INTERNATIONAL MONETARY FUND

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PAPUA NEW GUINEA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

December 2013

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 2013 Article IV consultation with Papua New Guinea, the following documents have been released and are included in this package:

- The **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF for the Executive Board's consideration on November 11, 2013, following discussions that ended on September 3, 2013, 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 24, 2013.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its November 11, 2013 consideration of the staff report that concluded the Article IV consultation with Papua New Guinea.
- A **Statement by the Executive Director** for Papua New Guinea.

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

October 24, 2013

KEY ISSUES

Context. After a decade of strong growth, Papua New Guinea (PNG) now faces a sharp slowdown in the nonmineral sector as construction winds down on a large liquefied natural gas (LNG) project. LNG revenue increases are expected to be modest and one-off over the near to medium term, posing challenges to meet the country's huge development needs while trying to maintain debt sustainability. PNG needs to create an enabling environment for sustained, inclusive growth in the post-boom era.

Outlook and risks. Overall growth prospects remain generally positive, but the slowdown of the nonmineral sector has increased headwinds for job-creating growth. Inflation is expected to stabilize at lower levels than in the recent past. Risks to economic growth in 2013-15 are broadly balanced, but they are increasingly tilted toward the downside over the longer term, reflecting uncertainty over mineral prices and investment and global shale gas development.

Policy assessment. Policy discussions focused on resource revenue management, macroeconomic and financial stability, and structural reforms to engender sustained, inclusive growth. Key recommendations include:

- Target a moderate fiscal deficit in 2014 in line with absorptive capacity and focus on improvement in spending quality. Over the medium term, constrain and smooth spending to stay below the government's debt ceiling of 30 percent of GDP.
- Strengthen the interest rate channel of monetary policy transmission by reducing excess liquidity. Closely monitor financial sector risks arising from possible price corrections in certain segments of the property market.
- Improve transparency in the management of resource revenue; safeguard resources for the sovereign wealth fund; continue to reform public enterprises; improve the business environment; and strengthen the agricultural sector.
- Take early action to address long-standing issues on economic statistics and anti-money laundering and combating the financing of terrorism.

Approved By
David Cowen (APD) and Ranil Salgado (SPR)

Discussions took place in Port Moresby during August 20–September 3, 2013. The team comprised Mr. Yang (Head and resident representative), Mses. Hunter, Rauqeuqe, Messrs. Oh, Wu (all APD), Bulman (World Bank), and Batten (ADB). Ms. Luu (OED) participated in the discussions.

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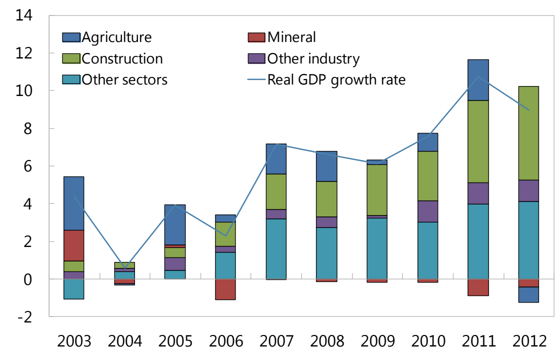
BACKGROUND AND OUTLOOK

While the expected commencement of LNG production next year will bring increases in mineral output and fiscal revenues over the near to medium term, the slowdown of the nonmineral sector as a result of the ending of project construction makes it more challenging to engender inclusive growth

1. **Over the past decade, Papua New Guinea (PNG) has achieved strong economic growth, supported by high commodity prices, large mineral investment inflows, sound macroeconomic policies, and a healthy banking sector.** Real GDP growth averaged 6 percent per year over the period 2003-12 (Table 1; Figure 1).[1] With the commencement of the construction of a large-scale liquefied natural gas (LNG) project in 2010,[2] average annual growth has since increased to nearly 9 percent. However, economic activity is projected to slow significantly in 2013, as nonmineral sector growth decelerates sharply with the growth-intensive construction phase of the LNG project drawing to a close.

Contribution to GDP Growth
(In Percent)



Sources: PNG authorities; and IMF staff calculations.

2. **Inflation eased sharply in 2012, but has rebounded steadily since the beginning of 2013**. Measured by the official consumer price index (CPI),[3] inflation (annual average) was about 2 percent in 2012, falling from almost 8½ percent in 2011, owing to moderating food prices, lagged pass-through of the kina appreciation in 2011, expanded tuition fee subsidies, and import tariff reductions. As the effects of these one-off factors faded out, inflation rose to 2.8 percent in the first quarter of 2013 and 3.2 percent in the second quarter, and is expected to reach an average of 4 percent for the year as a whole largely due to pass-through effects from kina depreciation.

3. **The current account deficit is expected to narrow sharply in 2013 as imports and income outflows decline with construction winding down on the LNG project** (Tables 3 and 5; Figure 4). Capital inflows (mostly in the form of foreign direct investment and medium-long term loans) associated with the project are also expected to decline over the next two years. Large capital inflows over the past three years and the expected revenue associated with the project have led the real effective exchange rate (REER) to appreciate by around 30 percent over the past three years.

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[1] PNG's national accounts estimates suffer from an outdated base year (1998) and poor source data. In addition, the current estimation methodology is inadequate in capturing the rapid structural change of the economy. The authorities plan to introduce a new estimation methodology for the 2014 Article IV consultation.

[2] The project, operated by a subsidiary of ExxonMobil, is expected to produce LNG for about 20 years beginning in the second half of 2014. Total investment amounts to US$19 billion, equivalent to 120 percent of PNG's 2012 GDP.

[3] PNG's official CPI tends to understate true inflation as a result of an outdated base year and data weaknesses.

The Bank of Papua New Guinea's (BPNG) foreign reserves were equivalent to 4½ months of imports at the end of 2012, and are expected to decline to about 4 months of imports by the end of 2013 before an expected large rebound in 2014 when LNG exports commence.

4. **Despite the strong growth performance, PNG faces daunting development challenges.** The country still lags far behind most of its peers in the region in key infrastructure services, mainly transportation, electricity, and water supply. Basic education and health services are undersupplied, with key health and education indicators well below Pacific island country averages (Box 1). PNG considered that the global Millennium Development Goals (MDGs) would not be achievable and hence set its own national targets, which correspond to the first seven global MDGs. Of these national targets, two are on track and three are off track, with mixed results for the remaining two (Table 8).

Logistics Performance Index Rankings (of 184 countries)

Country	Overall Rank	Infrastructure
Papua New Guinea	155	155
Solomon Islands	152	166
Fiji	148	150
Indonesia	67	101
Vietnam	62	84
Phillippines	60	70
Malaysia	33	32

Source: World Bank, 2012.

Staff's Views

5. **PNG's overall growth prospects remain generally positive, but a change in the composition of growth sources will pose significant challenges for inclusive growth**. With the winding down of LNG project construction, economic activity is expected to slow to about 5½ percent in 2013 (Table 5). It is projected to rise to about 6⅓ percent in 2014 and surge to 21½ percent in 2015 as LNG production peaks, but slow to around 3½ percent over the medium term as the nonmineral sector converges to its potential growth of around 4½ percent while output growth in mature mines continues to slow. Headline inflation is likely to rise somewhat in the short run, but underlying price pressures should be moderate with slowing domestic demand. Over the medium term, inflation is expected to stabilize at levels slightly above the BPNG's reference value of 5 percent[4]—barring any major increases in global food and fuel prices.

6. **Risks to economic growth in 2013-15 are broadly balanced, but they are increasingly tilted toward the downside over the longer term** (see the Risk Assessment Matrix in Appendix I). The continued high level of government spending planned for 2014 will offset part of slowing domestic demand as LNG project construction-related activities wind down. Risks of delays in the completion of the LNG project have diminished significantly as it enters the final stage of construction. However, a weak global economy could further dampen external demand and commodity prices. Over the longer term, shale gas development around the world could reduce LNG prices, exerting pressure on government revenue, export earnings, and the kina. Lower LNG and mineral prices, together with uncertainty surrounding the ending of quantitative easing in advanced economies, may also reduce future inflows of foreign direct investment.

[4] The inflation reference value is not a formal inflation target, as the BPNG does not have an inflation-targeting regime.

Box 1. Trends in Living Standards in Papua New Guinea

The recently released 2009-10 PNG Household Income Expenditure Survey (HIES) data indicate that 40 percent of Papua New Guineans consumed less than a minimum basket of food and other goods and services in 2010. This basket, which includes both items households purchase and those they produce themselves, is the sum of the costs of attaining a minimum number of daily calories (2200 per day for each adult-equivalent) based on prevailing local diets and food prices, plus an allowance for the purchase of essential nonfood items.

Other measures of welfare corroborate this analysis. For example, more than 40 percent of children under five years of age suffer from moderate to severe chronic undernutrition. Life expectancy at birth is 63 years, considerably below the Pacific islands[1] average of 70 years; the infant mortality rate is 48 per thousand compared to a regional average of 26.5;[2] and the maternal mortality ratio is very high at 230 per 100,000 live births. PNG's composite Human Development Index (HDI) was 0.462 in 2011, placing it 153 out of 187 countries and among the least developed. Food poverty rates—the share of households consuming less than the value of 2200 calories of moderate nutritional quality—are estimated at nearly one-quarter of the population nationally.

The share of the population in poverty varies considerably across regions. Poverty is significantly more prevalent in rural areas of PNG. Poverty rates range from 24 percent in the Southern region (outside of the National Capital District—NCD) and 27 percent in urban Momase to 46 percent in rural Momase and 45 percent in the New Guinea Islands. Reflecting their greater populations, the Highlands and rural Momase account for more than two-thirds of all the poor. Only 8.5 percent of PNG's poor population lives in urban areas, and these households appear to be only just below the poverty line, unlike rural Momase in particular where poor households report very low consumption levels.

Average living standards changed little between 1996 and 2010 for most Papua New Guineans. Material poverty rates were not statistically significantly different between the two survey years, either nationally or in any region apart from the NCD, where it rose from 31 percent of the population in 1996 to 42 percent in 2010. Other indicators also generally corroborate this finding. For example, child malnutrition rates were also little different between 1996 and 2010. In contrast, the HDI improved modestly, from 0.405 in 1995 to 0.458 in 2010.

Comparing the 2010 and 1996 snapshots of living standards is likely to mask significant changes over this fifteen-year period. Macroeconomic conditions deteriorated significantly between the early 1990s and the early 2000s, before PNG entered a decade of strong growth, and these trends are likely to have brought worsening living standards and rising poverty rates until the low-point around 2002, and improvements in subsequent years. Using GDP growth and inflation data, the World Bank simulated the poverty rate to have risen from near 40 percent in 1996 to at least 50 percent in the early 2000s, before returning to 40 percent at the time of the 2010 survey. Consistent with this pattern, formal sector employment declined by 2.8 percent between 1996 and 2002 before rising by 46 percent between 2002 and 2010 (and a further 14 percent between 2010 and 2012), while nominal kina cash crop export receipts rose by 88 percent between 1996 and 2002 but by 173 percent between 2002 and 2010.

1/ Include Cook Islands, Fiji, Kiribati, Marshall Islands, Federated States of Micronesia, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.

2/ Average of Fiji, Kiribati, Palau, Papua New Guinea, Samoa, and Vanuatu.

Source: Compiled by World Bank staff, drawing on an analysis prepared by John Gibson.

Authorities' Views

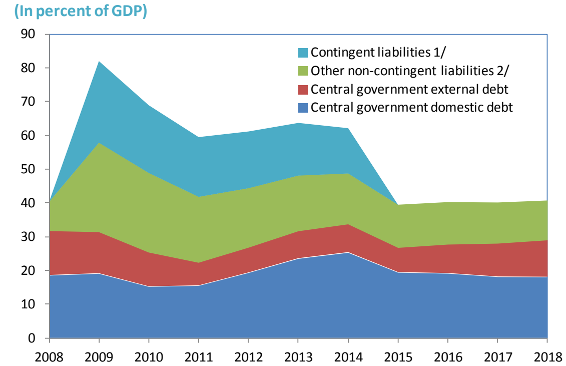
7. **The authorities broadly agreed with staff's assessment of the economic outlook and inflation.** Their growth outlook in 2013 is aligned with staff's view, revised up from the 4 percent projected in the 2013 budget to reflect the rebound in the mining and quarrying sector and longer-than-expected LNG project construction phase. The authorities recognized the risks posed by the external environment, but noted mitigating factors, including the LNG project's long-term supply contracts, which link the LNG sales price to oil prices. The BPNG agreed that inflation is likely to rise over the course of 2013 and noted that a weakening kina is the main source of inflationary pressure.

PRESERVING FISCAL SPACE AND IMPROVING SPENDING EFFICIENCY

In light of the weaker revenue prospects and recent spending increases, a moderate fiscal deficit in 2014 and a gradual reduction in real per capita spending over the medium term are needed to stay below the government's debt ceilings. Improvement in spending quality should be a key policy focus.

8. **Following a fiscal expansion in 2012, the government has further loosened its policy stance in 2013.** The budget slipped into a deficit of 3.3 percent of GDP in 2012 as a result of lower-than-expected commodity-related tax revenues and election-related spending. To counter the expected slowdown in nonmineral sector growth and deliver quicker development outcomes, the government adopted an expansionary fiscal stance for 2013, with a targeted fiscal deficit of 7.3 percent of GDP. Government expenditure is budgeted to increase by nearly 25 percent to target the so-called "development enablers" as identified in the 2013-17 Medium-Term Development Plan (Box 2). The 2013 Budget also featured a strong move to devolve spending, with an increasing share of it carried out at subnational levels (provinces, districts, and local governments).

Public debt and liabilities
(In percent of GDP)



Sources: PNG authorities; Asian Development Bank; and IMF staff calculations.
1/ Government completion guarantee for LNG project.
2/ Superannuation arrears and loan for underwriting LNG equity share.

9. **With the fiscal expansion of the past two years and lower commodity prices, PNG's fiscal space has been reduced significantly.** Gross central government debt, which had fallen to about 22 percent of GDP in 2011, rebounded to around 27 percent in 2012 and is expected to surpass 31 percent in 2013 (Table 2). Taking into account arrears to superannuation funds[5] and the financing of the government's LNG equity stake through a loan from a state-owned

[5] These funds are private pension funds managing contributions from employees and employers (including the government). Seven funds are currently in operation and their total assets at the end of March 2013 were 7.8 billion kina, accounting for 22 percent of total financial sector assets.

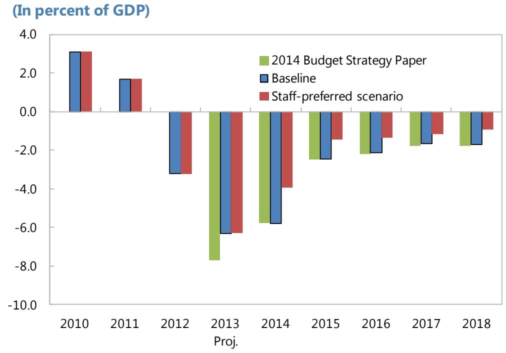
enterprise (SOE), gross public debt and non-contingent liabilities are expected to amount to about 50 percent of GDP at end 2013. Main contingent liabilities are the LNG project completion guarantee of 15 percent of GDP (ending effectively by 2015) and public enterprise liabilities of about 7½ of GDP.

Staff's Views

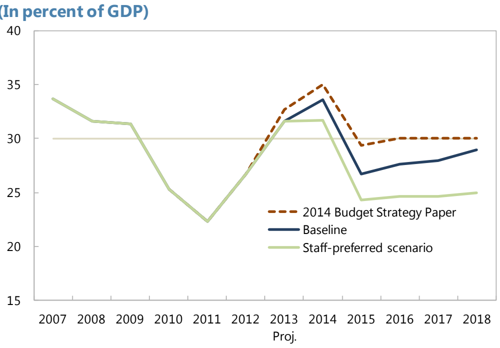
10. **The 2013 fiscal deficit is likely to be about 6.3 percent of GDP, lower than the budgeted 7.3 percent of GDP, on account of under-spending.** There are concerns that capacity constraints have led to major delays in project implementation and mixed spending quality, especially at subnational levels. Staff therefore advised that spending should not be rushed toward the end of the year for the sake of showing a higher budget implementation rate; any unused resources should be saved for reallocation in the 2014 budget (January/December). Action should also be taken to rein in provincial spending on personnel emoluments, which are at risk of exceeding budget allocations.

11. **Staff recommended an overall fiscal deficit of 4 percent of GDP for 2014 (including any expenditure rollover from 2013), with the budget focused on improving the quality of spending.** While there is a need to improve public services and support nonmineral sector growth to absorb thousands of workers being released from the LNG project, due consideration should be given to capacity constraints and the need to retain fiscal buffers to deal with external shocks. Greater attention should also be given to a clear identification of bottlenecks to spending and service delivery—including in priority areas such as health, education, and roads—and to proper appraisal, design and planning, and rigorous costing of development projects.

Overall fiscal deficit
(In percent of GDP)



Debt-to-GDP ratio
(In percent of GDP)



Sources: PNG authorities; and IMF staff calculations and projections.

12. **Over the medium term, staff agreed that the fiscal framework should aim to keep public debt below the government's ceiling of 30 percent of GDP.** To achieve this, the government will need to target a gradual decline in real per capita spending over the medium term from current elevated levels. Staff noted that the primary fiscal deficit had increased significantly over the past two years and is expected to reach nearly 5 percent of GDP in 2013 (a similar trend is observed for the nonmineral primary deficit), which is unsustainable. In this light, staff

recommended a more prudent fiscal path (see the "staff-preferred scenario" in the figures above) than the scenario proposed in the 2014 Budget Strategy Paper (BSP) to reduce the risk of breaching the debt ceiling should there be expenditure slippages or adverse shocks, This more conservative scenario would provide some buffer for the debt ceiling and enhance its credibility. With an increased focus on spending quality, it would still allow ample space for the government to fund its development enablers.

Box 2. Papua New Guinea: Medium-Term Fiscal Strategies and 2014 Budget Strategy

Over the past decade policymakers have been guided by three successive medium-term fiscal strategies (MTFS). The 2002–07 MTFS was a stabilization and structural reform program. Its target for a balanced budget was achieved in 2004, three years ahead of schedule, but progress on structural reforms was slow. The 2008–12 MTFS added rules to limit the fiscal impact of volatility in resource revenue. It required that resource revenue above a 'normal' level (4 percent of GDP) be used for debt reduction and pre-financing of development expenditure through trust accounts. Annual spending out of trust accounts was capped at 4 percent of GDP. Together, these rules imposed an 8 percent of GDP limit on the nonmineral budget deficit. Broad adherence to both strategies led to a reduction in government debt from 74 percent of GDP in 2002 to about 27 percent of GDP in 2012.

The 2013-17 MTFS gives greater attention to supporting development priorities identified in the Medium-Term Development Plan (MTDP). This move reflects the anticipated large inflows of resource revenue from the LNG project beginning in 2014. The MTFS aims to allocate, by 2017, two-thirds of total budget resources to the key development "enablers"—health, education, infrastructure and law and order. The operational rules for the nonmineral budget deficit have been replaced by a ceiling of government debt set at 30 percent of GDP, apart from in 2013 and 2014, when it will be capped at 35 percent. The MTFS also sets a target to return the budget to surplus by 2017.

The 2014 Budget Strategy Paper (BSP) aims to support the MTDP development priorities but has to take into account a much reduced fiscal space. Since the launch of the 2013-17 MTFS, revenue prospects have become much weaker owing to significant falls in commodity prices and fiscal deficits in 2012 and 2013 have turned out to be much larger than expected. The BSP thus proposes to relax MTFS budget balance targets by allowing a maximum deficit of 2½ percent of GDP from 2015 onward, although the debt targets set in the 2013-17 MTFS have been retained.

The BSP plans to rely mainly on domestic debt issuance and on additional borrowing through foreign currency denominated concessional loans to finance the 2014 deficit. To reduce refinancing and interest rate risks, the government intends to increase the average debt maturity. The government also plans to improve taxpayer compliance by simplifying tax administration and introducing a new computerized system.

13. **Greater efforts on revenue collection will be essential to keep the fiscal deficit in check and stay below the debt ceilings.** As nonmineral activity slows over the course of 2013, it will be challenging to achieve the government's revenue target this year. Over time, the authorities will need to improve tax administration, including clearance of tax arrears, and rationalize tax

exemptions and concessions, particularly given the expected moderate increases in mineral revenues from the LNG project over the near-medium term. Staff encouraged the authorities to expeditiously implement IMF technical assistance (TA) recommendations on extractive industries fiscal regimes, with a view to increasing government revenue over time. In particular, the authorities should aim to increase the progressivity of PNG's resource revenue regime—moving toward less reliance on dividends from state equity shares and more on rent-based taxes—and remove some of the tax incentives, such as income tax holidays and the double deduction for exploration.

14. **Staff welcomed the government's initiatives to improve public financial management.** The proposed integration of recurrent and development budgets for 2014 and continued implementation of multiyear budgeting are a major step forward and should help improve expenditure mix and prioritization. The establishment of a branch in the Department of Finance to monitor statutory bodies, including through standardizing financial reporting, is also a positive step. Continued proliferation of such statutory bodies could undermine budget integrity and reduce the coherence of national resource allocation. Efforts should be made to improve the comprehensiveness of reporting in the budget on all resources available to each department and statutory body—including those resources that are currently "off-budget." Staff also welcomed the publication of monthly expenditure warrants this year and encourages timely audit of public accounts.

15. **The integrity of the sovereign wealth fund (SWF) should be safeguarded for it to play a key role in managing PNG's resource revenues.** PNG's original SWF design has generally followed sound principles, in particular with regard to the fund's full integration with the budget (Box 3). At present, the SWF is not operational due to the need to amend the original SWF law and an ongoing process to finalize governance and revenue arrangements. Any significant diversion of mineral resource revenues from the SWF could undermine the role of the fund in macroeconomic stabilization and development. Moreover, staff noted that current withdrawal rules could risk leaving the SWF under-funded and that the government should revisit the rules to ensure that sufficient resources are accumulated in the SWF.

