus should shift to implementing and enforcing the new regulatory framework, including through regular on-site inspections.

28. **Given the high energy dependence, economic diversification is key to Brunei's medium-term growth prospects.** The various NDPs have appropriately aimed to promote diversification and strengthen economic growth. However, progress has been slow. To further diversification going forward, the mission recommends that government gradually withdraw from economic activities best carried out by the private sector, reduce administrative obstacles for business start-ups, better align skills with private sector demand, and further study options to increase the value added in the energy sector.

29. **Important steps have been taken to improve Brunei's statistical databases, although incomplete and slow data reporting hampers effective surveillance.**

30. The staff recommends that the next Article IV consultation with Brunei be held on the standard 12 month cycle.

Table 1. Brunei Darussalam: Selected Economic and Financial Indicators, 2001–07

Area: 5,765 sq. kilometers  
Population (2005): 370,100  
GDP per capita (2005): US\$25754  
Quota: SDR 215.2 million

	2001	2002	2003	2004	2005	Proj. 2006	Proj. 2007
<b>Output and prices</b>							
Nominal GDP (millions of Brunei dollars) 1/	10,035	10,463	11,424	13,306	15,864	18,243	19,242
Real GDP (percentage change) 1/	2.7	3.9	2.9	0.5	0.4	3.8	2.6
Oil sector GDP	0.3	3.2	4.5	-1.0	-2.6	3.3	0.9
Non-oil GDP	6.1	4.8	0.9	2.5	4.1	4.3	4.5
Average oil price (U.S. dollars per barrel) 2/	24.33	24.95	28.89	37.76	53.35	69.20	75.50
Average gas price (U.S. dollars per million BTU) 2/	4.41	4.17	4.54	4.90	6.96	7.45	7.55
Consumer prices (period average, percentage change)	0.6	-2.3	0.3	0.9	1.1	0.5	1.2
(In percent of GDP)							
<b>Public finances 3/</b>							
Total revenue	42.2	40.8	43.2	45.6	51.3	55.5	58.1
Oil and gas	36.1	35.3	37.7	41.7	47.2	51.9	54.0
Other	6.1	5.5	5.4	3.9	4.1	3.6	4.0
Total expenditure	39.0	45.8	35.3	34.5	30.9	29.0	29.0
Current	27.4	36.1	27.5	28.4	24.8	22.1	21.6
Capital	11.6	9.7	7.8	6.2	6.1	6.9	7.4
Primary budget balance	3.2	-5.0	7.9	11.1	20.4	26.5	29.1
Primary balance excluding royalties 4/	-0.7	-0.1	7.4	12.8	20.3	26.4	29.0
Non-oil primary balance	-32.9	-31.8	-26.2	-24.2	-21.8	-20.7	-20.3
(Percentage change)							
<b>Money and banking</b>							
Private sector credit	3.4	4.3	3.4	6.4	3.5	...	...
Narrow money	3.6	9.8	3.0	9.0	1.3	...	...
Broad money	-12.0	1.9	4.0	16.0	-4.5	...	...
(In millions of U.S. dollars, unless otherwise indicated)							
<b>Balance of payments 5/</b>							
Trade balance	2,542	2,193	3,167	3,721	4,836	6,568	7,007
Exports	3,640	3,702	4,421	5,057	6,249	8,087	8,640
Of which: Oil and gas	3,252	3,259	3,876	4,624	5,886	7,691	8,212
Imports	1,099	1,509	1,254	1,336	1,413	1,520	1,633
Services (net)	-580	-460	-594	-530	-494	-503	-502
Income (net) 6/	1,195	1,068	968	890	1,373	1,292	1,465
Current transfers	-273	-317	-290	-309	-376	-392	-413
Current account balance	2,883	2,484	3,252	3,773	5,339	6,964	7,557
Current account balance (percent of GDP)	51.5	42.5	49.6	47.9	56.0	60.7	61.6
<b>Gross official reserves 7/</b>							
In millions of U.S. dollars	391	438	482	505	494	540	576
In months of next year's imports of goods and services	2.0	2.3	2.4	2.4	2.2	2.3	2.3
Foreign exchange cover of currency issued (in percent) 7/	93.8	98.1	102.2	98.2	102.4	102.4	102.4
Brunei dollars per U.S. dollar (period average)	1.79	1.79	1.74	1.69	1.66	1.59	1.57

Sources: Data provided by the Brunei authorities; and Fund staff estimates.

