

Loi Martin Bakani: Economic prospects and outlook for 2011 to 2015

Address by Mr Loi Martin Bakani, Governor of the Bank of Papua New Guinea, to the Consultative Implementation and Monitoring Council (CIMC) National Development Forum, Port Moresby, 24 August 2011.

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Acknowledge dignitaries and organizers (CIMC) of the forum.

Although the period for the topic is 2011 to 2015, allow me to confine my presentation to the period 2011 to 2014, which is largely the period for the construction phase of the PNG LNG project.

I. Economic prospects: 2011 to 2014

Papua New Guinea is currently enjoying the longest streak of economic growth in its history as an independent nation. 2011 will be the 10th year of economic growth as measured by the increase in real Gross Domestic Product (GDP). The average increase in real GDP for the period from 2002 to 2010 was 5.4%. The driving force behind the growth for most of the period was the non-mineral sector.

Projections by the Bank of Papua New Guinea indicate that economic growth in 2011 will be around 9.5%. The growth in economic activity shall continue all through the 2011 to 2014 period. The high economic growth in 2011 is driven by the construction of the LNG project, and the global demand for the country's primary exports. Even if there will be a slowdown in the economic activity in the developed economies, high growth in the major emerging markets of Brazil, Russia, India, China and South Africa (BRICS) should ensure that the slowdown in global activity will not be severe. Hence, the international commodity prices might decline, but will still be historically high, which should benefit our agriculture, forestry and fisheries industries. The construction of the LNG project will benefit the sectors of the economy that supply inputs and services to the developer, mainly manufacturing, earth works, infrastructure, building and construction, transport, communication, commerce (wholesale and retail especially equipment and vehicles), personal services, accommodation and hotels, and local food production for the workforce.

In addition the high international metal prices of copper and gold will result in high mineral export receipts and taxes to the Government, which will allow for continued high public expenditure and the public sector contribution to aggregate demand, and GDP.

Based on the above outlook it is assumed that economic growth as measured by real GDP will continue to be high at the 8% to 10% range, all through the period of the construction of the LNG project, that is, up to the end of 2014. I will refrain from projecting developments beyond the LNG construction stage, given the need to fully assess what the impact of the production and export of the gas will have on the economy.

As can be expected, over the last five years the increase in economic growth resulted in an increase in formal employment averaging 6.0% per annum. In the June quarter of 2011 employment increased by 7.1%. It can be expected that this trend will continue during the period 2011 to 2014.

The increase in aggregate demand associated with the increase in economic growth, combined with higher public sector spending as a result of the increase in tax revenue, combined with higher prices of fuel and imported food items, led to an increase in the prices of goods and services. Annual inflation increased to 9.6% in the June quarter of 2011, up from 7.2% in the December quarter of 2010. There is some tradeoff between economic growth and inflation. I want to repeat what I said in my previous presentations. In this period

of high economic growth, there will be increased inflationary pressures. The Bank of Papua New Guinea will do all it can in using all the available instruments available to it – interest rates, exchange rate, and trade in Central Bank Bills – to contain inflation within the single-digit to low-two-digit range. To ensure that this objective is achieved, it will require very close cooperation and coordination with the Government in the management of fiscal and monetary policies, to ensure that inflation does not spiral out of control. At the same time, it will ensure that its policies do not counteract the objective of economic growth, development and the increase in the standard of living of the majority of the population.

II. Good economic management

Let me now turn to the issue of how to secure a balanced growth at acceptable inflationary levels, at these very challenging times in the history of our economic development.

I am confident that with close coordination and cooperation between the Government and the Central Bank the macro economy can be prudently and responsibly managed. I will touch upon the issue of the “Dutch Disease” phenomena and how to deal with it, later in my presentation.

