

**The Solomon Islands: 2009 Article IV Consultation—Staff Report; Staff Statement; Supplement to the Staff Report; Public Information Notice; Statement by the Executive Director for the Solomon Islands**

The following documents have been released and are included in this package:

- The staff report prepared by a staff team of the IMF, following discussions that ended on July 29, 2009, with the officials of the Solomon Islands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on September 21, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement
- A staff supplement of on the joint World Bank/IMF debt sustainability analysis.
- A Public Information Notice (PIN)
- A statement by the Executive Director for the Solomon Islands.

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INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

**Staff Report for the 2009 Article IV Consultation**

Prepared by the Staff Representatives for the 2009 Consultation with the Solomon Islands

Approved by Subir Lall and Dominique Desruelle

September 21, 2009

- **Consultation:** The 2009 Article IV consultation discussions with the Solomon Islands were held in Honiara July 20–29, 2009. The staff team comprised David Cowen (Head), Kiichi Tokuoka, Li Zeng (all APD), and Milo Lucich (Asian Development Bank). Raynold Moveni (Advisor, OED) also attended the meetings. The team met with Central Bank of Solomon Islands Governor Denton Rarawa, Minister of Finance and Treasury Snyder Rini, Minister of Development Planning and Aid Coordination Steve Abana, other senior officials, and donor and private sector representatives. Staff worked with the World Bank on a debt sustainability analysis, with the Asian Development Bank also collaborating.
- **Past surveillance and advice:** In recent consultations, the IMF and authorities have agreed on the broad priority and direction of policies. Since the 2008 Article IV consultation, monetary policy has been conducted in line with staff recommendations, but budget execution and cash management remain concerns. On the exchange rate, only modestly greater flexibility has been allowed. However, in the area of financial sector oversight, timely improvements have been made.
- **Exchange rate system:** The Solomon Islands accepted the obligations under Article VIII, Sections 2(a), 3, and 4 in 1979 and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions. The exchange rate arrangement is currently classified as an other managed arrangement.
- **Economic statistics:** Progress is being made in upgrading the statistical framework, but further improvements are necessary to ensure effective surveillance (Annex V). Monetary and balance of payments statistics are being standardized. However, fiscal data still lack coverage of provincial governments. Further work is needed in producing reliable national income accounts, following a major revision, and a monthly nationwide consumer price index should be compiled.

Contents	Page
Executive Summary .....	3
I. Overview.....	4
II. Recent Developments .....	4
III. Outlook and Risks.....	10
IV. Policy Discussions .....	11
A. Fiscal Policy and Debt Sustainability .....	11
B. Monetary and Exchange Rate Policy .....	14
C. Financial and Structural Issues.....	16
V. Staff Appraisal .....	17
 Boxes	
1. Recent Changes to the National Accounts.....	4
2. Medium-Term Fiscal Outlook and Policy Credibility .....	13
3. An Exchange Rate Assessment for the Solomon Islands .....	15
 Figure	
1. Regional Comparison of Recent Macroeconomic Performance.....	6
 Tables	
1. Selected Economic Indicators, 2004–10.....	20
2. Balance of Payments, 2007–14.....	21
3. Summary of Fiscal Accounts, 2004–10.....	22
4. Summary Accounts of the Banking System, 2005–09 .....	23
5. Medium-Term Baseline Scenario, 2008–14 .....	24
6. Millennium Development Goals Progress.....	25

## EXECUTIVE SUMMARY

### Background

**Economic performance has weakened in 2009, given the global recession and the logging sector's decline, which have weighed heavily on exports and growth.** Real GDP growth is projected at 0.4 percent in 2009, compared to 6.9 percent in 2008. With lower fuel and food prices and tightening liquidity conditions, inflation pressures have eased considerably. The lower cost of commodity imports is also expected to lead to a reduction in the external current account deficit in 2009, more than offsetting projected declines in export volume and prices—notably timber and copra. However, with net external inflows slowing, reserves are projected to decline modestly.

**Growth hinges on maintaining macroeconomic stability, developing basic infrastructure, and undertaking structural reforms, including on land issues.** Over the next few years, given a likely further drop in logging output, the recovery in exports and growth is expected to be slow and also depends on the start of new mining activity. Increasing the Solomon Islands' competitiveness and diversifying the production base are also essential to reducing fiscal and external vulnerabilities.

### Key policy issues and recommendations

*Discussions focused on the policy framework needed to strengthen the fiscal and external positions, ensure financial sector soundness, and restore supportive growth conditions. Staff and the authorities broadly agreed on the near to medium-term outlook, but views differed on the pace and scope of fiscal and exchange rate adjustment.*

**Fiscal policy:** In view of the government's weak cash position and existing borrowing constraints, a combination of discretionary revenue and spending measures and structural fiscal reforms is needed to bolster tax collections, slow recurrent expenditure growth, and adequately fund development outlays. However, the authorities saw resources as adequate for implementing the 2009 budget and necessitating only modest fiscal tightening next year, despite cash pressures. Given near - to medium-term prospects, staff viewed new external assistance in the form of budget support as providing a cushion for undertaking more lasting fiscal adjustment and improving budget execution.

**Monetary and exchange rate policy:** With inflation falling and liquidity tightening, a more accommodative monetary stance is appropriate. Further development of the central bank's liquidity management operations as currently envisaged is necessary to contain liquidity risks, foster interbank activity, and ultimately improve monetary controls. Given signs of overvaluation and expected reserve losses, staff urged pursuit of a more flexible exchange rate policy. However, the authorities did not see exchange rate movements as immediately easing external pressures, viewing the current managed arrangement as an effective nominal anchor.

**Financial sector and other reforms:** Timely efforts aimed at fortifying the bank supervisory framework and enhancing monitoring and oversight should help strengthen controls and manage risks, as necessary, to deal effectively with the fallout of the growth slowdown. Accelerating improvements in the operational and financial performance of state enterprises will also assist in reducing fiscal risks. Further trade, investment, and land reforms should be aimed at attracting new foreign investment and promoting conditions for broader-based and sustained growth.

## I. OVERVIEW

1. **The focus of the 2009 Article IV consultation was on the challenging period that lies ahead for the Solomon Islands' economy.** Economic developments are being driven by weak external conditions, declining timber production, and an uncertain policy environment, which threaten to undermine recent stability gains and increase external vulnerability. To the country's credit, resiliency has been a hallmark of the Solomon Islands in response to previous setbacks, as evidenced by recent robust growth following unrest earlier in the decade. However, in the face of current adversity, further resolve will be needed to restore favorable growth conditions and maintain a stable macroeconomic environment.

## II. RECENT DEVELOPMENTS

2. **The effects of the ongoing global recession and depleted forestry reserves are weighing heavily on export earnings and growth prospects.** Following a record harvest in 2008, logging (60 percent of exports) now appears to be entering a period of irreversible decline due to overexploitation, with lower timber exports and taxable prices also leading to fiscal revenue losses.<sup>1</sup> Lower commodity prices have also dragged down rural incomes. Fisheries production is expected to remain flat, owing to weaker external demand and still modest sector investment (Box 1).

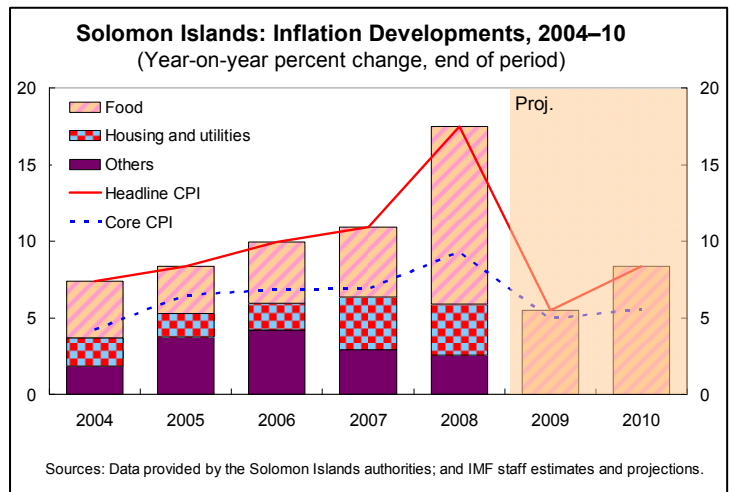
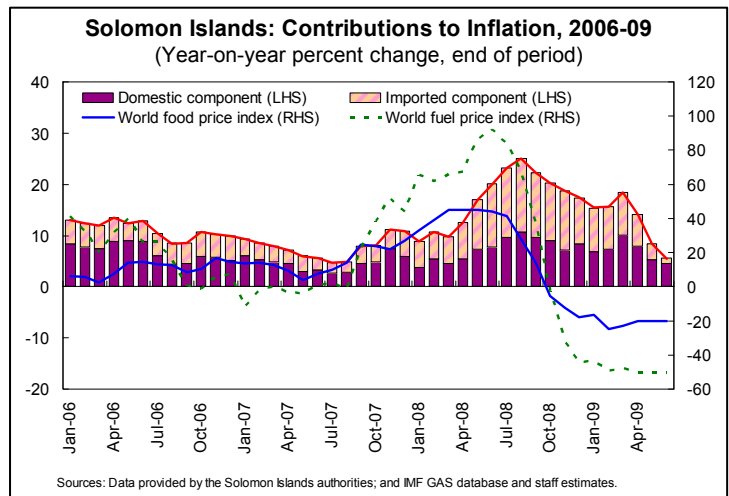
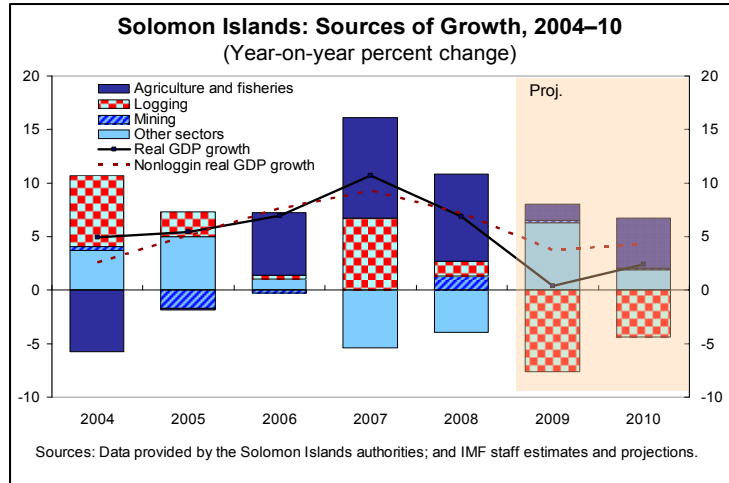
### Box 1. Solomon Islands—Recent Changes to the National Accounts

**Since the 2008 Article IV consultation, the authorities have adopted significant revisions to the national accounts data dating back to 2003.** The National Statistics Office (NSO), with assistance from the Pacific Financial Technical Assistance Center (PFTAC), has produced new constant and current price estimates of GDP by economic classification and expenditure share. These estimates, published by the NSO as a new series for 2003–06, have led to an increase in nominal GDP by 30–40 percent compared to the old series. National accounts data used in this report are based on the published series and growth estimates produced by the Central Bank of Solomon Islands for 2007 and 2008.

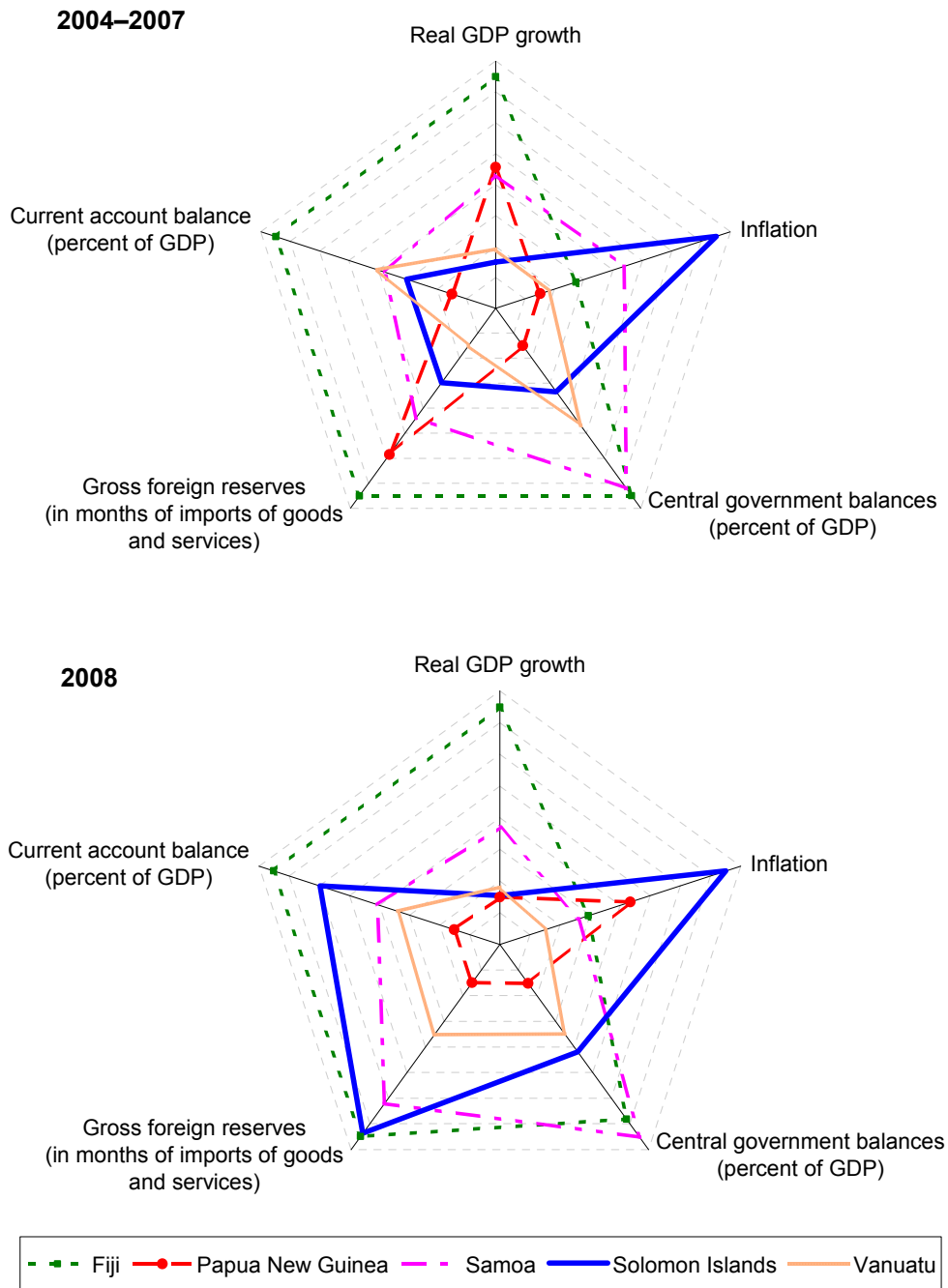
**Changes in the compilation of national accounts have focused on several key activities not fully captured in previous estimates.** The revisions come from two main sources. First, efforts have been made to more precisely capture household and informal activities, in particular those in the agricultural sector. These changes are now reflected in the published series. Second, recent PFTAC assistance has focused on producing more accurate estimates for public administration and defense, using data from the government's development budget, although series including this set of changes have not yet been published.

<sup>1</sup> The current outlook, in line with that of the authorities, is for logging output to decline from 1.5 million cubic meters in 2008 to 1.1 million cubic meters in 2009, and by another 20 percent a year in 2010 and 2011, with an even more rapid pace of decline thereafter.

- Boosted by timber exports, real GDP growth was an estimated 6.9 percent in 2008 (Table 1), driven also by strong demand and record prices for palm oil and copra and a healthy rise in tourism and trading activity. Compared to other countries in the region and relative to earlier years, signs of strain began to emerge in the Solomon Islands in 2008 (Figure 1), as evidenced by relatively high inflation, a weak external current account, and falling reserve cover.*
- However, in 2009, growth is projected to be only 0.4 percent, or around 3¾ percent excluding logging—about half the rate of the previous year. Aside from problems in the timber sector and the fall in commodity prices, major floods in early 2009 have adversely affected agricultural output, with El Niño conditions also possibly constraining sector growth this year and next. Combined with tighter credit conditions, domestic demand is expected to be less supportive in 2009.*
- On the positive side, inflation pressures have eased considerably with lower food and fuel prices. Headline inflation was 5½ percent (y/y) in June, down from a peak of 25 percent in mid-2008, and is expected to be at about the same level at end-2009.*
- The current account deficit is projected to be 11 percent of GDP in 2009, compared to around 19 percent in 2008 (Table 2). Notwithstanding the effects of lower logging production—with timber exports now expected to be down 25–30 percent in 2009, some cushion is being provided by low imported commodity prices, notably oil. Gross official*



**Figure 1. Solomon Islands: Regional Comparison of Recent Macroeconomic Performance 1/**



Sources: Data from country authorities; and IMF staff estimates.

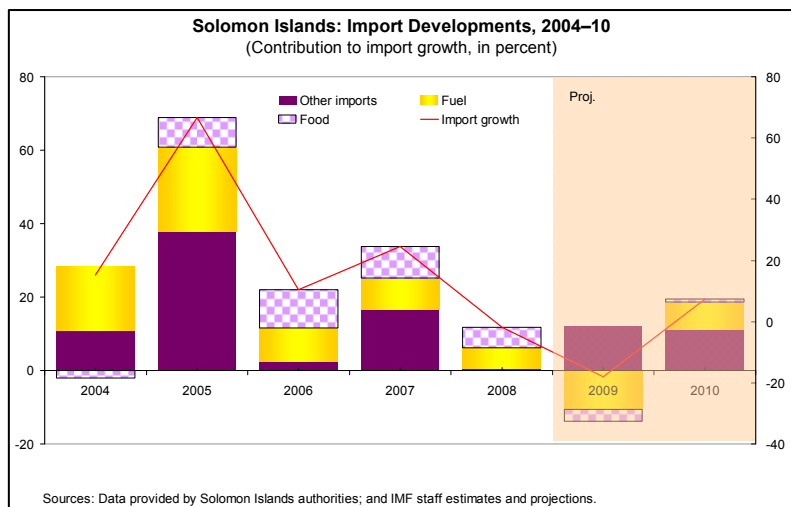
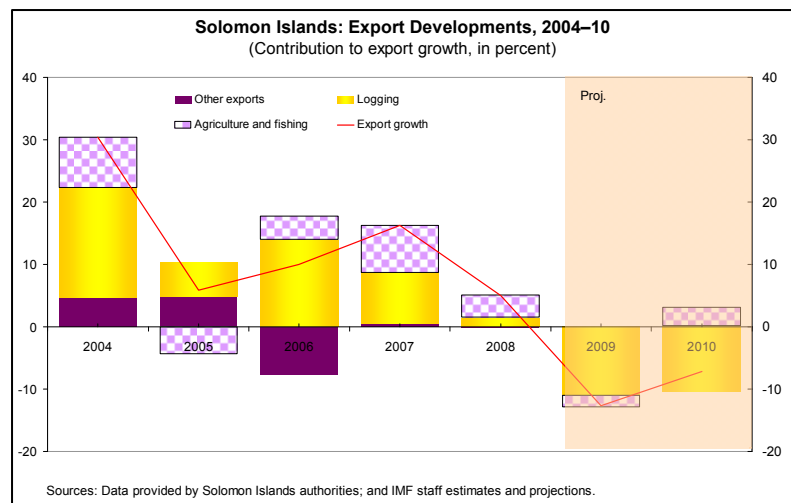
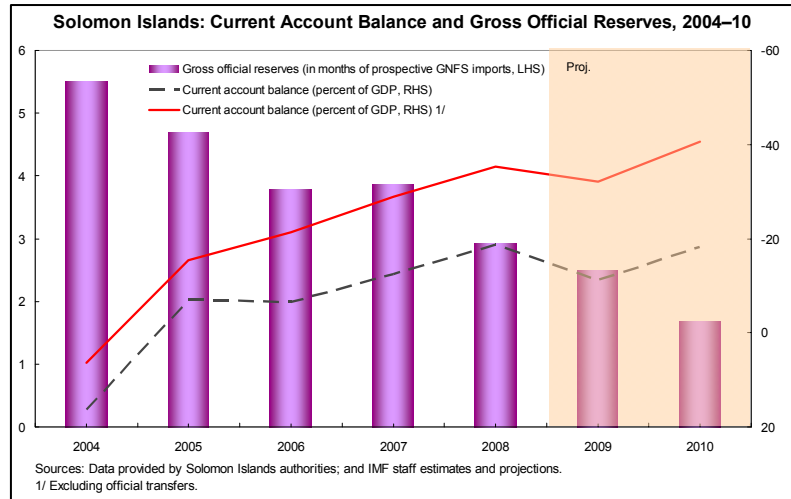
1/ The center of the chart signifies higher GDP growth, lower inflation, larger reserve cover, a more robust fiscal stance, and stronger current account balance.

reserves are expected to remain under pressure, with a projected decline to around US\$88 million (2.5 months of next year's imports) by end-2009.<sup>2</sup>

- The *exchange rate* has been allowed to depreciate against the U.S. dollar by around 5 percent since April 2008, following a long period of stability. Notwithstanding this and recent U.S. dollar weakness against other currencies in the basket peg, the real effective exchange rate has appreciated by about 20 percent (between April 2008 and May 2009), raising competitiveness concerns and possibly putting pressure on the balance of payments.

3. **In light of the slowdown, the fiscal position will likely weaken in 2009, with possible financing constraints, following comparatively strong performance in 2008.** The overall fiscal balance is expected to slip into a deficit (including grants) of around 0.4 percent of GDP in 2009, against an estimated surplus of 1.5 percent of GDP last year (Table 3).

- Budget performance in 2008 was bolstered by stronger-than-expected revenue growth.* The

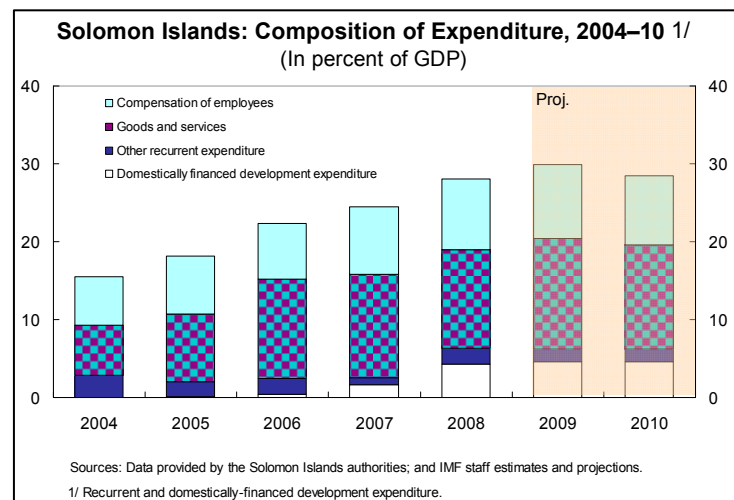
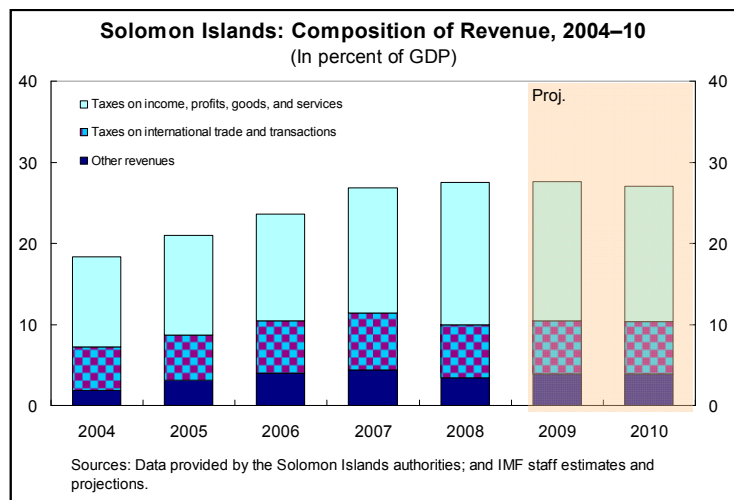
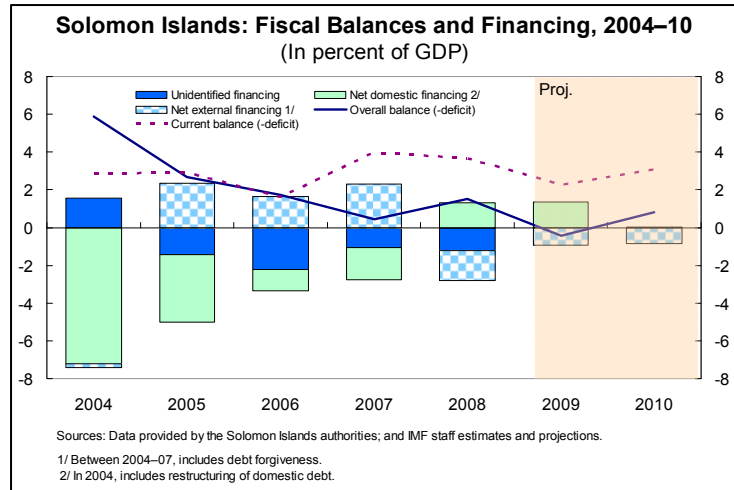


<sup>2</sup> Gross official reserves at end-2009 are inclusive of the general SDR allocation and special SDR allocation made by the IMF to the Solomon Islands in August and September 2009, respectively, totaling SDR 9.9 million.



collection of income taxes rose sharply, as did the goods and services tax (GST), including on fuel, and with tax relief given on rice imports (to partially mitigate food price increases). *At the same time, overall expenditure growth slowed as targeted.* Nonetheless, recurrent spending exceeded the budget, owing in part to the impact of minimum wage increases on civil service remuneration and higher utility costs.