1/ GDP numbers were recently revised to reflect both a new methodology and a new base in 2000.

2/ Based on WEO projections as of August 2006.

3/ Fiscal year changed from a calendar year to April–March in 2004; excludes interest and investment income.

4/ Excludes collection and disbursement of royalties.

5/ Balance of payments data for 2001 onwards were revised after the 2004 Article IV consultation.

6/ Fund staff estimates.

7/ Includes SDR holdings and reserve position in the Fund.

Table 2. Brunei Darussalam: Fiscal Developments, 2001–06/07 1/

	2001	2002	2003	2004/05	2005/06		2006/07	
				Actual	Budget 2/	Outturn	Budget 2/	Staff Proj.
(In millions of Brunei dollars)								
Total revenue	4,232	4,268	4,930	6,361	4,135	8,441	5,206	10,258
Tax	2,306	2,332	2,600	3,666	2,429	5,252	2,966	6,158
Oil and gas	2,125	2,116	2,393	3,439	2,221	4,988	2,750	5,894
Other	181	216	207	227	208	263	216	263
Nontax revenue	1,926	1,936	2,330	2,695	1,707	3,190	2,240	4,101
Oil and gas 3/	1,498	1,582	1,916	2,376	1,430	2,784	1,966	3,695
Other	428	354	414	319	276	406	274	406
Total expenditure	3,914	4,794	4,032	4,815	5,003	5,086	5,200	5,359
Total expenditure excluding royalties	3,914	3,895	3,613	3,935	4,723	4,253	4,880	4,500
Current	2,745	3,777	3,145	3,957	3,460	4,076	3,600	4,089
Wages and salaries	1,286	1,319	1,340	1,415	1,575	1,476	1,577	1,527
Other 4/	1,459	2,458	1,805	2,542	1,885	2,600	2,023	2,561
Capital	1,169	1,017	887	858	1,543	1,010	1,600	1,270
Of which: Development expenditure	210	435	263	356	900	485	900	630
Primary budget balance	318	-526	898	1,545	-868	3,355	6	4,900
Primary balance excluding royalties	-70	-11	843	1,783	-1,023	3,341	-180	4,885
Non-oil primary balance	-3,305	-3,325	-2,992	-3,370	-4,239	-3,584	-4,390	-3,831
Balance including investment income 5/	4,681	-1,079	1,840	2,199		5,929		6,724
Financing from General Reserve Fund	0	0	0	0	0	0	0	0
Financing from Consolidated Fund	-318	526	-898	-1,545	868	-3,355	-6	-4,900
(In percent of GDP)								
Total revenue	42.2	40.8	43.2	45.6	25.1	51.3	28.2	55.5
Tax	23.0	22.3	22.8	26.3	14.8	31.9	16.0	33.3
Oil and gas	21.2	20.2	20.9	24.7	13.5	30.3	14.9	31.9
Other	1.8	2.1	1.8	1.6	1.3	1.6	1.2	1.4
Nontax revenue	19.2	18.5	20.4	19.3	10.4	19.4	12.1	22.2
Oil and gas 3/	14.9	15.1	16.8	17.0	8.7	16.9	10.6	20.0
Other	4.3	3.4	3.6	2.3	1.7	2.5	1.5	2.2
Total expenditure	39.0	45.8	35.3	34.5	30.4	30.9	28.1	29.0
Total expenditure excluding royalties	39.0	37.2	31.6	28.2	28.7	25.8	26.4	24.3
Current	27.4	36.1	27.5	28.4	21.0	24.8	19.5	22.1
Wages and salaries	12.8	12.6	11.7	10.1	9.6	9.0	8.5	8.3
Other 4/	14.5	23.5	15.8	18.2	11.5	15.8	10.9	13.9
Capital	11.6	9.7	7.8	6.2	9.4	6.1	8.7	6.9
Of which: Development expenditure	2.1	4.2	2.3	2.6	5.5	2.9	4.9	3.4
Primary budget balance	3.2	-5.0	7.9	11.1	-5.3	20.4	0.0	26.5
Primary balance excluding royalties	-0.7	-0.1	7.4	12.8	-6.2	20.3	-1.0	26.4
Non-oil primary balance	-32.9	-31.8	-26.2	-24.2	-25.8	-21.8	-23.7	-20.7
In percent of non-oil GDP	-70.6	-67.4	-61.1	-65.7	-78.8	-66.6	-78.0	-68.0
Financing from General Reserve Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing from Consolidated Fund	-3.2	5.0	-7.9	-11.1	5.3	-20.4	0.0	-26.5
Memorandum items:								
Nominal GDP (in millions of Brunei dollars)	10,035	10,463	11,424	13,945	16,459	16,459	18,492	18,492
Non-oil GDP (in millions of Brunei dollars)	4,683	4,931	4,894	5,133	5,382	5,382	5,631	5,631

