Papua New Guinea

Ministerial Statement to Parliament

"State of the Economy"

Minister for Treasury & Finance
Hon. Patrick Pruaitch, MP

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1 INTRODUCTION

Mr. Speaker,

I rise to present to this Honourable House an update on the State of the Economy and the Government's Fiscal position and Mr. Speaker, this statement also draws on the Government's Budget Strategy Paper for 2009 that I will be releasing shortly.

2 STATE OF THE ECONOMY

- **2007**

Mr. Speaker,

Before I draw the attention of this Honorable House, I must also take this opportunity to once again congratulate the tireless effort of this Government in ensuring that our economy grows rapidly since the National Alliance led coalition

Government came into office in 2002. The economy since then has been growing more every year then ever experienced by any past Government since Independence.

Mr. Speaker,

This economic growth was once again strengthened when the people of Papua New Guinea confidently returned the Government in 2007. With the confidence and mandate given to this House, we must ensure that our people benefit from all sectors. As a result of the Government's strong economic leadership, we have restored fiscal responsibility by ensuring that priority was given to providing vital services and repayment of debt and other liabilities. By this we have provided the people real opportunity to improve their standard of living as economic growth is outstripping population growth.

Mr. Speaker

The economic growth to this date is the sixth and strongest in successive years since independence because of the confidence in the economic sector and the prudent management of the economy by this Government. The political stability over the last five years has enabled the Government to achieve this and we will continue to do so. Mr. Speaker, this House and the Government must once again be commended for achieving this.

Mr. Speaker,

Our economy grew by an estimated 6.5 per cent in 2007, up substantially from the 2.6 per cent in 2006 and slightly higher than the 6.2 per cent forecast at the time of the 2008 Budget. Economic activity increased in all sectors of the economy with the exception of the oil and gas extraction sector.

Mr. Speaker,

As Treasurer, I am proud to also make it known that economic growth is expected to further increase in 2008 to a very strong growth rate of 7.6 per cent, up from 6.5 percent in 2007. Economic activity increased in the Communication sector, the construction sector, wholesale, retail, trade and manufacturing sector. Employment grew by a very strong 10 percent in 2007.

FISCAL POSITION

Mr. Speaker,

The Government has a clear vision of where we want to see Papua New Guinea go over the next five years. We want to provide services for all our people, grow the economy, create jobs and generate income for our people. At the same time, we are faced with increasing inflationary pressures, as the strongly growing economy runs up against capacity constrains, such as a shortage of skilled workers.

The Government will strive to achieve a balance between good service delivery and growth outcomes, and keeping inflationary pressures in check, through good macroeconomic and fiscal management and sustained reform. The Government will need to show discipline and control in its actual Government spending and in budget deliberations later this year.

Mr. Speaker

Let me draw your attention back to the significant and strong economic growth that is being experienced in all sectors of the economy.

The communication sector grew exceptionally strongly in response to microeconomic reform that allowed competition in the mobile phone sector, where the existing operator and new entrant expanded operations. This increased subscriber numbers substantially, with the mobile phone users increasing from around 60,000 three years ago to around 900,000 currently. This has contributed greatly to increased domestic economic activity.

The stronger construction sector was driven by increased private investments in the mineral sector, in particular the Ramu Nickel and Cobalt project. It also reflected Government's increased capital spending into the rehabilitation of the country's infrastructure (i.e. construction of roads, wharves, utilities and airstrips); as well as increased private sector activity as businesses expand into other provinces or due to new business prospects.

Economic activities in the wholesale and retail trade sector, the manufacturing sector, and other smaller sectors grew strongly driven by improved business confidence and profitability, low interest rates, increased private sector investments, spin-off activities of larger robust sectors and higher household consumption.

Employment grew by a strong 10 per cent in 2007, with particular strength in the retail sector, agriculture sector; building and construction; transport, storage and communication sector and manufacturing sector. This very strong employment growth reflected increased confidence, profitability and growth in the non-mining sectors of the economy. The creation of real jobs is the best way to provide opportunity, more income in the community and to reduce poverty, so the strong employment growth over the last year or so is an excellent outcome that the Government is very proud of.

