PAPUA NEW GUINEA

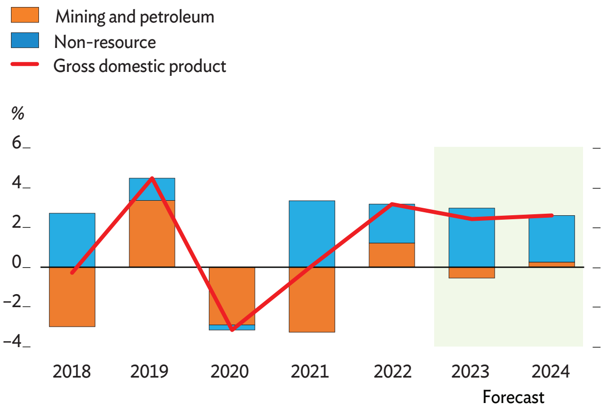
Growth rebounded in 2022 on normalizing economic activity, higher resource output, and commodity price spikes triggered by the Russian invasion of Ukraine. Recovery is forecast to continue at a moderate pace in 2023 and 2024, supported by expansion of the non-resource sector. Petroleum and gas output will likely contract, narrowing the current account surplus. Inflation is forecast to subside in line with global trends. Operationalizing the sovereign wealth fund would strengthen resource revenue management and macroeconomic stability.

Economic Performance

GDP grew by an estimated 3.2% in 2022 (Figure 2.34.1). Economic activity in Papua New Guinea (PNG) normalized across sectors following the impact of COVID-19. There were no additional surges of COVID-19 cases or national lockdowns in 2022, even though by the end of the year only about 3% of the population was fully vaccinated. This is the lowest vaccination rate in developing Asia. As of 28 February 2023, 46,809 cases of COVID-19 and 670 deaths had been reported, though the actual numbers were probably substantially higher.

Figure 2.34.1 Gross Domestic Product Growth

Growth recovered in 2022 on normalizing economic activity.



Source: Asian Development Bank estimates using data from Papua New Guinea National Statistical Office.

The resource sector expanded by an estimated 4.6% in 2022. This was driven by higher output in mining and liquefied natural gas (LNG) production, as well as commodity price spikes following the Russian invasion of Ukraine. Gold production increased in the Lihir and Ok Tedi mines, while the PNG LNG project produced above its nameplate capacity, or nominal registered output, of 8.3 million tons per year. The PNG economy benefited from higher foreign exchange (forex) inflows and an easing of forex restrictions that have persisted to varying degrees since 2015 to prop up an overvalued PNG kina. Spending related to the 2022 general election also provided stimulus. However, growth was hindered by the ongoing closure of the Porgera gold mine since April 2020. Unresolved negotiations between operator Barrick Niugini Limited and the government, in part over a tax dispute, have delayed its reopening. In the rest of the economy, global supply chain disruption delayed deliveries, lifted production costs, and deferred investment.

The current account surplus widened from the equivalent of 21.0% of GDP in 2021 to an estimated 23.7% in 2022 (Figure 2.34.2). This was a result of the rebound in mining and LNG output, as well as a surge in crude oil and LNG prices. Imports were still suppressed by forex restrictions and global supply chain disruption. But much of the current account surplus was offset by financial outflows associated with initial PNG LNG investments.

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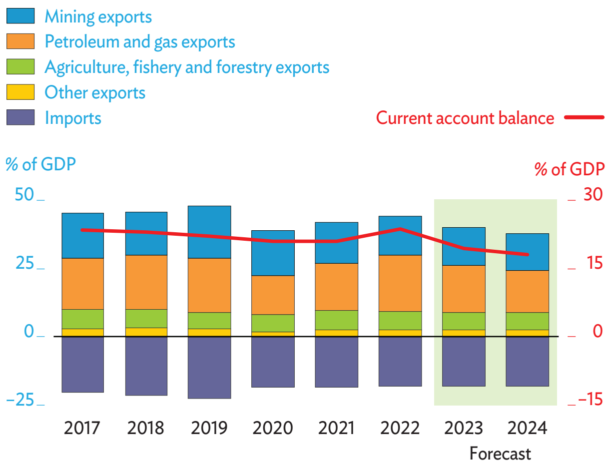
Figure 2.34.2 Current Account Balance

The current account surplus is expected to narrow as liquefied natural gas exports decline.



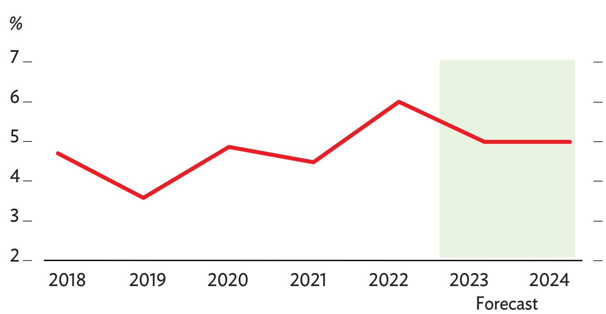
GDP = gross domestic product.

