INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/126

PAPUA NEW GUINEA

March 2023

REQUESTS FOR AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PAPUA NEW GUINEA

In the context of the Staff Report for the Requests for an Arrangement under the Extended Credit Facility and an Extended Arrangement under the Extended Fund Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 22, 2023, following discussions that ended on December 14, 2022, with the officials of Papua New Guinea on economic developments and policies underpinning the IMF Extended Credit Facility and Extended Fund Facility arrangements. Based on information available at the time of these discussions, the staff report was completed on March 8, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for Papua New Guinea.

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

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR23/89

IMF Executive Board Approves US$918 million Under the Extended Credit Facility and Extended Fund Facility for Papua New Guinea

FOR IMMEDIATE RELEASE

- The IMF Executive Board approved Papua New Guinea's request for SDR684.3 million (equivalent to US$918 million) under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF).[1]
- The 38-month arrangement will support Papua New Guinea's reform agenda, which seeks to help protect the vulnerable and foster inclusive growth. The reforms will focus on strengthening debt sustainability, alleviating FX shortages, and enhancing governance and operationalizing the anti-corruption framework.

Washington, DC – **March 22, 2023:** The Executive Board of the International Monetary Fund (IMF) today approved 38-month arrangements under the Extended Credit Facility and Extended Fund Facility for Papua New Guinea (PNG) in the amount of SDR684.3 million (equivalent to US$918 million).

The program seeks to protect the vulnerable and foster inclusive growth. The reforms will focus on strengthening debt sustainability, alleviating foreign exchange (FX) shortages, and enhancing governance and operationalizing the anti-corruption framework.

In recent years, PNG has been hit by multiple shocks including low commodity prices in 2014-20, a severe drought in 2015-16, a major earthquake in 2018, and the COVID-19 pandemic in 2020-21. These shocks softened growth and led to an aggravation of FX shortages and a build-up of public debt. PNG faces substantial development needs in order to tackle high poverty, with most of the population living in hard-to-reach rural areas and lacking access to basic infrastructure and services.

A recovery from the pandemic is now underway: real gross domestic product (GDP) is estimated to have grown by 4.5 percent in 2022 as most COVID-related restrictions were removed, allowing the non-resource sector to rebound. Growth in 2023 is projected to be 3.7 percent, driven by the non-resource sector. Growth in 2024 is projected to accelerate to 4.4 percent, driven by the expected reopening of Porgera gold mine. The post-pandemic recovery has also been supported by higher commodity prices, raising fiscal and export revenues, while causing domestic inflation to rise.

The medium-term outlook is positive: there are good prospects of new investments in the resource sector, which would boost growth, exports, and fiscal revenue collection. However, PNG is vulnerable to both domestic and external shocks, which is exacerbated by the buildup in public debt, ongoing FX shortages, and capacity constraints that impact the government's ability to formulate and implement development policies.

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[1] SDR figures for the program are converted at the market rate of U.S. dollar per SDR on the day of program approval.

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At the conclusion of the Executive Board's discussion, Mr. Kenji Okamura, Deputy Managing Director, and Acting Chair, made the following statement:

"Papua New Guinea has experienced multiple external shocks and natural disasters in recent years. These events have adversely impacted economic growth, worsened foreign exchange shortages that hampered private sector development, and increased public debt. The country also has large development needs, including bringing down poverty and improving access to infrastructure and services in remote rural areas. To address these long-standing structural issues, PNG has undertaken wide-ranging reforms, supported by the IMF and other international partners, including under two Staff Monitored Programs (SMPs).

Building on the progress under the SMPs, the authorities need to accelerate structural reforms to achieve resilient, inclusive, and sustainable growth. Debt vulnerabilities will be addressed by sustaining ongoing fiscal consolidation efforts while creating space to tackle development needs and preserve social spending. To reduce foreign exchange shortages, the authorities are committed to strengthening central bank operations and moving gradually to a market-clearing exchange rate. To foster greater transparency and accountability and strengthen the investment climate, the authorities will build on recent improvements to the anti-corruption and governance frameworks and make them effective.

The ECF/EFF arrangements will help address balance of payment needs and rebuild the buffers needed to facilitate a gradual and orderly return to greater exchange rate flexibility. The program will also go toward financing the budget, thereby supporting the authorities' ambitious fiscal consolidation plans while avoiding a disruptive adjustment. It is also expected to play a catalytic role with other development partners. Given the institutional and technical capacity constraints faced by the authorities, reform measures supported by the program are streamlined, focused, and will be carefully sequenced. Timely capacity development and advice from the IMF will support reform implementation throughout the duration of the program."

Table 1. Papua New Guinea: Selected Economic and Financial Indicators, 2019-2028

Nominal GDP (2019):	US$24.8 billion 1/
Population (2019):	8.6 million
GDP per capita (2019):	US$2,877
Quota:	SDR 263.2 million

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
			Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Percentage change)									
Real sector										
Real GDP growth	4.5	-3.2	0.1	4.5	3.7	4.4	3.1	3.1	3.0	3.1
Resource 2/	11.3	-9.2	-11.0	4.7	0.3	5.1	0.1	0.1	0.1	0.2
Non-resource	1.6	-0.4	4.8	4.5	4.9	4.2	4.2	4.1	4.0	4.1
Mining and quarrying (percent of GDP)	10.8	10.2	8.5	9.0	9.8	10.7	10.3	9.9	9.4	8.9
Oil and gas extraction (percent of GDP)	17.6	14.1	16.4	21.7	18.1	15.7	14.0	13.0	12.2	11.5
CPI (annual average)	3.9	4.9	4.5	6.6	5.4	4.9	4.6	4.5	4.5	4.5
CPI (end-period)	2.7	5.1	5.7	6.2	5.2	4.7	4.5	4.5	4.5	4.5
	(In percent of GDP)									
Central government operations										
Revenue and grants	16.3	14.7	15.0	15.8	17.1	16.6	17.0	17.1	17.3	17.5
Of which: Resource revenue	1.5	0.9	1.1	3.8	3.5	2.8	3.0	2.9	2.9	3.0
Expenditure and net lending	20.7	23.5	21.8	21.2	21.4	20.5	19.3	18.2	17.3	17.3
Net lending(+)/borrowing(-)	-4.4	-8.9	-6.8	-5.4	-4.3	-3.9	-2.3	-1.2	0.0	0.2
Non-resource net lending(+)/borrowing(-)	-5.9	-9.8	-7.9	-9.2	-7.8	-6.7	-5.3	-4.1	-2.9	-2.8
	(Percentage change)									
Money and credit										
Domestic credit	5.2	2.3	15.9	0.8	16.7	11.9	5.7	3.9	2.9	14.0
Credit to the private sector	4.1	4.2	2.5	9.2	8.4	8.5	8.8	8.8	8.6	8.3
Broad money	4.4	7.0	13.4	12.7	-2.7	4.9	7.0	6.8	5.5	7.2
	(In billions of U.S. dollars)									
Balance of payments										
Exports, f.o.b.	11.4	9.1	10.3	15.5	13.7	14.2	14.5	14.9	15.3	15.7
Imports, c.i.f.	-3.9	-3.3	-2.7	-2.9	-3.0	-3.1	-3.2	-3.3	-3.5	-3.7
Current account (including grants)	4.9	4.7	5.7	10.8	7.3	7.3	8.1	8.1	8.7	9.2
(In percent of GDP)	20.0	19.7	21.3	34.1	22.3	21.9	23.9	22.5	22.8	22.5
Gross official international reserves	2.3	2.7	3.2	4.1	2.8	2.5	2.9	3.2	3.3	2.5
(In months of goods and services imports)	6.2	8.0	9.0	11.1	7.5	6.4	7.2	7.8	7.8	5.7
	(In percent of GDP)									
Government debt										
Government gross debt	40.6	48.7	52.1	47.9	49.9	51.2	51.8	49.1	44.9	41.0
External debt-to-GDP ratio (in percent) 3/	17.1	21.8	24.8	23.4	25.7	28.0	30.0	29.1	27.0	23.3
External debt-service ratio (percent of exports)	1.2	5.3	4.4	1.9	3.0	3.5	4.1	4.2	3.7	6.7
Exchange rates										
US$/kina (end-period)	0.2935	0.2850	0.2850	0.2838	...	...	...	...	...	...
NEER (2005=100, fourth quarter)	97.0	90.7	91.2	100.3	...	...	...	...	...	...
REER (2005=100, fourth quarter)	125.5	122.6	125.1	135.5	...	...	...	...	...	...
Terms of trade (2010=100, end-period)	63.7	62.6	58.4	77.4	70.0	71.4	72.3	72.6	72.5	72.7
Nominal GDP (in billions of kina)	83.8	82.5	92.4	110.1	114.8	122.1	128.4	136.4	145.1	154.2
Non-resource nominal GDP (in billions of kina)	60.1	62.5	69.3	76.4	82.8	89.8	97.2	105.2	113.7	122.6

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

1/ Based on period average exchange rate.

2/ Resource sector includes production of mineral, petroleum, and gas and directly-related activities such as mining and quarrying, but excludes indirectly-related activities such as transportation and construction.

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

INTERNATIONAL MONETARY FUND

PAPUA NEW GUINEA

March 8, 2023

REQUESTS FOR AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

EXECUTIVE SUMMARY

Background. Papua New Guinea (PNG) is a fragile state, vulnerable to natural disasters and terms of trade shocks. Low commodity prices in 2014-20, a severe drought in 2015-16, and a major earthquake in 2018 softened growth, led to shortages of FX, and contributed to a pre-pandemic build-up of public debt. The pandemic further increased public debt, which is now at high risk of distress, while development needs remain considerable.

Program Objectives and Policies. Following completion of the Staff Monitored Program (SMP) with broadly satisfactory performance in June 2022, the authorities have requested a program under the Extended Credit Facility (ECF) and Extended Fund Facility (EFF) to address long-standing structural issues and foster reforms for inclusive and sustainable growth. The reforms focus on (i) strengthening debt sustainability through sustained fiscal consolidation, (ii) enhancing the legal and operational framework of the Bank of PNG (BPNG) to strengthen its mandate and autonomy, alleviate FX shortages and transition to a market-clearing exchange rate, and (iii) enhancing governance and operationalizing the anti-corruption framework.

Program Modalities. Staff supports a 38-month ECF/EFF, with access of SDR 228.11 million (86.7 percent of quota) under the ECF and SDR 456.21 million (173.3 percent of quota) under the EFF. The authorities intend to use the entire amounts to finance the budget. The program is expected to be fully financed. PNG's capacity to repay the Fund is adequate, but subject to elevated risks.

Staff Views. The Letter of Intent and Memorandum of Economic and Financial Policies demonstrate program ownership and appropriate policies to reach the goals of the authorities' program.

Approved By
Sanjaya Panth (APD) and Andrea Schaechter (SPR)

A staff team consisting of Tahsin Saadi Sedik (head), Fabien Gonguet, Narayanan Raman, Yirbehogre Modeste Some (all APD), Daniel Wales (SPR), and Zsolt Ersek (MCM) visited Port Moresby between December 1-14, 2022, and continued discussions through end-January 2023. The mission met with Prime Minister James Marape, Treasurer Ian Stuckey-Ling, BPNG Acting Governor Benny Popoitai, Treasury Secretary Andrew Oaeke, Internal Revenue Commissioner General Sam Koim, senior government officials, development partners, and representatives of the private sector. Ms. Karl (OED) participated in meetings with the government. The mission was assisted by Sohrab Rafiq, IMF Resident Representative to Papua New Guinea. Nadine Dubost, Enakshi Das, and Ricardo Davico provided administrative and research support for the preparation of the staff report.

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CONTEXT

1. **Papua New Guinea (PNG) is a fragile state, vulnerable to natural disasters and terms of trade shocks.** Low commodity prices in 2014-20, a severe drought in 2015-16, and a major earthquake in 2018 softened growth, led to shortages of foreign exchange, and contributed to a pre-pandemic build-up of public debt. The pandemic further increased public debt, which is now at high risk of distress. Development needs remain significant. Poverty is high, with most of the population living in rural areas, without access to basic infrastructure and services.

2. **The authorities are seeking 38-month arrangements under the Extended Credit Facility (ECF) and Extended Fund Facility (EFF).** Following the completion of the 6-month Staff Monitored Program (SMP) in June 2022, with broadly satisfactory performance, the authorities, with strong support at the highest level of government, have requested an ECF/EFF to address a protracted BOP need that is manifested in FX shortages and to advance reforms for inclusive and sustainable growth, while addressing debt vulnerabilities, strengthening central bank operations and gradually reinstating kina convertibility, and making strides on the anti-corruption framework. The program is broad and ambitious and will need to be sequenced carefully to ensure successful reform implementation and allow for capacity building.

3. **The post-election period offers an opportunity to pursue reforms.** The general election held in July 2022 returned Prime Minister James Marape to power with a large majority and the reappointment of the Treasurer. Both officials have reiterated their commitment to economic reforms and fiscal consolidation. In a fractious political environment, the government currently benefits from a grace period: it cannot face motions of no confidence until February-March 2024, creating a particularly opportune window to undertake difficult but necessary reforms.

RECENT DEVELOPMENTS, OUTLOOK AND RISKS

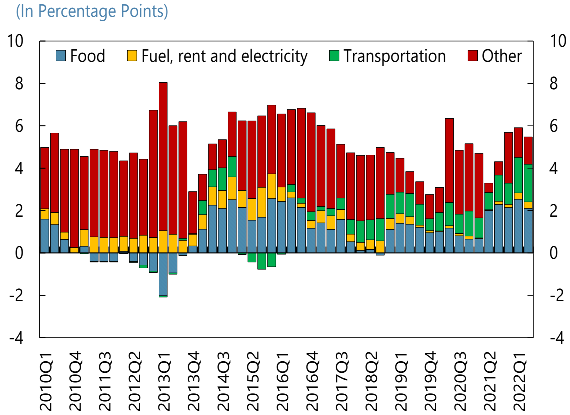
4. **A recovery is underway with the reopening of the economy amid favorable commodity prices.** The pandemic, coupled with vaccine hesitancy and poor public health resources, led to real GDP contracting by 3.2 percent in 2020 before recovering to 0.1 percent in 2021. In 2022, growth is estimated to have reached 4.5 percent, supported by the removal of COVID-related restrictions allowing the non-resource sector to rebound. The recovery in the resource sector, however, has been impacted by delays in reopening of the Porgera gold mine and planned maintenance shutdown of LNG production. Average inflation is estimated to have increased from 4.5 percent in 2021 to 6.6 percent in 2022, despite fiscal measures introduced to address the rising cost-of-living.

5. **Growth in 2023 is expected to be sustained at 3.7 percent driven by the non-resource sector.** Continuing delays in reopening the Porgera mine, now expected in the fourth quarter of 2023, will weigh on resource sector growth (0.3 percent), while growth in the non-resource sector (4.9 percent) is projected to be driven by the recovery in services. Inflation is expected to moderate

to 5.4 percent from the projected lower commodity prices and easing in supply chain constraints. Over the medium-term, growth is projected to converge to potential (around 3.1 percent), supported by the non-resource sector.

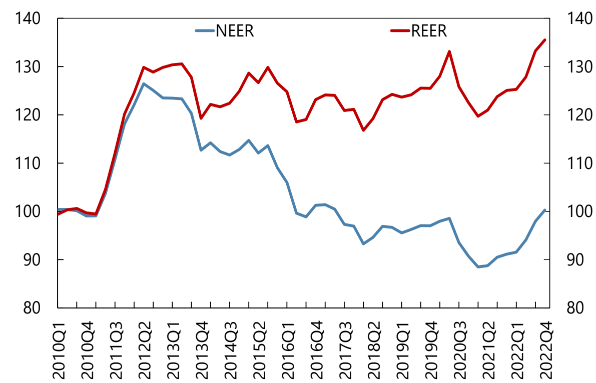
6. PNG's external position is substantially weaker than the level implied by fundamentals and desirable policies (Annex II). The Real Effective Exchange Rate (REER) is overvalued by 13.4 percent in 2022 (2.4 percent for 2021 in the last Article IV report). The Nominal Effective Exchange Rate (NEER) appreciated by 6.9 percent in 2022 as the kina remained broadly stable against a stronger trade-weighted US dollar, while the REER has appreciated by 6.6 percent (text chart). Higher commodity prices in 2022 and strong official flows helped maintain reserves at around 11 months of imports.[1]

Contribution to CPI Inflation
(In Percentage Points)



Source: IMF staff estimates.

Exchange Rates
(Index; 2010=100, quarterly average)



Sources: IFS and IMF staff estimates.

7. PNG's public and publicly guaranteed debt remains at high risk of debt distress (Debt Sustainability Analysis, DSA). After rapid increases in recent years, public debt ratios remain elevated while the bullet payment falling due in 2028 on PNG's existing Eurobond represents a liquidity risk leading to a spike in the debt service-to-revenue ratio in 2028, breaching the threshold in the DSA, thereby signaling a high risk of debt distress. The DSA also suggests that debt is susceptible to export-related and other shocks, underscoring downside risks to the debt outlook in a global environment of high uncertainty. The profile of domestic debt, with a high concentration in short-term Treasury bills, raises rollover risks, and calls for diversifying toward longer duration bonds.

8. The banking sector is reported to be well capitalized and profitable, with ample liquidity, though non-performing loans (NPLs) have been on the rise. The capital adequacy ratio (mostly Tier 1 capital) and the return on equity have been improving since the start of the

[1] Published data on the current account surplus in PNG is likely overstated due to long-standing challenges in classifying large income account outflows, including external debt service payments related to resource projects, which are incorrectly classified under the financial account.

pandemic, reaching respectively 37.6 and 17.9 percent as of June 2022. NPLs have increased to 6.3 percent, calling for closer monitoring of growing credit risks.

9. Risks to the outlook are tilted to the downside but there are significant upside risks to growth, exports and fiscal revenues (Annex I). Downside risks include weaker external demand for PNG's exports, large volatility in commodity prices and dividend payments, and natural disasters. Reform implementation could be hampered by political developments, particularly once the grace period enjoyed by the government expires in early 2024. On the upside, risks include higher-than-expected commodity prices, or the start of any of the several major projects, including Papua LNG, P'nyang LNG or the Wafi Golpu gold mine, which are not yet in either staff's or the authorities' medium-term framework.

AIMS OF THE PROGRAM

The program will build on progress under past SMPs (2020/21 and 2021/22), focusing on addressing structural impediments to growth and poverty reduction. The program will (i) address current and prospective medium-term balance of payments needs, particularly to finance the budget; (ii) continue progress on the fiscal consolidation program, advance structural reforms to strengthen central bank operations and foster reforms for inclusive and sustainable growth; and (iii) demonstrate credible policies to maintain support from official development partners. Accordingly, program objectives will focus on (a) strengthening debt sustainability through a multi-year fiscal consolidation program while making room to meet critical social and development needs, (b) enhancing the legal and operational framework of the BPNG to alleviate FX shortages and transition to a market-clearing exchange rate, and (c) build on improvements to governance and the anti-corruption framework.

A. Staying the Course on Fiscal Consolidation

10. After fiscal expansion during the initial COVID wave, consolidation is underway. The pandemic, together with strict lockdown measures, put public finances under pressure. This gap was partly met by support from development partners, including the June 2020 disbursement under the Rapid Credit Facility (RCF) amounting to SDR 263 million (100 percent of quota). As the initial COVID wave receded in 2021, the deficit narrowed by 2.1 pp of GDP largely due to lower expenditure, which was financed in significant part by external support, including through the SDR allocation. In the 2022 Budget, the authorities aimed for a further 1 pp reduction of the deficit on the back of higher revenues from commodity exports, and the introduction of the additional company tax (ACT),[2] a concentration levy on the largest companies in the banking and telecommunications sectors. In the event, the revenue outturn exceeded the budget forecast, which allowed the government to address higher inflation by temporarily removing taxes and excises on food and fuel

[2] The legality of the ACT is currently being challenged. Payments received to date have been held in trusts and were not included in reported revenues in 2022. Should the courts uphold the ACT, revenues would be higher.

and extending the free tuition program for school children and clearing domestic arrears while maintaining the nominal deficit target in the budget.

11. The 2023 budget envisions further fiscal consolidation. The 2023 budget, passed in December 2022, targets a deficit of 4.3 percent of GDP (Tables 2a and b). Domestic revenues are projected to increase relative to the estimated outturn for 2022 by around 1.2 percentage points of GDP on account of both tax and non-tax revenue. Tax revenues are expected to benefit from higher collection of corporate taxes and the goods and services tax. The higher corporate tax collection reflects both the rebound in profits and the imposition of a higher Company Tax rate on commercial banks. On the other hand, the increase in the personal income tax threshold from K12,500 to K20,000 is expected to narrow the tax base and adversely impact personal income tax collected while mining and petroleum tax collection is expected to be affected by lower commodity prices. The update of the dividend policy for state-owned enterprises (SOEs), which calls for a larger revenue contribution from SOEs involved in resource projects, should result to a significant increase in dividends from the sector (+0.7 pp of GDP) and greater predictability in future dividend payments. The implementation of the Non-tax Revenue Act (NTRA), which requires revenue-collecting government units to directly remit revenues collected under the Budget to the Consolidated Revenue Fund rather than the past practice of transferring the funds after netting out costs, is expected to contribute around a 0.3 pp increase in the revenue ratio, offsetting the impact of the expected decline in commodity prices. Budgeted expenditures remain largely unchanged at around 21.4 percent of GDP. The authorities intend to use the higher revenue to address accumulated arrears to suppliers and personnel spending (mainly the state's contribution to the employees' provident fund, MEFP ¶14). More broadly, the authorities have identified unrealistically low appropriations in previous budgets as a contributory cause of the arrears. More realistic budgeting will mitigate this going forward. As a result, real spending on goods and services is expected to remain largely constant despite the non-recurrence of one-off spending in 2020 and 2021 (due to the pandemic) and 2022 (for elections).

Text Table 1. Papua New Guinea: Contribution of Policy Measures to Change in Projected Domestic Revenues

	Change/Estimated Impact	
	million kina	pp of GDP
Change in domestic revenues[1]	**1,993**	**1.2**
Tax	1,068	0.6
Non-tax	925	0.5
Of which: due to policy measures	**1,713**	**1.0**
Tax	***-130***	***-0.1***
Imposition of a 45 percent Company Tax rate on commercial banks	240	0.1
Increase in excise duties on alcohol and mixed drinks	30	0.0
Increase in duty on round logs	30	0.0
Increase in the personal income tax threshold from K12,500 to K20,000	-280	-0.2
Removal of excise duties on fuels until June 2023	-150	-0.1
Update of the PNG Customs Harmonized System from HS 2017 to HS 2022	0	0.0
Non-tax	***1,843***	***1.1***
Update of SOE dividend policy	1,293	0.7
Ok Tedi	293	0.2
Kumul Petroleum	1,000	0.6
Introduction of the Non-Tax Revenue Act	550	0.3

1/ Relative to 2022. Does not include foreign grants.
Note: Figures may not necessarily add up due to rounding errors.
Source: PNG authorities, staff calculations.

Capital spending on the other hand is expected to be 0.4 pp of GDP lower than in 2022, reflecting the lower spending anticipated at the early stage of new investment projects.

12. The authorities' medium-term fiscal framework envisions a balanced budget by 2027 and surpluses thereafter. Revenues are expected to be supported by improvements in the contributions from both the resource and non-resource sectors. In particular, tax and dividend payments from the PNG LNG project are expected to increase once tax holidays expire and borrowings are repaid starting in 2024. The authorities also expect to see a continued improvement in non-resource revenues on the basis of ongoing revenue reforms. This will be complemented by strict control of recurrent spending as the authorities aim to reorient spending to delivery of frontline services and investment, which are aimed at meeting pressing social needs and reducing poverty. In particular, the authorities have committed reducing the real allocation for payment for goods and services to administrative agencies to make room for priority spending. Going forward, they expect their new IT system to enable them to ensure better alignment between budget allocations and spending commitments, and more timely oversight over spending patterns (see paragraph 15). Savings are also expected from the tapering of the domestic arrears clearance program over the medium term. Based on these projections, the authorities expect to be able to make substantive reductions in the deficit and debt level. The debt-stabilizing primary balance is expected to be achieved by 2026 (DSA).

Proposed Policy Reforms

13. The program builds on recent efforts to further narrow the deficit and durably address debt sustainability risks (MEFP ¶11). Given the debt sustainability concerns, the authorities have been appropriately pursuing a fiscal consolidation program that builds on the reduction of the fiscal deficit as the pandemic receded. As a result, the fiscal deficit has narrowed from nearly 9 percent of GDP in 2020 to an estimated 5.4 percent in 2022. To maintain progress, the program will set a ceiling on the fiscal deficit amounting to K4,985 million for 2023 (4.3 percent of GDP), in line with the budget target (quantitative performance criterion, QPC). As in the SMP, the deficit will be measured using financing data. Fiscal consolidation is expected to continue throughout the program period, with an expected deficit of around 1.2 percent of GDP by 2026 and a balanced budget by 2027. Fully executed, the envisaged consolidation path would contribute significantly toward strengthening debt sustainability. Equally, the authorities recognize that prudence in contracting financing is critical in this effort and intend to rely entirely on official development financing from their development partners, which is offered on better-than-market terms, and borrowing from the domestic markets to meet their financing needs (MEFP ¶19). To help guide this effort and manage risks, a QPC on the present value (PV) of newly contracted external borrowing will be in effect during the program. In 2023, this is set at US$1,405 million and will be effective for the whole year.

14. The authorities intend to strengthen revenue collection as a key part of their fiscal consolidation strategy (MEFP ¶12). The immediate revenue reform priorities are to implement the Tax Administration Act (TAA) and introduce amendments to the Income Tax Act (ITA) to Parliament by end-December 2023 (structural benchmark). In particular, the ITA is expected to modernize the tax system by improving assessments and streamlining compliance, which should improve tax collection over time. On revenue administration, the authorities intend to adopt a successor to the Medium-term Revenue Strategy (MTRS) by end-August 2023 (structural benchmark), in consultation with Fund staff based on technical assistance. The new Strategy will replace the old MTRS, which expired in 2022, and is intended to entrench past reforms and further strengthen revenue collection in the future. A lesson from the implementation of the last MTRS is the importance of Cabinet oversight as a critical factor in any future policy reforms. The authorities intend to maintain the role of the Budget Management Committee, consisting of Ministers in charge of the Departments of Treasury, Finance, and Planning, to oversee future reforms. The introduction of the NTRA would support the medium-term goal of increasing revenues from the resource sector but consideration should be given to the introduction of an ad valorem levy on mineral production for future mining projects to ensure PNG sees immediate benefits from the sector. To maintain focus on revenue reforms, a floor on non-resource tax revenue collection— set at K12,558 million in 2023—is proposed as an indicative target (IT).

15. Efforts to rebalance the composition of spending to emphasize delivery of frontline services and priority capital spending are underway (MEFP ¶13). The planned integration of the payroll system with the public financial management system, thereby allocating budgetary resources for employee compensation to approved staff numbers in line ministries, should address past tendencies to spend outside established commitment control mechanisms and incur new arrears related to the retirement fund and payment of allowances. To implement the recommendations of the 2022 Staffing and Establishment (S&E) Review for central agencies, HR Business Process workshops will be completed by June 2023 (structural benchmark). This is to strengthen compliance with HR and budgetary processes to ensure there is alignment between approved headcounts and budgetary allocations, thus reducing the potential for overspending and the incurrence of arrears. To complement the 2022 S&E Review, the authorities intend to embark on a similar exercise for teachers, who represent the bulk of public sector workers in 2023 (MEFP ¶15). The authorities also intend to review all relevant working forms/templates and policy guidelines as part of their efforts to prepare an updated 5th edition of the General Orders of the government. A timeline for this project will be finalized in 2023. In addition, with Fund TA, the authorities are upgrading their IT systems to manage expenditure, which would support efforts to control current spending. The reforms over the program period can be expected to deliver the full benefits over the medium term. To support the envisaged elevation in investment spending, staff recommends a Public Investment Management Assessment (PIMA) to ensure the investment program delivers quality projects at reasonable cost to strengthen potential growth. The program will also ensure space to maintain critical social spending on health, education and law and order. Therefore, an IT on social expenditures has been introduced and targets a floor of K3,866 million, or around 3.4 percent of GDP, for 2023 (MEFP ¶30).

B. Toward a More Effective Monetary Policy Framework

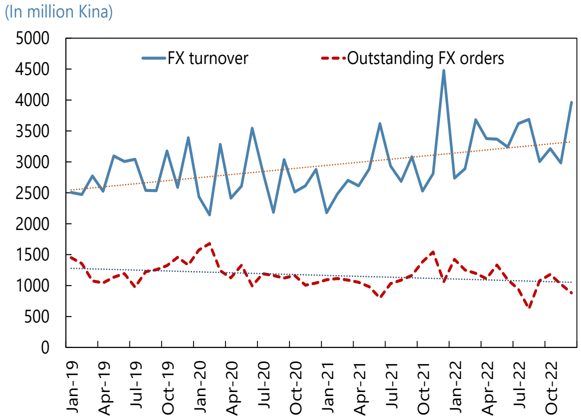
16. PNG's de jure exchange rate regime is floating, but de facto is classified as stabilized, which has impeded exchange rate adjustment and contributed to FX shortages. Staff assesses the kina to be overvalued (Annex II). The BPNG has imposed a trading margin on FX buy-sell spreads on authorized dealers since 2014, which, together with other characteristics of BPNG's FX allocation[3], impedes the exchange rate from adjusting to a market-clearing level that would help eliminate kina overvaluation, and, coupled with an insufficient supply into the market, has resulted in FX rationing.

17. Thanks to favorable commodity prices and greater BPNG provision of FX to the market, currency orders were fulfilled more promptly in 2022, but shortages remain a key hindrance for private sector activities. FX market turnover has improved in 2022 thanks to larger inflows from export receipts. FX shortages however persist, with private sector surveys highlighting these as a key impediment to doing business in PNG, especially for importers and for foreign companies wanting to repatriate dividends. Underlying reasons for shortages are the kina overvaluation (expected depreciation of the exchange rate), FX rationing (firms are not able to access FX when they need it) and strict administrative requirements, which have created incentives for firms to keep their FX offshore or modify business plans by reducing import activities, especially local firms, or reinvesting dividends (foreign firms).

18. In response to higher inflation, the BPNG tightened monetary policy, while keeping the exchange rate stable against the US dollar. The BPNG has cumulatively raised its policy (kina facility) rate by 50 basis points since mid-2022 to 3.5 percent, increased the reserve requirement ratio from 7 to 10 percent since mid-2022, and issued more central bank bills to mop up liquidity. However, excess liquidity remains substantial, undermining the effectiveness of monetary policy. While kina appreciation and fiscal measures have contributed to containing inflation, further tightening may be needed to avoid second-round effects if inflation pressures persist. The kina has been largely stable against the US dollar, resulting in nominal effective appreciation against key trading partners, contributing to the kina overvaluation (Annex II). Given the stabilized exchange rate with the US dollar, ongoing monetary policy tightening by the US Federal Reserve may lead to a difficult policy trade-off in case of an adverse current account shock.

FX Turnover and Outstanding Orders

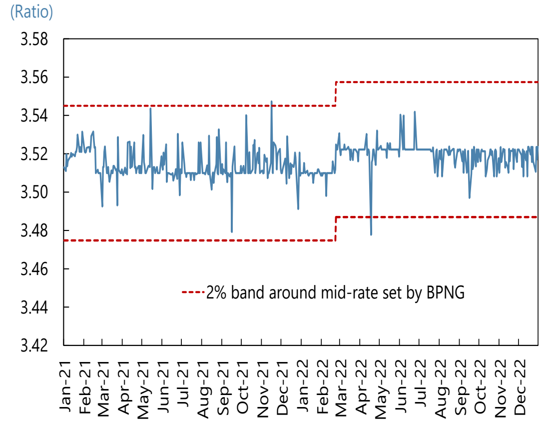
(In million Kina)



Sources: Sources: BPNG; Bloomberg Financial Markets L.P.; and IMF staff estimates.

Stabilized Exchange Rate: US Dollar to Kina

(Ratio)



Sources: BPNG; Bloomberg Financial Markets L.P.; and IMF staff estimates.

[3] BPNG's FX allocation is based on administrative criteria instead of price (participants have no incentive to deviate from the official rate) and forward transactions are forbidden.

19. Amendments to the Central Banking Act (CBA) were not fully in line with staff advice and conditionality under the 2021/22 SMP. Revisions to the CBA in December 2021 addressed several weaknesses identified in the IMF safeguards assessment. These include prohibiting carryover of central bank advances across fiscal years, and introducing eligibility criteria for all Board appointments, replacing the previous system of appointing ex-officio members. However, the 2021 amendments weakened BPNG's autonomy in other areas: (i) the inclusion of a requirement for BPNG to provide advances to the government on demand; (ii) the introduction of growth and employment in the non-resource sector as new (unranked) mandates, which could conflict with the price stability mandate; and (iii) the transfer of monetary policy decision-making to the BPNG Board, which creates potential conflict with the Board's oversight role. The Independent Advisory Group, which advises the government on the CBA review, is expected to deliver another set of recommendations by August 2023 (Phase II), with a focus on financial sector development reforms. Phase II is also expected to revisit some areas covered under Phase I, including clarifying the role of the Board in monetary policy formulation.