Authorities' Views

16. **The authorities acknowledged the challenges in effective spending in 2013 and agreed to focus on improving the quality of spending in the 2014 budget.** However, they stressed the importance of continued increases in expenditure on the development enablers while adhering to the debt target. To increase revenue, the authorities are considering the IMF TA recommendations on resource revenue regimes and have set up a committee to review the overall tax regime, with a view to focusing on compliance and restricting tax exemptions and special arrangements and to maintain an equitable tax regime. The amendments to the current SWF law are expected to be approved by Parliament this year, with the SWF to become operational in 2014. The authorities agreed that the withdrawal rules need to be reexamined.

Box 3. Papua New Guinea: The Sovereign Wealth Fund

In February 2012, the PNG Parliament approved an organic law to establish a sovereign wealth fund (SWF). The purpose of the SWF is to smooth government expenditure and decouple it from the short-term volatility of resource revenues. The SWF model, design, and institutional framework were guided by international best practice: offshore investment and onshore management, integration with the fiscal framework and the budget, and accountability and transparency rules based on the Santiago principles. The law envisaged a consolidated pool of two offshore funds with a single governance framework: a stabilization fund (SF) and a development fund (DF). The authorities have recently proposed to rename the DF to the "Future Fund." Amendments to the organic law are expected to be tabled in Parliament in November, together with the 2014 budget, paving the way for the operation of the SWF in 2014.

While the organic law provides broad guidelines for the structure and governance of the SWF, it also allows some operational flexibility. Under the law, an independent board will exercise oversight over the operation of the SWF, and a secretariat headed by an Executive Officer will advise the board to facilitate its investment decisions through external investment managers. The law also stipulates that contributions to the SF will include all mineral and petroleum revenues, earnings from its investments, and other government contributions. Withdrawals from the SF will go through the budget process, capped at the 15-year moving average of mineral and petroleum revenues as a share of non-mining revenues. Annual contributions to the DF will be no less than a guaranteed minimum allocation based on the expected average of the LNG project dividends determined by the parliament, earnings from its investments, and other government contributions. It is envisaged that trust accounts will be folded into the DF once it is operational. There are no clear rules governing withdrawals from the DF, but funds must be used to support the country's development plans in accordance with an act of Parliament.

Several issues need to be addressed before the SWF can operate effectively. Projections based on current global commodity prices show that revenue inflows to the SF will be limited under the currently stipulated withdrawal rules, suggesting the need to revisit the maximum amount of allowable withdrawal. If the rules are modified and/or expected revenue inflows increase, the authorities will need to establish guidelines on how to support the government's fiscal targets set in the 2013-17 Medium-Term Fiscal Strategy (MTFS) as well as to achieve the SWF's stabilization and development objectives. The authorities will also need to carefully define the relationship between the SWF and the proposed Kumul Trust (see Box 5) in order to protect the integrity and revenue sources of the SWF. The authorities have recently indicated that buffers will be established to protect against depletion of the SWF. They are also working on the governance/institutional structure of the SWF as well as capacity building to effectively implement the fund's investment mandate and strategy. The Fund has recently provided technical assistance in this area.

ENSURING PRICE AND FINANCIAL STABILITY

While the current monetary policy stance is appropriate given the inflation outlook, BPNG should stand ready to tighten its policy stance should inflationary pressure reemerge. Excess liquidity needs to be reduced, and financial sector risk closely monitored as nonmineral activity slows.

17. **The BPNG began easing its monetary policy stance in the second half of 2012, with declining inflation the main factor.** Until then, it had maintained a relatively tight policy stance, raising the Kina Facility Rate (KFR) to a peak of 7¾ percent in September 2011, hiking the Cash Reserve Requirement (CRR) to 8 percent from 7 percent in June 2012 and stepping up open market operations. However, as inflation began to fall, the Bank reduced the KFR to 6¾ percent in September 2012 and further to 6¼ percent in March 2013. Private sector credit grew strongly over the second half of 2012 and the first half of 2013 (by about 25 percent (y/y) at June 2013), due largely to growth in business lending.

18. **Concerns persist over the structurally high levels of excess liquidity in the banking system.** Until recently, unsterilized foreign exchange reserves had accumulated at the BPNG, as it purchased the government's foreign exchange revenues. This has added liquidity in the system, as the government put the majority of its kina deposits at commercial banks. Excess liquidity has dragged money market rates significantly below the KFR, weakening the monetary policy transmission mechanism. Despite the efforts to mop up liquidity, including through the sales of foreign exchange reserves, a divergence between market rates and the KFR has persisted. Limited participation in the formal economy and financial sector also restricts the effectiveness of the interest rate channel of monetary policy transmission.

19. **The financial sector remains sound, underpinned by comfortable capital adequacy ratios, stable profitability, and deposit-based funding.** Banks have maintained capital adequacy ratios above 25 percent and continue to post handsome profits. They maintain strong liquidity positions, with more than half of their assets held in government securities or cash. As banks have not underwritten loans to LNG projects, their direct exposure to the ongoing resource boom has been limited. However, authorized superannuation funds have significant exposure to the property market that has been buoyed by the LNG project. Anecdotal evidence suggests that the prices of high-end properties have declined by about 20 percent over the past few months, albeit from very high levels.

20. **Work on implementing the 2011 financial sector stability assessment (FSSA) recommendations has continued in several areas, guided by the BPNG's Strategic Plan 2012-2015.** Important progress is being made on payment system reform, with the BPNG conducting industry testing of the Kina Automated Transfer System, which will enable real time gross settlement. In addition, small investor participation in government debt markets has been supported by the introduction of the Central Bank Bill Tap facility, and the BPNG intends to develop regulations and standards on mobile phone banking. With regard to financial system supervision, the BPNG is working to improve its analysis of systemically important institutions and overall financial system

stability. A new prudential standard for the superannuation sector was issued in 2012, which focused on corporate governance.

Staff's Views

21. **Given the moderate underlying inflationary pressure, the BPNG should maintain its current policy stance, but stand ready to tighten policy should price pressures reemerge.** The BPNG should be prepared to tighten policies in the event of fiscal slippages and/or balance of payments pressures, which could raise inflation and put downward pressure on the kina. In light of slower domestic demand in the post-boom era, staff advised the BPNG to return to its 5 percent inflation reference value. This would help anchor inflation expectations and strengthen the central bank's policy credibility.

22. **Continued efforts will be needed to reduce excessive liquidity to minimize inflation risks down the road and strengthen monetary policy transmission.** Staff recommended that the Treasury Department move, to the extent possible, its commercial bank deposits and trust accounts to the BPNG to mute their liquidity impact. If this is not sufficient, the BPNG could conduct further open market operations by issuing additional Central Bank Bills (CBBs) as well as hike the CRR as needed. The BPNG should drain market liquidity to the point where the policy rate would begin to influence money market rates and become an effective signal of the monetary policy stance.

23. **The exposure of superannuation funds to heated segments of the real estate sector warrants close monitoring.** The BPNG should continue to monitor the funds' investment concentration in LNG project-related industries as well as in the real estate sector, which, after experiencing a period of tight supply, may face price corrections in certain market segments as supply catches up with demand. Even though banks have limited exposure to the real estate sector, their loan portfolios in construction, transportation, and communication should be examined as these industries have to varying degrees benefited from the LNG project-induced demand and are unlikely to continue to grow at the same pace as the past few years. The BPNG should explore ways to introduce macroprudential policies to prevent negative feedback between the macroeconomic and financial sectors, based on the recent Fund TA recommendations. Stress tests of banks should be conducted regularly

Authorities' Views

24. **The BPNG is actively considering options to withdraw further liquidity from the financial system.** These include further open market operations, raising the CRR, and working on transferring trust account funds from commercial banks to the BPNG. The authorities regard financial sector risk arising from the real estate market to be reasonably contained, as loan-to-value ratios for residential property lending have been relatively low, and according to stress tests, banks are expected to remain robust even under extreme stress scenarios. Superannuation funds have sought to diversify their assets including through foreign investment because of increased attention to risk in the property sector and the limited domestic market.

MAINTAINING THE STRONG EXTERNAL POSITION

Despite a strong external position and low risk of external debt distress, a continued prudent approach to external borrowing is advisable. It is important to monitor developments in private sector external debt and analyze its potential flow-on effects on the economy from LNG price declines.

Staff's Views

25. **PNG's external position is sound despite large current account deficits in recent years.** As LNG production comes on stream and imports related to the LNG project subside, the current account deficit is expected to narrow quickly and turn into a surplus in 2015. The foreign reserves cover (in months of nonmineral imports) remains adequate to absorb external shocks despite the recent declines reflecting weaker commodity prices. Standard cross-country CGER assessment of the kina and other information indicates no evidence of kina misalignment (Box 4). Staff recommended that the BPNG continue to maintain a floating exchange rate regime to help absorb external shocks.

26. **Debt sustainability analysis suggests that PNG continues to face low debt distress risk for external public debt under its medium-term policy setting.** However, this provisional finding assumes that the government will adhere to its debt target of 30 percent of GDP over the medium term. Staff encouraged the authorities to continue to take a prudent approach to external borrowing, focusing on available concessional loans and taking into account conditions that may increase implicit costs of loans, such as those associated with procurement restrictions. Should the government decide to float a sovereign bond in the future, it should carefully plan the move in advance and seek independent advice.

27. **The rapid increase in private sector external debt warrants close monitoring.** PNG's private sector external debt has grown rapidly in recent years, reaching around 120 percent of GDP at end 2012 based on official data. The majority of the debt is owed by LNG project partners and subcontractors. However, the sheer volume of the debt highlights the risk that a large decline in LNG prices could pose to project profitability, the capacity of borrowers to service their debts, and the impact on export earnings, the kina, and government revenue (through dividend and tax receipts).

Authorities' Views

28. **The BPNG considers the current exchange rate to be in line with PNG's economic situation.** Bank officials noted that its intervention in the foreign exchange market over the past year was motivated by the desire to smooth volatility, as well as to support liquidity management. However, they expressed concern that a strong kina would adversely affect external competitiveness, putting pressure on the nonmineral sector. With regard to PNG's external private debt, while acknowledging the need for close monitoring, the authorities considered that the debt is largely liabilities of foreign companies that have little connection with the domestic financial system. Moreover, debt repayment should begin next year when LNG exports commence.

Box 4. Papua New Guinea: Exchange Rate Assessment

The kina has experienced large fluctuations over the past few years. The real effective exchange rate (REER) appreciated by 37 percent over the period from October 2009 to June 2012, driven by strong commodity prices, particularly those for gold and cooper, two of PNG's key exports. However, as commodity prices softened and capital inflows associated with the LNG project passed their peak, the kina depreciated by 9 percent from April 2012 to August 2013.

CGER methodologies have produced mixed results on where the kina stands relative to its equilibrium value. The macroeconomic balance (MB) approach indicates that the kina is undervalued by 25 percent, while the external sustainability approach suggests an even higher undervaluation—around 30 percent. However, the purchasing power parity (PPP) approach indicates an overvaluation of around 27 percent, and the equilibrium real exchange rate (ERER) approach shows a kina overvaluation of around 34 percent. These results demonstrate the difficulties in using standard cross-country CGER methodologies to assess the equilibrium value of a commodity currency such as the kina, particularly with uncertain data quality.

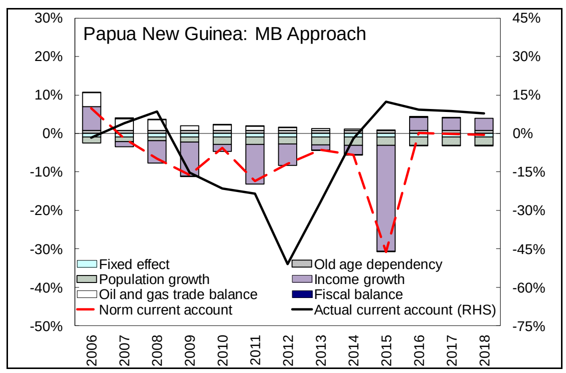
Overall, there seems to be no evidence of kina misalignment, but this conclusion is subject to uncertainty. The last Article IV consultation conducted in early 2012 suggested that the kina was undervalued, but the weaker prospects for commodity prices and recent foreign reserves developments are less supportive of this observation. Recent business surveys indicate the kina exchange rate is not regarded as a top impediment to nonmineral exports, suggesting the kina is broadly in line with PNG's current productivity levels.

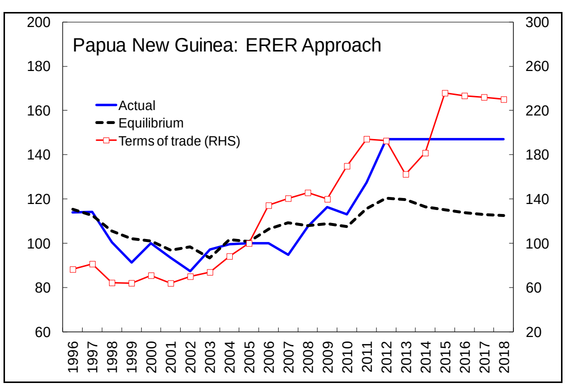
Exchange Rate Assessment: Baseline Results 1/

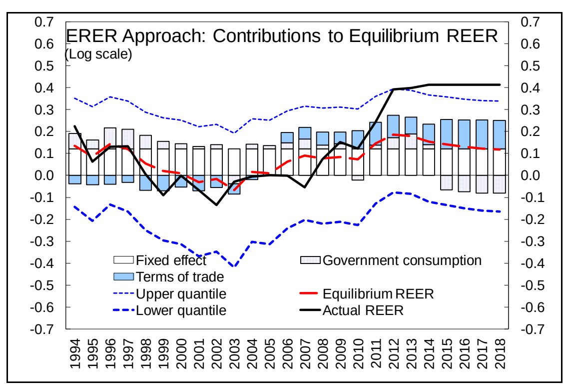
(In percent)

	CA/GDP		REER
	Norm	Underlying 1/	Overvaluation
PPP approach	...	...	27.1
MB approach 2/	-0.4	8.3	-25.2
ERER approach 3/	...	...	34.3
External sustainability approach 2/ 4/	-2.0	7.9	-29.7

1/ Staff projection over 2018 (last year of medium-term WEO projections)
2/ Based on a semi-elasticity of the CA/GDP with respect to the REER of -0.25.
3/ Overvaluation is assessed relative to 2013 Q2.
4/ CA norm stabilizing NFA at -30.8 percent of GDP, assuming a nominal GDP growth rate of 7.1 percent.





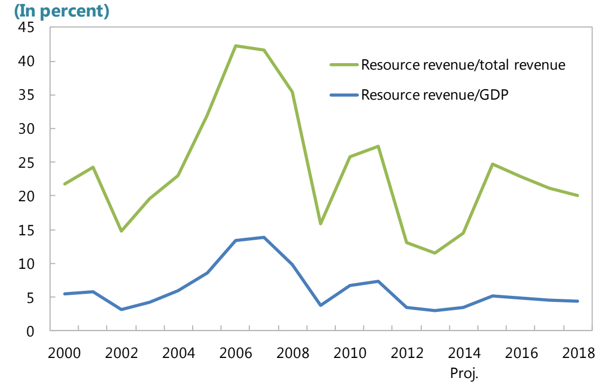


Source: IMF staff estimates and projections.

ENABLING SUSTAINED, INCLUSIVE GROWTH

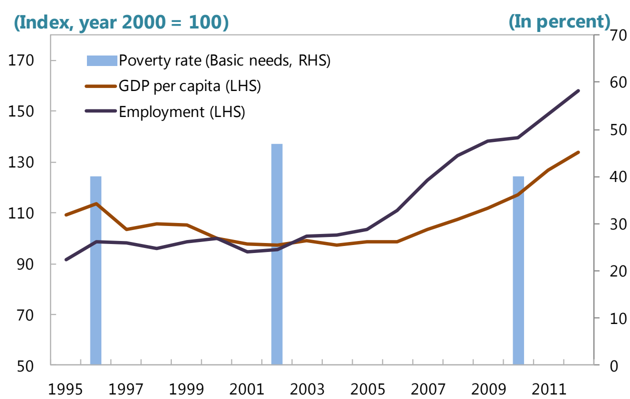
To counter increasing headwinds for inclusive growth, structural reforms must be accelerated to make better use of resource revenues and improve the business climate, concentrating on transparency, public enterprise reform, and the development enablers. Greater attention should be given to the development of small and medium sized enterprises and agriculture.

29. **Past resource booms have not benefited the population as widely as expected, with much of the resource revenues wasted.** However, expectations are high that the current resource boom, particularly those from the LNG project, will represent a break from the past and lead to substantial improvement in public services. However, while the expected commencement of LNG production will bring a large increase in measured GDP, the projected increase in government revenue over the near-medium term is one-off and quite modest (about 2 billion kina or 5 percent of 2013 GDP) compared with historical booms because the LNG project is approximately four-fifths owned by nonresidents and accelerated depreciation is expected to delay tax payments until early next decade. PNG has great potential to develop its resource sector, but the job creation effect of this development is likely to be limited.



Sources: PNG authorities; and IMF staff calculations and projections.

30. **Making the most of available resource revenues will be critical to boosting long-term growth in the nonmineral sector.** Over the past decade, the strong growth of the nonmineral sector has enabled formal employment to expand by an average of 5½ percent per year. With the nonmineral sector returning to its long-term growth trend without the boost from major resource projects, the pace of job creation is likely to slow significantly, making it even more challenging to improve the inclusiveness of future growth and reduce poverty.



Sources: PNG authorities; and World Bank staff calculations.

Staff's Views

31. **Staff welcomed the authorities' plans to join the Extractive Industries Transparency Initiative (EITI) and encouraged completion of required follow-on steps.** EITI membership provides a unique vehicle to demonstrate the government's determination to improve

revenue transparency and integrity, and supports the larger goals of fighting corruption, which is perceived to be pervasive and imposing significant drains on scarce public resources. Together with the SWF and general improvements in public financial management, EITI membership should put PNG in a stronger position to improve its use of resource revenues for more inclusive and broad-based growth.

32. **Staff supported increased resource allocation to medium-term development enablers**. Addressing law and order problems and other key obstacles to doing business should be a top priority. A significant improvement in law and order and investments in PNG's human resources would help create a vibrant private sector and more job opportunities, driven by the expansion of small and medium-sized enterprises (SMEs). Reforms to secured lending arrangements, together with steps to facilitate the development of more customary-held land, should encourage more investment and help reduce business costs.

33. **The development of agriculture will also be critical to inclusive growth as it is the key source of income for some 80 percent of PNG's population.** Staff welcomed the government's plans to tap the country's agricultural potential, including cash crops, by improving extension services, market access (both domestic and international), and logistic services such as distribution and storage.

34. **Improvements in access to finance should be integral part of the strategy to support economic diversification for inclusive growth.** PNG's banking sector is dominated by three banks, and like other Pacific island countries, there is room to improve competition in the sector. Staff welcomes the BPNG' intention to license more banks and commends the authorities for launching several financial inclusion initiatives, including a microfinance expansion project, a mobile/branchless banking program, and a financial literacy program. Continued efforts will be needed to increase the benefits of these initiatives for the rural communities and the SME sector. In this regard, the establishment of the Centre for Excellence in Financial Inclusion to coordinate financial inclusion activities is a major step forward. Staff encourages the authorities to examine ways to reduce the large foreign exchange spreads, including through a review of current trading practices in the industry with a view to increasing competition.

35. **A robust regulatory framework will be critical to creating a vibrant private sector and improve the welfare of PNG's citizens.** Staff commended the authorities for pushing for greater competition, which has resulted in lower prices and greater product variety to the benefit of consumers and economic efficiency. Nevertheless, more remains to be done to increase competition in many sectors, including telecommunications, power generation, aviation, and petroleum products, including through opening access to entry. The government should avoid reserving industries for domestic businesses except where the country's security interest is at stake. Instead, the focus should be on addressing the issues that constrain entrepreneurs' ability to grow, such as law and order, infrastructure, and skills development. Further streamlining of business registration and licensing arrangements would also help attract investment. With regard to the newly nationalized

Ok Tedi mine,[6] staff encourages the authorities to reaffirm their commitment to respecting property rights and contracts by adequately compensating the PNG Sustainable Development Program for its stake in the mine. This would help make entrepreneurs more willing to make long-term investment that is essential for sustained and inclusive development in PNG.

36. **Improvements in the efficiency of public enterprises require proper governance and strong accountability.** Despite significant government support, state-owned enterprises (SOEs) continue to produce low financial returns and provide poor-quality services to households and firms (Box 5). Recent proposals to consolidate and reorganize SOEs and public investments in mining and hydrocarbon companies through the Kumul Trust have the potential to enhance transparency and improve the management efficiency of state assets. However, the success of this initiative will hinge on adoption of governance structures at both the trust and company levels that will ensure their political independence and focus on stated corporate goals.

Authorities' Views

37. **The authorities recognized the need to improve governance in managing resource revenues and the importance of structural reforms for inclusive growth.** PNG is now targeting to become an EITI candidate by December. To improve the business environment, efforts are being made under the National Land Development Program to increase access to customary land for productive purposes and to improve housing and finance access. The authorities plan to strengthen the national electricity company as a commercially oriented business and to improve electricity supply and services by linking tariffs to service quality. The government is currently developing various policies to improve the performance of SOEs, including providing guidance on the dividend policy and clarifying the community service obligations (CSOs) of SOEs.

[6] The Ok Tedi mine is a copper and gold mine located in the Western Province. After the mine caused widespread environmental damage during 1980s-90s, BHP, then major owner and operating company, divested its shares to a charitable trust called the PNG Sustainable Development Program (SDP) to help affected communities and in return was granted legal immunity from liabilities on environmental damages in 2002. However, the PNG parliament passed legislation in September 2013 authorizing the government to take over SDP's shares and revoking BHP's immunity.