Sources: Data provided by the Brunei authorities; and Fund staff estimates.

1/ Fiscal year changed from a calendar year to April–March in 2004; excludes interests and investment income.

2/ Based on an oil price assumption of US\$25 per barrel for FY 2005/06 and US\$35 per barrel for FY 2006/07.

3/ Include energy sector royalties and dividends.

4/ Includes disbursements of royalties.

5/ Includes Fund staff estimates of investment income.

Table 3. Brunei Darussalam: Balance of Payments, 2001–07 1/

	2001	2002	2003	2004	2005	Proj. 2006	Proj. 2007
(In millions of U.S. dollars, unless otherwise indicated)							
Current account balance	2,883	2,484	3,252	3,773	5,339	6,964	7,557
In percent of GDP	51.5	42.5	49.6	47.9	56.0	60.7	61.6
Trade balance	2,542	2,193	3,167	3,721	4,836	6,568	7,007
Exports	3,640	3,702	4,421	5,057	6,249	8,087	8,640
Oil and gas	3,252	3,259	3,876	4,624	5,886	7,691	8,212
Other 2/	388	443	545	433	363	396	428
Imports	1,099	1,509	1,254	1,336	1,413	1,520	1,633
Services (net)	-580	-460	-594	-530	-494	-503	-502
Receipts	489	437	435	544	617	656	719
Payments	1,069	897	1,029	1,074	1,111	1,160	1,221
Income (net) 3/	1,195	1,068	968	890	1,373	1,292	1,465
Receipts	1,383	1,243	1,181	1,117	1,563	1,491	1,675
Payments	189	176	213	228	190	199	209
Current transfers (net)	-273	-317	-290	-309	-376	-392	-413
Capital and financial account balance	-1,040	-1,003	-1,431	-2,150	-2,568	-6,918	-7,521
In percent of GDP	-18.6	-17.2	-21.8	-27.3	-26.9	-60.3	-61.3
Capital account balance (net)	-0.8	-0.8	-1.2	-11.3	-11.0	-11.0	-11.0
Financial account balance	-1,039	-1,002	-1,430	-2,139	-2,557	-6,907	-7,510
Direct investment (net)	-63	-232	-122	-152	-167	-133	-137
Portfolio investment (net)	-182	8	60	-45	21	15	17
Other investment (net) 3/ 4/	-794	-778	-1,368	-1,942	-2,410	-6,789	-7,389
Errors and omissions 5/	-1,860	-1,435	-1,777	-1,599	-2,782	0	0
Overall balance	-17	46	44	24	-11	46	36
Gross official reserves 6/	391	438	482	505	494	540	576
In months of next year's imports of goods and services	2.0	2.3	2.4	2.4	2.2	2.3	2.3
Memorandum items:							
Exchange rates							
Brunei dollars per U.S. dollar (period average)	1.79	1.79	1.74	1.69	1.66	1.59	1.57
Brunei dollars per U.S. dollar (end of period)	1.85	1.74	1.70	1.63	1.66	1.58	1.57
Nominal effective exchange rates (2000=100) 7/	99.8	98.8	97.0	96.4	97.2	99.7	...
Real effective exchange rates (2000=100) 7/	99.1	97.6	95.0	92.9	92.3	93.4	...
Nominal GDP (in millions of U.S. dollars)	5,601	5,843	6,557	7,872	9,531	11,482	12,265

Sources: Data provided by the Brunei authorities; and Fund staff estimates and projections.

1/ Balance of payments data for 2001 onwards were revised after the 2004 Article IV consultation.