Proposed Policy Reforms

20. An immediate priority is to effectively mop up excess kina liquidity in the banking system, which undermines monetary policy transmission. To sterilize excess liquidity more effectively, the BPNG will modify its open market operations framework by introducing a fixed rate tender with full allotment by end-August 2023 (structural benchmark) and reviewing the terms of its short-term liquidity management instruments, with the support of Fund TA (MEFP ¶21). The combination of sterilizing banks' excess reserves and linking explicitly the rate of the main short-term instrument to the policy rate will enhance the transmission of the monetary stance to other borrowing rates.

21. The authorities are committed to enhancing the effectiveness of monetary policy and gradually moving to a market-clearing exchange rate over the duration of the program (MEFP ¶22). The gradual restoration of kina convertibility calls for a review of the monetary policy framework, continued improvement of liquidity management and forecasting, a gradual increase in exchange rate flexibility and removal of exchange restrictions, as well as the clarification of the monetary policy operational framework, which lacks a clearly defined operational target. Exit from the current system should be carefully sequenced, given the pent-up demand for FX and risks of the exchange rate overshooting which could affect financial stability and debt sustainability, and de-anchor inflation expectations. Hence, the authorities will, in consultation with the Fund, produce a roadmap by end-August 2023 for reforming monetary policy and exchange rate operations and framework (structural benchmark). Implementation of such a roadmap will require Fund TA and key actions under the roadmap will be featured as structural benchmarks in subsequent program reviews.

22. The authorities are committed to continue avoiding monetary financing and providing FX to the market (MEFP ¶21, 22). A QPC setting a ceiling on the BPNG's gross credit to government will be in effect over the duration of the program to avoid monetary financing; and a floor on the FX intervention of the BPNG will be set as an IT to help reduce pent-up demand for FX.

23. The authorities will further revise the CBA to tackle pending concerns regarding the mandate, governance, autonomy, transparency, and accountability of the BPNG (MEFP ¶23). Additional amendments to the CBA will be drafted in consultation with Fund staff and submitted to Parliament by end-2023 (structural benchmark). These amendments will address remaining weaknesses identified by the safeguards assessment and those introduced by the recent amendments (see paragraph 19). The authorities also intend to move away from setting BPNG's dividends to the government ex ante, in favor of a calculation based on realized profits which avoids constraining monetary policy operations. Phase II of the CBA review will introduce improvements in financial regulation and supervision, including profit-sharing provisions and an emergency liquidity assistance function. Phase II amendments should be considered in consultation with Fund staff to avoid the risk of unwinding hard won earlier gains in strengthening financial stability and AML/CFT frameworks (MEFP ¶24).

C. Operationalizing the Anti-Corruption Framework and Strengthening Governance

24. The authorities are making a concerted effort to strengthen governance, but significant challenges persist. The 2020 Independent Commission Against Corruption (ICAC) law bestows a new body with the power to investigate and pursue complex corruption cases. Legal challenges to the formation of the ICAC were dismissed in September 2022, allowing the Commission to begin staffing up and drafting internal rules and regulations. A shortlist of applicants for the ICAC Commissioner and Deputy Commissioners positions was finalized in late 2022, to support forthcoming appointment recommendations by the Appointments committee chaired by the Prime Minister. The authorities have also made progress regarding the governance and financial transparency of state-owned enterprises (SOEs), notably through legislative amendments to the Kumul Consolidated Holdings Act adopted in late 2021 with support from the Asian Development Bank. However, significant governance challenges remain, reflected in PNG's negative scores in almost all components of Worldwide Governance Indicators. To address governance weaknesses and corruption vulnerabilities, a sustained, multi-year effort with close external support, including from the IMF, is needed. BPNG's Financial Analysis and Supervision Unit (FASU) is actively preparing for PNG's 2023 mutual evaluation against the FATF standards, providing training to supervised entities and working on changes to the AML/CFT legal framework.

Proposed Policy Reforms

25. In the first few months of the program, the authorities will take important first steps towards the operationalization of the ICAC (MEFP ¶26). The authorities will appoint the ICAC Commissioner and two Deputy Commissioners by end-June 2023 (structural benchmark), and gradually fill up its operational staff positions, while providing them with proper training on investigation and prosecution. Building on technical support from UN and EU, they will finalize and adopt by end-2023 key implementing regulations to the ICAC law, to specify processes for ICAC's preventive, investigative and prosecutorial mandates, and ensure sharing of information across relevant entities (structural benchmark). Further structural benchmarks will be added in future program reviews to help turn the ICAC into a fully functioning body, able to effectively carry out its mandate. This will also require training on investigation and prosecution, formalize cooperation with other relevant anti-corruption bodies, including FASU, and design a case management IT system.

26. The authorities are committed to enhancing fiscal and financial transparency (MEFP ¶23, 25, 27, 28, 29). The authorities will improve transparency in public procurement by resuming full publication of information on COVID-related procurements by end-December 2023 (structural benchmark), including beneficial ownership information for all successful entities awarded emergency contracts. The break in reporting was a result of personnel movements, and because a significant part of the spending went through the regular procurement channel rather than emergency procedures. The Treasury intends to increase the frequency and detail contained in its published budget information, including in GFS format; and the BPNG will return to the timely publication of its audited financial statements and improve the computation of financial soundness indicators, with Fund support.

PROGRAM MODALITIES

27. Access. The authorities requested a 38-month blended ECF/EFF. PNG meets the PRGT-blending criteria and completed an SMP in June 2022 with broadly satisfactory performance. The proposed access level of SDR 684.32 million (260.0 percent of quota) reflects current and prospective BOP needs. This is comprised of SDR 228.11 million (86.7 percent of quota) under the ECF and 456.21 million (173.3 percent of quota) under the EFF. The BOP needs manifest as persistent and widespread shortages of FX, relating to an overvalued exchange rate and to FX rationing. Backlogs in the demand for FX, particularly driven by dividends accruing to non-residents, necessitate a careful approach to addressing exchange rate overvaluation to minimize risks of overshooting. Support in maintaining adequate foreign reserves will assist in gradually permitting greater exchange rate flexibility in an orderly manner, particularly during the later stages of the program (Box 1). The program targets a minimum level for net international reserves of US$1,700 million by end-2023 (QPC), consistent with gross reserves of US$2.8 billion (7.5 months of imports). Consistent with a sequenced and strengthened reform agenda, access is backloaded with only 50 percent of quota to be disbursed in the first year. Backloaded access allows the authorities to demonstrate their commitment to reforms and align higher disbursements with stronger measures over the course of the program, while also safeguarding Fund resources.

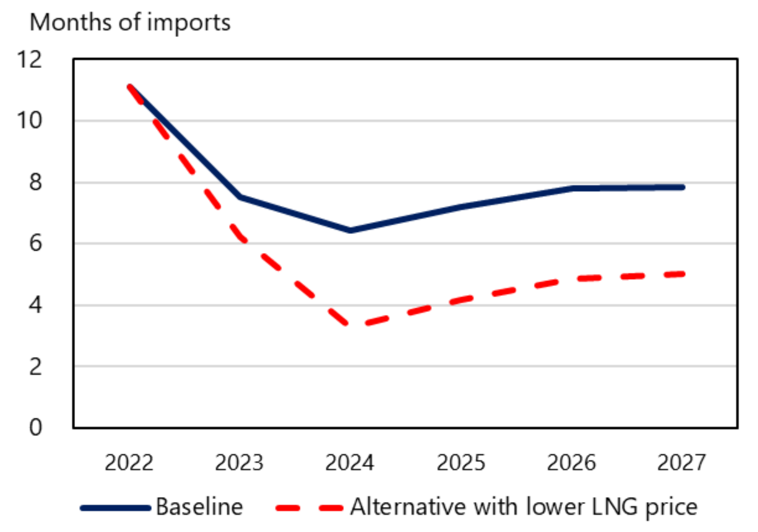
28. Financing assurances. The program is fully financed, with firm commitments for the first twelve months and good prospects of adequate financing throughout its duration. Assistance from the Fund is expected to play a catalytic financing role with other bilateral and multilateral partners, like the previous two SMPs. Fund burden sharing is expected to average 34.7 percent across the program.

Box 1. The Need for Higher Reserves in Papua New Guinea

PNG's gross international reserves are projected to remain above 6 months of imports throughout the program period. The baseline envisages that reserves will decline from 11 months of imports in 2022 to just above 6 months in 2024 as a result of: (i) increased provision of FX to the market by the BPNG in 2023, including to ease supply chain tensions caused by some companies' inability to access sufficient FX in due time (e.g., short-lived cases of interruption of fuel provision to the economy in recent months); and (ii) the removal of FX restrictions and administrative barriers to reduce FX backlogs, with a peak impact expected in 2024. The reserve path remains consistently above the US$2 billion (5.2 month) floor suggested by the reserve adequacy metrics (Annex II).

Higher reserves act as a buffer in an environment of heightened uncertainty. First, there is likely pent-up demand for FX (including for dividend repatriation). To avoid exchange rate overshooting, and rapid capital outflows, a well-sequenced reform roadmap will be critical, and its implementation will necessitate technical assistance from the Fund. A higher level of reserves will complement the reforms by strengthening market confidence in the reforms. The international experience shows that monetary and FX reforms are smoother when undertaken from a position of strength, including with an appropriate level of reserves. Second, commodity price volatility can significantly impact reserves given PNG's high dependence on the resource sector. Under a plausible downside scenario with temporarily lower LNG prices,[1] reserves could fall below the floor suggested by the adequacy metrics in the absence of offsetting factors (chart). This sensitivity underscores the need for maintaining a reserve level higher than the estimated floor.

Gross FX Reserves



[1] In this setting, LNG export prices fall by one standard deviation in 2023 and 2024, computed using the 15-year historical average of price movements, and return to the baseline thereafter.

29. Use of IMF resources. The authorities intend to use ECF/EFF disbursements to finance the budget. Without external budget support, the authorities would have to utilize reserves, complicating an orderly return to kina convertibility, and tighten the deficit much faster, which would constrain much-needed social and investment spending, or resort to costly domestic financing, strengthening the sovereign-bank nexus. IMF disbursements are expected to be made to the BPNG. A memorandum of understanding between BPNG and the Treasury will guide the terms and conditions of resources made available to the government and their respective roles and responsibilities for servicing financial obligations to the Fund.

30. Capacity to repay. PNG's capacity to repay the Fund is adequate (Table 8), but subject to elevated risks. Based on an ECF/EFF disbursement of 260 percent of quota, principal obligations to the Fund would peak in 2032 at around 121.7 million SDRs (46.2 percent of IMF quota). This represents 2.0 percent of government revenue and 0.9 percent of exports of goods and services. The peak in credit outstanding is below the top quartile of past UCT quality arrangements for PRGT countries when measured as a percent of GDP and external debt, but just above the top quartile when measured as a percentage of gross international reserves (Figure 4). Outstanding IMF credit peaks at 38.5 percent of gross international reserves in 2028. Downside risks include weaker external demand for PNG's exports, large volatility in commodity prices and natural disasters (Annex I). Risks to capacity to repay are partially mitigated by a commitment to fiscal sustainability and macroeconomic stability in the medium-term. In addition, the macroframework is built on conservative assumptions regarding prospects of the new resource sector projects, which are excluded from the baseline projections.

31. Safeguards assessment. The last safeguards assessment was completed in 2021 with slow progress on implementing recommendations, in part driven by protracted BPNG Board vacancies and its management (MEFP ¶23). A key recommendation to strengthen the legal framework of the BPNG remains outstanding and is expected to be addressed under this program (MEFP ¶23 and structural benchmark). Other outstanding priority recommendations include aspects of the reserves management framework and the internal audit mechanism. While the BPNG prepares its financial statements under international standards, the timeliness of publication has been interrupted for FY2021 and needs to be restored. In line with the safeguards policy, an update assessment will need to be completed by the first program review.

RISKS TO THE PROGRAM AND OTHER ISSUES

32. Risks to the program and mitigating measures. Risks to the program arise from the authorities' limited implementation capacity in an environment that is vulnerable to multiple shocks. Staff propose to address these risks through the use of streamlined, focused and macrocritical conditionality, building on the lessons from the approach taken in the 2021/22 SMP and in line with the Fund's Strategy for Fragile and Conflict-Affected States. The arrival of the Resident Representative in November 2022, re-activation of the Program Monitoring Committee (see below) and resumption of bi-weekly virtual meetings between the authorities and staff will support focus on program targets. While political instability is a risk that could delay reform implementation in the latter part of the program, it is somewhat mitigated by the current broad-based support.

33. Capacity development (CD) will center on clarifying the monetary policy framework and exchange rate regime (including FX regulations), enhancing the governance of the BPNG, preparing a new MTRS to strengthen revenue administration, enhancing cash and debt management, improving public investment management, strengthening control over payrolls and improving statistical systems, and enhancing macro-fiscal estimates and forecasts. In addition, the authorities have requested a Financial Sector Stability Review (FSSR) for 2023. Fund TA will be complemented by technical support from other partners in several areas, including, the UN and EU in strengthening the anti-corruption framework, ADB in reforming SOE governance, and Australia in preparing macro-economic statistics.

34. Data gaps. Data reporting has been strengthened to support program monitoring and a Program Monitoring Committee has been set up to support information-sharing with staff. The Committee, which is chaired by the Secretary of the Treasury Department, has been re-activated and regular meetings with staff have resumed. The authorities have, with Fund support, also started to compile BOP data under the 6th Edition of the Balance of Payments Manual. On fiscal data, the updated IT systems should ensure better alignment of budgetary allocations with spending commitments. More generally, the updated PFM system is expected to be able to improve both timeliness and quality of fiscal data. The authorities have requested Fund technical assistance to extend fiscal reporting under the 2014 Government Finance Statistics Manual to local governments and SOEs. Further work is needed to ensure the data to support policy formulation is timely and adequate. In particular, strengthening external sector, national accounts and public debt statistics should be priorities. Recommendations from ongoing Fund TA could inform future structural measures in subsequent phases of the program.

STAFF APPRAISAL

35. Multiple external shocks since 2014 have weighed on PNG's economy, led to FX shortages, and contributed to the build-up of public debt. The real exchange rate is assessed to be overvalued, and public debt at high risk of distress. Following the COVID-19 pandemic and the reopening of the economy, a recovery is underway amid favorable commodity prices. Risks to the outlook are tilted to the downside, but there are upside risks to growth, exports and fiscal revenues, as large resource projects have not yet been incorporated in the baseline.

36. The authorities need to accelerate the reforms initiated under the SMPs to achieve more resilient, inclusive, and sustainable growth. Reforms should focus on strengthening debt sustainability through sustained fiscal consolidation, enhancing the legal and operational framework of the BPNG, alleviating FX shortages and transitioning to a market-clearing exchange rate, and making strides in governance and operationalizing the anti-corruption framework. The ECF/EFF arrangements support the authorities' priorities in these areas.

37. Sustained fiscal consolidation efforts are needed to further narrow the deficit and durably address debt sustainability risks. The authorities have appropriately lowered the deficit from almost 9 percent of GDP in 2020 to a target that is below half of that in 2023, with the aim of a balanced budget by 2027 and surpluses thereafter. They intend to strengthen revenue collection as a key part of their fiscal consolidation strategy. On the expenditure side, efforts have focused on rebalancing the composition of spending, as well improving service delivery to the population. These policies are expected to put public debt on a sharp downward trajectory over the medium term.

38. Enhancing the effectiveness of the monetary and FX frameworks are key policy priorities. An immediate priority is to mop up excess kina liquidity in the banking system. Over the medium term, the authorities are committed to gradually restoring kina convertibility, which calls for moving to a market-clearing exchange rate, removing exchange restrictions, and clarifying the monetary policy operational framework. A sequenced reform roadmap, with Fund support, will be critical in helping guide the BPNG in implementing these important reforms and to avoid exchange rate overshooting. In addition, further revisions to the CBA are needed to address pending concerns regarding the mandate, governance, autonomy, transparency, and accountability of the BPNG.

39. The authorities are making a concerted effort to strengthen governance and anti-corruption frameworks, though significant challenges persist. While the creation of the ICAC was a key milestone, important first steps towards its operationalization include appointing its Commissioner and two Deputy Commissioners, gradually filling up its operational staff positions, and adopting implementing regulations to the ICAC law. The authorities are committed to improving transparency in government activities and enhancing the publication of fiscal and financial data, contributing to better governance.

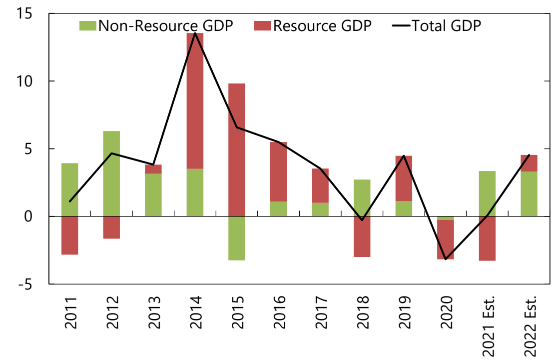
40. Based on the balance of payment needs and strong policy commitments, staff supports the authorities' request for 38-month arrangements under the ECF/EFF. An IMF-supported program will enable the authorities to make progress on their reform agenda by anchoring their commitment to sound macroeconomic policies and needed structural reforms. The program would address balance of payments needs, play a catalytic role with other development partners, and help re-build buffers needed to address FX shortages. It will also allow for an ambitious but non-disruptive fiscal consolidation path, while preserving needed social spending.

41. Implementation risks to the program stem from vulnerability to shocks, and capacity and political constraints. PNG is highly exposed to external shocks, including from commodity prices, that can adversely impact macroeconomic conditions. The authorities also face capacity constraints in policy implementation. The streamlined program design should mitigate some of these risks, particularly around the capacity and political constraints. Timely CD support from the Fund as well as effective implementation of the recommendations will be crucial in achieving program objectives. The arrival of the Resident Representative supports continued focus on program targets and strengthens real-time engagement with the authorities.

Figure 1. Papua New Guinea: Real and External Sector Developments

Real GDP recovered led by the non-resource sector.

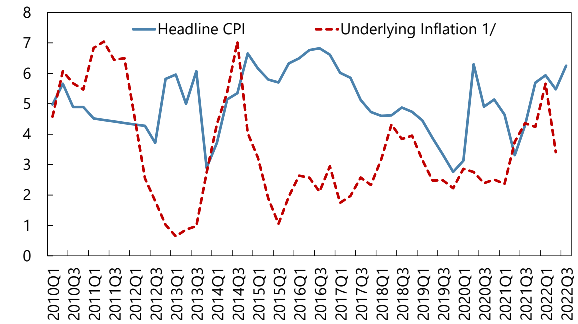
Real GDP Growth
(Contributions to percent change)



Source: IMF Staff Estimates

Headline and underlying inflation picked up despite fiscal measures introduced to address food and fuel price surges.

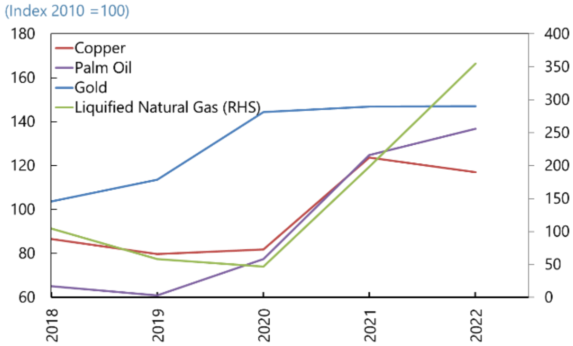
CPI Inflation
(In year-on-year percent change)



Sources: BPNG and IMF staff estimates
1/ Trimmed Mean by BPNG

Commodity prices have seen a sharp increase since 2020...

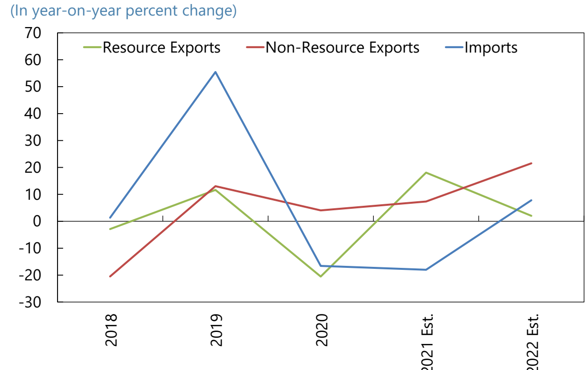
Commodity Prices
(Index 2010 =100)



Source: IMF Primary Commodity Price System

... bolstering export revenues despite supply bottlenecks.

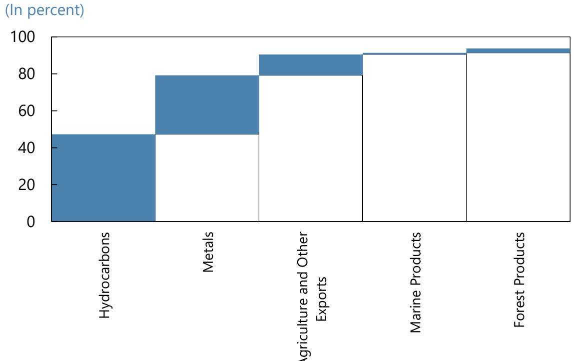
Exports and Imports
(In year-on-year percent change)



Source: IMF Staff Estimates

Strong global demand for PNG's export goods ...

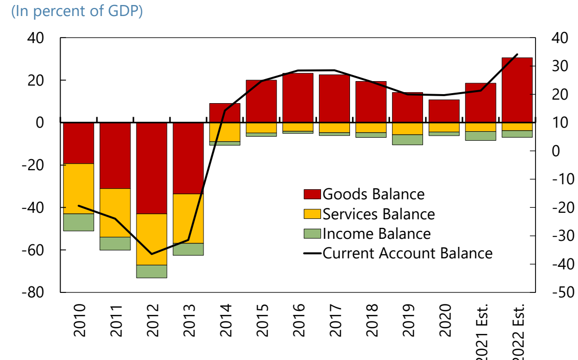
Export Product Share, 2021
(In percent)



Source: BPNG.

... support the trade balance and current account.

Current Account
(In percent of GDP)

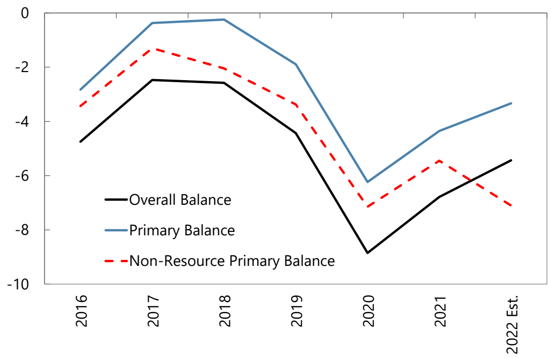


Source: IMF Staff Calculations

Figure 2. Papua New Guinea: Fiscal Developments

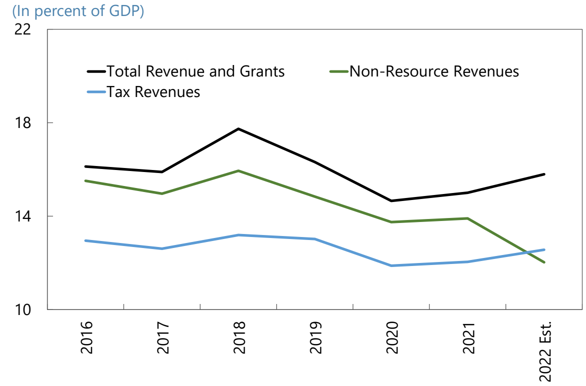
Fiscal consolidation continued in 2022…

Fiscal Balance
(In percent of GDP)



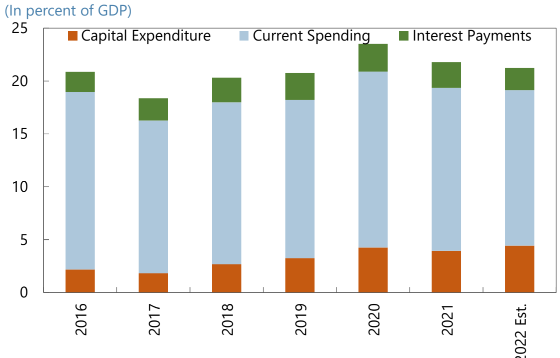
…driven by an improvement in resource revenues.

Central Government Revenue
(In percent of GDP)



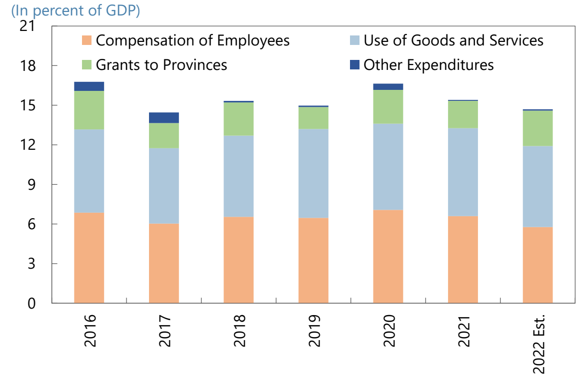
Current spending continues to take up the bulk of government spending…

Central Government Expenditure
(In percent of GDP)



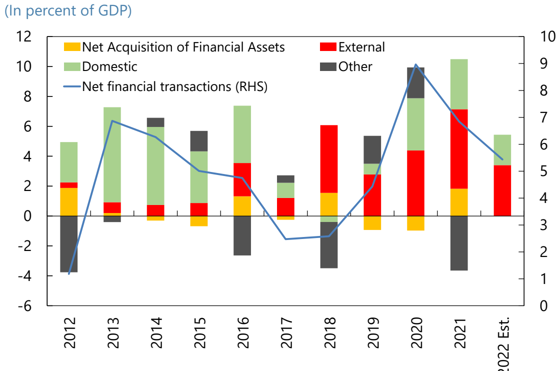
…driven by employee compensation and use of goods and services.

Recurrent Government Expenditure
(In percent of GDP)



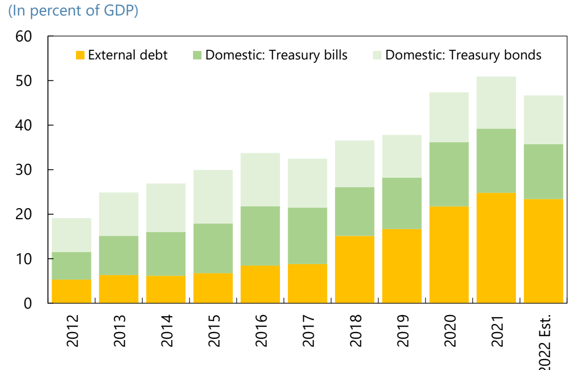
Domestic financing now meets the bulk of financing needs as COVID-driven external financing has receded

Financing
(In percent of GDP)



Public debt exceeded 50 percent of GDP in 2021, with external debt stabilizing as a percent of GDP.

Public Debt
(In percent of GDP)

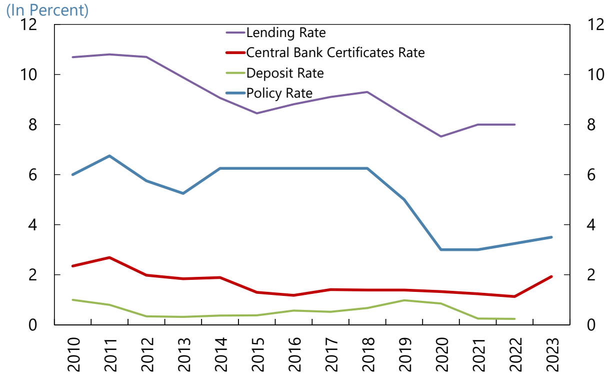


Sources: Country authorities; and IMF staff estimates and projections.

Figure 3. Papua New Guinea: Monetary and Financial Sector Developments

The central bank lifted the policy rate slightly in 2022 for the first time since the pandemic...

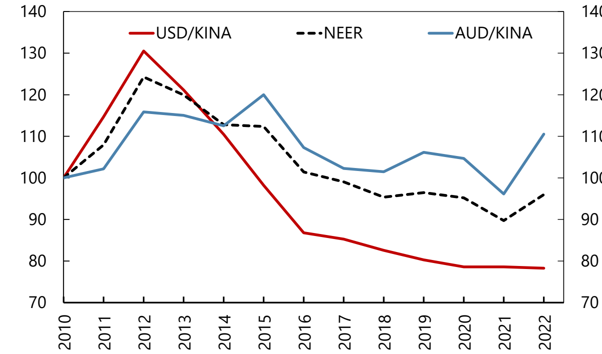
Policy Rate
(In Percent)



Note: Updated as of Jan 2023 (except deposit and lending rates, as of Jun 2022)
Sources: IFS and BPNG.

...while the kina has been stabilized against the US$ since 2020.

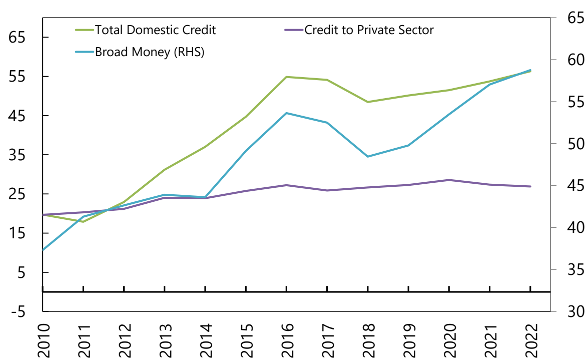
Exchange Rate
(Index; 2010=100)



Note: Data updated as of December 2022. Period averages.
Sources: IFS and IMF staff estimates.

Credit to the private sector has been broadly unchanged over the past six years...

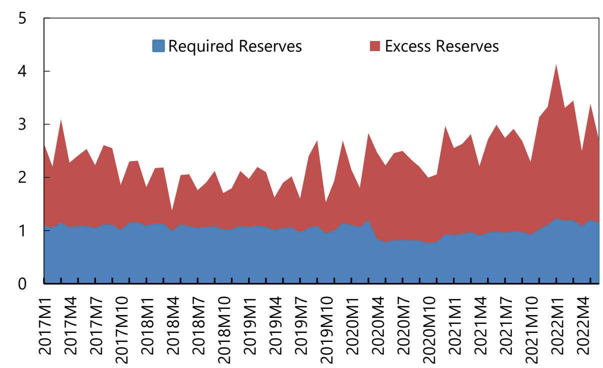
Money and Credit
(In Percent of Non-Resource GDP)



Sources: BPNG, updated as of June 2022

...with increasing excess liquidity in the banking system.

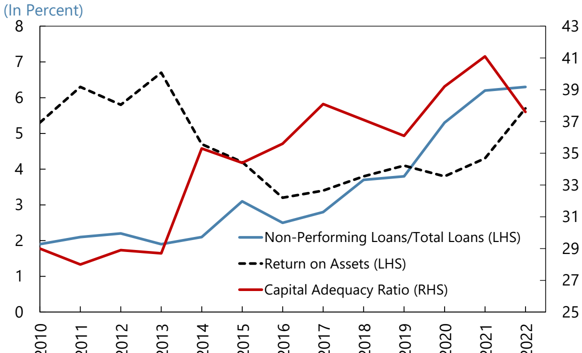
Liquidity
(Billions of Kina)



Source: BPNG.

NPLs are on the rise, though the banks are still well-capitalized.

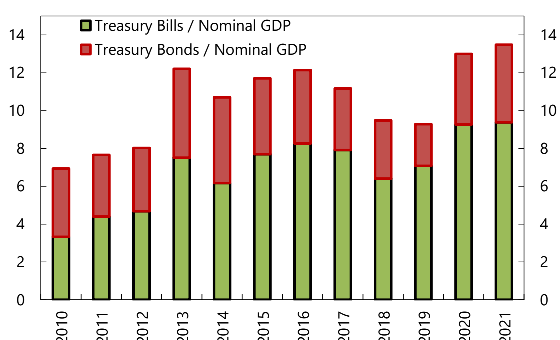
Financial Stability
(In Percent)



Note: Data updated as of June 2022.
Sources: BPNG and IMF staff estimates.

Commercial banks holdings of government paper were broadly unchanged.

