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GRAY/09/969

March 13, 2009

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

We thank staff for a set of well-written papers and Mr. Legg for his very helpful statement.

Following two years of strong performance, the growth prospects for Papua New Guinea (PNG) will be affected by the global economic downturn, mainly through lower export revenues as result of the collapse in commodity prices. Nonetheless, the expected coming on stream of a sizable LNG project could boost confidence and cushion against the risk of further deterioration in the terms of trade. The key issue going forward is to effectively manage the mineral wealth to support growth and macroeconomic stability. We broadly agree with staff appraisal and policy recommendations.

We commend the authorities for their prudent fiscal performance. Largely-saved mineral revenues in recent years have provided a cushion to the country to support growth and manage the volatility of mineral revenues. Adoption of the new Medium-Term Fiscal Strategy governing the use of mineral revenues, including in new development spending, is welcome. As recommended by staff, and underscored by Mr. Legg, efficiency of such spending should be carefully assessed, and administrative and capacity constraints addressed.

We agree that the expansionary fiscal stance for 2009 is appropriate and, like staff, we caution against over-stimulating domestic demand while inflation is still relatively high. This is especially important given the weak capacity and the shortcomings in oversight and accountability mechanisms. *In this regard, we would appreciate staff clarification regarding the 170 percent increase in the minimum wage and its implications.*

The external debt position has been significantly improved by early repayments, and the DSA indicates a moderate risk of debt distress. However, the magnitude of overall public debt, including all direct and indirect obligations of the public sector, and the deteriorating terms of trade call for caution. We agree with the authorities that slowing exchange rate adjustment is important for anchoring inflation expectations, while safeguarding official reserves.

We note that the banking system has not been affected by the global financial crisis, and banks remain relatively immune to the tight global capital markets, given that they are primarily funded by local deposits and hold highly liquid assets. Non-performing loans continue to decline and stand at a very low level, backed by strong provisioning. Nonetheless, we agree with staff that asset quality could potentially deteriorate as a result of declining commodity export prices and the weakening of debt repayment capacity. We encourage the authorities to address these issues as well as financial sector development needs, and we welcome their interest in participating in an FSAP, as indicated by Mr. Legg.

Structural reforms should aim at enhancing human capital, institutional capacity, infrastructure development, and a diversified economic base, in line with the Medium-Term Development Strategy update. We agree that priority areas should include utilities and transportation system, public service delivery, and private investment climate. Addressing the shortcomings in the quality and timeliness of macroeconomic data is necessary for enhancing economic policy formulation and implementation.

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