



Mr. Speaker and Honorable Members of Parliament, I now present to you an update on the state of the economy and the Final Budget Outcome for 2008.

State of the Economy

Mr Speaker, 2008 was a challenging year for PNG as the world economic environment abruptly changed towards the end of 2008, putting an end to the commodity price boom, experienced in recent years.

Mr Speaker, over recent years PNG has been the beneficiary of a huge and unprecedented terms of trade boom, the prices of our major commodities reached historical high levels , doubling the value of our exports, quadrupling the Government's mineral revenue, and increasing PNG's purchasing powers significantly.

Mr Speaker, sadly, this came to an end in 2008. The major channel through which the slowdown has affected PNG is through lower commodity prices. The prices of key commodities especially oil and copper have reversed back to 2004 levels. This certainly has had a major impact on Government revenue.

Mr Speaker, this year, we are starting to see some early indications of improvement in some countries (especially China) and the financial and commodity markets are starting to look more settled and, in some cases, have rallied, although this could easily unwind.

Mr. Speaker, despite the deteriorating state of the global economy in the latter part of 2008, PNG's economy continued to grow strongly in 2008 due to the stable macroeconomic policies, upbeat business confidence, the benefits of past microeconomic reform and the benefit of higher commodity prices in the first half of 2008.

Mr Speaker, the economy grew strongly in 2008, up slightly from 2007 but lower than 7.2 per cent forecast at the time of the 2009 budget. Economic activity increased in all sectors of the economy with the exception of the oil and gas extraction sector. Robust growth was again recorded in the communication, construction, wholesale and retail and manufacturing sectors.

Total estimated non-mining GDP grew strongly in 2008, slightly up from 7.3 per cent in 2007 but down slightly from the 2009 budget estimate of 7.9 per cent. This reflected continued exceptional growth in the communication and construction sectors, and strong growth in the wholesale and retail trade sectors and the manufacturing sector.

Mr Speaker, Treasury's inflation forecast at the time of the 2009 Budget was 10.6 percent which turned out to be exactly the same as the 2008 inflation outcome. Looking ahead, inflation is expected to decline in 2009 with global prices of food and energy falling significantly.

Mr. Speaker, employment grew by a strong 8 per cent in 2008 with broad based growth in most sectors of the economy, again reflecting the benefits of past microeconomic reform, and continued confidence, profitability and growth in the non mining sectors of the economy.

Final Budget Outcome for 2008

Mr Speaker, in accordance with Section 15 of the Papua New Guinea *Fiscal Responsibility Act 2006*, I now present to Parliament the Final Budget Outcome for 2008. I note that this report was released publicly on 31 March 2009. The publication and presentation of this Report is in line with the Government's commitment to increase transparency and accountability of public funds, particularly, Additional Priority Expenditure Appropriations and the various Trust Accounts.

Mr Speaker, a budget deficit of K478.5 million (or 2.2 per cent of GDP) was recorded in 2008, compared with the revised budget deficit estimate of K9.5 million (0.05 per cent of GDP), and the projection of a surplus of K202.4 million or 1.0 per cent of GDP announced in the 2008 Budget.

This budget outcome is attributed mainly to lower than expected revenue collections as a result of the sharp decline in commodity prices and the onset of the global financial crisis.

Total Revenue & Grants

Mr Speaker, total revenue and grants for 2008 was K7,073.3 million. While some of the revenue heads were broadly on target as expected, lower Mining and Petroleum Taxes and lower Dividend receipts from Ok Tedi, State Authorities and State owned enterprises were the major factors contributing to the overall lower revenues.

Total Expenditure & Net Lending

Mr Speaker, Total Expenditure and Net Lending for 2008 was K7,551.9 million.

The Recurrent Budget expenditure was K3,766.7 million. This higher expenditure was attributed mainly to over expenditures by Provinces and Statutory Authorities which were largely offset by savings identified in the amounts appropriated through the additional priority expenditure (part of the 2008 recurrent appropriation) and the 2008 Supplementary Budget.