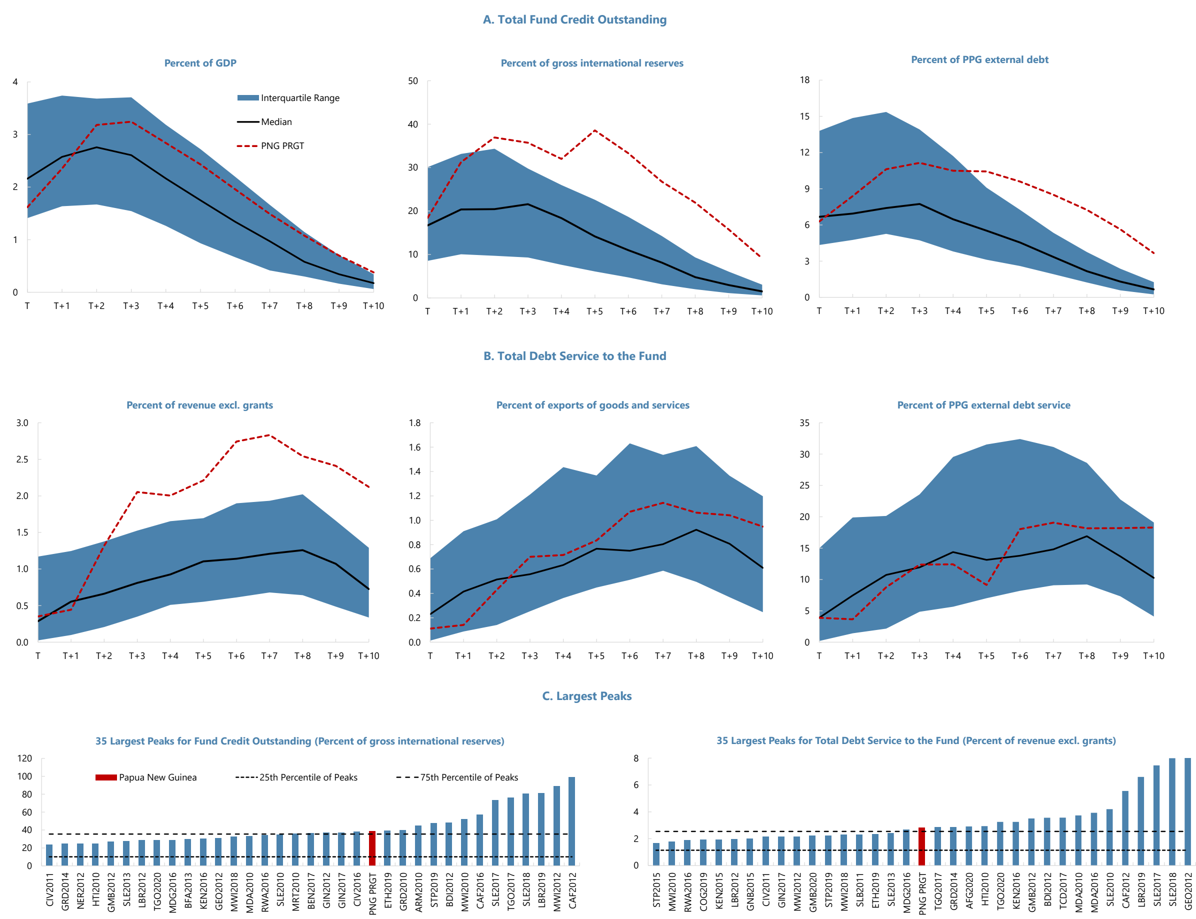
Holding of Government Securities by Commercial Banks
(In Percent of GDP)



Sources: BPNG and IMF staff estimates.

Figure 4. Papua New Guinea: Capacity to Repay Indicators Compared to UCT Arrangements for PRGT Countries

(In percent of the indicated variable)



Source: IMF Finance Department, World Economic Outlook.

Notes:
1) T = date of arrangement approval. PPG = public and publicly guaranteed.
2) Red lines/bars indicate the CtR indicator for the arrangement of interest.
3) The median, interquartile range, and comparator bars reflect all UCT arrangements (including blends) approved for PRGT countries between 2010 and 2020.
4) PRGT countries in the control group with multiple arrangements are entered as separate events in the database.
5) Comparator series is for PRGT arrangements only and runs up to T+10.
6) Debt service obligations to the Fund reflect prospective payments, including for the current year.
7) In the case of blenders, the red lines/ bars refer to PRGT+GRA. In the case of RST, the red lines/ bars refer to PRGT+GRA+RST.

Table 1. Papua New Guinea: Selected Economic and Financial Indicators, 2019-2028

Nominal GDP (2019): US$24.8 billion 1/
Population (2019): 8.6 million
GDP per capita (2019): US$2,877
Quota: SDR 263.2 million

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
			Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Percentage change)									
Real sector										
Real GDP growth	4.5	-3.2	0.1	4.5	3.7	4.4	3.1	3.1	3.0	3.1
Resource 2/	11.3	-9.2	-11.0	4.7	0.3	5.1	0.1	0.1	0.1	0.2
Non-resource	1.6	-0.4	4.8	4.5	4.9	4.2	4.2	4.1	4.0	4.1
Mining and quarrying (percent of GDP)	10.8	10.2	8.5	9.0	9.8	10.7	10.3	9.9	9.4	8.9
Oil and gas extraction (percent of GDP)	17.6	14.1	16.4	21.7	18.1	15.7	14.0	13.0	12.2	11.5
CPI (annual average)	3.9	4.9	4.5	6.6	5.4	4.9	4.6	4.5	4.5	4.5
CPI (end-period)	2.7	5.1	5.7	6.2	5.2	4.7	4.5	4.5	4.5	4.5
	(In percent of GDP)									
Central government operations										
Revenue and grants	16.3	14.7	15.0	15.8	17.1	16.6	17.0	17.1	17.3	17.5
Of which: Resource revenue	1.5	0.9	1.1	3.8	3.5	2.8	3.0	2.9	2.9	3.0
Expenditure and net lending	20.7	23.5	21.8	21.2	21.4	20.5	19.3	18.2	17.3	17.3
Net lending(+)/borrowing(-)	-4.4	-8.9	-6.8	-5.4	-4.3	-3.9	-2.3	-1.2	0.0	0.2
Non-resource net lending(+)/borrowing(-)	-5.9	-9.8	-7.9	-9.2	-7.8	-6.7	-5.3	-4.1	-2.9	-2.8
	(Percentage change)									
Money and credit										
Domestic credit	5.2	2.3	15.9	0.8	16.7	11.9	5.7	3.9	2.9	14.0
Credit to the private sector	4.1	4.2	2.5	9.2	8.4	8.5	8.8	8.8	8.6	8.3
Broad money	4.4	7.0	13.4	12.7	-2.7	4.9	7.0	6.8	5.5	7.2
	(In billions of U.S. dollars)									
Balance of payments										
Exports, f.o.b.	11.4	9.1	10.3	15.5	13.7	14.2	14.5	14.9	15.3	15.7
Imports, c.i.f.	-3.9	-3.3	-2.7	-2.9	-3.0	-3.1	-3.2	-3.3	-3.5	-3.7
Current account (including grants)	4.9	4.7	5.7	10.8	7.3	7.3	8.1	8.1	8.7	9.2
(In percent of GDP)	20.0	19.7	21.3	34.1	22.3	21.9	23.9	22.5	22.8	22.5
Gross official international reserves	2.3	2.7	3.2	4.1	2.8	2.5	2.9	3.2	3.3	2.5
(In months of goods and services imports)	6.2	8.0	9.0	11.1	7.5	6.4	7.2	7.8	7.8	5.7
	(In percent of GDP)									
Government debt										
Government gross debt	40.6	48.7	52.1	47.9	49.9	51.2	51.8	49.1	44.9	41.0
External debt-to-GDP ratio (in percent) 3/	17.1	21.8	24.8	23.4	25.7	28.0	30.0	29.1	27.0	23.3
External debt-service ratio (percent of exports)	1.2	5.3	4.4	1.9	3.0	3.5	4.1	4.2	3.7	6.7
Exchange rates										
US$/kina (end-period)	0.2935	0.2850	0.2850	0.2838	…	…	…	…	…	…
NEER (2005=100, fourth quarter)	97.0	90.7	91.2	100.3	…	…	…	…	…	…
REER (2005=100, fourth quarter)	125.5	122.6	125.1	135.5	…	…	…	…	…	…
Terms of trade (2010=100, end-period)	63.7	62.6	58.4	77.4	70.0	71.4	72.3	72.6	72.5	72.7
Nominal GDP (in billions of kina)	83.8	82.5	92.4	110.1	114.8	122.1	128.4	136.4	145.1	154.2
Non-resource nominal GDP (in billions of kina)	60.1	62.5	69.3	76.4	82.8	89.8	97.2	105.2	113.7	122.6

Sources: Department of Treasury; Bank of Papua New Guinea; and IMF staff estimates and projections.
1/ Based on period average exchange rate.
2/ Resource sector includes production of mineral, petroleum, and gas and directly-related activities such as mining and quarrying, but excludes indirectly-related activities such as transportation and construction.
3/ Public external debt includes external debt of the central government, the central bank, and statutory authorities.

Table 2a. Papua New Guinea: Summary Operations of the Central Government, 2019-2028

(In millions of Kina)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Supp. Budget	Proposed			Proj.		
Revenue and Grants	**13,681**	**12,093**	**13,860**	**17,389**	**19,582**	**20,256**	**21,835**	**23,261**	**25,083**	**27,014**
Taxes	10,918	9,802	11,129	13,831	14,900	16,211	17,596	18,824	20,145	21,733
Taxes on income, profits, and capital gains	6,070	5,669	6,356	8,842	8,935	9,717	10,668	11,344	12,081	13,313
of which: Personal income tax	3,212	3,517	3,468	3,317	3,518	4,222	4,571	4,925	5,313	5,856
of which: Company tax	1,697	1,554	1,690	1,763	2,395	2,601	2,824	3,085	3,359	3,780
Taxes on payroll and workforce	2	0	1	0	0	0	0	0	0	0
Taxes on goods and services	3,937	3,373	3,994	4,130	5,015	5,453	5,824	6,321	6,846	7,141
of which: GST	2,253	2,079	2,457	2,700	3,322	3,576	3,853	4,190	4,562	4,848
Taxes on international trade and transactions	909	760	779	859	949	1,041	1,104	1,159	1,218	1,280
Grants	1,776	1,425	2,088	1,825	2,025	1,775	1,825	1,875	2,075	2,116
Other Revenue	987	866	643	1,733	2,657	2,271	2,414	2,563	2,863	3,165
Resource revenue 1/	1,242	752	1,016	4,150	4,024	3,426	3,864	3,964	4,224	4,684
Mining and Petroleum Taxes	761	183	635	3,000	2,342	2,176	2,514	2,514	2,524	2,734
Mining and Petroleum and Gas Dividends	381	569	381	1,150	1,683	1,250	1,350	1,450	1,700	1,950
Other Dividends	100	0	0	0	0	0	0	0	0	0
Grants from other general government units 2/	0	0	0	0	0	0	0	0	0	0
Non-resource revenue	12,439	11,341	12,845	13,239	15,558	16,831	17,971	19,297	20,859	22,330
Expenditure	**17,396**	**19,398**	**20,131**	**23,374**	**24,567**	**25,060**	**24,760**	**24,882**	**25,109**	**26,682**
Expense	14,679	15,887	16,480	18,489	19,957	20,508	20,317	20,499	20,732	20,719
Compensation of employees	5,424	5,832	6,094	6,353	6,834	6,855	7,002	7,229	7,473	7,904
of which: Clearance of retirement arrears					300	200	100			
Use of goods and services	5,639	5,388	6,161	6,757	6,930	6,794	6,578	6,430	6,288	6,682
of which: COVID-19 related 3/		505	600							
General election expenses				850						
Clearance of arrears				255	600	600	500	500	300	
Interest	2,129	2,160	2,249	2,314	2,496	3,279	3,311	3,522	3,751	2,712
Grants 4/	1,401	2,190	1,915	2,958	3,514	3,385	3,221	3,100	2,987	3,174
Social benefits 5/	0	218	0	43	114	121	128	136	144	153
Other expenses	86	99	61	64	69	74	78	82	88	93
Net acquisition of non-financial assets	2,717	3,511	3,650	4,885	4,610	4,553	4,444	4,383	4,377	5,964
Gross operating balance	-999	-3,794	-2,620	-1,100	-375	-251	1,518	2,762	4,351	6,296
Net lending (+)/borrowing (-)	**-3,715**	**-7,305**	**-6,270**	**-5,985**	**-4,985**	**-4,804**	**-2,925**	**-1,621**	**-26**	**332**
Primary balance	-1,586	-5,145	-4,021	-3,671	-2,489	-1,525	385	1,901	3,725	3,044
Non-resource net lending (+)/borrowing (-)	-4,957	-8,056	-7,286	-10,135	-9,009	-8,230	-6,790	-5,585	-4,250	-4,352
Non-resource primary balance	-2,828	-5,896	-5,037	-7,821	-6,513	-4,950	-3,479	-2,063	-498	-1,641
Net financial transactions 6/	**3,715**	**7,399**	**6,324**	**5,985**	**4,985**	**4,804**	**2,925**	**1,621**	**26**	**-332**
Net acquisition of financial assets	-784	-803	1,685	0	0	0	0	0	0	0
Net acquisition of financial liabilities	2,932	6,596	8,009	5,985	4,985	4,804	2,925	1,621	26	-332
Net domestic	598	2,882	3,096	2,240	1,416	1,400	125	432	473	4,797
Treasury bills	898	1,711	1,395	260	708	672	59	199	213	2,159
Treasury bonds	-300	1,266	1,601	1,750	708	728	66	233	260	2,638
Other accounts payable	0	0	0	0	0	0	0	0	0	0
Net external	2,334	3,619	4,913	3,745	3,569	3,404	2,801	1,189	-447	-5,129
Debt securities	0	0	0	0	0	0	0	0	0	-1,896
IMF SDR allocation			1,244							
Loans	2,334	3,619	4,913	3,745	3,569	3,404	2,801	1,189	-447	-3,233
of which: net Fund financing		1,276	0	0	619	931	1,102	349	-267	-266
Rapid Credit Facility		*1,276*	*0*	*0*	*0*	*0*	*-134*	*-268*	*-267*	*-266*
Proposed ECF/EFF program					*619*	*931*	*1,237*	*617*		
Extended Fund Facility					*413*	*621*	*824*	*411*		
Extended Credit Facility					*206*	*310*	*412*	*206*		
Gross government debt	**33,678**	**40,168**	**48,173**	**52,745**	**57,333**	**62,567**	**66,458**	**66,931**	**65,191**	**63,189**
Domestic debt	19,701	22,216	25,258	26,982	27,799	28,351	27,976	27,243	25,956	27,270
Treasury bills	9,685	11,902	13,297	13,557	14,265	14,937	14,995	15,194	15,407	17,565
Treasury bonds	8,022	9,233	10,833	12,068	12,177	12,057	11,624	10,692	9,192	8,347
Loans	1,994	1,081	1,128	1,357	1,357	1,357	1,357	1,357	1,357	1,357
External debt	13,976	17,953	22,916	25,764	29,533	34,216	38,482	39,688	39,235	35,919
Debt securities	1,684	1,701	1,750	1,750	1,701	1,701	1,772	1,772	1,772	-125
Loans	12,293	16,252	21,166	24,014	27,833	32,516	36,711	37,916	37,463	36,044
Memorandum items:										
Contingent liabilities 7/	2,431	2,431	2,431	2,431	2,431	2,381	2,331	2,281	2,231	2,181
Future unfunded superannuation liabilities	2,431	2,431	2,431	2,431	2,431	2,381	2,331	2,281	2,231	2,181
SOE borrowing	0	0	0	0	0	0	0	0	0	0

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

1/ Does not include projected revenues from new mining projects where the investment decision has not yet been reached.

2/ Withdrawals from the Stabilization Fund (mining and petroleum taxes; mining, petroleum and gas dividends.)

3/ No specific allocation for COVID-19 related spending is proposed for 2022. Nevertheless, spending on healthcare and other social services is anticipated to cover any COVID-related needs.

4/ Grants include spending on wages and salaries, goods and services, and capital expenditure executed by provincial and local governments.

5/ Refers to direct social assistance. For the program, the indicative target on social spending is more expansive, covering current and capital spending in the identified sectors (see Technical Memorandum of Understanding accompanying the program request).

6/ Discrepancies between the overall balance and financing may arise because of data coverage gaps in revenue and expenditure for extrabudgetary units, and payment arrears and cash withdrawals from trust accounts which are not fully accounted for due to data weaknesses.

7/ Contingent liabilities include future unfunded superannuation liabilities with Nambawan Super and SOE borrowing.

Table 2b. Papua New Guinea: Summary Operations of the Central Government, 2019-2028
(In percent of GDP)

	2019	2020	2021	2022 Supp. Budget	2023 Proposed	2024	2025	2026 Proj.	2027	2028
Revenue and Grants	**16.3**	**14.7**	**15.0**	**15.8**	**17.1**	**16.6**	**17.0**	**17.1**	**17.3**	**17.5**
Taxes	13.0	11.9	12.0	12.6	13.0	13.3	13.7	13.8	13.9	14.1
Taxes on income, profits, and capital gains	7.2	6.9	6.9	8.0	7.8	8.0	8.3	8.3	8.3	8.6
of which: Personal income tax	3.8	4.3	3.8	3.0	3.1	3.5	3.6	3.6	3.7	3.8
of which: Company tax	2.0	1.9	1.8	1.6	2.1	2.1	2.2	2.3	2.3	2.5
Taxes on payroll and workforce	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes on goods and services	4.7	4.1	4.3	3.8	4.4	4.5	4.5	4.6	4.7	4.6
of which: GST	2.7	2.5	2.7	2.5	2.9	2.9	3.0	3.1	3.1	3.1
Taxes on international trade and transactions	1.1	0.9	0.8	0.8	0.8	0.9	0.9	0.8	0.8	0.8
Grants	2.1	1.7	2.3	1.7	1.8	1.5	1.4	1.4	1.4	1.4
Other Revenue	1.2	1.0	0.7	1.6	2.3	1.9	1.9	1.9	2.0	2.1
Resource revenue 1/	1.5	0.9	1.1	3.8	3.5	2.8	3.0	2.9	2.9	3.0
Mining and Petroleum Taxes	0.9	0.2	0.7	2.7	2.0	1.8	2.0	1.8	1.7	1.8
Mining and Petroleum and Gas Dividends	0.5	0.7	0.4	1.0	1.5	1.0	1.1	1.1	1.2	1.3
Other Dividends	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants from other general government units 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-resource revenue	14.8	13.7	13.9	12.0	13.5	13.8	14.0	14.1	14.4	14.5
Expenditure	**20.7**	**23.5**	**21.8**	**21.2**	**21.4**	**20.5**	**19.3**	**18.2**	**17.3**	**17.3**
Expense	17.5	19.3	17.8	16.8	17.4	16.8	15.8	15.0	14.3	13.4
Compensation of employees	6.5	7.1	6.6	5.8	6.0	5.6	5.5	5.3	5.1	5.1
of which: Clearance of retirement arrears					0.3	0.2	0.1			
Use of goods and services	6.7	6.5	6.7	6.1	6.0	5.6	5.1	4.7	4.3	4.3
of which: COVID-19 related 3/		0.6	0.6							
General election expenses				0.8						
Clearance of arrears				0.2	0.5	0.5	0.4	0.4	0.2	
Interest	2.5	2.6	2.4	2.1	2.2	2.7	2.6	2.6	2.6	1.8
Grants 4/	1.7	2.7	2.1	2.7	3.1	2.8	2.5	2.3	2.1	2.1
Social benefits 5/	0.0	0.3	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Other expenses	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net acquisition of non-financial assets	3.2	4.3	4.0	4.4	4.0	3.7	3.5	3.2	3.0	3.9
Gross operating balance	-1.2	-4.6	-2.8	-1.0	-0.3	-0.2	1.2	2.0	3.0	4.1
Net lending (+)/borrowing (-)	**-4.4**	**-8.9**	**-6.8**	**-5.4**	**-4.3**	**-3.9**	**-2.3**	**-1.2**	**0.0**	**0.2**
Primary balance	-1.9	-6.2	-4.4	-3.3	-2.2	-1.2	0.3	1.4	2.6	2.0
Non-resource net lending (+)/borrowing (-)	-5.9	-9.8	-7.9	-9.2	-7.8	-6.7	-5.3	-4.1	-2.9	-2.8
Non-resource primary balance	-3.4	-7.1	-5.5	-7.1	-5.7	-4.1	-2.7	-1.5	-0.3	-1.1
Net financial transactions 6/	**4.4**	**9.0**	**6.8**	**5.4**	**4.3**	**3.9**	**2.3**	**1.2**	**0.0**	**-0.2**
Net acquisition of financial assets	-0.9	-1.0	1.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net acquisition of financial liabilities	3.5	8.0	8.7	5.4	4.3	3.9	2.3	1.2	0.0	-0.2
Domestic	0.7	3.5	3.4	2.0	1.2	1.1	0.1	0.3	0.3	3.1
Treasury bills	1.1	2.1	1.5	0.2	0.6	0.6	0.0	0.1	0.1	1.4
Treasury bonds	-0.4	1.5	1.7	1.6	0.6	0.6	0.1	0.2	0.2	1.7
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	2.8	4.4	5.3	3.4	3.1	2.8	2.2	0.9	-0.3	-3.3
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-1.2
IMF SDR allocation			1.3							
Loans	2.8	4.4	5.3	3.4	3.1	2.8	2.2	0.9	-0.3	-2.1
of which net Fund financing		1.5	0.0	0.0	0.5	0.8	0.9	0.3	-0.2	-0.2
Rapid Credit Facility		*1.5*	*0.0*	*0.0*	*0.0*	*0.0*	*-0.1*	*-0.2*	*-0.2*	*-0.2*
Proposed ECF/EFF program		*0.0*	*0.0*	*0.0*	*0.5*	*0.8*	*1.0*	*0.5*		
Extended Fund Facility		*0.0*	*0.0*	*0.0*	*0.4*	*0.5*	*0.6*	*0.3*		
Extended Credit Facility		*0.0*	*0.0*	*0.0*	*0.2*	*0.3*	*0.3*	*0.2*		
Gross government debt	**40.2**	**48.7**	**52.1**	**47.9**	**49.9**	**51.2**	**51.8**	**49.1**	**44.9**	**41.0**
Domestic debt	23.5	26.9	27.3	24.5	24.2	23.2	21.8	20.0	17.9	17.7
Treasury bills	11.6	14.4	14.4	12.3	12.4	12.2	11.7	11.1	10.6	11.4
Treasury bonds	9.6	11.2	11.7	11.0	10.6	9.9	9.1	7.8	6.3	5.4
External debt	16.7	21.8	24.8	23.4	25.7	28.0	30.0	29.1	27.0	23.3
Debt securities	2.0	2.1	1.9	1.6	1.5	1.4	1.4	1.3	1.2	-0.1
Loans	14.7	19.7	22.9	21.8	24.2	26.6	28.6	27.8	25.8	23.4
Memorandum items:										
Contingent liabilities 7/	2.9	2.9	2.6	2.2	2.1	1.9	1.8	1.7	1.5	1.4
Future unfunded superannuation liabilities	2.9	2.9	2.6	2.2	2.1	1.9	1.8	1.7	1.5	1.4
SOE borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

1/ Does not include projected revenues from new mining projects where the investment decision has not yet been reached.

2/ Withdrawals from the Stabilization Fund (mining and petroleum taxes; mining, petroleum and gas dividends.)

3/ No specific allocation for COVID-19 related spending is proposed for 2022. Nevertheless, spending on healthcare and other social services is anticipated to cover any COVID-related needs.

4/ Grants include spending on wages and salaries, goods and services, and capital expenditure executed by provincial and local governments.

5/ Refers to direct social assistance. For the program, the indicative target on social spending is more expansive, covering current and capital spending in the identified sectors (see Technical Memorandum of Understanding accompanying the program request).

6/ Discrepancies between the overall balance and financing may arise because of data coverage gaps in revenue and expenditure for extrabudgetary units, and payment arrears and cash withdrawals from trust accounts which are not fully accounted for due to data weaknesses.

7/ Contingent liabilities include future unfunded superannuation liabilities with Nambawan Super and SOE borrowing.

Table 3. Papua New Guinea: Balance of Payments, 2019-2028
(In millions of U.S. dollars)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
			Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	**4,941**	**4,699**	**5,686**	**10,821**	**7,312**	**7,349**	**8,086**	**8,091**	**8,719**	**9,165**
Resource	7,013	5,853	6,447	11,341	8,229	8,250	8,989	9,001	9,634	10,085
Nonresource	-2,072	-1,154	-761	-520	-917	-901	-903	-909	-915	-920
Trade balance	7,458	5,855	7,650	12,602	10,744	11,104	11,320	11,538	11,772	12,058
Exports (f.o.b.)	11,394	9,139	10,343	15,505	13,743	14,174	14,510	14,876	15,271	15,724
Resource	9,961	7,648	8,743	13,590	12,074	12,438	12,707	12,994	13,302	13,664
Nonresource	1,433	1,491	1,600	1,915	1,669	1,736	1,802	1,882	1,969	2,060
Imports (f.o.b.)	-3,936	-3,283	-2,693	-2,903	-2,999	-3,071	-3,189	-3,339	-3,498	-3,666
Resource	-1,530	-1,091	-1,238	-1,275	-1,299	-1,302	-1,353	-1,416	-1,484	-1,555
Nonresource	-2,406	-2,192	-1,455	-1,628	-1,701	-1,768	-1,837	-1,923	-2,014	-2,111
Services	-1,417	-1,052	-1,122	-1,200	-1,262	-1,256	-1,256	-1,256	-1,256	-1,256
Income	-1,175	-409	-1,125	-1,006	-2,566	-2,905	-2,385	-2,597	-2,203	-2,043
Current Transfers	76	305	283	426	395	406	406	406	406	406
Official	337	299	312	458	430	444	444	444	444	444
Private	-261	5	-29	-32	-35	-38	-38	-38	-38	-38
Capital and financial account balance (+ = inflow)	**-5,125**	**-3,548**	**-6,013**	**-9,938**	**-9,015**	**-8,304**	**-8,376**	**-8,001**	**-8,467**	**-9,863**
Capital account balance	6	4	9	13	14	16	16	16	16	16
Financial account balance	-5,131	-3,553	-6,023	-9,951	-9,029	-8,320	-8,392	-8,017	-8,483	-9,879
Direct investment	-548	-804	-1,337	-1,737	-1,818	-1,980	-1,984	-2,015	-2,047	-2,027
Portfolio investment	20	-73	36	-123	-263	-289	-289	-289	-289	-789
Other investment	-4,603	-2,675	-4,722	-8,092	-6,947	-6,051	-6,118	-5,712	-6,146	-7,062
Loans (Net)	103	475	-410	594	814	714	710	287	-146	-882
Official[1]	617	955	204	783	1,009	923	739	314	-118	-852
Private	-515	-481	-614	-189	-195	-209	-28	-26	-28	-30
Commercial banks	-93	16	-229	-883	1,526	700	0	-200	-200	-89
Other private capital flows[2]	-4,613	-3,166	-4,083	-7,803	-9,287	-7,465	-6,828	-5,799	-5,800	-6,091
Net errors and omissions	281	-1538	544	0	0	0	0	0	0	0
Overall balance	**97**	**-388**	**217**	**883**	**-1,704**	**-955**	**-290**	**90**	**253**	**-697**
Financing	**-97**	**388**	**-217**	**-883**	**1,704**	**955**	**290**	**-90**	**-253**	**697**
Change in net reserve assets (+=fall in reserves)	-97	9	-217	-883	1,526	700	0	-200	-200	750
Use of IMF credit	0	379	0	0	178	255	290	110	-53	-53
Purchases	0	379	0	0	178	255	326	162	0	0
Repurchases	0	0	0	0	0	0	-35	-53	-53	-53
Memorandum items:										
Current account (in percent of GDP)	20.0	19.7	21.3	34.1	22.3	21.9	23.9	22.5	22.8	22.5
Resource	28.3	24.5	24.1	35.8	25.0	24.6	26.5	25.0	25.2	24.8
Nonresource	-8.4	-4.8	-2.8	-1.6	-2.8	-2.7	-2.7	-2.5	-2.4	-2.3
Net international reserves (end-year, millions of U.S. dollars)	2,135	2,126	2,343	3,226	1,700	1,000	1,000	1,200	1,400	650
Gross international reserves (end-year, millions of U.S. dollars)	2,309	2,686	3,240	4,132	2,843	2,487	2,877	3,221	3,347	2,527
In months of nonmineral sector imports	12.6	15.3	16.9	20.7	13.9	11.8	13.2	14.3	14.4	10.5
In months of imports of goods and services	6.2	8.0	9.0	11.1	7.5	6.4	7.2	7.8	7.8	5.7
Public external debt service-to-exports ratio[3] (in percent)	1.2	5.3	4.4	1.9	3.0	3.5	4.1	4.2	3.7	6.7
Public external debt-GDP ratio[3] (in percent)	17.1	21.8	24.8	23.4	25.7	28.0	30.0	29.1	27.0	23.3
Nominal GDP	24,751	23,848	26,706	31,689	32,861	33,543	33,859	35,973	38,267	40,706
Resource exports (in percent of GDP)	40	32	33	43	37	37	38	36	35	34

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

1/ Excludes IMF.

2/ Includes money-transfer via offshore accounts.

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

Table 4. Papua New Guinea: Monetary Developments, 2019-2024

	2019	2020	2021	2022	2023	2024
				Est.	Proj.	Proj.
Bank of Papua New Guinea	(In millions of kina; end of period)					
Net foreign assets	7,255	7,417	8,221	11,367	6,025	3,691
Foreign assets	7,867	9,424	11,369	14,560	10,076	9,182
Foreign liabilities	612	2,007	3,148	3,194	4,052	5,491
Net domestic assets	-1,340	-1,370	-1,519	-3,345	736	3,110
Domestic credit	1,315	-918	1,009	-749	1,774	3,131
Net credit to government	1,251	-1,003	934	-746	1,719	3,075
Claims on the government	2,312	1,615	3,581	3,380	3,719	3,775
Of which: Advances and holdings of inscribed stock and securities	2,312	1,615	2,319	2,051	2,400	2,400
Loans: IMF SDR Allocation			1,260	1,329	1,319	1,375
Central government deposits	1,061	2,619	2,648	4,126	2,000	700
Credit to other sectors	64	86	75	-3	56	56
Other items, net	-2,655	-453	-2,528	-2,596	-1,039	-21
Of which: Central bank securities	-1,778	-1,614	-3,040	-2,677	-3,620	-4,092
Of which: IMF credit		1,330	1,293	1,234	2,117	3,607
Reserve money	5,915	6,046	6,702	8,022	6,760	6,802
Currency in circulation	2,300	2,434	2,666	2,977	3,105	3,302
Deposits of other depository corporations	3,615	3,612	4,036	5,045	3,655	3,500
Required reserves	2,090	1,794	1,611	2,629	2,561	2,701
Excess reserves	1,525	1,818	2,425	2,415	1,095	799
Other deposits	0	0	0	0	0	0
Depository Corporations Survey	(In millions of kina; end of period)					
Net foreign assets	7,666	7,831	8,678	11,911	6,593	4,296
Net domestic assets	14,652	16,049	18,409	18,628	23,123	26,862
Domestic credit	22,477	22,990	26,636	26,855	31,350	35,089
Net credit to central government	7,150	7,451	11,262	10,239	13,496	15,881
Claims on other sectors	15,327	15,539	15,374	16,616	17,854	19,208
Claims on the private sector	12,238	12,754	13,076	14,273	15,470	16,780
Other items, net	-7,825	-6,941	-8,227	-8,227	-8,227	-8,227
Broad money	22,318	23,880	27,087	30,540	29,716	31,158
Narrow money	17,125	18,916	22,107	25,759	25,126	26,752
Currency outside other depository corporations	1,656	1,890	2,152	2,066	1,983	1,904
Demand deposits	15,469	17,026	19,955	23,693	23,143	24,848
Quasi-money	5,193	4,964	4,980	4,781	4,590	4,406
Securities other than shares	0	0	0	0	0	0
	(Annual percentage change)					
Net foreign assets	9.2	2.1	10.8	37.3	-44.7	-34.8
Net domestic assets	2.1	9.5	14.7	1.2	24.1	16.2
Net domestic credit	5.2	2.3	15.9	0.8	16.7	11.9
Of which: Private sector	4.1	4.2	2.5	9.2	8.4	8.5
Broad money	4.4	7.0	13.4	12.7	-2.7	4.9
Memorandum items:						
Reserve money (percentage change)	12.4	2.2	10.8	19.7	-15.7	0.6
Gross international reserves (in millions of U.S. dollars)	2,309	2,686	3,240	4,132	2,843	2,487
Nominal nonresource GDP/Broad money	2.7	2.6	2.6	2.5	2.8	2.9

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

Table 5. Papua New Guinea: Financial Soundness Indicators, 2017-2022 1/
(In percent)

	2017	2018	2019	2020	2021	2022 June
Capital Adequacy						
Capital to risk-weighted assets 2/	38.1	37.1	36.1	39.2	41.1	37.6
Tier 1 capital to risk-weighted assets	30.8	29.6	28.2	31.9	32.5	31.9
Asset Quality						
Nonperforming loans to total loans	2.8	3.7	3.8	5.3	6.2	6.3
Past due loans to total loans	5.4	5.1	5.1	n.a	n.a	n.a
Provision for losses to NPL	180.0	142.9	152.4	n.a	n.a	n.a
Earnings and Profitability						
Return on assets	3.4	3.8	4.1	3.8	4.3	5.7
Return on equity	12.1	12.7	14.4	13.1	15.2	17.9
Liquidity						
Liquid assets to total assets	16.9	15.9	17.7	18.3	18.9	17.4
Loan-to-deposit ratio	65.8	71.4	71.3	65.6	59.7	57.2
Other						
Capital to total assets 2/	14.2	14.5	14.0	14.5	13.5	13.2
Risk-weighted assets to total assets	46.6	49.3	50.8	47.5	42.9	41.6

Sources: Bank of Papua New Guinea; and IMF staff calculations.
1/ Fourth quarter data for each year, except 2022.
2/ Capital base includes Tier 1 and Tier 2 capital.