Box 5. Papua New Guinea: Public Investment and State-Owned Enterprise Reform[1]

Historically, state-owned enterprises (SOEs) have generated poor rates of return for the government. In 2012, dividend payments were estimated at K 239.1 million, representing an overall return of 3.2 percent on the estimated assets of K 9.5 billion (or 31 percent of GDP). However, more than 81 percent of these dividend payments came from the government's minority shareholdings in Oil Search, Ok Tedi and the Bank South Pacific. In addition to poor financial returns and soaking up capital resources, majority-owned SOEs have tended to provide poor-quality services to the people of PNG. Just 12 percent of households have access to power, and only 15 percent of schools are connected to the electricity grid.

In mid-2012 the government of PNG proposed a major reorganization of its public investment holding and management structures. The reform program proposes to consolidate all of the government's public investments under the umbrella of a single 'Kumul' Trust. Within the Kumul Trust will be three holding companies: Kumul Mining; Kumul Petroleum; and Kumul Corporations. There are some positive aspects to this reform approach. The proposed restructuring may bring with it some enhanced transparency through stronger public disclosure requirements. Consolidation of hydrocarbon and mining assets into single holding companies may also help to improve the efficiency and coherence of their management.

However, the restructuring of public investments is unlikely to address the underlying reasons for the poor SOE performance, which will require a renewed commitment to a number of uncompleted reforms. These include legislating an obligation for SOEs to operate on a commercial basis; setting out the government's dividend expectations for all SOEs; finalizing a community service obligations (CSO) framework to ensure that SOEs deliver CSOs on a commercial basis; adopting public private partnership (PPP) legislation to facilitate the private investment in infrastructure and related services; and an on-lending policy to ensure a level playing field between SOEs and the private sector. The governance structures will also be critical if the Kumul Trust initiative is to succeed. Current proposals suggest that the Kumul Trust will be controlled by two shares—one veto share held by the current Prime Minister, and another share held jointly by all ex-Prime Ministers. This structure appears inconsistent with the intention of setting up independent corporate boards and seems unlikely to deliver the corporate focus or political independence that is required for effective management of public investments.

Further, the proposed SOE reforms could be strengthened by ensuring that future dividend flows are fully integrated into the national budget process. Requiring funds to pass through the national budget process will ensure any future equity injections into public assets and state-owned enterprises are appraised and balanced against other spending priorities. It will also strengthen the transparency of funding and ensure that Parliament can maintain accountability over fund usage.

1/ This box was contributed by Aaron Batten (Asian Development Bank).

IMPROVING ECONOMIC STATISTICS AND STRENGTHENING ANTI-MONEY LAUNDERING EFFORTS

38. **Shortcomings in CPI and national accounts statistics—among others—make it challenging to formulate appropriate policies in PNG**. PNG's CPI basket has not been updated for more than 35 years and is likely to be a poor representation of today's consumption pattern. Moreover, data collection for compilation needs to be improved. The National Statistical Office has not released estimates of GDP since 2007. While the Treasury Department provides GDP estimates based on data collected through business surveys, this is only a temporary remedy and there is considerable room for improvement. Staff encouraged the authorities to take urgent action to address these long-standing issues.

39. **PNG is at risk of being gray-listed by the Financial Action Task Force (FATF) for failing to comply with requirements for anti-money laundering and combating the financing of terrorism (AML/CFT).** Staff encouraged the authorities to move expeditiously to address the weaknesses in this area.

Authorities' Views

40. **The authorities recognized the urgency of addressing the issues of economic statistics and AML/CFT.** On the former, they indicated a willingness to take action and would request TA from development partners after preparing a strategic plan. On the latter, an action plan has been prepared for the Cabinet's consideration. Australia is helping the authorities to analyze financial transaction data and to submit related reports to the FATF, and the Asian Development Bank also plans to provide TA in this area.

STAFF APPRAISAL

41. **After a decade of commendable performance, the PNG economy now faces a more challenging environment**. Although overall GDP will increase significantly when LNG production commences in 2014, the nonmineral sector is expected to slump in the short run and only revert to moderate growth over the medium term. At the same time, increases in resource revenue are expected to be one-off over the near-medium term and modest by historical standards, with considerable uncertainty. PNG will have to manage this reality in addressing its huge development needs.

42. **A prudent fiscal policy and a steadfast focus on spending quality are needed to maintain the hard-won macroeconomic stability and improve development outcomes.** In the short run, the government should provide support to nonmineral sector growth, but given the country's limited absorptive capacity, it should aim for a moderate fiscal deficit in 2014 to avoid waste of resources. A fiscal consolidation will be necessary over the medium term to stay within the

government's debt ceiling of 30 percent of GDP, which appears appropriate. However, considerable scope exists to improve spending efficiency, which should be the central focus for improvement in service delivery.

43. **Progress has been made in establishing the SWF, but more work remains to be done to ensure its most effective operation.** The SWF can play an important role in macroeconomic stabilization and development, but its integrity must be safeguarded by avoiding diversion of resource revenues or bypassing the budget process. The authorities' efforts to make the SWF operational soon are commendable, but an early review of the withdrawal rules should be undertaken to ensure the fund is adequately resourced.

44. **Monetary policy is broadly appropriate, but continued efforts are needed to strengthen monetary policy transmission and monitor financial sector risks.** In the short run, the BPNG should watch potential inflationary pressures arising from a weaker kina and government spending, and it should withdraw excess liquidity to strengthen the signaling effect of the Kina Facility Rate. As economic activity slows and price corrections in the property market take place, it is important to closely monitor risks facing the superannuation funds and banks.

45. **PNG's external position is sound despite the large current account deficits in recent years.** PNG's external public debt is sustainable under its medium-term policy setting. However, the authorities should continue with their prudent approach to external borrowing. The rapid increase in private sector external debt should be closely monitored given its sheer size.

46. **The authorities' increased focus on inclusive growth is welcomed.** Continued efforts will be needed to ensure better use of resource revenues, and the initiatives to make PNG an EITI candidate by December is an encouraging step. The development of the agriculture and the SME sector is also essential for broad-based growth, and the authorities are appropriately targeting an enabling business environment and human resource development, including through improving law and order, health, education and infrastructure. To contain fiscal risks and improve economic efficiency, SOE reforms should be accelerated and appropriate governance structures should be established in reorganized and consolidated public assets entities.

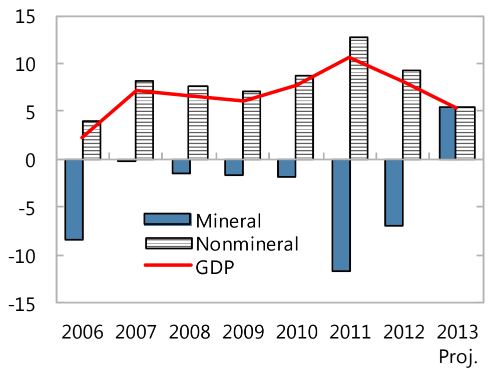
47. **Urgent action is needed to address the long-standing shortcomings in CPI and national accounts statistics, among others**. Formulation of a strategic plan on economic statistics is an important step. An early approval of an action plan on AML/CFT is also needed to ensure compliance with international standards.

48. **It is recommended that the next Article IV consultation be held on the standard 12-month cycle.**

Figure 1. Papua New Guinea: Macro Performance

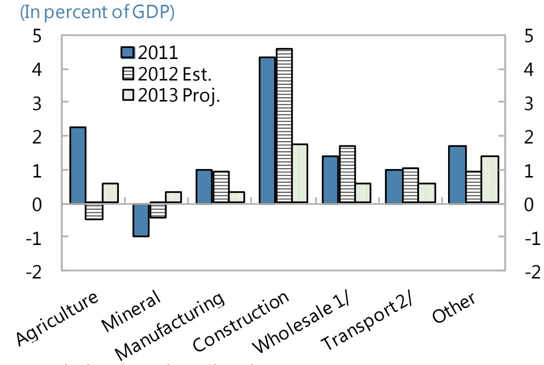
Economic growth is projected to slow in 2013…

Real GDP Growth
(In percent)



…as the construction phase of the LNG project draws to a close…

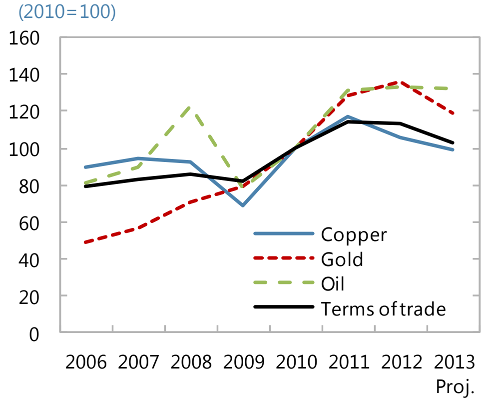
Sector Contribution to Real GDP Growth
(In percent of GDP)



1/ Wholesale and retail trade.
2/ Transportation and communication.

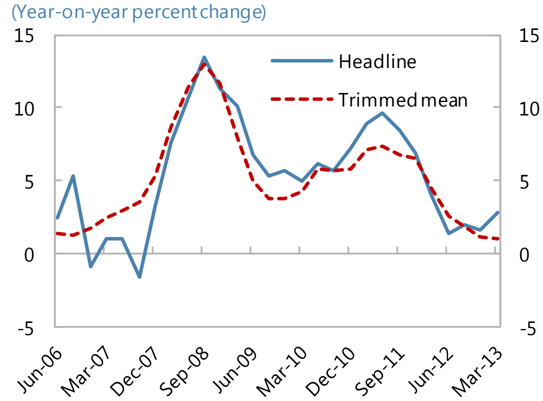
…and commodity prices fall.

Commodity Price Index
(2010=100)



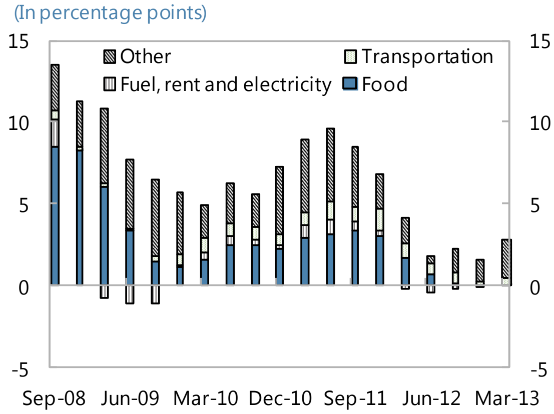
Meanwhile, inflation has moved to lower levels…

CPI Inflation
(Year-on-year percent change)



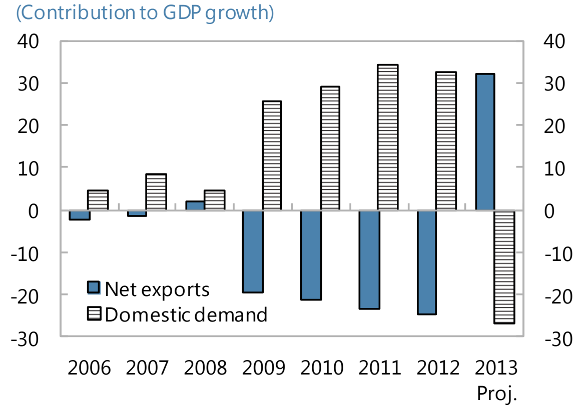
…on account of low international food prices and expanded tuition-free policy…

Contribution to CPI Inflation
(In percentage points)



…and low domestic demand pressure is expected to help stabilize inflation.

Real Domestic Demand and Net Exports
(Contribution to GDP growth)

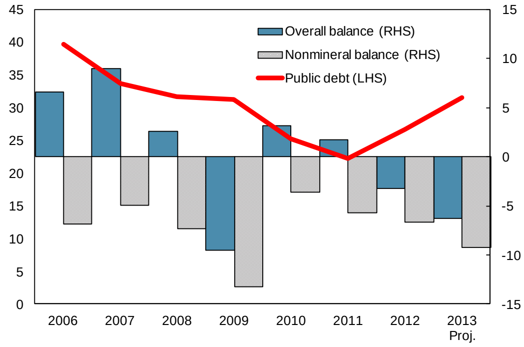


Sources: Bank of Papua New Guinea; IMF, *International Financial Statistics*, *World Economic Outlook*; and IMF staff estimates and projections.

Figure 2. Papua New Guinea: Fiscal Performance

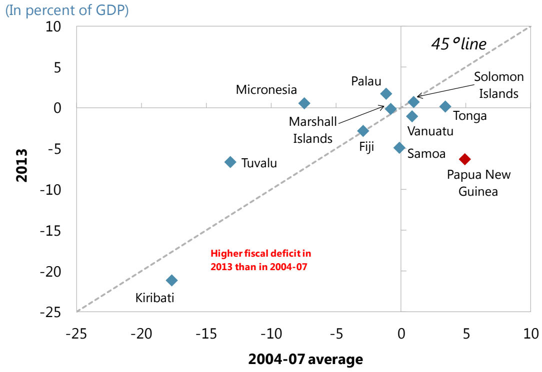
Overall balance has turned into deficit from 2012.

Fiscal Balance
(In percent of GDP)



Compared with the previous cautious stance, the recent fiscal balance has deteriorated distinctly...

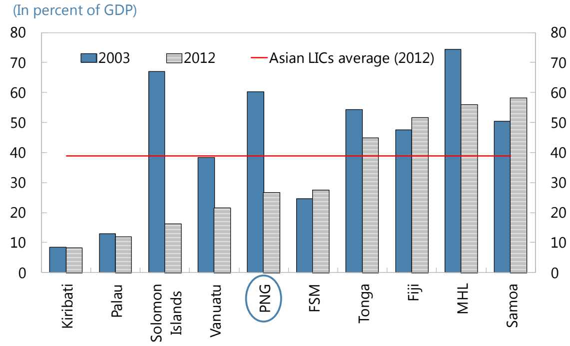
Fiscal Balance
(In percent of GDP)



...but public debt remains low compared with most other Pacific Island countries.

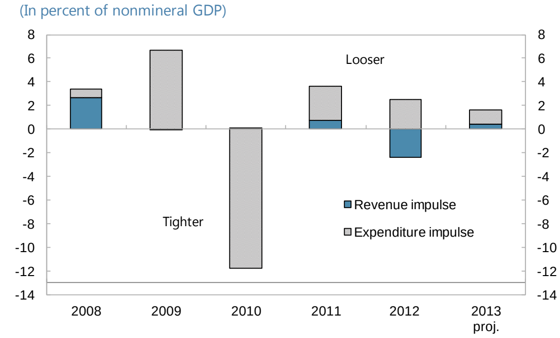
After a sharp tightening in 2010, the fiscal stance has been loose...

Public Debt
(In percent of GDP)



Source: APD LISC database.

Fiscal Impulse 1/
(In percent of nonmineral GDP)

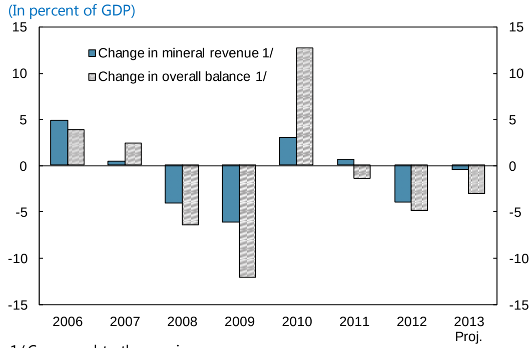


1/ Adjusted for cycle and mineral revenues.

...while mineral revenues and reserves fell...

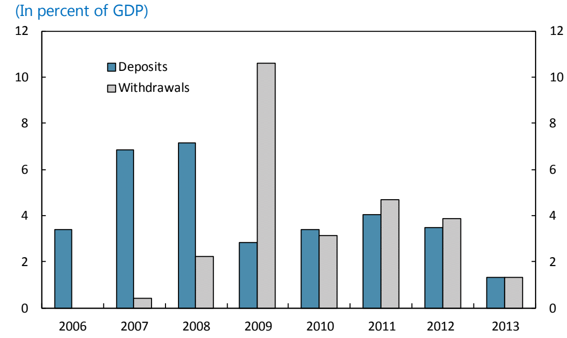
with trust account funds withdrawn to support development projects.

Mineral Revenue
(In percent of GDP)



1/ Compared to the previous year.

Trust Accounts Movements
(In percent of GDP)

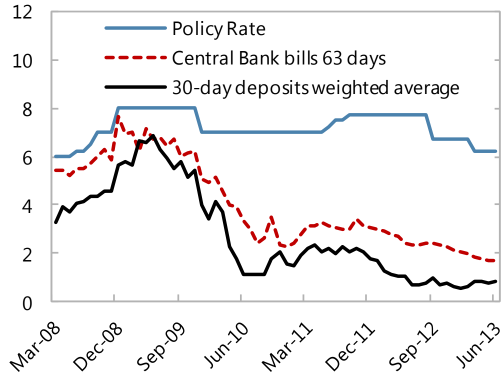


Sources: Papua New Guinea authorities; IMF, APD Low-Income Small Countries database, and IMF staff estimates and projections.

Figure 3. Papua New Guinea: The Monetary Stance

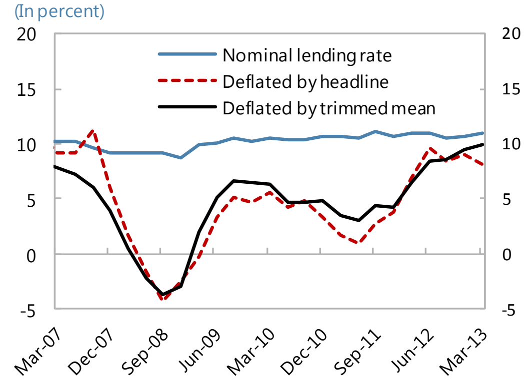
Policy stance has been loosened as inflation falls…

Policy Rate
(In percent)



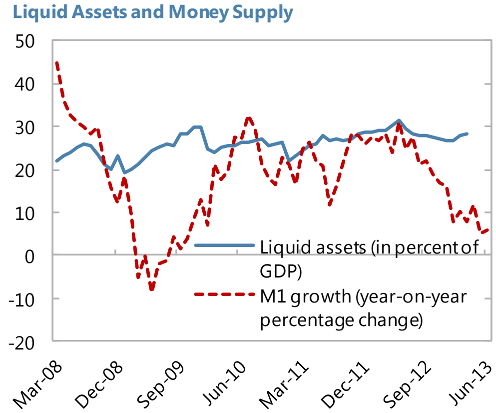
…but real interest rates have increased as a result.

Real Lending Rate
(In percent)



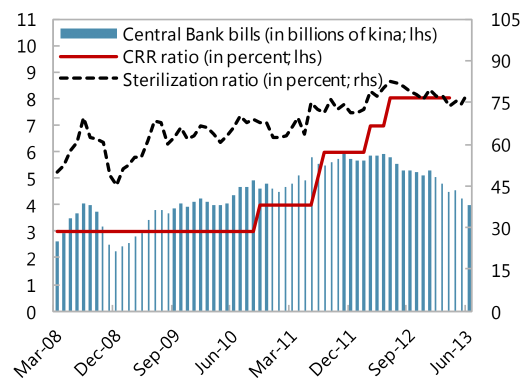
Ample liquidity remains but money growth has slowed owing to the exchange market intervention by the BPNG…

Liquid Assets and Money Supply



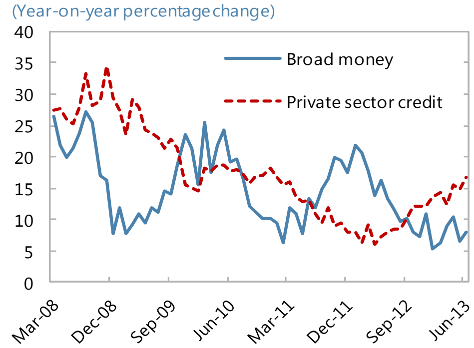
…allowing the BPNG's sterilization efforts to taper.

Central Bank's Sterilization



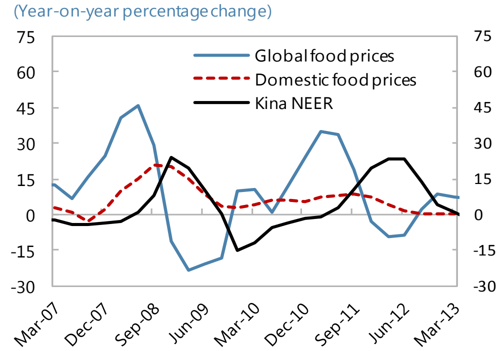
Broad money growth rate has also fallen, but private sector credit has picked up.

Credit Growth and Broad Money
(Year-on-year percentage change)



Stable food prices have greatly contributed to low inflation.

Food Prices and Nominal Effective Exchange Rate
(Year-on-year percentage change)

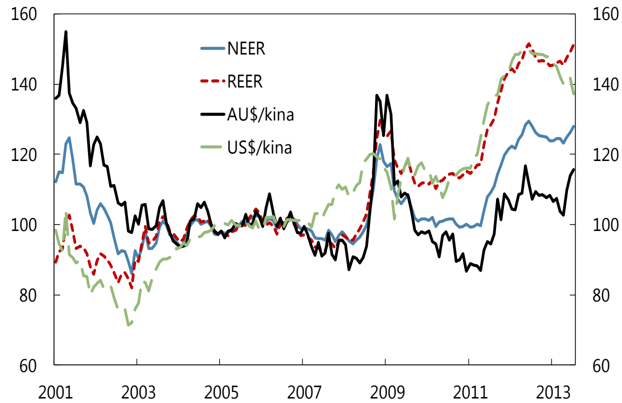


Sources: Bank of Papua New Guinea; IMF, *International Financial Statistics*, and IMF staff calculations.