- *A more supportive fiscal stance was targeted in 2009 with the weakening economy.* However, declining tax revenues and weak spending controls have led to periodic cash shortages, hampering effective fiscal operations. In response, the government took measures in April to conserve cash, led by a 10 percent cut in nonessential recurrent outlays and freeze on civil service hires.<sup>3</sup> Select import duties and excises also were increased and tax and customs exemptions were tightened. Subsequently, cuts were made in domestically financed development outlays. However, offsetting these measures was a supplemental appropriation bill approved in August authorizing

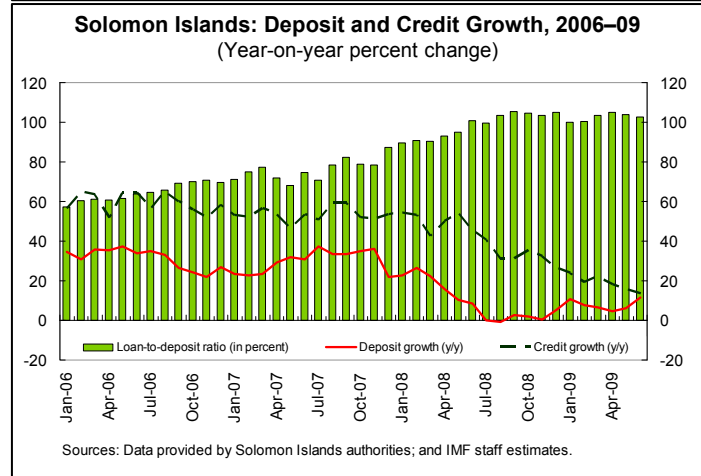
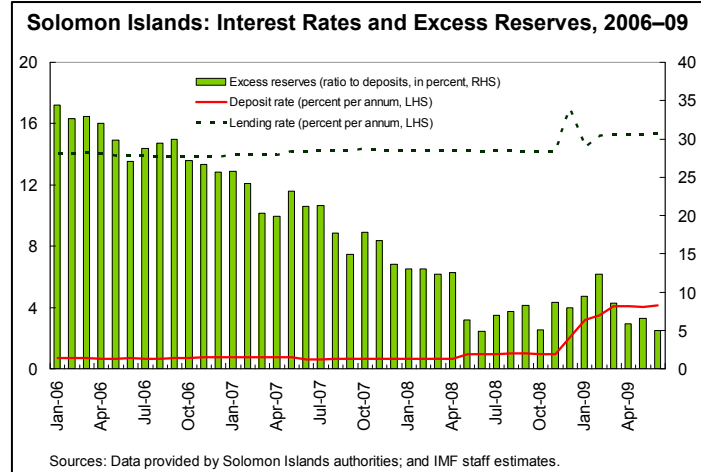
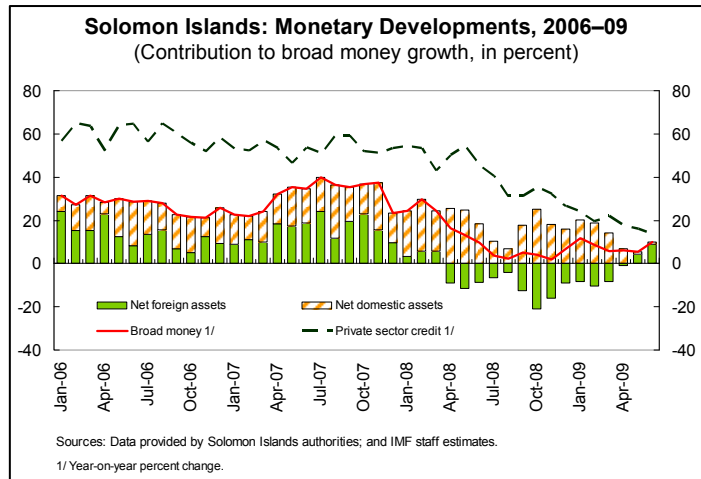


<sup>3</sup> In addition, for the remaining 90 percent of the recurrent allocation, line ministries were asked to reserve an additional 25 percent in spending until the cash situation improved.

new spending equivalent to around 1½ percent of GDP.<sup>4</sup>

- *In view of current plans and absent further support, the government's cash position could run down to less than one week of domestically financed spending by year's end. Borrowing constraints have hardened under the Honiara Club Agreement (HCA).<sup>5</sup> To cover essential outlays, the government at times has delayed payment orders and undertaken ad hoc budget reallocations, emblematic of long-standing weaknesses in cash management and budget execution.*

4. **At the same time, liquidity conditions have tightened, with external inflows and deposit growth slowing.** Broad money is expected to increase by around 8½ percent in 2009, with private sector credit projected to rise by 6 percent this year, compared to 26½ percent in 2008 (Table 4). In response to looser conditions prevailing in 2008, the Central Bank of Solomon Islands (CBSI) raised the liquid asset requirement (LAR) on banks to 7.5 percent last November. To help better manage liquidity conditions, the CBSI also introduced a Secured Advance Facility (SAF) in late 2008—timely given the recent need for temporary liquidity



<sup>4</sup> Included were increases in rural livelihood constituency grants for members of parliament to spend in their home districts, the use of which is not necessarily aligned with government development priorities.

<sup>5</sup> Under the HCA, the Solomon Islands was provided debt rescheduling and relief by a group of major creditors (Australia, the European Commission, the European Investment Bank, and International Fund for Agriculture Development) in 2007. In exchange, the government is expected to refrain from new external borrowing and pursue grant financing and ODA only until it achieves “green light status” under IDA’s debt distress ratings system. Following the 2004 domestic debt restructuring and a settling of expenditure arrears, new domestic borrowing has been limited by ongoing efforts by the central government to strengthen debt management.

support in the banking system.<sup>6</sup> A new liquidity forecasting framework was also introduced at the CBSI in mid-2009, with IMF technical assistance.

### III. OUTLOOK AND RISKS

5. **Under the current baseline, growth is expected to remain below recent trend over the next few years.** For 2010, real GDP is projected to expand by around 2½ percent (Table 5), supported by moderately improving conditions in China, Korea, and other major East Asian trading partners; increased palm oil and rebounding copra production; and new foreign direct investment (FDI) in mining and telecommunications.<sup>7</sup> Greater air carrier competition between the Solomon Islands and Australia has lowered ticket costs significantly, which should give tourism a boost along with further investment in this sector. However, declining logging and ancillary activity—in 2010 and beyond—would continue acting as a drag on income and employment, fiscal revenues, and export receipts. Starting in 2012, large-scale gold production is expected to boost growth significantly.<sup>8</sup>

6. **In view of these conditions, the fiscal position and external current account could come under more strain over the next several years, putting pressure on foreign reserves.** Under this baseline, the current account deficit would widen starting in 2010, given further expected declines in timber exports and a projected rise in the oil import bill. New capital imports associated with mining, telecommunications, and potentially large-scale agricultural and fisheries projects would also widen the deficit, although these would be financed largely by FDI and/or official inflows. Still, without additional external financing, reserves are projected to fall to the equivalent of 1.2 months of the following year's imports by end-2011. Even with gold exports from 2012, the external current account deficit will likely remain at an elevated level given the large import requirement of new nickel mining operations, now expected to commence by mid-decade. Risks would remain to the downside, namely stemming from a possible prolonged global downturn, delays in mining production, and further policy slippages. Complicating planned investment projects could be continued uncertainty about land tenure and access, commodity price volatility, and financing availability. On the upside, government capacity building, improved basic infrastructure, and streamlined investment regulations could be offsetting factors.

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<sup>6</sup> The SAF provides eligible banks a seven-day advance (with possible rollover), against which banks must pledge restructured government bonds as collateral. In addition to this new standing credit facility, the CBSI still maintains the Bokolo deposit facility for 1–2 year deposits.

<sup>7</sup> A Telecommunications Bill was approved in August 2009, which opens mobile services to competition in 2010 and internet services in 2011.

<sup>8</sup> Australian Solomons Gold Limited is undertaking a US\$134 million rehabilitation of the GoldRidge mine, with co-financing from the European Investment Bank and International Finance Corporation. Based on current plans, staff expect the mine to produce an average of 120,000 troy ounces of gold a year during 2012 to 2018.

7. **Based on this outlook, large and potentially destabilizing macroeconomic imbalances could emerge, necessitating sizable policy adjustment, as well as new exceptional financing.** Specifically, they are:

- A *budget financing gap* equivalent to 4 percent of GDP a year (around US\$25 million in 2009), based on the fiscal policy response needed to build up minimal government cash reserves to two months of recurrent and domestically financed development spending and avoid potentially debilitating spending cuts, backed by additional budget support.
- An *external financing gap* averaging around US\$25 million a year, arising from the adjustment and financing needed to maintain gross reserves to the equivalent of three months of prospective nonmining-related imports—a modest level in view of the Solomon Islands' vulnerability to shocks and current risk factors.

#### IV. POLICY DISCUSSIONS

8. **Policy discussions focused on actions needed to ensure fiscal sustainability, contain external vulnerability, and generate sustained high growth.** There was broad agreement on the near to medium-term outlook, but views differed on the pace and scope of actions needed to strengthen the fiscal position and on the role of the exchange rate in facilitating adjustment.

##### A. Fiscal Policy and Debt Sustainability

9. **The authorities recognized the worsening fiscal situation, with staff urging a cohesive strategy for easing the cash constraint, including pursuit of possible new budget support.** In the authorities' view, measures already in place were seen as providing adequate resources for executing the 2009 budget, as amended. Staff supported cuts in recurrent spending given its unchecked growth in recent budgets, but noted a rollback in development outlays could be destabilizing. In addition, the authorities were urged to raise the taxable price of logs,<sup>9</sup> scale back new parliamentary entitlements, and further reduce nonessential recurrent spending, including on government travel. Carryover restraints were also recommended in 2010, in addition to pursuing further budget support—all essential to building up minimal cash reserves, regularizing budgetary operations, and providing breathing space to implement ongoing structural fiscal reforms.

10. **On the 2010 budget, staff noted a tighter fiscal stance would be necessary to solidify the cash position, avoid spending arrears, and restore budget credibility.** To this end, the authorities were urged to target an overall surplus of at least 1½–2 percent of GDP in next year's budget. However, under current policies and based on existing donor commitments, staff projected the overall surplus would likely reach only around 0.8 percent of GDP in 2010. In the

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<sup>9</sup> As in recent consultations, the authorities expressed reluctance to raise the determined price of logs for taxation purposes using an automatic mechanism. By staff estimates, an increase in the determined price of logs by an average of US\$25 per cubic meter could raise revenue by 1 percent of GDP a year.

event, staff noted the government would face a high risks of cash shortages in the upcoming fiscal year, necessitating an even tighter hold on nonessential recurrent spending to avoid crowding out government-funded development spending and further placing an economic recovery at risk. Under this and even more optimistic scenarios (e.g., logging revenue remains constant as a share of GDP), further external assistance would likely be necessary. In response, the authorities saw improved tax and customs administration as providing a substantial revenue boost in 2010, with further buoyancy coming from an anticipated recovery. At the same time, they acknowledged spending pressures were already emerging associated with the 2010 elections. In view of recent high inflation, civil service wages hikes could add further pressure.

11. **There was general agreement that medium-term fiscal sustainability requires steady progress on reforms to strengthen the revenue base and improve budget execution.** Staff urged these efforts be underpinned by a medium-term budget framework, which would need to target expenditure smoothing during the transition period from logging to mining revenues (Box 2). This framework would be anchored by targeting a low to moderate overall surplus (including grants), given limited domestic financing options and foreign financing constraints. To this end, the authorities noted work under way to improve medium-term revenue forecasting.

12. **With respect to increasing fiscal revenue, efforts focus on broadening the tax base, curtailing the use of exemptions, and improving tax and customs administration.** Priorities on inland revenue include expanding taxpayer registration and further reducing tax arrears, but the authorities acknowledged more resources were needed for auditing and record keeping to improve compliance. Over time, they noted a value-added tax would be considered, as part of efforts to expand the revenue base and ease the burden imposed by the existing GST on final producers. On customs administration, in addition to further reductions in discretionary exemptions, projects are underway aimed at strengthening inspection procedures, implementing WTO valuations, and introducing post-clearance audits. A Customs Valuation Bill approved in August 2009 is expected to support these efforts, in part by increasing penalties for evasion of duties. Staff also urged the authorities to ensure that an internationally accepted tax regime was in place for the emerging mining sector, given the need to develop new sources of fiscal revenue and at the same time ensure sound resource management, with possible IMF technical assistance in this area.

13. **To strengthen expenditure control, public financial management reforms aim to improve cash management, budget integration, and accounting and audit functions.** Plans are underway to formulate a cash flow forecasting model, fully implement new payroll and accounting systems, and integrate cash and debt management. Ongoing government audits of line ministries' accounts will be used to help strengthen accounting and internal control functions. A debt management strategy, centralized recording system, and proper accounting for treasury bills could facilitate future government borrowing, as conditions allow.

14. **The Debt Sustainability Analysis (DSA) indicates that the Solomon Islands would continue to face moderate risk of debt distress.** Under the framework of the HCA, public debt has declined significantly in recent years, equivalent to 32 percent of GDP at end-2008. In the baseline, all debt

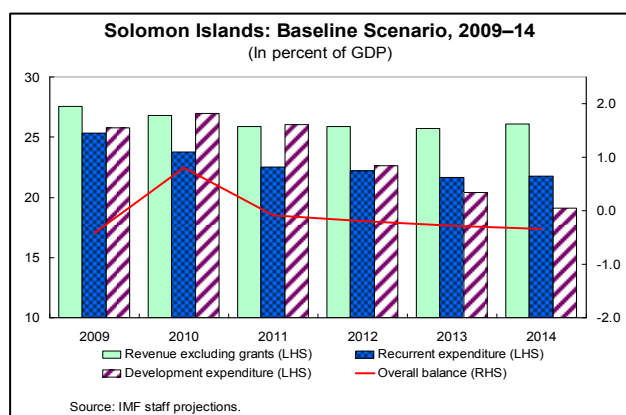
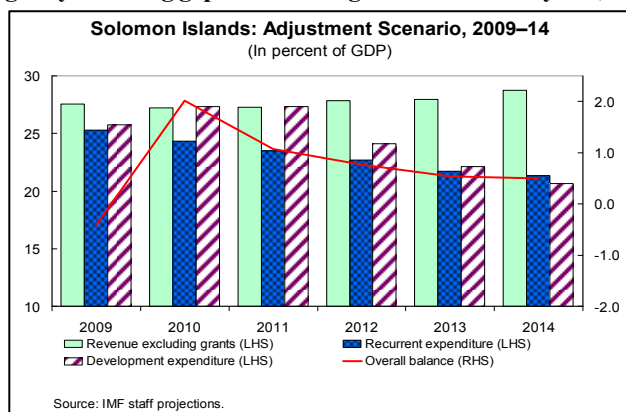
## Box 2. Solomon Islands—Medium-Term Fiscal Outlook and Policy Credibility

The Solomon Islands' fiscal performance has been relatively strong in recent years, supported by both robust economic growth and improved revenue administration. Since 2008, however, fiscal pressures have emerged. As a result, the government faces a severe cash constraint, reinforced by its pledge under the Honiara Club Agreement to restrict official borrowing in exchange for significant debt relief.

Under the current baseline, potentially large budgetary financing gaps could emerge the next several years, even assuming modest resumption of external borrowing from 2011. Based on the current outlook, donor commitments would be expected to decline in real terms starting in 2010, including those under the umbrella of the multi-donor Regional Assistance Mission to Solomon Island. Absent a significant rise in nonlogging revenues, this scenario would require major spending compression at a time when development-related assistance would be leveling off.

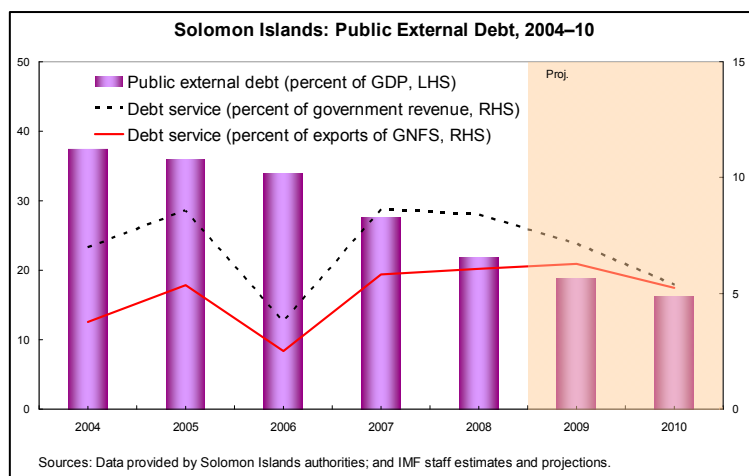
As an alternative, the adjustment scenario would be underpinned by a more robust policy framework, targeting more ambitious tax measures and public financial management reforms than currently envisaged. This framework would be expected to draw in additional donor assistance, including new budget support, and eventually enable the government to borrow abroad more aggressively for development expenditure. Policy adjustment would also give rise to a faster accumulation of cash reserves.

Going forward, scope may exist under an adjustment scenario for more flexible fiscal operations.



- *Current rules restricting external and domestic borrowing have been effective in lowering debt service payments.* However, they may act to excessively constrain fiscal policy by counteracting automatic stabilizers. Moreover, when revenue shortfalls are substantial, these rules could press the government to reduce its own outlays in essential areas such as health and education and for development spending.
- *As fiscal and debt management strengthens, the government may wish to consider adopting more flexible rules and anchor them with a medium-term budget framework.* Experience elsewhere suggests that credible fiscal rules can alleviate potential debt bias and time inconsistency problems. Theoretically, a sophisticated target, such as a fiscal deficit as a share of GDP that varies in line with the output gap, can help enforce fiscal discipline, while avoiding procyclicality often caused by a simple rule (e.g., a fixed cap on the debt as a share of GDP, allowing the deficit to reach near the ceiling in an economic boom).
- *A first step might be to design a simple target limiting the fiscal deficit (excluding grants) or to set caps on major spending categories, given the source of past slippages and need for budget credibility.* A target on the fiscal balance excluding natural resource revenues, as recently adopted by Papua New Guinea, may also be an option, given expected volatile timber-related and rising mining-related tax receipts over the medium term.

indicators are expected to remain below their policy-dependent indicative thresholds. However, the baseline scenario assumes only modest new external support, which risks financing gaps, as noted earlier, necessitating fiscal and external adjustment in the next few years to avoid even tighter cash constraints and larger reserve losses. Medium to long-term debt sustainability would continue to depend on developing new sources of export earnings to



replace logging. Domestic borrowing would also be expected to remain appropriately constrained by earlier debt restructuring agreements and the need to avoid crowding out of private sector borrowing.

## B. Monetary and Exchange Rate Policy

15. **With inflation pressures subsiding, the authorities agreed scope remained for monetary easing.** The CBSI already shifted to this bias earlier in 2009, as evidenced by modest open market purchases from banks and some exchange rate depreciation. However, given few monetary instruments, banks' limited (i.e., government) debt holdings, and an already moderate LAR, staff noted additional easing might come through foreign exchange operations. Staff indicated that such operations would likely necessitate greater day-to-day movement in the official exchange rate vis-à-vis the U.S. dollar, in part through a widening the daily trading band. This could help shore up reserves and address a sizable overvaluation of the Solomon Islands dollar (Box 3). The authorities noted banks were already required to sell foreign exchange to the CBSI under current net open limits.<sup>10</sup> However, they were reluctant to make more fundamental moves given concerns about the shallowness of the foreign exchange market and a view even a large change in the exchange rate might not immediately ease balance of payments pressures, seeing the current managed arrangement as an effective nominal anchor, notwithstanding recent high inflation.

16. **To improve monetary controls, the authorities were urged to develop new instruments and strengthen the operational framework.** In particular, with the standing (Bokolo) deposit facility offering low yields and new government debt issuance constrained, banks appear in need of short-term obligations to help manage liquidity. To this end, staff urged the issuance of short-term (e.g., 28-day) CBSI bills. Such an instrument would give the CBSI a more effective tool for managing liquidity and help promote greater interbank activity. Staff and the authorities agreed that the newly introduced SAF was an important tool for providing temporary liquidity support, which along with better designed deposit facilities, could help guide

<sup>10</sup> A limit on a bank's overnight position of SI\$5 million is currently imposed. Banks must either reduce the position in the foreign exchange market or sell excess holdings to the CBSI.



