

SUR/09/30

March 17, 2009

**The Acting Chair's Summing Up  
Papua New Guinea—2008 Article IV Consultation  
Executive Board Meeting 09/26  
March 16, 2009**

Executive Directors agreed with the thrust of the staff appraisal. They noted that Papua New Guinea was in a relatively favorable position at the onset of the global financial crisis. In particular, they commended the authorities for saving the bulk of recent windfall mineral revenues and repaying public debt to improve the external debt position. Directors noted that, while the banking system has only limited exposure to global financial markets, the deterioration in international economic conditions is having an impact. Owing to the collapse in commodity prices, lower export revenues are worsening both domestic and external balances.

Directors agreed that the current prudent monetary stance is appropriate. Despite the decline in food and energy prices, the authorities are paying due regard to risks that domestic price pressures could prevent a rapid decline in inflation. Given the downside risks to inflation associated with the deteriorating external environment, Directors considered it important to monitor developments closely and to be prepared to ease monetary policy if the domestic impact turns out more negative than expected.

Directors acknowledged the authorities' policy of slowing exchange rate depreciation to moderate inflationary pressures. Nevertheless, and noting the staff's assessment that the kina is mildly overvalued, they were generally of the view that the currency should be allowed to adjust to the sharp decline in commodity prices. This would help offset the impact on export incomes, safeguard foreign currency reserves, and help preserve external stability.

Directors welcomed the new Medium-Term Fiscal Strategy, observing that its full implementation will help maintain macroeconomic stability by reducing the risks associated with volatile mineral revenue. To enhance macroeconomic stability further, Directors encouraged the monetary and fiscal authorities to cooperate so as to ensure that the cyclical position of the economy determines the amount of spending from accumulated windfall revenues. Directors stressed that windfall revenues should be directed toward achieving the Medium-Term Development Strategy objectives and to support growth should the impact of the global slowdown be larger than expected.

Directors agreed that some easing in fiscal policy is warranted in 2009. Given domestic capacity constraints, in particular at the district level where a substantial increase in spending is planned, they nevertheless encouraged the authorities to adopt a less expansionary policy stance than envisaged and to protect the quality of public spending through careful prioritization. This would ensure that public demand does not stimulate inflation, and help maintain the level of public spending at a level consistent with medium-term fiscal sustainability.

Directors noted that the financial sector has been relatively immune to the global financial crisis. The strains in international capital markets are not affecting liquidity because banks are funded primarily via domestic deposits. Given the impact of declining commodity prices on incomes, Directors encouraged the authorities to ensure that banks maintain strict lending standards and carefully monitor debt-servicing abilities and non-performing loans. They supported the authorities' request for an FSAP.

Directors encouraged the authorities to expedite the pace of structural reform. To make progress on development objectives, they pointed to the need to reinvigorate public-sector reform programs in health, education, and law enforcement. Directors stressed that greater transparency of the financial conditions of state-owned enterprises and full transfer of their returns to general government revenue are desirable to ensure that the government has adequate resources to implement the reform agenda.

Given the importance of high quality and timely data for policy making, Directors stressed the need to press ahead with the improvement of economic statistics.

It is expected that the next Article IV consultation with Papua New Guinea will be held on the standard 12-month cycle.