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Solomon Islands: Second Review Under the Standby Credit Facility and Request for a Three-Year Arrangement Under the Extended Credit Facility—Staff Report; Press Releases on the Executive Board Discussion; and Statement by the Executive Director for Solomon Islands.

In the context of the second review under the standby credit facility and request for a three-year arrangement under the extended credit facility, the following documents have been released and are included in this package:

- The staff report for the Second Review Under the Standby Credit Facility and Request for a Three-Year Arrangement Under the Extended Credit Facility, prepared by a staff team of the IMF, following discussions that ended on October 25, 2012, with the officials of Solomon Islands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 14, 2012. 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.

- Joint IMF/World Bank Debt Sustainability Analysis.

- Press Releases summarizing the views of the Executive Board as expressed during its November 28, 2012 discussion of the staff report that completed the request and/or review.

- A statement by the Executive Director for the Solomon Islands.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Solomon Islands*
Memorandum of Economic and Financial Policies by the authorities of Solomon Islands*
Technical Memorandum of Understanding*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

Second Review Under the Standby Credit Facility and Request for a Three-Year Arrangement Under the Extended Credit Facility

Prepared by the Asia and Pacific Department in Consultation with Other Departments

Approved by Hoe Ee Khor and Masato Miyazaki

November 14, 2012

Key Issues

The current one-year SCF arrangement was approved on December 6, 2011, after the previous SCF arrangement expired in early December 2011. The arrangement was intended to be precautionary and no Fund's resources have been drawn. The current program sought to consolidate recent macroeconomic progress, strengthen institutional capacity, reform mining legislation to broaden the tax base, implement a new resource taxation regime to promote fiscal transparency, and enhance the efficiency of tax collection.

Program discussions: The authorities are requesting a three-year low-access Extended Credit Facility (ECF) arrangement, equivalent to 10 percent of quota (SDR 1.04 million). Building on the success of the SCF arrangement, the ECF-supported program will be instrumental in tackling deep institutional and structural issues and is seen by the authorities as critical for supporting Solomon Islands, which remains vulnerable to external shocks associated with its undiversified export base, strong dependence on aid, and frequent natural disasters.

Key policy messages:

- Comply with the structural benchmarks to advance reforms.
- Strengthen fiscal discipline, continue to build fiscal and reserve buffers to save for rainy days, and tighten the fiscal stance in 2013.
- Continue mopping up excess liquidity and tighten monetary policy if domestic inflation pressures re-emerge.

Team: Discussions took place in Honiara during October 16–25, 2012. The team comprised: Ms. Tumbarello (head), Mr. Abdel-Rahman, Ms. Agustin, Mr. Wu (all APD), and Ms. Svirydzenka (SPR). Ms. Hunter (OED) joined the policy discussions. The mission met with Prime Minister Gordon Darcy Lilo, Minister of Finance Rick Houenipwela, Permanent Secretary of Finance Shadrach Fanega, Governor of the Central Bank Denton Rarawa, other senior officials, and development partners.

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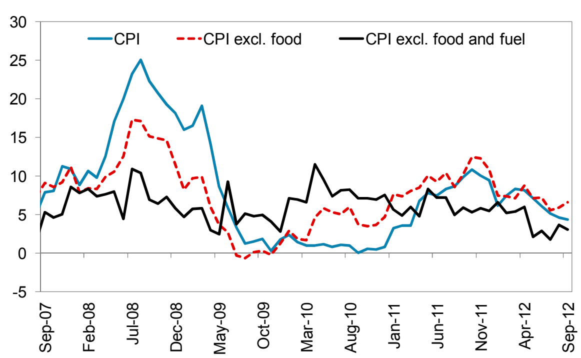
I. BACKDROP AND OUTLOOK

1. **Macroeconomic conditions have improved in recent years.** The implementation of IMF-supported programs over the last two and a half years, together with strong political commitment, has helped restore and strengthen macro and financial stability and trigger donor support.

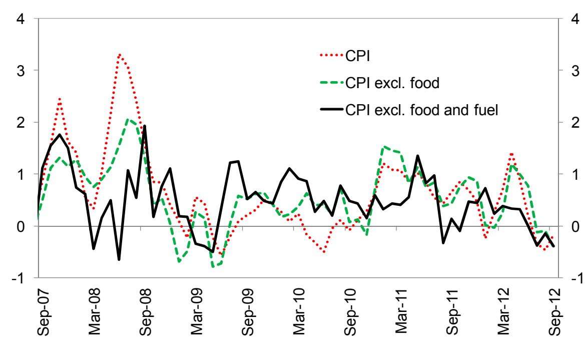
2. **Economic activity in Solomon Islands, while moderating from the rapid pace of 2010–11, remains robust and inflation pressures have eased.** After rebounding from the 2009 recession to achieve 8 percent growth in 2010 and nearly 11 percent in 2011, growth is expected to slow to a still-strong 5½ percent this year (Table 1). Growth has been driven by mining, with gold production in the first half of 2012 surpassing total output for all of 2011 by 50 percent, and the service sectors; the contribution of logging, albeit still positive through September, has declined relative to previous years. Growth remains highly concentrated in the commodity sector, with limited spillover to the rest of the economy, although the Festival of Pacific Arts of June 2012 boosted activity in other sectors, mainly construction, retailing and tourism. Nonetheless, leading indicators, including export and credit growth, suggest that growth momentum has weakened in the second half of 2012. Inflation is moderating. After surging to 11 percent (year-on-year) in October 2011 (although from a low base), the pace of inflation slowed in subsequent months, posting an annual rate of 4.3 percent in September 2012.