Table 6. Papua New Guinea: Proposed Schedule of Disbursements and Purchases under the ECF-EFF Arrangements[1]

Availability date	Amount (SDR Million)			Percent of Quota			Conditions for disbursement/purchases
	Total	ECF	EFF	Total	ECF	EFF	
22 March 2023	65.81	21.94	43.87	25.0	8.3	16.7	Executive Board approval of the ECF/EFF arrangements.
18 September 2023	65.81	21.94	43.87	25.0	8.3	16.7	Observance of end-June 2023 performance criteria, and completion of the first review under the arrangements.
18 March 2024	94.75	31.58	63.17	36.0	12.0	24.0	Observance of end-December 2023 performance criteria, and completion of the second review under the arrangements.
18 September 2024	94.75	31.58	63.17	36.0	12.0	24.0	Observance of end-June 2024 performance criteria, and completion of the third review under the arrangements.
18 March 2025	121.07	40.36	80.71	46.0	15.3	30.7	Observance of end-December 2024 performance criteria, and completion of the fourth review under the arrangements.
18 September 2025	121.07	40.36	80.71	46.0	15.3	30.7	Observance of end-June 2025 performance criteria, and completion of the fifth review under the arrangements.
18 March 2026	121.06	40.35	80.71	46.0	15.3	30.7	Observance of end-December 2025 performance criteria, and completion of the sixth review under the arrangements.
Total	**684.32**	**228.11**	**456.21**	**260.0**	**86.7**	**173.3**	

Source: IMF Staff Estimates

1/Papua New Guinea's quota is 263.2 million SDR.

Table 7. Papua New Guinea: External Financing Requirements and Sources, 2019-2027

(In millions of U.S. dollars)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
			Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Total financing requirements	**-5007**	**-2801**	**-5671**	**-9759**	**-8608**	**-7701**	**-7575**	**-7264**	**-7874**
Current account deficit	-4941	-4699	-5686	-10821	-7312	-7349	-8086	-8091	-8719
Public sector loan amortization	117	369	342	178	224	343	479	570	589
Interest and amortization on existing IMF loans	0	0	0	1	6	6	31	57	56
Reserve accumulation (-=fall in reserves)	97	-9	217	883	-1526	-700	0	200	200
Errors and omissions	-281	1538	-544	0	0	0	0	0	0
Financing sources	**-5027**	**-4257**	**-6673**	**-10560**	**-9373**	**-8560**	**-8218**	**-7651**	**-7874**
Capital account balance	6	4	9	13	14	16	16	16	16
Net foreign direct investments	-548	-804	-1337	-1737	-1818	-1980	-1984	-2015	-2047
Net portfolio investments	20	-73	36	-123	-263	-289	-289	-289	-289
Public sector project loan disbursements	715	247	-456	161	652	667	897	663	475
Other capital inflows (net)	-5220	-3631	-4926	-8875	-7956	-6974	-6856	-6025	-6028
Financing gap	**20**	**1456**	**1002**	**801**	**764**	**860**	**642**	**386**	**0**
Bilateral budget support[1]	0	558	732	531	386	508	224	224	0
Multilateral budget support[1] (excl. IMF)	20	520	270	270	200	96	92	0	0
IMF exceptional financing	0	379	0	0	178	255	326	162	0
RCF	0	379	0	0	0	0	0	0	0
Proposed EFF	0	0	0	0	118	170	217	108	0
Proposed ECF	0	0	0	0	59	85	109	54	0
Unidentified financing	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Memorandum items:									
Annual IMF financing (percent of quota)		100%	0%	0%	50%	72%	92%	46%	0%
Cumulative IMF financing (percent of quota)		100%	100%	100%	150%	222%	304%	330%	309%
IMF share of financing gap (percent)		26%	0%	0%	23%	30%	51%	42%	0%

Sources: Papua New Guinea authorities and Fund staff estimates.

1/Includes loans and grants

Table 8. Papua New Guinea: Indicators of Capacity to Repay the IMF, 2023-2036[1]

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036
IMF obligations based on existing credit (millions of SDRs)														
Principal	0.0	0.0	26.3	52.6	52.6	52.6	52.6	26.3	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	9.2	12.3	12.3	12.3	12.3	12.3	12.3	12.3	12.3	12.3	12.3	12.3	12.3	12.3
Total obligations based on existing and prospective credit														
Principal														
Millions of SDRs	0.0	0.0	26.3	52.6	56.3	74.7	107.0	121.1	117.6	121.7	115.8	89.8	53.8	10.8
Millions of Kina	0.0	0.0	134.4	268.1	285.5	378.9	542.4	613.9	596.4	616.9	587.2	455.5	272.8	54.6
Percent of government revenue	0.0	0.0	0.7	1.3	1.2	1.5	2.1	2.2	2.0	2.0	1.7	1.3	0.7	0.1
Percent of exports of goods and services	0.0	0.0	0.2	0.5	0.5	0.6	0.9	1.0	0.9	0.9	0.8	0.6	0.4	0.1
Percent of GDP	0.0	0.0	0.1	0.2	0.2	0.2	0.3	0.4	0.3	0.3	0.3	0.2	0.1	0.0
Percent of quota	0.0	0.0	10.0	20.0	21.4	28.4	40.6	46.0	44.7	46.2	44.0	34.1	20.4	4.1
Charges and interest														
Millions of SDRs	11.0	18.6	24.7	31.1	31.7	31.3	30.1	27.8	24.7	21.5	18.2	15.4	13.3	12.4
Millions of Kina	51.6	91.6	126.4	158.3	160.6	158.7	152.5	141.1	125.1	108.8	92.3	77.9	67.5	62.6
Outstanding IMF credit														
Millions of SDRs	394.8	584.3	800.1	868.6	812.3	737.5	630.6	509.5	391.9	270.2	154.4	64.6	10.8	0.0
Millions of Kina	1857.1	2870.7	4086.6	4423.2	4118.5	3739.6	3197.2	2583.3	1986.9	1370.1	782.9	327.4	54.6	0.0
Percent of government revenue	10.6	15.5	20.4	20.7	17.9	15.0	12.1	9.2	6.7	4.3	2.3	0.9	0.1	0.0
Percent of exports of goods and services	3.8	5.5	7.3	7.7	7.0	6.2	5.1	4.0	3.0	2.0	1.1	0.5	0.1	0.0
Percent of GDP	1.6	2.4	3.2	3.2	2.8	2.4	2.0	1.5	1.1	0.7	0.4	0.1	0.0	0.0
Percent of quota	150.0	222.0	304.0	330.0	308.6	280.2	239.6	193.6	148.9	102.7	58.7	24.5	4.1	0.0
Percent of gross international reserves	18.4	31.3	36.9	35.7	32.0	38.5	33.2	26.7	21.8	15.6	9.0	3.5	0.5	0.0
Net use of IMF credit (millions of SDRs)														
Disbursements (including prospective ones)	394.8	189.5	242.1	121.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	0.0	0.0	26.3	52.6	56.3	74.7	107.0	121.1	117.6	121.7	115.8	89.8	53.8	10.8
Memorandum items:														
Nominal GDP (billions of Kina)	114.8	122.1	128.4	136.4	145.1	154.2	163.9	174.3	185.6	197.8	210.9	224.4	238.8	254.4
Exports of goods and services (billions of Kina)	48.7	52.3	55.8	57.2	58.7	60.4	62.2	64.0	65.9	67.9	69.9	72.1	74.3	76.5
Government revenue (billions of Kina)	17.6	18.5	20.0	21.4	23.0	24.9	26.4	28.0	29.8	31.6	33.6	35.6	37.8	40.2
Kina / SDR (period average)	4.7	4.9	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1
Quota (millions of SDRs)	263.2	263.2	263.2	263.2	263.2	263.2	263.2	263.2	263.2	263.2	263.2	263.2	263.2	263.2

Source: IMF Staff estimates and projections.

1/Data are projections.

Table 9. Papua New Guinea: Summary Table of Projected External Borrowing Program January 1, 2023 to December 31, 2023

PPG external debt	Volume of new debt in 2023		PV of new debt in 2023 (program purposes)		PV of new debt in 2023 (including negative GEs)	
	USD million	Percent	USD million	Percent	USD million	Percent
By sources of debt financing	**1577.7**	**100**	**1404.7**	**100**	**1404.7**	**100**
Concessional debt, of which	**0.0**	**0**	**0.0**	**0**	**0.0**	**0**
Multilateral debt	0.0	0	0.0	0	0.0	0
Bilateral debt	0.0	0	0.0	0	0.0	0
Other	0.0	0	0.0	0	0.0	0
Non-concessional debt, of which	**1577.7**	**100**	**1404.7**	**100**	**1404.7**	**100**
Semi-concessional	1577.7	100	1404.7	100	1404.7	100
Commercial terms	0.0	0	0.0	0	0.0	0
By Creditor Type	**1577.7**	**100**	**1404.7**	**100**	**1404.7**	**100**
Multilateral	893.8	57	775.1	55	775.1	55
Bilateral - Paris Club	683.9	43	629.6	45	629.6	45
Bilateral - Non-Paris Club	0.0	0	0.0	0	0.0	0
Other	0.0	0	0.0	0	0.0	0
Uses of debt financing	**1577.7**	**100**	**1404.7**	**100**	**1404.7**	**100**
Infrastructure	875.4	55	777.7	55	777.7	55
Social Spending	116.0	7	93.7	7	93.7	7
Budget Financing	586.3	37	533.3	38	533.3	38
Other	0.0	0.0	0.0	0.0	0.0	0.0
Memo Items						
Indicative projections						
Year 2	**467.0**		**440.6**		**440.6**	
Year 3	**184.6**		**176.5**		**176.5**	

Sources: Country authorities; and IMF calculations.

Annex I. Risk Assessment Matrix[1]

Sources of Risk	Relative Likelihood	Expected Impact	Staff Advice on Policy Response
Domestic Risks			
Natural disasters, including related to climate change.	**Medium**: PNG is highly vulnerable to natural disasters (flooding, landslides, earthquakes) and climate change (droughts & sea level rise)	**Medium**: Negative impact on GDP growth, export and fiscal revenues, higher inflation.	Invest in disaster risk reduction and resilience with the help of development partners. Build fiscal and external buffers for post-disaster relief effort.
Widespread social discontent and political instability.	**Medium**: While the post-election period provides relative stability, the limited capacity of the state and a high level of social fragmentation remain chronic sources of political instability.	**Medium**: Adverse impact on foreign direct investment and confidence, negatively impacting growth. This can exacerbate pre-existing inequalities, causing socio-economic hardship (unemployment, poverty).	Focus on transparent and effective communication on key policies. Implement policies to support vulnerable households for which there is a need to build fiscal buffers through fiscal consolidation.
Major natural resource projects initiated; Higher LNG revenues over the medium term.	**Medium**: Some major projects are being negotiated, but not yet included in the baseline.	**Medium**: Upside risk. Favorable impact on GDP, external balance, and fiscal position.	Fast-track their implementation; Build fiscal and external buffers.
External Risks			
Cyberthreats.	**Medium**: Cyber-attacks on critical infrastructure and institution. PNG had a ransomware attack in October 2021.	**Medium**: Can affect provision of Government service and trigger financial instability or widespread disruptions in socio-economic activities and remote work arrangements.	Need to invest in advanced IT security systems and train key personnel on cyber/ ransomware attacks. Invest in business recovery sites and backup for important Government services and financial sector
Commodity price volatility.	**Medium**: A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand weakness causes recurrent commodity price	**High**: Volatility in commodity prices will have an impact on external position and fiscal balance. This leads to	Higher resource revenue should help create fiscal space. Continue with fiscal spending to support the most vulnerable but ensure fiscal consolidation remains priority.

[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 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 between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively."

Sources of Risk	Relative Likelihood	Expected Impact	Staff Advice on Policy Response
	volatility, external and fiscal pressures, and social and economic instability.	bouts of price and real sector volatility.	Build buffers to prepare for lower commodity prices.
Abrupt global slowdown or recession including in China.	**High:** Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries, spillovers through trade and downward pressures on some commodity prices.	**High:** Would lead to lower external demand and lower commodity prices; BOP would worsen.	Build buffers to support the economy and most vulnerable in the non-resource sector, as needed.

Annex II. External Sector Assessment

Overall Assessment: *Staff's judgement is that PNG's external position in 2022 is substantially weaker than the level implied by medium-term fundamentals and desirable policies (current account gap of -4.4 percent of GDP based on the REER model). Estimates for 2022 suggest the real effective exchange rate was overvalued by 13.4 percent.*

Potential Policy Responses: *The assessment of Kina valuation is consistent with limited exchange rate adjustment to international inflation differentials or terms of trade movements. Future real exchange rate depreciation would help support competitiveness of non-resource exports and address foreign exchange shortages. Improved FX operations and liquidity management would also strengthen the BPNG's ability to manage inflation and the real exchange rate.*

Foreign Assets and Liabilities: Position and Trajectory

Background. PNG does not produce international investment position (IIP) data.

Current Account

Background. In 2022, goods exports in volume are expected to increase by 6.5 percent compared to 2021, with widespread increases across mineral resource exports, including gold, silver, copper and nickel. In addition, buoyant commodity prices in 2022 supported export values, which are expected to increase by 49.9 percent compared to 2021. The nominal value of goods imports is expected to increase by 7.8 percent in 2022. Consequently, the current account (CA) surplus is expected to increase from 21.3 percent of GDP in 2021 to 34.1 percent of GDP, in 2022.

Assessment. The EBA-lite framework provides multiple models to aid assessment of potential misalignment of the CA and REER. The models do not capture well PNG's characteristics: a fragile state, prone to major shocks and undergoing economic transformation.

Considering all estimates, and the uncertainties around them, staff's assessment of PNG's external position is based on the REER model, which estimates the CA gap at -4.4 percent of GDP in 2022 and the REER as overvalued by 13.4 percent. This judgement is preliminary, given most 2022 data are still estimates. The preferred model is the REER model due to statistical challenges with the current account (see below).

The EBA-lite REER model, before adjustments, estimates an overvaluation of 12.8 percent, which is increased by 1.2 percent to reflect deviations of current policy setting between PNG and the Rest of the World (ROW) but reduced by an additional 0.5 percent to reflect natural disasters. The REER norm therefore suggests a 13.4 percent overvaluation. Using a semi-elasticity of -0.33 (Nakatani 2017), this is equivalent to a CA gap of -4.4 percent of GDP. This suggests the external position is substantially weaker than the level implied by fundamentals and desirable policies.

Papua New Guinea: EBA-lite Model Results, 2022		
	CA model 1/	**REER model**
	(in percent of GDP)	
CA-Actual	**34.1**	
Cyclical contributions (from model) (-)	0.7	
COVID-19 adjustors (-) 2/	-0.3	
Additional temporary/statistical factors (-)	0.0	
Natural disasters and conflicts (-)	0.1	
Adjusted CA	**33.7**	
CA Norm (from model) 3/	**-1.2**	
Adjustments to the norm (-)	0.0	
Adjusted CA Norm	**-1.2**	
CA Gap	**34.9**	**-4.4**
o/w Relative policy gap	0.7	
Elasticity	-0.3	
REER Gap (in percent)	**-105.7**	**13.4**

1/ Based on the EBA-lite 3.0 methodology

2/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism (1.6 percent of GDP).

3/ Cyclically adjusted, including multilateral consistency adjustments.

There is an extremely large divergence in the estimates from the EBA-lite models. The published data on the CA surplus in PNG is likely overstated due to long-standing challenges in classifying large income account outflows, including external debt service payments related to resource projects, under the financial account rather than the current account. This significantly distorts the results from standard models when these are reliant on PNG's current account. The EBA-lite CA model results are, therefore, discounted. The authorities are receiving Fund technical assistance (TA) in external sector statistics.

Real Exchange Rate

Background. While the kina has significantly depreciated in nominal terms (NEER) since 2012, the REER has remained relatively stable throughout this time. In 2021 the NEER depreciated by 5.7%, while the REER depreciated by 3.9%. Data for 2022 suggest a reversal for both series. The REER appreciated by 6.6 percent in 2022 while the NEER appreciated by 6.9 percent on an annual basis.

Assessment. The EBA-lite models suggest that the kina is overvalued by 13.4 percent. This overvaluation in the REER for 2022 compares to an assessment that the REER was 2.4 percent overvalued in 2021, as presented in the last Article IV report. The higher current overvaluation is explained by several factors. The 6.6 percent REER appreciation in 2022 explains around half of the change; other data changes explain around a third; and the remainder is accounted for by changes in the Fund's methodology (including re-estimation of the REER regression and a change in the explanatory variables included). The overvaluation of the Kina contributes to continued pressures in the domestic FX market.

Exchange Restrictions and Developments in, and Policy Measures Affecting, the Capital and Financial Accounts

Background. The capital account balance continues to be very small (US$13 million in 2022, net). The financial account balance is estimated to have worsened substantially in 2022 to US$-10.0 billion, from US$-6.0 billion in 2021. Net direct investment in 2022 amounted to around US$-1.7 billion, driven by depressed direct investment into PNG. Portfolio investment and financial derivatives have traditionally been negligibly small. Most investment flows, including offshore flows, are captured as other investment.

Assessment. PNG maintains exchange restrictions subject to IMF approval under Article VIII, Section 2(a) of the IMF's Articles of Agreement arising from: (i) the requirement to obtain a tax clearance certificate evidencing the payment of all taxes prior to making payments or transfers for certain current international transactions; and (ii) the rationing of FX which results in undue delays and arrears in current international payments. Staff recommends eliminating these impediments to exchange. Their removal would imply the need to adjust the foreign exchange system, including allowing the exchange rate to adjust flexibly to a market clearing level to eliminate the kina overvaluation, and clearing the existing backlog of FX orders to reduce delays in providing FX. Although a fiscal policy gap contributes towards the current account gap, the role of fiscal policy in the misalignment of the external sector is estimated to be small. PNG also maintains the following multiple currency practices (MCPs) subject to Fund approval under Article VIII, Section 3: (1) a MCP arising from the spread of more than 2% between the rates set by Bank of Papua New Guinea (BPNG) for its foreign exchange allocations to authorized foreign exchange dealers (AFEDs), and the rates used by AFEDs in transactions with their clients; and (2) an MCP arising from the potential spread deviation of more than 2 percent between the rates set by BPNG for its FX transactions with the government and embassies, and the rates use by AFEDs in transactions with their clients.

FX Intervention and Reserves Level

Background. With limited domestic and external borrowing opportunities, PNG's fiscal and balance-of-payment financing gaps typically need to be financed with reserves. In 2022, gross reserves increased to 11.1 months of total imports (or 20.7 months of non-mineral imports). Over the past few years, the BPNG has been targeting a gross international reserves level of no less than US$2.0 billion to meet the economy's needs for FX.

Assessment. Higher commodity prices in 2023 are expected to compensate for continued supply constraints owing mainly to the impact of the pandemic on resource-sector production. The 2021 SDR allocation provided an additional US$360 million boost to reserves temporarily helped to reduce foreign exchange imbalances, and ease FX shortages. The government used these SDRs for budget support in 2021. Further, in recent years the disbursement of external project financing and bilateral budget support typically occurred towards the end of the year, implying that FX pressures subside by year-end. The reserve adequacy assessment suggests that a floor of about US$2.0 billion appears sufficient to cover needs without severe disruption. However, a reserve path above this floor is appropriate in the case of a fragile state like PNG, given the higher level of uncertainty it faces (See Box 1)). Going forward, it will be important to address FX shortages with the aim of a gradual return to kina convertibility, by eliminating exchange restrictions and multiple currency practices, and the adoption of a market-determined exchange rate.

References

Nakatani, Ryota, 2017, "External Adjustment in a Resource-Rich Economy: The Case of Papua New Guinea", IMF Working Papers, Volume 217, Issue 267, Washington, DC.

Annex III. Enhanced Safeguards for Papua New Guinea

The size of Papua New Guinea's de facto senior debt plus other multilateral and collateralized debt as a share of total external debt is above 50 percent at program initiation and rises to above 60 percent over the medium term under the baseline projection. These ratios are a little above the mean and median for LICs at 56 and 57 percent respectively, and well below the 75 percentile of 77 percent. This indicates a substantial buffer of potentially restructurable debt. At program initiation, debt held by institutions afforded preferred creditor status—the IMF, World Bank, and other major development banks—accounts for 53 percent of external debt; adding debt held by other multilaterals and collateralized debt marginally increases. The combined share of such debt is projected to rise to 63 percent of external debt by 2025.

Papua New Guinea: Debt Composition (US$ millions)

	Actual	Projections		
Creditor profile	*2022*	*2023*	*2024*	*2025*
Total debt[1]	14969	16176	16947	17281
External	7312	8333	9268	10006
Multilateral creditors	3937	4792	5582	6258
o/w: IMF and WB	1556			
o/w: IMF	709	892	1147	1436
o/w: ADB/AfDB/IADB	2288			
o/w: Other Multilaterals	92			
Bilateral Creditors	2814	3041	3185	3248
o/w: Paris Club	1638			
o/w: Non-Paris Club	1175			
Private creditors	561	500	500	500
o/w: Bonds	500	500	500	500
o/w: Loans	61	0	0	0
Domestic	7657	7844	7679	7275
Memo items:				
Collateralized debt	n/a	n/a	n/a	n/a
Nominal GDP	31689	32861	33543	33859
Multilateral and collateralized debt				
Multilateral debt	3937	4792	5582	6258
Percent of external debt	54	58	60	63
Percent of GDP	12	15	17	18
o/w: IMF and WB	1556			
Percent of external debt	21			
Percent of GDP	5			
o/w: ADB/AfDB/IADB	2288			
Percent of external debt	31			
Percent of GDP	7			
o/w: Other Multilaterals	92			
Percent of external debt	1			
Percent of GDP	0			
Collateralized debt	n/a	n/a	n/a	n/a
Percent of external debt	n/a	n/a	n/a	n/a
Percent of GDP	n/a	n/a	n/a	n/a

1/Data derived from Debt Holder Profile table as reported by country authorities, while projections are based on the LIC-DSA analyses.

Appendix I. Letter of Intent

Ms. Kristalina Georgieva Managing Director International Monetary Fund Washington, D.C. 20431	March 7, 2023 Port Moresby

Dear Ms. Georgieva:

Papua New Guinea has been undertaking a wide-ranging program of reforms, supported by the International Monetary Fund and other international partners. This reform focus has allowed us to make significant strides in lifting the performance of the economy including starting to address some issues that have been outstanding for too long. These have included improved governance, a re-direction of economic policy effort towards the rural sector and SMEs, reform of our state-owned enterprises (SOEs), revamping public finance including seeking greater returns from our resources, investing in infrastructure, expenditure restraint on wages, restarting growth especially with central banking reforms to deal with foreign exchange shortages, and crucially our program of budget repair and reconstruction.

The support from the IMF through our previous Staff Monitored Programs has been valuable in helping focus and build a coalition around our reforms. It has supported us in getting international validation of our efforts and created a momentum for further work.

We successfully completed the review of the second Staff Monitored Program, a six-month program, in June 2022, alongside our Article IV consultation with the IMF. This program saw us approve a budget in line with an agreed framework with the IMF, indeed with a lower deficit figure; pass our Tax Administration Act (TAA) amendments through Parliament to give effect to the TAA; strengthened the public debt committee; and prepared a staffing and establishment report as the groundwork for future payroll reforms. We also met all our quantitative targets, including on the deficit (recording a deficit that was 9 percent lower than our target), reserves (exceeding the target by 62 percent), and other areas.

Throughout our engagement with the IMF, there have been a number of crucial steps forward. We are pleased that some key initiatives like the passage of the Independent Commission Against Corruption Act (ICAC) moved ahead, after decades in the making. We have made great strides in improving the financial reporting of our SOEs, and their governance arrangements. We have improved oversight of our debt with a new loan guarantee policy. We have started the work towards fiscal repair following from COVID-19 and have done it with an eye to maintaining the historically high level of capital investment that our country needs to build the connections between our major cities. With the IMF's assistance, we have made headway in controlling our salaries, and we hope to continue this; we have made advances in improving our reporting and engagement with the IMF;

and we have started the process of modernizing our central bank, introducing a board with oversight powers. While much remains to be done, we have set the groundwork for a strong continuing reform agenda.

Despite tackling some key structural vulnerabilities there remain many that we are proactively addressing: ensuring sufficient financing to maintain our budget repair plan while protecting key social services; continuing governance reforms; dealing with our balance of payments imbalance; moving back towards a freely convertible Kina to help deal with a lack of predictable availability of foreign exchange for the private sector; and addressing an ongoing vulnerability to the effects of climate change for many parts of our country. Accordingly, our reform priorities include the need to address domestic revenue mobilization while reorienting expenditure to maintain the progress on budget repair; build on recent successes in strengthening the governance framework, particularly around our ICAC, to improve the business and investment climate in Papua New Guinea, strengthen the capacity of the Bank of Papua New Guinea to formulate and implement monetary policy to ensure sustainable growth through low and stable inflation, and improve the functioning of the foreign exchange and other financial markets to support development. These will be the focus of our program, as set out in the attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU).

At this time, the Government of Papua New Guinea is requesting access to IMF resources under the Extended Credit Facility (ECF) in the amount of SDR 228.11 million (86.7 percent of quota) and under the Extended Fund Facility (EFF) in the amount of SDR 456.21 million (173.3 percent of quota) over 38 months. Upon approval of this request by the IMF Executive Board, we are requesting an immediate disbursement of SDR 65.81 million (25.0 percent of quota), of which SDR 21.94 million (8.3 percent of quota) under the ECF and SDR 43.87 million (16.7 percent of quota) under the EFF. The ECF/EFF program will help address balance of payments and budget financing needs, while smoothly achieving the next stage of our reform plan.

We are confident that our policies are adequate to achieve the objectives of the program and will take any additional measures that may become appropriate for this purpose. We will consult with the Fund on the adoption of these measures, and in advance of any revision contained in the MEFP, in accordance with the Fund's policies on such consultation and will refrain from any policy that would not be consistent with the program's objectives and our commitments herein. Moreover, we will provide all information requested by the IMF to assess implementation of the program.

Underscoring our commitment to transparency, we consent to the publication of this letter, the MEFP, TMU and related board documents.

Yours Sincerely

/s/

Hon. James Marape
Prime Minister of the Independent State of Papua New Guinea

/s/

Hon. Ian Ling-Stuckey, CMG. MP.
Treasurer of the Independent State of Papua New Guinea

/s/

Ms. Elizabeth Genia
Acting Governor, Bank of Papua New Guinea

c.c. Mr. Robert Nicholl, Executive Director for Papua New Guinea
Mr. Krishna Srinivasan, Director, Asia and Pacific Department

Attachment I. Memorandum of Economic and Financial Policies

A. Economic Developments through 2022, and Performance under the Staff Monitored Programs (SMPs) with the IMF

1. After a strong growth in the non-resource economy in 2021, the economy is on course to register another strong growth in 2022. Real non-resource GDP growth is estimated to have reached 4.5 percent last year following the reopening of the economy after the pandemic. In the resource sector, growth is estimated at 4.7 percent, reflecting increases in LNG production with offsets related to lower levels of condensate and the delayed reopening of the Porgera mine. The global inflation shock, triggered by the war in Ukraine, led to domestic inflation rising to 6.6 percent, however, it is still well below global averages.

2. PNG's external position strengthened as high commodity prices led to higher export receipts, an increase in our international reserves despite an increase in the release of FX to the market from US$60 million per month in the SMP up to a monthly average of US$73 million in 2022.

3. The government was able to move forward on critical reforms under the Staff Monitored Program (SMP) approved in December 2021. We met all our quantitative targets and were rated as meeting all but one of the structural benchmarks in the program.[1] In particular, we were able to

- Pass a budget for 2021 that targeted a higher degree of fiscal consolidation than set out in the program with the IMF and subsequently surpassed this higher target for deficit reduction;
- Pass Consequential Amendments to our Tax Administration Act to prevent conflicts with other legislation and support stronger domestic revenue mobilization;
- Complete a staffing and establishment review of our ministries and budget agencies to establish proper recording of staffing numbers; and
- Strengthen the public debt committee (PDC) by establishing its objectives, aligning its terms of reference (TOR) to clarify members' objectives and produce an annual debt issuance strategy.

We also completed most of the first Phase of our review of the Central Banking Act (CBA), guided by the recommendations from an Independent Advisory Group (IAG). We intend to address the remaining issues and complete the first phase and most of the second phase by the end of 2023. Another important feature of the SMP was the creation of a Program Monitoring Committee aimed at improving coordination among our different agencies and communication and information sharing with the Fund.

[1] Please see our Letter of Intent dated May 21, 2022, published along with the Staff Report for the 2022 Article IV Consultation and Review of the SMP.

B. Outlook and the Government's Economic and Financial Reform Program

Outlook for 2023 and the Medium Term

4. **Growth is expected to moderate in 2023 as activity in the resource sector softens while the ongoing recovery in the non-resource sector remains strong.** The non-resource sector is expected to grow by 4.9 percent in 2023 with overall GDP growth falling to 3.7 percent in 2023, driven by slowdown in activity in the resource sector (0.3 percent). The slowdown in the resource sector is driven by an expected contraction in the oil and gas sector due to substantial downgrade in condensate and LNG production and natural decline in oil production while key mine operations gradually increase towards full capacity**.**

5. **An easing of commodity prices is expected to lead to a decline in export revenues but the impact on the fiscal picture remains positive given the 2 to 4 month lag in LNG prices adjusting to oil prices.**

6. **Over the medium term, we expect growth to be sustained on the back of higher private investment, supported by the government's public investment program (PIP).**

7. **We recognize that the external environment is uncertain but there are both downside and upside risks to the outlook for growth, exports and the fiscal picture.** Downside risks largely stem from a sharp downturn in our main trading partners and tighter global financial conditions. However, we have been conservative in our baseline by prudently excluding large projects in the pipeline with a high probability of approval in the extractive sector. If approved, these projects would have a large positive impact on growth, investment, exports and fiscal revenues.

Key Challenges in Delivering Sustainable Growth and Addressing Poverty

8. **Notwithstanding the progress under the SMP, PNG continues to face large development and financing needs.** Poverty remains high, with most of our people living in rural areas, with limited access to basic infrastructure and services. We urgently need to invest in basic infrastructure, particularly power, utilities and transport links, as well as in the provision of critical social services such as education, health care and security. However, we also face constraints that will necessitate steadfast reforms. Our public debt had been increasing even before the pandemic, rising from K8 billion in 2012, to K34 billion in 2019, with an attendant increase in payment arrears. Additionally, the COVID-19 pandemic led to a major reduction of 20 per cent in domestic revenues. A 13-year fiscal reform plan has been put in place to reduce budget deficits and public debt ratios. This calls for hard choices as we seek to direct our resources to where the needs are greatest, namely addressing gaps in the delivery of critical social services, closing the infrastructure deficit, enhancing financial development and inclusion and strengthening the business climate to encourage investment and growth. Over time, progress in these areas will be the most durable way to reduce poverty and improve inclusion.

Key Elements of the Government's Medium-term Agenda

9. To ensure sustainable growth and address our development needs, our structural reform agenda prioritizes strengthening debt sustainability, rebalancing expenditure to support public investment in both human and physical capital, addressing FX shortages and strengthening the overall governance framework in PNG.

C. Policies Under the Proposed IMF-Supported Program

Aims of the IMF-Supported Program

10. An IMF-supported program would enable us to make progress on our reform agenda to ensure sustainable growth and poverty reduction especially for rural areas. The program would aim to ensure that we:

- Continue to make progress on our program of budget repair with the aim of strengthening domestic revenue mobilization, improve the quality and composition of public expenditure, and lower our fiscal deficit and debt to meet the requirements of our Fiscal Responsibility Act and strengthen overall debt sustainability;
- Further modernize the governance and operations of the BPNG, thereby allowing us to durably address FX shortages and reinstate the convertibility of the Kina; and
- Strengthen the overall governance framework in PNG by operationalizing the Independent Commission Against Corruption (ICAC) and setting in place a program to improve our AML/CFT framework consistent with the Financial Action Task Force (FATF) standards, while ensuring our financial and payments systems are able to facilitate increased efficiencies and financial deepening and inclusion.

The program would contribute to these objectives through both agreement on a series of commitments with the Fund, which will galvanize domestic support, and Fund TA.

Fiscal Policies: Extending Budget Repair to Strengthen Debt Sustainability and Make Room for Public Investment

11. We have passed a budget for 2023 that will build on the progress in narrowing the fiscal deficit. The budget targets a K1 billion reduction in the deficit (1.1 percentage point of GDP decline) relative to the outturn in 2022 (quantitative performance criterion, QPC). We will achieve this by increasing revenues while maintaining strict discipline on expenditures. We intend to achieve a balanced budget by 2027. This will put our public debt firmly on a downward path, reducing risks.

12. Improving domestic revenue mobilization is a key plank of our fiscal reforms. We have achieved a number of important milestones in 2022 including the passage of the Non-Tax Revenue Administration (NTRA) Act that will support higher revenue mobilization. We have introduced a broadened banking tax to help fund pressing development needs. We request IMF TA on improving the banking tax while ensuring any changes at least maintain the revenue estimate for this tax. In 2023, a key reform that is planned is the passage of amendments to the Income Tax Act (ITA).

