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PAPUA NEW GUINEA

November 2015

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PAPUA NEW GUINEA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with Papua New Guinea, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its October 30, 2015 consideration of the staff report that concluded the Article IV consultation with Papua New Guinea.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on October 30, 2015, following discussions that ended on August 21, 2015 with the officials of Papua New Guinea on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 8, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Papua New Guinea.

The documents listed below has been separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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IMF Executive Board Concludes 2015 Article IV Consultation with Papua New Guinea

On October 30, the Executive Board of the International Monetary Fund (IMF) concluded the 2015 Article IV consultation[1] with Papua New Guinea.

Papua New Guinea is facing strong headwinds from lower global commodity prices. While the commencement of liquefied natural gas (LNG) production has boosted overall GDP growth in 2014–15, the slow growth of the non-resource sector calls for a renewed policy focus on inclusive growth in the post-LNG construction period. Falling commodity prices and temporary suspension of a large mining operation have lowered government revenue prospects substantially, reducing the country's fiscal space and leading to an increase in government debt, which is likely to exceed the legislated targets in 2015.

With LNG production and exports now coming on stream, resource sector growth is projected to expand strongly in 2015 but spillovers to the rest of the economy may be limited. Inflation remains contained, as the effects of the kina depreciation are offset by lower oil and commodity prices. Meanwhile, the current account balance is expected to turn into a surplus as the LNG plant has its first full year of operation. Nevertheless, lower commodity prices and a reduction in LNG project-related capital inflows have led to depreciation pressure on the kina since mid-2013. In early June 2014, the Bank of Papua New Guinea (BPNG) introduced measures to require authorized dealers to transact with their customers within a trading band of 150 basis

[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.

points around the official (interbank) exchange rate. This move caused a large *de facto* currency appreciation. Since then, the kina has depreciated vis-à-vis the U.S. dollar.

Risks to the outlook are increasingly skewed to the downside. Fiscal consolidation necessitated by weaker-than-anticipated revenue performance will dampen non-resource growth over the short run, and a weak global economy could further dampen external demand and commodity prices. Over the longer term, LNG developments in Australia and shale gas developments around the world could continue to put downward pressure on LNG prices and government revenue. Global financial market instability could also affect prospects for external commercial financing or foreign direct investment. Upside risks include the potential for a second LNG project, further mineral resource development, and scope for increasing trade with Asia.

Executive Board Assessment[2]

Executive Directors commended the authorities for achieving impressive economic growth in recent years. While growth remains robust this year, the sharp drop in commodity prices and slowing growth in non-resource sectors has adversely affected fiscal and external sector performance and poses challenges going forward. Against this background, Directors stressed the need to maintain prudent macroeconomic policies to ensure debt sustainability and safeguard the external position. They also encouraged prompt implementation of structural reforms to diversify the economy, boost growth potential, and promote inclusiveness in the longer run.

Directors agreed that strong fiscal consolidation is needed to keep the government debt-to-GDP ratio on a downward trajectory over the medium term, while safeguarding key social outlays. They stressed the importance of strengthening expenditure prioritization and public financial management, as well as developing a medium-term debt management strategy. Directors also welcomed the government's efforts to set up a Sovereign Wealth Fund and supported their plans to make the fund operational soon. They emphasized the need to channel resource revenues from the fund through the budget to ensure transparency and accountability.

[2] 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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors called for greater exchange rate flexibility, and generally saw scope for further depreciation, to safeguard external buffers and eliminate imbalances in the foreign exchange market, supported by appropriately tight fiscal and monetary policies. They agreed that the exchange rate should be allowed to move more quickly to a market-clearing rate, and that the authorities should mop up excess liquidity to strengthen monetary policy effectiveness.

Directors underscored the importance of decisive implementation of structural reforms to boost medium-term growth prospects. Priorities include improving infrastructure and law and order, investing in health and education, strengthening the agricultural and small- and medium-size enterprise sectors and their access to finance, increasing competition in the banking sector, and reducing business costs. It will also be important to accelerate the reform of state-owned enterprises. Directors welcomed the progress made on anti-money laundering and combating the financing of terrorism (AML/CFT) legislation and encouraged its timely implementation.

Directors welcomed the recent progress to improve statistics, and called for further efforts to enhance institutional capacity.