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Statement by the Hon. **LEONARD WILSON KAMIT,**
Governor of the Bank and the Fund for **PAPUA NEW GUINEA,**
at the Joint Annual Discussion

**Statement by the Hon. Sir Wilson L. Kamit, CBE,
Governor of the Bank and the Fund for Papua New Guinea,
at the Joint Annual Discussion**

I would like to thank the President of the World Bank Group, Managing Director of the IMF, and the Government and people of Turkey for hosting the 2009 Annual Board of Governors Meeting. I thank you all for the warm welcome and hospitality extended to the Papua New Guinea delegation. We look forward to a fruitful round of meetings here in Istanbul, sharing and discussing experiences and issues pertinent to all of us during this time of unprecedented financial, economic and social crisis.

Papua New Guinea, as a small open economy, has experienced its share of the adverse effects from global developments in 2008. High international prices of food and fuel resulted in annual inflation reaching 13.5 percent in the September quarter of 2008. The Government recording a deficit of K478 million in 2008, mainly attributed to lower-than-expected revenue collections as a result of the sharp decline in commodity prices and the onset of the global financial crisis. Whilst domestic economic activity continued to remain strong in 2008, with real GDP growing by over 7 percent, this has contributed to the high inflation outcomes. In response to the high inflation outcomes in 2008, the Central Bank tightened monetary policy in June 2008.

The pass through of lower international food and fuel prices and the appreciation of the kina exchange rate in the second half of 2008, combined with declines in prices of seasonal produce, resulted in inflation declining to 6.7 percent in June 2009. The Central Bank has however maintained the tight monetary policy stance due to on-going inflationary pressures associated with strong domestic demand, a weaker kina exchange rate, and a rapid draw down of Government trust funds.

Our banking system was not adversely affected by the immediate effects of the global financial crisis because almost all their funds are raised through deposit takings domestically. The domestic banks are generally sound with high capital adequacy ratios with no exposure to sophisticated financial products linked with the sub-prime mortgage market. In addition, the high level of liquidity in the banking system provides sufficient funds for the banks to operate without resorting to borrowing from the international financial system. Our banks also remain well managed and closely regulated. However, the companies and financial institutions that have been affected are the superannuation funds and Papua New Guinean companies with exposures in overseas stock markets. The two major superannuation funds have some of their funds invested in offshore equities, while the rest are invested in commodity-based stocks that are dual-listed in PNG and overseas markets. They however reported positive returns in 2008 and expected positive, but lower returns in 2009.

Though we have not been adversely affected by the global financial crisis, we will be by the follow-on second round effects through the global economic slowdown that stem from it. Our major trading partners have recorded negative GDP growth rates in the first half of 2009. Whilst there has been a recovery in international commodity prices in recent months, they are still lower than their high levels in the first half of 2008. During the first half of 2009, we recorded a deficit in our current account as a result of lower exports of our major commodities. The Government has also recorded lower tax revenues during this period. The other likely effects would be reduction in borrowers' capacity to service their loans which would increase non-performing loans of commercial banks and a fall in foreign direct investments for new resource-based projects.

All these developments would mean a slowdown in economic activity in 2009. The authorities have revised downwards our GDP growth rates for 2009 from 7 percent to between 4 and 5 percent. Whilst the growth rates are higher that our population growth rate of 2.5 percent per annum, a stronger and sustainable growth is needed to ensure there is marked improvement in income per capita growth and the general living standards of our populace.

The Government remains committed to its medium term strategies – the *Medium-Term Fiscal Strategy*, the *Medium-Term Development Strategy* and the *Medium-Term Debt Strategy* – which provide a coherent medium term policy framework and sets out our future plans.

Inflation has progressively declined over successive quarters to June 2009 since the high of 13.5 percent in September 2008. However, interest rates were high, reflecting the tight stance of monetary policy. The kina depreciated against the US and Australian dollars due to higher import demand. Despite this, foreign exchange reserves remained at historical high levels. The country will maintain its floating exchange rate regime and the role of the Central Bank remains smoothening out short-term exchange rate volatility. We will also maintain our liberalized exchange control regime to help encourage easy cross border flow of funds and improve investment in the country.

Papua New Guinea still faces several risks to our economic outlook. The risks include any: further down-turn in the global economy and continued declines in export commodity prices; a larger-than-expected depreciation of our currency, especially against the Australian dollar; high imported inflation; managing the impact of the LNG project, including the 'Dutch' disease; and natural disasters such as pests, frosts, floods, landslides, cyclones, and volcanic eruptions.

On the fiscal side, the Government recorded a surplus of K387 million over the six months to June 2009. This was however due to the use of K423 million from the Gas Commercialisation Trust Account. In its Mid-Year Economic and Fiscal Outlook Report in June 2009, the Government revised upwards its budget deficit to 1.2 percent of GDP due to lower-than-forecasted revenue. Government debt has declined from 72 percent of GDP in 2002 to 32 percent of GDP in 2008 where additional revenues have been used to repay outstanding debt and other liabilities, and to invest in priority infrastructure projects. However, this ratio may increase in 2009 with the projected fiscal deficit.

The windfall revenues in recent years from the then high mineral prices were placed in trust funds for public infrastructure maintenance, district improvement programs and the priority areas of education, health and justice. We have also used funds previously allocated for the Gas Commercialisation project this year.

The proposed US$10 billion LNG project has immense benefit to the country. Reaching a timely successful financial closure to the financing agreements and on relevant Government and landowner issues would enable this project to start. Whilst the project would be a boost to our country, we are also mindful of the limited capacity constraints that may be placed on our human and physical infrastructure.

Our development prospects however remain challenging. HIV/AIDS continues to be a threat to our population. We recently experienced a cholera outbreak in parts of our country. The improvements to our public health and education facilities and rehabilitation of our transport infrastructure are however limited by the capacity of our implementing agencies, which need improvements themselves. We continue to face the challenge of raising the efficiency of the utilities which provide important and affordable, reliable and efficient services to businesses and homes. Competition has also improved the delivery of telecommunication services throughout the country. Other services such as electronic banking and payment of some utility charges have taken advantage of the impressive take-up by the population of the mobile telephone services.

We acknowledge our limitations and are therefore grateful for the continued assistance of our development partners in terms of technical assistance, funding and advice. Working together, we can ensure that our efforts complement each other and are directed in the most effective way for the benefit of all of us.

Papua New Guinea is not immune to natural disasters and, in recent years, we have experienced several. In 2007, tropical cyclone Guba devastated a couple of our maritime provinces. In 2008, we also experienced high sea levels with king tides washing away shorelines in several of our provinces. This year, we had a cholera outbreak in several provinces. We continue to deal with the cocoa borer disease which has affected our cocoa industry. We therefore express our condolences and sympathy to the Government and people of our neighbouring countries who are now experiencing natural disasters – earthquake and tsunami in Samoa and Tonga, flooding in the Philippines, and earthquake and landslides in Indonesia.

As we work towards building on our gains and growing the economy, we seek the support, understanding and counsel of the World Bank Group, IMF and our other development partners. I therefore look forward to the discussions at this meeting and the insights of the participants.

In conclusion, I would like to acknowledge and express my country's sincere gratitude to the management and staff of the World Bank and the Fund for their continuous support in Papua New Guinea's development efforts.