The Development Budget recorded an outcome of K1,630.1 million. The lower development expenditure was due mainly to lower than expected utilization of infrastructure tax credits, lower drawdown of concessional loans and lower project grants due to the appreciation of the Kina against donor currencies.

Mr Speaker, Additional Priority Expenditure outcome was K100.0 million lower in 2008, compared to the K1,476.0 million that was allocated for this. This reflects a reallocation of K100.0 million set aside for the Commercialization of PNG's Gas resources which was not transferred to Trust but expended on other government priorities at the end of 2008.

Mr Speaker, of the K850.0 million Supplementary Budget that was handed down in September 2008, K779.0 million was expended on priority areas, while K21.0 million was used to offset recurrent budget commitments as stated earlier and K50.0 million was used to repay debt.

Public Debt

Mr Speaker, I now move on to public debt.

The level of total public debt was K6,821.7 million at the end of 2008, K551.6 million above the 2008 budget estimate and K570.7 million above the revised estimate due to the higher than expected Budget deficit and higher cash balances.

This increase was due to lower revenue inflows towards the end of 2008 resulting from falling commodity prices. Strong nominal GDP growth contributed to debt as a percentage of GDP falling from 33.9 percent at the end of 2007 to 31.6 percent at the end of 2008.

Mr Speaker, I now want to explain further the underlying causes and reasons for the Budget outcome for 2008.

Global Financial Crisis

Mr Speaker, when this Government released the revised 2008 estimates in the 2009 Budget, it was effectively predicting a balanced budget. The revised budget was the Government's final forecast of revenue and expenditure for 2008, and was delivered amid world economic turmoil that is unprecedented in the past 80 years.

The Global Financial Crisis has had a devastating impact on all of the major economies, including the United States, the United Kingdom, Germany, and Japan. Most developed nations are now in recession and expecting very large budget deficits as a direct consequence of this.

Mr Speaker, whilst it is inappropriate to measure PNG's budget deficit against these developed countries as economic circumstances differ, recent media statements suggest that the United States budget deficit accelerated to hit a record US\$1.41 trillion (13.1% of GDP) in the current fiscal year as the Federal government moved to bail out troubled institutions. It is also likely that Australia's budget deficit will be significantly higher than the 1.9 per cent of GDP previously forecast. These just indicate the seriousness of the global financial crisis.

Mr Speaker, PNG is not immune from the international crisis, and nor is PNG's budget performance. PNG's budget has always been deeply affected by fluctuations in the international commodity prices and

2008 was no exception as commodity prices have collapsed from record highs.

In accordance with the Fiscal Responsibility Act, the Government released the Mid Year Economic and Fiscal Outlook (MYEFO) report for 2008 in July 2008. At the time the 2008 MYEFO was released, commodity prices were at historically high levels, there was continued strong growth in the non mineral sector of the economy and expected higher inflation. These factors contributed to a higher revised revenue estimate for 2008.

The MYEFO estimates were made against a background of a significantly stronger economic outlook. However, the Government acted prudently by taking a conservative view regarding revenue collections. Given uncertainties in the movement of commodity prices, it was pointed out that commodity prices could move in either direction. Additional Revenue in the 2008 MYEFO were conservatively estimated at K1,447.1 million or 20 per cent higher than the 2008 original budget.

Budget Balance (Kina, Millions)

	2007	2008	2008	2008	2008
	Actual	Budg et	MYEF O	Revis ed	Outco me
Total Revenue and Grants	7028.6	7201.6	8648.7	7780.4	7073.3
Total Expenditure and Net Lending	6552.4	6999.2	7031.6	7789.9	7551.8
Deficit (-)/Surplus (+)	476.2	202.4	1617.1	-9.5	-478.5
% of GDP	2.5%	1.0%	7.3%	0.0%	-2.2%

Mr Speaker, there was also a small upward revision made to the expenditure side in the 2008 MYEFO. Total Expenditure and Net Lending was increased by K32.4 million or 0.5 per cent.

