INTERNATIONAL MONETARY FUND
Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 09/44
FOR IMMEDIATE RELEASE
April 3, 2009

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2008 Article IV Consultation with Papua New Guinea

On March 16, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Papua New Guinea.[1]

Background

Macroeconomic performance has improved, but Papua New Guinea remains a poor country highly exposed to commodity price fluctuations. GDP per capita remains low and improvement has lagged other low-income countries in the region. An unattractive investment environment, due primarily to weak infrastructure, problems with and governance, and high crime curtails development.

Real GDP grew by 6.5 percent in 2007, on the back of strong growth in the nonmineral sector. Leading indicators suggest that activity continued to expand rapidly in 2008. After remaining in the low single digits during 2004–07, CPI inflation accelerated in late-2007, reaching nearly 13.5 percent (year-on-year) in September 2008.

In response to rising inflation the Bank of Papua New Guinea (BPNG) has increased the policy interest rate during the second half of 2008. However, monetary conditions remain accommodative as rising inflation has reduced real lending rates. In the last few years, the fiscal balance has been in surplus, with the mineral windfall largely saved and public debt reduced. For 2008, the estimated fiscal surplus is 4½ percent of GDP, down from 8 percent in 2007.

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[1] 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.

To date, spillovers from the global financial market turmoil have been limited. Banks are very liquid and largely isolated from international capital markets. However, the stock market has weakened since its peak in June, in line with other stock markets in the region.
Both the real and nominal effective exchange rates were stable between 2003 and mid-August 2008, but have appreciated since then. Improved terms-of-trade delivered a sequence of current account surpluses that reduced external debt to about 27 percent of GDP at end-2008.

Executive Board Assessment

Executive Directors 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 Financial Sector Assessment Program (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.

Papua New Guinea: Selected Economic Indicators, 2005–09

Nominal GDP (2007): US$6.39 billion
Population (2007): 6.3 million
GDP per capita (2007): US$1,012
Quota: SDR 131.6 million

	2005	2006	2007	2008 Est.	2009 Proj.
Real sector (percent change)					
Real GDP growth	3.6	2.6	6.5	7.0	3.9
Mineral	5.0	-5.9	0.2	4.8	2.6
Nonmineral	3.4	3.8	7.3	7.2	4.1
CPI (annual average)	1.8	2.4	0.9	10.7	8.2
CPI (end-period)	4.7	-0.9	3.2	11.2	5.3
Central government operations (percent of GDP)					
Revenue and grants	34.9	36.7	37.3	32.6	27.1
Expenditure and net lending	31.2	30.0	29.2	28.1	29.1
Overall balance, cash basis (including grants) 1/	3.7	6.7	8.2	4.4	-2.0
Overall balance, cash basis (including grants) 2/	3.8	5.6	7.2	4.4	-2.0
Nonmineral balance 2/	-4.7	-7.6	-6.8	-6.8	-7.2
Money and credit (end-period percentage change)					
Domestic credit	8.6	19.4	5.5	-4.5	15.7
Credit to the private sector	23.7	38.2	34.4	39.4	21.3
Broad money	29.5	38.9	27.8	11.2	17.7
Interest rate (182-day T-bills; period average)	3.8	3.7	4.4	6.0	…
Balance of payments (millions of U.S. dollars)					
Exports, f.o.b.	3,278	4,207	4,750	5,397	4,197
Of which: Mineral	2,467	3,391	3,709	4,104	3,063
Imports, c.i.f.	-2,462	-2,805	-3,331	-3,794	-3,521
Current account (including grants)	205	128	112	228	-546
(In percent of GDP)	4.1	2.3	1.8	2.8	-6.7
Overall balance	315	661	657	5	50
Reserves and external debt (end-period; millions of U.S. dollars)					
Net international reserves	765	1,425	2,083	2,090	2,140
(In months of goods and services imports)	2.4	3.8	4.7	4.3	4.7
Public external debt-service-ratio (percent of exports) 3/	6.0	3.5	4.1	2.5	2.1
Public external debt-to-GDP ratio (in percent) 3/	25.4	21.1	16.7	12.2	14.7
Exchange rates					
US$/kina (period-average)	0.3273	0.3288	0.3416	0.3731	…
US$/kina (end-period)	0.3230	0.3310	0.3618	0.3735	…
NEER (2000=100, end-period)	80.7	78.0	77.7	95.0	…
REER (2000=100, end-period)	104.2	98.0	98.7	135.2	…
Nominal GDP (millions of kina)	15,195	17,132	18,716	22,246	22,362

Sources: Data provided by the Papua New Guinea authorities; and IMF staff estimates and projections.
1/ Measured from above the line in the fiscal accounts.
2/ Measured from below the line in the fiscal accounts.
3/ Includes central government, central bank external debt, and statutory authorities.