### Box 3. An Exchange Rate Assessment for the Solomon Islands

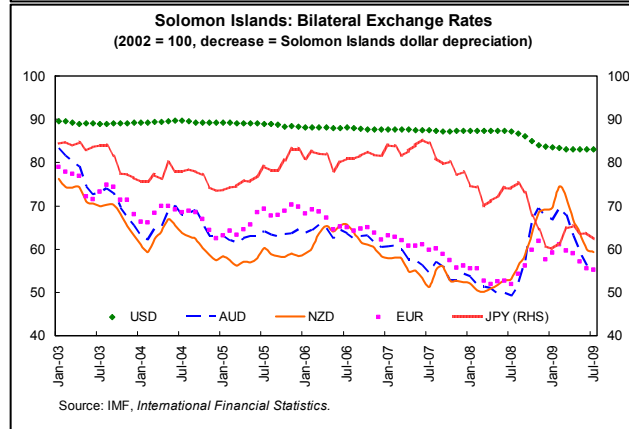
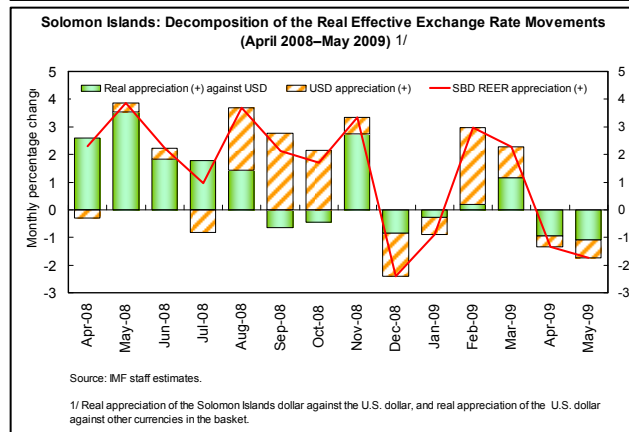
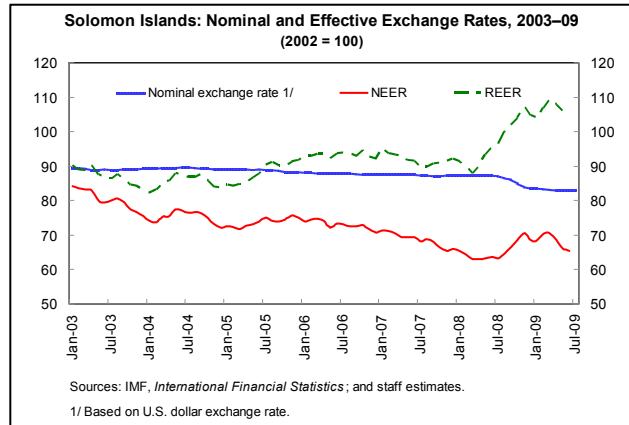
**The exchange rate assessment points to a substantial overvaluation of the Solomon Islands dollar (SIS).**

These findings differ since the last assessment at the time of the 2008 Article IV consultation, when the exchange rate was found to be broadly in line with fundamentals.<sup>1</sup> Following a period of relatively little change, the Solomon Islands dollar depreciated by about 5 percent vis-à-vis the U.S. dollar (US\$) in nominal terms between April 2008 and May 2009, but has since been mostly stable. From the start of the same period through March 2009, however, the real effective exchange rate (REER) appreciated by about 25 percent.

**The recent REER appreciation can be decomposed into (i) the SIS’s real appreciation vis-à-vis the US\$ and (ii) the US\$’s real appreciation relative to other currencies in the basket peg arrangement.** The first component, largely driven by the Solomon Islands’ high inflation relative to the United States, was a major factor until mid-2008, when inflation pressures began to ease with falling commodity prices. Since then, large swings in US\$ exchange rates vis-à-vis other currencies in the basket have become the main reason behind the REER appreciation. Since April 2008 the SIS has appreciated by 5, 10, and 20 percent against the euro, Australian dollar, and New Zealand dollar, respectively.

**Given recent large external imbalances and the near-to-medium-term outlook, some further depreciation of the SIS vis-à-vis the US\$ is justifiable.** Using the equilibrium real effective exchange rate (ERER) approach, the assessment results suggest that the REER of the Solomon Islands is currently overvalued by about 26 percent. The same holds using a modified macroeconomic balance approach, where the impact of REER on foreign reserves is gauged with a VAR model. Here, the results imply that the SIS is overvalued by around 20 percent, that is, the adjustment needed in order to maintain official foreign reserves at three month’s coverage of prospective nonmining-related imports.

**Historical experience shows that the exchange rate can be used as an effective adjustment tool for the Solomon Islands.** While the authorities indicated concerns about the low elasticity of import demand, the results of this analysis suggest that exchange rate adjustment tends to have a larger impact on exports than on imports, and thus could lead to improvements in the country’s external balance. However, recognizing that in a small open economy the exchange rate cannot carry the full burden of adjustment, progress in other areas is needed to strengthen competitiveness, such as improving transportation infrastructure, lowering operating and borrowing costs, and implementing new streamlined business regulations.



1/ See IMF Country Report No 08/358.



market interest rates. Along with the new liquidity monitoring framework, more effective use of these instruments in injecting and withdrawing liquidity could also help facilitate a move toward adopting quantitative targets.

17. **Staff and the authorities agreed that the newly allocated SDRs by the IMF should be used to boost foreign reserves, in view of mounting external pressures.** However, given the near to medium-term outlook and risks, these additional resources should be viewed as complementary to necessary fiscal and external adjustment.

### C. Financial Sector and Structural Issues

18. **The authorities have taken timely steps to strengthen the banking supervision framework, but agreed risks lie ahead that bear close watch.** They noted new prudential guidelines had been issued addressing capital adequacy, asset classification and provisioning, and large credit exposure, which staff welcomed. Stipulations in the new Secured Transaction Act also broaden the base of eligible collateral. While the banking sector has been very profitable in recent years, staff cautioned that the recent uptick in nonperforming loans (NPLs) and funding constraints suggest credit and liquidity risks are rising.<sup>11</sup> The government's weak cash position may also be affecting borrowers' ability to stay current with loans, which staff urged be monitored closely. Going forward, with banks' funding costs rising and limited fee-based income, profits could come under pressure. If so, staff noted this could possibly limit banks' ability to provision for loan losses.

19. **In view of global financial conditions and the economic slowdown, the authorities agreed the National Provident Fund (NPF) should continue to be monitored closely.** In particular, staff urged the NPF proceed cautiously with diversifying its balance sheet—both onshore and offshore—especially in view of operating losses incurred recently, namely on overseas investment. In addition, members' use of own contributions as pledged collateral against real property would need to be watched closely by the NPF to ensure this practice was limited to creditworthy borrowers.

**Given the longstanding financial difficulties of state-owned enterprise (SOEs) and associated fiscal risks, staff urged swift action to commercialize their operations.** In preparation for this, external audits of the large SOEs' financial accounts have been completed through 2007. As audits of the 2008 and 2009 accounts become available and in view of the need to avoid cross-arrears with government, staff urged SOEs proceed quickly into the strengthening phase of their reform program, which aims to improve record keeping, accounting and control standards, and corporate governance. The authorities indicated that the Ministry of Finance and Treasury's new SOE monitoring unit would play a key role in assessing progress in achieving these objectives, with a view to also guiding privatization decisions over the medium term.

20. **The authorities noted progress made in other areas aimed at improving the investment climate, but a number of challenges remain, especially on land issues.** To help

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<sup>11</sup> Some of the recent increase in NPLs is due to application of new loan classification standards adopted in 2008.

streamline business formation and regulation, a new Companies Act and Companies (Insolvency and Receivership) Act were approved in 2009. A legal framework to help guide investment in transportation infrastructure was also established earlier this year with passage of the National Transport Fund Act, which enables donors to set up funds for road and maritime projects. The Solomon Islands completed its second World Trade Organization (WTO) Trade Policy Review in June 2009, highlighting progress made in reducing the level and dispersion of most favored nation (MFN) applied tariffs, but also pointing to the need to comply fully with WTO binding commitments and address the discriminatory application of certain internal taxes. On the other hand, land reforms continue to proceed slowly. A Land Reform Unit (LRU), formed in 2007 to guide government land policy, has yet to become fully operational. The Tribal Land Bill, which aims to expedite resolution of land ownership to ease access for commercial purposes, has also stalled following legal review, awaiting redrafting by the LRU.

## V. STAFF APPRAISAL

21. **Macroeconomic outlook:** The effects of the global recession and depleted forestry reserves are weighing heavily on export earnings and growth prospects. With little growth expected in 2009 and only modest recovery the next few years, the overall fiscal position and external current account could come under more strain, putting pressure on foreign reserves. Over the medium term, with new mining operations expected to come on stream by 2012, the outlook improves, but still with uncertainty given previous production delays. More than this, improving conditions for sustained high growth requires maintenance of macroeconomic stability and pursuit of structural, trade, and legal reforms aimed at ensuring better service delivery, reducing costs, and resolving land disputes. All of this should be done with a view to raising competitiveness and possibly attracting new FDI in labor-intensive and export-rich activities, notably agriculture, fisheries, and tourism.

22. **Near-term risks:** Risks are expected to remain to the downside over the foreseeable future, with the main factors being a prolonged global recession, delayed mining production, and further policy slippages. Related to this, the failure to undertake necessary adjustment to adequately address fiscal and external imbalances could act to undermine macroeconomic stability and already-strained investor confidence. These factors could undercut growth prospects, limit employment opportunities, and invite social unrest—possibly reversing some of the noteworthy security gains made in recent years. On the upside, government capacity building, improved infrastructure, and streamlined investment regulations could provide an added lift.

23. **Fiscal policy:** Given prevailing conditions, sizable fiscal slippages are likely in 2009, with the risks of carryover into 2010 absent decisive measures. While some deterioration might be expected as automatic stabilizers kick in, the lack of cash is constraining effective fiscal operations. Some immediate relief could be found in increasing the taxable price of logs, scaling back new parliamentary entitlements, and further restraining nonessential recurrent spending, including in the 2010 budget. However, more lasting efforts are needed to deal effectively with the permanent loss in logging revenues and persistent weaknesses in cash and spending controls, as the current fiscal path is neither sustainable nor desirable, with existing limits on new

borrowing expected to stay in place for some time. More fiscal space also needs to be created for well-targeted, export-related, and employment-intensive development spending.

24. **Medium-term fiscal prospects:** Ensuring a sustainable fiscal stance and effective budget operations hinges on further broadening the revenue base, strengthening tax and customs administration, and reducing tax exemptions, as well as rolling back nonessential recurrent spending, managing closely civil service wage and employment growth, and improving cash management, accounting, and audit functions. However, these efforts may take some time. In the interim, more external assistance in the form of budget support may be essential to building a cash cushion, regularizing budgetary operations, and providing impetus for lasting structural fiscal reforms and adjustment.

25. **Monetary policy:** With liquidity conditions tightening and inflation pressures subsiding, the move towards a more accommodative monetary stance appears appropriate. Given an already moderate LAR and limits on open market operations, further policy loosening could come principally through foreign exchange operations. In view of current limitations, the CBSI should take further steps to improve monetary policy effectiveness. Foremost, the new liquidity monitoring framework could be used as a basis for developing a more flexible set of instruments and informing an appropriate choice of monetary targets. Complementing these efforts, a further refinement of standing facilities and issuance of short-term CBSI bills would help to deepen interbank activity and improve banks' own liquidity management.

26. **Exchange rate policy and competitiveness:** Taking account of recent and prospective external imbalances, greater exchange rate flexibility could help facilitate necessary adjustment to stem reserve losses. Based on an updated assessment, the exchange rate appears to be substantially overvalued. Under the current managed arrangement, more flexibility is needed vis-à-vis the U.S. dollar. Recognizing in a small open economy the exchange rate cannot carry the full burden of adjustment, a more stable fiscal stance and stronger reform efforts are also necessary to strengthen external competitiveness and improve growth opportunities.

27. **Financial sector:** The banking system appears well positioned to handle the slowdown in growth and associated rise in NPLs, given its recent strong performance and efforts by the CBSI to strengthen oversight. However, signs of increasing liquidity and credit risks facing banks need to be monitored closely. Complementing this effort should be tight enforcement by the CBSI of new prudential guidelines on capital adequacy, loan loss recognition, and large credit exposure to help safeguard the banking system during the current slowdown. Risk management controls should also be in line with parent bank operations. In light of recent global financial turmoil, NPF operating losses should continue to be monitored closely.

28. **External assistance:** Given the near- to medium-term outlook, development partners appear willing to provide new budget support, but recognize that in the current environment this will entail considerable risks, especially going into an election year. The DSA still points to a moderate risk of debt distress, with positive debt dynamics dependent on growth-inducing adjustment, new mining and export opportunities, and renewed access to concessional borrowing.

29. **Fund engagement:** Given potentially large financing gaps and the uncertain external environment, staff is prepared to further discuss with the authorities possible modalities of support, including access to Fund financial resources. In technical areas, the Solomon Islands should continue to avail itself of PFTAC support to further strengthen macroeconomic management, statistical policy, and financial sector oversight.

30. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Table 1. Solomon Islands: Selected Economic Indicators, 2004–10

	2004	2005	2006	2007	2008	2009	2010
					Est.	Proj.	
Growth and prices (percentage change)							
Real GDP	4.9	5.4	6.9	10.7	6.9	0.4	2.4
CPI (period average)	6.9	7.1	11.1	7.7	17.2	8.0	7.0
CPI (end of period)	7.4	8.3	9.9	10.9	17.5	5.5	8.4
Per capita GDP (in US\$)	815	878	945	1,093	1,266	1,290	1,351
Central government operations (percent of GDP)							
Total revenue and grants	33.5	46.9	47.3	50.2	48.9	50.6	51.9
Revenue	18.3	21.0	23.6	26.8	27.5	27.6	27.2
Grants	15.2	25.9	23.8	23.4	21.4	23.1	24.7
Total expenditure	27.6	44.2	45.6	49.7	47.3	51.1	51.1
Recurrent expenditure	15.5	18.1	22.0	22.8	23.8	25.3	24.2
Development expenditure	12.2	26.1	23.6	26.9	23.5	25.8	26.9
Overall balance	5.9	2.7	1.7	0.5	1.5	-0.4	0.8
Foreign financing (net)	-0.2	2.3	1.6	2.3	-1.6	-0.9	-0.8
Domestic financing (net)	-5.6	-1.4	-0.9	-1.4	1.6	0.9	-0.1
Other 1/	-0.1	-3.6	-2.4	-1.4	-1.5	0.4	0.2
Central government debt (percent of GDP, unless otherwise indicated) 2/							
Domestic debt	18.8	16.6	23.1	12.6	10.0	8.5	7.7
External debt	42.8	36.0	33.9	27.6	21.8	18.8	16.3
(In US\$ millions, end of period)	160.0	148.2	154.8	149.4	135.5	124.1	115.2
Monetary and credit (percentage change, end-year data)							
Credit to private sector	8.5	58.4	58.6	53.3	26.5	6.0	...
Broad money	17.7	37.1	25.9	23.3	6.9	8.4	...
Reserve money	75.8	19.6	6.2	-3.5	-5.0	-10.1	...
Interest rate - deposit (percent per annum) 3/	0.9	0.7	0.7	0.7	2.0	4.1	...
Interest rate - lending (percent per annum) 3/	14.2	14.0	13.8	14.2	17.0	15.3	...
Balance of payments (US\$ millions, unless otherwise indicated)							
Current account balance	61.1	-28.9	-29.4	-67.3	-120.0	-74.2	-130.7
(Percent of GDP)	16.3	-7.0	-6.4	-12.4	-18.7	-11.1	-18.2
Exports of goods and nonfactor services (GNFS)	127.1	138.7	162.2	215.0	244.4	209.5	199.9
(Percentage change)	33.2	9.1	16.9	32.5	13.7	-14.3	-4.6
Imports of GNFS	107.9	173.3	241.6	330.5	374.1	370.1	424.3
(Percentage change)	30.3	60.6	39.4	36.8	13.2	-1.1	14.6
Overall balance	43.4	16.0	10.5	16.6	-27.1	-1.8	-25.1
Gross official reserves (US\$ millions, end of period) 4/							
(In months of next year's imports of GNFS)	79.5	94.6	104.4	120.6	90.1	88.3	63.2
	5.5	4.7	3.8	3.9	2.9	2.5	1.7
Exchange rate (SI\$/US\$, end of period) 5/	7.51	7.58	7.62	7.66	8.00	8.06	...
Real effective exchange rate (period average, 2005 = 100)	97.0	100.0	107.5	106.4	115.9	...	...
Nominal effective exchange rate (period average, 2005 = 100)	102.0	100.0	99.1	93.1	88.9	...	...

Sources: Data provided by the authorities; and IMF staff estimates and projections.

1/ Includes privatization receipts, changes in arrears, and unidentified financing.

2/ Includes arrears.

3/ For 2009, as of end-June.

4/ Gross official reserves at end-2009 include the general SDR allocation and special SDR allocation made by the IMF to the Solomon Islands in August and September 2009, respectively, totaling SDR 9.9 million.

5/ For 2009, as of September 21.

**Table 2. Solomon Islands: Balance of Payments, 2007–14**  
(In millions of U.S. dollars)

	2007	2008	2009	2010	2011	2012	2013	2014
		Est.			Proj.			
Current account balance	-67.3	-120.0	-74.2	-130.7	-174.8	-136.5	-129.6	-262.4
In percent of GDP	-12.4	-18.7	-11.1	-18.2	-22.4	-15.2	-12.9	-24.2
Trade balance for goods	-75.0	-65.4	-97.6	-162.9	-195.5	-132.5	-96.0	-212.6
Exports	159.6	196.8	160.0	145.2	135.0	214.7	263.7	266.3
<i>Of which:</i> Logs	100.2	110.3	80.2	60.0	45.2	36.5	22.2	13.8
Fish	20.6	24.1	24.2	24.9	24.8	24.8	24.8	25.4
Minerals	0.8	3.1	3.4	3.7	4.0	84.4	143.1	146.8
Imports	-234.6	-262.2	-257.6	-308.0	-330.6	-347.1	-359.7	-478.9
<i>Of which:</i> Food	-50.5	-63.5	-54.9	-57.5	-59.1	-61.8	-64.4	-68.0
Fuel	-71.1	-84.4	-56.7	-75.9	-81.7	-86.7	-94.5	-103.9
Trade balance for services	-40.5	-64.4	-63.0	-61.5	-60.9	-61.6	-61.6	-65.6
Exports	55.4	47.6	49.5	54.7	59.5	65.5	71.9	77.1
Imports	-95.9	-112.0	-112.5	-116.2	-120.3	-127.0	-133.5	-142.7
Income balance	-37.4	-94.9	-52.2	-64.1	-73.4	-87.1	-107.3	-110.8
Credits	18.1	18.9	18.1	19.3	19.7	20.0	20.6	21.1
Debits	-55.5	-113.8	-70.3	-83.4	-93.2	-107.1	-127.9	-132.0
Current transfers balance	85.7	104.7	138.6	157.8	155.0	144.7	135.3	126.7
Credits	92.4	113.2	147.5	167.4	165.4	156.7	148.7	141.2
Debits	-6.7	-8.6	-8.9	-9.6	-10.4	-12.0	-13.4	-14.5
Capital account balance	14.4	6.9	11.6	14.9	16.2	16.4	18.2	21.6
Credits	15.4	8.6	13.4	16.8	18.3	18.9	21.0	24.5
Debits	-1.0	-1.7	-1.8	-1.9	-2.1	-2.4	-2.7	-2.9
Financial account balance	61.4	77.3	60.8	90.7	141.3	138.8	140.5	323.6
Direct investment balance	56.9	86.0	67.6	107.4	148.8	144.2	144.2	325.0
Outwards	-9.8	-12.0	-12.2	-12.6	-13.2	-14.2	-15.0	-15.6
Inwards	66.7	98.0	79.8	120.1	161.9	158.4	159.2	340.7
Other investment balance	4.5	-8.8	-6.8	-16.7	-7.5	-5.4	-3.7	-1.4
Assets	-26.1	-18.1	-20.5	-17.0	-15.7	-15.1	-14.4	-12.8
Liabilities	30.6	9.3	13.7	0.3	8.2	9.7	10.7	11.4
Errors and omissions	8.1	8.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	16.6	-27.1	-1.8	-25.1	-17.3	18.8	29.1	82.8
Change in NFA of central bank (+ decrease)	-16.6	27.1	1.8	25.1	17.3	-18.8	-29.1	-82.8
Memorandum items:								
Gross official foreign reserves 1/	120.6	90.1	88.3	63.2	45.9	64.7	93.8	176.6
In months of next year's GNFS	3.9	2.9	2.5	1.7	1.2	1.6	1.8	2.7
In months of nonmining-related imports of GNFS	...	...	2.6	1.9	1.3	1.8	2.5	4.9
Gross external debt (percent of GDP)	32.1	25.4	22.2	19.4	17.7	15.5	14.1	13.3
Private sector	4.5	3.6	3.4	3.1	2.9	2.5	2.2	2.1
Public sector	27.6	21.8	18.8	16.3	14.8	13.0	11.9	11.2
External debt service (percent of GDP)	2.6	3.9	3.5	2.9	2.6	2.2	1.9	1.8
Principal	1.7	3.1	3.0	2.5	2.2	1.9	1.7	1.5
Interest	0.8	0.9	0.5	0.4	0.4	0.3	0.3	0.2
Nominal GDP	541.1	641.8	668.4	717.1	779.8	895.5	1,001.7	1,085.7

Sources: Data provided by the Solomon Islands authorities, and IMF staff projections.

1/ Gross official reserves at end-2009 include the general SDR allocation and special SDR allocation made by the IMF to the Solomon Islands in August and September 2009, respectively, totaling SDR 9.9 million.

Table 3. Solomon Islands: Summary of Fiscal Accounts, 2004–10

	2004	2005	2006	2007	2008 Est.	2009		2010 Proj.
						Budget	Proj.	
(In millions of Solomon Islands dollars)								
Total revenue and grants	941	1,461	1,645	2,078	2,429	2,786	2,746	3,098
Total revenue	514	654	819	1,111	1,366	1,641	1,496	1,625
Tax revenue	462	556	679	931	1,197	1,429	1,283	1,391
Income and profits	148	184	221	297	446	488	465	494
Goods and services	164	200	237	341	427	578	464	501
International trade and transactions	150	173	221	292	324	363	355	397
Of which: Tax on logging	66	85	130	179	205	192	181	147
Other revenue	52	98	140	180	168	212	212	233
Grants	427	807	826	967	1,064	1,145	1,251	1,474
Development grants- Identified	340	767	751	939	954	1,044	1,150	1,336
Of which: IFI grants- Identified	0	0	22	27	0	0	0	0
Recurrent budget grants- Identified	87	40	74	29	109	101	101	138
Other grants- Unidentified					0	0	0	0
Expenditure	776	1,378	1,585	2,059	2,354	2,776	2,769	3,050
Recurrent expenditure	434	564	764	946	1,184	1,441	1,373	1,443
Of which: Compensation of employees	173	233	250	359	453	562	512	538
Goods and services	181	269	442	547	627	786	768	806
Development expenditure	342	814	821	1,113	1,170	1,336	1,396	1,608
Of which: Domestically financed	0	2	14	67	211	292	247	272
Current balance	167	130	130	194	291	301	224	320
Overall balance	165	83	60	19	75	9	-23	48
Total financing	-165	-83	-60	-19	-75	-9	23	-48
Identified financing	-208	-39	17	25	-15	-9	23	-48
Foreign (net)	-6	73	57	95	-79	...	-50	-50
Domestic (net)	-157	-45	-33	-56	78	...	49	-8
Banking system	-157	-45	-35	-42	92	...	58	0
Nonbank	0	0	2	-15	-14	...	-9	-8
Privatization receipts	0	0	8	0	0	...	24	10
Expenditure arrears (- reduction) 1/	-101	-75	-14	-14	-14	...	0	0
Principal debt arrears (- reduction)	-196	8	-1	0	0	...	0	0
Restructured Bonds	252	0	0	0	0	...	0	0
Unidentified financing	44	-44	-77	-44	-61	0	0	0
(In percent of GDP)								
Total revenue and grants	33.5	46.9	47.3	50.2	48.9	51.4	50.6	51.9
Total revenue	18.3	21.0	23.6	26.8	27.5	30.3	27.6	27.2
Tax revenue	16.5	17.8	19.5	22.5	24.1	26.3	23.7	23.3
Income and profits	5.3	5.9	6.4	7.2	9.0	9.0	8.6	8.3
Goods and services	5.8	6.4	6.8	8.2	8.6	10.7	8.6	8.4
International trade and transactions	5.3	5.5	6.4	7.1	6.5	6.7	6.5	6.7
Of which: Tax on logging	2.4	2.7	3.7	4.3	4.1	3.5	3.3	2.5
Other revenue	1.8	3.1	4.0	4.4	3.4	3.9	3.9	3.9
Grants	15.2	25.9	23.8	23.4	21.4	21.1	23.1	24.7
Expenditure	27.6	44.2	45.6	49.7	47.3	51.2	51.1	51.1
Recurrent expenditure	15.5	18.1	22.0	22.8	23.8	26.6	25.3	24.2
Of which: Compensation of employees	6.2	7.5	7.2	8.7	9.1	10.4	9.4	9.0
Goods and services	6.4	8.6	12.7	13.2	12.6	14.5	14.2	13.5
Development expenditure	12.2	26.1	23.6	26.9	23.5	24.6	25.8	26.9
Of which: Domestically financed	0.0	0.1	0.4	1.6	4.3	5.4	4.5	4.5
Current balance	2.8	2.9	1.6	4.0	3.6	3.7	2.3	3.1
Overall balance	5.9	2.7	1.7	0.5	1.5	0.2	-0.4	0.8
Total financing	-5.9	-2.7	-1.7	-0.5	-1.5	-0.2	0.4	-0.8
Identified financing	-7.4	-1.2	0.5	0.6	-0.3	-0.2	0.4	-0.8
Foreign (net)	-0.2	2.3	1.6	2.3	-1.6	...	-0.9	-0.8
Domestic (net)	-5.6	-1.4	-0.9	-1.4	1.6	...	0.9	-0.1
Banking system	-5.6	-1.4	-1.0	-1.0	1.9	...	1.1	0.0
Nonbank	0.0	0.0	0.1	-0.4	-0.3	...	-0.2	-0.1
Privatization receipts	0.0	0.0	0.2	0.0	0.0	...	0.4	0.2
Expenditure arrears (- reduction) 1/	-3.6	-2.4	-0.4	-0.3	-0.3	...	0.0	0.0
Principal debt arrears (- reduction)	-7.0	0.3	0.0	0.0	0.0	...	0.0	0.0
Restructured Bonds	9.0	0.0	0.0	0.0	0.0	...	0.0	0.0
Unidentified financing	1.6	-1.4	-2.2	-1.1	-1.2	0.0	0.0	0.0
Memorandum item:								
Nominal GDP (in million SI dollars)	2,808	3,117	3,475	4,141	4,972	5,422	5,422	5,968

Sources: Data provided by the Solomon Islands authorities; and IMF staff estimates and projections.