The microeconomic aspects are as important as the macroeconomic ones, to achieve a balanced non-inflationary growth. The first and most important one is, to ensure that the Government is not competing with the Private Sector for limited productive resources and capacities. Such competition will only result in price increases, increase in imported inputs, including materials, equipment and labour, and misallocation of the limited resources resulting in losses to the nation. Therefore, my recommendation is that during the LNG construction period the Government should refrain from undertaking major infrastructure projects. Undertaking major infrastructure projects by the Government will only compete with the limited resources in equipment and manpower in the areas of earth moving, building and construction, as well as other industries that are and will be fully utilized for the LNG project construction. The Government should instead do work in the areas of, maintenance, upgrading and some instances complement work done by the developer of the LNG project. The Government should commence planning its infrastructure implementation and be ready to implement them, as and when the LNG project scales down its construction operations and the highly skilled labour trained by the developer, equipment and materials, become available and can be utilized, for other infrastructure developments.

During the construction phase of the LNG project, the Government should concentrate its efforts on areas that do not compete with the LNG developer on resources, 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. It is clear that the expansion of the services in these areas will require investment in classrooms, aid posts, police stations and housing for teachers, health workers and police personnel. The recommendation is not to refrain from all work in the area of building and construction, but to limit them to the bare minimum necessary to maintain the existing infrastructure and complement it with the most needed additions. Once the LNG project construction winds down, the opportunity to move the skilled labour trained by it, and the resources becoming available, to major infrastructure and building and construction projects should be planned. This means that the Government must have a clearly designed plan, including detailed implementation plans and programs for it.

III. Combating “Dutch Disease”

The second important micro level proposed initiative is to invest in the agriculture sector and social infrastructure. In many presentations of the problems that the development of the LNG project might create, the subject of the “Dutch Disease” which involves the pricing out of the traditional export sectors is raised. One of the most efficient ways to counteract it is, by investing and developing a competitive traditional export industry. Papua New Guinea is

blessed with very fertile land, abundant water resources, and available labour force, and has the potential to develop a competitive, advanced agricultural sector. Given the world wide food shortage and the steady increase in food prices, the Government should develop a plan of investment in the agricultural sector that will place Papua New Guinea as a food supplying country, not only for its own use, but for exports. This is the most efficient and effective way to counteract the “Dutch Disease” risks emanating from the LNG development where we have alternate sources of income generation with a wider base of exports.

Given the projections of revenue and tax flows during the next four years 2011–2014, the Government should have the resources to invest in the social sectors and the development of the agriculture sector. I recommend to the Government to set up a Special Purpose Account (that is budgeted for) with the Bank of Papua New Guinea in which all the excess revenue will be deposited, to be used for these purposes.

IV. Initiatives by the central bank

Allow me to end my presentation with two subjects at the top of my agenda as the Governor of the Bank of Papua New Guinea.

The first is Financial Inclusion: We are in the process of planning and implementing a program of enabling every Papua New Guineans wherever they live to have access to banking and financial services. This will include the advancement of the microfinance service and mobile phone banking. It will be complemented by financial awareness, literacy training and education. I plan that during my term as the Governor the program will, as much as possible; reach every citizen of this country wherever they live.

The second is the Payment Systems: We are planning to enhance and improve the National and International Payment Systems, and turn them into a modern, low cost and efficient one. We also aim to upgrade our payment laws in the process. We are in the process of selecting a vendor to assist us in the development of the system.

Conclusion

To conclude, let me reiterate three important points.

1. The Government, through its fiscal policy, can redistribute effectively the windfall revenue gain (through increased taxes from high commodities prices and spin-off business activities) by investing in the social sector and agriculture for wealth creation, to combat *Dutch Disease*, and to achieve a balanced growth in the PNG economy;
2. Government should not compete with the private sector for limited resources during the construction phase of the LNG project by engaging in large infrastructure projects, but maintain and improve existing infrastructures, and plan to use the resources when they are released after the construction phase;
3. There has to be a more close and coordinated management of fiscal policy and monetary policy to fight inflation so that it does not spiral out of control in this period of high economic growth.