Sources: Bank of Papua New Guinea; Asian Development Bank estimates.

Inflation accelerated from 4.5% in 2021 to an estimated 6.0% in 2022 (Figure 2.34.3). Prices for food and nonalcoholic beverages rose by an estimated 7.2% in 2022, transportation by 12.5%, and household appliances by 10.6%. To cushion households against inflation, the government introduced tax exemptions for retail fuel and increased the tax-free threshold on salaries from K12,500 to K17,500.

Figure 2.34.3 Inflation

Inflationary pressures are forecast to ease, but inflationary risks remain.



Sources: Papua New Guinea National Statistical Office; Papua New Guinea Department of Treasury; and Asian Development Bank estimates.

A supplementary budget passed in September 2022 estimated the fiscal deficit at the equivalent of 5.6% of GDP. This was broadly in line with the original budget, maintaining a decline from 6.8% of GDP in 2021. The increase in both operational and capital expenditure was partially offset by a resource revenue windfall. Public debt rose to equal 50.2% of GDP.

Economic Prospects

Growth is forecast at 2.4% in 2023 and 2.6% in 2024 with a mixed outlook across sectors (Table 2.34.1). Growth will be supported primarily by ongoing recovery outside of the resource sector. It will be led by agriculture, forestry, and fishing, projected to expand by 3.0% this year, information and communication by 8.0%, and trade by 4.5%. Accommodation and food services, transportation, and real estate are among the other businesses likely to benefit from increased international travel, supply chain recovery, and fiscal stimulus through investment spending.

Table 2.34.1 Selected Economic Indicators, %

Recovery will continue at a moderate pace as inflation subsides in 2023 and 2024.

	2021	2022	2023	2024
GDP growth	0.1	3.2	2.4	2.6
Inflation	4.5	6.0	5.0	5.0

GDP = gross domestic product.

Source: Asian Development Bank estimates.

The resource sector, typically the PNG growth engine, is expected to contract by 2.0% this year. The reason is a 6.0% drop in output of petroleum and gas as the PNG LNG project operator envisages production below nameplate capacity. This is somewhat offset by a 7.0% increase in mining as the Ok Tedi mine accesses higher-grade ore. The Porgera gold mine is removed from the baseline forecast because there is no clear indication of startup operations materializing. In 2024, resource sector growth will be lackluster as PNG LNG production is expected to remain below its nameplate capacity.

Forex restrictions are likely to continue, weighing down the economy. The forex situation has been tightening in early 2023, with increases in average processing time for forex orders and a backlog on commercial banks' order books. The forex situation has also affected fuel supplies. In January, all domestic flights were suspended for 2 days because of a fuel shortage. In February, fuel rationing by Puma Energy closed many service stations and generated long queues outside others.

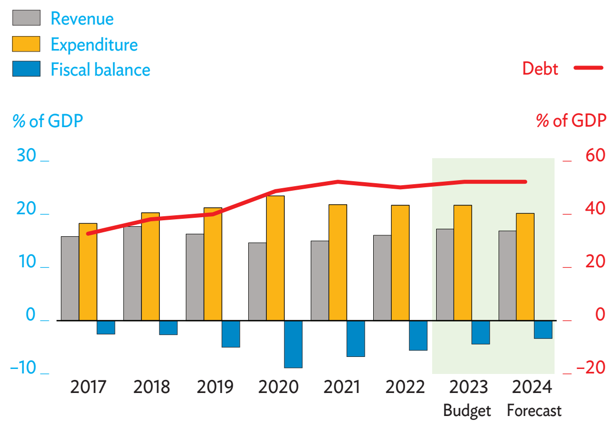
Inflation is forecast to moderate to 5.0% in both 2023 and 2024. The main reasons for inflation to ease are lower commodity prices, the gradual resolution of global supply chain issues, and generally decelerating world inflation, particularly in the US. A potential upside risk to the inflation outlook is currency depreciation, considered in light of persistent kina overvaluation. Another is any escalation of the Russian invasion of Ukraine.

The current account surplus is projected to narrow to the equivalent of 19.5% of GDP in 2023 and 18.0% in 2024. Even as LNG exports decline, supply chain recovery and the pick-up in activity aside from resources are likely to spur higher demand for imports. It remains to be seen whether the Bank of Papua New Guinea, the central bank, will release the reserves necessary to pay for additional imports.