Consultations on the existing draft with businesses have highlighted that they require greater certainty about the changes to minimize disruptions to business operations, and this will require the development of Regulations to be passed at the same time as the ITA. There are also some important proposed policy changes in the draft legislation, such as reducing depreciation rates in the agricultural sector and the introduction of a capital gains tax, which require greater consultation. We intend to bring a policy paper to the NEC to decide by April 2023, followed by the preparation of draft supporting regulations in consultation with business and technical assistance, by August 2023. We plan to pass the ITA alongside the 2024 budget (structural benchmark, SB by end-December 2023), with a view to begin implementation on 1 January 2024. On revenue policy and administration, we intend to introduce a new Medium-term Revenue Strategy (MTRS) by end-August 2023 and have requested the Fund to provide TA to support its preparation and implementation (SB). The MTRS, which succeeds the second Strategy that ended in 2022, will guide our reforms through to 2027 and incorporates inputs from our key revenue collecting authorities including the IRC, Customs and Departments of Treasury and Finance. We also continued making progress on revenue administration including through the modernization of the Internal Revenue Commission (IRC)’s operations. The IRC, with the support of IMF TA, is in the midst of finalizing its new organization structure and business plan. This IRC workplan, along with Customs and Finance workplans on revenue, will be fed into Treasury’s coordination work on the MTRS. We will request the Fund TA on an examination of the current operation of the GST and possible alternatives or improvements.

13. While there are pressures to increase spending, we commit to maintaining our overall spending envelope in real per capita terms. Over the last five years, the budget has shifted to significantly expand the capital investment budget, which has been growing at a faster rate than the recurrent budget. Historic under-budgeting for personnel emoluments, which reached 25 percent in 2018 prior to our budget repair program, has been reduced to only 6 percent in 2021. However, we intend to go further to ensure that salary budgets are realistic and focused on service delivery. Moving forward, the government remains committed to its expenditure rule to reduce the recurrent budget as a share of non-resource GDP. However, we will increase in real terms the funding to recurrent to allow for a greater number of police, teachers and health care workers as part of the operation and maintenance costs stemming from the new capital investment. This process is being managed by providing greater increases in staff funding to these departments, while limiting increases elsewhere, coupled with the payroll reform efforts that include upgrades to the payroll system and ensuring staff are recorded under the correct appropriations. This structural realignment has been possible due to improved forecasting and budgeting for compensation of employees, and slower increases in recurrent spending on goods and services, even after allowing for one-off spending in 2020 and 2021 due to the pandemic and in 2022 for the elections. We also tightened the budget envelope for many of our government agencies, with goods and services expenditure being cut by over 40 per cent in non-priority or central agencies, emphasizing the need to spend more effectively in order to make room for other priority items. This does not include cuts to priority social programs included in the operating budget which have been quarantined or long term fixed commitments like rentals, utilities and other items that cannot be easily reduced in year, to avoid the risk of arrears build up.

14. The 2023 budget aims to build on the progress in verifying and clearing Government arrears accumulated in previous years. These efforts will also allow us to continue making progress in addressing arrears related to personnel emoluments (PE) and use of goods and services. At the end of 2022, we identified over 800 retirees at a cost of K120 million. This is K60 million in final entitlement and K60 million in superannuation. We expect more outstanding retirees to step forward in 2023. By clearing these arrears, we will be able to remove these staff from payrolls and have allocated K300 million for this purpose in 2023. Similarly, we have recorded some K6.6 billion in outstanding claims on goods and services to date, and have successfully verified and paid K998.2 million of these. We will continue to work through the remaining stock of claims and have appropriated K300 million to clear arrears related to purchases of goods and services in 2023.

15. To prevent the recurrence of arrears, we intend to review our processes in managing our payrolls and public expenditure management systems. For PE, we completed the Staffing and Establishment Review for all public sector employees, except teachers, in 2022 and among the key findings were that arrears often result from the lack of integration between payroll and expenditure management systems in some agencies, or, where the systems were integrated, due to a lack of compliance with HR procedures and processes. As a result, the Review recommended that the integration of payrolls and the IFMS systems be fully integrated in all remaining agencies. We also intend to undertake a review of our HR practices and processes with a view to streamlining procedures to support higher compliance. We will complete the Staffing and Establishment Review for teachers in 2023. The findings of this review will provide greater clarity on weaknesses in our payrolls and HR management processes and allow us to formulate and implement additional reforms. Finally, the Parliamentary Committee on Public Sector reforms has completed its own review, led by Deloitte, of some of the issues in the payroll system and procedures with actionable measures to introduce better controls on Compensation of Employees, including better data entry controls within the ALESCO payroll system, the eventual upgrade of the system, and systematic audit and review of larger monthly payments to individuals. This report will be shared with IMF staff once the Parliamentary Committee provides its final report. We believe this will complement ongoing work on cleaning the payroll structure and appropriations, and intend to integrate achievable conclusions into our workplan.

16. We are strengthening our budget process, and bringing in new reforms to aid in setting policy in the budget. This will include the introduction of approved sector budget ceilings early in the budget process, based on an assessment of ongoing policy needs, international comparisons with peer countries, and remaining available resources. In particular, we intend to assess the appropriate balance between the wages, goods and services, and capital components of sectoral spending. The aim is to strengthen the policy focus of the budget, and provide high level guidance early on the direction of the budget. To support this, we have requested technical assistance from the World Bank to conduct a Public Expenditure Review commencing in early 2023.

17. We are working toward improving our cash management practices. The current framework in PNG is decentralized. Payments for a large number of government projects are being effected through trust accounts in the BPNG and commercial banks. In addition, to avoid the incurrence of arrears on debt service payments, we proactively work to build cash reserves in a debt repayment trust account. The amounts set aside in this manner are substantial: the project trust funds stood at around K1 billion as at end-September 2022 while the debt repayment account held around K600 million on average in 2022. While this process ensures timely payments for projects and debt service payments, it is very costly as we incur interest charges on the overdraft even as cash balances elsewhere remain unused. The passage of the NTRA will help by bringing in statutory bodies' revenues directly into the Common Revenue Fund in the BPNG and out of commercial banks, thereby allowing us to more effectively manage cash, and lower the excess reserves in the banking system (see next section). But more could be done through better cash flow forecasting to the Budget Management Committee. We also intend to work closely with our development partners to avoid international support being received in the last month of the financial year, which complicates both budget execution and liquidity management.

18. We recognize our fiscal targets are ambitious but we are confident they are reasonable and achievable. An indicative target (IT) will be set on non-resource tax revenues, which will ensure focus on this for the program. That said, we recognize that our fiscal framework also hinges on a significant contribution from oil and gas dividends though we believe the risks here are manageable: a significant portion of the planned remittances to the budget are based on profits earned in 2022 and therefore are less prone to underperformance, given our expectations that these funds would flow into the budget in the first half of the year. Nevertheless, we intend to monitor revenue developments closely. In the event we experience significant shortfalls, we are prepared to undertake expenditure adjustments to meet our fiscal deficit target by reprioritizing spending. We will identify contingency measures early in the fiscal year, consisting of spending items that could be rephased and communicate this to Fund staff.

19. We have continued to strengthen our debt recording and management capacity, and pursued a prudent financing strategy to reduce costs and lower risks. This strategy includes the substitution of costly financing with concessional financing from multilateral and bilateral partners, which has improved PNG's debt profile. To ensure our financing strategy continues to carefully monitor and control risks, we will maintain a limit on new public external debt contracted under the program, to be measured in present value terms (continuous QPC). We also commit to the non-accumulation of new external payment arrears during the program period (continuous QPC). More generally, we will continue to ensure that our borrowing plan (TMU Table 2) will be linked closely to the financing needed to execute our budget. Our 2023 budget envisages a transparent program of borrowing and on-budget spending that allows this link to be easily monitored and tracked. Our future borrowing program will aim to lower the risk of debt distress. Thus, these will be closely guided by the results of updated Debt Sustainability Analyses, which will be undertaken by staffs of the Fund and World Bank.

Monetary and Exchange Rate Policies: Modernizing Our Monetary Framework and Paving the Way to a Return to Kina Convertibility

20. We tightened our monetary stance in 2022 in response to rising inflationary pressures. The Kina Facility Rate (KFR) was raised to 3.5 percent, while the Cash Reserve Requirement (CRR) was increased in stages back to the pre-COVID level of 10 percent. To further support these measures, we have actively used the issuance of central bank bills (CBB) to further mop up excess liquidity in the banking system. However, excess liquidity remains substantial, undermining the effective transmission of monetary policy. The excess liquidity also fuels demand for FX at the margin, contributing to the mismatch between demand and supply in the FX market.

21. To strengthen the monetary policy operational framework, we intend to intensify efforts to mop up excess liquidity and adopt more effective short-term liquidity management instruments. This will be done primarily by modifying the open market operations (OMOs) framework through the introduction of a fixed rate tender with full allotment by August 2023 (SB), with the support of IMF TA. The fixed rate tender with full allotment, accompanied with an interest rate corridor to limit interest rate volatility, would be a clear signal of the BPNG's commitment to mop up all excess liquidity from the market. We will also review the terms of the CBBs with a view to making them better suited for short-term liquidity management. Key steps would be to explicitly link the rate of the main short-term liquidity management instrument to the KFR, in order to ensure that changes in the KFR can effectively transmit to lending rates; and to reduce its tenor from 28 days currently to no more than 2 weeks. These modifications will be complemented by a review of the main parameters of the CRR system, including the length of the maintenance period and its averaging features, to align it with best practices. We will continue to avoid monetary financing and monitor it through a QPC on the BPNG's gross credit to government (Table 1).

22. We intend to continue supplying FX to the market in 2023 to help reduce FX shortages and start on our path to return to kina convertibility. We will make enough FX available for the timely payment of current account (or authorized) transactions. In 2023, the BPNG will increase the amount of its provision of foreign exchange to authorized FX dealers to help reduce pent-up demand for FX; a cumulative floor of US$ 1,200 million will be set as an indicative target. Given our floating exchange rate legal regime, we will prepare and start implementing a sequenced roadmap for reforming foreign exchange market operations and regulations, that can make the exchange rate more flexible in the medium-term. The roadmap, which will also cover needed improvements in the monetary policy operations framework in addition to those described above, will be prepared in consultation with the IMF by end-August 2023 (SB). The roadmap is an important commitment that will serve as a reference for future monetary and FX framework reform conditionalities in the first program review and beyond. For preparing the roadmap, we seek Fund advice on the trade-offs of our reform options, experiences of other countries that have undertaken similar reforms, and a communication strategy that helps ensure that the roadmap is well understood. We will request technical assistance from the IMF to help with the implementation of the roadmap.

23. We intend to further strengthen the financial independence and the governance of the BPNG by filling vacancies at the Board and addressing outstanding items from the first phase of the CBA review in the first year of the program. In the next few months, we will appoint BPNG's governor and deputy governors, and fill out remaining Board vacancies. We will move away from specifying BPNG dividends ex ante. Future dividend payments will be based on BPNG's realized profits, after the need to ensure the BPNG has the financial resources needed to effectively implement monetary policy is taken into account. We will further amend the CBA to address remaining issues related to mandate, governance, autonomy, transparency, and accountability of the BPNG; in particular, we will limit the provision of advances to the government; rank the mandates of the BPNG with price stability as the BPNG's primary objective; and clarify the role of the Board in monetary policy formulation. The IAG is into its second phase focusing on financial sector regulation and supervision and will have produced recommendations on at least high-level governance structures for this by August 2023. Additional amendments to the CBA will be drafted in consultation with the IMF and adopted by end-December 2023 (SB). BPNG will also ensure returning to the timely publication of its audited financial statements starting with FY 2022. The BPNG will undergo an update safeguards assessment and we remain committed to making progress in implementing the resulting recommendations.

The Financial Sector: Addressing Risks to Financial Stability and Strengthening Financial Inclusion

24. Our financial sector remains stable but vigilance is needed to ensure this continues while also promoting development. The second phase of the CBA review is aimed at examining the role of the BPNG as the financial regulator with a view to supporting the development of the financial sector while maintaining its soundness and enhancing financial inclusion. The banking system needs to be able to offer services more widely to the people of PNG and bring a larger part of the population in the formal financial system. The expansion of the system would also allow us to leverage technologies that could promote economic efficiency and lower costs. However, we recognize this needs to be balanced with financial stability and in particular, not giving up hard-won gains in strengthening our AML/CFT framework.

25. To ensure this balance is met, we are committed to enhancing our capacity to analyze and monitor financial stability and to carefully prepare for the upcoming APG (Asia/Pacific Group on Money Laundering) AML/CFT mutual evaluation. We are working to expand the set of financial soundness indicators (FSIs) we produce and compile in accordance with the IMF's 2019 FSI compilation guide. We are also actively preparing our first financial stability report. We have requested a financial sector stability review to the IMF, to help us identify key areas for improvement. Concurrently, BPNG's Financial Analysis and Supervision Unit (FASU) will continue raising awareness about the upcoming APG mutual evaluation and providing training to supervised entities to ensure a successful evaluation.

Governance: Building on Recent Reforms

26. We intend to make progress on operationalizing the Independent Commission Against Corruption (ICAC) to deliver an effective anti-corruption framework. To make the ICAC a fully functioning institution, we intend to appoint a Commissioner and two deputy Commissioners (SB for end-June 2023), and start filling up its staff, while providing them with proper training on investigation and prosecution. Building on technical support from UN and EU, we are at an advanced stage in drafting and adopting key implementing regulations to the ICAC law, to specify processes for ICAC's preventive, investigative and prosecutorial mandates, and to ensure sharing of information across relevant entities (SB for end-December 2023). We are also working on draft memoranda of understanding to enhance cooperation between relevant anti-corruption bodies such as the police, Ombudsman Commission, Auditor-Generals Office, Public Prosecutors Office, and FASU, as well as civil society. We are also developing regulations for the Whistleblower Act (increasing protections). We are also looking to operationalize the Unexplained Wealth provision that has been added to the Proceeds of Crime Act.

27. We are committed to strengthening transparency around procurement. As a key part of this, we will post details of COVID-19 related procurements on the government procurement website, including the names of the entities awarded the contract and their beneficial owners, in line with the commitments under the RCF from April 2020 at least covering years 2020 and 2021 (SB for end-December 2023) to ensure full accountability for contracts entered into under emergency procedures. For contracts made under normal procurement processes, we will account for these under the normal audit procedures undertaken by the Auditor General's Office, whose next report is expected to be ready by the 30th April of the succeeding year, in line with the Audit Act, 1989.

28. To promote fiscal transparency, we will produce and publish budget books in GFS format. This will improve comparability with international reporting and will be published alongside the current books to ensure local understanding. In addition, we will build on our data sharing efforts with the inclusion of more reporting on transfers and expenditure on the Treasury website on a regular basis. Information will be provided in electronic database form to assist public analysis and accountability. Finally, the PNG Extractive Industries Transparency Initiative (PNGEITI) has completed the 2019 Reconciliation report, and we have provisioned K3 million in the budget to support their work in 2023.

29. We aim to further improve the governance of state-owned enterprises (SOE). With the Asian Development Bank's support, we have amended the legal framework for the governance of SOEs and addressed shortcomings in their corporate governance. We will continue to strengthen the legislative and policy framework for SOEs, enhance financial transparency and accountability, and improve the financial sustainability of SOEs.

Social Protections and Poverty Reduction: Ensuring Our People Participate Fully in the Economy

30. We are committed to strengthening the social safety net in PNG. In the 2023 budget, the total allocation (current and capital) directed to the education, health and law and order sectors stood at K5.26 billion, an increase of 12.6 percent over 2022 and 46.9 percent from 2021. These expenditures will go toward meeting the most pressing needs of our people, particularly the poor. We intend to safeguard this allocation to ensure we do not backtrack on recent gains in alleviating poverty (IT). We will continue to work with our development partners to advance work on strengthening delivery of public services to our rural population, address urban youth unemployment, improve labor mobility and remove barriers to employment, address urgent needs in child nutrition and preventing the spread of communicable diseases, and continue to support education through our Government Tuition Fee Subsidy scheme.

D. Financing Needs and Size of the Program

31. The program would also address an immediate balance of payments needs, allowing us to engage with our other development partners and build the buffers needed to support a more flexible exchange rate system. The Fund program will be a critical component in reinforcing the Government's commitment to sound macroeconomic policies and needed structural reforms. These policies will lay the ground for durable and sustainable growth and allow us to reduce poverty and strengthen inclusion. Further, a Fund program is an important signal to our development partners that PNG is on the path to sustainability. More directly, financing from the Fund program will allow us to address near-term balance of payments needs, allowing the Government to build the international reserve buffer needed to safely address the demand-supply mismatches in the FX market; and allow for an ambitious but non-disruptive fiscal consolidation path that enables us to preserve needed social spending.

32. To this end, we are targeting an international gross reserves level of US$2.9 billion (7 months of imports) by end-2025. To achieve this goal while ensuring balance of payments needs are met, we request a program amounting to 260 percent of quota, to be disbursed over 38 months. In the first year of the program, we will aim for net international reserves, that is reserves net of IMF financing outstanding, of US$1.7 billion by end-2023 (QPC). To achieve this level of reserves by end-2023, and given the external payment obligations we expect, we estimate that we will need US$764 million in financing, of which 23 percent will come from drawings under the Fund program. We further request that our drawings under the program will be channeled toward budget support, thereby allowing us to continue executing the budget at a reasonable cost.

E. Program Reviews and Monitoring

33. Test dates and program reviews. In line with the normal practice for disbursements under the Poverty Reduction and Growth Trust, we request a 6-monthly review cycle based on quantitative performance criteria outlined in Table 1. The first two reviews will take place on or after September 18, 2023 and March 18, 2024. Accordingly, we propose our first two test dates would be June 30 and December 31, 2023 respectively. Subsequent test dates will be set in future program reviews. Further, we propose the inclusion of indicative targets for the interim periods (assessment dates of March 31, 2023, September 30, 2023 and March 31, 2024) to help guide program implementation. Tables 1 and 2 outline our proposed quantitative performance criteria, indicative targets and structural benchmarks for the first 12 months of the program. Detailed definitions of the quantitative performance criteria and indicative targets are provided in the attached Technical Memorandum of Understanding.

34. Data and information sharing, and program coordination. We have reactivated the Program Monitoring Committee to coordinate PNG's interactions with staff and the Fund and have already started regular meetings in preparation for the program's approval. We intend to continue meeting regularly with Fund staff to appraise them of developments, provide updates on data and program performance and request assistance from the Fund. It is our intention to meet with Fund staff at least every two weeks, during the program, with more frequent meetings when required. In addition, we will remain in close and frequent contact with the IMF Resident Representative on both program and other issues. Internally, the Committee, chaired by the Secretary of the Treasury, will coordinate activities in PNG related to the program by bringing together the main stakeholders. We welcome the arrival of the Fund Resident Representative in November 2022 and are in close and constant contact with his office. We continue to improve the quality and timeliness of our data. Recent Fund TA on external sector statistics has allowed us to re-state our BOP data from 2015 to 2022 in line with the recommendations of the 6th Balance of Payments Manual (BPM6). We will publish the revised data and will prepare subsequent data in accordance with the updated standard.

Table 1. Papua New Guinea: Proposed Quantitative Performance Criteria and Indicative Targets (March 2023—March 2024)

(In millions of Kina unless otherwise specified)

	2022	2023				2024
	December	March	June	September	December	March
		Indicative target	Test date	Indicative target	Test date	Indicative target
	Est.	Proposed	Proposed	Proposed	Proposed	Proposed
A. Quantitative performance criteria[1]						
Fiscal deficit of the government (ceiling, cumulative from the beginning of the year)	5,985	1,646	3,092	4,239	4,985	1,586
Stock of net international reserves of the BPNG (floor, US$ millions)	3,226	2,845	2,463	2,082	1,700	1,525
BPNG's gross credit to government (ceiling)	2,051	2,400	2,400	2,400	2,400	2,400
B. Continuous quantitative performance criteria (ceilings)[2]						
New external payment arrears of the government (ceiling, US$ millions)	0.0	0.0	0.0	0.0	0.0	0.0
Present value of new external debt contracted or guaranteed by the government[3] (ceiling, US$ millions)		1,405	1,405	1,405	1,405	
C. Indicative Targets						
Non-resource tax revenue of the government (floor, cumulative from the beginning of the year)	10,831	2,512	5,023	9,167	12,558	2,807
New domestic payments arrears of the government (ceiling)	0.0	0.0	0.0	0.0	0.0	0.0
Social and other priority spending (floor, cumulative from the beginning of the year)[4]	3,678	500	1,500	2,817	3,866	500
BPNG provision of foreign exchange to authorized FX dealers (floor, cumulative from the beginning of the year, US$ millions)	878	300	600	900	1,200	300

Sources: Papua New Guinea authorities and Fund staff estiamates.

[1] Quantitative performance criteria listed under A. and indicative targets listed under C. are assessed as at the end of each reference month above.

[2] Quantitative performance criteria listed under B. are effective continuously from program approval.

[3] Annual for 2023. The debt limit for 2024 will be revised in line with the authorites' borrowing plan and and updated DSA.

[4] Comprises government spending on health, education and law and order (both capital and operating expenses).

Table 2. Papua New Guinea: Proposed Structural Benchmarks (March 2023—January 2024)

No.	Measure	Purpose/Macro-criticality	Implementation date
		Budget repair	
1.	Introduce amendments to the Income Tax Act to the Parliament aimed at strengthening revenue mobilization, streamlining its operation and ensuring consistency with the Tax Administration Act.	To strengthen domestic revenue mobilization.	End-December 2023
2.	Adopt a new Medium-term Revenue Strategy (MTRS), in consultation with Fund staff, based on technical assistance requested. The MTRS will be adopted once it has been endorsed by the National Executive Council.	To guide revenue administration reforms.	End-August 2023
3.	Complete HR Business Process workshops on staffing and remuneration guidelines with government departments accounting for the majority of government staff.	To ensure government departments are aware of HR rules on staffing and remuneration to strengthen compliance, avoid overspending and prevent payment arrears.	End-June 2023
		Governance and operations of the BPNG	
4.	Modify the open market operations framework by introducing a fixed rate tender with full allotment to sterilize excess liquidity more effectively.	To address excess liquidity in the banking system, improve monetary policy effectiveness and strengthen the monetary policy transmission.	End-August 2023
5.	Produce a sequenced roadmap with a concrete action plan and a timeline for (i) reforming monetary policy operations frameworks, and (ii) reforming exchange rate operations and regulations, in consultation with Fund staff.	To improve monetary policy effectiveness, reduce FX shortages and move towards a more flexible exchange rate.	End-August 2023
6.	Submit to the Parliament amendments to the CBA, in consultation with Fund staff, to address the remaining issues related to mandate, governance, autonomy, transparency, and accountability of BPNG and improvements in financial regulation and supervision.	To strengthen BPNG's financial independence and governance and improve the operation of the financial system.	End-December 2023
		Governance and Anti-corruption Framework	
7.	Appoint a Commissioner and two Deputy Commissioners to the Independent Commission Against Corruption (ICAC) in line with the requirements of the applicable laws.	To enable the ICAC to begin activities to operationalize its mandate.	End-June 2023
8.	Adopt key implementing regulations to the ICAC law.	To specify operational processes for ICAC to meet its preventive, investigative and prosecutorial mandates, and to ensure sharing of information across relevant entities.	End-December 2023
9.	Post details (including the names of the entities awarded the contract and their beneficial owners) of COVID-19 related procurements awarded on the government procurement website, at least covering years 2020 and 2021.	To improve transparency in public procurement in COVID-related contracts, in line with commitments made under the disbursement under the Rapid Credit Facility.	End-December 2023

Attachment II. Technical Memorandum of Understanding

This technical memorandum of understanding (TMU) sets out the understanding between the Papua New Guinea authorities and the International Monetary Fund (IMF) regarding the definitions of the performance criteria (PCs) and the indicative targets that will be applied under PNG's 38-month Extended Credit Facility/Extended Fund Facility Program (ECF/EFF) spanning from March 2023 to May 2026, and should be read in conjunction with the Memorandum of Economic and Financial Policies (MEFP) that accompanies this TMU. It specifies the quantitative performance criteria and indicative targets on which the implementation of the ECF/EFF will be monitored in the period until March 2024. In addition, the TMU reaffirms the terms and timeframe for transmitting the data that will enable IMF staff to assess program implementation and performance.

A. Assessment Criteria: Quantitative Targets

1. Assessment Criteria have been set as of test dates and performance under the program is assessed against those quantitative targets, unless otherwise specified. Specifically, the First Review will assess the end-June 2023 test date and the Second Review will assess the end-December 2023 test date, etc. The assessment criteria are specified in Table 1 of the MEFP.

Definitions

2. For the purposes of the ECF/EFF program, government is defined as the central government of the Independent State of Papua New Guinea. Central government is defined as the component of general government covered by the national budget and encompasses fundamental activities of the national executive, legislative and judiciary powers. It includes Extra Budgetary Units which have individual budgets not fully covered by the national budget. The general government represents: the national and provincial governments; the Autonomous Bougainville government; and the commercial and statutory authorities.

3. Exchange rates under the program. For the purposes of this TMU, the value of transactions denominated in foreign currencies will be converted into PNG's domestic currency (PGK) based on the key exchange rates below as of December 31, 2022 (Table 1).

Table 1. Papua New Guina: Exchange Rates
(End of period, 2022)

PGK/USD	3.524
PGK/AUD	2.387
USD/SDR	1.330

4. Debt is defined for the program purposes in accordance with Executive Board Decision No. 15688-(14/107), Point 8(a) and (b), as published on the IMF website (https://www.imf.org/external/SelectedDecisions/Description.aspx?decision=15688-(14/107)). The term “debt” will be understood to mean all current, i.e. not contingent liabilities, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take various forms; the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers’ credits, i.e., contracts where the supplier permits the obligor to defer payments after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of these guidelines, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

(iv) Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on a contractual obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

5. **For the purposes of this ECF/EFF program, debt shall include borrowing by, or that receives guarantees from, the central government and the Bank of Papua New Guinea (BPNG) as set out in paragraph 10.** Accumulation of liabilities for the purposes of conducting monetary policy by the BPNG, including the issuance of securities or other marketable instruments such as central bank bills or notes, shall be excluded from the definition of debt.

6. **External debt of the government** is defined as a debt denominated, or requiring payment, in a currency other than the Kina. For program purposes, a debt and/or guarantee is considered contracted when all conditions for its coming into effect have been met, including approval by the Treasury. The contracting of credit lines with no predetermined disbursements schedules or with multiple disbursements will be also considered as contracting of debt. For the purposes of the program, the definition of “debt” is set forth in point No. 9 of the “Guidelines on Performance Criteria with Respect to External Debt” (see Decision No. 6230-(79/140) as revised on August 3, 2009 (Decision No. 14416-(09/91)).

For program evaluation, performance criteria under the ECF/EFF have been set (see Table 1 of the MEFP) as follows:

Quantitative Performance Criteria (QPCs)

Floor on the Cumulative Fiscal Deficit of the Central Government

7. The **fiscal deficit** is calculated on a cash basis, and will be calculated as the **net acquisition of financial assets less net incurrence of financial liabilities** by the central government from the start of the fiscal year on January 1, as set out in Table E ("Transactions in Assets and Liabilities") in the 2021 Final Budget Outcome published by the Government of PNG.

8. **Net acquisition of financial assets** will be calculated as the net change in domestic financial assets plus the net change in external financial assets of the central government.

9. **Net incurrence of liabilities** is defined as the sum of the net incurrence of domestic liabilities and net incurrence of external liabilities.

a. **Domestic liabilities** will include debt securities outstanding; loans received from residents of PNG; insurance, pension and standardized guarantee schemes; financial derivatives and employee stock options; and other accounts payable.

b. **External liabilities** will include debt securities outstanding; and loans received from lenders not resident of PNG; and any other liabilities that meet the definition of external debt as set out in paragraph 6 above.

10. **For the purpose of program performance assessment,** the cumulative fiscal deficits at end-June 2023 and December 2023 (PCs) and end-March 2023 and end-September 2023 (ITs) must be smaller than or equal to the amounts specified in Table 1 of the MEFP.

Floor on the Stock of Net International Reserves of BPNG

11. **Net international reserves** (stock) are defined as the difference between the BPNG's gross foreign assets and the use of IMF credit by BPNG.

12. **Gross foreign assets are defined as the sum of:**

- The BPNG's holdings of monetary gold (excluding amounts pledged as collateral);
- Holding of Special Drawing Rights (SDRs);
- BPNG holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments);
- Papua New Guinea's reserve tranche position with the IMF.

13. **Gross foreign assets exclude:**

- Any foreign currency claims on residents;
- Capital subscriptions in international institutions;

- Assets obtained through currency swaps of less than three months duration;
- Pledged, swapped, or any encumbered reserve assets, including but not limited to reserve assets used as collateral or guarantees for third-party external liabilities;
- Precious metals other than gold, assets in nonconvertible currencies and illiquid foreign assets.

14. The use of IMF credit by the BPNG includes the credit outstanding under IMF financing programs (including resulting from the present request) and the SDR allocations to the BPNG.

15. For the purpose of program performance assessment, the stock of net international reserves at end-June 2023 and end-December 2023 must be equal or greater than specified in Table 1 of the MEFP.

Ceiling on BPNG's Gross Credit to Government

16. BPNG's gross credit to government is defined as the sum of:

- government securities held by BPNG including T-bills and T-bonds,
- advances made by BPNG to the central government excluding temporary advances made within the Temporary Advance Facility (TAF); and
- loans made by BPNG to the central government excluding on-lent IMF or other external financing by BPNG to the government.

17. For the purpose of program performance assessment, BPNG's gross credit to government at end-June 2023 and December 2023 must be lower than or equal to the amounts specified in Table 1 of the MEFP.

Continuous Performance Criteria (PCs)

Ceiling on the Present Value (PV) on New External Debt Contracted or Guaranteed by the Government

18. The present value (PV) of any external borrowing by the government is defined as the annual discounted future debt service payments for that loan, using a discount rate of 5 percent.

19. For debts carrying a variable interest rate in the form of a benchmark interest rate plus a fixed spread, the PV of the debt would be calculated using a program reference rate plus the fixed spread (in basis points) specified in the debt contract. The program reference rate for the six-month USD LIBOR is 2.73 percent and will remain fixed for the duration of the program. Where the variable rate is linked to a benchmark interest rate other than the six-month USD LIBOR, a spread reflecting the difference between the benchmark rate and the six-month USD LIBOR (rounded to the nearest 50 bps) will be added. For interest rates on the Australian Dollar, the spread over six month USD LIBOR is 50 basis points.

20. For the purposes of program monitoring, a continuous ceiling in PV terms will apply to the contracting or guaranteeing of new external debt by the Government or the BPNG. The ceiling applies to debt contracted or guaranteed for which value has not yet been received, including private debt for which official guarantees have been extended.

21. An adjustor of up to 5 percent of the external debt ceiling set in PV terms applies to this ceiling, in case deviations from the performance criterion on the PV of new external debt are prompted by a change in the financing terms (interest, maturity, grave period, payment schedule, upfront commissions, management fees) of a debt or debts. The adjustor cannot be applied when deviations are prompted by an increase in the nominal amount of total debt contracted or guaranteed.

22. For program purposes, a debt is considered to be contracted when all conditions for its entry into effect have been met, including approval by Treasury. Contracting of credit lines (which can be drawn at any time and entered into effect) with no predetermined disbursement schedules or with multiple disbursements will be also considered as contracting of debt

23. Government debt guarantee means an explicit legal obligation of the central government or the BPNG to service a debt in the event of nonpayment by the borrower.

Ceiling on New External Payment Arrears of the Government

24. For the purposes of the PC on the non-accumulation of new external payment arrears, **external payment arrears of the government** are defined as external debt obligations of the government that have not been paid when due in accordance with the relevant contractual terms (taking into account any contractual grace periods).

B. Other Assessment Criteria

25. During the program period, PNG will not:

a. Impose or intensify restrictions on the making of payments and transfers for current international transactions;

b. Introduce or modify multiple currency practices (MCPs);

c. Conclude bilateral payments agreements which are inconsistent with Article VIII of the IMF Articles of Agreement; and

d. Impose or intensify import restrictions for balance of payments reason.

C. Assessment Criteria: Indicative Targets

26. Indicative targets have been set for end of March 2023 and September 2023. Indicative targets serve to assess progress under the program but are not binding quantitative criteria under which performance under the program is evaluated. The targets are specified in Table 1 of the MEFP. For the calculation, monitoring and evaluation of the indicative targets, the following definitions will be used:

Definitions and Calculations

27. Non-resource tax revenues of the government are defined in line with the GFSM 2014 and consist of: (i) taxes on income, profits, and capital gains; (ii) taxes on payroll and workforce; (iii) taxes on property; (iv) taxes on goods and services; and (v) taxes on international trade and transactions but shall exclude mining and petroleum taxes.

28. BPNG provision of foreign exchange to authorized foreign exchange dealers is defined as the amount of FX sold by BPNG to banks and other authorized FX dealers in PNG each month, with the intention to assist meeting the FX orders in the market.

29. Social and other policy priority spending is measured on a cash basis and comprises central government spending in the following areas: health, education and law and order (both capital and operating expenses).