2/ From 2004, excludes reexports.

3/ Based on Fund staff estimates.

4/ Includes changes in banks' net foreign assets.

5/ The large scale of errors and omissions reflects the lack of comprehensive balance of payments data.

6/ Includes Brunei Currency and Monetary Board's foreign exchange assets, SDR holdings, and reserve position in the Fund.

7/ Period average. 2006 data is average for the first half of the year.

Table 4. Brunei Darussalam: Monetary Developments, 2001–06 1/

	2001	2002	2003	2004	2005				2006	
					Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
(In millions of Brunei dollars; end of period)										
Brunei Currency and Monetary Board (BCMB)										
External assets (net) 2/	706	783	807	810	829	832	812	829	801	808
Foreign exchange holdings	628	621	666	655	657	664	679	722	719	724
Other assets	628	710	680	809	906	881	876	770	751	764
Currency issued	648	655	651	667	702	687	691	705	...	...
Reserve money excl. currency outside banks	494	548	578	696	779	767	768	741	...	...
Other liabilities	298	354	416	403	420	449	431	440	435	441
BCMB net external asset ratio 3/	0.97	0.95	1.02	0.98	0.94	0.97	0.98	1.02	...	...
Banking Survey										
Foreign assets (net)	5,477	5,149	6,115	7,906	8,292	7,706	8,595	8,622	...	...
Net claims on government	-1,806	-1,673	-2,493	-3,517	-3,976	-4,059	-4,574	-4,805	...	...
Claims on nonfinancial public sector	1	6	47	82	79	79	73	71	...	...
Claims on private sector	5,382	5,616	5,808	6,179	6,211	6,360	6,383	6,392	...	...
Capital accounts	798	849	939	957	962	1,008	1,032	1,076	...	...
Other items (net)	451	298	270	101	33	57	-9	45	...	...
Broad money	7,803	7,948	8,264	9,588	9,608	9,019	9,451	9,156	...	...
Money	2,864	3,145	3,239	3,531	3,648	3,571	3,560	3,576	...	...
Of which: Currency outside banks	572	575	554	576	586	585	583	601	...	...
Quasi-money	4,939	4,803	5,025	6,057	5,960	5,448	5,891	5,580	...	...
(Annual percentage change, unless otherwise indicated)										
Banking Survey										
Foreign assets (net)	-11.6	-6.0	18.8	29.3	34.7	17.3	21.9	9.1	...	...
Claims on private sector	3.4	4.3	3.4	6.4	5.8	6.3	4.9	3.5	...	...
Broad money	-12.0	1.9	4.0	16.0	17.6	0.1	1.3	-4.5	...	...
Money	3.6	9.8	3.0	9.0	8.1	5.5	3.8	1.3	...	...
Of which: Currency outside banks	-2.1	0.4	-3.6	4.0	3.7	3.8	3.0	4.4	...	...
Quasi-money	-19.1	-2.8	4.6	20.5	24.3	-3.1	-0.2	-7.9	...	...
Memorandum items:										
Prime lending rate (end of period)	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50
Brunei dollars per U.S. dollar (end of period)	1.85	1.74	1.72	1.63	1.65	1.68	1.69	1.66	1.62	1.59

Source: IMF, *International Financial Statistics*.

1/ Data on monetary aggregates have been subject to significant revisions in the past.

2/ Include reserve position in the Fund and SDR holdings.

3/ Ratio of foreign exchange holding to currency.