1/ Includes interest arrears.

Table 4. Solomon Islands: Summary Accounts of the Banking System, 2005–09

	2005	2006	2007	2008	2009		
					Mar. Est.	Jun. Est.	Dec. Proj.
(In millions of Solomon Islands dollars, end of period)							
Central Bank of Solomon Islands (CBSI)							
Net foreign assets (NFA)	715	794	923	716	663	798	606
Assets 1/	718	794	924	716	663	798	726
Liabilities 1/	4	0	1	1	0	1	120
Net domestic assets (NDA)	-262	-314	-460	-276	-245	-405	-211
Net claims on central government	-101	-88	-148	-52	-53	-107	13
Claims	197	162	150	138	136	133	132
Deposits	297	250	298	190	189	241	119
Other items (net)	-162	-226	-312	-224	-192	-298	-224
Reserve money	452	480	463	440	417	392	396
Currency in circulation	157	187	245	273	239	253	267
Bank deposits	295	287	212	165	177	138	127
Other deposits	1	6	6	2	1	2	2
Commercial banks							
NFA of commercial banks	71	74	55	137	111	193	139
Assets	76	79	63	143	112	194	140
Liabilities	5	5	8	6	1	1	1
NDA of commercial banks	362	556	852	888	917	915	1,009
Net claims on central government	123	76	94	90	95	88	83
Claims	142	133	131	116	123	106	106
Deposits	19	58	37	26	28	18	26
Claims on the private sector	413	655	1,006	1,274	1,268	1,296	1,350
Other items (net)	-174	-175	-248	-476	-446	-470	-424
Reserves	310	313	244	188	196	159	150
Deposits	742	944	1,151	1,213	1,224	1,267	1,298
Monetary survey							
NFA of the banking system	785	869	978	853	773	990	745
Central bank	715	794	923	716	663	798	606
Commercial banks	71	74	55	137	111	193	139
NDA of the banking system	100	246	397	617	676	514	848
Net claims on central government	23	-13	-54	38	42	-19	96
Claims on the private sector 2/	415	659	1,010	1,278	1,272	1,301	1,355
Other items (net)	-338	-400	-559	-698	-638	-767	-602
Broad money (M3)	885	1,115	1,375	1,470	1,449	1,505	1,593
M1	399	521	724	701	591	621	689
Currency outside banks	142	161	213	250	220	231	244
Demand deposits	257	359	511	451	371	390	446
Savings and time deposits	486	594	650	769	858	883	904
(Annual percentage change, unless otherwise indicated)							
Credit to the private sector 2/	58.4	58.6	53.3	26.5	21.8	13.6	6.0
Broad money	37.1	25.9	23.3	6.9	5.8	10.0	8.4
NFA of the banking system 3/	29.3	9.4	9.8	-9.1	-8.5	8.8	-7.3
NDA of the banking system 3/	7.9	16.5	13.5	16.0	14.2	1.3	15.7
Memorandum items:							
Money multiplier	2.0	2.3	3.0	3.3	3.5	3.8	4.0
Reserve money (annual percentage change)	19.6	6.2	-3.5	-5.0	-6.0	6.6	-10.1
Interest rates (percent per annum)							
Deposit rate 4/	0.7	0.7	0.7	2.0	4.1	4.2	...
Lending rate 4/	14.0	13.8	14.2	17.0	15.3	15.3	...

Sources: Data provided by the Central Bank of the Solomon Islands; and IMF staff estimates and projections.

1/ The December-2009 projections reflect the changes caused by the new SDR allocation by the IMF made in August and September 2009.

2/ Includes claims of the CBSI on the nonbank financial sector.

3/ Contribution to year-on-year broad money growth, in percentage points.

4/ Weighted average of different maturities.



**Table 5. Solomon Islands: Medium-Term Baseline Scenario, 2008–14**

	2008	2009	2010	2011	2012	2013	2014
	Est.	Proj.					
Growth and prices (percentage change)							
Real GDP	6.9	0.4	2.4	2.8	8.8	6.5	3.7
<i>Of which</i> : Nontimber and nonmining	7.1	3.7	4.3	4.3	4.5	4.6	4.8
CPI (period average)	17.2	8.0	7.0	7.4	6.3	6.1	5.9
(End of period)	17.5	5.5	8.4	6.5	6.2	6.1	5.7
Nominal GDP (millions of SI\$)	4,972	5,422	5,968	6,643	7,804	8,931	9,903
Per capita GDP (in US\$)	1,266	1,290	1,351	1,438	1,617	1,771	1,881
Central government operations (percent of GDP)							
Total revenue and grants	48.9	50.6	51.9	48.8	44.6	41.6	40.3
Recurrent revenue	27.5	27.6	27.2	26.1	25.9	25.5	25.8
Grants	21.4	23.1	24.7	22.6	18.7	16.1	14.5
Total expenditure	47.3	51.1	51.1	48.8	44.8	41.9	40.6
Recurrent expenditure	23.8	25.3	24.2	22.8	22.2	21.5	21.5
Development expenditure	23.5	25.8	26.9	26.0	22.6	20.4	19.1
Current balance	3.6	2.3	3.1	3.3	3.7	4.0	4.3
Overall balance	1.5	-0.4	0.8	-0.1	-0.2	-0.3	-0.3
Central government debt (percent of GDP) 1/	31.8	27.3	24.0	21.8	18.9	17.0	15.9
Balance of payments							
Current account (balance (- deficit) 2/	-120.0	-74.2	-130.7	-174.8	-136.5	-129.6	-262.4
(Percent of GDP)	-18.7	-11.1	-18.2	-22.4	-15.2	-12.9	-24.2
Overall balance (accrual)	-27.1	-1.8	-25.1	-17.3	18.8	29.1	82.8
Gross official reserves (US\$ millions, end of period) 3/							
(in months of next year's imports of GNFS)	90.1	88.3	63.2	45.9	64.7	93.8	176.6
	2.9	2.5	1.7	1.2	1.6	1.8	2.7

Sources: Data provided by the authorities; and IMF staff estimates and projections.

1/ Includes interest arrears.

2/ In 2014, figure includes large imports associated with nickel mine construction.

3/ Gross official reserves at end-2009 include the general SDR allocation and special SDR allocation made by the IMF to the Solomon Islands in August and September 2009, respectively, totaling SDR 9.9 million.

**Table 6. Solomon Islands: Millennium Development Goals Progress**

	1990	2000	Latest Data 2003–08	Target 2015
<b>Goal 1: Eradicate Extreme Poverty and Hunger</b>				
Prevalence of child malnutrition (percent of children under 5)	21	21	21	11
<b>Goal 2: Achieve Universal Primary Education</b>				
Net enrollment ratio in primary education	83	74	80	100
<b>Goal 3: Promote Gender Equality</b>				
Ratio of girls to boys in primary school (percent)	86	94	96	100
Ratio of girls to boys in secondary school (percent)	63	79	84	100
Proportion of seats held by women in national parliament (percent)	0	2	0	...
<b>Goal 4: Reduce Child Mortality</b>				
Under 5 mortality rate (per 1,000)	121	88	70	12
Infant mortality rate (per 1,000 live births)	86	65	53	25
<b>Goal 5: Improve Maternal Health</b>				
Maternal mortality ratio (per 100,000 live births)	...	130	220	...
Births attended by skilled health staff (percent of total)	...	85	...	...
<b>Goal 6: Combat HIV/AIDS, Malaria and Other Diseases</b>				
Incidence of tuberculosis (per 100,000 people)	312	185	128	...
Incidence of malaria (per 100,000 people)	45,000	15,172	19,600	less than 8,000
<b>Goal 7: Ensure Environmental Sustainability</b>				
Forest area (percent of total land area)	99	91	78	...
Nationally protected areas (percent of total land area)	...	0.0	0.7	...
CO2 emissions (metric tons per capita)	0.5	0.4	0.4	...
Access to an improved water source (percent of population)	...	70	70	100
Access to improved sanitation (percent of population)	...	31	32	...
<b>Goal 8: Develop a Global Partnership for Development</b>				
Fixed line and mobile telephones (per 1,000 people)	15	21	30	...
Personal computers (per 1,000 people)	...	39	47	...

Sources: World Bank, World Development Indicators, and World Bank Human Development Indicators.

INTERNATIONAL MONETARY FUND AND  
THE INTERNATIONAL DEVELOPMENT ASSOCIATION

SOLOMON ISLANDS

**Joint IMF/World Bank Debt Sustainability Analysis 2009<sup>1</sup>**

Prepared by the Staffs of the International Monetary Fund and  
The International Development Association

Approved by Subir Lall and Dominique Desruelle (IMF)  
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September 21, 2009

*Based on the joint IMF-World Bank low-income country DSA (LIC DSA), the Solomon Islands remains classified as being at medium risk of debt distress.<sup>2</sup> Under the baseline, all debt indicators are below their policy-dependent indicative thresholds and are expected to remain so over the medium and long term. However, several stress tests result in a substantial increase in the debt burden and cause some indicators to rise significantly above their thresholds. Given past debt problems and uncertain growth prospects, the government of the Solomon Islands will need to proceed cautiously with new borrowing over the medium to long term. In particular, the potential dependence on mining as a main driver of growth highlights the need to improve the investment climate and business environment to raise productivity in other sectors and broaden the production base.*

## I. BACKGROUND

1. At end-2008, total public debt was US\$200 million (including arrears and public credit guarantees), or equivalent to 32 percent of GDP.<sup>3</sup> This level of debt encompasses the central government only, with debt data unavailable for state enterprises and provincial governments. Around two-thirds of total public debt is external debt. The vast majority of

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<sup>1</sup> This DSA was prepared jointly by the IMF and World Bank, in consultation with the Asian Development Bank (AsDB). The debt data underlying this exercise were provided by the Solomon Islands authorities.

<sup>2</sup> See “Debt Sustainability in Low-Income Countries: Proposal for an Operational Framework and Policy Implications” (<http://www.imf.org/external/np/pdr/sustain/2004/020304.htm> and IDA/SECM2004/0035, 2/3/04) and “Debt Sustainability in Low-Income Countries: Further Considerations on an Operational Framework, Policy Implications” (<http://www.imf.org/external/np/pdr/sustain/2004/091004.htm> and IDA/SECM2004/0629, 9/10/04) and “Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief,” ([www.imf.org/external/np/pp/eng/2006/110606.pdf](http://www.imf.org/external/np/pp/eng/2006/110606.pdf) and IDA/SecM2006-0564, 8/11/06).

<sup>3</sup> Compared to the previous DSA, the debt-to-GDP ratios have fallen substantially as a result of changes in the methodology for compiling national accounts data. This has resulted in a large upward revision of the official series for nominal GDP.

domestic public debt is owed to the banking sector (including the Central Bank of Solomon Islands), with the National Provident Fund also holding government bonds amounting to about one fifth of the total domestic public debt.<sup>4</sup> The overall level of public debt has declined significantly in recent years (Table 1a and 2a). After a period of distress, the debt situation improved substantially in 2007 following a rescheduling agreement reached with major creditors under the Honiara Club Agreement (HCA).<sup>5</sup> As a result, total public debt (as a share of GDP) declined from 57 percent in 2006 to 40 percent in 2007. Arrears to external creditors were settled and all external debt obligations are now being serviced regularly.

**2. As of end-2008, total external debt amounted to US\$160 million, or 25 percent of GDP.** Public external debt accounted for over 85 percent of total external debt, mainly stemming from multilateral agencies. Key creditors are the Asian Development Bank (AsDB) and the World Bank Group's IDA, with their shares of the total public external debt around 40 percent and 30 percent, respectively, at end-2008. Other external creditors include the European Commission, European Investment Bank, International Fund for Agriculture Development, and Organization of the Petroleum Exporting Countries.

Solomon Islands: Selected Economic Indicators, 2008–29						
	2008	2009	2010–14	2015–19	2020–29	2029
	Est.	Proj.		Proj.		Proj.
Growth and prices (percentage change)						
Real GDP (percent change)	6.9	0.4	4.9	6.3	5.6	4.6
<i>Of which</i> : Nontimber and nonmining	7.1	3.7	4.4	5.2	5.0	4.5
CPI (period average, in percent)	17.2	8.0	6.5	5.7	5.0	4.5
Per capita GDP (nominal terms, in US\$)	1,266	1,290	1,612	2,488	4,100	5,140
Central government operations (percent of GDP)						
Total revenue and grants	48.9	50.6	45.4	34.4	29.7	28.8
Total revenue excluding grants	27.5	27.6	26.1	26.4	27.2	27.6
Total expenditure	47.3	51.1	45.5	35.2	31.0	30.3
Recurrent expenditure	23.8	25.3	22.4	21.2	21.2	21.4
Development expenditure	23.5	25.8	23.0	14.0	9.8	8.9
<i>Of which</i> : Domestic financed	4.3	4.5	4.8	5.5	6.6	7.1
Overall balance	1.5	-0.4	0.0	-0.8	-1.3	-1.6
Overall balance excluding grants	-19.9	-23.5	-19.3	-8.8	-3.8	-2.7
Balance of payments (US\$ millions, unless otherwise indicated)						
Current account	-120.0	-74.2	-166.8	-208.5	-149.5	-193.3
(Percent of GDP)	-18.7	-11.1	-18.6	-14.6	-5.0	-4.8
Gross official reserves (US\$ millions, end of period)	90.1	88.3	88.8	698.6	500.5	248.6
(In months of projected imports of GNFS)	2.9	2.5	1.8	11.9	6.4	3.4

Sources: Data provided by Solomon Islands authorities; and IMF staff estimates and projections.

<sup>4</sup> The shares of the central bank and the private banking sector of the total debt are about 30 percent and 50 percent, respectively.

<sup>5</sup> The Honiara Club is a multilateral forum convened by the government of the Solomon Islands in October 2005 to seek debt relief from a group of major official creditors (Australia, the European Commission, the European Investment Bank, and International Fund for Agriculture Development). The final agreement resulted in a moratorium on principal repayments and forgiveness of interest payments during the moratorium period. It also led to debt forgiveness from external creditors (equivalent to 1 percent of GDP).

## II. MAIN ASSUMPTIONS

3. **The baseline scenario encompasses current policies.** The government is assumed to make moderate policy adjustments on both the macroeconomic and structural fronts (Box 1).<sup>6</sup> However, the fiscal stance would continue to be constrained by a slow growth recovery, weak cash position, and limited borrowing capacity, necessitating a sizable compression in government spending over the next few years. Even with envisaged large expenditure cuts (as a share of GDP), the government's cash position would still remain extremely tight, requiring strict fiscal discipline and treasury management to ensure proper budget execution and avoid spending arrears. A key assumption is that gold and nickel mining exports will start in 2012 and 2015, respectively, boosting medium-term growth prospects and buttressing official foreign reserves.

## III. DEBT SUSTAINABILITY

### A. External Debt Sustainability

#### Baseline

4. **Under the baseline, all external debt indicators remain below the indicative policy-dependent debt burden thresholds.** Despite modest new external borrowing assumed to start in 2011, all of the indicators would decline moderately over the medium term (Table 1a), led by steady repayment of existing debt. Over the long term, they would stabilize at about half of the current levels.

#### Alternative scenarios and stress tests

5. **Several thresholds are breached under the historical scenario and a few stress tests.**

- *The present value (PV) of debt-to-GDP ratio, debt-to-exports ratio, and debt-to-revenue ratio:* Under the historical scenario, the PVs of debt-to-GDP ratio and debt-to-exports ratio exceed the thresholds. Among the bound tests, two result in significant increases in debt burden indicators—the shock to net nondebt creating flows and the combined shock to growth, exports, deflators, and these flows, surpassing the policy-dependent thresholds over the near to medium term (Table 1b).<sup>7</sup>
- *Debt service-to-exports ratio and debt service-to-revenue ratio:* Under all scenarios and stress tests, these indicators would stay below the policy-dependent thresholds, supported by the relatively high concessionality of public external borrowing.

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<sup>6</sup> The Solomon Islands is currently classified as a weak performer with regard to its policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA) index.

<sup>7</sup> These results are highly sensitive to expected large FDI inflows in 2010 and 2011 associated with new mining and telecommunications operations.

### Box 1. Main Assumptions in the Baseline Scenario

**Real GDP growth** is projected to average around 5 percent during 2010 to 2014—higher than the historical average, which reflects negative growth experienced during the period of social and political unrest in the early 2000s. Notwithstanding expected low growth in 2009, recent growth projections through 2008 have been in line with outturns. Consistent with the official outlook, logging activity is projected to decline sharply over the medium term due to depleted timber reserves. Activities in other sectors will pick up, mostly in mining and agriculture. New, large gold and nickel mining operations are assumed to commence production in 2012 and 2015, respectively, in line with recent developments.<sup>1</sup> **Inflation** is expected to average 6½ percent a year during 2010 to 2014, declining to about 5 percent in the longer term as international commodity prices stabilize.

**The overall fiscal position** is projected to run a small deficit, on average, during 2010 to 2014. However, rather than reflecting major policy adjustment, this situation is due largely to a combination of falling revenue (as a share of GDP), a weak cash position, and limited capacity to borrow. Reflecting existing donor commitments, inclusive of some scaling back over time of assistance provided under the umbrella of the Regional Assistance Mission in Solomon Islands, external grants are expected to fall in real terms. As a result, recurrent spending will likely be compressed significantly from current levels in order to maintain a positive cash balance and avoid expenditure arrears. The direct impact of new mining-related revenues is assumed to be relatively low (below 1 percent of GDP), given no firm agreement on the tax regime in this area.

**The current account deficit** is expected to widen sharply over the medium term, due both to the rapid decline in logging exports and large projected mining-related imports, principally supported by foreign direct investment (FDI) in this sector. Before peaking at about 25 percent of GDP in 2016, the deficit would be expected to narrow temporarily in 2012 and 2013, when gold export receipts start to materialize. In the long run, with nickel mining providing a major boost to export earnings, the deficit would gradually fall and then stabilize at about 5 percent to GDP.

**New borrowing and aid flows:** Under the baseline scenario, the government is assumed to maintain its policy of no new borrowing for recurrent expenditure. However, starting in 2011 it is assumed to restart modest external borrowing for development expenditure, responding to needs to improve basic infrastructure and given the expected fall-off in external grants. Nonetheless, the authorities are expected to pursue a high grant element in their new external borrowing in keeping with the spirit of the Honiara Club Agreement (HCA). Under the HCA, the government is expected to refrain from new external borrowing and pursue grant financing and ODA until it achieves “green light status” under IDA’s debt distress ratings system. Aid inflows would still decline moderately over the medium term, while FDI from the mining sector (gold and nickel) expected to increase significantly. The reserve cover would fall over the near to medium term to the equivalent 1.2 months of prospective imports coverage in 2011. It would then reverse, but fall below the three-month threshold for most of the projection period again by 2028.

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1/ Gold: Australian Solomons Gold Limited is leading a consortium (including the European Investment Bank and World Bank Group’s International Finance Corporation) in investing around US\$150 million to restart operations of the Gold Ridge mine. Currently, the mine has proven reserves of around 800,000 troy ounces of gold, and is assumed here to operate during 2012 to 2018. Nickel: The Sumitomo Metal Mining Company is expected to invest around US\$2 billion in a large nickel mining operation. The mine is assumed here to produce from 2015 onwards, with annual production reaching around 30,000 tons (55 percent purity).

6. **Two country specific scenarios are also examined, based on different assumptions from the baseline.** They demonstrate the potential volatility of the Solomon Islands' external position and benefits that could accrue from pursuing a moderate path of adjustment over the near to medium term.

- *Higher-case scenario* (Table 3a): Under this scenario, the fiscal stance is underpinned by a more robust policy framework. Revenue growth would be higher than under the baseline. Expenditure levels (as a share of GDP) would also exceed those in the baseline, in part aided by additional donor budget support, which would backstop further reforms. The more stable fiscal position would allow the government to build cash reserves. Growth prospects would be expected to improve, in part due to higher development spending. Over time, this would be expected to facilitate greater external borrowing by both the government and the private sector. Based on these assumptions, external debt (total and public) would be expected rise above that in the baseline, mainly given the government's greater capacity to borrow.
- *Lower-case scenario* (Table 4a): The main assumptions under this scenario are that the start of new large gold mining production is delayed by two years to 2014 and that large nickel mining operations, expected to start in 2015, do not materialize, in part due to volatile commodity prices, land tenure issues, and financing constraints. Compared to the baseline scenario, lower GDP growth, smaller export earnings, and larger fiscal deficits that would be expected to arise in this case would not necessarily lead to larger external debt. This is because government's capacity to borrow abroad would be constrained by its weaker underlying fiscal position, necessitating greater recourse to domestic borrowing—potentially squeezing out the private sector and further dampening growth prospects. The reserve cover would rise initially with gold exports, but fall subsequently following the end of production. Assuming moderate nonmining export growth, it would only be at around 1.5 months of import coverage by 2029—well below the levels envisaged in the baseline and higher-case scenarios.

## **B. Public Sector Debt Sustainability**

### **Baseline**

7. **Total public debt is expected to decline steadily over the medium and long term.** The debt-to-GDP ratio is projected to halve to 16 percent of GDP in 2014 from 32 percent of GDP in 2008. However, some debt indicators would remain relatively high. In particular, the PV of public sector debt to revenue (excluding grants) would stay above 40 percent through 2014.

### **Alternative scenarios and stress tests**

8. **Debt dynamics are subject to substantial risks.** The results of the alternative scenarios and stress tests indicate that lower GDP growth would significantly inflate debt

indicators, such as the PVs of debt-to-GDP ratio and debt-to-revenue ratio, particularly in the longer term (Table 2b). The first bound test (a temporary but significant decline in GDP growth) corresponds to the most extreme shock, owing to the combined effects over time of relatively low expected growth in 2010 and 2011 and very large standard deviations in historical growth averages. This finding again points to the sensitivity of this DSA to growth conditions.

9. **Public debt dynamics differ under the additional alternative scenarios.** Despite higher external public borrowing for development expenditure, public debt is lower under the *higher case scenario* (Table 3b) than in the baseline scenario. This is due to a smaller need for domestic financing under the former, as a result of stronger fiscal balances. On the other hand, the *lower-case scenario* (Table 4b) points to a substantially higher public debt burden due to both larger fiscal deficits and lower nominal GDP over the medium and long term.