D. Program Monitoring and Data Reporting

30. To facilitate the monitoring of program implementation, the Papua New Guinea authorities shall maintain a Program Monitoring Committee. The committee will be composed of senior officials from the Treasury and the Bank of Papua New Guinea, and shall be responsible for monitoring the performance of the program, informing the Fund regularly, and transmitting the supporting materials necessary for the evaluation of benchmarks. With respect to continuous QTs, the authorities will report any non-observance to the IMF promptly.

31. The Committee will prepare and provide to the Fund staff electronically the following information contained in the data reporting table below.

Table 2. Papua New Guinea: Data Reporting for Program Monitoring

Data Description	Type of Data	Reporting Agency	Reporting Frequency	Reporting Lag
Fiscal Sector				
Net acquisition of financial assets and net incurrence of financial liabilities, consisting of:	Budget operations	Treasury	Monthly	1 month
• External loans disbursed and external debt instruments issued, broken down by type of creditor or holder	Debt	Treasury	Monthly	1 month
• External loans repaid and external debt instruments redeemed, broken down by type of creditor or holder	Debt	Treasury	Monthly	1 month
• Domestic financial assets accumulated including deposits at the BPNG or other depository institutions	Debt	Treasury	Monthly	1 month
• External financial assets accumulated, including FX deposits at the BPNG and other depository institutions, including foreign entities	Debt	Treasury	Monthly	1 month
• Domestic loans disbursed	Debt	Treasury	Monthly	1 month
• Domestic loans repaid	Debt	Treasury	Monthly	1 month
• Domestic securities issued, broken down by original maturity, by face value and proceeds from issuance	Debt	Treasury	Monthly	1 month
• Domestic securities redeemed by original maturity	Debt	Treasury	Monthly	1 month
• Loans or advances from the BPNG (excluding any on-lending of external loans contracted with the Fund or other development partners)	Debt	Treasury	Monthly	1 month
• Any other long-term (exceeding 1 year) domestic liability of the central government	Debt	Treasury	Monthly	1 month
Payments incurred by the central government on education, health, and law and order (both capital and current spending)	Debt	Treasury	Monthly	1 month

Table 2. Papua New Guinea: Data Reporting for Program Monitoring (Continued)

Data Description	Type of Data	Reporting Agency	Reporting Frequency	Reporting Lag
Total tax revenues received by the central government, consisting of: • taxes on income, profits, and capital gains; • taxes on payroll and workforce; • taxes on property; • taxes on goods and services; and • taxes on international trade and transactions	Revenue	Treasury	Monthly	45 days
Total revenue taxes received by the central government, consisting of: • mining and petroleum taxes; • royalties levied on petroleum companies; and • [management taxes]	Revenue	Treasury	Monthly	45 days
The monthly cash plan			Monthly	1 month
Stock of domestic debt, disbursements, amortization, interest, and other fees and charges; face value, maturity, interest rate, and payment schedule	Domestic debt	Treasury	Monthly	1 month
Stock of external debt, disbursements, amortization, interest, and other fees and charges; face value, maturity, interest rate, and payment schedule			Monthly	1 month
Details on amount and terms of disbursed external budget support and project grants and loans	External debt	Treasury	Monthly	1 month
End of year external debt in U.S. dollars, by creditor, and originating currency.			Monthly	1 month
The amount of new external debt contracted by Government			Monthly	1 month
All guarantees provided by the government including guarantees to public corporations and private sector			Monthly	1 month

Table 2. Papua New Guinea: Data Reporting for Program Monitoring (Continued)				
Data Description	**Type of Data**	**Reporting Agency**	**Reporting Frequency**	**Reporting Lag**
Real Sector				
Consumer Price Index	Economic indicators	NSO	Quarterly	3 months
National Accounts (breakdown of production) in real and nominal terms			Annual	24 months
Agricultural production data (volume/value of major products)		[BPNG /Treasury]	Quarterly	3 months
Mineral production data (volume/value of major products)		[BPNG/ Treasury]	Quarterly	3 months
Structural Benchmarks				
A table with a description of the status of implementation of the structural measures in Table 2 of the MEFP.	Structural benchmarks	Treasury	[Quarterly]	3 months
Monetary and Financial Sector				
Detailed balance sheet data of the BPNG submitted in the reporting template	Monetary Survey	BPNG	Monthly	1 month
Cash flows of the Waigani Public Account, Debt Repayment Account, and the Temporary Advance Facility (TAF)			Monthly	1 month
Daily sale of FX (in USD) by the BPNG to authorized FX dealers (detailed by dealer)			Weekly	1 week
Depository Corporations Survey			Quarterly	3 months
Balance sheets and income statements by financial institutions (aggregate and by bank)			Quarterly	3 months
Outstanding amount of unsatisfied requests for FX purchase to pay for current account (or authorized) transactions.			Weekly	1 week
Financial Soundness Indicators (aggregate and by bank)			Quarterly	1 month
Lending activity of banks (by sector)			Monthly	1 month

Table 2. Papua New Guinea: Data Reporting for Program Monitoring (Concluded)				
Data Description	**Type of Data**	**Reporting Agency**	**Reporting Frequency**	**Reporting Lag**
External Sector				
Balance of Payments data in the reporting template provided by IMF staff	BOP	BPNG	Quarterly	3 months
Import and export data, by sectors			Quarterly	3 months
Net international reserves, including reserve assets/liabilities by original currency			Monthly	1 month
Foreign exchange flow data (by type of flow)			Monthly	1 month
Banks' purchases and sales of foreign currency (specified by bank, sector and by type of flow)			Monthly	1 month
List of the foreign exchange allocation pipeline (orderbook) with information about length of time needed to fulfill order			Monthly	1 month

INTERNATIONAL MONETARY FUND

PAPUA NEW GUINEA

March 8, 2023

REQUESTS FOR AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—INFORMATIONAL ANNEX

Prepared By Asia and Pacific Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of February 28, 2023)

Membership Status

Joined: October 9, 1975; Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	263.20	100.00
Fund holdings of currency	262.72	99.82
Reserve position in Fund	0.58	0.22

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	377.76	100.00
Holdings	1.49	0.39

Outstanding Purchases and Loans

	SDR Million	Percent Quota
RCF Loans	263.2	100.00

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				
	2023	2024	2025	2026	2027
Principal			26.32	52.64	52.64
Charges/interest	9.65	12.94	12.93	12.94	12.94
Total	**9.65**	**12.94**	**39.25**	**65.58**	**65.58**

[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

The first Safeguards Assessment of the Bank of Papua New Guinea (BPNG) was completed. The assessment found that the Central Banking Act requires amendments to sufficiently protect the BPNG's financial, personal, and institutional autonomy and enhance governance arrangements. Such amendments remain necessary after the 2021 review of the Act. While transparency is supported by compliance with International Financial Reporting Standards (IFRS), audit arrangements should be improved to safeguard the external auditors' independence and align internal audit to international standards. The internal control system is being strengthened, including through the establishment of a risk management function. Closer engagement of the BPNG's oversight bodies over the ongoing initiatives is needed to ensure timely implementation.

Exchange Rate Arrangement

Papua New Guinea's de jure exchange rate arrangement is "floating". On June 4, 2014, the BPNG introduced an exchange rate trading margin with a kina buying rate within 75 basis points (bps) above the interbank midrate and a kina selling rate within 75 bps below the midrate. Since November 2020, the exchange rate has stabilized within a two percent band against the US dollar. Accordingly, the de facto exchange rate arrangement was reclassified to "stabilized" from crawl-like, effective November 3, 2020. The BPNG publishes the intervention data in its annual report and semi-annual monetary policy statement.

Papua New Guinea maintains the following exchange restrictions subject to IMF approval under Article VIII, Section 2(a) of the IMF's Articles of Agreement arising from: (i) the requirement to obtain a tax clearance certificate (TCC) evidencing the payment of all taxes prior to making payments or transfers for certain current international transactions; and (ii) the rationing of FX, which results in undue delays and arrears in current international payments. Papua New Guinea also maintains the following multiple currency practices (MCPs) subject to Fund approval under Article VIII, Section 3: (i) a MCP arising from the spread of more than 2 percent between the rates set by BPNG for its FX allocations to authorized FX dealers (AFEDs), and the rates used by AFEDs in transactions with their clients; and (ii) a MCP arising from the potential spread deviation of more than 2 percent between the rates set by BPNG for its FX transactions with the government and embassies, and the rates used by AFEDs in transactions with their clients.

Article IV Consultations

The 2022 Article IV consultation discussions were held remotely on April 4-26, 2022. It was concluded by the Executive Board on June 13, 2022 (IMF Country Report No. 22/305). Papua New Guinea is on the standard 12–month consultation cycle.

TA from Headquarters

FAD: In 2020, missions were conducted on IPSAS Cash Reporting, IRC external governance, Taxpayer service implementation, IRC organization design and IT tender evaluation support. Joint FAD/PFTAC mission on MTRS update and review were conducted in September and October 2020 and January-February 2021. In April 2021, TA was provided on the rewrite of Income Tax Act and Tax modeling. In December 2021, a mission on revenue administration program was carried focused on further development and introduction of new organizational structure for IRC.

LEG: A mission in September 2018 assisted in planning legislative reforms for the MTRS. In 2020 (February to March), a virtual mission was conducted on Institutional and Governance Review of the Internal Revenue Commission and PNG Customs.

MFD/MCM: A mission in August 2018 delivered technical assistance in liquidity forecasting and management, and foreign exchange operations. Missions in December 2017 and February 2018 delivered TA on banking supervision.

STA: TA was provided on government finance statistics (January and September 2020); national accounts and price statistics (February 2020); a remote TA on Balance of Payments Statistics/Direct Investment (October 2020) and a remote TA on External Sector Statistics (February 2022). In January 2022, a virtual technical assistance mission was conducted on public sector debt statistics. In November 2022, an in-person TA mission was conducted on financial soundness indicators.

Resident Representative

The Fund reopened its Resident Representative Office in Port Moresby on November 21, 2022. Mr. Sohrab Rafiq is the current resident representative. Prior to this, PNG was served by the Regional Resident Representative Office for Pacific Island Countries based in Suva, Fiji.

RELATIONS WITH THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTER

(As of April 2022)

The Pacific Financial Technical Assistance Centre (PFTAC) in Suva, Fiji, is a regional TA institution operated by the IMF with financial support of PFTAC member countries, the Asian Development Bank, Australia, the European Union, Korea, New Zealand, Canada and the US Government. 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. Technical assistance to PNG suffered due to COVID 19.

A. Public Financial Management

PFTAC led a multilateral mission in July 2019 with colleagues from UNDP, World Bank, JICA, and the ADB for a full Public Expenditure Financial Accountability (PEFA) diagnostic assessment of the country's PFM systems, which was published in 2020. In September 2020, a remote mission helped formulate a sequenced and prioritized PFM reform roadmap, building on the findings of the 2020 PEFA assessment and taking on board capacity constraints. The government remains committed to the broader PFM roadmap.

B. Tax Administration and Policy

The Department of the Treasury, with FAD assistance, has developed a 2018-2022 Medium-Term Revenue Strategy (MTRS) of which a comprehensive Revenue Mobilization Framework is a key element. FAD missions[1] provided advice on the MTRS framework and content. PFTAC missions[2] facilitated the design of a new corporate plan, design and monitoring unit, taxpayer services unit and a large taxpayer office. Funding to support PNG's MTRS implementation had been sourced through the multi-lateral Revenue Mobilization Trust Fund (RMTF) and included the placement of an IMF resident advisor in Port Moresby (August 2018-June 2021). Support through the RMTF ended in June 2021, with continued capacity development provided through PFTAC. In December 2021, a PFTAC mission focused on further development and introduction of new organizational structure for IRC.

C. Financial Sector Regulation and Supervision.

In 2018 PFTAC and BPNG initiated the Supervision Framework Enhancement Program (SFEP), incorporating a Supervision Framework Development strategy and a TA plan. The SFEP covers

[1] Cotton (August 2017) and Baunsgaard (September 2017) provided advice on the MTRS framework and content.

[2] PFTAC missions in July 2017, December 2017, and September 2018 (STX McNeil) facilitated the design of a new corporate plan, design and monitoring unit, taxpayer services unit and a large taxpayer office.

development and enhancement of risk rating; supervisory action planning; on-site examination; financial analysis; and a review and update of legislation and prudential standards. The SFEP with BPNG has been successfully running for three and a half years, with significant development of BPNG's risk-based supervision (RBS) framework, in risk rating and supervisory action planning, and on-site examination and off-site analysis capabilities. In 2021, PFTAC provided TA to review and develop 11 prudential standards including consolidated supervision. The report was completed in August 2021.

D. Economic and Financial Statistics

Support for Real Sector Statistics has been provided in close collaboration with the Australian Bureau of Statistics (ABS). ABS has provided TA on data collection issues including business and household surveys, with temporary repeated secondments of ABS staff to the PNG National Statistics Office (NSO). PFTAC provides on-the-job training and improvement on the production system. Further PFTAC TA on real sector statistics is scheduled for FY23. Government finance statistics and public sector debt statistics TA are supported by PFTAC and the Data for Decisions (D4D) Trust Fund. External sector statistics continue to be supported by the Japan Administered Account for Selected IMF Activities (JSA) for the Asia-Pacific region through October 31, 2023.

E. Macroeconomic Analysis

In January 2019, the Department of Treasury hosted an interagency workshop with participants from the Department of Treasury, the Bank of Papua New Guinea, and the National Statistics Office on Economic and Fiscal Forecasting which was facilitated by the PFTAC macro advisor.

In May 2021, a three-week Financial Programing course was conducted by ICD and PFTAC, with the aim of this being part of the long-term adoption of a new Financial Programing model, with further missions planned.

F. Public Debt Management

During October and November 2021, a two-week regional training course provided capacity development on the fundamentals of debt reporting and monitoring. Department of Treasury officials attended the training and gained understanding of the benefits and key requirements of publishing reliable, comprehensive, timely, and accurate debt data.

In November 2021, PFTAC delivered a remote training on financial and loan analysis to Papua New Guinea Department of Treasury officials. Papua New Guinea has access to both a domestic debt market and external financing and CD of officials in financial and loan analysis is part of the foundations for improving debt management practices. The training focused on building capacity in financial and market concepts, debt and liability management operation instruments, loan structures and cashflows, and portfolio risk indicator analysis. Enhancing the foundational knowledge of officials is also fundamental towards Papua New Guinea's aim to raise overall Debt Management Performance Assessment (DeMPA) scores. The DeMPA is a diagnostic of government debt management practices and institutions.

INFORMATION ON THE ACTIVITIES OF OTHER IFIS

Information on the activities of other IFIs in Papua New Guinea can be found at:

- World Bank: https://www.worldbank.org/en/country/png
- Asian Development Bank: https://www.adb.org/countries/papua-new-guinea/main

STATISTICAL ISSUES

(As of April 2022)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but data are 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 and lagged release dates. Due to management and capacity constraints, GDP data is released with a lag of two years. In November 2021, the NSO released GDP for 2019. To assist the NSO in addressing these issues, PFTAC and ABS agreed on a coordinated approach to TA. ABS addressed the timely compilation and publication of GDP figures, while PFTAC focused on the steady improvement of data and methodology. Nevertheless, to increase user confidence in the NSO, proactive management and regular stakeholder engagement must improve.
Price Statistics: The NSO currently disseminates a quarterly consumer price index, with expenditure weights from the 2009–10 Household Income Expenditure Survey. These weights should ideally be updated. Producer price indexes are not compiled.
Government Finance Statistics (GFS): The Department of Treasury annually compiles and reports GFS data for the budgetary central government (BCG) to the IMF, making PNG a regular reporter, although coverage and timeliness could improve. 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 limited records on the use of trust accounts are available. Tax revenues collected by authorities (extrabudgetary units of the central government) are generally not reflected in the central government's financial information. While interest payment records are accurate, there are timing issues regarding the recording of interest on discounted securities. Even though compiling, reconciling and disseminating public sector debt statistics and government guarantees has improved challenges remain in debt instrument and institutional coverage. These weaknesses contribute to discrepancies in financing between estimates from monetary and debt data and those derived from fiscal records. Financial balance development remains a priority to support better decision making for fiscal policy and fiscal sustainability. Papua New Guinea continue to benefit from technical assistance and regional capacity building initiatives through the PFTAC and Data for Decisions (D4D) Trust Fund.
Monetary and Financial 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 of 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). A 2013 TA mission introduced general insurance companies into the institutional coverage of OFCs and an improved SRF for OFCs. Most of the monetary statistics published in *International Financial Statistics (IFS)* are currently aligned with the *Monetary and Financial Statistics Manual and Compilation Guide* (*MFSMCG*).

Financial sector surveillance: In the area of financial soundness indicators (FSIs), the BPNG has compiled selected FSIs for deposit takers to support the financial sector assessment. BPNG currently reports thirteen core financial soundness and eight additional indicators for deposit takers and real estate markets to STA, with quarterly data availability starting in 2008Q4 and in line with the 2019 FSI *Compilation Guide*. However, no FSIs are reported on other sectors such as other financial corporations, nonfinancial corporations, and households. A 2022 TA mission assisted the BPNG in preparing for the reporting of additional FSIs. Papua New Guinea reports data on several series indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

External Sector Statistics: PNG's annual balance of payments data up to 2018 are disseminated on the IMF's website. IIP data are not available. A Remote TA mission was conducted in February 2022 to improve the quality of external sector statistics (ESS). The mission conducted training to Bank of Papua New Guinea staff on compiling balance of payments statistics in line with the BPM6 framework and provided guidance on how to address critical data gaps, particularly in sectors with large cross-border transactions such as the liquified natural gas project, mining sector, and deposit taking corporations. Significant effort is required on the part of the authorities to implement the recommendations of the recent and previous TA Missions to improve the quality, coverage, periodicity and timeliness of ESS.

II. Data Standards and Quality

PNG began to participate in the General Data Dissemination System in 2012. PNG has not yet implemented the recommendations of the enhanced GDDS (e-GDDS) by launching a National Summary Data Page (NSDP).

III. Reporting to STA

PNG last reported GFS for publication in *Government Finance Statistics Yearbook* and *IFS* for 2017, covering only the budgetary central government. Monetary data are reported to STA for publication in *IFS* on a regular monthly basis. BOP data for 2018 were reported to STA for publication in *Balance of Payments Yearbook* and *IFS*. National accounts data for 2006-13 were reported to STA for publication in *IFS*.

Papua New Guinea: Table of Common Indicators Required for Surveillance
(As of January, 2023)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	12/2022	01/2023	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	12/2022	02/03/2023	M	M	M
Reserve/Base Money	11/2022	02/03/2023	M	M	M
Broad Money	11/2022	02/03/2023	M	M	M
Central Bank Balance Sheet	11/2022	02/03/2023	M	M	Q
Consolidated Balance Sheet of the Banking System	11/2022	02/03/2023	M	M	Q
Interest Rates[3]	08/2022	10/2022	M	M	M
Consumer Price Index	9/2022	12/7/2022	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5, 8]	N/A	N/A	N/A	N/A	N/A
Revenue, Expenditure, Balance and Composition of Financing[4]—Central Government	12/2021	4/14/2022	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[6]	12/2021	4/14/2022	Q	A	A
External Current Account Balance	Q2 2019	11/28/2019	Q	Q	Q
Exports and Imports of Goods and Services	Q2 2019	11/28/2019	Q	Q	Q
GDP/GNP	2019	11/04/2021	A	A	I
Gross External Debt	2018	07/03/2018	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] Including currency and maturity composition.
[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[8] Lack of capacity prevented the authorities from providing the data.

INTERNATIONAL MONETARY FUND

PAPUA NEW GUINEA

March 8, 2023

REQUESTS FOR AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—DEBT SUSTAINABILITY ANALYSIS

Approved By
Sanjaya Panth (IMF), Manuela Francisco and Hassan Zaman (both IDA)

Prepared by the staff of the International Monetary Fund (IMF) and the International Development Association (IDA)

Papua New Guinea Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	*High*
Overall risk of debt distress	*High*
Granularity in the risk rating	*Sustainable*
Application of judgment	*No*

Papua New Guinea (PNG) remains at high risk of debt distress under the Low-Income Country Debt Sustainability Framework (LIC DSF), with weak debt-carrying capacity.[1, 2] *While the planned fiscal consolidation helps address debt vulnerabilities exacerbated by the global COVID-19 shock, the risk of both external and public debt distress continues to be assessed as high. Over the medium-term, public debt enters a downward trend and the projected temporary breaches of sustainability indicators can mostly be addressed by debt management operations as well as improvements in revenue generation. The Debt Sustainability Analysis (DSA) suggests that PNG is susceptible to export related and other shocks, underscoring downside risks to the debt outlook in a global environment of high uncertainty. To lower the risk of debt distress and ensure debt sustainability, gradual fiscal consolidation, including by boosting revenues, and steadfast structural reforms to promote private sector growth would be needed. Conditional on the implementation of the authorities' plans for further fiscal consolidation and conservative financing strategies, PNG's external and overall debt is judged as sustainable.*

[1] This Debt Sustainability Analysis has been prepared jointly by the International Monetary Fund and the World Bank, in accordance with the revised Debt Sustainability Framework for low-income countries approved by the Executive Boards of the IMF and the International Development Association.

[2] The Composite Indicator (CI) of 2.58 is based on the latest available CI information—October 2022 IMF World Economic Outlook (WEO) and the World Bank's Country Policy and Institutional Assessment (CPIA) for 2021 indicating a "weak" capacity to carry debt.

PUBLIC SECTOR DEBT COVERAGE

1. **The coverage of public debt in the DSA is unchanged from the previous (May 2022) DSA** (Text Table 1). The segments of the public sector captured in the DSA include the central government, state and local government, and guarantees to other entities in the public and private sector, including parts of state-owned enterprises (SOEs). However, debt numbers do not fully capture implicit government guaranteed debts of SOEs and unfunded superannuation liabilities relating to pensions.[3] For the purposes of this DSA, the coverage of public sector debt remains unchanged from the last DSA, which was prepared in May 2022 in the context of the IMF 2022 Article IV Consultation and review of the Staff Monitored Program (SMP). Given continued difficulties in capturing and assessing SOE risks, a contingent liabilities stress test is included in this DSA, assuming 9 percent of GDP as SOE debt is not captured in official public debt data (the stock of explicit government guarantees is around 1.3 percent of GDP), and 3 percent of GDP for other elements of general government (mainly unfunded superannuation liabilities related to pensions, which are projected to be 2.1 percent of GDP in 2023). Separately, according to the World Bank's PPP database, the PPP capital stock in PNG is zero and, therefore, no default shock is triggered. A financial market shock of 5 percent is added, reflecting the average fiscal cost of financial crisis in low-income countries. With these assumptions, the cumulative shock in the contingent liabilities stress test amounts to 17 percent of GDP—compared to 7 percent under default assumptions. Currency denomination is used to define external debt.

Text Table 1. Papua New Guinea: Coverage of Public Debt

	Subsectors of the public sector	Subsection Covered
1	Central government	X
2	State and local government	X
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	
8	Non-guaranteed SOE debt	

1	The country's coverage of public debt	The central, state, and local governments, government-guaranteed debt		
		Default	Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0 percent of GDP	3	Unfunded superannuation liabilities relating to pensions
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	9	SOE sovereign guarantee in dispute
4	PPP	35 percent of PPP stock	0	Default used
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5	Default used
	Total (2+3+4+5) (in percent of GDP)		17	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

[3] Comprehensive data on the debt stock of SOEs in PNG is not publicly available. The ADB have been supporting the authorities with a three-year program (2020-2023) aiming to reform the governance of state-owned enterprises, increase their financial transparency and ensure financial sustainability. This included providing advice on the overarching policy and legal framework for SOEs, leading to the adoption of an amended Kumul Consolidated Holdings Act in 2021.

BACKGROUND ON DEBT

2. **Between 2017 and 2022, the stock of public debt in PNG increased from around 24 billion Kina to 53 billion Kina.** This was mainly due to external loans, while the creditor composition has been gradually shifting away from commercial loans towards official multilateral and bilateral financing (*Text Table 2*). However, expensive commercial loans have generally been replaced with official multilateral and bilateral financing at more favorable conditions. This has helped to improve debt sustainability indicators in the medium-term. Public and Publicly Guaranteed (PPG) external debt figures used for this DSA are consistent with the information in the World Bank's International Debt Statistics.

Text Table 2. Papua New Guinea: Decomposition of Public Debt Service by Creditors[1], 2022-2024

	Debt Stock (end of period)			Debt Service					
	2022			2022	2023	2024	2022	2023	2024
	(In US$ million)	*(Percent total debt)*	*(Percent GDP)*	*(In US$ million)*			*(Percent GDP)*		
Total	15004	100	47	4356	4771	4943	14	15	15
External	7312	49	23	382	531	752	1	2	2
Multilateral creditors[2,3]	3948	26	12	158	279	376	0	1	1
IMF	738	5	2	1	6	6	0	0	0
World Bank	847	6	3	53	51	68	0	0	0
ADB	2272	15	7	97	215	295	0	1	1
Other Multilaterals	91	1	0	6	7	8	0	0	0
Bilateral Creditors[2]	2802	19	9	165	193	327	1	1	1
Paris Club	1627	11	5	72	78	198	0	0	1
o/w: Australia	1117	7	4	64	63	185	0	0	1
Non-Paris Club	1175	8	4	93	115	129	0	0	0
o/w: China EXIM	1085	7	3	68	90	97	0	0	0
Bonds	500	3	2	42	42	42	0	0	0
Commercial creditors	61	0	0	17	17	7	0	0	0
Other international creditors	0	0	0	0	0	0	0	0	0
Domestic	7693	51	24	3974	4240	4192	12	13	12
Held by residents, total	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Held by non-residents, total	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
T-Bills	3614	24	11	3843	3628	3691	12	11	11
Bonds	3231	22	10	104	485	397	0	1	1
Loans	848	6	3	27	127	104	0	0	0
Memo items:									
Collateralized debt[2,4]	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Contingent liabilities	816	5	3	n/a	n/a	n/a	n/a	n/a	n/a
Nominal GDP	31819	n/a	100						

1/As reported by Country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as the DSA.

2/Some public debt may not be shown in the table due to confidentiality clauses/capacity constraints.

3/Multilateral creditors" are simply institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policies (e.g. Lending Into Arrears)

4/Debt is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. Collateralization entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. Collateral is "unrelated" when it has no relationship to a project financed by the loan. An example would be borrowing to finance the budget deficit, collateralized by oil revenue receipts. See the joint IMF-World Bank note for the G20 "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers" for a discussion of issues raised by collateral.

3. **The IMF's general allocation of Special Drawing Rights (SDRs) became effective in August 2021, with SDR 252 million (US$ 357 million, or 95.7 percent of quota) allocated to PNG.** The authorities used the full SDR allocation to support the 2021 budget. They used the SDR allocation to replace costly financing, which has helped reduce the budget deficit. For the purpose of this DSA, the SDR

allocation is included in total public debt while the associated debt service for the amount outstanding is also reflected.

4. **A new 38-month IMF program will support PNG's reform agenda, help protect the vulnerable and foster inclusive growth.** These facilities total SDR 684.3 million under the IMF's Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) arrangements. The program builds on progress under the past SMPs (2020/21 and 2021/22), focusing on addressing structural impediments to growth and poverty reduction. Program objectives will focus on (i) strengthening debt sustainability through a multi-year fiscal consolidation program while making room to meet critical social and development needs, (ii) enhancing the legal and operational framework of the BPNG to alleviate FX shortages and transition to a market-clearing exchange rate, and (iii) build on improvements to governance and the anti-corruption framework.

5. **PNG is an IDA blend country, with total IDA20 allocation at SDR 173.7 million.** PNG is currently eligible to access the Regional Window, Crisis Response Windows , SUW-SMLs and the Private Sector Window. The IDA decision to graduate a country to IBRD-only status is based on an assessment of the country's macroeconomic prospects, risk of debt distress, vulnerability to shocks, institutional constraints, and levels of poverty and social indicators.

6. **The IDA Sustainable Development Finance Policy (SDFP) supports PNG in addressing key debt vulnerabilities.** As part of the SDFP, PNG has satisfactorily implemented the Performance and Policy Actions (PPA) for fiscal year 2022. These were aimed at limiting non-concessional borrowing and operationalizing the 2021 State Guarantee Policy. PNG has two further SDFP PPAs for fiscal year 2023: (i) a US$ 1 billion non-concessional PPG borrowing limit for new non-concessional long-term contractual obligations, which applies continuously throughout FY23, and (ii) to improve management of fiscal risks by both approving a revised on-lending policy (which introduces credit risks assessments and strengthens enforcement arrangements, recording and reporting requirements) and refraining from any new on-lending until the revised policy is adopted.

BACKGROUND ON MACROECONOMIC FORECASTS

7. **An economic recovery is underway with the reopening of the economy amid favorable commodity prices** (Text Table 3). Real GDP in 2022 is estimated to have increased by 4.5 percent as most COVID-related restrictions have been removed, allowing the non-resource sector to rebound. Headline inflation (period-average CPI) is expected to increase to 6.6 percent in 2022, despite fiscal measures introduced by the government to address the cost-of-living impact following Russia's invasion of Ukraine. Following sustained high commodity prices, strong resource sector export revenue is expected to drive a current account surplus of 35 percent of GDP in 2022.[4] This is the most substantial change since the 2022 Article IV and SMP review which projected a smaller surplus, at 23 percent of GDP. The immediate direct

[4] The published current account data in PNG are likely overstated due to long-standing challenges in classifying large income account outflows, including external debt service payments related to resource projects, under the financial account rather than the current account. The authorities are receiving Fund technical assistance (TA) in external sector statistics.

impact of this resource sector windfall on the fiscal balance is expected to be minimal. In 2022, goods exports volumes are expected to have increased by 6.5 percent compared to 2021, with widespread increases across mineral resource export volumes, including gold, silver, copper and nickel. In addition, buoyant commodity prices in 2022 were supportive of export values, which increased by 49 percent compared to 2021. Expected lower commodity prices in 2023 underpin assumptions for a fall in nominal export growth in 2023.

Text Table 3. Papua New Guinea: DSA Vintages: Macroeconomic and Fiscal Assumptions, 2022-2027

	DSA Vintage	2022	2023	2024	2025-2027
Real GDP growth y/y (in percent)	**2023 ECF/EFF**	**4.5**	**3.7**	**4.4**	**3.1**
	2022 AIV/SMP	4.2	4.7	3.0	3.0
Resource sector	2023 ECF/EFF	4.7	0.3	5.1	0.1
	2022 AIV/SMP	4.8	5.9	-0.1	0.1
Non-resource sector	2023 ECF/EFF	4.5	4.9	4.2	4.1
	2022 AIV/SMP	4.0	4.3	4.2	4.1
Inflation, annual average (consumer prices, percent)	**2023 ECF/EFF**	**6.6**	**5.4**	**4.9**	**4.5**
	2022 AIV/SMP	6.4	5.4	4.9	4.5
Current account balance (percent of GDP)	**2023 ECF/EFF**	**34.9**	**24.0**	**22.4**	**23.8**
	2022 AIV/SMP	23.1	22.0	20.6	19.0
Growth of exports of G&S (US$, in percent)	2023 ECF/EFF	48.9	-11.2	3.1	2.5
	2022 AIV/SMP	26.6	3.4	0.3	2.1
Growth of imports of G&S (US$, in percent)	2023 ECF/EFF	7.1	3.6	1.5	3.1
	2022 AIV/SMP	9.9	6.3	5.1	3.2
Primary balance (percent of GDP)	**2023 ECF/EFF**	**-3.3**	**-2.2**	**-1.2**	**1.4**
	2022 AIV/SMP	-3.4	-2.5	-1.1	0.8
Government revenues (excluding grants, percent of GDP)	2023 ECF/EFF	14.1	15.3	15.1	15.7
	2022 AIV/SMP	13.1	13.3	13.8	14.6

Source: PNG authorities; IMF staff estimates and projections.

8. **The medium-term baseline macroeconomic forecast is broadly unchanged from the 2022 DSA** (Text Table 3). At around 3 percent, the long-term potential real growth estimate remains little changed from the 2022 DSA.[5] Owing largely to imported inflation from global markets, inflation is projected to remain elevated in the medium term before falling to an annual average of 4.5 percent. As strong global demand for PNG's export goods is expected to persist over the medium-term, the current account surplus is forecast to remain very large at around 24 percent of GDP, in the medium-term.

9. **The medium-term baseline also assumes rapid progress on fiscal consolidation, as envisaged by the authorities.** This is appropriate to strengthen debt sustainability and build a fiscal buffer. While continued primary deficits are anticipated in the short-term (Text Table 3 and Text Table 4), the projection builds in a significant amount of fiscal consolidation and primary surpluses in the second half of the projection period, consistent with the authorities' plans to meet the requirements of the Fiscal

[5] Expected new resource projects are not included in the (authorities' or staff's) baseline, explaining the low resource sector growth in the medium-term. Higher growth in the resource sector due to new projects is therefore a major upside risk to the baseline projection.