Figure 4. Papua New Guinea: The External Position

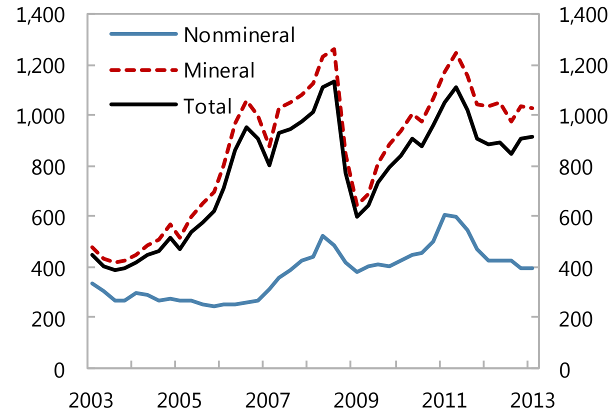
Exchange rates have stabilized after rapid appreciation for several years…

Exchange Rates
(2005 =100)



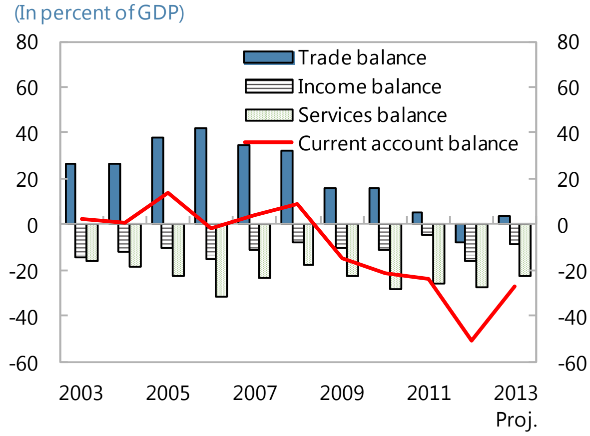
…but the terms of trade worsened as both mineral and nonmineral export prices fell.

Export Price Indices
(1994=100)



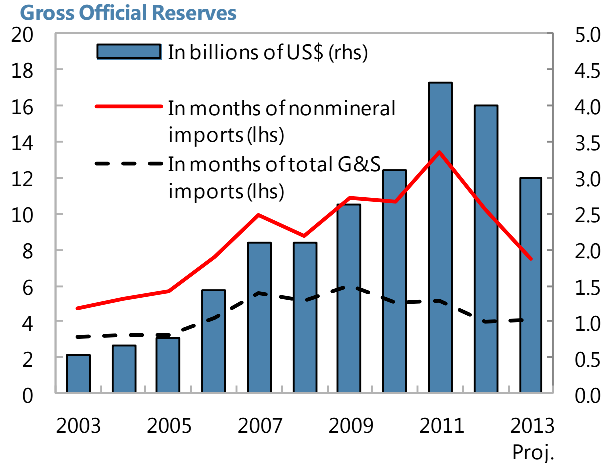
The current account deficit is expected to narrow sharply as imports and income outflows related to the LNG project decline.

External Trade and Current Account
(In percent of GDP)



Official reserves have declined but remain adequate.

Gross Official Reserves



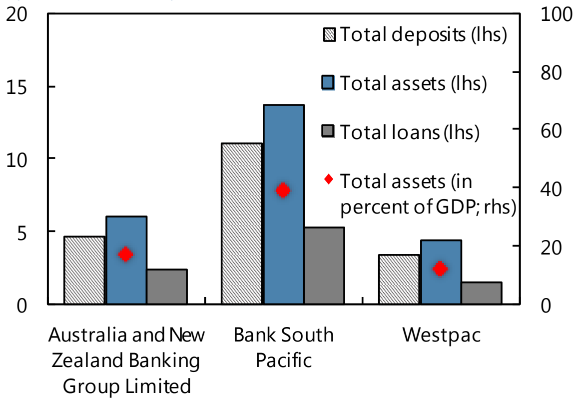
Sources: Bank of Papua New Guinea; Bloomberg; Information Notice System; and IMF staff estimates and projections.

Figure 5. Papua New Guinea: The Banking Sector

The banking sector is dominated by three banks…

Banks' Assets and Liabilities, March 2013

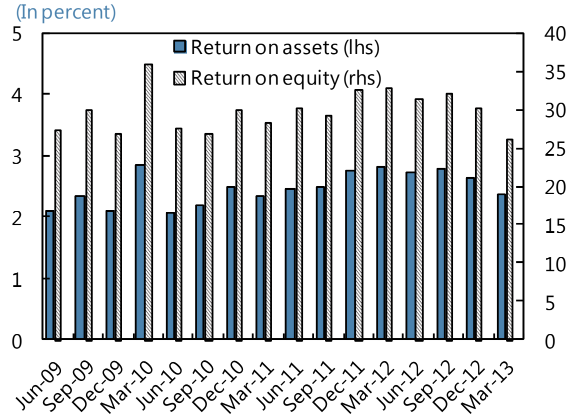
(In billions of kina)



…and they continue to be quite profitable.

Banks' Return on Assets and Equity

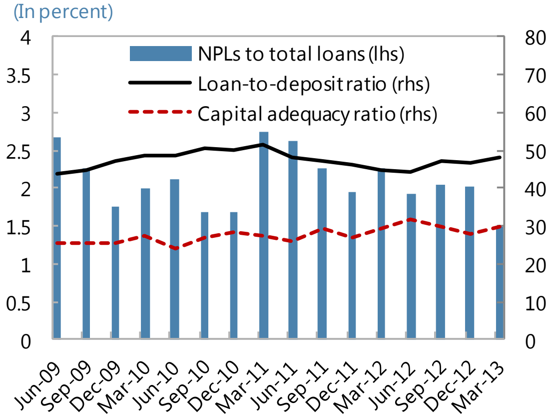
(In percent)



…with low NPLs and high capital adequacy…

Bank Vulnerability Ratios

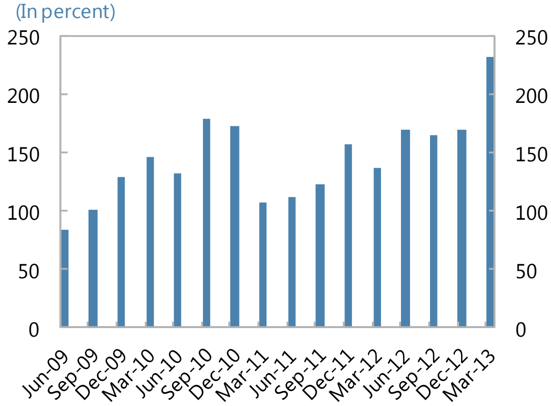
(In percent)



…while provisioning also remains high.

Bank Provisioning to NPLs

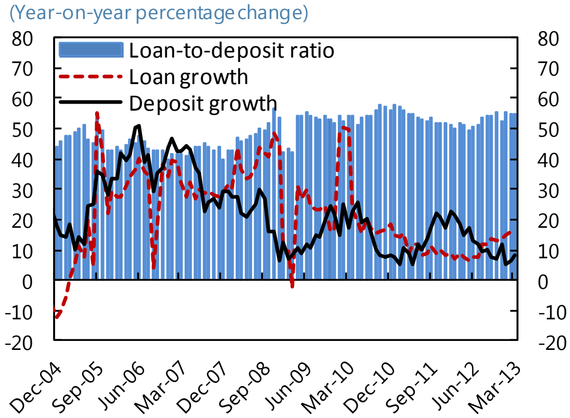
(In percent)



The loan-to-deposit ratio has stayed low reflecting deposit-based funding structure and excess liquidity.

Growth of Bank Loans and Deposits

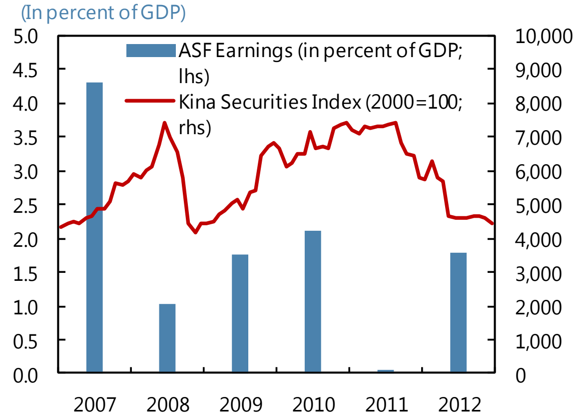
(Year-on-year percentage change)



Meanwhile, earnings of superannuation funds improved a little after a big drop in 2011.

Earnings of Superannuation Funds

(In percent of GDP)

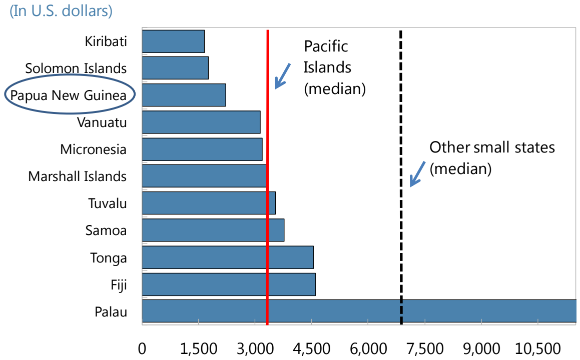


Sources: Bank of Papua New Guinea; IMF, *International Financial Statistics*, and IMF staff calculations.

Figure 6. Papua New Guinea: The Cross-Country Context

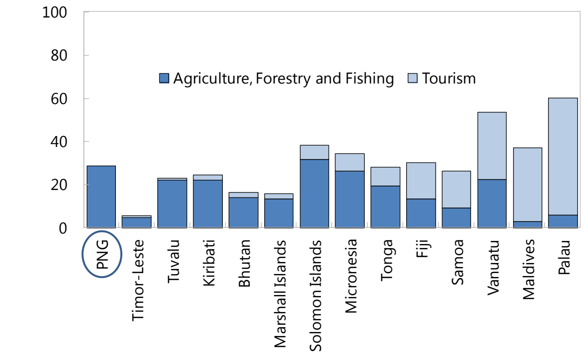
Papua New Guinea is among the lowest income countries in the region…

GDP per Capita, 2012
(In U.S. dollars)



…with a large share of subsistence farming and an underdeveloped tourism industry.

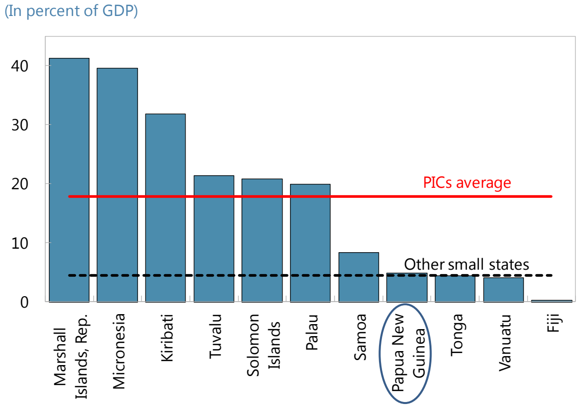
Real GDP - Selected Industries, 2011[1]



[1]For Timor-Leste, Kiribati and Palau 2010; and for Solomon Islands, PNG and Tuvalu 2012.

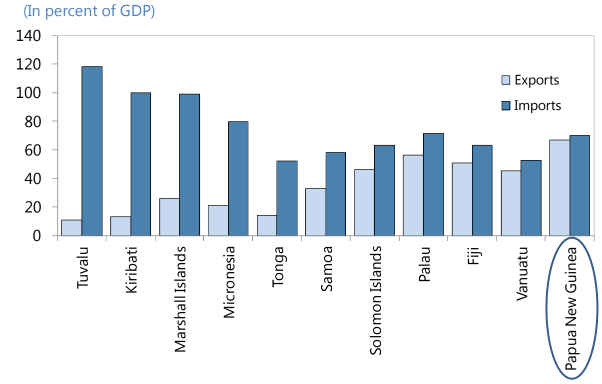
However, it does not depend much on foreign aid.

External Grants, 2005-2012
(In percent of GDP)



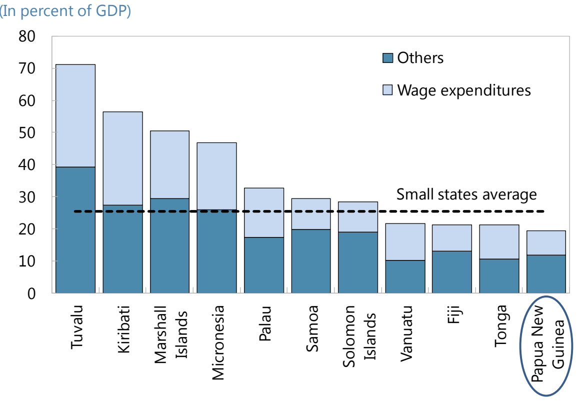
The trade account is more balanced than peer countries.

Trade Goods and Services, 2005-2012
(In percent of GDP)



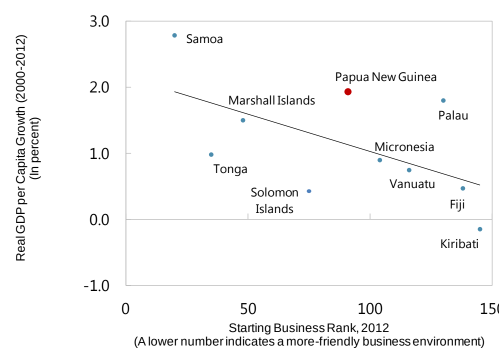
Government spending is moderate in regional comparison…

Current Government Expenditure, 2012
(In percent of GDP)



…while there is scope for improving the business climate.

Business Environment and Real GDP per Capita Growth



Sources: Bank of Papua New Guinea; IMF, *International Financial Statistics, World Economic Outlook*; country authorities, and IMF staff calculations.

Table 1. Papua New Guinea: Selected Economic and Financial Indicators, 2009–14

Nominal GDP (2012):	US$15.4 billion 1/
Population (2012):	7.2 million
GDP per capita (2012):	US$2,146
Quota:	SDR 131.6 million

	2009	2010	2011	2012	2013	2014
				Est.	Proj.	
			(Percentage change)			
Real sector						
Real GDP growth	6.1	7.7	10.7	8.1	5.4	6.3
Mineral	-1.7	-2.0	-11.8	-6.9	5.3	80.7
Nonmineral	7.0	8.7	12.8	9.2	5.4	1.7
CPI (annual average)	6.9	6.0	8.4	2.2	4.0	6.0
CPI (end-period)	5.7	7.2	6.9	1.6	5.5	6.0
			(In percent of GDP)			
Central government operations						
Revenue and grants	27.3	31.3	30.4	29.6	27.6	25.4
Expenditure and net lending	36.9	28.2	28.7	32.8	33.9	31.3
Net lending(+)/borrowing(-) [Overall balance] (Revenue - expenditure)	-9.6	3.1	1.7	-3.2	-6.3	-5.8
Nonmineral net lending(+)/borrowing(-)	-13.3	-3.6	-5.7	-6.7	-9.3	-9.3
			(Percentage change)			
Money and credit (percentage change)						
Domestic credit	37.3	4.9	-5.2	37.7	24.6	20.3
Credit to the private sector	15.1	18.1	7.9	12.1	11.2	9.6
Broad money	21.3	10.2	17.5	11.0	10.1	9.2
Interest rate (182-day Treasury bills; period average)	7.2	6.4	6.7	4.9	…	…
			(In billions of U.S. dollars)			
Balance of payments 2/						
Exports, f.o.b.	4.5	5.9	6.9	6.1	6.0	7.2
Of which: Mineral	3.4	4.4	4.9	4.5	4.5	5.5
Imports, c.i.f.	-3.3	-4.3	-6.3	-7.4	-5.4	-4.4
Current account (including grants)	-1.2	-2.1	-3.0	-7.7	-4.4	-0.4
(In percent of GDP)	-15.2	-21.4	-23.5	-51.0	-27.0	-2.0
Gross official international reserves	2.6	3.1	4.3	4.0	3.0	4.3
(In months of nonmining imports, c.i.f.)	10.9	10.6	13.5	10.3	7.5	11.4
(In months of goods and services imports)	6.0	5.0	5.2	4.0	4.1	7.1
			(In percent of GDP)			
Government debt	31.3	25.3	22.3	26.7	31.6	33.6
External debt-to-GDP ratio (in percent) 3/	12.5	10.4	7.5	7.5	7.9	8.2
External debt-service ratio (percent of exports) 3/	1.8	1.4	1.3	0.7	1.4	1.2
Exchange rates						
US$/kina (end-period)	0.3700	0.3785	0.4665	0.4755	…	…
NEER (2005=100, end-period)	106.9	100.7	108.6	125.4	…	…
REER (2005=100, end-period)	116.4	113.1	127.5	147.0	…	…
Nominal GDP (in billions of kina)	22.3	26.4	30.5	32.1	34.6	40.2

Sources: Department of Treasury; Bank of Papua New Guinea; and IMF staff estimates and projections.

1/ Based on period average exchange rate.

2/ Includes staff's estimates related to the PNG LNG project.

3/ Public external debt includes external debt of the central government, the central bank, and statutory authorities.

Table 2. Papua New Guinea: Summary Operations of the Central Government, 2009-14

	2009	2010	2011	2012	2013	2014
					Proj.	
	(In millions of kina, unless otherwise indicated)					
Revenue and grants	6,097	8,261	9,280	9,497	9,561	10,233
Nonmineral revenue	4,388	5,095	5,991	7,302	7,835	8,097
Mineral revenue	831	1,775	2,264	1,103	1,022	1,380
Grants	878	1,391	1,025	1,091	704	756
Expenditure	8,238	7,441	8,764	10,535	11,748	12,577
Expense	4,184	4,162	5,348	6,200	7,053	7,436
Net acquisition of nonfinancial assets	4,054	3,279	3,416	4,335	4,695	5,141
Gross operating balance (Revenue - expenditure)	1,912	4,099	3,932	3,297	2,508	2,797
Net lending(+)/borrowing(-) [Overall balance]	-2,141	820	516	-1,039	-2,187	-2,344
Nonmineral net lending(+)/borrowing(-) [Nonmineral overall balance]	-2,972	-955	-1,748	-2,142	-3,209	-3,724
CASH FLOWS FROM FINANCING ACTIVITIES:						
Net acquisition of financial assets	1,066	-697	-1,763	359	33	104
Net incurrence of liabilities	171	-330	954	2,333	2,214	2,380
	(In percent of GDP)					
Revenue and grants	27.3	31.3	30.4	29.6	27.6	25.4
Nonmineral revenue	19.7	19.3	19.6	22.7	22.6	20.1
Mineral revenue	3.7	6.7	7.4	3.4	3.0	3.4
Grants	3.9	5.3	3.4	3.4	2.0	1.9
Expenditure	36.9	28.2	28.7	32.8	33.9	31.3
Expense	18.7	15.8	17.5	19.3	20.4	18.5
Net acquisition of nonfinancial assets	18.2	12.4	11.2	13.5	13.6	12.8
Gross operating balance (Revenue - expenditure)	8.6	15.5	12.9	10.3	7.2	6.9
Net lending(+)/borrowing(-) [Overall balance]	-9.6	3.1	1.7	-3.2	-6.3	-5.8
Nonmineral net lending(+)/borrowing(-) [Nonmineral overall balance]	-13.3	-3.6	-5.7	-6.7	-9.3	-9.3
CASH FLOWS FROM FINANCING ACTIVITIES:						
Net acquisition of financial assets	4.8	-2.6	-5.8	1.1	0.1	0.3
Net incurrence of liabilities	0.8	-1.3	3.1	7.3	6.4	5.9
	(In percent of nonmineral GDP)					
Revenue and grants	34.6	40.3	37.4	34.5	31.8	31.6
Nonmineral revenue	24.9	24.8	24.1	26.5	26.1	25.0
Taxes on income, profits, and capital gains	9.0	8.3	7.7	8.1	7.8	7.7
Taxes on payroll and workforce	7.0	7.3	8.7	9.6	8.9	8.8
Taxes on property	0.0	0.2	0.2	0.2	0.4	0.3
Taxes on goods and services	6.0	5.8	4.2	5.7	5.8	5.8
Taxes on international trade and transactions	2.2	2.8	2.9	2.5	2.4	1.9
Other taxes	0.6	0.5	0.4	0.4	0.8	0.5
Mineral revenue	4.7	8.7	9.1	4.0	3.4	4.3
Mineral and petroleum taxes	3.9	7.2	8.3	3.6	3.0	3.8
Mining and petroleum dividends	0.8	1.5	0.8	0.4	0.4	0.5
Grants	5.0	6.8	4.1	4.0	2.3	2.3
Expenditure	46.8	36.3	35.3	38.3	39.1	38.9
Expense	23.8	20.3	21.5	22.5	23.5	23.0
Compensation of employees	10.1	9.0	9.2	8.8	10.0	9.5
Purchases of goods and services	7.6	6.2	7.8	8.7	6.6	6.3
Interest	2.5	1.7	1.7	1.6	1.7	2.7
Subsidies	1.5	1.4	1.2	1.4	0.4	0.4
Grants	0.8	0.7	0.7	0.8	1.0	1.0
Other payments	1.2	1.2	1.0	1.3	3.6	3.2
Net acquisition of nonfinancial assets	23.0	16.0	13.8	15.7	15.6	15.9
Gross operating balance (Revenue - expenditure)	10.9	20.0	15.8	12.0	8.3	8.6
Net lending(+)/borrowing(-) [Overall balance]	-12.2	4.0	2.1	-3.8	-7.3	-7.2
Nonmineral net lending(+)/borrowing(-) [Nonmineral overall balance]	-16.9	-4.7	-7.0	-7.8	-10.7	-11.5
Memorandum items:						
Additional priority expenditure (in percent of GDP)	10.6	3.3	4.7	3.9	1.3	0.0
Government deposits (in percent of GDP)	11.5	12.3	15.8	11.7	10.8	9.0
Gross government debt (in percent of GDP)	31.3	25.3	22.3	26.7	31.6	33.6
Domestic (in percent of GDP)	19.1	15.2	15.5	19.3	23.5	25.3
External (in percent of GDP)	12.3	10.1	6.8	7.4	8.1	8.3
Non-contingent liabilities (in percent of GDP)	26.5	23.6	19.5	17.6	16.5	15.1
Net public debt (in percent of GDP) 1/	29.0	20.1	13.3	21.5	27.3	31.2
Nonmineral GDP at current prices (in millions of kina)	17,616	20,504	24,842	27,537	30,063	32,355
GDP at current prices (in millions of kina)	22,331	26,421	30,511	32,132	34,605	40,244

Sources: Department of Treasury; and IMF staff estimates and projections.

1/ Gross public debt and non-contingent liabilities less government assets including LNG equity stake.