Table 5. Brunei Darussalam: Medium-Term Scenario, 2001–11

	2001	2002	2003	2004	2005	Projections					
						2006	2007	2008	2009	2010	2011
Output and prices											
Nominal GDP (millions of Brunei dollars) 1/	10,035	10,463	11,424	13,306	15,864	18,243	19,242	19,353	19,525	19,748	19,957
Real GDP (percentage change) 1/	2.7	3.9	2.9	0.5	0.4	3.8	2.6	3.0	2.9	3.1	3.1
Oil sector GDP 1/	0.3	3.2	4.5	-1.0	-2.6	3.3	0.9	1.5	1.2	1.4	1.4
Non-oil GDP 1/	6.1	4.8	0.9	2.5	4.1	4.3	4.5	4.6	4.8	4.8	4.9
Oil production ('000 barrels/day)	195	203	207	206	201	205	205	205	205	205	205
Natural gas output (mln. cu. ft./day)	1,133	1,143	1,229	1,210	1,181	1,229	1,248	1,279	1,305	1,331	1,357
Average oil price (U.S. dollars per barrel) 2/	24.33	24.95	28.89	37.76	53.35	69.20	75.50	74.25	72.25	70.50	69.25
Average gas price (U.S. dollars per million BTU) 2/	4.41	4.17	4.54	4.90	6.96	7.45	7.55	7.25	7.09	6.92	6.69
Consumer prices (percentage change, period average)	0.6	-2.3	0.3	0.9	1.1	0.5	1.2	1.2	1.2	1.1	1.1
	(In percent of GDP)										
Public finances 3/											
Total revenue	42.2	40.8	43.2	46.2	49.9	53.7	58.5	56.7	54.5	51.4	48.5
Oil and gas	36.1	35.3	37.7	41.6	45.9	50.1	54.6	52.5	50.3	47.3	44.3
Non-oil and gas	6.1	5.5	5.4	4.6	4.0	3.7	4.0	4.2	4.2	4.2	4.2
Total expenditure	39.0	45.8	35.3	36.6	31.6	29.0	28.8	29.4	29.7	29.5	29.4
Current	27.4	36.1	27.5	30.5	25.5	22.4	21.6	21.6	21.5	21.3	21.1
Capital	11.6	9.7	7.8	6.1	6.1	6.6	7.2	7.8	8.2	8.2	8.3
Primary budget balance	3.2	-5.0	7.9	9.6	18.3	24.7	29.7	27.3	24.9	21.9	19.1
Primary balance excluding royalties	-0.7	-0.1	7.4	11.5	18.6	24.7	29.7	27.2	24.8	21.9	19.0
Non-oil primary balance	-32.9	-31.8	-26.2	-25.4	-22.3	-20.7	-20.2	-20.7	-21.1	-21.1	-21.2
In percent of non-oil GDP	-70.6	-67.4	-61.1	-66.7	-66.3	-67.8	-66.4	-64.8	-63.0	-60.4	-57.9
	(In millions of U.S. dollars, unless otherwise indicated)										
Balance of payments											
Trade balance	2,542	2,193	3,167	3,721	4,836	6,568	7,007	6,772	6,508	6,256	5,999
Exports	3,640	3,702	4,421	5,057	6,249	8,087	8,640	8,531	8,404	8,297	8,197
Of which: Oil and gas	3,252	3,259	3,876	4,624	5,886	7,691	8,212	8,071	7,912	7,770	7,634
Imports	1,099	1,509	1,254	1,336	1,413	1,520	1,633	1,759	1,895	2,041	2,197
Services (net)	-580	-460	-594	-530	-494	-503	-502	-500	-497	-491	-483
Income (net) 4/	1,195	1,068	968	890	1,373	1,292	1,465	1,559	1,642	1,732	1,826
Current transfers (net)	-273	-317	-290	-309	-376	-392	-413	-436	-461	-487	-516
Current account balance	2,883	2,484	3,252	3,773	5,339	6,964	7,557	7,394	7,193	7,009	6,827
Current account balance (percent of GDP)	51.5	42.5	49.6	47.9	56.0	60.7	61.6	59.9	57.7	54.8	52.0
Gross official reserves											
In millions of U.S. dollars	391	438	482	505	494	540	576	609	644	691	742
In months of next year's imports of goods and services	2.0	2.3	2.4	2.4	2.2	2.3	2.3	2.2	2.2	2.2	...
Foreign exchange cover of currency issued (in percent)	93.8	98.1	102.2	98.2	102.4	102.4	102.4	102.4	102.4	102.4	102.4
Brunei dollar per U.S. dollar (period average)	1.79	1.79	1.74	1.69	1.66	1.59	1.57	1.57	1.57	1.54	1.52

Sources: Data provided by the Brunei authorities; and Fund staff estimates and projections.

1/ GDP numbers were recently revised to reflect both a new methodology and a new base in 2000.

2/ Based on WEO projections as of August 2006.

3/ On a calendar year basis.

4/ Fund staff estimates.