When the Government handed down the 2008 Supplementary Budget in September, it pointed out very clearly that since the MYEFO estimates were published there had been a number of significant developments affecting revenue. At that time, the international economic environment had become extremely uncertain, commodity prices were falling and the exchange rate had appreciated significantly.

The Government acted responsibly by handing down a Supplementary Budget of only K850.0 million rather than K1,447.1 million. Had it handed down a Supplementary Budget of K1,447.1

million, the Final Budget Outcome for 2008 would have been even worse.

Mr Speaker, in handing down the 2008 Supplementary Budget, the Government was mindful of the following:

- the need to continue with prudent fiscal management and Budget discipline;
- the large amounts already appropriated in 2008 including the funds sitting in Trust accounts and the significant lead time it takes to prepare quality spending plans including capacity constraints;
- the capacity of the economy and the impact on domestic demand and interest rates;
- equity consideration for future generations; and
- most importantly, the need to strike a good balance in relation to the great development needs of PNG.

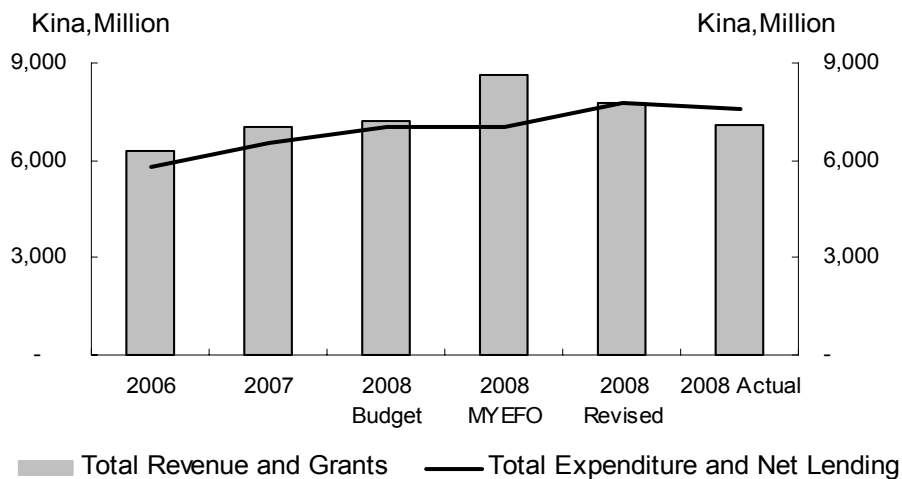
Mr Speaker, the pressing development needs of the country including the level of public debt and other liabilities can not be ignored. Hence it was important to ensure that the extra revenues were used productively.

Mr Speaker, the 2008 fiscal estimates were then revised down in the 2009 Budget in November 2008. The Government reassessed the domestic and international economic environment. Commodity prices

had fallen further after the Supplementary Budget was handed down. The Government revised Total Revenue and Grants for 2008 below the MYEFO estimate by K868.3 million or 10 per cent. Total Expenditure and Net Lending then largely matched the new revenue estimate thus making it effectively a balanced budget.

Mr Speaker, at no point did the Government lose control over the 2008 Budget. The 2008 Budget Outcome reflects the Governments commitment to prudent fiscal management.

Total Revenue & Grants and Total Expenditure & Net Lending



Mr Speaker, the Government is not defending the Budget deficit as indicated by the Deputy Opposition Leader. The 2008 Budget deficit was principally due to two factors on the revenue side of the Budget:

- Lower than expected mining and petroleum revenue, which was K430 million lower than the revised estimate. This was a

direct consequence of the collapse in international commodity prices in late 2008, and was completely outside the control of the Government.