Table 3. Papua New Guinea: Balance of Payments, 2009–14
(In millions of U.S. dollars)

	2009	2010	2011	2012	2013	2014
				Est.	Proj.	
Current account balance 1/	-1,233	-2,080	-3,021	-7,717	-4,355	-357
Mineral	587	-204	-2,684	-4,987	-1,235	2,025
Nonmineral	-1,819	-1,876	-1,546	-2,758	-3,120	-2,383
Trade balance	1,264	1,564	628	-1,207	609	2,719
Exports (f.o.b.)	4,526	5,857	6,906	6,144	5,965	7,154
Mineral	3,441	4,444	4,854	4,470	4,477	5,467
Nonmineral	1,085	1,413	2,052	1,674	1,487	1,686
Imports (c.i.f.)	-3,262	-4,293	-6,278	-7,351	-5,355	-4,435
Mineral	-1,356	-1,939	-3,625	-4,726	-2,797	-1,700
Nonmineral	-1,907	-2,354	-2,654	-2,626	-2,559	-2,735
Services	-1,813	-2,765	-3,342	-4,226	-3,637	-2,287
Income	-857	-1,068	-553	-2,450	-1,454	-997
Current Transfers	173	190	246	167	126	208
Capital and financial account balance	1,636	2,552	4,398	7,595	3,351	1,635
Direct investment	1,382	554	1,024	1,883	904	2,100
Other investment	254	1,998	3,374	5,712	2,447	-1,465
Medium- and long-term loans	956	1,808	4,299	8,329	-175	-918
Commercial banks	98	89	76	-88	-6	-47
Other	-800	100	-1,000	-2,528	2,628	-500
Net errors and omissions	-71	-3	-147	-199	0	0
Overall balance	333	469	1,231	-321	-1,004	1,277
Financing	-333	-469	-1,231	321	1,004	-1,277
Reserve assets	-529	-469	-1,231	321	1,004	-1,277
Other foreign liabilities	196	0	0	0	0	0
Memorandum items:						
Current account (in percent of GDP)	-15.2	-21.4	-23.5	-51.0	-27.0	-2.0
Mineral	7.2	-2.1	-20.9	-33.0	-7.7	11.2
Nonmineral	-22.4	-19.3	-12.0	-18.2	-19.3	-13.2
Net international reserves (end-year)						
In millions of U.S. dollars	2,426	2,895	4,126	3,804	2,800	4,077
Gross official reserves (end-year)						
In millions of U.S. dollars	2,623	3,092	4,323	4,001	2,997	4,275
In months of imports of goods and services	6.0	5.0	5.2	4.0	4.1	7.1
Public external debt-service-exports ratio (in percent) 2/	1.8	1.4	1.3	0.7	1.4	1.2
Public external debt-GDP ratio (in percent) 2/	12.5	10.4	7.5	7.5	7.9	8.2

Sources: Data provided by the Papua New Guinea authorities; and IMF staff estimates and projections.

1/ Includes staff's estimates related to the PNG LNG project.

2/ Public external debt includes external debt of the central government, the central bank, and statutory authorities.

Table 4. Papua New Guinea: Summary Accounts of the Depository Corporations, 2009–14

	2009	2010	2011	2012	2013	2014
					Proj.	
Bank of Papua New Guinea			(In millions of kina; end of period)			
Net foreign assets	6,554	7,652	8,844	8,000	5,965	8,851
Foreign assets	7,091	8,170	9,266	8,415	6,397	9,299
Foreign liabilities	536	518	423	415	431	448
Net domestic assets	-4,741	-5,636	-5,585	-4,167	-1,710	-4,127
Domestic credit	-220	-639	-1,423	-438	-708	-700
Net credit to government	-261	-652	-1,501	-487	-757	-749
Claims	333	367	431	499	752	990
Central government deposits	593	1,019	1,933	985	1,508	1,738
Credit to other sectors	40	13	79	49	49	49
Other items, net	-4,520	-4,997	-4,162	-3,729	-1,002	-3,427
Of which: Central bank securities	-4,117	-4,594	-5,687	-5,149	-1,383	-5,110
Reserve money	1,814	2,016	3,259	3,834	4,255	4,723
Currency in circulation	1,002	1,193	1,532	1,679	1,809	2,103
Deposits of other depository corporations	808	810	1,724	2,142	2,434	2,607
Required reserves	369	514	945	1,391	1,529	1,668
Excess reserves	440	296	779	751	905	940
Other deposits	3	13	3	13	13	13
Depository Corporations Survey			(In millions of kina; end of period)			
Net foreign assets	7,924	8,968	10,114	9,472	7,551	10,694
Net domestic assets	3,846	3,999	5,118	7,432	11,054	9,631
Domestic credit	6,665	6,993	6,630	9,131	11,378	13,690
Net credit to central government	574	-202	-1,077	297	1,599	3,005
Claims on other sectors	6,091	7,195	7,707	8,834	9,779	10,684
Claims on the private sector	5,902	6,971	7,522	8,434	9,377	10,279
Other items, net	-2,820	-2,994	-1,513	-1,699	-324	-4,058
Broad money	11,770	12,967	15,231	16,904	18,605	20,325
Narrow money	6,233	7,644	9,620	11,148	12,158	13,105
Currency outside other depository corporations	789	955	1,188	1,214	1,360	1,523
Demand deposits	5,444	6,689	8,431	9,934	10,798	11,582
Quasi-money	5,537	5,323	5,612	5,756	6,447	7,220
			(Annual percentage change)			
Net foreign assets	28.9	13.2	12.8	-6.3	-20.3	41.6
Net domestic assets	8.2	4.0	28.0	45.2	48.7	-12.9
Net domestic credit	37.3	4.9	-5.2	37.7	25	20.3
Of which: Private sector	15.1	18.1	7.9	12.1	11.2	9.6
Broad money	21.3	10.2	17.5	11.0	10.1	9.2
Memorandum items:						
Reserve money (percentage change)	11.9	11.1	61.7	17.6	11.0	11.0
Gross international reserves (in millions of U.S. dollars)	2,623	3,092	4,323	4,001	2,997	4,275
Nominal nonmineral GDP/Broad money	1.5	1.6	1.6	1.6	1.6	1.6

Sources: Bank of Papua New Guinea; and IMF staff estimates and projections.

Table 5. Papua New Guinea: Medium-Term Scenario, 2009–18

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
				Est.			Projections			
Growth and prices (percentage change)										
Real GDP 1/	6.1	7.7	10.7	8.1	5.4	6.3	21.4	3.3	3.4	3.5
Mineral	-1.7	-2.0	-11.8	-6.9	5.3	80.7	178.3	-0.7	-0.6	-0.6
Nonmineral	7.0	8.7	12.8	9.2	5.4	1.7	4.2	4.5	4.5	4.5
CPI (period average)	6.9	6.0	8.4	2.2	4.0	6.0	6.0	6.0	6.0	6.0
CPI (end-period)	5.7	7.2	6.9	1.6	5.5	6.0	6.0	6.0	6.0	6.0
Central government operations (in percent of GDP)										
Total revenue and grants	27.3	31.3	30.4	29.6	27.6	25.4	22.4	22.6	22.9	23.1
Total revenue	23.4	26.0	27.1	26.2	25.6	23.5	20.9	21.1	21.4	21.7
Of which: Mineral revenue	3.7	6.7	7.4	3.4	3.0	3.4	5.2	4.8	4.5	4.4
Grants	3.9	5.3	3.4	3.4	2.0	1.9	1.4	1.5	1.5	1.4
Total expenditure	36.9	28.2	28.7	32.8	33.9	31.3	24.8	24.7	24.6	24.8
Primary balance	-7.6	4.4	3.1	-1.9	-4.8	-3.7	-0.6	-0.2	0.2	0.2
Nonmineral net lending(+)/borrowing(-) (Revenue - expenditure)	-13.3	-3.6	-5.7	-6.7	-9.3	-9.3	-7.6	-6.9	-6.2	-6.1
Net lending(+)/borrowing(-) [Overall balance]	-9.6	3.1	1.7	-3.2	-6.3	-5.8	-2.4	-2.1	-1.7	-1.7
Gross public debt (in percent of GDP) 2/	31.3	25.3	22.3	26.7	31.6	33.6	26.7	27.7	27.9	28.9
Domestic	18.8	14.9	14.7	19.2	23.7	25.5	19.5	19.3	18.3	18.2
External	12.5	10.4	7.5	7.5	7.9	8.2	7.1	8.4	9.7	10.7
Balance of payments (in millions of U.S. dollars) 3/										
Exports, f.o.b.	4,526	5,857	6,906	6,144	5,965	7,154	12,063	11,799	11,916	12,003
Of which: Mineral	3,441	4,444	4,854	4,470	4,477	5,467	10,177	9,888	9,936	10,010
Imports, c.i.f.	-3,262	-4,293	-6,278	-7,351	-5,355	-4,435	-4,837	-4,865	-5,011	-5,161
Current account	-1,233	-2,080	-3,021	-7,717	-4,355	-357	3,021	2,323	2,263	2,095
(In percent of GDP)	-15.2	-21.4	-23.5	-51.0	-27.0	-2.0	12.3	9.3	8.8	7.9
Overall balance (including exceptional financing)	333	469	1,231	-321	-1,004	1,277	1,549	894	610	1,390
Net official reserves (in millions of U.S. dollars)	2,426	2,895	4,126	3,804	2,800	4,077	5,626	6,520	7,130	8,520
(In months of goods and services imports, c.i.f.)	6.0	5.0	5.2	4.0	4.1	7.1	9.2	10.8	11.6	13.4
(In months of nonmining imports, c.i.f.)	10.1	9.9	12.8	9.8	7.0	10.8	14.0	15.6	16.9	19.6
Public external debt service-export ratio (in percent) 4/	1.8	1.4	1.3	0.7	1.4	1.2	0.8	0.7	0.7	0.8
Memorandum items:										
Nominal GDP (in millions of U.S. dollars)	8,105	9,716	12,869	15,134	16,145	18,062	24,489	24,977	25,705	26,659
Assumed commodity prices: 5/										
Gold (U.S. dollars per ounce)	973	1,225	1,569	1,669	1,462	1,396	1,413	1,433	1,459	1,490
Copper (U.S. dollars per ton)	5,165	7,538	8,823	7,959	7,446	7,403	7,456	7,503	7,550	7,615
Oil (U.S. dollars per barrel)	62	79	104	105	104	101	95	91	89	87

Sources: Department of Treasury; Bank of Papua New Guinea; and IMF staff estimates and projections.

1/ Real GDP growth projections are based on the chained Laspeyres measure.

2/ Public external debt includes external debt of the central government, the central bank, and statutory authorities.

3/ Includes staff's estimates related to the PNG LNG project.

4/ Public external debt service includes changes in check float.

5/ August 2013 IMF WEO projections.

Table 6. Papua New Guinea: Indicators of External Vulnerability, 2009–13

(In percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012 Est.	2013 Proj.
Financial indicators					
Gross public debt 1/ 2/	31.3	25.3	22.3	26.7	31.6
Broad money (percentage change, 12-month basis)	21.3	10.2	17.5	11.0	10.1
Private sector credit (percentage change, 12-month basis)	15.1	18.1	7.9	12.1	11.2
Interest rate (182-day Treasury bills; period average)	7.2	6.4	6.7	4.9	…
External indicators					
Exports (percentage change, 12-month basis in U.S. dollars)	-20.6	29.4	17.9	-11.0	-2.9
Imports (percentage change, 12-month basis in U.S. dollars)	3.7	31.6	46.2	17.1	-27.2
Current account balance	-15.2	-21.4	-23.5	-51.0	-27.0
Capital and financial account balance (in millions of U.S. dollars)	1,636.3	2,551.9	4,398.2	7,594.7	3,351.3
Of which: Inward foreign direct investment	1,382.1	554.2	1,023.7	1,882.8	903.9
Gross official reserves (in millions of U.S. dollars)	2,623.5	3,092.2	4,322.8	4,001.5	2,997.4
Central Bank short-term foreign liabilities (in millions of U.S. dollars)	1.7	2.7	194.5	197.2	197.2
Commerical bank foreign assets (in millions of U.S. dollars)	578.1	579.0	646.2	793.0	821.9
Commerical bank foreign liabilities (in millions of U.S. dollars)	71.2	80.9	61.9	93.1	96.5
Gross official reserves (in months of nonmineral imports, c.i.f.)	10.9	10.6	13.5	10.3	7.5
Broad money to gross reserves (ratio)	1.7	1.6	1.6	2.0	2.8
Total short-term external debt to reserves (in percent) 3/	2.7	2.6	1.4	2.3	3.2
Public external debt-to-GDP ratio (in percent)	12.5	10.4	7.5	7.5	7.9
Exchange rate (kina per U.S. dollar; period average)	2.7	2.6	2.1	2.1	..
Financial market indicators					
Foreign currency long-term government debt rating 1/					
Moody's	Ba2	Ba2	Ba2	Ba2	..
Standard & Poors	B+	B+	B+	B+	..

Sources: Department of Treasury; Bank of Papua New Guinea; and IMF staff estimates and projections.

1/ End of period.

2/ Public external debt includes external debt of the central government, the central bank, and statutory authorities.

3/ Short-term external debt covers only the banking system.

Table 7. Papua New Guinea: Financial Soundness Indicators of Deposit-taking Institutions, [1/] 2009–13

(In percent)

	2009	2010	2011	2012	2013
Capital Adequacy					
Capital to risk-weighted assets 2/	25.7	28.3	26.9	28.0	29.7
Tier 1 capital to risk-weighted assets	18.5	21.1	19.6	20.1	23.6
Asset Quality					
Nonperforming loans to total loans	1.8	1.7	2.0	2.0	1.5
Past due loans to total loans	2.8	2.2	5.1	2.8	2.8
Provision for losses to NPL	129.6	173.6	158.2	170.9	232.1
Earnings and Profitability					
Return on assets	2.1	2.5	2.8	2.6	2.4
Return on equity 3/	26.9	29.8	32.5	30.0	26.0
Liquidity					
Liquid assets to total assets	58.0	56.6	58.5	56.6	55.9
Loan-to-deposit ratio	47.0	49.9	46.3	46.9	48.2
Other					
Capital to total assets 2/	12.4	13.7	12.8	13.6	14.4
Risk-weighted assets to total assets	48.5	48.5	47.5	48.7	48.4

Sources: Bank of Papua New Guinea; and IMF staff calculations.
1/ Fourth quarter data for each year. For 2013, as of March 2013.
2/ Capital base includes Tier 1 and 2 capital.
3/ Return on equity is calculated with Tier 1 capital.

Table 8. Papua New Guinea: State of Millennium Development Goals

Progress on Millennium Development Goals (MDGs)		
	Global targets	**Papua New Guinea's National Targets**
Goal 1: Eradicate extreme poverty and hunger	Off track	On track
Goal 2: Achieve universal primary education	Off track	Mixed
Goal 3: Promote gender equality and empower women	Off track	Mixed
Goal 4: Reduce child mortality	Off track	On track
Goal 5: Improve maternal health	Off track	Off track
Goal 6: Combat HIV/AIDS, malaria and other diseases	Off track	Off track
Goal 7: Ensure environmental sustainability	Off track	Off track
Goal 8: Develop a global partnership for development	Off track	Not a national target

Sources: UNDP Papua New Guinea; and Pacific Islands Forum Secretariat, 2012 and 2013 Pacific Regional MDGs Tracking Reports.

Appendix I. Papua New Guinea—Risk Assessment Matrix[1]

Main Sources of Risks	Likelihood (high, medium, or low)	Expected Impact on Economy (high, medium, or low)	Possible Policy Responses
Lower than anticipated emerging market growth potential	**Medium** A significant growth shock to emerging markets, especially a further slowdown in China, could result in a large drop in world commodity prices.	**High** A sharp decline in PNG's exports would worsen the trade balance. It would also reduce fiscal revenue and weaken the reserves buffer and the kina. FDI inflows would also be adversely affected.	Introduce temporary fiscal and monetary stimulus; allow the kina to depreciate to boost exports and protect foreign reserves; redirect expenditure further to the vulnerable.
LNG price drop owing to shale gas development	**Low/Medium** Shale gas development around the world could depress LNG prices in the medium to long run.	**High** Lower LNG prices would reduce fiscal revenue and export proceeds. Development of future LNG projects would become less likely.	Allow the kina to depreciate to boost nonmineral exports; increase tax rates and/or broaden revenue base; lower expenditure over time.
Protracted economic and financial volatility, especially for emerging markets	**High** Capital flows to emerging markets would reverse as advanced economies unwind credit easing.	**Low/Medium** Higher funding costs would adversely affect the mining sector with flow-on effects on nonmining activities.	Allow the kina to depreciate to support exporting firms; intensify monitoring of the financial sector as activity slows.
Property market corrections	**Low/Medium** Property prices in Port Moresby and Lae could fall sharply.	**Medium** Authorized superannuation funds and local banks could be adversely affected.	Accelerate clearance of superannuation arrears; write down losses in the funds; ensure banks' capital adequacy; and provide emergency liquidity support if needed.
Political instability and worsening security	**Low/Medium** Tensions could arise within the ruling coalition; regional and tribal tensions could increase and law and order worsen.	**Medium/High** Rent-seeking behavior could intensify and more nonproductive expenditures could arise. Confidence would fall and investment would be discouraged.	Increase spending to improve security, but with greater fiscal transparency; resist monetary accommodation of fiscal expansion; highlight economic importance of political and social stability.
Natural disasters	**Low/Medium** PNG is prone to earthquakes and cyclones.	**Medium/High** Given PNG's poor infrastructure and weak capacity, the economic impact can be significant.	Ensure fiscal buffers are adequate to support affected groups and spend more on preparation and prevention; encourage take-up of disaster insurance.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities.

Appendix II. Papua New Guinea—Authorities' Response to Fund Policy Advice

Fund Recommendation	Policy Actions
Monetary Policy	
To enhance the effectiveness of monetary policy, the operation should move to interest rate-based policy and the liquidity abundant situation has to be addressed.	Even though the BPNG has frequently used its policy rate as a monetary policy tool, its effectiveness appears to be limited due to the existence of large excess liquidity. Money market rates remain weakly anchored by the policy rate.
To absorb possible external shocks, the exchange rate needs to be more flexible.	The kina began to depreciate in the second half of 2012. The BPNG's intervention has aimed to stabilize the kina from fluctuating widely from trends while also assisting liquidity management.
Monetary policy cost for BPNG to drain excess liquidity in the market has to be reduced by transferring trust accounts from commercial banks to BPNG.	The trust accounts are expected to be phased out over time as the government implements multiyear budgeting and the SWF begins to operate, but early steps to move them to BPNG could aid monetary policy effectiveness.
Fiscal Policy	
The fiscal policy framework should move from a quasi-balanced budget approach toward a steady real expenditure path.	Based on the new 2013-17 Medium-Term Fiscal Strategy, the authorities target annual fiscal deficits and a debt ceiling of 30 percent of GDP in the medium term. This does not guarantee a steady expenditure path, but it does allow more flexibility for countercyclical policy and expenditure management.
To secure taxes from the resource sector efficiently, the related tax codes need to be reviewed and existing tax concessions need to be streamlined.	After Fund TA, a comprehensive review of the tax regime is in progress with a view to maximizing revenue and encouraging new investments.
The withdrawal rules for SWF should be set in conjunction with the new MTFS. Moreover, the integration of the Development Fund with the budget process should be clarified. Existing trust accounts should be consolidated with the fund.	The withdrawal rules were clarified. However, the maximum amount allowed to be withdrawn appears to be too high, such that funds accumulated in the SWF may not ultimately be enough to serve its stabilization purposes. The authorities agreed to revisit the withdrawal rules again.
Structural Reform	
Further measures to improve competition are needed in sectors with established monopolies, especially in rice production.	Several regulatory and industry reviews have been undertaken to encourage greater private sector participation in areas such as information and communications technology and electricity. The rice monopoly issue has been resolved.
Financial Sector Policy	
AML/CFT recommendations need to be implemented.	PNG is at risk of being "gray-listed" by the Financial Action Task Force (FATF). The government has prepared a draft action plan for Cabinet approval.

Appendix III. Papua New Guinea: Debt Sustainability Analysis Update[1]

This debt sustainability analysis (DSA) indicates that Papua New Guinea remains at low risk of debt distress. Baseline projections suggest that PNG's overall public debt is sustainable. Scenario analysis highlights the need to exercise fiscal discipline and to control broad public liabilities—including contingent liabilities—as well as the importance of successfully completing the LNG project to maintain PNG's debt sustainability.

A. Background

PNG has been reducing its public and external debt burden over the past decade.[2] Public sector debt declined from 62 percent of GDP at end-2004 to about 27 percent of GDP at end-2012 (Table 1a). Public and publicly guaranteed (PPG) external debt has also declined sharply, from a peak of over 50 percent of GDP in 2001 to the current 7½ percent of GDP (Table 3a). Around 70 percent of current public external debt is owed to the Asian Development Bank and the World Bank, with the rest mainly to China and Japan.

B. Economic Outlook and Underlying DSA Assumptions

PNG's growth prospects and current account developments over the medium term will be heavily influenced by its extractive sector. Box 1 summarizes the medium-term macroeconomic framework underlying this DSA update. Economic activity is projected to slow significantly in 2013, as the construction phase of the LNG project draws to a close. When LNG production starts in the second half of 2014, real GDP growth is expected to rise to more than 6 percent in 2014 and 21 percent in 2015 when LNG production reaches full capacity. The current account deficit has widened sharply in recent years, largely as a result of increased imports and income outflows related to the LNG project, which are funded by corresponding FDI and medium and long-term loans. The deficit is expected to narrow significantly in 2013, and with LNG exports coming on stream next year, it is set to decline quickly and turn into a surplus in 2015.

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[1] As Papua New Guinea is an IBRD/IDA blend country, this DSA update is prepared by Fund staff in close consultation with the World Bank and the Asian Development Bank (AsDB) using the IMF-World Bank DSA framework for Low-Income Countries. The fiscal year for Papua New Guinea is the calendar year. An IMF country team visited Papua New Guinea for the 2013 Article IV consultation from late August to early September 2013.