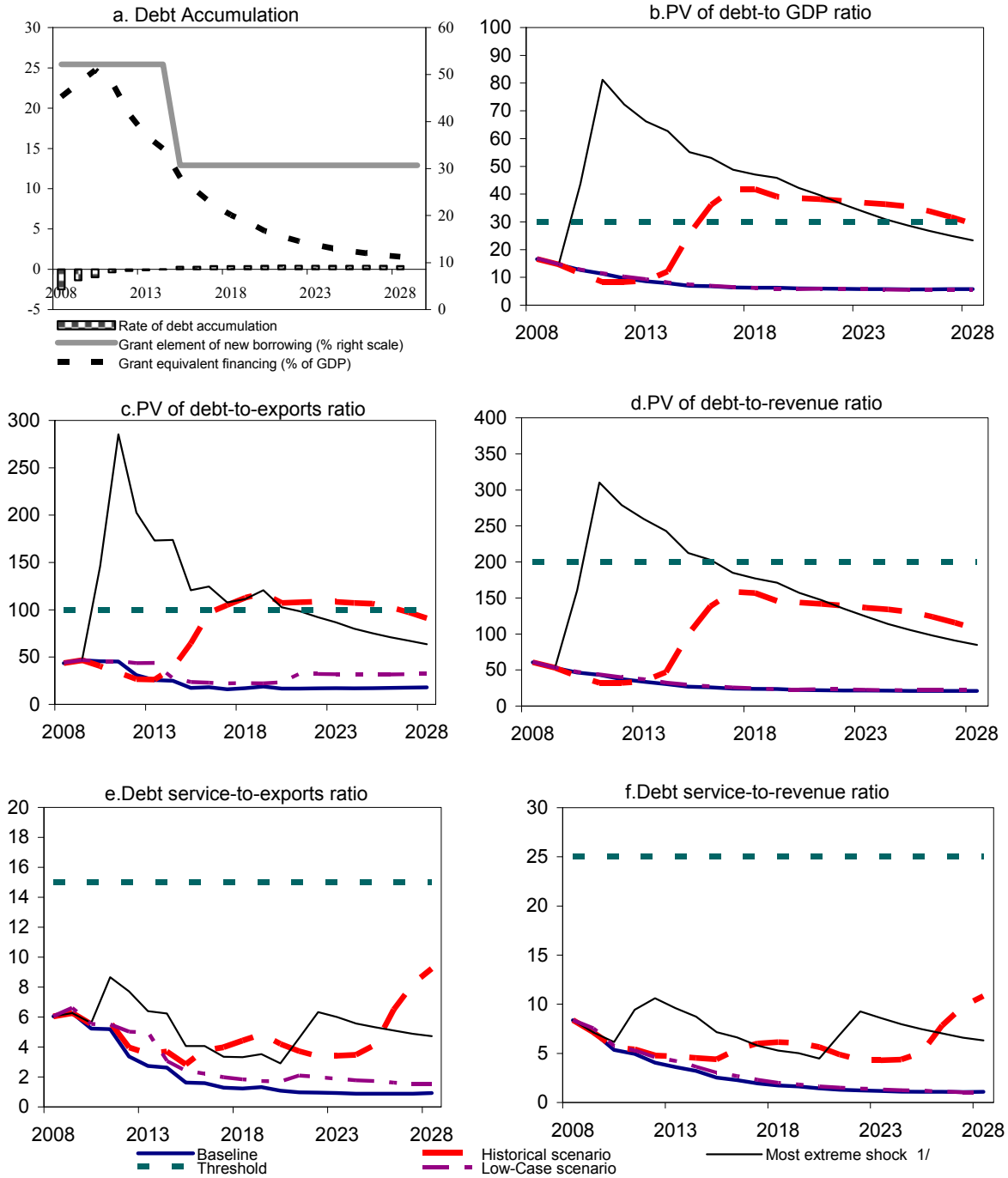
#### IV. CONCLUSION

10. **The Solomon Islands face a moderate risk of debt distress.** Under the baseline, no thresholds are breached. However, several thresholds are breached under several stress tests, indicating the vulnerability of the baseline to shocks, in particular to net nondebt creating flows and the combined shock for the external DSA and to a temporary growth shock for the public sector DSA. The balance of risks is to the downside. Weak government finances already point to the need for further fiscal adjustment and exceptional financing. In addition, delays in developing the mining sector could intensify dependence on traditional sectors, reduce the level of potential growth and pace of poverty reduction, and ultimately jeopardize fiscal and external sustainability.

11. **Considering past debt problems and uncertain growth prospects, the government of the Solomon Islands will need proceed cautiously with new borrowing over the medium to long term,** concentrating on productive development outlays—notably growth-enhancing infrastructure. In the meantime, given current vulnerabilities and the near to medium-term outlook, policies will need to be put in place to strengthen underlying fiscal and external positions, supported by additional external assistance.



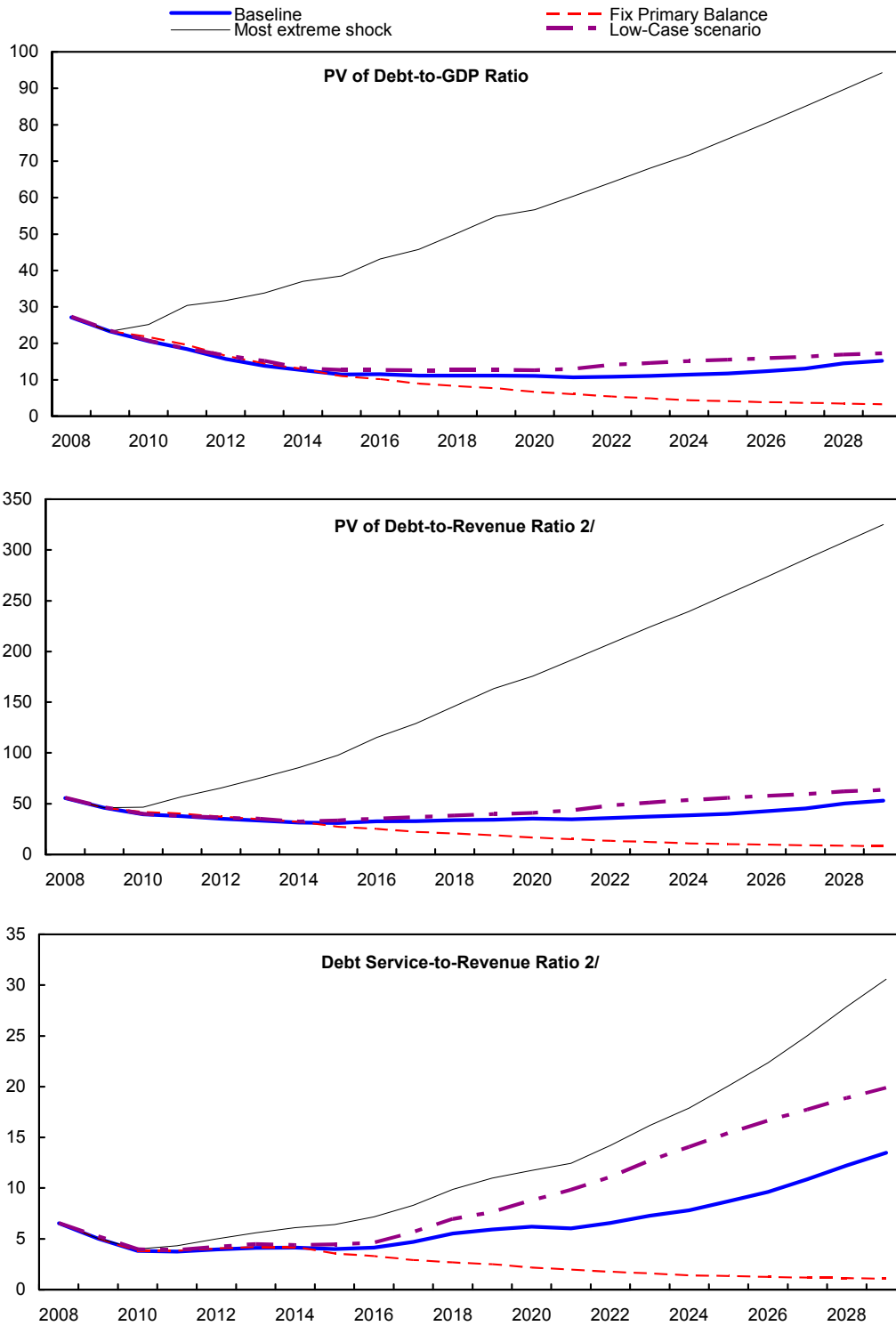
**Figure 1. Solomon Islands: Indicators of Public and Publicly Guaranteed External Debt under Alternatives to Baseline Scenario, 2008–29 1/**



Source: IMF staff estimates.

1/ The most extreme stress test is the test (among the various bound tests) that yields the highest ratio in 2019. In figure b-f. it corresponds to a combination shock.

**Figure 2. Solomon Islands: Indicators of Public Debt under Alternatives to Baseline Scenario, 2008–29 1/**



Source: IMF staff estimates.

1/ The most extreme stress test is the test that yields the highest ratio in 2019.

2/ Revenues are defined inclusive of grants.

**Table 1a. Solomon Islands: External Debt Sustainability, Baseline Scenario, 2006–29 1/**  
(In percent of GDP, unless otherwise indicated)

	Actual		Est. 2008	Historical Average 6/	Standard Deviation 6/	Projections							2015–29 Average	
	2006	2007				2009	2010	2011	2012	2013	2014	2009–14 Average		2019
External debt (nominal) 1/	39.4	32.1	25.4			22.2	19.4	17.7	15.5	14.1	13.3		10.6	9.2
<i>Of which:</i> public and publicly guaranteed (PPG)	33.9	27.6	21.8			18.8	16.3	14.8	13.0	11.9	11.2		9.0	7.9
Change in external debt	-2.8	-7.3	-6.7			-3.2	-2.8	-1.7	-2.2	-1.4	-0.8		-0.1	0.1
Identified net debt-creating flows	-3.3	-4.2	0.3			0.0	1.7	1.8	-3.2	-3.1	-6.9		4.2	0.8
Noninterest current account deficit	5.9	11.6	17.8	1.2	9.1	10.6	17.8	22.1	14.9	12.7	23.9		7.5	4.6
Deficit in balance of goods and services	17.4	21.4	20.2			24.0	31.3	32.9	21.7	15.7	25.6		4.7	1.0
Exports	35.5	39.7	38.1			31.3	27.9	24.9	31.3	33.5	31.6		33.4	32.0
Imports	52.9	61.1	58.3			55.4	59.2	57.8	52.9	49.2	57.3		38.1	33.0
Net current transfers (negative = inflow)	-14.4	-15.8	-16.3	-4.6	6.6	-20.7	-22.0	-19.9	-16.2	-13.5	-11.7		-4.1	-1.1
<i>Of which:</i> official	-15.4	-17.0	-17.6			-22.0	-23.3	-21.2	-17.5	-14.8	-13.0		-5.3	-1.5
Other current account flows (negative = net inflow)	2.9	6.1	13.9			7.3	8.5	9.1	9.4	10.4	10.0		6.8	4.7
Net FDI (negative = inflow)	-5.8	-10.5	-13.4	-1.4	4.4	-10.1	-15.0	-19.1	-16.1	-14.4	-29.9		-2.9	-3.5
Endogenous debt dynamics 2/	-3.4	-5.3	-4.1			-0.5	-1.1	-1.2	-2.0	-1.4	-0.8		-0.4	-0.4
Contribution from nominal interest rate	0.6	0.8	0.9			0.5	0.4	0.4	0.3	0.3	0.2		0.2	0.2
Contribution from real GDP growth	-2.7	-3.6	-1.9			-0.1	-0.5	-0.5	-1.4	-0.9	-0.5		-0.3	-0.4
Contribution from price and exchange rate changes	-1.3	-2.6	-3.2			-0.9	-1.0	-1.1	-0.9	-0.7	-0.6		-0.4	-0.2
Residual (3-4) 3/	0.6	-3.0	-7.0			-3.2	-4.5	-3.5	1.0	1.7	6.1		-4.2	-0.7
<i>Of which:</i> exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
PV of external debt 4/	...	26.6	20.0			17.9	15.8	14.2	12.2	10.8	9.9		7.9	7.1
In percent of exports	...	67.0	52.6			57.2	56.6	56.8	38.9	32.2	31.3		23.5	22.1
PV of PPG external debt	...	22.2	16.6			14.6	12.7	11.3	9.7	8.6	7.9		6.3	5.8
In percent of exports	...	55.8	43.6			46.6	45.5	45.4	30.9	25.5	24.9		19.0	18.1
In percent of government revenues	...	82.6	60.4			52.9	46.6	43.3	37.3	33.6	30.5		23.6	20.9
Debt service-to-exports ratio (in percent)	3.5	6.4	10.3			11.1	10.3	10.4	7.0	5.8	5.6		3.4	2.6
PPG debt service-to-exports ratio (in percent)	2.5	5.8	6.0			6.3	5.2	5.2	3.4	2.7	2.6		1.3	1.0
PPG debt service-to-revenue ratio (in percent)	3.8	8.6	8.4			7.1	5.4	5.0	4.1	3.6	3.2		1.6	1.1
Total gross financing need (millions of U.S. dollars)	8.6	22.9	55.6			28.8	42.8	45.4	10.9	3.9	-44.3		103.0	80.8
Noninterest current account deficit that stabilizes debt ratio	8.6	18.9	24.6			13.8	20.6	23.7	17.1	14.1	24.7		7.6	4.6
<b>Key macroeconomic assumptions</b>														
Real GDP growth (in percent)	6.9	10.7	6.9	1.0	7.6	0.4	2.4	2.8	8.8	6.5	3.7	4.1	2.8	4.6
GDP deflator in US dollar terms (change in percent)	3.2	7.0	10.9	0.7	9.1	3.7	4.8	5.8	5.5	5.0	4.5	4.9	3.5	2.1
Effective interest rate (percent) 5/	1.5	2.5	3.3	3.8	5.5	2.0	2.0	2.0	2.0	1.9	2.0	2.0	2.0	2.3
Growth of exports of G&S (US dollar terms, in percent)	16.9	32.5	13.7	2.4	26.8	-14.3	-4.6	-2.7	44.0	19.8	2.3	7.4	-4.0	6.0
Growth of imports of G&S (US dollar terms, in percent)	39.4	36.8	13.2	5.8	33.1	-1.1	14.6	6.3	5.2	4.0	26.0	9.2	4.8	6.5
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	52.2	52.2	52.2	52.2	52.2	30.7	30.7
Government revenues (excluding grants, in percent of GDP)	23.6	26.8	27.5			27.6	27.2	26.1	25.9	25.5	25.8		26.8	27.6
Aid flows (in millions of US dollars) 7/	115.8	140.5	137.8			154.2	177.1	184.1	176.5	171.3	167.7		106.5	59.5
<i>Of which:</i> grants	108.5	126.4	137.3			154.2	177.1	176.3	167.6	161.2	156.9		99.3	46.2
<i>Of which:</i> Concessional loans 8/	7.3	14.1	0.5			0.0	0.0	7.8	9.0	10.0	10.9		7.2	13.3
Grant-equivalent financing (in percent of GDP) 9/	...	...	21.4			23.1	24.7	23.1	19.2	16.6	15.0		5.9	1.4
Grant-equivalent financing (in percent of external financing) 9/	...	...	100.0			100.0	100.0	98.0	97.6	97.2	96.9		90.9	73.8
<b>Memorandum items:</b>														
Nominal GDP (millions of US dollars)	456.7	541.1	641.8			668.4	717.1	779.8	895.5	1001.7	1085.7		1776.0	4003.9
Nominal dollar GDP growth	10.3	18.5	18.6			4.2	7.3	8.8	14.8	11.9	8.4	9.2	6.4	6.8
PV of PPG external debt (in millions of US dollars)	...	120.0	106.5			97.6	91.0	88.3	86.7	85.7	85.4		112.3	231.5
(PVT-PVT-1)/GDPL-1 (in percent)	...	...	-2.5			-1.4	-1.0	-0.4	-0.2	-0.1	0.0	-0.5	0.4	0.4

Sources: Solomon Islands authorities; and IMF staff estimates and projections.

1/ Includes both public and private sector external gross debt. The DSA exercise was conducted jointly with the World Bank.

2/ Derived as  $[r - g - r(1+g)] / (1+g+r+gr)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate, and  $r$  = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., debt relief); changes in gross foreign assets; and valuation adjustments. Residuals are large in the latter half of the projection period, as reserves fluctuate mainly due to the large and volatile FDI from the nickel mining company.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are derived over the past 10 years.

7/ Defined as grants, concessional loans, and debt relief.

8/ In 2008, refers to disbursements from previous loans.

9/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

**Table 1b. Solomon Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009–29**  
(In percent)

	Projections							
	2009	2010	2011	2012	2013	2014	2019	2029
PV of debt-to GDP ratio								
Baseline	15	13	11	10	9	8	6	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010–29 1/	15	11	8	8	9	12	39	27
A2. New public sector loans on less favorable terms in 2010–29 2/	15	13	11	10	9	8	7	7
A3. High-Case Scenario 3/	14	13	11	10	9	9	8	8
A4. Low-Case Scenario 4/	15	13	11	10	9	8	6	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010–11	15	14	14	12	10	9	8	7
B2. Export value growth at historical average minus one standard deviation in 2010–11 5/	15	16	15	13	12	11	8	7
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2010–11	15	15	15	13	11	10	8	8
B4. Net nondebt creating flows at historical average minus one standard deviation in 2010–11 6/	15	40	67	59	54	51	38	17
B5. Combination of B1–B4 using one-half standard deviation shocks	15	44	81	72	66	63	46	22
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 7/	15	17	15	13	12	11	9	8
PV of debt-to-exports ratio								
Baseline	47	46	45	31	26	25	19	18
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010–29 1/	47	40	34	27	26	38	117	85
A2. New public sector loans on less favorable terms in 2010–29 2/	47	46	46	32	26	26	21	22
A3. High-Case Scenario 3/	46	46	46	33	29	29	25	26
A4. Low-Case Scenario 4/	47	46	46	44	44	28	22	32
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010–11	47	45	45	31	25	25	19	18
B2. Export value growth at historical average minus one standard deviation in 2010–11 5/	47	75	97	67	56	55	41	33
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2010–11	47	45	45	31	25	25	19	18
B4. Net nondebt creating flows at historical average minus one standard deviation in 2010–11 6/	47	145	267	190	162	163	113	55
B5. Combination of B1–B4 using one-half standard deviation shocks	47	146	285	203	173	174	121	59
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 7/	47	45	45	31	25	25	19	18
PV of debt-to-revenue ratio								
Baseline	53	47	43	37	34	30	24	21
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010–29 1/	53	41	32	32	34	47	146	98
A2. New public sector loans on less favorable terms in 2010–29 2/	53	47	44	38	35	32	26	25
A3. High-Case Scenario 3/	53	45	41	36	34	32	27	26
A4. Low-Case Scenario 4/	53	47	44	40	37	32	23	22
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010–11	53	51	52	45	40	37	28	25
B2. Export value growth at historical average minus one standard deviation in 2010–11 5/	53	61	57	50	45	41	31	24
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2010–11	53	53	57	49	44	40	31	28
B4. Net nondebt creating flows at historical average minus one standard deviation in 2010–11 6/	53	148	254	229	213	199	140	63
B5. Combination of B1–B4 using one-half standard deviation shocks	53	160	310	279	260	243	171	79
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 7/	53	64	59	51	46	42	32	28
Debt service-to-exports ratio								
Baseline	6	5	5	3	3	3	1	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010–29 1/	6	6	6	4	4	4	5	9
A2. New public sector loans on less favorable terms in 2010–29 2/	6	5	5	3	3	3	2	1
A3. High-Case Scenario 3/	6	5	5	3	3	3	1	1
A4. Low-Case Scenario 4/	7	6	6	5	5	3	2	2
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010–11	6	5	5	3	3	3	1	1
B2. Export value growth at historical average minus one standard deviation in 2010–11 5/	6	7	9	6	5	5	2	2
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2010–11	6	5	5	3	3	3	1	1
B4. Net nondebt creating flows at historical average minus one standard deviation in 2010–11 6/	6	5	8	7	6	6	3	4
B5. Combination of B1–B4 using one-half standard deviation shocks	6	6	9	8	6	6	4	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 7/	6	5	5	3	3	3	1	1
Debt service-to-revenue ratio								
Baseline	7	5	5	4	4	3	2	1
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2010–29 1/	7	6	5	5	5	5	6	11
A2. New public sector loans on less favorable terms in 2010–29 2/	7	5	5	4	4	3	2	1
A3. High-Case Scenario 3/	7	5	4	4	3	3	2	1
A4. Low-Case Scenario 4/	8	6	5	5	4	4	2	1
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010–11	7	6	6	5	4	4	2	1
B2. Export value growth at historical average minus one standard deviation in 2010–11 5/	7	5	5	4	4	3	2	1
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2010–11	7	6	7	5	5	4	2	1
B4. Net nondebt creating flows at historical average minus one standard deviation in 2010–11 6/	7	5	7	8	8	7	4	5
B5. Combination of B1–B4 using one-half standard deviation shocks	7	6	9	11	10	9	5	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 7/	7	7	7	6	5	4	2	2
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 8/	0	0	0	0	0	0	0	0

Source: IMF staff estimates.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows. The DSA exercise was conducted jointly with the World Bank.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

3/ See Table 3a for details.

4/ See Table 4a for details.

5/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

6/ Includes official and private transfers and FDI.