The 2023 national budget forecasts fiscal deficits equal to 4.4% of GDP in 2023 and 3.3% in 2024 (Figure 2.34.4). Revenue including grants is projected to increase by K2.2 billion, or 1.9% of GDP, on higher goods and services tax, dividend payments, and the imposition of a 45% corporate income tax on commercial banks. On the expenditure side, the capital budget allocation is expected to increase by 0.7% of GDP and the operation budget allocation by 0.2%. The payroll bill is projected at 28% of total expenditure. Successful fiscal consolidation hinges on the government's ability to strengthen its revenue collection strategy and control spending. Executing the budget will continue to depend on support from multilateral and bilateral development partners. The Department of Treasury forecasts public debt rising to 52.3% of GDP in 2023 before stabilizing at 52.2% in 2024.

Figure 2.34.4 Fiscal Balance

Public debt is projected to stabilize in 2024 as fiscal deficits decline.



GDP = gross domestic product.
Source: Papua New Guinea Department of Treasury.

Risks to the growth outlook are considerable but tilt to the upside. Early reopening of the Porgera gold mine would add up to 2 percentage points to growth, but even in the most optimistic scenario this is unlikely before the end of 2023, given that negotiations continue and start-up operations would take time to be completed. Another upside risk is Papua LNG, a multibillion-dollar LNG project, going ahead. The final investment decision is planned for the end of 2023 or early 2024, possibly followed by 4 years of construction and the first gas production thereafter. A downside risk would be an unexpected tightening of forex restrictions stifling recovery, especially if fuel rationing recurs and drags on.

Policy Challenge—Operationalizing the Sovereign Wealth Fund

Sovereign wealth funds (SWFs) are important vehicles for managing volatile revenue from exhaustible resources. PNG legislated its SWF through the Organic Law on the Sovereign Wealth Fund, 2015. The law gives SWF objectives as (i) macroeconomic stabilization, (ii) inter-generational equity, and (iii) asset management through the establishment of a stabilization fund and a savings fund. However, these funds have never been operationalized, possibly because commodity prices and resource revenue were low in the years after the law was passed (Figure 2.34.5).

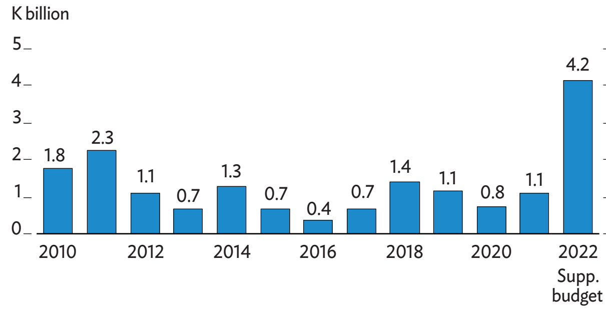
Last year's revenue windfall of K4.2 billion, or K2.7 billion more than budgeted, highlighted the need to operationalize the SWF. Despite arrears, and perhaps because of high spending pressure on the newly elected government, the 2022 supplementary budget allocated this windfall to additional expenditure. According to the Organic Law, 50% of mining and petroleum tax revenue and 75% of dividends returned to the government must be deposited into the stabilization fund. Withdrawals are governed by a legislated formula that aims to smooth expenditure countercyclically. K2.1 billion should thus have been deposited into the stabilization fund last year and only about K800 million withdrawn, for net accumulation of K1.3 billion.

Now is an opportune time to operationalize the SWF before the next resource revenue bonanza. Tax revenue from the resource sector is anticipated to rise in the coming years from the PNG LNG project when tax exemptions expire in 2026, early royalties and production levies from Papua LNG when production commences as envisaged in 2027, and Porgera's reopening when it materializes.

An SWF that is up and running would help manage the next boom-bust cycle and bring better macroeconomic outcomes. During a boom period, SWF deposits restrain inflation, fiscal spending sprees, and excessive appreciation of the kina in real terms. This promotes activity in tradeable goods outside of the resource sector. When the boom dissipates and revenue declines, withdrawals from the stabilization fund support recurrent spending on health and education and avoid any need for sharp kina depreciation, thereby protecting real incomes. Heightened macroeconomic stability means more growth for PNG over the long term.

Figure 2.34.5 Mining and Petroleum Revenue

The resource revenue windfall in 2022 was significant.



Source: Papua New Guinea Department of Treasury.

Should PNG establish a savings fund in addition to a stabilization fund? While a savings fund addresses intergenerational equity, directly investing in the capital-poor domestic economy would bring higher returns than would accumulating foreign assets. Future generations would benefit from higher incomes in a more developed economy. The challenges are low absorptive capacity in the domestic economy and the accrual of resource revenue not necessarily coinciding with when domestic investment would be most productive. A "parking fund" could help navigate these challenges. While the organic law in its current form does not foresee the establishment of a parking fund, an amendment to that effect would be prudent.