Table 6. Brunei Darussalam: Indicators of Vulnerability, 2001–05

	2001	2002	2003	2004	2005
<b>Financial Sector Indicators</b>					
Broad money (M3, percent change, y/y)	-12.0	1.9	4.0	16.0	-4.5
Private sector credit (percent change, y/y)	3.4	4.3	3.4	6.4	3.5
Credit to the construction sector (percent change, y/y)	-20.1	-6.6	-0.9	8.2	0.6
Credit to the general commerce sector (percent change, y/y)	5.3	-9.6	-15.9	4.0	5.4
Credit as personal loans (percent change, y/y)	4.2	8.3	10.7	2.8	-1.6
NPL ratio (local banks, percent)	14.5	14.7	13.0	12.5	12.2
Capital adequacy ratio of local banks (percent)		21.90	20.00	18.40	21.70
<b>External indicators</b>					
Current account balance (US\$ billion)	2,883	2,484	3,252	3,773	5,339
(in percent of GDP)	51.5	42.5	49.6	47.9	56.0
Gross official reserves (US\$ billion)	391	438	482	505	494
(in months of next year's imports of goods and services)	2.0	2.3	2.4	2.4	2.2
Real effective exchange rate (period average, 2000=100)	99.1	97.6	95.0	92.9	92.3

Sources: Data provided by the Brunei authorities.

**APPENDIX I: BRUNEI DARUSSALAM—FUND RELATIONS**  
(As of August 31, 2006)

<b>I.</b>	<b>Membership Status:</b>	Joined October 10, 1995; Article VIII	
<b>II.</b>	<b>General Resources Account:</b>	SDR Millions	Percent of Quota
	Quota	215.20	100.00
	Fund holdings of currency	190.83	88.67
	Reserve position in the Fund	24.58	11.42
<b>III.</b>	<b>SDR Department:</b>	SDR Millions	Percent of Allocation
	Holdings	10.94	N/A
<b>IV.</b>	<b>Outstanding Purchases and Loans:</b>	None	
<b>V.</b>	<b>Latest Financial Arrangements:</b>	None	
<b>VI.</b>	<b>Projected Obligations to the Fund:</b>	None	
<b>VII.</b>	<b>Implementation of HIPC Initiative:</b>	Not applicable	
<b>VIII.</b>	<b>Safeguards Assessments:</b>	Not applicable	
<b>IX.</b>	<b>Exchange Arrangements:</b>	The Brunei Currency and Monetary Board maintains the Brunei dollar at par with the Singapore dollar.	
<b>X.</b>	<b>Article IV Consultation:</b>	Brunei is on the 12-month consultation cycle. The Executive Board concluded the 2005 Article IV consultation on July 13, 2005.	
<b>XI.</b>	<b>FSAP Participation:</b>	Not applicable	
<b>XII.</b>	<b>Technical Assistance:</b>	MFD: Establishment of Monetary Authority Follow-up (August 2006) MFD: Establishment of Brunei Darussalam Monetary Authority (January 2006) STA: Monetary and Financial Statistics (January 2006) STA: Balance of Payments Statistics (June 2004) STA: Balance of Payments Statistics (June 2003) STA: Money and Banking Statistics (October 1998) FAD: A Medium-Term Strategy for Fiscal Sustainability (June 1998) MFD: Developing the Financial System (December 1997) STA: Balance of Payments Statistics (May 1996)	
<b>XIII.</b>	<b>Resident Representatives:</b>	None	



## APPENDIX II: BRUNEI DARUSSALAM—STATISTICAL ISSUES

While data provision for surveillance purposes is adequate overall, staff's analysis is affected by major deficiencies in many areas. These include information deficiencies on the government's investment income, limited data on financial sector soundness, and weak statistical coverage of the labor market. In 2004, the authorities began to improve dissemination of data with the country becoming a participant in the GDDS. Following a technical assistance mission in January 2006, a country page for Brunei Darussalam was published in the May 2006 issue of *IFS*. Even though the authorities agreed to report data regularly for publication in *IFS*, very few data have been received since the mission. The principal statistical publications are the *Brunei Economic Bulletin*, first issued in 2002, and the *Brunei Darussalam Statistical Yearbook*. Annual reports of the Brunei Currency and Monetary Board (BCMB) have not been published since 1998.