7/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

8/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

**Table 2a. Solomon Islands: Public Sector Debt Sustainability, Baseline Scenario, 2006–29**  
(In percent of GDP, unless otherwise indicated)

	Actual		Est. 2008	Historical Average 6/	Standard Deviation 6/	Projections									
	2006	2007				2009	2010	2011	2012	2013	2014	2009–14 Average	2019	2029	2015–29 Average
Public sector debt 1/	57.1	40.3	31.8			27.3	24.0	21.8	18.9	17.0	15.9		13.7	17.3	
<i>Of which:</i> foreign-currency denominated	33.9	27.6	21.8			18.8	16.3	14.8	13.0	11.9	11.2		9.0	7.9	
Change in public sector debt	4.4	-16.8	-8.5			-4.4	-3.3	-2.2	-2.8	-1.9	-1.1		-0.1	0.7	
Identified debt-creating flows	-7.2	-9.6	-7.3			-2.1	-3.1	-1.8	-2.5	-1.6	-0.9		-0.1	0.5	
Primary deficit	-2.4	-1.4	-2.4	-0.2	4.3	0.0	-1.2	-0.1	0.1	0.2	0.3	-0.1	0.6	1.1	1.0
Revenue and grants	47.3	50.2	48.9			50.6	51.9	48.8	44.6	41.6	40.3		32.4	28.8	
<i>Of which:</i> grants	23.8	23.4	21.4			23.1	24.7	22.6	18.7	16.1	14.5		5.6	1.2	
Primary (noninterest) expenditure	45.0	48.8	46.4			50.6	50.7	48.7	44.7	41.8	40.5		33.0	29.9	
Automatic debt dynamics	-4.6	-8.1	-4.8			-1.6	-1.7	-1.7	-2.6	-1.8	-1.2		-0.6	-0.6	
Contribution from interest rate/growth differential	-4.4	-6.9	-3.5			-0.7	-0.9	-1.0	-2.1	-1.5	-0.9		-0.5	-0.6	
<i>Of which:</i> contribution from average real interest rate	-1.0	-1.4	-0.9			-0.5	-0.2	-0.3	-0.4	-0.3	-0.3		-0.1	0.1	
<i>Of which:</i> contribution from real GDP growth	-3.4	-5.5	-2.6			-0.1	-0.6	-0.7	-1.8	-1.2	-0.6		-0.4	-0.7	
Contribution from real exchange rate depreciation	-0.2	-1.2	-1.3			-1.0	-0.8	-0.8	-0.5	-0.4	-0.3		-0.1	0.0	
Other identified debt-creating flows	-0.3	-0.2	0.0			-0.4	-0.2	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.2	0.0	0.0			-0.4	-0.2	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities 2/	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-0.1	-0.2	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	11.6	-7.1	-1.3			-2.4	-0.3	-0.4	-0.3	-0.3	-0.2		0.0	0.2	
Other Sustainability Indicators															
PV of public sector debt	...	34.8	27.1			23.3	20.6	18.4	15.7	13.8	12.6		11.1	15.2	
<i>Of which:</i> foreign-currency denominated	...	22.2	17.1			14.8	12.8	11.4	9.8	8.7	8.0		6.4	5.8	
<i>Of which:</i> external	...	22.2	17.1			14.8	12.8	11.4	9.8	8.7	8.0		6.4	5.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	-0.1	2.6	1.1			2.8	1.0	2.0	2.0	2.1	2.1		2.6	5.0	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	69.4	55.5			46.0	39.6	37.7	35.2	33.2	31.3		34.1	52.8	
PV of public sector debt-to-revenue ratio (in percent)	...	129.9	98.7			84.5	75.6	70.4	60.6	54.2	48.9		41.2	55.0	
<i>Of which:</i> external 4/	...	82.7	62.4			53.7	47.2	43.8	37.8	33.9	30.8		23.8	21.2	
Debt service-to-revenue and grants ratio (in percent) 5/	3.6	6.7	6.5			5.0	3.8	3.7	4.0	4.1	4.1		5.9	13.5	
Debt service-to-revenue ratio (in percent) 5/	7.2	12.4	11.7			9.2	7.3	7.0	6.8	6.7	6.5		7.2	14.0	
Primary deficit that stabilizes the debt-to-GDP ratio	-6.7	15.4	6.1			4.4	2.1	2.2	2.9	2.1	1.4		0.6	0.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.9	10.7	6.9	1.0	7.6	0.4	2.4	2.8	8.8	6.5	3.7	4.1	2.8	4.6	5.8
Average nominal interest rate on forex debt (in percent)	0.8	2.1	2.9	1.2	0.6	1.3	1.3	1.3	1.2	1.2	1.1	1.2	1.3	1.7	1.5
Average real interest rate on forex debt (in percent)	-2.3	-0.6	0.7	-1.3	0.9	0.4	0.9	0.7	-0.2	-0.8	-0.8	0.0	-0.6	-0.2	-0.9
Real exchange rate depreciation (in percent, + indicates depreciation)	-0.5	-4.0	-5.0	1.3	10.3	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.3	7.6	12.3	7.8	2.5	8.6	7.5	8.2	7.9	7.5	6.9	7.8	5.9	4.5	5.5
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.2	0.0	0.2	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	...	...	52.2	52.2	52.2	52.2	...	30.7	30.7	30.7

Source: Solomon Islands authorities; and IMF staff estimates and projections

1/ The public sector covers only the central government.

2/ Current estimate of recognized contingent liabilities.

3/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

4/ Revenues excluding grants.

5/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

6/ Historical averages and standard deviations are derived over the past 10 years.

Table 2b. Solomon Islands: Sensitivity Analysis for Key Indicators of Public Debt 2009-29

	Projections							
	2009	2010	2011	2012	2013	2014	2019	2029
PV of Debt-to-GDP Ratio								
Baseline	23	21	18	16	14	13	11	15
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	23	22	20	18	16	14	10	4
A2. Primary balance is unchanged from 2009	23	22	20	17	14	13	8	3
A3. Permanently lower GDP growth 1/	23	21	20	19	19	20	35	109
A4. High-Case Scenario 2/	23	20	18	16	14	14	11	10
A5. Low-Case Scenario 3/	23	21	19	17	15	13	13	17
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-11	23	25	30	32	34	37	55	94
B2. Primary balance is at historical average minus one standard deviations in 2010-11	23	26	28	24	22	20	17	19
B3. Combination of B1-B2 using one half standard deviation shocks	23	25	26	25	25	27	36	59
B4. One-time 30 percent real depreciation in 2010	23	26	24	21	19	18	16	20
B5. 10 percent of GDP increase in other debt-creating flows in 2010	23	31	28	24	22	20	17	19
PV of Debt-to-Revenue Ratio 4/								
Baseline	46	40	38	35	33	31	34	53
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	46	42	40	38	36	33	23	9
A2. Primary balance is unchanged from 2009	46	42	40	37	35	32	19	8
A3. Permanently lower GDP growth 1/	46	41	41	42	44	48	105	375
A4. High-Case Scenario 2/	46	38	35	34	33	33	30	32
A5. Low-Case Scenario 3/	46	40	38	36	35	32	40	64
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-11	46	46	57	65	75	86	163	325
B2. Primary balance is at historical average minus one standard deviations in 2010-11	46	50	57	54	52	50	51	66
B3. Combination of B1-B2 using one half standard deviation shocks	46	48	52	54	59	64	108	204
B4. One-time 30 percent real depreciation in 2010	46	50	49	47	45	44	49	70
B5. 10 percent of GDP increase in other debt-creating flows in 2010	46	59	57	55	53	51	52	66
Debt Service-to-Revenue Ratio 4/								
Baseline	5	4	4	4	4	4	6	13
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	5	4	4	4	5	5	3	1
A2. Primary balance is unchanged from 2009	5	4	4	4	4	4	2	1
A3. Permanently lower GDP growth 1/	5	4	4	4	4	5	9	31
A4. High-Case Scenario 2/	5	3	3	4	4	4	3	4
A5. Low-Case Scenario 3/	5	4	4	4	4	4	8	20
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-11	5	4	4	5	6	6	11	31
B2. Primary balance is at historical average minus one standard deviations in 2010-11	5	4	4	5	5	5	7	15
B3. Combination of B1-B2 using one half standard deviation shocks	5	4	4	5	5	5	9	23
B4. One-time 30 percent real depreciation in 2010	5	4	5	5	5	5	7	15
B5. 10 percent of GDP increase in other debt-creating flows in 2010	5	4	5	5	5	5	7	15

Source: IMF staff estimates.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the length of the projection period. The DSA exercise was conducted jointly with the World Bank.

2/ See Table 3b for details.

3/ See Table 4b for details.

4/ Revenues are defined inclusive of grants.

**Table 3a. Solomon Islands: External Debt Sustainability, High-Case Scenario, 2006–29 1/**  
(In percent of GDP, unless otherwise indicated)

	Actual		Est.	Historical Average 6/	Standard Deviation 6/	Projections									
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009-14 Average	2019	2029	2015–29 Average
External debt (nominal) 1/	39.4	32.1	25.4			22.2	19.2	17.9	16.4	15.8	15.8			13.5	13.4
Of which: public and public guaranteed (PPG)	33.9	27.6	21.8			18.8	16.2	15.1	14.0	13.7	13.9			12.1	10.5
Change in external debt	-2.8	-7.3	-6.7			-3.2	-2.9	-1.3	-1.5	-0.6	0.0			-0.2	0.2
Identified net debt-creating flows	-3.3	-4.2	0.3			-0.7	0.3	1.9	-2.9	-2.6	-4.9			3.9	-0.3
Noninterest current account deficit	5.9	11.6	17.8	1.2	9.1	10.0	17.8	20.7	14.1	12.1	23.6			7.0	4.1
Deficit in balance of goods and services	17.4	21.4	20.2			23.4	33.1	33.6	22.1	15.9	25.1			4.9	2.2
Exports	35.5	39.7	38.1			31.3	27.5	24.5	30.6	32.6	30.7			33.0	31.4
Imports	52.9	61.1	58.3			54.7	60.7	58.2	52.7	48.5	55.8			37.9	33.5
Net current transfers (negative = inflow)	-14.4	-15.8	-16.3	-4.6	6.6	-20.7	-23.8	-21.8	-17.2	-13.8	-11.0			-3.9	-1.4
Of which: official	-15.4	-17.0	-17.6			-22.0	-25.1	-23.1	-18.5	-15.1	-12.3			-5.0	-1.4
Other current account flows (negative = net inflow)	2.9	6.1	13.9			7.3	8.4	8.9	9.1	10.0	9.5			5.9	3.3
Net FDI (negative = inflow)	-5.8	-10.5	-13.4	-1.4	4.4	-10.1	-16.2	-17.3	-14.7	-13.1	-27.4			-2.4	-3.7
Endogenous debt dynamics 2/	-3.4	-5.3	-4.1			-0.6	-1.3	-1.4	-2.2	-1.6	-1.1			-0.7	-0.7
Contribution from nominal interest rate	0.6	0.8	0.9			0.5	0.4	0.4	0.3	0.3	0.2			0.2	0.3
Contribution from real GDP growth	-2.7	-3.6	-1.9			-0.1	-0.6	-0.7	-1.5	-1.1	-0.8			-0.5	-0.7
Contribution from price and exchange rate changes	-1.3	-2.6	-3.2			-1.0	-1.1	-1.1	-1.0	-0.8	-0.6			-0.5	-0.3
Residual (3-4) 3/	0.6	-3.0	-7.0			-2.5	-3.2	-3.2	1.3	2.0	4.9			-4.1	0.4
Of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0
PV of external debt 4/	...	26.4	19.9			17.8	15.6	14.1	12.4	11.4	11.0			9.6	10.9
In percent of exports	...	66.6	52.2			57.0	56.6	57.5	40.6	35.1	35.7			29.2	34.8
PV of PPG external debt	...	22.0	16.4			14.5	12.5	11.3	10.0	9.3	9.0			8.2	8.0
In percent of exports	...	55.4	43.2			46.4	45.5	46.2	32.7	28.6	29.4			24.9	25.6
In percent of government revenues	...	82.0	59.8			52.6	45.3	41.3	36.0	33.5	32.1			27.2	26.2
Debt service-to-exports ratio (in percent)	3.5	6.4	10.3			10.9	10.1	10.1	6.8	5.6	5.4			3.3	4.9
PPG debt service-to-exports ratio (in percent)	2.5	5.8	6.0			6.0	5.0	4.9	3.2	2.6	2.5			1.4	1.3
PPG debt service-to-revenue ratio (in percent)	3.8	8.6	8.4			6.8	4.9	4.4	3.5	3.1	2.8			1.5	1.3
Total gross financing need (millions of U.S. dollars)	8.6	22.9	55.6			24.0	33.9	48.5	14.7	10.8	-22.6			110.2	95.9
Noninterest current account deficit that stabilizes debt ratio	8.6	18.9	24.6			13.2	20.7	22.0	15.6	12.7	23.7			7.1	3.9
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.9	10.7	6.9	1.0	7.6	0.4	3.0	3.8	9.7	7.7	5.3	5.0	3.7	6.1	6.7
GDP deflator in US dollar terms (change in percent)	3.2	7.0	10.9	0.7	9.1	4.0	5.3	6.1	5.6	4.9	4.0	5.0	3.4	2.1	3.0
Effective interest rate (percent) 5/	1.5	2.5	3.3	3.8	5.5	2.0	2.0	2.0	2.0	1.9	1.7	1.9	1.8	2.6	2.1
Growth of exports of G&S (US dollar terms, in percent)	16.9	32.5	13.7	2.4	26.8	-14.3	-4.5	-1.8	44.6	20.4	3.1	7.9	-2.6	7.4	10.6
Growth of imports of G&S (US dollar terms, in percent)	39.4	36.8	13.2	5.8	33.1	-2.1	20.4	5.7	5.0	4.0	26.0	9.8	5.7	8.3	6.5
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	52.2	52.2	52.2	52.2	52.2	30.7	20.5	27.3
Government revenues (excluding grants, in percent of GDP)	23.6	26.8	27.5			27.6	27.7	27.4	27.8	27.8	28.1			30.2	30.7
Aid flows (in millions of US dollars) 7/	115.8	140.5	137.8			154.6	192.2	208.5	199.2	192.7	180.5			111.3	60.6
Of which: grants	108.5	126.4	137.3			154.6	192.2	196.5	183.0	171.8	157.5			102.2	50.0
Of which: concessional loans 8/	7.3	14.1	0.5			0.0	0.0	12.0	16.2	21.0	23.0			9.1	10.6
Grant-equivalent financing (in percent of GDP) 9/	...	...	21.4			23.1	26.4	25.3	20.6	17.4	14.7			5.6	1.3
Grant-equivalent financing (in percent of external financing) 9/	...	...	100.0			100.0	100.0	97.2	96.1	94.8	93.9			89.0	61.3
<i>Memorandum items:</i>															
Nominal GDP (millions of US dollars)	456.7	541.1	641.8			670.1	726.9	801.0	928.4	1049.1	1149.2			1920.1	4732.2
Nominal dollar GDP growth	10.3	18.5	18.6			4.4	8.5	10.2	15.9	13.0	9.5	10.3	7.2	8.3	9.9
PV of PPG external debt (in millions of US dollars)	...	119.0	105.5			97.2	91.1	90.8	93.1	97.8	103.8			158.1	379.6
(Pvt-Pvt-1)/GDPt-1 (in percent)	...	...	-2.5			-1.3	-0.9	0.0	0.3	0.5	0.6	-0.1	0.6	0.7	0.7

Source: Solomon Islands authorities; and IMF staff estimates and projections

1/ Includes both public and private sector external gross debt. The DSA exercise was conducted jointly with the World Bank.

2/ Derived as  $[r - g - r(1+g)] / (1+g+r+gr)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate, and  $r$  = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., debt relief); changes in gross foreign assets; and valuation adjustments. Residuals are large in the latter half of the projection period, as reserves fluctuate mainly due to the large and volatile FDI from the nickel mining company.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are derived over the past 10 years.

7/ Defined as grants, concessional loans, and debt relief.

8/ In 2008, refers to disbursements from previous loans.

9/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

**Table 3b. Solomon Islands: Public Sector Debt Sustainability, High-Case Scenario, 2006–29**  
(In percent of GDP, unless otherwise indicated)

	Actual		Est. 2008	Historical Average 6/ 2006–10	Standard Deviation 6/ 2006–10	Projections									
	2006	2007				2009	2010	2011	2012	2013	2014	2009–14 Average	2019	2029	2015–29 Average
Public sector debt 1/	57.1	40.3	31.8			27.3	23.8	22.0	19.8	18.7	18.4		13.6	12.5	
Of which: foreign-currency denominated	33.9	27.6	21.8			18.8	16.2	15.1	14.0	13.7	13.9		12.1	10.5	
Change in public sector debt	4.4	-16.8	-8.5			-4.4	-3.5	-1.9	-2.2	-1.1	-0.4		-1.0	0.0	
Identified debt-creating flows	-7.2	-9.6	-7.3			-2.2	-4.5	-3.2	-3.7	-2.7	-2.0		-2.7	-0.7	
Primary deficit	-2.4	-1.4	-2.4	-0.2	4.3	0.0	-2.4	-1.3	-0.8	-0.6	-0.5	-0.9	-2.0	0.0	
Revenue and grants	47.3	50.2	48.9			50.6	54.1	51.9	47.5	44.2	41.8		35.6	31.7	
Of which: grants	23.8	23.4	21.4			23.1	26.4	24.5	19.7	16.4	13.7		5.3	1.1	
Primary (noninterest) expenditure	45.0	48.8	46.4			50.6	51.7	50.7	46.7	43.6	41.3		33.6	31.7	
Automatic debt dynamics	-4.6	-8.1	-4.8			-1.7	-1.9	-2.0	-2.8	-2.1	-1.4		-0.8	-0.7	
Contribution from interest rate/growth differential	-4.4	-6.9	-3.5			-0.7	-1.0	-1.2	-2.3	-1.7	-1.2		-0.6	-0.7	
Of which: contribution from average real interest rate	-1.0	-1.4	-0.9			-0.5	-0.2	-0.3	-0.3	-0.3	-0.3		-0.1	0.0	
Of which: contribution from real GDP growth	-3.4	-5.5	-2.6			-0.1	-0.8	-0.9	-2.0	-1.4	-0.9		-0.5	-0.7	
Contribution from real exchange rate depreciation	-0.2	-1.2	-1.3			-1.1	-0.9	-0.8	-0.5	-0.4	-0.3		-0.2	0.0	
Other identified debt-creating flows	-0.3	-0.2	0.0			-0.4	-0.2	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.2	0.0	0.0			-0.4	-0.2	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities 2/	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-0.1	-0.2	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	11.6	-7.1	-1.3			-2.2	1.0	1.4	1.5	1.6	1.6		1.8	0.7	
Other Sustainability Indicators															
PV of public sector debt	...	34.7	27.0			23.2	20.3	18.3	15.9	14.5	13.6		9.8	10.1	
Of which: foreign-currency denominated	...	22.0	17.0			14.7	12.6	11.4	10.1	9.4	9.1		8.3	8.1	
Of which: external	...	22.0	17.0			14.7	12.6	11.4	10.1	9.4	9.1		8.3	8.1	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	-0.1	2.6	1.1			2.7	-0.3	0.7	1.0	1.2	1.2		-0.7	1.2	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	69.1	55.2			45.8	37.6	35.2	33.5	32.7	32.6		27.7	32.0	
PV of public sector debt-to-revenue ratio (in percent)	...	129.2	98.1			84.0	73.5	66.7	57.2	51.9	48.5		32.5	33.1	
Of which: external 4/	...	82.1	61.8			53.2	45.7	41.7	36.4	33.8	32.4		27.5	26.4	
Debt service-to-revenue and grants ratio (in percent) 5/	3.6	6.7	6.5			4.8	3.5	3.3	3.5	3.7	3.8		3.4	3.7	
Debt service-to-revenue ratio (in percent) 5/	7.2	12.4	11.7			8.9	6.8	6.3	6.0	5.9	5.7		4.0	3.8	
Primary deficit that stabilizes the debt-to-GDP ratio	-6.7	15.4	6.1			4.4	1.1	0.6	1.3	0.5	-0.2		-1.0	0.0	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.9	10.7	6.9	1.0	7.6	0.4	3.0	3.8	9.7	7.7	5.3	5.0	3.7	6.1	
Average nominal interest rate on forex debt (in percent)	0.8	2.1	2.9	1.2	0.6	1.3	1.3	1.3	1.2	1.1	1.1	1.2	1.3	1.9	
Average real interest rate on forex debt (in percent)	-2.3	-0.6	0.7	-1.3	0.9	0.4	0.9	0.7	-0.3	-0.8	-0.9	0.0	-0.6	-0.1	
Real exchange rate depreciation (in percent, + indicates depreciation)	-0.5	-4.0	-5.0	1.3	10.3	...	...	...	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	4.3	7.6	12.3	7.8	2.5	8.6	7.5	8.1	7.5	6.8	5.9	7.4	5.3	4.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.2	0.0	0.2	0.3	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	
Grant element of new external borrowing (in percent)	...	...	...	...	...	...	...	52.2	52.2	52.2	52.2	...	30.7	20.5	

Source: Solomon Islands authorities; and IMF staff estimates and projections.

1/ The public sector covers only the central government.

2/ Current estimate of recognized contingent liabilities.

3/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

4/ Revenues excluding grants.

5/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

6/ Historical averages and standard deviations are derived over the past 10 years.



**Table 4a. Solomon Islands: External Debt Sustainability, Low-Case Scenario, 2006–29 1/**  
(In percent of GDP, unless otherwise indicated)

	Actual		Est.	Historical Average 6/	Standard Deviation 6/	Projections									
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009–14 Average	2019	2029	2015–29 Average
External debt (nominal) 1/	39.4	32.1	25.4			22.2	19.4	17.8	16.4	15.4	13.8			11.5	10.6
<i>Of which: public and publicly guaranteed (PPG)</i>	33.9	27.6	21.8			18.8	16.3	14.9	13.7	12.9	11.6			9.5	8.9
Change in external debt	-2.8	-7.3	-6.7			-3.2	-2.8	-1.6	-1.4	-1.0	-1.6			-0.3	0.0
Identified net debt-creating flows	-3.3	-4.2	0.3			0.2	2.2	4.9	2.9	2.0	-3.4			2.5	-0.5
Noninterest current account deficit	5.9	11.6	17.8	1.2	9.1	10.8	18.3	18.2	14.4	12.9	4.3			7.5	2.6
Deficit in balance of goods and services	17.4	21.4	20.2			24.2	31.9	29.5	24.8	21.2	8.1			5.6	0.9
Exports	35.5	39.7	38.1			31.4	28.1	25.1	23.6	21.4	29.7			26.8	17.5
Imports	52.9	61.1	58.3			55.7	60.0	54.6	48.3	42.6	37.7			32.3	18.4
Net current transfers (negative = inflow)	-14.4	-15.8	-16.3	-4.6	6.6	-20.7	-22.2	-20.5	-17.9	-15.9	-13.3			-5.4	-1.7
<i>Of which: official</i>	-15.4	-17.0	-17.6			-22.0	-23.5	-21.5	-18.8	-16.6	-13.9			-6.0	-2.0
Other current account flows (negative = net inflow)	2.9	6.1	13.9			7.3	8.5	9.1	7.5	7.5	9.6			7.4	3.5
Net FDI (negative = inflow)	-5.8	-10.5	-13.4	-1.4	4.4	-10.1	-15.1	-12.2	-10.5	-10.1	-6.1			-4.3	-2.7
Endogenous debt dynamics 2/	-3.4	-5.3	-4.1			-0.5	-1.0	-1.1	-1.0	-0.8	-1.6			-0.7	-0.4
Contribution from nominal interest rate	0.6	0.8	0.9			0.5	0.4	0.4	0.3	0.3	0.3			0.2	0.2
Contribution from real GDP growth	-2.7	-3.6	-1.9			-0.1	-0.5	-0.5	-0.5	-0.4	-1.2			-0.5	-0.4
Contribution from price and exchange rate changes	-1.3	-2.6	-3.2			-0.8	-0.9	-0.9	-0.8	-0.7	-0.6			-0.4	-0.2
Residual (3-4) 3/	0.6	-3.0	-7.0			-3.4	-5.0	-6.5	-4.3	-3.1	1.8			-2.8	0.4
<i>Of which: exceptional financing</i>	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0
PV of external debt 4/	...	26.9	20.2			18.1	15.9	14.3	13.0	11.9	10.4			7.8	7.3
In percent of exports	...	67.6	53.2			57.5	56.7	57.1	55.0	55.6	35.0			29.2	42.0
PV of PPG external debt	...	22.4	16.8			14.7	12.8	11.4	10.3	9.4	8.2			5.9	5.6
In percent of exports	...	56.4	44.1			46.9	45.6	45.6	43.6	43.9	27.6			22.1	32.3
In percent of government revenues	...	83.5	61.1			53.4	47.4	43.9	39.9	37.3	32.5			23.2	22.0
Debt service-to-exports ratio (in percent)	3.5	6.4	10.3			11.5	10.6	10.8	10.2	10.3	6.5			4.8	5.9
PPG debt service-to-exports ratio (in percent)	2.5	5.8	6.0			6.6	5.5	5.5	5.0	5.0	3.1			1.7	1.5
PPG debt service-to-revenue ratio (in percent)	3.8	8.6	8.4			7.5	5.8	5.3	4.6	4.2	3.6			1.8	1.0
Total gross financing need (millions of U.S. dollars)	8.6	22.9	55.6			30.5	45.6	68.4	54.5	46.9	2.6			68.7	28.8
Noninterest current account deficit that stabilizes debt ratio	8.6	18.9	24.6			14.0	21.0	19.8	15.7	13.9	5.9			7.8	2.6
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.9	10.7	6.9	1.0	7.6	0.4	2.4	2.7	3.1	2.7	9.1	3.4	4.4	3.6	3.8
GDP deflator in US dollar terms (change in percent)	3.2	7.0	10.9	0.7	9.1	3.4	4.2	5.1	4.9	4.4	3.9	4.3	3.8	2.1	3.3
Effective interest rate (percent) 5/	1.5	2.5	3.3	3.8	5.5	2.0	2.0	2.1	2.0	2.0	1.9	2.0	1.7	2.0	1.9
Growth of exports of G&S (US dollar terms, in percent)	16.9	32.5	13.7	2.4	26.8	-14.3	-4.6	-3.6	1.6	-2.8	57.4	5.6	5.1	6.3	3.9
Growth of imports of G&S (US dollar terms, in percent)	39.4	36.8	13.2	5.8	33.1	-0.8	15.0	-1.7	-4.2	-5.5	0.4	0.5	3.0	5.1	2.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	52.2	52.2	52.2	52.2	52.2	52.2	40.9	44.7
Government revenues (excluding grants, in percent of GDP)	23.6	26.8	27.5			27.6	27.1	26.0	25.8	25.2	25.2			25.6	25.7
Aid flows (in millions of US dollars) 7/	115.8	140.5	137.8			153.7	176.9	183.6	175.4	169.6	166.3			108.8	56.7
<i>Of which: grants</i>	108.5	126.4	137.3			153.7	176.9	175.9	167.1	160.7	156.2			96.0	42.1
<i>Of which: concessional loans 8/</i>	7.3	14.1	0.5			0.0	0.0	7.7	8.3	8.9	10.1			12.8	14.6
Grant-equivalent financing (in percent of GDP) 9/	...	...	21.4			23.1	24.9	23.4	20.6	18.5	16.0			6.8	1.8
Grant-equivalent financing (in percent of external financing) 9/	...	...	100.0			100.0	100.0	98.0	97.7	97.5	97.1			94.4	80.9
<i>Memorandum items:</i>															
Nominal GDP (millions of US dollars)	456.7	541.1	641.8			666.5	710.8	767.9	830.8	891.4	1010.5			1507.8	2869.5
Nominal dollar GDP growth	10.3	18.5	18.6			3.9	6.7	8.0	8.2	7.3	13.4	7.9		8.4	5.8
PV of PPG external debt (in millions of US dollars)	...	121.2	107.7			98.2	91.1	87.8	85.4	83.6	82.6			89.3	161.9
(Pvt-Pvt-1)/GDPT-1 (in percent)	...	...	-2.5			-1.5	-1.1	-0.5	-0.3	-0.2	-0.1			0.2	0.4

Source: Solomon Islands authorities; and IMF staff estimates and projections

1/ Includes both public and private sector external gross debt. The DSA exercise was conducted jointly with the World Bank.