The headline inflation outcome for 2007 was 3.2 in the year to the December quarter 2007, while underlying inflation (which excludes volatile items) was up 6.0 per cent – around the highest rate since inflation was brought under control in 2003. The difference between the headline and underlying rate was due to some sharp declines in volatile food items – a trend which has since been reversed. The rise in underlying inflation is more indicative of overall rising inflationary pressures.

The Government's fiscal position has also been well managed, the Government's debt stock has been reduced down to K6,317.3 million or 33.8 per cent of GDP in 2007 from a high level of K8.36 billion or 72 percent of GDP in 2002. This is a significant result, and is a continuation of the responsible fiscal policies implemented over the past 5 years, which have more than halved the debt to GDP ratio since 2002.

- **2008 Outlook**

Mr. Speaker,

Economic growth is expected to increase further in 2008 to a very strong growth rate of 7.6 per cent, up from 6.5 per cent in 2007. Non-mining GDP is expected to grow by 7.1 per cent in the year. The forecast acceleration in growth is largely due to: the continuation of strong growth in the construction and communication sector; a rebound in the mining sector from weaker performance in 2007; and a more robust agriculture sector.

Mr. Speaker

Annual inflation in 2008 is expected to rise substantially to an estimated 8.1 per cent which is very worrying. This outlook reflects the build up of inflationary pressures from the fast growth in money supply, higher import prices for oil and foods, the increased terms of trade and the fiscal stimulus from the Supplementary Budgets in 2006 and 2007.

- *The increasing food and fuel prices come in the context of broader inflationary pressures throughout the PNG economy, with both imported and domestic inflation on the rise. This is due to high domestic demand, stemming from the commodity price boom, improved business confidence and relatively loose monetary policy, as well as global increase in the price of most commodities.*

- *Furthermore, the expected government spending arising from the 2007 Supplementary Budget and 2008 Budget, especially on maintenance and infrastructure projects, will inject further stimulus into the economy as the funds for the projects are used to buy goods and services. It will be important that additional government spending in 2008 is contained so that it does not add to existing inflationary pressures.*

- **2007**

Mr. Speaker,

The budget position for 2007 was a cash surplus of K454.4 million or 2.4 per cent of GDP compared with the original budget deficit estimate of K35 million or 0.2 per cent of GDP. Consistent with sound fiscal management, the surplus has been used for debt reduction.

The larger than expected surplus in 2007 was due to higher than expected revenue collections, combined with slightly lower than anticipated expenditure. The lower than anticipated expenditures were mainly in the development Budget, where there were underspends of domestic funded development expenditure and concessional loan draw downs.

- **2009 Outlook**

The fiscal outlook for 2008 to date is looking stronger than it was when the 2008 Budget was put together. This is mainly due to higher than expected commodity prices and the stronger economy that I have just outlined. I will be providing further detailed information in the Government's Mid Year Economic Fiscal Outlook report which is expected to be published at the end of this month.

4 INTERNATIONAL ECONOMIC DEVELOPMENTS

Mr. Speaker

While the domestic outlook has strengthened, the international environment that PNG is linked to has deteriorated markedly over the last year. It was around this time last year that the sub prime mortgage crisis emerged in the United States. Since that time, there has been a huge amount of turmoil and weakness on world financial markets. Share markets in many countries have declined markedly and finance has been much harder to raise on world markets, as risk is being repriced.

In the past, this repricing of risk, which translates into significantly higher interest rates could have affected PNG significantly. However, the halving of public debt over the past 5 years, as well as the rebalancing of the debt portfolio towards domestic and longer maturity debt – which has resulted in improvements to our credit ratings – has shielded the PNG economy from the worst of these impacts.

Global economic growth forecast has been revised down to 3.7 per cent, from 4.9 per cent in 2007 while growth forecast for emerging and developing economies has been revised down to 6.7 per cent from 7.9 per cent in 2007. The US dollar has also continued to weaken considerably over the last year against many other major currencies and this has been reflected to some extent in the price of commodities such as oil that are expressed in US dollars. Over the same period, commodity prices have continued to boom, especially the price of oil and the price of some food stuff.. This has seen global inflation rise. Advance economies inflation is revised up to 2.9 per cent from 2.1 per cent in 2007 while emerging and developing economies inflation forecast has been revised up to 7 per cent from 6.3 per cent in 2007. While commodity prices are higher, the risks to the world economic outlook have increased over the last year.