Responsibility Act, which specifies government debt should be maintained at no more than 40 percent of GDP over the long term. In the near-term, tax revenue is expected to increase following the Non-Tax Revenue Act (NTRA), which is expected to result in higher dividends from state-owned enterprises (SOEs) in the resource sector. Immediate revenue reform priorities include implementation of the Tax Administration Act (TAA) and introducing amendments to the Income Tax Act (ACT). From 2026 onward, the authorities also project a sharp increase in tax revenues from the PNG LNG project as tax exemptions expire. Further, the authorities see scope for significantly higher dividends after loan amortization for the project is completed but this is not yet included in the baseline in full. Achieving a balanced budget by 2027 would lower the risks from significant debt service obligations on external borrowing coming due in 2028.

Text Table 4. Papua New Guinea: Summary of Fiscal Operations, 2022-2024

	2022	2023	2024
Revenue and grants (percent of GDP)	**15.8**	**17.1**	**16.6**
Taxes	12.6	13.0	13.3
Grants	1.7	1.8	1.5
Other revenue	1.6	2.3	1.9
Expenditure (percent of GDP)	**21.2**	**21.4**	**20.5**
Expense	16.8	17.4	16.8
Compensation of employees	5.8	6.0	5.6
Use of goods and services	6.1	6.0	5.6
Interest	2.1	2.2	2.7
Other	2.8	3.2	2.9
Net acquisition of nonfinancial assets	4.4	4.0	3.7
	0.0	0.0	0.0
Gross operating balance	1.1	1.8	2.5
Net lending (+)/borrowing (-)	-5.4	-4.3	-3.9
Primary balance (percent of GDP)	**-3.3**	**-2.2**	**-1.2**

Source: PNG authorities; IMF staff estimates and projections.

10. **The main downside risks to the baseline projection include: natural disasters, lower global growth, and social or political instability.** PNG is vulnerable to natural disasters (flooding, landslides and earthquakes) as well as the impact of climate change (through droughts and sea level rises). Lower global growth would likely impact PNG through lower commodity prices, with adverse consequences for the balance of payments and budget through lower resource revenue. Although the 2022 general elections were accompanied by several violent disruptions, political and social risks appear to have fallen since then. With limited sources of financing available in an adverse scenario, and continued pressing social and development needs, the room for significant policy adjustment is relatively limited. Engagement with the IMF through the proposed ECF/EFF program provides an important anchor for the authorities to advance their reform agenda. If growth deteriorated significantly compared to the projections, further debt buildup may be needed to finance the budget and maintain government services. Upside risks also exist and

include higher-than-expected commodity prices, or start of any of several major projects, including Papua LNG, P'nyang LNG or the Wafi Golpu mining, which are not yet in the baseline scenario.

11. The LIC DSA's realism tools indicate that the government's primary balance adjustment is moderately ambitious. At about 3.0 precent, the three-year cumulative adjustment the primary balance is within the top 17 percent of historical experiences, relative to peers. Much of this adjustment has already taken place during 2022 (Figure 4). Similarly, one-off factors also explain the divergence of GDP growth from the implied path consistent with the range fiscal multipliers. A low base, unwinding of Covid-19 and high commodity prices support activity while the Porgera gold mine is expected to reopen in late 2023, further contributing to strong growth in the resource sector.

12. Financing mix: For domestic financing, the DSA assumes that the composition of T-bills and T-bonds remains unchanged compared to the past six years. For the near-term, the DSA considers all existing commitments. Although the profile of domestic debt, with a high concentration in short-term Treasury bills, raises concerns over rollover risks, short-term liquidity risks and reliance on domestic financing fall throughout the projection horizon because the level of newly issued debt falls markedly as fiscal deficits are replaced by surpluses, particularly after 2027. While the trend in the projection period remains constant, continued development of the domestic debt market is necessary to increase liquidity and transition towards greater reliance upon domestic financing sources, while shifting to longer maturities.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TEST

13. PNG's debt carrying capacity is assessed as weak. According to the October 2022 World Economic Outlook and the 2021 Country Policy and Institutional Assessment (CPIA), PNG's Composite Indicator (CI) is 2.58, indicating weak debt-carrying capacity (Text Table 5).[6] Hence, the applicable thresholds are 30 percent for the present value (PV) of external debt-to-GDP ratio; 140 percent for the PV of the external debt-to-exports ratio; 10 percent for the external debt service-to-exports ratio; 14 percent for the external debt service-to-revenue ratio; and 35 percent for the PV of public debt-to GDP ratio, respectively.

14. Scenario stress tests: As indicated in the section on public debt coverage, a contingent liabilities stress test is included to account for SOE debt not captured in official public debt data.[7] Further, given the size and importance of PNG's resource sector (with a share of commodities in total exports of goods and services of 96 percent), a commodity price shock is included in the DSA. Considering the high price volatility over the past few years, the fuel price shock is set at 35 percent (compared to the default shock of 27 percent), and the shock to non-fuel commodity prices is set to 21 percent—with 20 percent for base

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[6] At 2.58 PNG's CI is close to the weak/medium threshold of 2.69.

[7] During the 2021 SMP, the authorities initiated an SOE reform program to reduce the backlog of audited annual financial statements and to strengthen SOE oversight and improve understanding of fiscal risks. This program includes a detailed review of SOE debt and government guarantees and is also expected to improve the reporting of public debt.

metals and precious metals, and 22 percent for agricultural commodities other than grain (price shocks to grain like wheat, corn, and soybeans, are not relevant for PNG and, therefore, not included in the stress test). Mitigating factors are included as well, and at default values (2 percent for fuel, and 27 percent for non-fuel). PNG's single outstanding Eurobond (maturing in 2028) activates the market financing module.

Text Table 5. Papua New Guinea: Composite Indicator and Applicable Thresholds

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	2.851	1.10	42%
Real growth rate (in percent)	2.719	2.324	0.06	2%
Import coverage of reserves (in percent)	4.052	52.722	2.14	83%
Import coverage of reserves^2 (in percent)	-3.990	27.796	-1.11	-43%
Remittances (in percent)	2.022	0.149	0.00	0%
World economic growth (in percent)	13.520	2.898	0.39	15%
CI Score			2.58	100%
CI rating			Weak	

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintage
Weak	Weak 2.58	Weak 2.62	Weak 2.63

Applicable thresholds

APPLICABLE	
EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	140
GDP	30
Debt service in % of	
Exports	10
Revenue	14

APPLICABLE	
TOTAL public debt benchmark	
PV of total public debt in percent of GDP	35

DEBT SUSTAINABILITY

A. External Debt Sustainability Analysis

15. **Under the baseline scenario, the debt-service to revenue indicator is projected to breach its threshold.** A, relatively large, breach in 2028 arises due to the bullet payment for the US$500 million

Eurobond, which was issued in 2018. Marginal breaches arise in 2026 and 2027 as the debt-service-to-revenue ratio increases to 15, 1pp above the threshold value. Both before and after 2028 the indicator remains close to the threshold, which is falling by 2032. In the baseline scenario, the present value of the debt-to-GDP ratio as well as the debt-to-exports and debt service-to-export ratios remain below their respective thresholds over the entire projection horizon. The solvency indicators are on a downwards trend in the latter half of the projection.

16. Stress tests point to vulnerabilities in PNG's external debt dynamics particularly with respect to exports shocks, which would cause threshold breaches for all four external sustainability indicators. Changes in policy and the structure of the economy manifests in a divergence between the historical scenario and the baseline. The historical scenario reflects large current account deficits associated with the construction phase of PNG LNG and is not considered an appropriate indicator for future risks. The market financing risk module indicates a high risk of heightened liquidity pressures primarily due to an elevated EMBI spread. However, a heightened market stress event would not have a substantial impact of debt burden indicators as few future external debt disbursements are projected on commercial terms (Figure 5). PNG's elevated sovereign spreads likely reflect the perceived risks due to the country's characteristics (small and undiversified export base, small revenue base, vulnerability to shocks).

17. As in the past, the assessment of debt dynamics is hampered by large residuals from external financial flows from money transfer by resource companies via offshore accounts (Table 1 and Figure 3). The published data on the current account surplus in PNG is likely overstated due to long-standing challenges in classifying large income account outflows, including external debt service payments related to resource projects, under the financial account rather than the current account. This over-estimation of the current account manifests as large positive residuals from external financial flows which persist into the projection period as a consistent accounting framework is used. The authorities have received technical assistance from the IMF to help resolve these issues and plan to publish the balance of payments in BPM6 format.

B. Public Sector Debt Sustainability Analysis

18. Public debt PV ratios have increased substantially in recent years and are currently expected to fall to 43 percent of GDP for 2022. Starting from this level means that the public debt sustainability indicator is in breach of the threshold for countries with weak debt-carrying capacity (that is, 35 percent of GDP) during the first half of the projection horizon. Under the baseline scenario, the public debt to GDP ratio peaks at 47 percent of GDP in 2025, before falling in the second half of the projection. This downward trend in the public debt-to-GDP ratio arises through stronger real GDP growth and a smaller fiscal deficit than over the past 5 years, as growth headwinds wane and gradual fiscal consolidation continues (Figure 3). The profile of domestic debt, with a high concentration in short-term Treasury bills, raises concerns over rollover risks. Diversifying the issuance structure by issuing longer term Treasury bonds would lower these risks, make debt service costs more predictable and help with financial deepening effort (Figure 2). In addition, the fall in the level of short-term debt, from a peak of 15.1bn Kina in 2024 to 11.1bn Kina in 2028, is a mitigating factor of for liquidity risks. The substantial residuals from unidentified debt creating flows, arising largely in 2019, are not anticipated to be repeated (Figure 3) as the government has taken several steps to improve recording and reporting of debt.[8]

19. Stress tests point to several vulnerabilities for public debt (Figure 2 and Table 4). As for external debt, the most extreme shock impacting the PV of public debt is a shock to exports. In this scenario the PV of public debt-to- GDP ratio increases to a peak of 72 percent of GDP by 2025, more than double the 35 percent threshold value and substantially above the starting level of 43 percent of GDP in 2022. The tailored stress test for the combined contingent liability shock causes a deterioration in public debt sustainability which is felt most acutely through the total public debt service-to-revenue measure. This analysis suggests contingent liabilities represent an important source of vulnerabilities in PNG. The trajectory of the PV of the public debt-to-revenue ratio is impacted most by the commodity price shock, reflecting the strong reliance upon commodity exports within PNG.

RISK RATING AND VULNERABILITIES

20. PNG remains at "high" risk of external and overall debt distress. The (mechanical) external debt distress rating as well as the overall debt distress rating are "high", owing to the multiple breaches of sustainability thresholds under the baseline scenario, as discussed in the previous section. No staff judgement has been applied to these ratings.

21. Debt service on existing loans, paired with relatively weak revenue generation, are expected to almost double the debt service-to-revenue ratio by 2025. However, as debt service reduces and revenues increase, and barring further shocks to demand growth, the indicator enters a significant downward trend from this peak.

22. Stress tests show that adverse shocks to exports, commodity prices and contingent liabilities constitute the main risks to public debt sustainability. Further, the historical scenario indicates that it will be challenging to reduce debt from current levels and that reforms, including those already implemented during the recent SMPs, are essential for supporting the sustainability of public finances. Market financing risks continue to be relevant, with the EMBI spread and the GFN thresholds breached, pointing to high market financing pressures.

23. Debt dynamics are assessed as sustainable. Public debt is expected not to increase in the near-term and to enter a clear downward path over the medium-term. Also, the projected temporary breaches of sustainability indicators can be prevented by debt management operations as well as by boosting revenue generation. external debt-to-GDP and debt-to-exports ratios are below their thresholds over the entire projection horizon. Public external and overall debt is judged to be sustainable conditional on the implementation of the authorities plans for further fiscal consolidation and conservative financing strategies. This baseline sustainability assessment also relies upon higher future resource revenue as tax exemptions expire from 2026 onwards.

[8] This includes the state guarantee policy initiated during the 2021 SMP.

AUTHORITIES' VIEWS

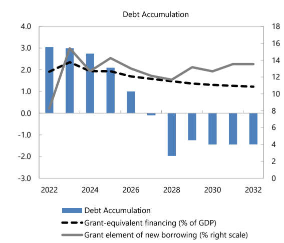
24. The authorities noted the Staff's assessment that PNG remains at high risk of debt distress but remains sustainable under the baseline projection. They also noted that addressing public debt including arrears, which had been increasing prior to the pandemic, rising from K8 billion in 2012 to K34 billion in 2019 is a significant priority. Unfortunately, the COVID-19 pandemic significantly impacted domestic revenues and led to a large financing requirement. This was met in part through support under the IMF's Rapid Credit Facility. The redemption of the US$ 500 million sovereign bond in 2028, issued in 2018, is a key risk. However, the authorities were more optimistic about their debt-carrying capacity and perceived a lower risk of debt distress noting that since COVID-19, PNG has already undertaken major fiscal consolidation, reducing the budget deficit from 8.9 percent of GDP in 2020 to an expected 4.3 percent of GDP in 2023. A 13-year fiscal reform plan has been put in place to reduce budget deficits and public debt ratios, with a target of a budget surplus by 2027. Balancing this, the authorities seek to direct resources to addressing gaps in the delivery of critical social services, closing the infrastructure deficit, enhancing financial development and inclusion and strengthening the business climate to encourage investment and growth. The authorities also pointed to increased revenues by 2027 as debt payments for the PNG LNG project are completed. They highlighted their strategy in recent years to substitute costly financing with concessional financing from multilateral and bilateral partners, which has improved PNG's debt profile and lowered average interest costs. The authorities noted the interest costs of domestic securities has also declined over the past two years and highlighted the importance of more favorable future contract negotiation and the medium-term revenue strategy as key to reducing risks in the medium term. No new resource projects have been built into the analysis even though there are prospects for Final Investment Decisions in late 2023 on major new projects, creating a potential upside to the fiscal projections. The authorities are committed to fiscal consolidation and conservative financing strategies to support the sustainability of PNG's debt going forward.

Table 1. Papua New Guinea: External Debt Sustainability Framework, Baseline Scenario, 2019-2042

(In percent of GDP, unless otherwise indicated)

	Actual			Projections																					Average 8/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	Historical	Projections
External debt (nominal) 1/	61.7	69.0	67.8	60.4	62.1	64.3	66.7	64.3	61.2	56.4	52.4	48.5	44.9	41.5	38.5	35.8	33.4	31.5	29.8	28.3	26.8	25.4	23.5	21.8	77.5	56.6
of which: public and publicly guaranteed (PPG)	17.1	21.8	24.8	23.4	25.7	28.0	30.0	29.1	27.0	23.3	20.4	17.5	14.9	12.4	10.3	8.5	7.0	5.9	5.0	4.2	3.5	2.9	2.3	1.9	11.5	22.9
Change in external debt	-5.4	7.3	-1.2	-7.4	1.7	2.3	2.3	-2.3	-3.2	-4.8	-3.9	-3.9	-3.6	-3.4	-3.0	-2.7	-2.3	-1.9	-1.7	-1.6	-1.5	-1.4	-1.9	-1.7		
Identified net debt-creating flows	-21.6	-17.7	-28.5	-37.1	-25.2	-25.5	-26.7	-25.3	-25.4	-26.2	-24.0	-23.1	-22.3	-21.4	-20.7	-19.9	-19.2	-18.5	-17.8	-17.2	-16.6	-16.0	-15.5	-14.9	-13.5	-25.7
Non-interest current account deficit	-22.1	-21.5	-22.8	-35.3	-23.4	-23.0	-24.9	-23.4	-24.9	-24.6	-23.6	-22.8	-22.0	-21.2	-20.4	-19.7	-19.0	-18.3	-17.7	-17.1	-16.5	-15.9	-15.4	-14.8	-13.3	-24.5
Deficit in balance of goods and services	-24.4	-20.1	-24.4	-36.0	-28.9	-29.4	-29.7	-28.6	-27.5	-26.5	-25.6	-24.7	-23.9	-23.1	-22.3	-21.5	-20.8	-20.1	-19.4	-18.7	-18.1	-17.5	-16.9	-16.3	-13.5	-27.6
Exports	47.5	38.8	39.5	49.6	42.4	42.9	43.5	41.9	40.4	39.1	37.9	36.7	35.5	34.4	33.3	32.2	31.2	30.2	29.3	28.4	27.5	26.7	25.9	25.1		
Imports	23.0	18.6	15.1	13.6	13.6	13.5	13.7	13.3	13.0	12.6	12.2	11.9	11.6	11.3	11.0	10.7	10.4	10.2	9.9	9.7	9.4	9.2	9.0	8.8		
Net current transfers (negative = inflow)	-0.3	-1.3	-1.1	-1.3	-1.2	-1.2	-1.2	-1.1	-1.1	-1.0	-0.9	-0.9	-0.8	-0.8	-0.7	-0.7	-0.6	-0.6	-0.6	-0.5	-0.5	-0.5	-0.4	-0.4	-0.9	-1.1
of which: official	-1.4	-1.3	-1.2	-1.4	-1.3	-1.3	-1.3	-1.2	-1.2	-1.1	-1.0	-1.0	-0.9	-0.9	-0.8	-0.8	-0.7	-0.7	-0.6	-0.6	-0.6	-0.5	-0.5	-0.5		
Other current account flows (negative = net inflow)	2.6	-0.1	2.7	2.0	6.7	7.6	6.0	6.3	3.6	3.0	2.9	2.8	2.8	2.7	2.6	2.5	2.5	2.4	2.3	2.2	2.1	2.0	2.0	1.9	1.0	4.2
Net FDI (negative = inflow)	0.1	-0.3	0.1	-0.4	-0.8	-0.9	-0.9	-0.8	-0.8	-1.9	-0.7	-0.6	-0.6	-0.6	-0.5	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3	-0.3	0.6	-0.8
Endogenous debt dynamics 2/	0.4	4.2	-5.9	-1.4	-1.0	-1.6	-0.9	-1.0	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2		
Contribution from nominal interest rate	2.1	1.8	1.5	1.2	1.1	1.1	1.0	0.9	2.1	2.1	1.9	1.8	1.7	1.6	1.5	1.4	1.3	1.2	1.2	1.1	1.1	1.0	0.9	0.9		
Contribution from real GDP growth	-2.9	2.0	0.0	-2.6	-2.2	-2.7	-2.0	-2.0	-1.8	-1.8	-1.6	-1.5	-1.4	-1.3	-1.2	-1.1	-1.0	-1.0	-0.9	-0.9	-0.8	-0.8	-0.7	-0.7		
Contribution from price and exchange rate changes	1.2	0.3	-7.3	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...		
Residual 3/	16.2	25.0	27.4	29.7	26.9	27.7	29.0	22.9	22.2	21.4	20.1	19.3	18.6	18.0	17.6	17.2	16.8	16.6	16.1	15.6	15.2	14.7	13.6	13.2	12.4	23.3
of which: exceptional financing	0.0	-1.6	0.0	0.0	-0.5	-0.8	-0.9	-0.3	0.1	0.1	0.1	0.1	0.3	0.2	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators																										
PV of PPG external debt-to-GDP ratio	...	...	18.9	18.5	20.7	23.0	24.9	24.3	22.8	19.6	17.2	14.8	12.6	10.5	8.6	7.1	5.8	4.8	4.1	3.4	2.8	2.2	1.7	1.3		
PV of PPG external debt-to-exports ratio	...	...	47.8	37.3	48.8	53.6	57.2	58.1	56.3	50.0	45.5	40.5	35.5	30.5	26.0	21.9	18.5	16.0	13.8	11.8	10.0	8.3	6.7	5.3		
PPG debt service-to-exports ratio	1.1	5.3	4.4	2.0	2.9	3.9	4.9	5.7	5.8	9.1	5.9	6.0	5.9	5.7	5.2	4.6	3.9	2.9	2.4	2.2	2.0	1.9	1.8	1.5		
PPG debt service-to-revenue ratio	3.8	15.8	13.5	7.1	8.0	11.0	13.7	15.1	14.7	21.8	13.2	12.5	11.4	10.8	9.5	8.2	6.8	4.9	4.0	3.6	3.2	2.9	2.6	2.1		
Gross external financing need (Million of U.S. dollars)	-2737.0	-3082.4	-3748.0	-9171.2	-5506.1	-5702.2	-6211.5	-6928.2	-6891.6	-7284.0	-7484.4	-7746.9	-8013.0	-8304.2	-8551.4	-8919.8	-9321.6	-9807.5	-10190.9	-10536.3	-10885.3	-11247.8	-11629.4	-12055.5		
Key macroeconomic assumptions																										
Real GDP growth (in percent)	4.5	-3.2	0.1	4.5	3.7	4.4	3.1	3.1	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.9	3.4
GDP deflator in US dollar terms (change in percent)	-1.7	-0.5	11.9	13.5	0.0	-2.2	-2.1	3.0	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	0.6	2.9
Effective interest rate (percent) 4/	3.3	2.9	2.4	2.1	1.9	1.8	1.6	1.5	3.5	3.6	3.5	3.6	3.6	3.7	3.7	3.8	3.9	3.9	3.9	3.9	4.0	4.0	3.9	3.9	2.7	2.8
Growth of exports of G&S (US dollar terms, in percent)	16.6	-21.3	14.2	48.9	-11.2	3.1	2.3	2.5	2.6	2.9	2.9	3.0	3.0	3.0	3.0	3.0	3.1	3.1	3.1	3.1	3.1	3.2	3.2	3.2	5.4	5.7
Growth of imports of G&S (US dollar terms, in percent)	42.9	-22.2	-9.3	7.1	3.6	1.5	2.6	3.2	3.3	3.4	3.4	3.5	3.5	3.6	3.6	3.6	3.7	3.7	3.8	3.8	3.8	3.9	3.9	3.9	-4.6	3.5
Grant element of new public sector borrowing (in percent)	...	...	...	8.2	15.4	12.7	14.2	13.0	12.1	11.7	13.2	12.7	13.5	13.5	13.5	13.5	13.5	13.5	13.5	13.5	13.5	13.5	13.5	13.5	...	12.8
Government revenues (excluding grants, in percent of GDP)	14.2	12.9	12.7	14.1	15.3	15.1	15.6	15.7	15.9	16.4	17.0	17.6	18.2	18.1	18.1	18.0	18.0	17.9	17.8	17.8	17.7	17.6	17.6	17.5	15.7	16.3
Aid flows (in Million of US dollars) 5/	1258.7	1736.2	1419.8	544.1	824.6	576.9	552.6	543.9	603.7	590.6	586.0	601.1	619.4	638.2	657.6	677.6	697.0	717.6	739.1	761.5	784.6	808.5	833.2	858.6		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	1.9	2.3	1.9	1.9	1.7	1.6	1.5	1.4	1.3	1.3	1.2	1.2	1.1	1.1	1.1	1.0	1.0	1.0	0.9	0.9	0.9	...	1.6
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	40.5	42.2	36.7	38.6	44.1	59.2	69.4	89.9	98.0	98.3	98.4	98.4	98.5	99.3	99.6	99.8	99.9	100.0	100.0	100.0	100.0	...	65.0
Nominal GDP (Million of US dollars)	24,751	23,848	26,706	31,689	32,861	33,543	33,859	35,973	38,267	40,706	43,301	46,062	48,998	52,122	55,445	58,980	62,740	66,740	70,995	75,521	80,335	85,457	90,905	96,701		
Nominal dollar GDP growth	2.7	-3.6	12.0	18.7	3.7	2.1	0.9	6.2	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	4.3	6.4
Memorandum items:																										
PV of external debt 7/	...	...	61.9	55.4	57.1	59.3	61.6	59.6	56.9	52.6	49.3	45.9	42.6	39.6	36.8	34.4	32.2	30.5	28.9	27.4	26.1	24.8	23.0	21.3		
In percent of exports	...	...	156.6	111.8	134.4	138.4	141.6	142.1	140.7	134.5	130.1	125.1	120.2	115.3	110.8	106.7	103.3	100.8	98.6	96.6	94.7	92.8	88.6	84.7		
Total external debt service-to-exports ratio	23.1	23.0	21.8	13.7	17.5	16.0	17.1	11.8	19.0	22.0	18.5	18.0	17.5	16.8	16.5	15.6	14.7	13.4	12.7	12.3	12.0	11.6	11.2	10.6		
PV of PPG external debt (in Million of US dollars)			5045.1	5859.8	6809.2	7712.2	8415.6	8755.4	8719.4	7964.9	7456.5	6830.3	6165.1	5459.3	4786.9	4166.9	3618.8	3221.7	2877.3	2542.0	2216.5	1890.5	1571.3	1291.7		
(PVt-PVt-1)/GDPt-1 (in percent)				3.1	3.0	2.7	2.1	1.0	-0.1	-2.0	-1.2	-1.4	-1.4	-1.4	-1.3	-1.1	-0.9	-0.6	-0.5	-0.5	-0.4	-0.4	-0.4	-0.3		
Non-interest current account deficit that stabilizes debt ratio	-16.7	-28.8	-21.6	-27.9	-25.1	-25.3	-27.2	-21.1	-21.8	-19.8	-19.7	-18.9	-18.3	-17.8	-17.4	-17.0	-16.6	-16.4	-16.0	-15.5	-15.0	-14.6	-13.5	-13.1		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	No



Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g) + Ɛα (1+r)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ɛ=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

3/ 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.

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

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

6/ 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).

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

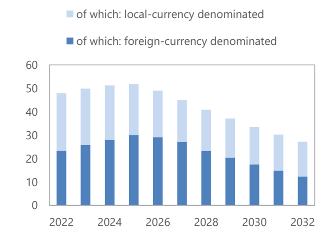
8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

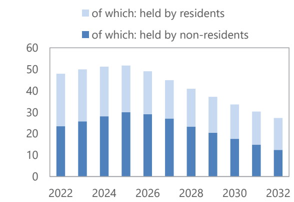
Table 2. Papua New Guinea: Public Sector Debt Sustainability Framework, Baseline Scenario, 2019-2042
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2032	2042	Historical	Projections
Public sector debt 1/	**40.6**	**48.7**	**52.1**	**47.9**	**49.9**	**51.2**	**51.8**	**49.1**	**44.9**	**27.3**	**7.7**	**33.9**	**42.2**
of which: external debt	**17.1**	**21.8**	**24.8**	**23.4**	**25.7**	**28.0**	**30.0**	**29.1**	**27.0**	**12.4**	**1.9**	**11.5**	**22.9**
Change in public sector debt	8.2	8.1	3.5	-4.2	2.0	1.3	0.5	-2.7	-4.1	-3.0	-1.3		
Identified debt-creating flows	**0.5**	**8.2**	**0.0**	**-2.8**	**1.0**	**-0.4**	**-1.1**	**-2.4**	**-3.5**	**-2.6**	**-1.3**	**2.2**	**-2.2**
Primary deficit	**1.9**	**6.2**	**4.4**	**3.3**	**2.2**	**1.2**	**-0.3**	**-1.4**	**-2.6**	**-2.1**	**-1.2**	**2.9**	**-0.8**
Revenue and grants	16.3	14.7	15.0	15.8	17.1	16.6	17.0	17.1	17.3	19.4	18.4	**17.7**	**17.7**
of which: grants	2.1	1.7	2.3	1.7	1.8	1.5	1.4	1.4	1.4	1.2	0.9		
Primary (noninterest) expenditure	18.2	20.9	19.4	19.1	19.2	17.8	16.7	15.7	14.7	17.2	17.2	**20.6**	**16.9**
Automatic debt dynamics	**-1.4**	**2.0**	**-4.4**	**-6.1**	**-1.2**	**-1.6**	**-0.8**	**-1.0**	**-0.9**	**-0.4**	**-0.1**		
Contribution from interest rate/growth differential	-1.6	1.5	-2.9	-6.1	-1.2	-1.6	-0.8	-1.0	-0.9	-0.4	-0.1		
of which: contribution from average real interest rate	-0.2	0.2	-2.9	-3.8	0.5	0.5	0.7	0.5	0.5	0.5	0.2		
of which: contribution from real GDP growth	-1.4	1.3	0.0	-2.3	-1.7	-2.1	-1.5	-1.6	-1.5	-0.9	-0.3		
Contribution from real exchange rate depreciation	0.2	0.5	-1.5	...	...	...	...	...	...	...	...		
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**	**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 contingent liabilities (e.g., bank recapitalization)	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 debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	**7.7**	**-0.1**	**3.5**	**-1.5**	**1.1**	**1.7**	**1.7**	**-0.3**	**-0.6**	**-0.5**	**-0.1**	**2.5**	**-0.1**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	**...**	**...**	**46.5**	**43.3**	**45.2**	**46.5**	**47.0**	**44.7**	**41.0**	**25.5**	**7.2**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**309.9**	**273.9**	**265.2**	**280.5**	**276.3**	**261.9**	**237.2**	**131.7**	**39.0**		
Debt service-to-revenue and grants ratio 3/	**72.0**	**114.4**	**110.4**	**86.7**	**85.1**	**88.8**	**86.7**	**80.0**	**70.3**	**39.5**	**5.4**		
Gross financing need 4/	13.6	23.0	20.9	17.0	16.7	16.0	14.4	12.2	9.6	5.5	-0.2		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	4.5	-3.2	0.1	4.5	3.7	4.4	3.1	3.1	3.0	3.0	3.0	**3.9**	**3.4**
Average nominal interest rate on external debt (in percent)	0.6	2.8	2.3	2.1	2.4	2.5	2.7	2.8	2.9	2.9	3.0	**0.9**	**2.7**
Average real interest rate on domestic debt (in percent)	-0.3	-0.4	-9.2	-11.2	2.7	2.0	2.4	1.4	1.3	2.1	2.6	**2.7**	**0.7**
Real exchange rate depreciation (in percent, + indicates depreciation)	1.9	2.5	-6.9	...	...	...	...	...	...	...	...	**3.1**	**...**
Inflation rate (GDP deflator, in percent)	1.1	1.6	11.9	14.0	0.6	1.8	2.0	3.0	3.2	3.2	3.2	**4.2**	**3.7**
Growth of real primary spending (deflated by GDP deflator, in percent)	5.8	11.1	-7.3	3.3	4.2	-3.1	-3.4	-3.3	-3.1	3.0	3.0	**3.3**	**2.4**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-6.3	-1.9	0.9	7.6	0.1	-0.1	-0.8	1.3	1.6	0.9	0.1	**-2.4**	**1.4**
PV of contingent liabilities (not included in public sector debt)	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**No**

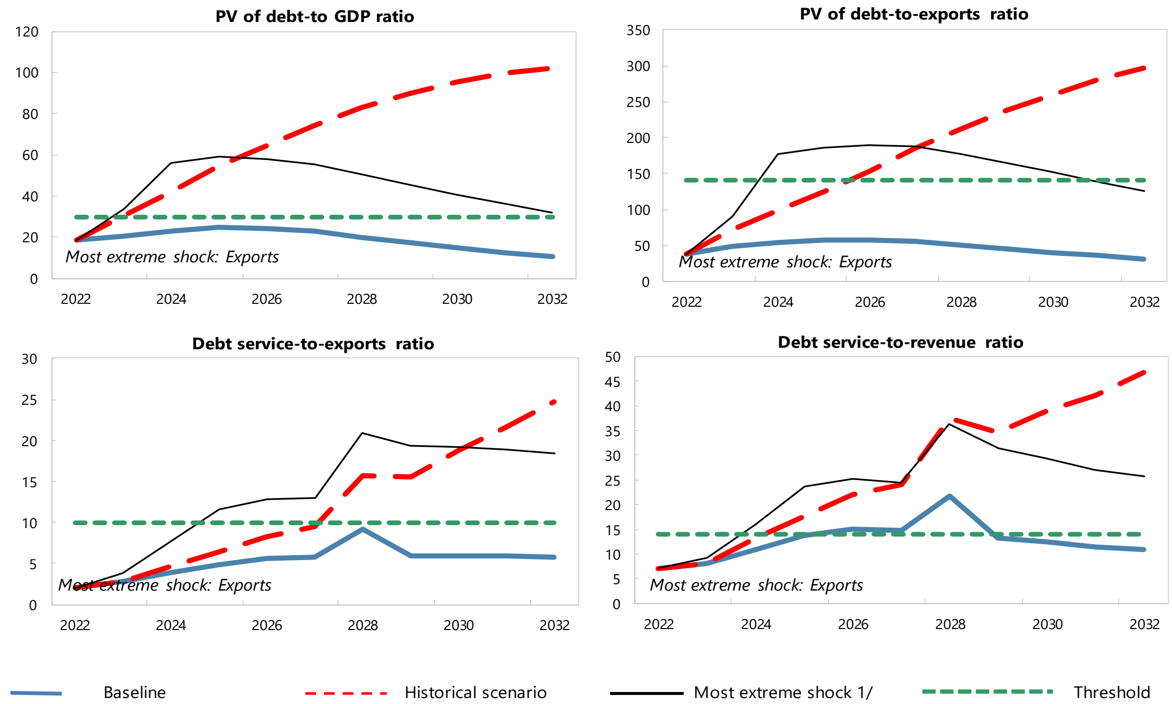
Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.
1/ Coverage of debt: The central, state, and local governments, government-guaranteed debt . Definition of external debt is Residency-based.
2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.
4/ 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 and other debt creating/reducing flows.
5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.
6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Figure 1. Papua New Guinea: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2022-2032



Customization of Default Settings		
	Size	Interactions
Tailored Stress		
Combined CL	Yes	
Natural disaster	n.a.	n.a.
Commodity price	Yes	No
Market financing	No	No