2/ Derived as  $[r - g - r(1+g)] / (1+g+gr)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate, and  $r$  = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., debt relief); changes in gross foreign assets; and valuation adjustments. Residuals are large in the latter half of the projection period, as reserves fluctuate mainly due to the large and volatile FDI from the nickel mining company.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are derived over the past 10 years.

7/ Defined as grants, concessional loans, and debt relief.

8/ In 2008, refers to disbursements from previous loans.

9/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

**Table 4b. Solomon Islands: Public Sector Debt Sustainability, Low-Case Scenario, 2006–29**  
(In percent of GDP, unless otherwise indicated)

	Actual		Est.	Historical Average 6/	Standard Deviation 6/	Projections									
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009–14 Average	2019	2029	2015–29 Average
Public sector debt 1/	57.1	40.3	31.8			27.3	24.0	21.8	20.0	18.5	16.4		16.2	20.4	
<i>Of which:</i> foreign-currency denominated	33.9	27.6	21.8			18.8	16.3	14.9	13.7	12.9	11.6		9.5	8.9	
Change in public sector debt	4.4	-16.8	-8.5			-4.4	-3.3	-2.2	-1.8	-1.4	-2.1		0.0	0.3	
Identified debt-creating flows	-7.2	-9.6	-7.3			-2.0	-3.0	-1.7	-1.2	-0.8	-1.6		0.0	0.3	
Primary deficit	-2.4	-1.4	-2.4	-0.2	4.3	0.0	-1.2	-0.1	0.3	0.4	0.5	0.0	1.1	1.0	1.2
Revenue and grants	47.3	50.2	48.9			50.6	51.9	48.9	45.9	43.2	40.6		31.9	27.2	
<i>Of which: grants</i>	23.8	23.4	21.4			23.1	24.9	22.9	20.1	18.0	15.5		6.4	1.5	
Primary (noninterest) expenditure	45.0	48.8	46.4			50.6	50.7	48.9	46.2	43.6	41.1		33.0	28.1	
Automatic debt dynamics	-4.6	-8.1	-4.8			-1.5	-1.6	-1.6	-1.5	-1.2	-2.1		-1.1	-0.7	
Contribution from interest rate/growth differential	-4.4	-6.9	-3.5			-0.7	-0.9	-0.9	-1.0	-0.9	-1.8		-0.9	-0.7	
<i>Of which:</i> contribution from average real interest rate	-1.0	-1.4	-0.9			-0.5	-0.2	-0.3	-0.4	-0.4	-0.3		-0.3	0.0	
<i>Of which:</i> contribution from real GDP growth	-3.4	-5.5	-2.6			-0.1	-0.6	-0.6	-0.7	-0.5	-1.6		-0.7	-0.7	
Contribution from real exchange rate depreciation	-0.2	-1.2	-1.3			-0.9	-0.7	-0.7	-0.5	-0.3	-0.2		-0.2	0.0	
Other identified debt-creating flows	-0.3	-0.2	0.0			-0.4	-0.2	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.2	0.0	0.0			-0.4	-0.2	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities 2/	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-0.1	-0.2	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	11.6	-7.1	-1.3			-2.5	-0.4	-0.5	-0.7	-0.6	-0.5		0.0	0.0	
Other Sustainability Indicators															
PV of public sector debt	...	35.1	27.3			23.5	20.7	18.5	16.7	15.2	13.1		12.6	17.2	
<i>Of which:</i> foreign-currency denominated	...	22.4	17.3			15.0	13.0	11.6	10.4	9.5	8.3		6.0	5.7	
<i>Of which:</i> external	...	22.4	17.3			15.0	13.0	11.6	10.4	9.5	8.3		6.0	5.7	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	-0.1	2.6	1.1			2.9	1.1	2.1	2.4	2.5	2.4		3.6	6.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	69.9	55.9			46.4	39.9	37.9	36.4	35.1	32.4		39.5	63.5	
PV of public sector debt-to-revenue ratio (in percent)	...	130.7	99.5			85.2	76.6	71.3	64.7	60.3	52.2		49.4	67.1	
<i>Of which:</i> external 4/	...	83.6	63.1			54.3	48.1	44.5	40.5	37.8	33.0		23.5	22.3	
Debt service-to-revenue and grants ratio (in percent) 5/	3.6	6.7	6.5			5.2	4.0	3.9	4.2	4.5	4.4		7.6	19.9	
Debt service-to-revenue ratio (in percent) 5/	7.2	12.4	11.7			9.6	7.7	7.3	7.5	7.7	7.1		9.5	21.0	
Primary deficit that stabilizes the debt-to-GDP ratio	-6.7	15.4	6.1			4.4	2.1	2.1	2.2	1.8	2.6		1.1	0.7	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.9	10.7	6.9	1.0	7.6	0.4	2.4	2.7	3.1	2.7	9.1	3.4	4.4	3.6	3.8
Average nominal interest rate on forex debt (in percent)	0.8	2.1	2.9	1.2	0.6	1.3	1.3	1.3	1.2	1.2	1.1	1.2	0.9	1.1	1.0
Average real interest rate on forex debt (in percent)	-2.3	-0.6	0.7	-1.3	0.9	0.4	0.9	0.7	-0.2	-0.8	-0.8	0.0	-1.0	-0.8	-1.4
Real exchange rate depreciation (in percent, + indicates depreciation)	-0.5	-4.0	-5.0	1.3	10.3	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.3	7.6	12.3	7.8	2.5	8.6	7.5	8.2	7.9	7.5	6.9	7.8	6.8	5.1	6.3
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.2	0.0	0.2	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	...	...	52.2	52.2	52.2	52.2	...	52.2	40.9	44.7

Source: Solomon Islands authorities; and IMF staff estimates and projections

1/ The public sector covers only the central government.

2/ Current estimate of recognized contingent liabilities.

3/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

4/ Revenues excluding grants.

5/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

6/ Historical averages and standard deviations are derived over the past 10 years.

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

**Staff Report for the 2009 Article IV Consultation—Informational Annex**

Prepared by the Asia and Pacific Department

September 21, 2009

	Contents	Page
I.	Fund Relations .....	2
II.	Support from the Pacific Financial Technical Assistance Center.....	4
III.	Relations with the World Bank.....	5
IV.	Relations with the Asian Development Bank.....	8
V.	Statistical Issues.....	10

**ANNEX I. SOLOMON ISLANDS—FUND RELATIONS**

(As of August 31, 2009)

**I. Membership Status:** Joined September 22, 1978; Article VIII

<b>II. General Resources Account:</b>	<b>SDR Million</b>	<b>Percent Quota</b>
Quota	10.40	100.00
Fund holdings of currency	9.85	94.73
Reserve position in the Fund	0.55	5.29

<b>III. SDR Department:</b>	<b>SDR Million</b>	<b>Percent Allocation</b>
Net cumulative allocation	8.36	100.00
Holdings	7.72	92.26

**IV. Outstanding Purchases and Loans:** None

**V. Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Mission)	Amount Drawn (SDR Million)
Stand-by	6/22/1983	6/21/1984	2.40	0.96

**VI. Projected Payments to Fund:**

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2009	2010	2011	2012	2013
Charges/Interest	0.00	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	0.00	0.00

**VII. Implementation of HIPC Initiative:** Not applicable.

**VIII. Implementation of MDRI Assistance:** Not applicable.

**IX. Exchange Rate Arrangements:**

Since November 2000, the exchange rate for the Solomon Islands (SI) dollar has been based on a trade-weighted basket of its major trading partners' currencies, with the U.S. dollar as the intervention currency. The Solomon Islands now maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

**X. Last Article IV Consultation:**

The 2008 Article IV Consultation discussions were held in Honiara during July 16–25, 2008. The staff report (IMF Country Report No. 08/358) was considered by the Executive Board and the consultation concluded on October 20, 2008.

**XI. Technical Assistance:**

<b>Date</b>	<b>Department</b>	<b>Purpose</b>
January 2005	PFTAC	Financial reporting system
February 2005	PFTAC	Financial supervision of insurance
April 2005	PFTAC	Financial supervision
May, August, and October 2005; and February 2006	MFD	Financial supervision of insurance
May 2005	PFTAC	Tax policy and administration
August 2005	MFD	Reserve management
August 2005, February and April 2006	PFTAC	Statistics
September 2005 and February 2006	PFTAC	AML/CFT
October 2005	LEG	AML/CFT
November 2005 and July 2005	STA	Monetary and Financial Statistics
January 2006	PFTAC and LEG	Tax policy
April and June 2006	MFD	Central Bank Accounting
May, August, and October 2006 and January 2007	PFTAC	Public Financial Management and Accounting
October 2006	MCM	TA program monitoring
October 2006	MCM	Financial sector supervision
October 2006	MCM	Reserve Management
December 2006	PFTAC	Business Revenue Reform
February 2007	PFTAC	Balance of Payments Statistics
February and November 2007 and May 2008	PFTAC	National Income Accounts
March 2007 and March 2008	MCM	Accounting
February 2008-February 2009	STA	Peripatetic Export on Import Price Index Statistics
February-March 2008	PFTAC and FAD	Tax Policy
April 2008 and February 2009	PFTAC	Balance of Payments Statistics
June 2008	LEG	Review of Central Bank Act
April 2008-April 2009	MCM	Peripatetic Advisor to CBSI
June and September 2008 and June 2009	MCM	Monetary Operations and Liquidity Management
July 2008	STA	Money and Banking Statistics

**XII. Resident Representative: None**

## ANNEX II: SOLOMON ISLANDS—SUPPORT FROM THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTER<sup>1</sup>

Over the past few years, support for the Solomon Islands from the Pacific Financial Technical Assistance Center (PFTAC) has focused on the following areas:

**Tax policy and administration:** A PFTAC mission in December 2006 and follow-up visit in May 2007 assisted the authorities in the preparation of a project plan for implementing business revenue reform. A joint FAD-PFTAC regional mission took place in February–March 2008 and recommended strategies for addressing future revenue needs, with a follow-up visit in May 2008. However, the government’s revenue policy remains to be finalized.

**Bank supervision and examination:** A PFTAC mission in October 2008 reviewed the implementation of Basel I by the Central Bank of Solomon Islands (CBSI) and the adequacy of regulatory reporting requirements for banking institutions. A follow-up mission in February 2009 completed the review and revised the reporting requirements. During these visits, PFTAC Advisor also provided assistance and training to the CBSI supervision staff in the proper use of regulatory enforcement actions and conduct of an on-site examination of the National Provident Fund. Additional visits are planned to assist the CBSI in strengthening its off-site monitoring and analysis of banking institutions through the introduction of formalized output analysis reports to be generated by the new regulatory reporting forms. PFTAC also will provide support for an IT expert in August 2009 to assess the CBSI’s computer needs and reconfigure the current FRE\D database used by the Supervision Department to accommodate the new regulatory reporting requirements and forms.

**Statistical issues:** A monetary and financial statistics (MFS) mission visited in July 2007 to assist the CBSI in moving towards the *MFS Manual 2000* reporting standards. During a two-year period ending February 2009, a PFTAC statistics advisor and short-term experts undertook eight visits to the Solomon Island to assist the authorities strengthening compilation of balance of payments statistics, developing import prices statistics, and improving the quality and timeliness of national accounts statistics. Constant price GDP estimates have been rebased to 2004 prices. A follow-up mission on national accounts statistics is planned for February 2010.

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<sup>1</sup> The Pacific Financial Technical Assistance Center in Suva, Fiji, is a regional technical assistance institution operated by the IMF with financial support of the Asian Development Bank, Australia, Japan, Korea, and New Zealand. The Center’s aim is to build skills and institutional capacity for effective economic and financial management that can be sustained at the national level. Member countries are: Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, and Vanuatu.

**ANNEX III: SOLOMON ISLANDS—RELATIONS WITH THE WORLD BANK GROUP**  
(As of August 2009)

The Solomon Islands has been a member of the World Bank since the country's independence in 1978, receiving 11 IDA operations to date totaling US\$63.4 million in education and health, roads and rural development, and energy, as well as a structural adjustment credit. Following the repayment of all outstanding arrears in 2003, the Solomon Islands emerged from nonaccrual status, and country relations were normalized. The Solomon Islands qualifies for grant funding under the IDA Debt Sustainability Framework and is eligible for an IDA15 allocation of US\$9.8 million.

The World Bank Group's (WBG) assistance is motivated by the need for re-engagement in a low capacity, post-conflict country, while recognizing the abundance of donor funds. Bank activities in the Solomon Islands are currently addressed under the *Regional Engagement Framework FY06–FY09 for Pacific Islands*. However, the World Bank and International Finance Corporation (IFC) are now preparing a joint stand-alone *Interim Strategy Note* addressing the period FY10–12. The opening of a WBG country office in 2008, together with the Asian Development Bank (AsDB), reflects increased institutional and regional commitment to small and fragile states.

The Bank's current activities in the Solomon Islands are concentrated in the following areas:

**Energy:** The Bank has two projects under implementation in the energy sector. The first is the Sustainable Energy Project comprising an IDA14 grant of US\$4.0 million, which aims to support reform of the Solomon Islands Electricity Authority by enhancing its operational efficiency, system reliability and financial performance and by strengthening its financial and operational management through a commercialization program, with a view to reducing power losses and increasing the reliability of generation and distribution systems. The Tina River Hydropower project, currently under preparation, is expected to reduce the country's high level of dependence on imported diesel, while providing a more reliable and sustainable power supply. The Bank's contribution will take the form of a partial risk guarantee, based on US\$4 million in IDA resources. The regional Sustainable Energy Finance Project provides US\$0.5 million in loan guarantees for the purchase of household sustainable energy systems—a scheme implemented by the Central Bank of Solomon Islands.

**Telecommunications:** The Bank is providing technical assistance (TA) to the government to examine ways to improve the competitiveness of the sector, in order to reduce telecommunication costs and improve service quality and coverage, in particular outside Honiara. Supported by a proposed US\$3.8 million IDA operation, this work will (i) assist government in managing the transition from a monopoly to competition; (ii) establish a regulator with the appropriate legal, regulatory, and technical expertise; and (iii) assist in

implementing a sustainable, self-financing connectivity program for rural and remote areas. Board consideration is anticipated for end 2009.

**Rural development:** The Bank launched the Rural Development Program (RDP) in February 2008, focusing initially on four provinces. The program is expected to expand to include the remaining provinces in 2010. Implemented by the Ministry of Development Planning and Aid Coordination, the RDP aims to raise the living standards of rural households by (i) providing local services and basic infrastructure through community grants; (ii) increasing the capacity of Ministry of Agriculture and Livelihoods to provide agriculture extension services; and (iii) supporting rural business development. Approved in September 2007, total project financing is approximately US\$21.8 million including an IDA grant (US\$3.2 million), EC grant (US\$10.1 million), and AusAID grant (US\$ 6.6 million).

**Health:** A Health Sector Support Technical Assistance Program was approved in March 2008 with an IDA grant of US\$1.2 million, complementing the larger AusAID Health Sector Support Program SWAp with TA for the Ministry of Health and Medical Services in (i) public expenditure management and medium-term planning at the provincial level; (ii) sector performance monitoring; and, (iii) training and capacity building. Following initial implementation delays, project activities are expected to start in October 2009.

**Economic analysis:** In 2008, the government requested World Bank and IFC support to identify sources of revenue to replace the anticipated decline in logging, which in 2008, accounted for 16 percent of GDP, 60 percent of exports, and 18 percent of government revenue. This initiative aims to encourage policy changes and actions by government, donors, and the private sector to increase economic growth based on realistic assessments of the medium-term fiscal outlook and growth prospects across key sectors of the economy. The work has three streams: (i) Near and Medium-Term Growth Prospects to 2013; (ii) Long-Term Growth Prospects, 2013 and Beyond; (iii) case studies of customary land tenure carried out by the Bank's Justice for the Poor program. The first stream has been completed, with preliminary findings presented in March 2009; the second stream will be finalized in the latter half of 2009.

In addition, the Ministry of Finance and Treasury (MoFT) has asked the World Bank to assist in undertaking a *Public Expenditure Review* (PER). The move to a PER reflects the desire of the ministry to improve public financial management (PFM), and as such forms an important component of Government's response to the Public Expenditure and Financial Accountability (PEFA) conducted in late 2008. The PER will be critical to overall improvements in PFM, maximizing the development impacts of the government's limited resources, as well as rationalizing financial flows and spending at the provincial level.

**Rapid Employment Program (REP):** The REP will be a labor-based public-works program to create employment in Honiara and peri-urban settlements. It will provide an alternative



source of income to those most vulnerable to the effects of the global financial crisis and contractions in government spending, with the overarching objective of helping to reduce risks of social instability. The REP aims to (i) address unemployment, underemployment, and poverty; (ii) augment basic life skills and household incomes, particularly for the working poor; and (iii) increase economic productivity through investing in the maintenance of infrastructure assets.

**Regulatory Simplification and Investment Policy and Promotion Project (RSIPP):**

Undertaken by the IFC's Investment Climate Advisory Services, the RSIPP fosters public-private dialogue to bring about simplifications in business processes and improvements in investment climate. Components include streamlining business startup and licensing, reducing the time and cost of contract enforcement, improving investment promotion, and speeding up and making more affordable land transfers. A gender component seeks to assess and reduce gender-based barriers to private sector participation. In the area of business licensing, the IFC is coordinating closely with the AsDB.

**IFC Investments:** IFC is considering substantial loan and equity positions in a mining enterprise (Gold Ridge mine), which is expected to resume production soon. The project has two main components: (i) the rehabilitation of the processing plant and equipment by an engineering contractor, and (ii) the redevelopment of the mine and associated costs of infrastructure. IFC is also actively pursuing potential investments in sustainable agriculture and fisheries.

**ANNEX IV: SOLOMON ISLANDS—RELATIONS WITH THE ASIAN DEVELOPMENT BANK**  
(As of August 2009)

Since joining the Asian Development Bank (AsDB) in 1973, the Solomon Islands has received 16 loans amounting to US\$79.3 million, 9 grants amounting to US\$53.6 million and 61 technical assistance (TA) projects amounting to US\$18.3 million. The Solomon Islands is eligible for Asian Development Fund (ADF) grants available to countries that are very poor, heavily indebted, or in a post-conflict situation. The AsDB approved ADF grants of US\$5.0 million and US\$14.0 million in 2007 and 2008, respectively. The 2007–08 ADF allocations for the Solomon Islands succeeded in catalyzing substantial grant cofinancing from the governments of Australia and New Zealand, the European Commission, and the Regional Assistance Mission to Solomon Islands (RAMSI).

The AsDB's country assistance strategy seeks to reduce poverty by promoting equitable private-sector-led economic growth through improved transportation infrastructure and services and a stronger business-enabling environment.<sup>1</sup> An Interim Country Partnership Strategy (2009–11) is being prepared for approval in September 2009. Capacity development and the promotion of good governance are guiding priorities. In light of the global economic turbulences, the AsDB is adjusting its operations to support the government in terms of mitigating the impacts, currently through analytical support and adjustments in the design and delivery of investment projects to increase local content. AsDB assistance is currently provided entirely on a grant basis and, in line with government policy, no new lending to the country will be provided until public finances stabilize.

In transport infrastructure, the AsDB supports the institutional strengthening of the Ministry of Infrastructure Development. Investment projects, all grant funded, include an Emergency Assistance Project in response to the 2007 earthquake and consequent tsunami that is rebuilding damaged roads, bridges, wharves, and water supplies; the Solomon Islands Road Improvement Project to rehabilitate roads and bridges; the Domestic Maritime Support Sector Project for the establishment of a franchise shipping scheme for services to remote locations and the construction of selected wharves. A transport sector development project is being prepared for approval in 2010.

AsDB operations in private sector development focus on business law reform, public enterprise reform, and access to finance. Specific interventions include the modernization of the company registry; establishment of a secured transactions registry; and selected state-owned enterprise (SOE) reform, privatization, and public–private partnership support.

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<sup>1</sup> The Country Strategy and Program Update 2007–09 can be found at <http://www.adb.org/Documents/CSPs/SOL/2006>, and the Country Operations Business Plan 2009-2011 at <http://www.adb.org/Documents/CSPs/SOL/2008/COBP-SOL-2008.pdf>.

These interventions complement recent reforms such the passing, in March 2009, of the new Companies Act and Companies (Insolvency and Receiverships) Act.

The AsDB's Pacific Liaison and Coordination Office in Sydney is responsible for country programming, project implementation, and administration, supported by the Pacific Operations Division in Manila.

**Solomon Islands: Loans, Approvals, and Disbursements, 1999–2007**  
(In millions of U.S. dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Loan approvals	10.00	--	--	--	--	--	--	--	--
Loan disbursements	0.00	0.00	0.00	0.00	0.89	2.76	4.09	3.75	0.073
Cumulative loan amount approved (as of end-of-year)	79.31	79.31	79.31	79.31	79.31	79.31	79.31	79.31	79.31
Cumulative net effective loans (as of end-of-year)	54.30	64.05	64.83	65.87	66.31	79.31	79.31	79.31	79.31
Cumulative disbursements (as of end-of-year)	54.07	54.07	54.07	54.30	55.16	57.91	62.00	65.75	65.82

Contact person: Eugenie Zhukov, Regional Director, Pacific Liaison and Cooperation Office, AsDB Sydney (ezhukov@adb.org).