What does all this mean for PNG?

Mr. Speaker

While PNG's commodity exports have benefited from the continued boom in commodity prices, our consumers of oil and some food stuff have suffered from higher world prices like consumers elsewhere.

The Government understands the pain being felt in the community caused by higher prices – but higher oil and fuel prices is a world wide problem. In terms of how any Government can respond to these difficulties, the Government is mindful that many other countries are going through the very difficult process of trying to **unwind** their fuel subsidies which have proved to be hugely expensive and unsustainable. The Government needs to take the lessons of this into account when considering populist calls for price subsidies.

While providing subsidies may lower prices marginally in the short term, this comes at a greater cost to the budget and subsidies tend to be unsustainable. **Price subsidies for fuel tend to provide very little price relief to ordinary people and usually benefit well off individuals (who use most of the fuel) more than people on lower incomes**. Subsidies will also add to aggregate demand, increasing inflationary pressures elsewhere in the economy. Moreover subsidies often are very expensive and very difficult to unwind in the future – witness the riots in Indonesia and Nigeria recently.

However, the Government has asked the Department of Treasury to examine this whole subsidy issue to see if there are any sensible options for the Government to provide some limited price relief in the most effective, least distortionary and lowest cost manner. Once the Government has the Department of Treasury's analysis, the Government will consider the issue. But there is no magic pill to this global problem and it would be misleading to suggest otherwise and to raise unrealistic expectations.

With the economy growing strongly, the Government will seek to keep inflation under control by adopting responsible monetary and fiscal policies that promote macroeconomic stability. As part of this, actual government spending will need to be carefully monitored and controlled in order to ensure that it does not add to inflation. This means that Government spending like the District Service Improvement Program spending will be released over the next few years as good spending plans are developed and implemented. To do otherwise would see Government funds wasted and prices being driven up. It is imperative that the Government acts responsibly to the changed global and domestic circumstances.

5 REFORM AND THE OUTLOOK

Mr. Speaker,

It is easy to focus on the major challenges and difficulties that we face but there are also valid reasons to be optimistic about our future. The World Bank through its country director reports that there has been an improvement in the country assessment of PNG which is a direct result of good micro economic performance by government. We have seen the major social and economic benefits that have arisen as a result of competition in mobile telephone sector. Prices have fallen dramatically, the coverage of service provision across the country has risen and there has been a lot of product innovation in this segment of the market. People in our villages are enjoying communicating like they never have before. However, PNG needs to advance further and we need to extend more competition and private sector involvement to other sheltered sectors of the economy.

We have also recently signed a gas agreement with the Exxon Mobil led consortium and the project has now entered the front end engineering and design stage. If this project proceeds, it will have a dramatic positive effect on economic growth, employment opportunities, royalty payments for landowners and eventually taxation revenue that will benefit the entire population. The project is enormous and we need to start thinking about how we will deal with the challenges and benefits that are likely to arise from this massive project.

Mr. Speaker,

If we adhere to our prudent financial medium term framework that includes the Medium Term Development Strategy, the Medium Term Fiscal Strategy, the debt management strategy and the Fiscal Responsibility Act, we will be well placed to provide ongoing macroeconomic stability and to keep inflation in check. With continued fiscal and monetary policy discipline and responsibility, the outlook for PNG will continue to be optimistic.

6 CONCLUSION

Mr. Speaker,

The Somare-Temu Government's vision is to build a brighter future for all Papua New Guineans and by ensuring the benefits of the vibrant economy benefit the vast majority of our people. We will continue to do that by adopting responsible policies that promote sustained economic growth, create real jobs and income, and keeping inflation under control.

We need to ensure that there is ongoing political stability in the county to create an environment conducive to attracting foreign investment and at the same time ensuring that current and future policies become a reality so that our people can benefit.

The Government will continue to ensure that there is prudent management of the economy which will in turn provide the required environment for PNG to continue to develop at a strong but sustainable growth rate. In short Mr. Speaker, we now have the opportunity in our hands to continue to advance PNG.

Thank you.

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