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Statement by the Hon. **LOI M. BAKANI**,  
Governor of the Bank and the Fund for **PAPUA NEW GUINEA**



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Papua New Guinea**

Mr. Chairman, President of the World Bank Group, Managing Director of the International Monetary Fund (IMF), Colleague Governors, Ladies and Gentlemen, it is my pleasure to release this Statement on the occasion of the 2011 Annual Meeting of the Board of Governors of the International Monetary Fund and World Bank Group. On behalf of the Papua New Guinea Government, I would like to express our gratitude and appreciation to the Bank and the Fund for their ongoing technical, financial and intervention programs aimed at improving the living standards of societies and strengthening of the financial systems.

Governors and colleagues, the slower than anticipated global economic recovery in the first half of 2011 and the present sluggish growth and/or the possibility of a recession in some advanced economies is indeed worrying and calls for a greater coordinated effort and complementary actions of our two organizations and individual countries in addressing these concerns. I echo the IMF's downward revision of anticipated growth of 4.3 percent for 2011 (in its June World Economic Outlook Update) from its earlier projection of 4.5 percent. Downside risks still persist as sovereign debt crisis and fiscal imbalances linger in Europe, which potentially could trigger another global recession.

Turning to my country, Papua New Guinea is currently enjoying the longest streak of economic growth in its history as an independent nation. With little exposure to the troubled financial institutions abroad, the Papua New Guinea economy was able to escape the onslaught of the recent global financial crisis. Real gross domestic product (GDP) grew by 5.5 percent in 2009 and 7.1 percent in 2010. Revised projections indicate that economic growth could reach low double digit in 2011, making it the ninth year in succession of economic growth. Starting in 2003, high export commodity prices, strong macroeconomic fundamentals of relatively stable prices including domestic exchange rate, interest rates and inflation, strong balance of payments position, and prudent macroeconomic management - including fiscal management (except for a lapse in 2008), gave rise to increased

business confidence and growth in investment and employment in the economy. Starting in 2010, in addition to the above factors, the construction phase of the multi-billion Liquefied Natural Gas (LNG) project has triggered positive spin-off effects to the other sectors of the economy such as transportation, manufacturing, building and construction, and wholesale & retail. Also, Government spending has increased with the windfall tax revenue from exports and business activity. All these have led to an increase in aggregate domestic demand and consequently, increased inflationary pressures.

With the high commodity prices and increased investment inflows associated with the LNG project, the country's balance of payments position is strong- having recorded an overall surplus of K471 million in the first half of 2011. The level of gross international reserves at the end of June 2011 was K8,485.90 (US\$3,738.6) million, sufficient for 10.5 months of total and 14.6 months of non-mineral import covers. The Government, in its Mid Year Economic and Fiscal Outlook (MYEFO) Report, projects a budget surplus of K606.8 million for 2011. This surplus has now been appropriated through a supplementary budget of around K800 million that includes other revenue expected from non-taxation sources. While the new Government has publicly announced its intention to seriously tackle corruption by instigating investigation into cases of misappropriation of public funds, the pace of its commitment and spending is a concern for prudent macroeconomic management.

The economy is further supported by a sound and strong financial system. The financial system is well capitalized with adequate levels of liquidity, low level of non-performing loans, and are highly profitable. The major strategic project to provide a cost effective and efficient payment system (both domestic and international transactions) that started in 2009 is continuing, with the procurement of a system expected to be completed this year. The reform to the payment system will enhance our efforts to promote financial inclusion and financial literacy in the country through the promotion of micro banks, savings and loan societies, and mobile phone banking.

While the PNG economy is growing and is flushed with liquidity, there are some key issues and challenges. First, the economy needs to steer a course between high economic growth and high inflation as there is a trade-off between the two. This will require a closer coordination between fiscal and monetary policy in supporting macroeconomic stability. Second, Government spending should be directed at needy areas that include health, education, infrastructure and law and order to improve delivery of social services and help improve micro level development. Third, good governance is required not only in the political sphere but also in the bureaucratic administration and processes.

With the rise in annual headline inflation to 9.0 percent in the March quarter and 9.6 percent in the June quarter 2011, the Central Bank has tightened monetary policy by increasing the policy signaling rate- the Kina Facility Rate (KFR) progressively by 25 basis points in June, July and September 2011 to 7.75 percent and by increasing the Cash Reserve Requirement by 100 basis points each in July and August to 6.0 percent. It will require a joint effort by the Departments of Treasury, Finance and National Planning, and the Central Bank to ensure quality and productive Government spending on essential areas – not excessive wasteful spending especially ahead of the upcoming National Elections in 2012, and appropriate monetary policy conduct to contain inflation at a reasonable level in this period of high economic growth.

In this regard, first the Government can assist by concentrating its efforts on areas that do not compete with the LNG developer, which are the social sectors of education, including the up-skilling of the workforce through vocational and on the job training, health and law and order. Engaging in new projects will only add to demand pressures and exert upward pressure on inflation. The second strategy is for the Government to invest seriously in the agriculture sector to ensure the export sector remains competitive and food production is increased for local consumption and import replacement. This will assist in mitigating the effects of *Dutch Disease*.

Above all, good governance in political leadership and the bureaucracy is required to weed out corruption and minimize law and order problems for the country to prosper.

The agenda on Sovereign Wealth Fund has been advanced by relevant Government authorities following the decision by the Government in 2010 to establish the Fund. The underlying rationale to have the Fund is for the country to better manage the windfall revenue that will result from the LNG projects and other mineral projects. The continuing involvement and advice of the IMF in the macro sphere and the World Bank in development of programs and initiatives to reduce poverty and improve the country's social development indicators are welcomed. We are grateful for the continued assistance provided by the Fund and the Bank and our other development partners in terms of technical assistance, funding and advice. Working together, we can ensure that our efforts can complement each other for the benefit of our people.

Thank you.