Thank you for having invited me to make this presentation at this important forum.

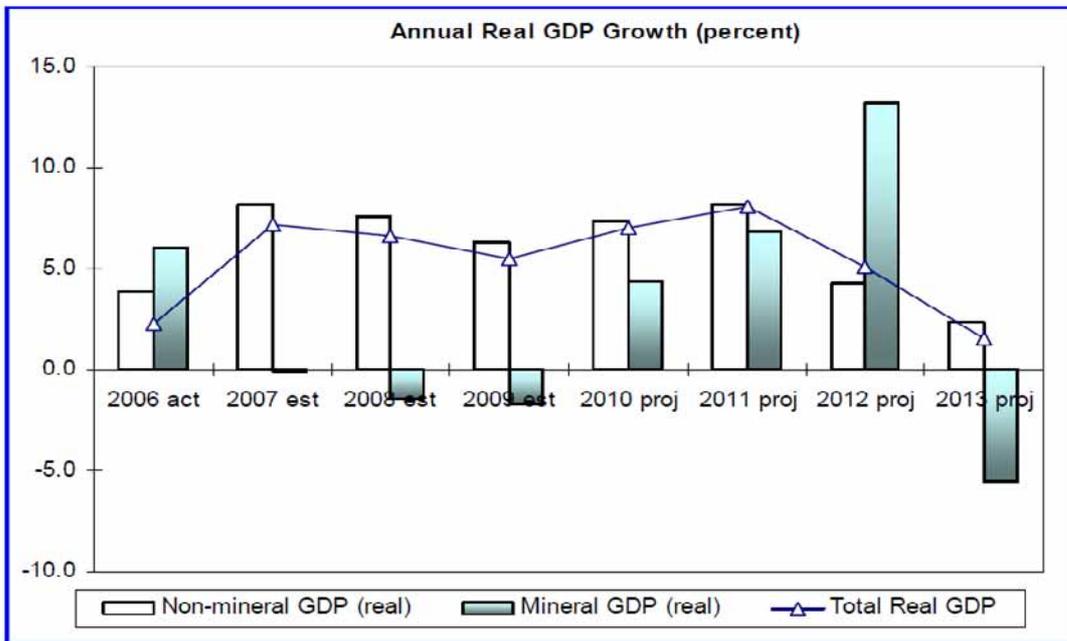
I wish you all success in this forum.

Thank you and God bless.



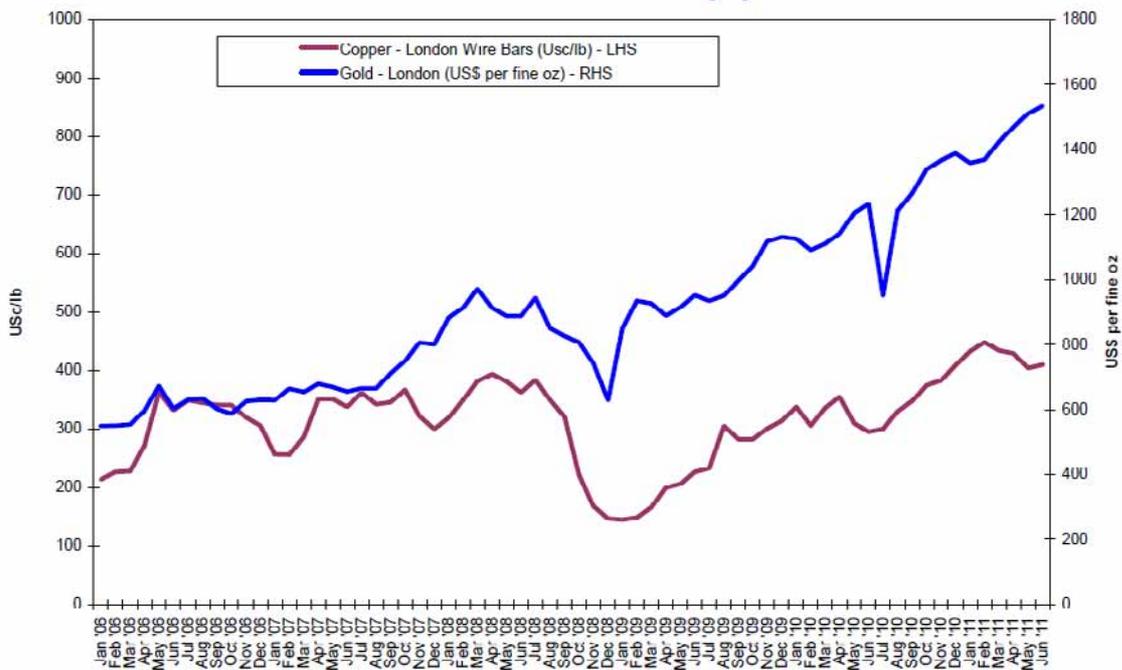
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1) Economic Prospects: 2011-2014



