

Papua New Guinea

Papua New Guinea's macroeconomic performance has remained strong, aided by favorable terms of trade trends and fiscal discipline. Growth in 2007 is expected to accelerate with positive repercussions for employment. The government budget and balance of payments are projected to remain in surplus in 2007, public debt continues to decline and international reserves are increasing. However, weak governance, inadequate delivery of education and health care services, and a high and rising HIV/AIDS incidence result in poor human development indicators and continue to present difficult development challenges.

The political situation has stabilized. The national elections held in July 2007 proceeded more smoothly than previous elections. A new coalition has been formed, with Prime Minister Somare returning to office for a second term. The elections also marked the first time since independence that an incumbent government had completed its term.

Real GDP growth in 2007 is projected to rise above 5 percent compared to 2.6 percent in 2006. After contracting by 8 percent last year, mining and quarrying production is now leading the growth and is expected to expand by 14 percent in 2007. Agricultural production is also projected to accelerate in 2007, to over 3 percent, aided by the recovery in export-oriented agricultural production (coffee, copra, copra and palm oil). The construction sector is expected to grow by 8 percent. While formal employment growth has accelerated across most sectors over the past two years (non-mining employment is rising by 10 percent on an annual basis), urban unemployment remains high.

Despite some volatility earlier in 2007, world prices for key export commodities (oil, copper and gold) have remained strong and reached new highs by late summer, contributing to continued significant budget and current account surpluses in 2007. Higher mineral tax receipts, together with collection of tax arrears, are expected to lead to a budget surplus of around 5 percent of GDP in 2007. This follows a surplus of around 7 percent of GDP in 2006 notwithstanding additional appropriations through two supplementary budgets in August and November 2006. Fiscal restraint is also playing an important role in the strong fiscal performance. In particular, the national elections this year were not marked by significant overspending as during past elections. The non-mineral fiscal balance is expected to increase only slightly in 2007 – to just over 8 percent of GDP (from 7.7 percent in 2006).

Restrained fiscal policy, including use of fiscal surpluses to reduce domestic and external public liabilities, together with economic growth in recent years has led to a significant reduction of public debt – from over 60 percent of GDP in 2003 to an estimated 37 percent in 2007. Public external debt service has fallen from 8 percent of exports of goods and services to under 3 percent over the same period.

Inflation remains subdued although the quality of inflation statistics needs to be improved. Consumer prices rose by an average of 2.3 percent in 2006 and are projected to increase by around 3 percent in 2007. The expected pick-up in inflation in part reflects strong monetary expansion: broad money grew by around 40 percent in 2006 and in 2007 it is expected to grow by around 25 percent. Both rapid accumulation of foreign exchange reserves and private credit growth as a result of record low interest rates are contributing to the monetary expansion.

The current account surplus, which reached 5.3 percent of GDP in 2006, is projected to remain high in 2007 as well, benefiting from favorable commodity prices, but also reflecting strong growth of non-mineral exports. The kina has been broadly stable over the past year, appreciating by about 2 percent against the U.S. dollar in nominal terms. International reserves increased from US\$1.4 billion at the end of 2006 to US\$1.9 billion as of September 2007, equivalent to about 4.5

months of imports of goods and services. The increase reflects the high foreign exchange inflows, mainly from mineral exports. The ratio of short-term debt to reserves has declined and is currently estimated at about 9 percent.