### National accounts

Annual GDP by industry is prepared by the Economic Planning and Development Department (EPDD) of the Prime Minister's Office, using methods recommended by UN experts. The data have recently been improved and the base year for constant prices was changed from 1974 to 2000. The improvements include a more comprehensive data coverage, use of new data sources, application of better methodologies, and the compilation of the expenditure side. This gave rise to significant revisions to both the level and composition of GDP, in particular with the oil and gas sector now accounting for a much larger share as measured in nominal terms.

### Prices, employment, and wages

A monthly consumer price index with base year 2002 is prepared by the EPDD; expenditure weights are based on a Household Expenditure Survey conducted from October 1997 to September 1998. The basket of goods for the CPI has been divided into 10 major groups since 2002, compared with 5 in 1990.

Data on public sector employment (by grades) and private sector employment (by industry) are available on an annual basis. On private sector employment, the Labor Department of the Ministry of Home Affairs publishes an annual report, including data for employment, wages, and the number of vacancies. More comprehensive data are available from labor force surveys that have taken place at ten-year intervals since 1971. The most recent survey was conducted in 2002. Only limited data are available on wages.

### Government finance statistics

Fiscal data are compiled by the Budget and Tender Division of the Ministry of Finance and published by the EPDD. Fiscal data are deficient in several important respects. First, the

government's investment income has been omitted from revenue since 1986. Second, information on extra-budgetary funds is limited. Third, a breakdown of expenditure data is available only by ministry and a subset of major departments, while no breakdown is available on a functional or economic basis. Fourth, a comprehensive presentation of the public sector accounts is not possible due to the unavailability of financial accounts of the major public sector enterprises. Brunei does not provide fiscal data for publication in either the *Government Finance Statistics Yearbook* or *IFS*.

### **Monetary statistics**

The BCMB prepares its annual balance sheet and monthly trial balance sheet, while the Financial Institutions Division (FID) compiles monthly consolidated balance sheets of nine commercial banks, one trust fund, and three finance companies, based on the monthly call report forms. The presentation of monetary data is highly summarized and does not comply with international standards for the dissemination of key statistical aggregates. Monetary statistics are disseminated on an irregular basis and with a significant lag. The January 2006 monetary and financial statistics mission made recommendations aimed at aligning the sectorization of the domestic economy, classification of financial instruments, basis for recording, reconciliation of the positions of the sub sectors within the financial sector, and the institutional coverage of the depository corporations with the *Monetary and Financial Statistics Manual* and ensuring the regular reporting of monetary data to STA for publication in *IFS*. The mission introduced the standardized form for reporting monetary data for the BCMB. Even though the authorities agreed to report regularly monetary data to STA for publication in *IFS*, only sporadic submissions of data for the BCMB and commercial banks have been received.

### **Balance of payments statistics**

Brunei started to publish balance of payments statistics in 2002, although information for the financial account is limited. The coverage and quality of the balance of payments data have been improved and data are now compiled quarterly. A 2003 STA balance of payments statistics mission recommended that the EPDD begin using a system of direct compilation from major enterprises (including the Brunei Shell Group) monetary statistics, and reports from remittance companies. A preliminary IIP, excluding the foreign assets of the Brunei Investment Agency (BIA), was also constructed. Follow-up technical assistance in June 2004 provided further training in data compilation and refined the methodology for estimating remittances and travel services. A major impediment to the compilation of the balance of payments is the lack of data on the BIA's foreign investments and associated investment income.

**Official international reserves**

It was agreed during the 2003 Article IV consultation mission that official reserves should comprise the foreign exchange assets of the BCMB, as well as Brunei's SDR holdings and reserve position in the Fund. However, foreign exchange assets held by the BIA should not be included in official reserves, since they are not under the direct control of the monetary authorities for balance of payments support.

**International investment position**

The authorities provided to staff during the 2005 Article IV consultation mission and after the 2006 Article IV consultation, orally and on a confidential basis, the value of Brunei's international investment position (IIP), as required under the Articles of Agreement. The 2003 TA mission provided instructions on the mechanics of deriving IIP data.