[2] Papua New Guinea is rated as a medium performer for its policies and institutions for the purposes of the IMF-World Bank low-income country DSA framework. Consequently, the applicable thresholds for PNG for external public debt are: 40 percent for the present value (PV) of the debt-to-GDP ratio; 150 percent for the PV of the debt-to-exports ratio; 250 percent for the PV of the debt-to-revenue ratio; 20 percent for the debt service-to-exports ratio; and 20 percent for the debt service-to-revenue ratio.

C. External Debt Sustainability Analysis

The baseline scenario indicates that all PPG external debt ratios stay well below the indicative thresholds. The external debt burden registers a small increase in the medium term, peaking at around 10 percent before declining in the long run (Figure A1; Table 3). Since additional financing needs for the LNG project and the current account deficit would be met with projected large FDI inflows and medium- and long-term debt drawdowns, the need for public external borrowing is relatively small. PNG's public external debt service ratios are also very low, reflecting its relatively small debt stock as well as the fact that most of its public external debt is highly concessional.

PNG is vulnerable to shocks under the historical scenario despite the current low debt burden, but this scenario has a low probability of materializing. There is a protracted breach of the PV of debt-to-GDP ratio under the historical scenario (Figure A1-b), which could be thought of as circumstances where the LNG project has completely failed or suffered a major delay. In this scenario, when the current account deficit is fixed at the ten-year average of 2003-12, the simulation effectively keeps imports at levels elevated by the LNG project and rules out the expected large increases in LNG exports over time. Given that the LNG project is over 90 percent complete, this scenario represents an unlikely event.

D. Public Debt Sustainability Analysis[3]

The overall public debt dynamics for PNG is favorable, but there are risks. The public debt burden is expected to decline continuously over the projection period under the baseline (Figure A2; Table 1). However, the projected debt path is particularly sensitive to assumptions of GDP growth and fiscal policy. For example, if the expected primary fiscal deficit in 2013 (a year of large fiscal expansion) is assumed to be maintained for the projection period, the PV of the public debt-to-GDP ratio would be above 100 percent by 2030. A scenario to analyze the debt dynamics implied by the authorities' recently released 2014 Budget Strategy Paper (BSP) is also considered. This BSP scenario assumes that the unspent portion of expenditure from 2013 will be rolled over to 2014 and spent. The analysis shows that gross government debt could rise to 37 percent of GDP in 2014, exceeding the 35 percent ceiling set by the government for that year.[4]

Other country-specific liabilities increase risks to debt sustainability. The unfunded superannuation liabilities, estimated to be about 9 percent of GDP at end-2012, remain sizable despite the recent partial payment. Contingent liabilities related to the LNG project are estimated to be about 15 percent of GDP and public enterprise liabilities are about 7½ of GDP. Should these contingent liabilities materialize, there would be a significant increase in the public debt burden over the medium term (Figure 2).

[3] Public debt includes domestic central government debt and external public and publicly guaranteed debt.

[4] The authorities' own projections suggest that the 35 percent of GDP debt ceiling will be observed.

E. Conclusion

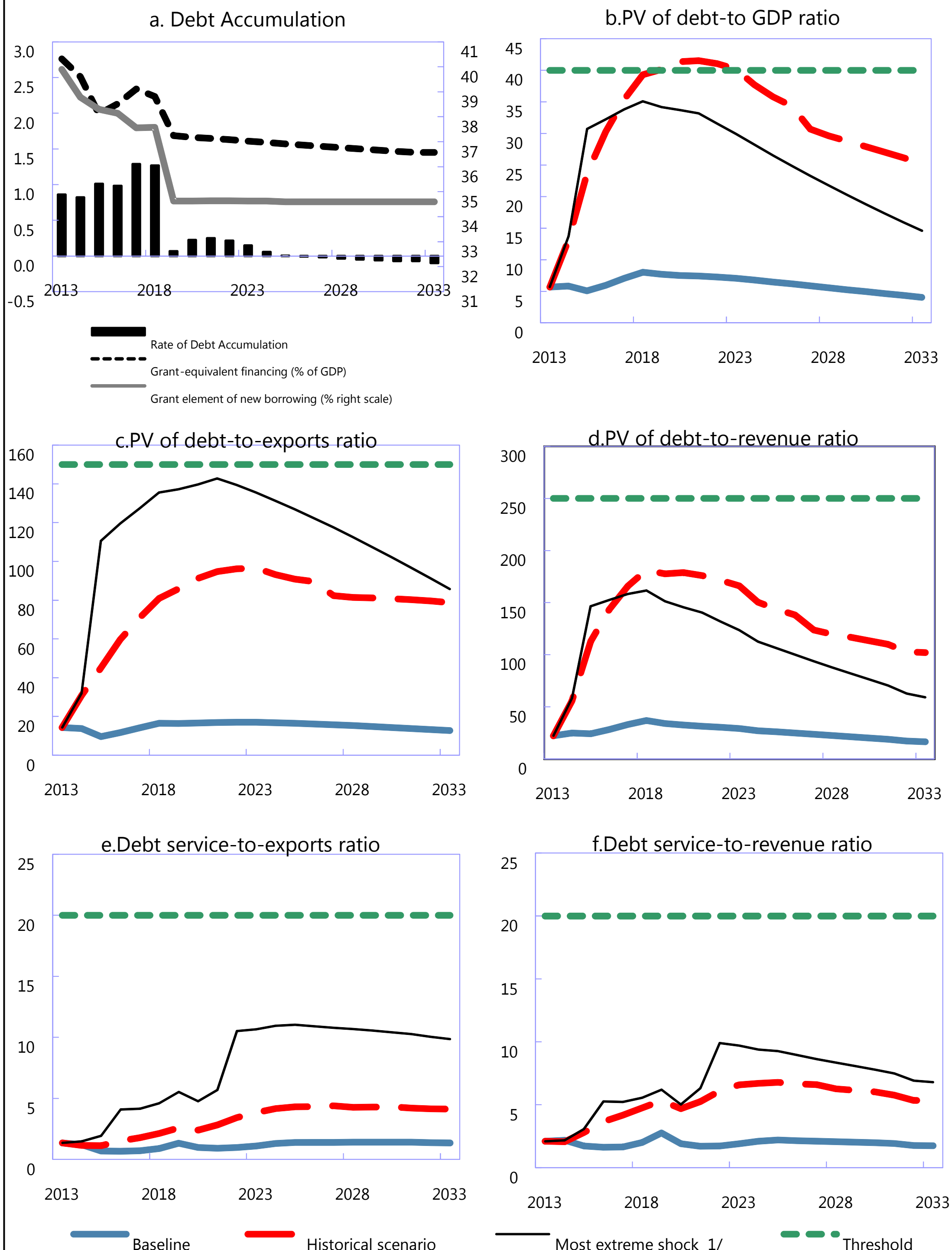
Papua New Guinea's public external debt remains at low risk of debt stress. The baseline scenario indicates that all external PPG debt burden indicators are well below their indicative thresholds. While PNG's external debt dynamics is vulnerable under the historical scenario, the increased debt burden simulated in this scenario is distorted by sharp increases in the current account deficit in recent years related to the LNG project, and thus unlikely to materialize. On the broader public debt, while the government debt burden is relatively low, the existence of large contingent liabilities has significantly increased PNG's debt vulnerability.

This DSA highlights the importance of pursuing a prudent fiscal policy and the need to control broad public liabilities. Staff encourages the authorities to adhere to the government's debt target while focusing on improving spending quality to overcome constrained fiscal space in meeting the country's development needs. Continued structural reforms to increase PNG's growth potential and diversify the economy will also help reduce its vulnerability to external shocks.

Box 1. Macroeconomic Assumptions Underlying the DSA Update

- **Real GDP growth** is projected at 7.6 percent on average over the medium term, and to slow to 3.5 percent in the long run.
- **Inflation** is expected to stabilize over the medium term at about 6 percent and is maintained at this level in the long run.
- **The current account** (including grants) will remain in deficit until 2014, primarily reflecting the strong import growth related to the construction phase of the LNG project. It will turn into a surplus in 2015 as LNG production comes on stream and imports related to the LNG project subside, and is projected to be 7 percent of GDP on average during 2015-25.
- **The grant element of loans** is expected to decline. As per capita income rises, the share of external financing provided on concessional terms is expected to decline gradually over the projection period.
- **The primary fiscal balance** is estimated to be in deficit of 5.2 percent of GDP in 2013. During the current medium-term fiscal strategy period (2013-2017), a continuous primary deficit of 3 percent of GDP on average is expected. After 2023, the primary fiscal balance is projected to turn into surplus, with an average of 0.5 percent of GDP during 2023-33.

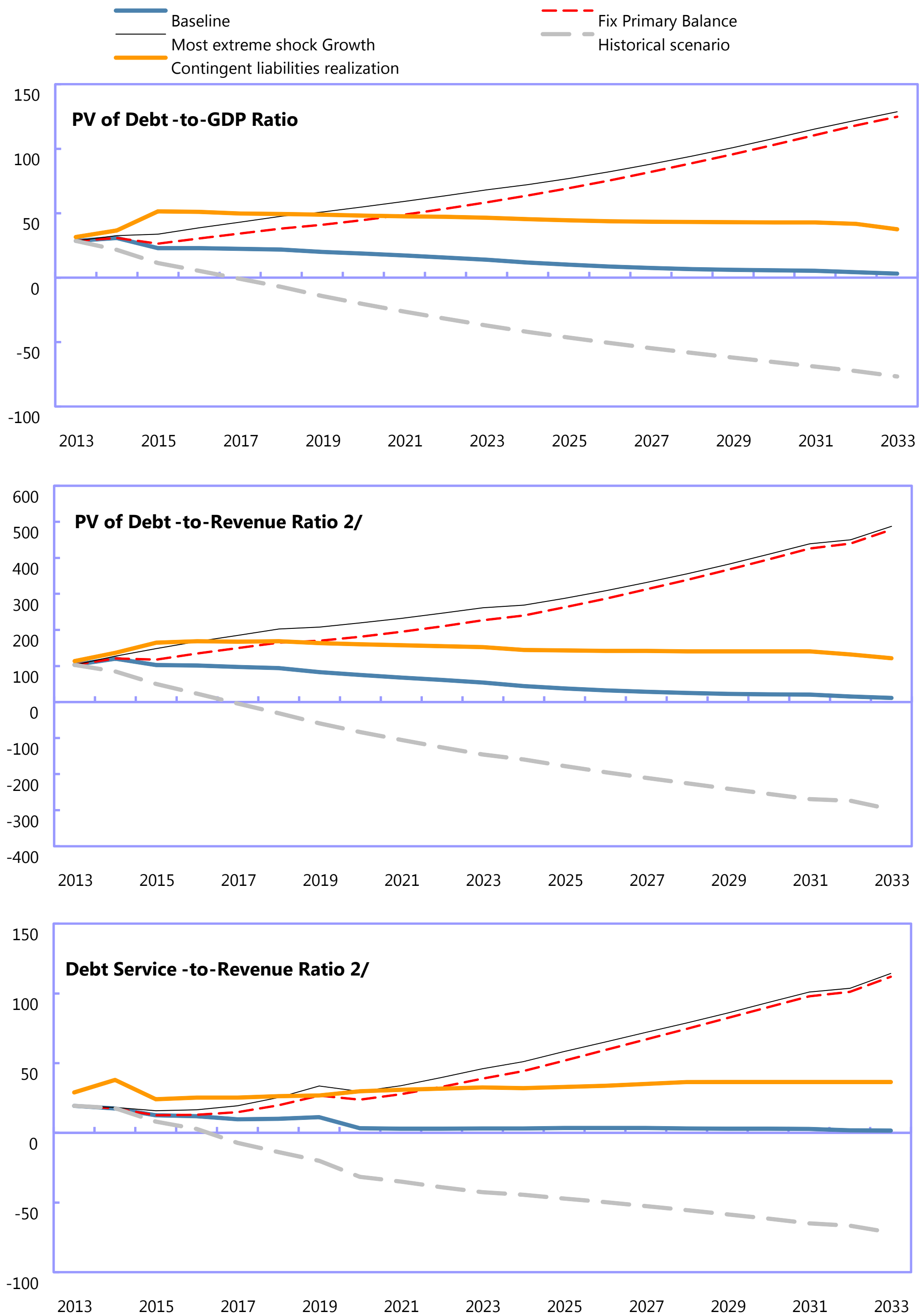
Figure A1. Papua New Guinea: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2013-2033 1/



Sources: Papua New Guinea authorities; and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2023. In figure b. it corresponds to a Combination shock; in c. to an Exports shock; in d. to a Combination shock; in e. to an Exports shock and in figure f. to a Combination shock

Figure A2.Papua New Guinea: Indicators of Public Debt Under Alternative Scenarios, 2013-2033 1/



Sources: Papua New Guinea authorities; and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2023.

2/ Revenues are defined inclusive of grants.

Table 1.Papua New Guinea: Public Sector Debt Sustainability Framework, Baseline Scenario, 2010-2033

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate				Projections					
	2010	2011	2012	Average 1/	Standard Deviation 1/	2013	2014	2015	2016	2017	2018	2013-18 Average	2023	2033	2019-33 Average
Public sector debt 2/	25.3	22.3	26.7			30.9	32.6	24.7	25.1	24.7	24.3		13.6	-0.5	
of which: foreign-currency denominated	10.1	6.8	7.4			8.1	7.8	6.9	8.1	9.5	10.5		6.8	0.5	
Change in public sector debt	-6.0	-3.0	4.4			4.1	1.7	-7.9	0.4	-0.3	-0.5		-2.0	-1.0	
Identified debt-creating flows	-8.2	-6.7	2.0			4.7	1.8	-6.8	1.0	0.3	0.3		-0.7	0.0	
Primary deficit	-4.2	-2.5	1.9	-3.7	5.6	5.3	5.2	2.0	1.4	1.2	1.2	2.7	-0.2	-0.1	-0.3
Revenue and grants	31.3	30.4	29.6			27.6	25.4	22.4	22.6	22.9	23.1		25.7	26.1	
of which: grants	5.3	3.4	3.4			2.0	1.9	1.4	1.5	1.5	1.4		1.5	1.3	
Primary (noninterest) expenditure	27.1	27.9	31.5			32.9	30.7	24.4	24.0	24.1	24.3		25.5	25.9	
Automatic debt dynamics	-4.0	-4.2	0.1			-0.6	-3.5	-8.8	-0.5	-0.8	-0.9		-0.5	0.1	
Contribution from interest rate/growth differential	-2.9	-2.4	-0.1			-0.9	-3.2	-8.3	-0.7	-1.0	-1.0		-0.5	0.1	
of which: contribution from average real interest rate	-0.6	0.1	1.6			0.5	-1.4	-2.5	0.1	-0.2	-0.2		0.0	0.1	
of which: contribution from real GDP growth	-2.2	-2.4	-1.7			-1.4	-1.8	-5.7	-0.8	-0.8	-0.8		-0.5	0.0	
Contribution from real exchange rate depreciation	-1.1	-1.9	0.2			0.3	-0.2	-0.6	0.2	0.2	0.1		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	2.2	3.7	2.5			-0.5	-0.1	-1.0	-0.6	-0.7	-0.7		-1.3	-0.9	
Other Sustainability Indicators															
PV of public sector debt	...	...	24.3			28.5	30.6	22.9	22.9	22.4	21.8		13.9	3.1	
of which: foreign-currency denominated	...	...	5.1			5.7	5.8	5.1	6.0	7.1	8.0		7.1	4.1	
of which: external	...	...	5.1			5.7	5.8	5.1	6.0	7.1	8.0		7.1	4.1	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	6.3	6.0	12.3			18.1	17.5	11.4	10.3	9.2	8.9		0.6	0.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	82.4			103.1	120.5	102.5	101.3	97.6	94.1		54.3	11.8	
PV of public sector debt-to-revenue ratio (in percent)	...	...	93.0			111.3	130.2	109.5	108.4	104.7	100.4		57.6	12.5	
of which: external 4/	...	...	19.3			22.2	24.8	24.2	28.2	33.1	37.0		29.2	16.4	
Debt service-to-revenue and grants ratio (in percent) 5/	14.8	15.2	19.3			19.4	17.6	12.6	11.9	9.8	10.0		3.0	1.7	
Debt service-to-revenue ratio (in percent) 5/	17.8	17.1	21.8			21.0	19.0	13.5	12.7	10.5	10.7		3.2	1.8	
Primary deficit that stabilizes the debt-to-GDP ratio	1.9	0.5	-2.5			1.2	3.5	9.9	1.0	1.5	1.7		1.8	0.8	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	7.7	10.7	8.1	5.8	3.0	5.4	6.3	21.4	3.3	3.4	3.5	7.2	3.0	3.0	3.1
Average nominal interest rate on forex debt (in percent)	1.6	1.5	1.7	2.4	0.7	1.5	1.7	1.9	1.8	1.7	1.7	1.7	2.2	16.8	6.1
Average real interest rate on domestic debt (in percent)	-3.9	1.0	11.0	5.2	5.4	2.9	-6.5	-12.3	0.7	-1.1	-1.2	-2.9	-0.7	...	9.1
Real exchange rate depreciation (in percent, + indicates depreciation)	-10.0	-20.6	2.7	-7.9	8.4	3.7	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	9.9	4.3	-2.6	4.6	4.6	2.2	9.4	16.1	2.7	3.5	3.8	6.3	5.0	5.0	5.1
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.2	0.1	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	39.9	38.8	38.3	38.1	37.6	37.6	38.4	34.6	34.6	...

Sources: Papua New Guinea authorities; and IMF staff estimates and projections.

1/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

2/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

3/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

4/ Revenues excluding grants.

5/ Debt service is defined as the sum of interest and amortization of medium- and long-term debt.

Table 2.Papua New Guinea: Sensitivity Analysis for Key Indicators of Public Debt 2013-2033

(In percent)

		Projections						
	2013	2014	2015	2016	2017	2018	2023	2033
PV of Debt-to-GDP Ratio								
Baseline	28	31	23	23	22	22	14	3
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	28	22	11	5	-1	-7	-37	-77
A2. Primary balance is unchanged from 2013	28	31	26	30	34	38	58	125
A3. Permanently lower GDP growth 1/	28	31	24	24	24	25	24	44
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviation in 2014-2015	28	33	34	39	43	47	68	129
B2. Primary balance is at historical average minus one standard deviation in 2014-2015	28	27	20	20	19	19	10	-1
B3. Combination of B1-B2 using one half standard deviation shocks	28	25	17	21	25	28	43	88
B4. One-time 30 percent real depreciation in 2014	28	33	25	25	24	23	17	9
B5. 10 percent of GDP increase in other debt-creating flows in 2014	28	41	32	32	32	31	24	16
PV of Debt-to-Revenue Ratio 2/								
Baseline	103	121	102	101	98	94	54	12
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	103	85	50	23	-4	-31	-145	-298
A2. Primary balance is unchanged from 2013	103	121	118	134	150	165	227	478
A3. Permanently lower GDP growth 1/	103	122	105	106	106	106	92	168
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviation in 2014-2015	103	128	148	168	185	203	262	488
B2. Primary balance is at historical average minus one standard deviation in 2014-2015	103	107	89	87	84	80	40	-5
B3. Combination of B1-B2 using one half standard deviation shocks	103	98	77	93	106	120	164	335
B4. One-time 30 percent real depreciation in 2014	103	130	110	109	105	101	68	36
B5. 10 percent of GDP increase in other debt-creating flows in 2014	103	161	142	141	138	135	94	60
Debt Service-to-Revenue Ratio 2/								
Baseline	19	18	13	12	10	10	3	2
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	19	18	8	3	-7	-14	-43	-72
A2. Primary balance is unchanged from 2013	19	18	13	13	15	20	39	112
A3. Permanently lower GDP growth 1/	19	18	13	12	11	11	10	36
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviation in 2014-2015	19	18	16	17	19	25	46	114
B2. Primary balance is at historical average minus one standard deviation in 2014-2015	19	18	11	9	6	6	-1	-3
B3. Combination of B1-B2 using one half standard deviation shocks	19	18	10	7	2	5	22	77
B4. One-time 30 percent real depreciation in 2014	19	18	13	13	11	11	6	7
B5. 10 percent of GDP increase in other debt-creating flows in 2014	19	18	19	21	20	21	13	14