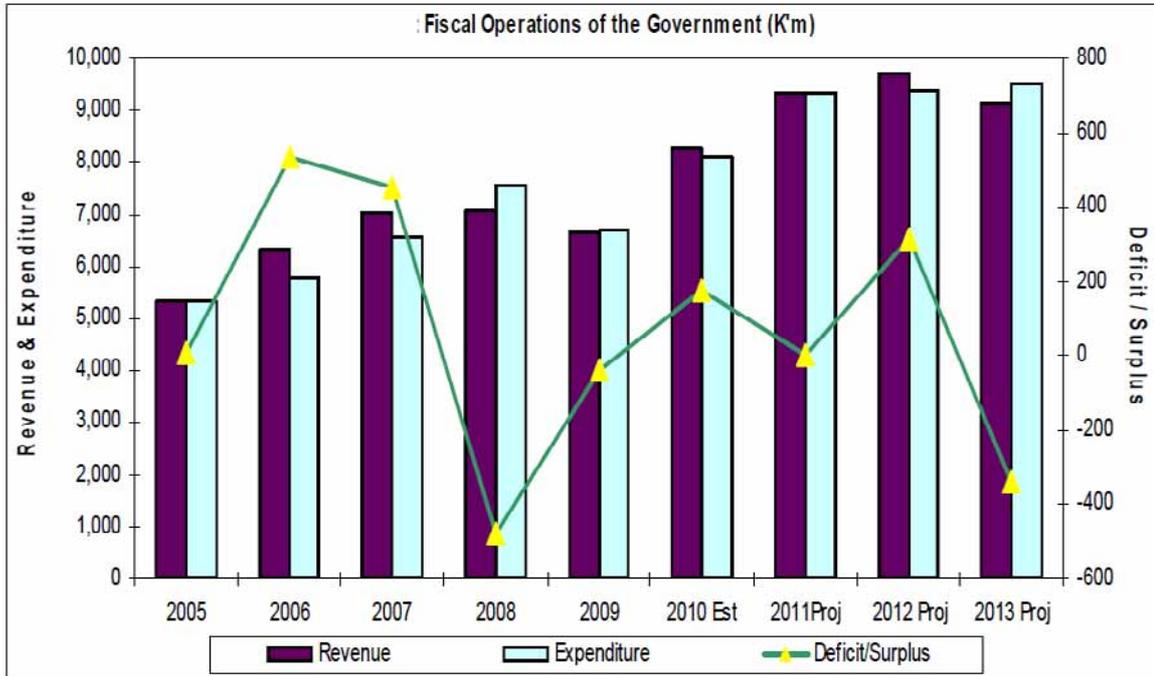
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International Prices of Copper and Gold





Fiscal Operations



Employment (formal private sector)





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Inflation — annual % change