- Lower than expected dividends from Government agencies, in particular the Bank of PNG, the National Fisheries Authority, and IPBC, by K114.5 million relative to the revised budget.

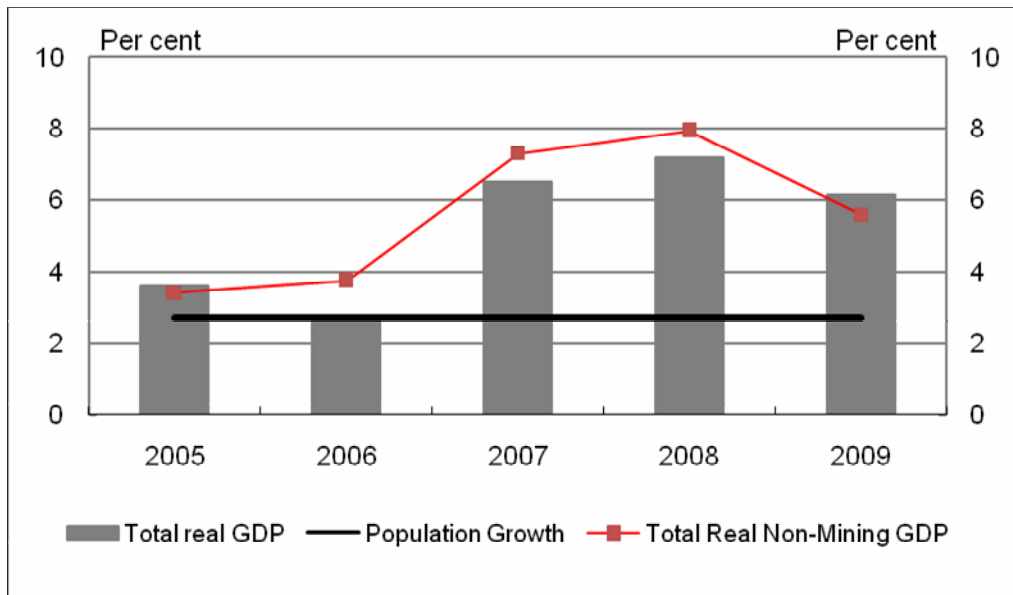
Mr Speaker, the Opposition fails to understand that the budget deficit in 2008 could have been far worse, had the 2008 Supplementary Budget been larger, and if not for the prudent use of the additional mineral revenue from the commodity boom. Because the Government has used the additional mineral revenue to put into trust funds and repay debt, recurrent expenditure was far lower than what it would otherwise have been.

In addition, the total expenditure and net lending in 2008 was K238 million lower than the revised estimate in the 2009 Budget. Had it not been the case, the deficit would have been even greater.

Mr Speaker, despite the global financial crisis and collapse in international commodity prices, the PNG economy has experienced strong growth rates over recent years including 2008. In real terms, the economy has grown from 3.6 per cent in 2005 to 7.2 per cent in 2008. Economic growth has exceeded population growth.

Most importantly, the non mining sector of the economy has been growing at a very high rate. In 2009, the economy is expected to continue to grow but at a slower rate than forecast at the time of the 2009 Budget.

Economic Growth (2005 – 2009)



To sustain PNG's high rate of economic growth and economic development, the Government will draw up to 4 per cent of GDP per annum from the trust funds saved during the boom years. This is consistent with the Government's Medium Term Fiscal Strategy 2008-12.

Summary

Mr Speaker, to conclude, the Government wishes to inform the Opposition and the public that we are concerned about the size of the

budget deficit in 2008 and it will undertake fiscal discipline measures in 2009 to avoid any unplanned spending outside of the budget process. However, the Government is currently operating in a highly uncertain external economic environment over which we have no control.

But we assure Parliament and the public that the Government is committed to prudent economic management and fiscal discipline, and that the Government is working hard to ensure that the 2009 Budget position is strengthened to the maximum extent possible.

Thank you.