Sources: Papua New Guinea authorities; and IMF staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Table 3a.: External Debt Sustainability Framework, Baseline Scenario, 2010-2033 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 2/	Standard Deviation 2/	Projections									
	2010	2011	2012			2013	2014	2015	2016	2017	2018	2013-2018 Average	2023	2033	2019-2033 Average
External debt (nominal) 1/	**71.0**	**86.5**	**129.1**			**120.2**	**101.8**	**68.8**	**61.5**	**53.2**	**48.6**		**20.3**	**0.6**	
of which: public and publicly guaranteed (PPG)	10.1	6.8	7.4			8.1	7.8	6.9	8.1	9.5	10.5		6.8	0.5	
Change in external debt	34.8	15.5	42.6			-8.9	-18.4	-33.0	-7.3	-8.3	-4.6		-4.7	-0.1	
Identified net debt-creating flows	9.7	-1.9	25.6			14.8	-16.4	-31.0	-14.1	-13.4	-12.2		-8.2	-3.2	
Non-interest current account deficit	**19.5**	**22.5**	**49.5**	**7.0**	**19.5**	**25.7**	**0.8**	**-12.9**	**-9.7**	**-9.2**	**-8.2**		**-5.5**	**-1.5**	-3.8
Deficit in balance of goods and services	12.4	21.1	35.9			14.7	-2.4	-21.5	-20.8	-20.3	-19.2		-15.0	-10.2	
Exports	63.5	56.5	43.5			39.7	42.5	52.4	50.8	49.9	48.6		41.6	32.1	
Imports	75.8	77.6	79.4			54.4	40.1	30.9	30.0	29.6	29.4		26.6	21.9	
Net current transfers (negative = inflow)	-2.0	-1.9	-1.1	-3.6	2.4	-0.8	-1.1	-0.7	-0.7	-0.7	-0.8		-1.2	0.1	-0.6
of which: official	-2.8	-3.1	-2.8			-2.5	-2.1	-1.5	-1.5	-1.5	-1.5		-1.5	-1.3	
Other current account flows (negative = net inflow)	9.0	3.3	14.7			11.8	4.4	9.3	11.8	11.8	11.8		10.7	8.6	
Net FDI (negative = inflow)	**-5.7**	**-8.0**	**-12.4**	**-5.8**	**5.6**	**-5.6**	**-11.6**	**-2.6**	**-2.6**	**-2.6**	**-2.5**		**-2.2**	**-1.8**	-2.1
Endogenous debt dynamics 3/	**-4.1**	**-16.4**	**-11.4**			**-5.3**	**-5.6**	**-15.5**	**-1.8**	**-1.6**	**-1.4**		**-0.5**	**0.1**	
Contribution from nominal interest rate	1.9	1.0	1.5			1.2	1.1	0.6	0.4	0.4	0.3		0.2	0.1	
Contribution from real GDP growth	-2.3	-5.7	-6.0			-6.6	-6.8	-16.1	-2.2	-2.0	-1.8		-0.7	0.0	
Contribution from price and exchange rate changes	-3.7	-11.7	-7.0			...	...	...	...	...	...		...	...	
Residual (3-4) 4/	**25.1**	**17.4**	**17.0**			**-23.8**	**-2.0**	**-2.0**	**6.9**	**5.1**	**7.5**		**3.5**	**3.1**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 5/	...	...	126.7			117.8	99.9	67.0	59.3	50.8	46.1		20.7	4.1	
In percent of exports	...	...	291.5			296.7	234.9	127.7	116.8	101.7	94.8		49.6	12.8	
PV of PPG external debt	**...**	**...**	**5.1**			**5.7**	**5.8**	**5.1**	**6.0**	**7.1**	**8.0**		**7.1**	**4.1**	
In percent of exports	**...**	**...**	**11.6**			**14.3**	**13.7**	**9.7**	**11.7**	**14.2**	**16.5**		**17.0**	**12.7**	
In percent of government revenues	**...**	**...**	**19.3**			**22.2**	**24.8**	**24.2**	**28.2**	**33.1**	**37.0**		**29.2**	**16.4**	
Debt service-to-exports ratio (in percent)	**15.5**	**16.2**	**15.4**			**9.0**	**31.6**	**15.8**	**15.7**	**17.5**	**9.9**		**9.2**	**1.5**	
PPG debt service-to-exports ratio (in percent)	**1.4**	**1.2**	**1.4**			**1.4**	**1.2**	**0.7**	**0.7**	**0.7**	**0.9**		**1.1**	**1.4**	
PPG debt service-to-revenue ratio (in percent)	**3.3**	**2.4**	**2.4**			**2.1**	**2.2**	**1.7**	**1.6**	**1.6**	**2.0**		**1.9**	**1.8**	
Total gross financing need (Billions of U.S. dollars)	2.3	3.0	6.6			3.8	0.5	-1.8	-1.1	-0.8	-1.6		-1.3	-1.5	
Non-interest current account deficit that stabilizes debt ratio	-15.3	6.9	6.8			34.7	19.2	20.1	-2.5	-0.9	-3.6		-0.8	-1.4	
Key macroeconomic assumptions															
Real GDP growth (in percent)	7.7	10.7	8.1	5.8	3.0	5.4	6.3	21.4	3.3	3.4	3.5	7.2	3.0	3.0	3.1
GDP deflator in US dollar terms (change in percent)	11.3	19.7	8.8	11.2	6.9	1.2	5.3	11.7	-1.3	-0.5	0.2	2.8	1.9	1.8	1.8
Effective interest rate (percent) 6/	6.4	1.9	2.1	3.2	1.3	1.0	1.1	0.8	0.7	0.7	0.7	0.8	0.9	16.2	5.2
Growth of exports of G&S (US dollar terms, in percent)	30.9	17.9	-9.6	14.5	17.4	-2.6	19.8	67.2	-1.2	1.1	0.9	14.2	2.2	2.3	2.1
Growth of imports of G&S (US dollar terms, in percent)	40.1	35.5	20.3	21.6	13.0	-26.9	-17.5	4.5	-1.1	1.5	3.0	-6.1	3.0	2.8	2.9
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	39.9	38.8	38.3	38.1	37.6	37.6	38.4	34.6	34.6	34.6
Government revenues (excluding grants, in percent of GDP)	26.0	27.1	26.2			25.6	23.5	20.9	21.1	21.4	21.7		24.2	24.7	24.4
Aid flows (in Billions of US dollars) 7/	0.6	0.5	0.8			0.5	0.6	0.6	0.8	0.9	0.9		0.6	0.8	
of which: Grants	0.5	0.4	0.5			0.3	0.3	0.4	0.4	0.4	0.4		0.5	0.7	
of which: Concessional loans	0.1	0.0	0.2			0.2	0.2	0.3	0.4	0.5	0.5		0.1	0.1	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			2.8	2.5	2.0	2.1	2.3	2.2		1.6	1.4	1.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			71.7	71.5	68.9	66.7	63.9	62.8		86.1	91.3	87.3
Memorandum items:															
Nominal GDP (Billions of US dollars)	9.7	12.9	15.1			16.1	18.1	24.5	25.0	25.7	26.7		34.1	55.1	
Nominal dollar GDP growth	19.9	32.4	17.6			6.7	11.9	35.6	2.0	2.9	3.7	10.5	4.9	4.9	5.0
PV of PPG external debt (in Billions of US dollars)			0.8			0.9	1.0	1.2	1.5	1.8	2.1		2.4	2.2	
(PVt-PVt-1)/GDPt-1 (in percent)						0.9	0.8	1.0	1.0	1.3	1.3	1.0	0.1	-0.1	0.0
Gross workers' remittances (Billions of US dollars)	-0.1	-0.2	-0.3			-0.3	-0.2	-0.2	-0.2	-0.2	-0.2		-0.1	-0.8	
PV of PPG external debt (in percent of GDP + remittances)	...	...	5.1			5.8	5.9	5.1	6.0	7.1	8.1		7.1	4.1	
PV of PPG external debt (in percent of exports + remittances)	...	...	12.1			15.0	14.1	9.8	11.9	14.4	16.8		17.1	13.3	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	1.5			1.4	1.2	0.7	0.7	0.7	0.9		1.1	1.4	

Sources: Papua New Guinea authorities; and IMF staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

3/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

4/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

5/ Assumes that PV of private sector debt is equivalent to its face value.

6/ Current-year interest payments divided by previous period debt stock.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 3b.Papua New Guinea: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013-2033

(In percent)

	Projections							
	2013	2014	2015	2016	2017	2018	**2023**	2033
PV of debt-to GDP ratio								
Baseline	6	6	5	6	7	8	**7**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	6	13	24	30	35	39	**40**	25
A2. New public sector loans on less favorable terms in 2013-2033 2/	6	6	6	7	8	10	**9**	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	6	6	6	7	8	10	**9**	5
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	6	11	27	29	30	31	**27**	13
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	6	6	5	6	7	9	**8**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	6	13	12	13	14	15	**13**	7
B5. Combination of B1-B4 using one-half standard deviation shocks	6	14	31	32	34	35	**30**	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	6	8	7	8	10	11	**10**	6
PV of debt-to-exports ratio								
Baseline	14	14	10	12	14	17	**17**	13
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	14	31	45	60	71	81	**97**	79
A2. New public sector loans on less favorable terms in 2013-2033 2/	14	14	11	14	17	20	**23**	22
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	14	13	9	11	14	16	**17**	12
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	14	32	111	120	127	136	**136**	86
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	14	13	9	11	14	16	**17**	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	14	31	23	25	28	31	**31**	21
B5. Combination of B1-B4 using one-half standard deviation shocks	14	37	87	95	101	108	**107**	68
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	14	13	9	11	14	16	**17**	12
PV of debt-to-revenue ratio								
Baseline	22	25	24	28	33	37	**29**	16
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	22	56	113	143	166	181	**166**	102
A2. New public sector loans on less favorable terms in 2013-2033 2/	22	26	27	33	40	46	**39**	28
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	22	25	29	34	40	45	**35**	20
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	22	47	130	135	140	143	**110**	52
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	22	25	26	30	35	39	**31**	17
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	22	56	57	61	66	69	**53**	27
B5. Combination of B1-B4 using one-half standard deviation shocks	22	58	147	153	158	162	**124**	59
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	22	34	33	39	45	51	**40**	23

Table 3b.Papua New Guinea: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013-2033 (concluded)

(In percent)

Debt service-to-exports ratio								
Baseline	1	1	1	1	1	1	**1**	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	1	1	1	2	2	2	**4**	4
A2. New public sector loans on less favorable terms in 2013-2033 2/	1	1	1	1	1	1	**2**	2
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	1	1	1	1	1	1	**1**	1
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	1	1	2	4	4	5	**11**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	1	1	1	1	1	1	**1**	1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	1	1	1	1	1	1	**2**	2
B5. Combination of B1-B4 using one-half standard deviation shocks	1	1	2	3	3	4	**8**	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	1	1	1	1	1	1	**1**	1
Debt service-to-revenue ratio								
Baseline	2	2	2	2	2	2	**2**	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	2	2	3	4	4	5	**7**	5
A2. New public sector loans on less favorable terms in 2013-2033 2/	2	2	2	2	2	2	**3**	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	2	2	2	2	2	2	**2**	2
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	2	2	2	5	5	5	**9**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	2	2	2	2	2	2	**2**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	2	2	2	3	3	3	**4**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	3	5	5	6	**10**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	2	3	2	2	2	3	**3**	2
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	34	34	34	34	34	34	**34**	34

Sources: Papua New Guinea authorities; and IMF staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), noninterest current account in percent of GDP, and non-debt-creating flows.
2/ Assumes that the interest rate on new borrowing is 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.
3/ Export values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

INTERNATIONAL MONETARY FUND

PAPUA NEW GUINEA

October 24, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	Asia and Pacific Department (In collaboration with other departments, the World Bank and the Asian Development Bank)

CONTENTS

FUND RELATIONS

(As of September 30, 2013)

Membership Status

Joined: October 9, 1975; Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	131.60	100.00
Fund holdings of currency	131.16	99.67
Reserve position in Fund	0.44	0.33

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	125.49	100.00
Holdings	9.35	7.45

Outstanding Purchases and Loans

	SDR Million	Percent Quota
	0.00	0.00

Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	3/29/2000	9/28/2001	85.54	85.54
Stand-by	7/14/1995	12/15/1997	71.48	35.34
Stand-by	7/31/1991	9/30/1992	26.36	0.00

Projected Payments to Fund[1]

(SDR million; based on existing use of resources and present holding of SDRs):

	Forthcoming				
	2013	**2014**	**2015**	**2016**	**2017**
Principal					
Charges/interest	0.02	0.08	0.08	0.08	0.08
Total	**0.02**	**0.08**	**0.08**	**0.08**	**0.08**

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Safeguards Assessments

Under the Fund's Safeguards Assessments policy, the Bank of Papua New Guinea (BPNG) was subject to a transitional assessment based on its Stand-By Arrangement with the Fund, which was approved in March 2000 and expired in September 2001. The transitional assessment was completed on May 4, 2001 and recommendations were made to alleviate identified weaknesses. Currently, the BPNG is not subject to the Safeguards Assessments policy.

Exchange Rate Arrangement

Papua New Guinea has a floating exchange rate arrangement; the exchange rate of the kina is determined in the interbank market in which authorized banks participate. Papua New Guinea has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions.

Article IV Consultations

The 2012 Article IV consultation discussions were held during February 16–28, 2012. It was concluded by the Executive Board on May 14, 2012 (IMF Country Report No. 12/126). Papua New Guinea is on the 12–month cycle.

Technical Assistance from Headquarters

FAD: A joint FAD/PFTAC mission in March 2000 assisted the authorities in preparing a Report on the Observance of Standards and Codes Fiscal Transparency Module, published in October 2000. A mission in December 2000 provided advice on the reconciliation of large and volatile differences in fiscal reporting based on information provided by the Treasury Department and information reported by the Bank of Papua New Guinea. A mission in February 2002 assessed progress in improving fiscal transparency. A joint FAD/PFTAC mission visited PNG to provide advice on the sovereign wealth fund management in May 2011. A mission in March 2013 provided advice on reform of the extractive industries fiscal regime.

LEG: A mission in November 2005 provided advice on the drafting of a tax administration law. A mission in July 2006 provided a comprehensive program of assistance in the development of the AML/CFT regime, including legislative drafting and capacity building. A mission in August-September 2007 assisted the authorities in finalizing the terms of the Revenue Administration Bill.

MFD/MCM: Technical assistance through peripatetic visits was delivered on bank regulation and supervision (2001, February-March 2007, July–August 2009, and February 2010), medium-term monetary policy formulation (October 2004 and September 2005), reserve management (June 2006, September 2007, March/July–August 2009, January–February 2010), internal audits (2004, August 2007), accounting (September-October 2006, February 2007, February–March/June–July/November 2009), liquidity management (January 2009), monetary and forex operations (July–August 2009, February 2010), macroprudential oversight and financial stability (September 2012), and the sovereign wealth fund (July 2013).

STA: A mission reviewed monetary and financial statistics in April 2005 and a follow-up mission took place in May 2006. Subsequently, a multisector statistics mission visited in September 2006 followed by a high-level STA visit in December 2007. Two follow-up missions in balance of payments took place in June 2008 and November 2009 and three follow-up missions in monetary and financial statistics took place in April 2008, November 2009, and May 2010. In 2012, three missions provided advice on GDDS metadata, government finance statistics, and the balance of payments. In May-June 2013, a mission reviewed balance of payments and the international investment position. To support migration to GFSM 2001, a training mission was conducted in May 2013.

Resident Representative:

The Regional Resident Representative Office for Pacific Island Countries based in Suva, Fiji was opened on September 13, 2010 and the office covers Fiji, Kiribati, Marshall Islands, Micronesia, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. Mr. Yongzheng Yang is the resident representative.

RELATIONS WITH THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTRE

(As of September 2013)

The Pacific Financial Technical Assistance Centre (PFTAC) in Suva, Fiji, is a regional technical assistance institution operated by the IMF with financial support of the Asian Development Bank, Australia, Korea, the European Union, and New Zealand. The Center's aim is to build skills and institutional capacity for effective economic and financial management that can be sustained at the national level. Member countries are: Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor Leste, Tokelau, Tonga, Tuvalu, and Vanuatu.

A. Public Financial Management

The PFTAC assisted in the preparation of a ROSC, which was published in October 2000. The PFTAC PFM Advisor has participated in occasional FAD technical assistance missions, and an attachment of one PNG official to PFTAC was completed in April 2007. PNG participated, with four officials, in the U.S. Treasury study visit in September 2008. In May 2011, the PFTAC macroeconomic advisor participated in an FAD mission on advising PNG on the SWF. In July 2013, a PFTAC PFM Advisor visited PNG at the request of the Treasury Minister to review the budget preparation process, and discuss with authorities plans for training in the PEFA methodology, and tentative scheduling for a PEFA in 2014.

B. Tax Administration and Policy

PNG is supported by the Australian Taxation Office (ATO) and has a number of long-term in-country ATO advisers. The Internal Revenue Commission (IRC) has additional support under the ATO / IRC twinning program and several other internationally and locally funded international advisers. IMF HQ has provided strategic advice to the IRC in the Natural Resources area and support will continue in this area should the authorities wish to undertake reform. PNG will be encouraged to take a stronger role in supporting regional tax reform and sharing training opportunities provided by the ATO with fellow PIC tax administrators.

C. Financial Sector Regulation and Supervision

There is no current PFTAC involvement in this area. In October 2005, the BPNG hosted the annual meeting of the Association of Financial Supervisors of Pacific Countries, for which PFTAC is the secretariat. In March 2007, PFTAC funded an attachment for two supervisors from the Bank of Papua New Guinea to assist the Cook Islands' supervisory authority to undertake an on-site examination of a domestic bank. In 2008, PFTAC funded an attachment of one supervisor to assist the Reserve Bank of Fiji under an on-site examination of a local branch of a PNG-based bank.

D. Economic and Financial Statistics

In February 2006, an Advisor briefly assessed the BOP compilation with a view to improving its quality, and to assessing progress with regard to recommendations made by previous missions. A multisector statistics mission in September 2006 assessed the statistical systems (BOP, national accounts, prices statistics, government finance statistics, and monetary statistics), with the PFTAC Advisor assessing the national accounts and providing overall coordination. In 2008 and 2009 the Advisor undertook BOP statistics missions to review statistics prerequisites, progress in improving compilation methods and source data, as well as to assist BPNG statistics staff in assessing the feasibility of electronic data collection. A PFTAC Advisor conducted a mission during August 2013 to start reviewing the methodologies and data sources used for the compilation of national accounts statistics.

E. Macroeconomic Analysis

Following a request by the BPNG for assistance in building up financial programming capacity, starting in 2011 a PFTAC work program together with BPNG staff created a number of tools such as empirical output gap measures and inflation models as inputs into a financial programming framework, followed by the development of a PNG-specific financial programming framework in 2012 and 2013. Training in the use and updating of the framework was provided to staffs of both BPNG and the Department of Treasury, most recently in August 2013. Staffs from both institutions also benefited from training in financial programming techniques provided jointly by PFTAC and the Singapore Regional Training Institute during a regional workshop in Fiji in December 2012. A separate work program with the Department of Treasury and BPNG developed in collaboration with the APD country team and the IMF's Research Department modeling tools for exploring the macroeconomic impact of the surge in natural resource revenues that is expected as the LNG project enters into production. Two workshops for rolling out the resulting model and providing training in its use were held in 2011 and 2012 respectively. Results were shared with a broader public through a seminar organized by a local research institute in 2013.

JOINT MATRIX OF BANK-FUND COLLABORATION

Papua New Guinea: JMAP Implementation Table			
Title	**Products**	**Provisional Timing of Missions**	**Delivery Date (tentative)**
A. Mutual Information on Relevant Work Programs			
Bank work program	Papua New Guinea Economic Briefing (two per year)		Published online in Q2 2012, Q1 2013 and Q4 2013.
	Papua New Guinea Economic Policy Notes		Ongoing irregular series of notes. Note presented to the PNG government December 2012.
	Support for analysis and dissemination of the 2009-2010 Papua New Guinea Household Income and Expenditure Survey	Ongoing	Statistical abstract disseminated August 2012. Ongoing series of notes and materials presented to GoPNG (June 2012, October 2012, May 2013, August 2013).
	Support for the development and implementation of the PNG Sovereign Wealth Fund	Ongoing	October 2012, January 2013.
	Social protection technical assistance	Ongoing	Policy Brief highlighting key considerations with regard to social pensions presented September 2013.
	Cost of crime and violence	Ongoing	Notes presented July 2012, October 2013, with further notes expected H1 2014.
	Education public expenditure review	Ongoing	Notes disseminated in December 2012 and August 2013. Further dissemination expected in January 2014.
	Health financing and resourcing analysis: (1) analysis of rural health financing; (2) review of expenditure by provincial administrations on front line rural health	Ongoing	Dissemination of policy notes and report on expenditure by provincial administrations October 2013, and rural health financing by December 2013.
IMF work program	2013 Staff Visit	June 2013	
	2013 Article IV mission	August-September 2013	Board discussion expected in December 2013
B. Request for Work Program Inputs			
Fund request to Bank	Information sharing	Semi-annual or more frequent	Ongoing
Bank request to Fund	Information sharing	Semi-annual or more frequent	Ongoing

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of August 31, 2013)

Papua New Guinea (PNG) joined the Asian Development Bank (AsDB) in 1971. The AsDB has approved 79 loans to PNG totaling $1,624.3 million for 54 projects, of which 32 loans ($824.1million) have been extended from Ordinary Capital Resources (OCR) and 47 loans ($800.3 million) from the Asian Development Fund (ADF). ADF resources were also used for one grant amounting to $15 million. In addition, $63.4 million has been provided for 149 technical assistance projects. The AsDB's active portfolio in PNG is $867.6 million comprising 20 public sector loans to finance 10 projects ($716.4 million); eight grants ($76.9 million); 9 technical assistance projects ($8.3 million); two private sector loans ($58 million); and a private sector equity investment ($8.0 million).

In August 2010, the AsDB and the Government of PNG agreed on a new country partnership strategy, 2011–2015. The strategy was developed in close consultation with the government and other stakeholders, and is well aligned to the government's Development Strategic Plan (DSP), 2010–2030 and the Medium-Term Development Plan, 2011–2015. It centers on infrastructure improvements and other measures to help PNG plan and implement a successful transition through the conversion of its natural resources wealth into inclusive economic growth.

In 2012 and 2013, the AsDB approved 3 public sector loans of $107.9 million to finance two projects; i) the Maritime and Waterways Safety Project, and ii) the Port Moresby Power Grid Development Project. The AsDB's ongoing lending activities support road, seaport, and airport rehabilitation and improvement; community water transport; renewable power generation and transmission; rural health services delivery; access to microfinance; and expansion of telecommunication services. The AsDB provides technical assistance in all these areas to improve policy, capacity, and knowledge. The AsDB also finances experts and programs to improve the government's public financial management, and to mitigate and adapt to climate change risks.

The AsDB's lending to PNG for 2013–2015 is expected to remain a blend of OCR and ADF resources. The AsDB's ADF allocation for PNG for 2013–2015 totals approximately $180 million and OCR lending is expected to be approximately $230 million. Indicative Nonlending assistance for 2013–2015 totals $6 million.

Creating a conducive environment for private sector development is also a strategic priority. The AsDB's Pacific Private Sector Development Initiative (PSDI) is currently working with the Government of PNG to (i) expand access to finance through branchless banking and the implementation of a secured transactions framework; (ii) increase the efficiency of services provided by state-owned enterprises through performance benchmarking, policy reforms, capacity building and advocacy; (iii) promote greater use of public private partnerships (PPPs) through the development of a legal framework and associated institutions; and (iv) support the assessment of PPP opportunities for major infrastructure projects. PSDI has recently been funded for a further six years of operation and will be expanding its work areas including business law reform, promotion of competition, and economic empowerment of women.