**ANNEX V. SOLOMON ISLANDS—STATISTICAL ISSUES**  
As of September 1, 2009

<b>I. Assessment of Data Adequacy for Surveillance</b>	
<b>General:</b> Data provision has some shortcomings, but is broadly adequate for surveillance.	
<p><b>National Accounts:</b> Recent technical assistance (TA) from the Pacific Financial Technical Assistance Center has led to improvements in constant and current price GDP estimates. Revised estimates have been produced for 2005 to 2007, but await final analysis before being published. Currently, GDP estimates produced by the National Statistical Office differ from those used by the Central Bank of Solomon Islands (CBSI). No official expenditure-based GDP estimates are published. A census survey, which will be a basis of future GDP estimates, is scheduled to be completed later this year. While limited data on employment can be obtained from the National Provident Fund, wage data are not compiled. In light of the inadequacy of labor statistics, the authorities plan to conduct a <i>Labor Force Survey</i> in 2011.</p>	
<p><b>Price statistics:</b> A monthly consumer price index (CPI) is produced with a short lag (about a month), but covers only the capital Honiara. The weights of this index were revised in 2007, based on the results of the 2005–06 <i>Household Income and Expenditure Survey</i>. The authorities plan to compile a nationwide CPI, and have already compiled a list of goods to be contained in the basket. However, the timing of actual compilation is unclear due to lack of funds. TA has been provided on the development of an import price index but, due to resource constraints, there has been little progress in implementation.</p>	
<p><b>Government finance statistics:</b> Currently, annual fiscal data are prepared for the central government, but they do not cover provincial governments. Tentative monthly revenue and expenditure data are available, but they are generally not consistent with annual statistics. The authorities started collecting disbursement information on donors' grants in 2006. The quality of public debt data has been improved recently through better coordination between the Ministry of Finance and Treasury and the CBSI. To expand coverage of general government activity, major state-owned enterprises' financial accounts have recently been produced for the first time up to 2007, with accounts for 2008 expected to be available by late 2009.</p>	
<p><b>Monetary and financial statistics:</b> The CBSI publishes monthly monetary and financial statistics (MFS) in summary form and provides more detailed data in its quarterly and annual reports. An integrated monetary database is operational as a result of TA from the IMF's Statistics Department, and MFS are reported to the Fund using the standardized report forms (SRFs). A follow-up mission is scheduled for January 2010 to derive the SRFs for the other depository corporations and other financial corporations based on a soon-to-be introduced call report form to collect balance-sheet data from reporting corporations.</p>	
<p><b>External Sector Statistics:</b> The CBSI has been compiling quarterly balance of payment statistics (BPS) using its own survey since 2006. Compared to the previous method, which was based on foreign exchange transactions reported through the banking system, the newly compiled BPS has improved both coverage and data accuracy. However, these quarterly data have not yet been reported to the IMF's Statistics Department, and only annual BOP data are currently available in the Balance of Payments Statistics Yearbook up to 2006.</p>	
<b>II. Data Standards and Quality</b>	
Solomon Islands does not participate in the General Data Dissemination System (GDDS).	No data ROSC available.
<b>III. Reporting to STA (Optional)</b>	
No data are currently reported to STA for publication in the <i>Government Finance Statistics</i> .	

**Solomon Islands: Table of Common Indicators Required for Surveillance**  
(As of September 1, 2009)

	Date of latest observation	Date received	Frequency of Data/7	Frequency of Reporting/7	Frequency of Publication/7
Exchange Rates	31/07/09	18/08/09	D	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities/1	30/06/09	24/07/09	W	M	Q
Reserve/Base Money	30/06/09	24/07/09	M	M	M
Broad Money	30/06/09	24/07/09	M	M	M
Central Bank Balance Sheet	30/06/09	24/07/09	M	M	Q
Consolidated Balance Sheet of the Banking System	30/06/09	24/07/09	M	M	Q
Interest Rates/2	30/06/09	24/07/09	W	M	Q
Consumer Price Index	30/06/09	21/07/09	M	M	M
Revenue, Expenditure, Balance and Composition of Financing/3 – General Government/4	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing/3– Central Government	31/12/08	23/07/09	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt/5	31/12/08	20/07/09	A	A	A
External Current Account Balance	30/06/09	24/07/09	Q	Q	Q
Exports and Imports of Goods and Services	30/06/09	24/07/09	Q	Q	Q
GDP/GNP	31/12/08	19/07/09	A	A	A
Gross External Debt	31/12/08	20/07/09	A	A	A
International Investment Position/6	30/06/09	24/07/09	Q	Q	Q

1/ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

2/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

3/ Foreign, domestic bank, and domestic nonbank financing.

4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

5/ Including currency and maturity composition.

6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

**Statement by the IMF Staff Representative on the Solomon Islands  
October 16, 2009**

1. This statement provides additional information that has become available since the circulation of the staff report. The information does not change the thrust of the staff report.
2. **Headline CPI was 3 percent year/year (y/y) in July**, benefiting from the lagged effect of declining commodity prices.
3. **Exports performed in line with staff expectations through August** (imports have not been officially reported). Export receipts from logging activity increased slightly in July and August, but falling production during these months suggests export levels will likely decline going forward. Fish and palm oil exports dropped more than anticipated, while copra and cocoa exports performed as expected.
4. **The Solomon Islands dollar has begun depreciating in real effective terms**, mainly due to a weaker U.S. dollar vis-à-vis trading partners' currencies. Nonetheless, owing to an earlier strengthening, the real effective exchange rate still appreciated by around 10 percent (y/y) through July 2009.
5. **Gross foreign reserves were around US\$125 million at end-September**. In addition to the Fund's SDR allocation, the rise also reflects foreign exchange sold to the Central Bank of Solomon Islands resulting from the sale offshore of a large loan by a major commercial bank to comply with liquidity requirements. Staff now expect reserves at end-2009 could be moderately higher than originally projected, but with the same declining trend still expected over the medium term.
6. **On the fiscal front, the government continues to face a tight cash situation**. While overall revenue performance (through August) is slightly below expectations, expenditure pressures appear to have eased modestly. As a result, net claims on government by the banking system rose by SI\$ 33 million in July and August as expected, mainly on account of a drawdown in deposits.
7. **Broad money growth is in line with the staff's outlook for 2009**. However, despite a further easing of liquidity conditions, credit growth declined to 2.4 percent (y/y) in August, reflecting the general slowdown in economic activity.

**Statement by Hi-Su Lee, Executive Director for Solomon Islands  
and Raynold Moveni, Advisor to the Executive Director  
October 16, 2009**

## **INTRODUCTION**

Our Solomon Islands authorities would like to express their sincere gratitude to staff for the useful discussions during their recent visit to Honiara. They value the discussions with staff on issues ranging from strategies to minimizing the effects of the global shocks on Solomon Islands' economy to reforms needed to placing Solomon Islands on a sustainable footing going forward. The authorities also express their sincere gratitude to development partners, the Pacific Financial Technical Assistance Center (PFTAC), the World Bank, and the Fund, for advice and assistance received over the years.

Solomon Islands is an import-dependent nation comprising of eight provinces scattering over a vast ocean. Strong growth performance in recent years was a result of stable policy implementation and return in confidence. However, the slowing of demand for external products, remittances and investment flows, has hit the economy and fiscal position. The authorities have tighten monetary conditions and taken a number of measures in the face of a deteriorating fiscal position. Further support of the donor community is needed to help preserve the social safety net in the face of these shocks.

The authorities wish to continue to strengthen the engagement with the Fund in the face of short-term challenges, and value the continued technical assistance to strengthen policy frameworks. Strengthened monitoring and the maintenance of a strong dialogue with donor parties on the macroeconomic framework would help the authorities address the immediate challenges. To this end, they welcome the recent assurances from the Fund regarding its willingness to remain engaged in a dialogue with donors and assist the authorities over the next 12 months.

## **ECONOMIC OVERVIEW**

The Solomon Islands' economy grew by 6.9 percent in 2008. The main drivers are the agriculture and forestry sectors, with each sector contributing 17 percent and 16 percent to Solomon Islands GDP, respectively. For 2009, the authorities project a growth of 1.1 percent, somewhat higher than the staff's estimate of 0.4 percent. The difference lies in the assumptions used. The authorities and the staff both share the view that a slowdown in logging and ancillary activities will act as drag on growth. Nonetheless, the authorities consider that an uptick in agriculture, tourism, and FDI-financed construction activities will lift growth in 2009 and 2010.

After reaching a peak of 23.5 percent in September 2008, the headline inflation decelerated to 3 percent year-on-year in July 2009. Lower inflation reflects the easing of international food and fuel prices and the central bank's tight monetary policy stance. External reserves have strengthened in recent months, increasing from less than 3 months worth of imports to 4.8 months worth of import cover in September. The improvement reflects donor inflows, a recovery in log exports, and the recent SDR allocation.

## POLICY ISSUES

- Fiscal Policy

Fiscal performance was broadly on track in the first half of 2008, revenue collections exceeded targets and expenditure growth slowed as intended. However, with the onset of the global economic crisis, confidence has all but evaporated. Revenues have fallen sharply, and recurrent spending has been higher than budgeted. The effect of the pass-through of the international food and fuel price shocks was immediate. The costs of utilities (due to the increase in energy costs) and of providing and sustaining government services shot up significantly. The authorities considered the environment after the shocks hit to be abnormal and responded to the situation by increasing budget allocations to utilities and provincial government grants. Without such allocations, government services would have been disrupted and potentially destabilizing. They consider their decision to provide higher budget allocations to be appropriate at the time and viewed the increased cost of providing and sustaining government services – owing to the increase in inflation – to be the main driver of the recurrent spending overrun in 2008 and in the first half of 2009. Meanwhile, the authorities passed a supplementary budget of around SI\$70 million to offset the effect of inflation on the costs of providing government services, address the needs of those hit by a tsunami last year, and advance structural reform in the telecommunications sector.

The authorities agree that fiscal pressures have emerged and that there is a need to create fiscal space to sustain fiscal operations and over time make a greater contribution to development spending. Mindful of the emerging pressures, the authorities took a series of measures to stabilize the fiscal situation. These include spending re-prioritization, freezing of public service hiring, and imposition of a 25 percent reservation on recurrent “other charges” or on non-payroll charges excluding pensions and gratuities, and debt servicing. In addition to these measures, the authorities also: (i) placed a cap on discretionary revenue exemptions at 50 percent; (ii) increased excise on beer and tobacco; (iii) broadened excise on spirits to include wine, spirits and premix; (iv) increased duty on motor vehicles; (v) increased vehicle licensing fees; and (vi) directed all government ministries to collect all outstanding dues to the government. Meanwhile, the authorities note staff’s advice of scaling back non-essential recurrent spending and parliamentary entitlements. On the latter, the authorities have sought a judicial review of the appropriateness of increasing the parliamentary entitlements.

The authorities note staff’s recommendation to raise “the taxable price of logs” and to increase the determined price of logs by “an average of US\$25 per cubic meter” to lift revenue “by 1 percent of GDP a year.” The authorities understand the rationale behind this recommendation. However, experience with implementing similar policies in the past produced unwanted outcomes. Logging companies have colluded to protect their interests in the past by cutting back production, laying off workers, and holding back exports, resulting in huge revenue and foreign exchange losses. A similar reaction at this point of economic weakness and low foreign exchange reserves could prove to be counter-productive. Meanwhile, the authorities are encouraging investors to move to downstream processing and Kolombaraga Forest Products Limited has become a sustainable forestry role model.



Staff has singled out the impact of minimum wage increases as one of the factors responsible for driving recurrent costs up. The first review of the legal minimum wage rate for 12 years was completed in 2007 and came into force on May 1, 2008. However, the impact on government finances is minimal because the wage rate of the majority of civil servants is already higher than the revised minimum wage rate. The cost of living adjustments award and the hiring of labor to fill up unfunded positions – based on public service establishments rather than on budget allocations – are the two main factors contributing to the increase in public service remuneration.

The authorities welcome the staff's recommendation to adopt an internationally-accepted tax regime for the emerging mining project. They agree that designing a good tax regime will be important to ensuring sound resource management but will lack the necessary resources and expertise in this area. As such, Solomon Islands would welcome Fund assistance in this area.

The authorities agree with the staff on the need to expedite fiscal structural reforms to enhance medium-term fiscal sustainability. Under quite difficult circumstances, the authorities are aiming to record a surplus budget in 2010. In line with this, they are committed to strengthening further the revenue and expenditure measures that they have already put in place. They are also committed to implementing further measures to enhance stability over the medium term, where appropriate. The road ahead will be difficult and, in that context, the authorities agree with staff that external budget support is critical to preserving the social safety net.

- Monetary Policy and Exchange Rate

The authorities welcome the discussion on scope for monetary easing and note the staff recommendation for a more accommodative monetary stance. The authorities agree that inflation pressures have eased but caution that a careful assessment of the impact of the global shocks on the domestic economy is required before changes to the current monetary policy stance can be considered. Solomon Islands does not produce a national CPI with monetary policy decisions largely being based on price information in Honiara. So the actual inflation rate for the country as a whole could still be higher than the one quoted in the report.

The authorities are aware of the need to enhance the monetary policy operational framework. In this regard, they are considering measures to improve the efficiency of the indirect policy instruments for liquidity management purposes and look forward to working closely with the Fund in this area.

There is broad agreement between the staff and the authorities on the need for greater exchange rate flexibility as the basis for providing an effective anchor and that, because the exchange rate alone cannot bear the full brunt of the adjustment, this will require addressing structural bottlenecks to improve the economy's competitiveness over the medium term. Notwithstanding, the authorities are not entirely comfortable with the staff's advice to widen the daily trading band as the basis to shore up reserves and address the external imbalances. The authorities' past experience, however, has been that this does little to address the imbalances and simply results in additional profits to commercial banks. Against this background, and considering the desire to prevent further inflationary pressures, the authorities will continue to maintain its current exchange rate policy of

pegging the value of the Solomon Islands dollar to a trade-weighted basket of currencies with the US dollar being the intervention currency.

- Financial Sector

The domestic banking system has been largely unaffected by the global financial crisis and is well-positioned to deal with the slowdown in domestic activity. The banks are profitable and continue to meet prudential requirements for capital adequacy, asset quality, and liquidity during the year. As staff mention, credit growth has slowed in 2008 owing to the general slowdown in economic activities, lack of viable investment proposals, and tight lending standards. In addition to the slowing credit growth, asset quality has also deteriorated – albeit moderately. Non-performing loans increased from 2.7 percent of total loans and advances at the end of the fourth quarter of 2008 to 4.2 percent of total loans and advances at the end of the second quarter of 2009 – while liquidity conditions have tightened.

In response to tightening liquidity condition, the CBSI provided a short-term standing facility that commercial banks can access. The commercial banks also raised deposit rates. Two out of the three commercial banks that operate in Solomon Islands are branches of well-established Australian banks. They are subject to strict banking standards from their parent banks. Viewed from this angle, the authorities are confident that, despite some evidence of emerging pressures, the domestic banks will continue to comply with the prudential requirements this year and the next.

Moving forward, the authorities wish to assure Directors that they are committed to maintaining a stable financial system. The recent upgrading of the prudential standards, along with the strengthening of the regulation and supervisory framework, are a testament to that commitment.

- Structural policies

The authorities have made significant progress in some areas of structural policy, in particular, they have streamlined business formation and regulations, established regular audits of SOE accounts, and reformed telecommunications and transport sectors to allow new entrants. These actions have begun to show results. Following the government’s decision to open up the telecommunications sector, a service provider has expressed its interest to enter the market in the second quarter of 2010.

However, the authorities agree that further structural reforms will be needed to lift Solomon Islands’ medium- to long-term growth prospects. In this regard, they are committed to working closely with their main donors to implement their medium-term development strategy. In particular, the authorities are aware that management of public enterprises, in general, needs to be improved, given the drain on budget resources.

Finally, in relation to land reform, the authorities are aware of the need to move forward. The authorities have acknowledged the concerns of the business community, in particular, on difficulties to securing land titles for investment. However, the authorities recognize that sustainable land reform needs to take place with broad public ownership. In the Solomon Islands, this requires significant time and effort, given the complex land ownership structure and the resistance to land sales.



INTERNATIONAL MONETARY FUND

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November 4, 2009

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Executive Board Concludes 2009 Article IV Consultation with the Solomon Islands**

On October 16, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Solomon Islands.<sup>1</sup>

### **Background**

Economic conditions in the Solomon Islands have weakened in 2009, given the effects of the global recession and a logging sector decline. Real GDP growth is projected at 0.4 percent this year, compared to 6.9 percent in 2008. On the positive side, inflation pressures have eased substantially, mainly owing to lower fuel and food prices. An expected drop in timber exports has been more than offset by the lower cost of commodity imports, leading to a projected narrowing in the external current account deficit to 11 percent of GDP in 2009, from around 19 percent in 2008.

In light of the slowdown, the fiscal position will likely weaken in 2009, with possible financing constraints. The overall fiscal balance is expected to slip into a deficit of around 0.4 percent of GDP this year, as compared to a surplus of 1.5 percent of GDP in the previous year. Affecting this are lower timber-related tax receipts and weak spending controls, despite measures taken by the government to conserve cash. As a result, its cash position is expected to remain under strain in 2009 and possibly the next few years, absent further fiscal adjustment and new external assistance.

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

At the same time, liquidity conditions have tightened, with external inflows and deposit growth slowing significantly. Private sector credit is projected to rise by only 6 percent this year, compared to 26½ percent in 2008. The exchange rate vis-à-vis the U.S. dollar has been allowed to weaken modestly since mid-2008, but in real effective terms it has increased substantially, possibly adding to external pressures.

In the near to medium term, growth is expected to remain below the levels observed in recent years. Although recovery of the global economy and new foreign direct investment, especially in mining and telecommunication sectors, could provide a lift to the economy in 2010, declining logging and ancillary activity will likely act as a drag to income and employment, fiscal revenue, and export receipts over the medium term. In the event, both the fiscal position and current account could come under more strain, with the possibility of large and unsustainable macroeconomic imbalances.

In order to place the economy on a more stable path and lay down the conditions for higher sustained growth, policy measures should be adopted to strengthen the fiscal position, reduce external vulnerabilities, and improve the overall investment climate. On the fiscal front, more efforts are needed to broaden the revenue base and contain recurrent spending, especially in view of the current cash and borrowing constraints, which may persist for some time. In this light, the 2010 budget should be geared toward a modest surplus.

Regarding monetary policy, the current accommodative stance appears appropriate. However, greater exchange rate flexibility may be needed, in view of tight liquidity conditions and to protect foreign reserves. Over the longer term, additional monetary control will need to come through development of new policy instruments and a strengthening of the liquidity management framework.

The banking system appears well positioned against the current slowdown, but given rapid credit expansion in earlier years and signs of rising liquidity and credit risks, tight enforcement by the Central Bank of Solomon Islands of new prudential rules will be important to ensuring sound financial performance and proper risk management control by banks.

Creating conditions for higher growth in nonlogging sectors is essential to improving the fiscal and external position, providing new employment opportunities, and reducing vulnerability to shocks. In addition to maintaining a stable macroeconomic environment, further structural reforms aimed at lowering operating costs and ensuring better access to land are also needed.

### **Executive Board Assessment**

Executive Directors noted that the Solomon Islands faces a more challenging environment than in the recent past. The impact of the global recession and lower logging output could dampen short-term growth prospects, undermine the fiscal position, and increase external vulnerability given projected reserve losses. Against this background, Directors encouraged the authorities to continue to gear macroeconomic policies toward maintaining stability, while pressing ahead with essential structural reforms aimed at strengthening public administration, improving the business climate,

and diversifying the production base.

Directors advised the authorities to address the increasingly unsustainable fiscal situation, given possible permanent losses in logging-related revenues, relatively large expenditure outlays, and government financing constraints. They highlighted the need to tighten fiscal policy to conserve cash and avoid external pressures in the near-term through greater spending discipline, especially in nonessential recurrent areas and the government wage bill, which could also avoid squeezing out domestically financed development spending. Directors welcomed the authorities' intention to adopt an internationally accepted tax regime for the emerging mining sector, with the help of Fund technical assistance.

Directors agreed that medium-term fiscal sustainability hinges on steady implementation of structural fiscal reforms aimed at strengthening revenue administration and reducing tax and customs exemptions, as well as improving cash management, budget integration, and accounting and auditing functions. They underlined the importance of additional external budget support to safeguard essential social spending and help secure more lasting fiscal adjustment. In view of the continued moderate risk of debt distress, Directors commended the efforts to implement a sound debt management strategy.

Directors noted that the current accommodative monetary stance is broadly appropriate, given the moderation of inflation. They encouraged the authorities to improve the liquidity management framework to strengthen the central bank's effectiveness, including through the development of short-term debt instruments and new standing facilities, which would also help to promote interbank activity. Directors welcomed the authorities' intention to use the recent SDR allocation to boost reserves, given external pressures.

Directors noted the staff's assessment that the exchange rate appears to be substantially overvalued, which could undermine medium-term external sustainability. In this context, Directors generally considered that greater exchange rate flexibility could help improve overall competitiveness and facilitate external adjustment, while noting that this should be accompanied by efforts to improve transportation infrastructure, reduce operating and borrowing costs, and streamline business regulations.

Directors welcomed the timely steps taken to strengthen banking supervision, while highlighting that credit and liquidity risks necessitate close monitoring. They encouraged banks to bring risk management controls in line with parent bank operations. Closer monitoring of the National Provident Fund would also be useful, given the recent impact of adverse global conditions on operating income.

**Public Information Notices (PINs)** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2009 Article IV Consultation with Solomon Islands is also available.

## Solomon Islands: Selected Economic Indicators, 2006–10

	2006	2007	2008 Est..	2009 Proj.	2010
<b>Growth and prices (percentage change)</b>					
Real GDP	6.9	10.7	6.9	0.4	2.4
CPI (period average)	11.1	7.7	17.2	8.0	7.0
CPI (end of period)	9.9	10.9	17.5	5.5	8.4
Per capita GDP (in U.S. dollar)	945	1,093	1,266	1,290	1,351
<b>Central government operations (percent of GDP)</b>					
Total revenue and grants	47.3	50.2	48.9	50.6	51.9
Revenue	23.6	26.8	27.5	27.6	27.2
Grants	23.8	23.4	21.4	23.1	24.7
Total expenditure	45.6	49.7	47.3	51.1	51.1
Recurrent expenditure	22.0	22.8	23.8	25.3	24.2
Development expenditure	23.6	26.9	23.5	25.8	26.9
Overall balance	1.7	0.5	1.5	-0.4	0.8
Foreign financing (net)	1.6	2.3	-1.6	-0.9	-0.8
Domestic financing (net)	-0.9	-1.4	1.6	0.9	-0.1
Other 1/	-2.4	-1.4	-1.5	0.4	0.2
Central government debt (percent of GDP, unless otherwise indicated) 2/	57.1	40.3	31.8	27.3	24.0
Domestic debt	23.1	12.6	10.0	8.5	7.7
External debt	33.9	27.6	21.8	18.8	16.3
(In millions of U.S. dollar; end of period)	154.8	149.4	135.5	124.1	115.2
<b>Monetary and credit (percentage change, end-year data)</b>					
Credit to private sector	58.6	53.3	26.5	6.0	...
Broad money	25.9	23.3	6.9	8.4	...
Reserve money	6.2	-3.5	-5.0	-10.1	...
Interest rate - deposit (percent per annum) 3/	0.7	0.7	2.0	4.1	...
Interest rate - lending (percent per annum) 3/	13.8	14.2	17.0	15.3	...
<b>Balance of payments (in millions of U.S. dollars, unless otherwise indicated)</b>					
Current account balance	-29.4	-67.3	-120.0	-74.2	-130.7
(Percent of GDP)	-6.4	-12.4	-18.7	-11.1	-18.2
Overall balance	10.5	16.6	-27.1	-1.8	-25.1
Gross official reserves (in millions of U.S. dollars, end of (In months of prospective imports of GNFS)	104.4	120.6	90.1	88.3	63.2
	3.8	3.9	2.9	2.5	1.7
Exchange rate (S.I. dollar/U.S. dollar, end of period)	7.62	7.66	8.00		...
Real effective exchange rate (period average, 2005 = 100)	107.5	106.4	115.9	...	...
Nominal effective exchange rate (period average, 2005 = 100)	99.1	93.1	88.9	...	...

Sources: Data provided by the authorities; and IMF staff estimates and projections.

1/ Includes privatization receipts, changes in arrears, and unidentified financing.

2/ Includes arrears.

3/ For 2009, as of end-June 2009.