**Brunei Darussalam: Table of Common Indicators Required for Surveillance**  
(As of September 7, 2006)

	Date of latest observation	Date received	Frequency of Data <sup>6</sup>	Frequency of Reporting <sup>6</sup>	Frequency of publication <sup>6</sup>
Exchange Rates	07/06	08/15/06	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	03/06	04/06	M	I	A
Reserve/Base Money	06/06	09/01/06	M	I	Q
Broad Money	12/05	01/06	M	I	Q
Central Bank Balance Sheet	06/06	09/01/06	M	I	Q
Consolidated Balance Sheet of the Banking System	12/05	01/06	M	I	Q
Interest Rates <sup>2</sup>	12/05	01/06	M	I	Q
Consumer Price Index	12/05	05/06	M	I	Q
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	Q3/05	03/06	Q	I	Q
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government					
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>					
External Current Account Balance	2005	07/06	A	I	A
Exports and Imports of Goods and Services	Q2/05	03/06	Q	I	Q
GDP/GNP	2005	07/06	A	I	A
Gross External Debt					

<sup>1</sup>Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

<sup>2</sup>Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup>Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup>The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup>Including currency and maturity composition.

<sup>6</sup>Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).



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### **Appendix III: IMF Concludes 2006 Article IV Consultation with Brunei Darussalam**

On [October 16, 2006], the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Brunei Darussalam.<sup>1</sup>

#### **Background**

Brunei continues to benefit from high prices for its large energy resources. The oil and gas sector accounts for around 50 percent of real GDP and generates more than 90 percent of total export earnings and government revenues. The government has adopted a prudent fiscal strategy of saving the windfall from the recent increases in energy prices for future generations. Wealth from oil and gas provides Brunei's small population with a high standard of living, with GDP per capita estimated at US\$25,754 in 2005.

Economic growth has been modest in recent years, while the external position has strengthened further. Based on the new national accounts data for 2005, annual economic growth is estimated to have been around ½ percent (year-on-year), largely unchanged from

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the [October, 16, 2006] Executive Board discussion based on the staff report.

2004. The modest overall expansion primarily reflected output declines in the oil and gas sector due to repairs and upgrades of production facilities. The private non-oil sector, benefiting from the spillovers from higher oil prices, grew by around 4¾ percent year-on-year. Inflation has remained subdued, supported by the currency board arrangement fixing the exchange rate at par with the Singapore dollar. Consumer prices rose by about 1 percent in 2005 and ¼ percent during the first half of 2006. Reflecting the high energy prices, the external current account surplus widened substantially to 56 percent of GDP in 2005 from 48 percent in 2004.

Credit growth slowed in 2005 and bank asset quality has improved slightly. Bank claims on the private sector have increased by 3½ percent in 2005, down from 6½ percent in 2004. While lending to businesses strengthened, personal loan growth (mostly consumer loans) slowed, partly resulting from the introduction by the Ministry of Finance of a directive aimed at curbing personal indebtedness. While non-performing loans (NPLs) as a share of total loans dropped to 12 percent at end-2005 from 13 percent at end-2004, they remain high. However, loan loss provisioning is adequate, reaching 93 percent of NPLs in 2005.

The fiscal position has continued to strengthen. The fiscal surplus for FY 2005/06 was much larger than budgeted due to high energy prices and slow expenditure execution. Energy-related revenues were more than double the budget projections, which were based on an average oil price of US\$25 per barrel. Moreover, actual expenditures (excluding royalties) were only around 95 percent of the full-year target, primarily due to slow execution of development spending. The primary budget surplus reached 20 percent of GDP compared with a budgeted deficit of around 5 percent. The FY 2006/07 budget, presented for the first time to the legislative council, is again based on very conservative assumptions about oil and gas prices, suggesting another significant revenue windfall. At the same time, the authorities have taken steps to step up the execution of development spending.

While economic growth has been slow in recent years, it is expected to strengthen. Staff expects growth to pick up in the near term as capacity in the energy sector is restored and the non-oil sector continues to benefit from a stable macroeconomic environment and high energy-related income flows. The main risks to the short-term outlook stem from a global economic slowdown following a rise in interest rates or a disorderly unwinding of global economic imbalances, a downward correction in oil prices, and/or an avian flu pandemic. GDP growth is projected to average around 2¾–3 percent over the medium term, assuming some productivity growth in the oil and gas sector, development of downstream industries in the energy sector, and stepped-up implementation of government development projects. However, new hydrocarbon discoveries and a resolution of territorial disputes over oil and gas fields provide a possible upside to the outlook.

**Executive Board Assessment**

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