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March 13, 2009

**Statement by Mr. Warjiyo and Ms. Matoto on Papua New Guinea
(Preliminary)
Executive Board Meeting 09/26
March 16, 2009**

1. We thank staff for the well-written set of papers and Mr. Legg for his informative buff statement.
2. Papua New Guinea has experienced strong macroeconomic performance in recent years largely attributed to high commodity export revenues. The global crisis has limited impact on the country as the banking system has very few links with the global financial markets, and the sound fiscal and external positions have placed the economy in a better position to weather the turbulence. Nevertheless, the economy's vulnerability to fluctuations in commodity prices poses significant downside risks as external demand continues to weaken and growth is projected to slow down in the near- to medium-term. Implementing the right macroeconomic policy mix, combined with further structural reforms are essential to address the challenges ahead.
3. We commend the authorities for the strong fiscal performance over the last few years, which led to substantial reduction in public debt. Nonetheless, we note that the fiscal balance is projected to deteriorate going forward, turning from surplus to deficit reflecting a large fall in mineral revenues and higher spending. While there is some merit in the expansionary fiscal stance in view of the deteriorating external environment, we support staff's recommendation for targeting a balanced budget in 2009 to maintain fiscal and debt sustainability while containing inflation. In that context, spending should be restrained and prioritized while safeguarding accumulated mineral windfall which should be used effectively to improve infrastructure and address development needs to support sustainable growth. We welcome the commitment to the refined MTFS to help strengthen the fiscal framework, given the volatility of mineral revenues. Having said that, we encourage the authorities to press forward with the tax reform to help reduce reliance on mineral revenues in the budget. Like staff, we believe that the prospective LNG project will support economic development, provided that the returns are used effectively to address development needs.

4. The current monetary policy stance has been broadly appropriate in response to high food and energy prices, and strong credit growth and liquidity. In light of the heightened global uncertainty, it is critical that the authorities strike the right balance between the need to bring down inflation and sustain growth. Consolidating government's trust accounts at the Bank of PNG is a step in the right direction to ease credit growth, mop up excess liquidity from the system and reduce domestic demand pressures. In relation to exchange rates, we are reassured by Mr. Legg that the authorities are carefully considering the need to allow the kina to adjust in response to commodity price movements. Given the importance of imported inflation in the consumer basket, leaning against the wind could prove to be an effective means of controlling inflation.

5. Papua New Guinea is fortunate that the financial system has been relatively unaffected by the global financial crisis. However, given the current global economic downturn, the lower commodity export incomes could increase nonperforming loans. In this regard, we share staff's view on the need for the banks to maintain strict lending standards and monitor borrowers' servicing abilities carefully.

6. Turning to the reform agenda, we believe that expediting appropriate structural reforms will help achieve the development objectives and sustain long-term growth. In this connection, we support staff call to improve the transparency of the financial conditions of state-owned enterprises as well as the investment climate to support private sector development. *Could staff elaborate on the status of privatizing the state-owned enterprises?*

7. Lastly, we encourage the authorities to resolve the impasse on improving the quality and timeliness of macroeconomic data to improve policy decision making.

8. With these remarks, we wish the authorities every success in their future endeavors.