Papua New Guinea: Public Sector Loan Approvals and Disbursements, 2004–2013

(In millions of U.S. dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013[1]
Loan approvals	19.0	0.0	53.0	100.0	100.0	120.0	70.3	195.8	41.5	66.5
Loan disbursements	19.2	21.5	29.3	27.4	19.8	17.4	27.9	26.2	89.3	89.1

Source: Asian Development Bank

[1] 2013 disbursements are as at August 31, 2013.

STATISTICAL ISSUES

(As of September 30, 2013)

A. Assessment of Data Adequacy for Surveillance

General: Data provision has significant shortcomings, but is broadly adequate for surveillance. Most affected areas are: national accounts, fiscal accounts, and balance of payments.

National accounts: The accuracy and reliability of the statistics are affected by inadequate source data. The most recent official national accounts statistics were published by the National Statistical Office (NSO) for National Income, Expenditure and Product, for reference years 1993–98. These estimates were compiled using the 1968 System of National Accounts (SNA). Subsequently, a preliminary set of national accounts (NA) estimates using the 1993 SNA for 1994–2004, rebased to 1998 prices, was compiled. However, as these estimates were still in need of substantial improvements, the 2006 STA multisector mission recommended against publication of the new GDP statistics until the needed revisions were made. No further data have been provided by the NSO to STA since that time. In an attempt to fill the vacuum, the Treasury department began estimating the NA since reference year 2002. The Bank of Papua New Guinea also compiles, but does not publish, its own estimates of GDP. A technical assistance mission was conducted by PFTAC during August 2013 to start reviewing the methodologies and the data sources used to compile the national accounts statistics. The mission identified significant shortcomings. In the short term, PFTAC will provide TA to strengthen capacities and improve cooperation between compiling organizations. Reforming the NSO will be necessary to resume regular data collection and compilation of national accounts statistics by the official agency.

Price statistics: The NSO currently compiles a quarterly wholesale price index (which it does not publish) and a quarterly consumer price index that is based on weights that are thirty-five years old. These out-of-date weights have significantly reduced the accuracy of CPI estimates. With assistance from the Secretariat of the Pacific Community, the NSO has recently completed price data collection, documentation, and publication of the survey results for the 2009-10 Household Income Expenditure Survey (HIES) that is needed to rebase the CPI.

Government finance statistics: Annual GFS have not been reported to STA since 2002. Data received to that point in time suffered from insufficient coverage and timeliness. Central government tax revenue, nontax revenue, and public expenditure data are deficient. Development budget expenditures and the utilization of grants and project loans are recorded with long lags, and few records on the use of trust accounts are available. Tax revenues collected by authorities (extra-budgetary units) are generally not reflected in the central government's financial information; this includes the portion of value-added tax directly transferred to provinces by the revenue agency. While interest payment records are accurate, there are timing issues regarding the recording of interest on discounted securities. These weaknesses contribute to discrepancies in domestic financing between estimates from monetary and debt data and those derived from fiscal records. In the 2013 Budget report, the Papua New Guinea Government announced that it intends to migrate to *GFSM 2001*, with a goal of using this methodology for budget estimate and outturn presentations in the future. As part of this commitment, the authorities are participating in the Japan Administered Account (JSA)-funded three-year regional GFS capacity-building project. It is anticipated that a total of 6 missions to PNG will be conducted under this project, the first of which was a training mission conducted in May 2013.

Monetary statistics: Monetary data are now being produced and reported to STA on a regular basis. Progress has been achieved by the BPNG in many areas in the collection, compilation, and dissemination of monetary and financial statistics (MFS), leading to the introduction of the standardized report form (SRF) for the central bank, other depository corporations (ODCs), and the other financial corporations (OFCs). The 2013 mission introduced general insurance companies in the institutional coverage of the other financial corporations and also introduced the improved SRF for OFCs. Most of the monetary statistics are currently aligned to the *Monetary and Financial Statistics Manual* (*MFSM*) in *International Financial Statistics*.

Balance of payments statistics: Annual balance of payments data are derived from the International Transactions Reporting System (ITRS), which is not tightly monitored despite the BPNG reporting requirements. There are marked differences between the official data on exports and imports of goods and those reported by trading partners. The financial accounts data are of poor quality because of major deficiencies in data collection, especially in the area of private external debt and foreign direct investment. Quarterly data are also published by the BPNG. The 2006 STA multisector mission identified as a priority the strengthening of current account estimates, including through improved classification of investment earnings, trade credits, and grant receipts as well as enhancing source data for imports and exports. Progress is being made in implementing the recommendations from the PFTAC's BOP missions in June 2008 and November 2009. PNG has been one of the beneficiaries of the Japan Administered Account Project on the improvement of external sector statistics. A TA mission under this project was conducted in 2013, with more missions planned.

B. Standards and Quality

PNG participated in the General Data Dissemination System (GDDS) in 2012.

C. Reporting to STA

Papua New Guinea last reported government finance statistics for publication in the *Government Finance Statistics Yearbook* and in *International Financial Statistics* for 1999–2002; cover only the budgetary central government.

Monetary data are reported to STA for publication in *IFS* on a regular monthly basis.

Balance of payments data for 2010 were reported to STA for publication in *IFS* and *BOPSY*.

National accounts data for 2004 were reported to STA for publication in *IFS*.

Papua New Guinea: Table of Common Indicators Required for Surveillance

(As of September 19, 2013)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	09/18/13	09/18/13	D	W	W
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	03/13	07/13	W	W	Q
Reserve/Base Money	06/13	08/13/13	M	M	Q
Broad Money	06/13	08/13/13	M	M	Q
Central Bank Balance Sheet	07/13	08/13/13	M	M	Q
Consolidated Balance Sheet of the Banking System	06/13	08/13/13	M	M	Q
Interest Rates[3]	07/13	08/13/13	W	W	Q
Consumer Price Index	06/13	07/13	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5, 6]	N/A	N/A	N/A	N/A	N/A
Revenue, Expenditure, Balance and Composition of Financing[4]—Central Government	2012	09/12/13	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[7]	03/13	07/13	Q	Q	Q
External Current Account Balance	03/13	07/13	Q	Q	Q
Exports and Imports of Goods and Services	03/13	07/13	Q	Q	Q
GDP/GNP	2012	09/12/13	A	A	A
Gross External Debt	12/2012	07/13	Q	A	A
International Investment Position[7, 8]	N/A	N/A	N/A	N/A	N/A

[1] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); and Not Available (N/A).

[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[3] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

[4] Foreign, domestic bank, and domestic nonbank financing.

[5] The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.

[6] Lack of capacity prevented the authorities from providing the data.

[7] Including currency and maturity composition.

[8] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 13/457
FOR IMMEDIATE RELEASE
November 18, 2013

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with Papua New Guinea

On November 11, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Papua New Guinea.

Papua New Guinea has achieved strong economic growth over the past decade, benefitting from high commodity prices, mineral investment inflows, sound macroeconomic policies, and financial sector stability. The construction of a large-scale liquefied natural gas (LNG) project has boosted growth and employment over the past few years. However, as the LNG project moves from the construction to production phase, the nonmineral sector faces a sharp slowdown, spotlighting the need for structural reforms and financial deepening to support more inclusive growth.

The current account deficit is expected to narrow sharply in 2013 as imports and income outflows decline with the winding down of LNG project construction. Capital inflows associated with the LNG project are also declining, and, together with falling commodity prices, have led to the depreciation of the kina since mid 2012. Pass-through effects from kina depreciation and increased government spending are likely to raise inflation to about 4 percent in 2013 from 2 percent in 2012, but underlying price pressure remains moderate. The Bank of Papua New Guinea has kept the policy interest rate unchanged since early 2013 given weakening nonmineral sector demand, but has issued central bank bills and raised cash reserve requirements to absorb excess liquidity in the banking system.

Papua New Guinea continues to face daunting development challenges, with power and transport infrastructure and basic education and health services remaining undersupplied. The change in growth composition further increases the need to accelerate structural reforms to diversify the economy. To deliver quicker development results and counter the slowdown in the

[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.

nonmineral sector, the government increased expenditure substantially in 2013 to target its development enablers—law and order, health, education, and infrastructure. The 2013 budget envisages a fiscal deficit of 7.3 percent of GDP with a strong push to devolve spending to provincial, district, and local governments. However, capacity constraints have delayed project implementation and the quality of spending has been mixed.

Risks to economic growth in 2013-15 are broadly balanced, but tilted toward the downside over the longer term. A weak global economy could further dampen external demand and commodity prices, while global shale gas development could reduce LNG prices, with each potentially exerting pressure on government revenue, export earnings, and the kina. Lower LNG and mineral prices, together with uncertainty surrounding the ending of easy global monetary conditions, may also reduce future inflows of foreign direct investment.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for achieving a strong economic performance over the past decade. While growth prospects remain favorable in the medium term, the expected slowdown in the nonmineral sector, uncertain mineral prices, and large development needs pose challenges. Structural reforms, accompanied by a prudent fiscal stance, will be needed to reduce vulnerabilities and promote more inclusive growth.

Directors saw some scope for fiscal support to growth in the short term, but cautioned that spending should stay in line with PNG's absorptive capacity. While noting the need to allocate significant resources for development, they stressed the importance of fiscal consolidation over the medium term and improvements in spending quality. In this context, they welcomed the commitment to keeping public debt below 30 percent of GDP over the medium term.

Directors agreed that the current monetary policy stance is appropriate given low inflation and the slowdown in the nonmineral sector, but advised the authorities to stand ready to tighten policy should inflationary pressures arise. They welcomed efforts to absorb excess liquidity to strengthen monetary policy transmission and encouraged continued vigilance on financial sector risks in light of possible price corrections in the property market.

Directors noted the role of PNG's floating exchange rate regime in helping absorb external shocks and maintaining a strong external position. They recommended close monitoring of private sector external debt and associated risks should LNG prices decline significantly.

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[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 welcomed the authorities' continued efforts to ensure better use of resource revenues, and their intention to join the Extractive Industries Transparency Initiative. They also supported plans to make the Sovereign Wealth Fund operational soon, while ensuring that resource revenues are not diverted away from the fund.

Directors encouraged the authorities to accelerate structural reforms to promote more inclusive growth. Priorities are to strengthen the agriculture and small- and medium-size enterprise sectors, broaden access to finance, create an enabling business environment, and develop human resources. It will also be important to improve the efficiency and ensure appropriate governance of public enterprises.

Directors called for efforts to address long-standing shortcomings in CPI and national accounts statistics and supported the provision of technical assistance in this area. They also encouraged swift action to ensure compliance with international standards for anti-money laundering and combating the financing of terrorism.

The next Article IV consultation with Papua New Guinea is expected to take place on the standard 12-month cycle.

Papua New Guinea: Selected Economic and Financial Indicators, 2009–14

Nominal GDP (2012):	US$15.4 billion 1/
Population (2012):	7.2 million
GDP per capita (2012):	US$2,146
Quota:	SDR 131.6 million

	2009	2010	2011	2012	2013	2014
				Est.	Proj.	
			(Percentage change)			
Real sector						
Real GDP growth	6.1	7.7	10.7	8.1	5.4	6.3
Mineral	-1.7	-2.0	-11.8	-6.9	5.3	80.7
Nonmineral	7.0	8.7	12.8	9.2	5.4	1.7
CPI (annual average)	6.9	6.0	8.4	2.2	4.0	6.0
CPI (end-period)	5.7	7.2	6.9	1.6	5.5	6.0
			(In percent of GDP)			
Central government operations						
Revenue and grants	27.3	31.3	30.4	29.6	27.6	25.4
Expenditure and net lending	36.9	28.2	28.7	32.8	33.9	31.3
Net lending(+)/borrowing(-) [Overall balance] (Revenue - expenditure)	-9.6	3.1	1.7	-3.2	-6.3	-5.8
Nonmineral net lending(+)/borrowing(-)	-13.3	-3.6	-5.7	-6.7	-9.3	-9.3
			(Percentage change)			
Money and credit (percentage change)						
Domestic credit	37.3	4.9	-5.2	37.7	24.6	20.3
Credit to the private sector	15.1	18.1	7.9	12.1	11.2	9.6
Broad money	21.3	10.2	17.5	11.0	10.1	9.2
Interest rate (182-day Treasury bills; period average)	7.2	6.4	6.7	4.9	...	...
			(In billions of U.S. dollars)			
Balance of payments 2/						
Exports, f.o.b.	4.5	5.9	6.9	6.1	6.0	7.2
Of which: Mineral	3.4	4.4	4.9	4.5	4.5	5.5
Imports, c.i.f.	-3.3	-4.3	-6.3	-7.4	-5.4	-4.4
Current account (including grants)	-1.2	-2.1	-3.0	-7.7	-4.4	-0.4
(In percent of GDP)	-15.2	-21.4	-23.5	-51.0	-27.0	-2.0
Exceptional financing (net)	0.0	0.0	0.0	0.0	0.0	0.0
Gross official international reserves	2.6	3.1	4.3	4.0	3.0	4.3
(In months of nonmining imports, c.i.f.)	10.9	10.6	13.5	10.3	7.5	11.4
(In months of goods and services imports)	6.0	5.0	5.2	4.0	4.1	7.1
			(In percent of GDP)			
Government debt	31.3	25.3	22.3	26.7	31.6	33.6
External debt-to-GDP ratio (in percent) 3/	12.5	10.4	7.5	7.5	7.9	8.2
External debt-service ratio (percent of exports) 3/	1.8	1.4	1.3	0.7	1.4	1.2
Exchange rates						
US$/kina (end-period)	0.3700	0.3785	0.4665	0.4755	...	...
NEER (2005=100, end-period)	107.0	100.7	108.6	125.5	...	...
REER (2005=100, end-period)	116.4	113.0	127.6	147.0	...	...
Nominal GDP (in billions of kina)	22.3	26.4	30.5	32.1	34.6	40.2

Sources: Department of Treasury; Bank of Papua New Guinea; and IMF staff estimates and projections.

1/ Based on period average exchange rate.

2/ Includes staff's estimates related to the PNG LNG project.

3/ Public external debt includes external debt of the central government, the central bank, and statutory authorities.

Statement by Jong-Won Yoon, Executive Director for Papua New Guinea
and Nghi Luu, Senior Advisor to Executive Director
November 11, 2013

Papua New Guinea is now in its 12th year of consecutive economic growth. For this period of strong growth to continue, our PNG authorities recognize that sustained effort to implement structural reforms is needed to strengthen the fundamental building blocks for growth. There are significant challenges ahead, but our PNG authorities are sanguine about the opportunities and economic outlook and are strongly committed to improving the living standards of all Papua New Guineans.

PNG has significant infrastructure needs, which is further compounded by the geographical dispersion of the population. In addition to improving the quality of investment spending, the challenge will be to prioritize the provision of basic services (water, electricity, sewerage) and infrastructure (roads, ports and housing), both of which are critical to support broad-based growth.

PNG has enormous unrealized potential. In addition to being a resource-rich country, PNG is strategically located in the Asian region to service the growing demand of emerging market economies. The PNG government has set ambitious targets to capitalize on the recent reform momentum. The authorities welcome the significant technical assistance they are receiving from the IMF, World Bank, the Asian Development Bank (ADB) and donor partners in advancing the substantial structural reform agenda.

Economic Outlook

GDP growth is expected to moderate this year as the construction phase of the LNG project comes to an end. Nonetheless, economic activity remains buoyant, underpinned by fiscal stimulus and strong credit growth. Growth is forecast to pick up in 2014 with the first shipment of LNG exports scheduled for delivery in the second half of the year.

Risks to growth are broadly balanced between domestic and external sources. Fluctuations in commodity prices and the exchange rate continue to pose significant risks to the outlook and reinforce the importance of fiscal and external buffers for a small open economy such as PNG. The key sources of domestic risk include (1) the process of demobilizing PNG workers from the construction of the LNG project back into the workforce, and (2) spillovers from the high-end housing market in Port Moresby, where a correction in prices has begun.

Sovereign Wealth Fund (SWF)

The SWF will become operational in 2014, once the Organic Law is passed by the Parliament. As outlined in the recent Budget Strategy Paper, the overall objective of the SWF is to support macroeconomic stabilization, support long-term economic and social development; and to support asset management in relation to financial assets accrued from natural resources revenue.

The SWF provides a possible source of funding to ensure infrastructure activities receive greater priority. The design of the SWF is consistent with international best practice and all funds withdrawn from the Fund will be accounted for through the national budget. The authorities have agreed to reexamine the withdrawal rules to ensure that they are consistent with the Government's medium-term fiscal strategy. They are also acutely aware of the importance of safeguarding the integrity of the SWF so that it can play a key role in managing PNG's resource revenues.

The authorities are currently considering the IMF TA recommendations on extractive industries fiscal regimes. These recommendations will be examined by a recently established committee, tasked with undertaking a comprehensive review of the tax system. The PNG authorities would like to express their appreciation for the valuable TA provided by MCM and FAD on the SWF.

Fiscal Policy

Fiscal prudence has been an important anchor for PNG's development. Political commitment to a sustainable fiscal strategy is set out in the Medium-Term Fiscal Strategy (MTFS) and is designed to ensure ongoing confidence in the Government's fiscal position. The MTFS is underpinned by a number of guiding principles including: maintaining a gross government debt-to-GDP ratio of less than 30 percent, apart from 2013 and 2014 when it will not exceed 35 percent; and to limit gross government liabilities to less than 60 percent of GDP. The MTFS is also focused on improving expenditure effectiveness, transparency reporting, public accountability, and ensuring that no new infrastructure programs will be funded unless they have gone through proper design and costing process. On the revenue side, the MTFS will focus on maintaining equitable taxation regimes with a focus on compliance and restricting tax exemptions and special arrangements.

The 2014 Budget will require additional debt issuance to meet the government's financing needs. The financing task will comprise: additional borrowing through concessional loans from development partners to fund key projects, issuance of domestic debt to finance the budget deficit, and restructuring the portfolio of domestic debt to increase the average term of maturity and to reduce rollover risks.

For the first time in several decades, the 2014 Budget will integrate the recurrent budget with the development budget. The government will also continue with the implementation of multi-year budgeting which commenced last year. Multi-year budgeting will enhance the ability of agencies to plan expenditure over time as well as give individual departments the ability to better manage their budget allocations from year to year. The move to multi-year budgeting can also help reduce the end-of-year surge in expenditure where agencies simply spend money to avoid losing it. The carry-over will be modest to create better incentives for quality spending.

Monetary Policy

Inflation has edged up, but remains manageable and under control. Inflation is expected to remain modest in 2013, even after accounting for the lagged effects from the depreciation of the kina. If inflationary pressures emerge, the Bank of Papua New Guinea (BPNG) stands ready to tighten monetary policy as necessary. The BPNG will assess the appropriateness of returning to a 5 percent inflation reference rate in light of the significant structural changes to the economy.

Excess liquidity is complicating monetary policy and impairing the transmission mechanism. The authorities have taken steps to remove liquidity from the system but agree that further action is needed. They remain open to considering a suite of options including moving the government's trust accounts from commercial banks to the BPNG, issuing Central Bank Bills and raising the CRR.

External Sector

The authorities continue to support a floating exchange rate. The kina has stabilized in 2013, following strong appreciation over the past two years. BPNG's foreign exchange intervention is guided by its price stability objective, and is targeted at smoothing volatility and providing liquidity support to reflect market conditions. The kina is expected to remain relatively stable, but to gradually decline over the next two years as capital inflows slow down from the completion of the PNG LNG project.

The PNG authorities agree that a continued prudent approach to external borrowing is important to preserve the government's debt reduction efforts over the past decade. They welcome the findings that PNG's external position is sound and that the risk of debt distress is low, as suggested by the debt sustainability analysis. Foreign reserves remain adequate at four months of import coverage, and are expected to surge in the second half of 2014 with the first shipment of LNG. The commencement of LNG exports will also drive a sharp turnaround in the current account as it moves into a surplus position from 2015.

Structural Reforms

A key priority in the upcoming 2014 Budget will be expanding funding for education and health. The government recognizes the limitations on growth from the severe skills shortage within PNG's labor force. They also recognize that investment in human capital must begin in early childhood and are continuing their commitment to providing free education up to grade 10 and subsidizing tuition fees for grades 11 and higher. In terms of other key development areas, the government will focus on unlocking land and providing affordable housing for development; improving law and order; establishing national transport corridors that connect rural populations to markets and services; and improving the provision of key utilities of electricity, clean water and sanitation, and communications.

Improving the business environment for the agriculture sector and SMEs is an important priority for the government. There is significant untapped potential to increase the scale of agricultural production and to improve supporting services and logistics to the sector. The commercialization of agriculture remains a long term opportunity and can drive sustained growth and employment. The development of the agriculture sector will also contribute to the government's goal of diverse and inclusive growth.

The development of a sound financial sector is also critical for PNG's development. Financial penetration is low, and the government is actively exploring ways to encourage greater financial participation, particularly for those living in rural areas where access to financial services is limited. The authorities remain committed to the ongoing implementation of the 2011 financial sector stability assessment recommendations, as evidenced by the advancement of a number of initiatives including the Kina Automated Transfer System and the Central Bank Bill Tap facility.

The authorities are committed to improving service delivery through reform of poor work practices across the public service. The government will ensure that Heads of agencies exercise their managerial powers to improve service delivery and to hold them accountable for poor performance. As noted earlier, expenditure reporting will be strengthened, as well as project planning and costing to ensure effective project planning early on.

Statistics and Anti-Money Laundering

The government recognizes the need to improve economic statistics. Following years of underperformance, the government has recently appointed a new acting National Statistician and head of the National Statistic Office (NSO). The government is developing a strategic plan to expedite improvements in the quality and timeliness of statistics. Once the strategic plan is completed, and following organizational changes to the NSO, our PNG authorities will formally request TA from the IMF and other development partners in the areas of national accounts and the CPI.

On AML/CFT, our PNG authorities have prepared an action plan for Cabinet's consideration. As noted in the staff report, Australia and the ADB will work with the PNG authorities to prepare the necessary reports for submission to the Financial Action Task Force.