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

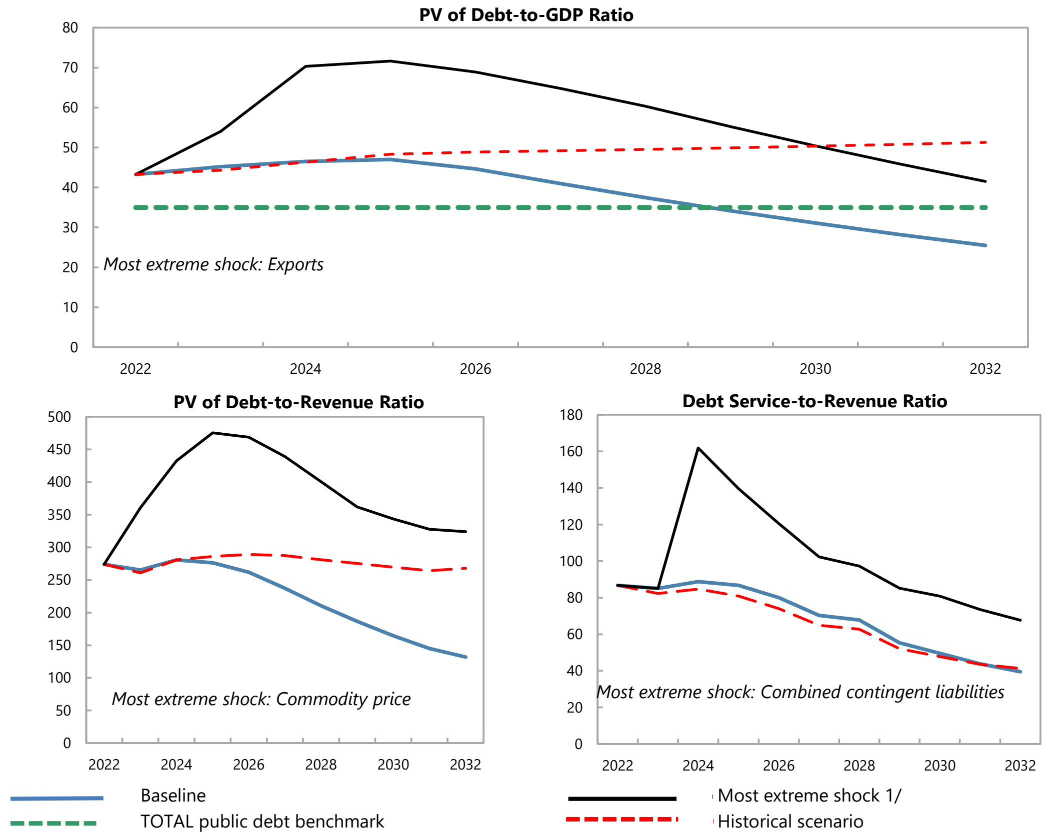
Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	3.5%	3.5%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	19	19
Avg. grace period	4	4

* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 2. Papua New Guinea: Indicators of Public Debt Under Alternative Scenarios, 2022-2032



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	12%	12%
Domestic medium and long-term	16%	16%
Domestic short-term	72%	72%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	3.5%	3.5%
Avg. maturity (incl. grace period)	19	19
Avg. grace period	4	4
Domestic MLT debt		
Avg. real interest rate on new borrowing	3.8%	3.8%
Avg. maturity (incl. grace period)	7	7
Avg. grace period	4	4
Domestic short-term debt		
Avg. real interest rate	1.5%	1.5%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Table 3. Papua New Guinea: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2022-2032

(In percent)

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
PV of debt-to GDP ratio											
Baseline	18	21	23	25	24	23	20	17	15	13	10
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	18	**31**	**42**	**54**	**64**	**75**	**83**	**90**	**95**	**99**	**102**
B. Bound Tests											
B1. Real GDP growth	18	22	27	29	28	26	23	20	17	15	12
B2. Primary balance	18	21	24	27	26	25	22	20	17	15	13
B3. Exports	18	**34**	**56**	**59**	**58**	**56**	**51**	**46**	**41**	**36**	**32**
B4. Other flows 3/	18	24	29	**31**	**31**	29	26	23	20	17	15
B5. Depreciation	18	26	**33**	**36**	**35**	**33**	29	25	22	19	16
B6. Combination of B1-B5	18	**31**	**40**	**43**	**42**	**40**	**36**	**32**	28	24	21
C. Tailored Tests											
C1. Combined contingent liabilities	18	23	26	29	29	28	25	23	21	19	17
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	18	28	**37**	**42**	**44**	**45**	**43**	**41**	**39**	**38**	**36**
C4. Market Financing	18	23	26	28	27	25	22	19	17	14	12
Threshold	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	37	49	54	57	58	56	50	45	40	35	30
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	37	72	98	125	**153**	**184**	**212**	**238**	**260**	**280**	**297**
B. Bound Tests											
B1. Real GDP growth	37	49	54	57	58	56	50	45	40	35	30
B2. Primary balance	37	50	57	61	63	62	56	52	47	43	38
B3. Exports	37	91	**178**	**185**	**189**	**188**	**176**	**164**	**151**	138	125
B4. Other flows 3/	37	56	68	72	73	72	65	60	54	48	43
B5. Depreciation	37	49	61	65	66	64	58	53	47	42	37
B6. Combination of B1-B5	37	73	79	105	107	106	97	89	81	73	65
C. Tailored Tests											
C1. Combined contingent liabilities	37	53	61	66	69	68	63	60	56	53	49
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	37	78	100	108	114	117	113	112	111	109	107
C4. Market Financing	37	49	54	57	58	56	50	45	40	35	30
Threshold	140	140	140	140	140	140	140	140	140	140	140
Debt service-to-exports ratio											
Baseline	2	3	4	5	6	6	9	6	6	6	6
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	2	3	5	6	8	9	**16**	**16**	**19**	**22**	**25**
B. Bound Tests											
B1. Real GDP growth	2	3	4	5	6	6	9	6	6	6	6
B2. Primary balance	2	3	4	5	6	6	9	6	7	6	6
B3. Exports	2	4	8	**12**	**13**	**13**	**21**	**19**	**19**	**19**	**18**
B4. Other flows 3/	2	3	4	5	6	6	**10**	7	8	7	7
B5. Depreciation	2	3	4	5	6	6	9	7	7	7	6
B6. Combination of B1-B5	2	3	6	7	8	9	**14**	**11**	**11**	**11**	**10**
C. Tailored Tests											
C1. Combined contingent liabilities	2	3	4	5	6	6	10	6	7	6	6
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	2	3	5	7	8	8	**13**	**11**	**12**	**12**	**12**
C4. Market Financing	2	3	4	5	6	6	9	6	6	6	6
Threshold	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	7	8	11	14	**15**	**15**	**22**	13	12	11	11
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	7	8	13	**18**	**22**	**24**	**37**	**35**	**39**	**42**	**47**
B. Bound Tests											
B1. Real GDP growth	7	9	13	**16**	**17**	**17**	**25**	**15**	**14**	13	13
B2. Primary balance	7	8	11	**14**	**16**	**15**	**23**	**14**	14	13	12
B3. Exports	7	9	**16**	**24**	**25**	**24**	**36**	**31**	**29**	**27**	**26**
B4. Other flows 3/	7	8	12	**15**	**17**	**16**	**24**	**17**	**16**	**14**	14
B5. Depreciation	7	10	14	**18**	**20**	**20**	**28**	**19**	**18**	**16**	**15**
B6. Combination of B1-B5	7	9	**15**	**20**	**21**	**20**	**32**	**23**	**21**	**20**	**19**
C. Tailored Tests											
C1. Combined contingent liabilities	7	8	11	**14**	**16**	**16**	**23**	**14**	14	13	12
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	7	10	**17**	**23**	**24**	**22**	**33**	**24**	**23**	**23**	**23**
C4. Market Financing	7	8	11	14	**15**	**15**	**22**	13	12	11	11
Threshold	14	14	14	14	14	14	14	14	14	14	14

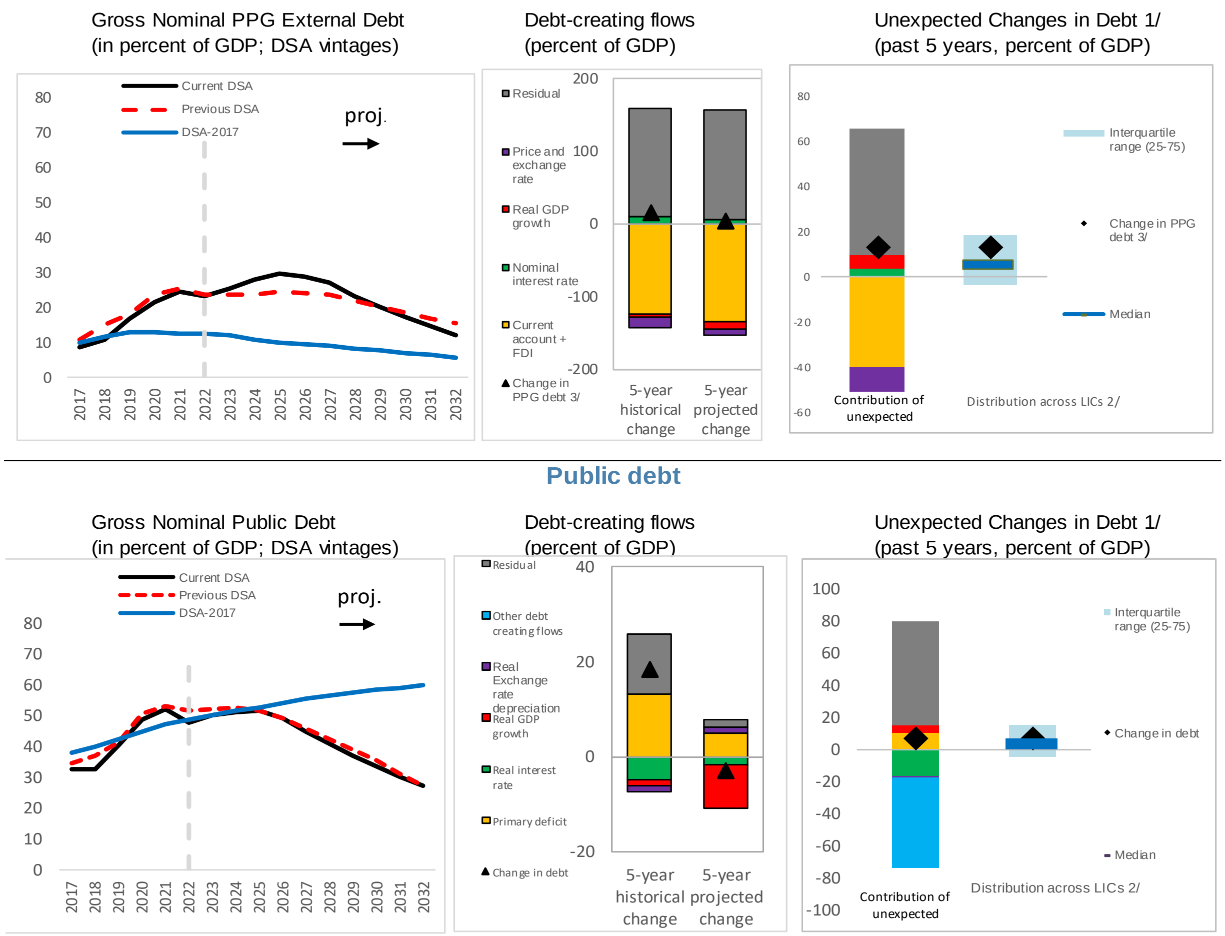
Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

Table 4. Papua New Guinea: Sensitivity Analysis for Key Indicators of Public Debt, 2022-2032

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
	PV of Debt-to-GDP Ratio										
Baseline	**43**	**45**	**47**	**47**	**45**	**41**	**37**	34	31	28	25
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	**43**	**44**	**46**	**48**	**49**	**49**	**50**	**50**	**50**	**51**	**51**
B. Bound Tests											
B1. Real GDP growth	**43**	**50**	**57**	**60**	**60**	**58**	**56**	**55**	**53**	**53**	**52**
B2. Primary balance	**43**	**48**	**54**	**54**	**52**	**48**	**44**	**41**	**38**	35	32
B3. Exports	**43**	**54**	**70**	**72**	**69**	**65**	**60**	**55**	**50**	**46**	**42**
B4. Other flows 3/	**43**	**48**	**53**	**54**	**51**	**47**	**44**	**40**	**36**	33	30
B5. Depreciation	**43**	**48**	**48**	**47**	**44**	**39**	35	31	27	23	19
B6. Combination of B1-B5	**43**	**46**	**51**	**52**	**50**	**47**	**44**	**41**	**38**	**35**	33
C. Tailored Tests											
C1. Combined contingent liabilities	**43**	**62**	**63**	**63**	**61**	**57**	**53**	**50**	**46**	**43**	**40**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**43**	**50**	**58**	**66**	**69**	**70**	**69**	**67**	**65**	**64**	**63**
C4. Market Financing	**43**	**45**	**47**	**47**	**45**	**41**	**37**	34	31	28	25
TOTAL public debt benchmark	35	35	35	35	35	35	35	35	35	35	35
	PV of Debt-to-Revenue Ratio										
Baseline	274	265	281	276	262	237	211	186	165	145	132
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	274	261	281	286	289	287	281	275	269	264	268
B. Bound Tests											
B1. Real GDP growth	274	289	340	349	345	330	311	294	280	268	266
B2. Primary balance	274	283	324	319	303	278	249	224	201	180	166
B3. Exports	274	317	424	421	404	375	339	301	267	236	215
B4. Other flows 3/	274	283	319	315	300	274	244	217	192	169	154
B5. Depreciation	274	282	290	280	259	229	197	169	143	119	101
B6. Combination of B1-B5	274	270	308	307	294	271	245	222	200	180	168
C. Tailored Tests											
C1. Combined contingent liabilities	274	363	378	371	355	328	298	270	245	222	208
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	274	361	432	475	468	439	400	362	343	328	324
C4. Market Financing	274	265	281	276	262	237	211	186	165	145	132
	Debt Service-to-Revenue Ratio										
Baseline	87	85	89	87	80	70	68	55	50	44	40
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	87	82	85	81	74	65	63	52	48	44	41
B. Bound Tests											
B1. Real GDP growth	87	91	106	113	112	106	107	97	94	92	93
B2. Primary balance	87	85	102	114	101	87	82	69	64	58	54
B3. Exports	87	85	91	92	85	75	76	67	61	54	49
B4. Other flows 3/	87	85	90	88	81	72	70	58	53	47	42
B5. Depreciation	87	80	86	84	79	70	70	55	49	43	39
B6. Combination of B1-B5	87	83	91	91	85	76	74	62	56	51	47
C. Tailored Tests											
C1. Combined contingent liabilities	87	85	162	140	121	102	97	85	81	74	68
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	87	107	116	118	126	118	113	95	88	84	84
C4. Market Financing	87	85	89	87	80	70	68	55	50	44	39

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

Figure 3. Papua New Guinea: Drivers of Debt Dynamics – Baseline Scenario

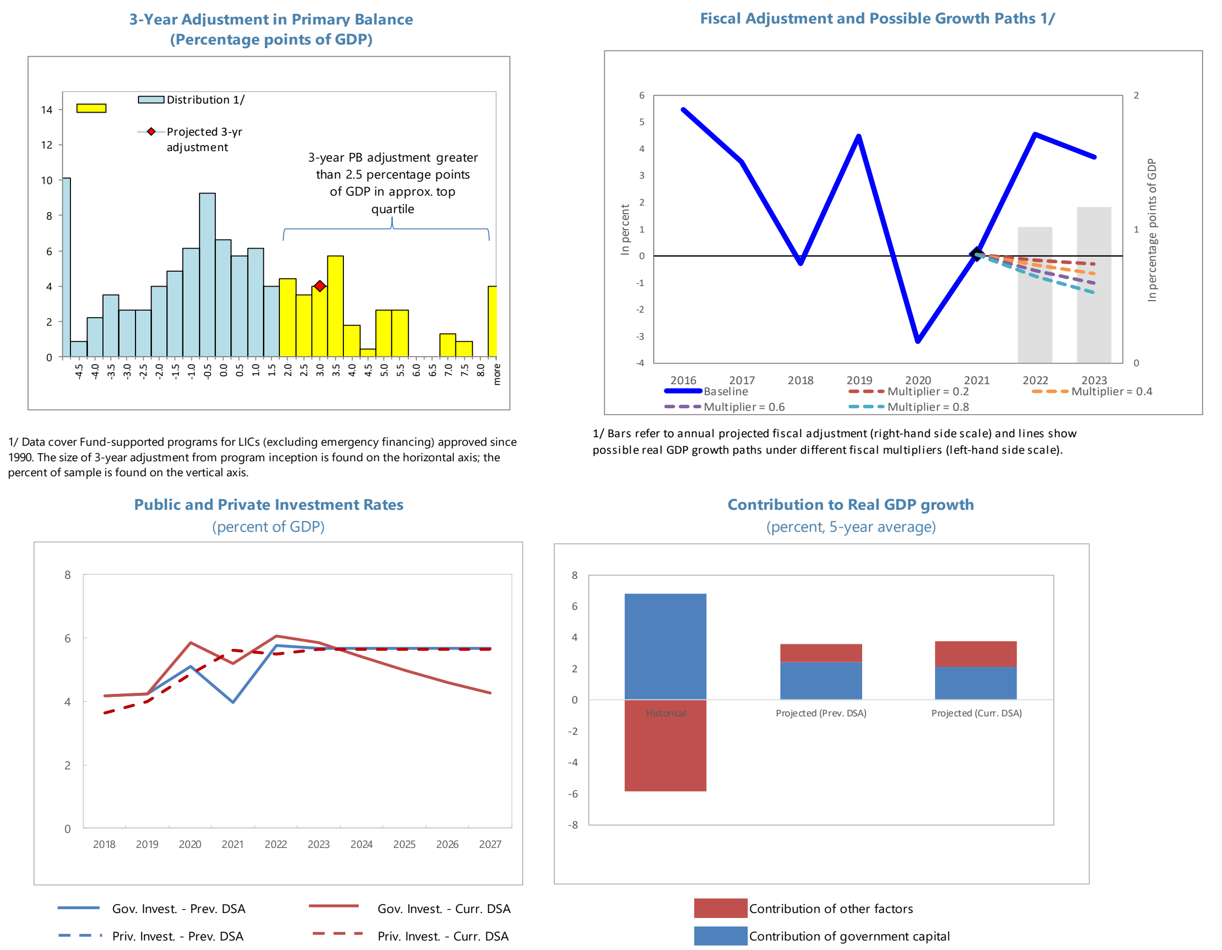


1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

Figure 4. Papua New Guinea: Realism Tools



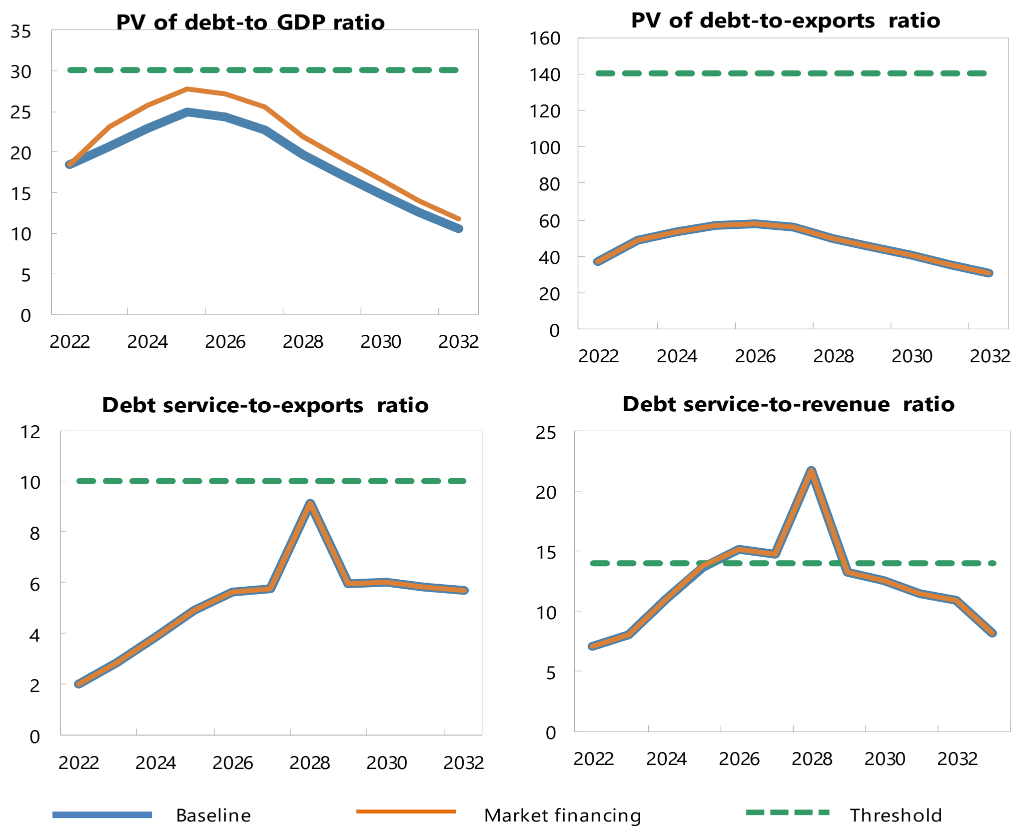
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Figure 5. Papua New Guinea: Market-Financing Risk Indicators

	GFN 1/	EMBI 2/
Benchmarks	14	570
Values	17	672
Breach of benchmark	Yes	Yes
Potential heightened liquidity needs	High	

1/ Maximum gross financing needs (GFN) over 3-year baseline projection horizon.
2/ EMBI spreads correspond to the latest available data.



Sources: Country authorities; and staff estimates and projections.

Statement by Robert Nicholl, Executive Director for Papua New Guinea and Rhoda Karl, Advisor to Executive Director
March 22, 2023

We convey our authorities' appreciation to the mission team for their close engagement since the completion of the Staff Monitored Programs (SMPs) and the guidance provided on the request for follow-up financial assistance under the Extended Credit Facility (ECF) and the Extended Fund Facility arrangement (EFF). A successful program (access under the ECF and EFF) will leave Papua New Guinea (PNG) in a much stronger position economically, fiscally, and through reduced debt exposure. Improvements in governance will also play an important role in supporting confidence from the community and external partners in the management of PNG. Together, the reforms to be undertaken will give our authorities more effective pathways to management of the economy, thereby promoting growth prospects while building resilience. Our authorities would like to extend their sincere gratitude to Mr. Saadi Sedik, the Mission Chief, and his team, for their outstanding work, commitment, and fruitful discussions.

Overview

PNG is the second largest island in the world, but much of the country is covered with rugged mountains and swamps. PNG is one of the most culturally diverse countries in the world, with over 800 different languages spoken amongst 9 million people. Most of the population live in rural and remote areas, where access to government services and the formal economy remains a challenge. Vulnerability to effects of climate change and frequently occurring natural disasters also present challenges.

Notwithstanding the significant progress under the SMPs, and in the Government's budget repair strategy, our authorities continue to face large development support and financing needs. Our authorities have engaged extensively with the Fund since the first SMP in 2019 and they have made significant strides towards achieving key reforms, even during the COVID outbreak. The second SMP was successfully completed in 2022. All the quantitative targets were met and all but one of the structural benchmarks were achieved. PNG's achievements in this regard represent a strengthened engagement not only with the IMF but other international partners/bodies. It highlights our authorities' commitment to transparency, good governance, and prudent macroeconomic management.

Economic Conditions

The PNG economy stabilized from the pandemic in 2021 and is on course to register strong growth in 2022, estimated at 4.5 percent. Growth will be driven by a strong recovery in the non-resource sector. Growth is expected to moderate to 3.7 percent in 2023 and converge to potential over the medium term, driven by higher private investment and the government's public investment program. Other areas of strength include: empowering and investing in Small-Medium Enterprises; improving connectivity/access to markets; reducing public sector arrears; and undertaking structural reforms to improve efficiency in State Owned Enterprises.

Inflation had accelerated to 6.6 percent in 2022 due to global price shocks caused by supply disruptions from the pandemic and the war in Ukraine and is expected to moderate to 5.4 percent in 2023. Our authorities used both fiscal and monetary policy instruments to cushion the cost-of-living impact and anchor inflation expectations. Fixed term budget measures in the form of general subsidies on fuel, staple foods, and hygiene, together with personal income tax relief and expanded school tuition fee subsidies to reach rural areas formed the mainstay of the fiscal response. These policies were funded by windfall revenue from high commodity prices. A phased removal of support measures has commenced with the reintroduction of the goods and services tax (GST) on fuel in the beginning of this year, and the reintroduction of the excise planned for June. Monetary policy was also tightened but excess liquidity in the system has weighed on the effectiveness of its transmission.

The risks to the outlook for PNG are tilted to the downside. The downside risks include weaker external demand for PNG's exports, the impact of tighter global financial conditions, a delay in the resumption of Porgera mine operations, and climate-related natural disasters. However, there are also notable upside risks over the medium term that our authorities did not include in their baseline fiscal estimates. This relates to the potential for significantly larger LNG revenues once amortization and depreciation expenses are completed; and the commencement of new extractive projects (Papua LNG, P'nyang LNG, and the Wafi Golpu mining project), each of which will have an appreciable positive impact on growth through investment and exports and increased fiscal revenues.

The Blended ECF/EFF Financing Program

The financing program builds on the policy objectives of the last SMP, that is to: progress further reforms to budget repair and fiscal consolidation; improve governance; and strengthen the monetary policy and exchange rate policy frameworks, while addressing prospective balance of payments needs. Our authorities are committed to achieving the 9 Structural Benchmarks (SBs) and several Quantitative Performance Criteria (QPC) and indicative targets.

Fiscal Policy

PNG remains committed to continuing on the fiscal consolidation achieved under the SMP and has demonstrated further consolidation in the 2023 Budget. The budget targets a K1 billion reduction in the deficit (a 1.1 percentage points of GDP decline) relative to 2022. Over the course of the program, our authorities intend to reduce the deficit to below 2 percent of GDP (from the 2022 estimate of 5.4 percent) and to achieve a balanced budget by 2027. Increasing revenues while maintaining strict discipline on expenditures including strengthening debt management will underpin this objective.

On revenue, our authorities have passed the Non-Tax Revenue Act as part of the 2023 Budget. This will support the budget by appropriating fees and charges that are currently collected and retained by the statutory authorities. With continued support from the Fund our authorities are stepping-up efforts to pass the Income Tax Act rewrite (SB No.1) to strengthen domestic revenue mobilization. This will involve simplifying and streamlining the process of filing, assessment, and tax payments, as well as removing tax exemptions that are no longer in line with policy objectives. Our authorities have also requested Fund TA to develop the Medium-Term Revenue Strategy. This will map out the revenue policy and administrative reforms (SB No.2) including specific assistance on taxation reforms in the banking sector and GST operations. Continued progress is being made to improve revenue administration and to modernize the Internal Revenue Commission (IRC) operations.

On the expenditure side, our authorities are committed to maintaining the medium-term expenditure envelope in a 13-year plan. Our authorities aim to increase spending efficiency to address gaps in the delivery of critical social services, closing the infrastructure deficit, enhancing financial development, and strengthening the business climate to encourage investment and growth. The 2023 budget aims to build on this progress. Our authorities are taking several steps to strengthen payroll management to ensure salary budgets are realistic and focused on service delivery. They are committed to maintaining an expenditure rule to reduce the recurrent budget as a share of non-resource GDP.

The revenue and expenditure efforts are complemented by authorities' continued commitment to strengthening transparency in debt recording and management, and through pursuing a prudent financing strategy aimed at reducing debt distress risks and vulnerabilities. Risk reduction will be facilitated by the expected increase in revenues from the PNG LNG project in 2027 upon completion of its debt payments. This will be complemented by continued efforts to refinance debt where possible to lower the cost of financing. Under the program, our authorities will maintain a limit on new public external debt contracted under the Fund program, to be measured in present value terms (continuous QPC). They are also committing to the non-accumulation of new external arrears during the program period (continuous QPC).

Monetary and Financial sector policies

The Bank of PNG (BPNG) will strengthen its monetary policy operational framework by intensifying efforts to drain excess liquidity and adopt more effective short-term liquidity management instruments. According to program requirements this will be done by modifying open market operations through the introduction of a fixed rate tender with full allotment (SB No.4). Given that this approach is untested and might not fully take into account PNG's specific circumstances, authorities have asked for Fund TA to support understanding, costing and introduction of this new instrument. It may also be prudent to review this approach should its costs and resulting market volatility exceed reasonable preliminary expectations.

BPNG has also committed to continue supplying FX to the market in 2023 to help reduce FX shortages and to return to Kina convertibility. A sequenced roadmap for reforming exchange rate operations and regulations will be adopted to make the exchange rate more flexible in the medium-term to support Kina convertibility, which our authorities believe will help address pressing issues like the recent fuel supply constraints. The roadmap will be established with the support of IMF TA to bring needed improvements in the monetary policy operations framework (SB No.5). The work will need to commence urgently, including the provision of supporting Fund TA.

Our authorities launched a review of the Central Banking Act in 2020, through the Independent Advisory Group (IAG) and they look forward to collaboration with the Fund to step-up efforts to strengthen the financial independence and governance of BPNG. The reform task includes addressing outstanding items from the first phase of the Central Banking Act (CBA) review; this will occur in the first year of the Fund program. This includes further amendments to the CBA to strengthen its mandate, governance, autonomy, transparency, and accountability (SB No.6). BPNG will also ensure returning to the timely publication of audited financial statements. The IAG will also continue to review the overall financial sector and our authorities would be grateful for Fund support with this process.

Our authorities value the timely Fund release of information, advice, and technical assistance relevant to the implementation of reforms and believe that this is a mutually reinforcing partnership that supports the reform agenda.

Addressing risks to financial stability and strengthening financial inclusion is critical. The current CBA review will examine the role of BPNG as the financial regulator, with a view to supporting development of the financial sector while maintaining its soundness, support for growth, and financial inclusion. Our authorities are committed to enhancing their capacity to analyze and monitor financial stability, to carefully preparing for the upcoming Financial Stability Task Force mutual evaluation, and to ensuring continued strengthening of AML/CFT framework while remaining vigilant to avoid going back onto the grey list.

Governance

PNG is committed to improving Governance by fully operationalizing the new Independent Commission Against Corruption (ICAC) to deliver an effective anti-corruption framework. Our authorities intend to appoint a Commissioner and two deputy Commissioners (SB No.7), and will continue to recruit more staff and train them on investigation and prosecution to effectively perform its mandate. Further, the ICAC will draft key implementing regulations to specify processes for ICAC's preventive, investigative and prosecutorial mandates, and to ensure sharing of information across relevant entities (SB No.8). The ICAC is drawing significant TA support from the UN and EU. Our authorities are also drafting memoranda of understanding to enhance cooperation between relevant anti-corruption bodies such as the police, Ombudsman Commission, Auditor-Generals Office, Public Prosecutors Office, and Financial Analysis and Supervision Unit. In the same manner, they are developing regulations for the Whistleblower Act to increase protection of whistleblowers.

Further, authorities are committed to strengthening transparency around procurement and are pleased that they were able to hold to a strong commitment made under the RCF in 2020 during the initial phase of the COVID pandemic to publish the procurement contracts undertaken during the COVID emergency. Recognizing that this needs to be continued, our authorities will post details of all Covid-19 related procurement contracts up to end 2021 (SB No.9). Further, to promote fiscal transparency, our authorities will continue to introduce GFS formatting to all budget books.

Our authorities will continue to strengthen the social safety net. In the 2023 budget, the total allocation (current and capital) directed toward the education, health and law and order sectors stood at K5.26 billion, an increase of 12.6 percent over 2022 and 46.9 percent higher than in 2021. These expenditures will go toward meeting the most pressing needs, particularly amongst the poor, and will be safeguarded to alleviate poverty (IT). Work will continue with PNG's development partners to advance work on strengthening the delivery of public services to rural populations, addressing urban youth unemployment, improving labor mobility and removing barriers to employment, addressing urgent needs in child nutrition, and preventing the spread of communicable diseases.

Fund Relationship

Our authorities appreciate the support from the IMF during COVID through the Rapid Credit Facility; and the decision by the IMF Board to undertake a General Allocation of SDR in 2021 which helped stabilize economies worldwide including PNG.

Under the SMPs the relationship with the Fund has been productive and authorities have taken steps to strengthen the bilateral flow of information with the establishment of the Program Monitoring Committee to improve coordination and communication among the different agencies, including the Treasury and the Central Bank, as well as information sharing with the Fund.

An important part of a successful program will be ensuring the benefits of reforms are clearly communicated to PNG's general public; this can be a complex and difficult task. Our authorities are committed to working closely, where appropriate, with the Fund on this important communication task. Clear guidance and timely technical assistance from Fund staff on specific reforms will be a valuable component of this task and promote the overall likelihood of maximizing the benefits of the program.

Our authorities are grateful for the placement of a Resident Representative in PNG. This will strengthen communication through the TA engagement to further the reform process with the guidance of policy advice sufficiently tailored to consider PNG's specific circumstances.

Our authorities are strongly of the view that the program is meaningfully aligned with and supports their economic reform agenda to promote a stronger economy for the community. In this regard our authorities are looking forward to continuing a partnership with the Fund.