Solomon Islands: CPI Inflation, Sept. 2007–12
(Year-on-year percent change)



Sources: Country authorities; and IMF staff estimates.

Solomon Islands: CPI Inflation, Sept. 2007–12
(Three-month moving average of m/m percent change, seasonally adjusted)



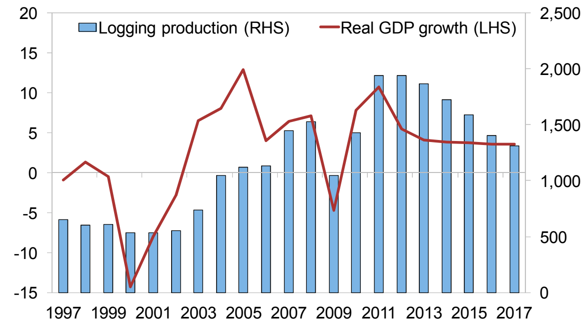
Sources: Country authorities; and IMF staff estimates.

3. **External buffers have been rebuilt, but export growth slowed to just 1 percent in September (on a three-month moving average, year-on-year percentage change).** This was down from the average growth of 14 percent in the second quarter of 2012, reflecting a weaker regional and global outlook, including reduced demand from China. The current account balance for the last quarter of 2011 and first quarter of 2012 shifted into a small surplus from a deficit of 30 percent of GDP in 2010. More recent data, however, point to a deterioration of the current account to a deficit of about 1½ percent of GDP, financed by foreign direct investment and capital transfers. As of September, gross international reserves rose to US$497 million (about eight months of 2013 imports), up from US$412 million at the end of 2011 (7.4 months of next year's imports) and from less than US$100 million in mid-

2009 (Table 2). Reserves in September leveled off, however, relative to August, because of weakness in export demand from Asia. Thanks to the country's still-strong external position, no disbursement under the current Standby Credit Facility (SCF) arrangement has been made.

4. **Economic growth is expected to moderate further in 2013, with risks to the outlook tilted to the downside.** GDP growth is projected to slow to 4 percent over the near and medium term, with gold output and services remaining the main drivers of expansion and logging production declining over the medium term. The rehabilitation of the main roads in Honiara for the Festival of Pacific Arts and further planned investment in infrastructure should also underpin growth in 2013 and beyond. Inflation is projected to average about 5 percent in 2012, reaching 6¼ percent at yearend reflecting the pass-through of higher global food and fuel prices with a two-quarter lag. Inflation is then projected to fall to 4 percent over the medium term. The regional and global outlook has worsened, however, including for the Solomon Islands' main regional trading partners—China and other Asian emerging markets—and this poses risks for the country's external demand and FDI. The main near-term external risk is a deeper and more protracted slowdown in the global and regional economy, which would sharply reduce commodity and forestry exports. But gold production and prices could mitigate such declines, reflecting the role of gold as a safe haven at times of heightened economic uncertainty. On the domestic front, the fluid political situation and potential slippages in implementing structural reforms could dampen growth significantly.

Solomon Islands: Logging Production and Real GDP Growth
1997-2017, 1/



Sources: Country authorities; and IMF staff estimates.
1/ Logging production in thousands of cubic meter; real GDP growth in percent.

5. **Downside scenario.** Staff's analysis suggests that in a downside scenario, in which an intensification of the euro area crisis materializes, global growth would be lowered by almost 2 percentage points in 2013 and 2014, relative to the WEO. The impact on Solomon Islands' growth would be substantial. Adverse growth spillovers from emerging Asia and other regional partners would imply a contraction of FDI (projected at 25 percent lower relative to the baseline) and lower demand for logging—and a deterioration in the terms of trade. With exports and FDI falling under this scenario, foreign reserves would be rapidly depleted, prompting the need for an increase in access of the ECF arrangement.

Solomon Islands: Baseline and Downside Scenarios 1/

	2012	2013		2014	
	Baseline	Baseline	Downside	Baseline	Downside
Real GDP growth (in percent)	5.5	4.0	2.0	3.8	2.0
Current account balance (in percent of GDP)	-5.8	-10.6	-19.3	-8.7	-21.9
Logging exports (in percent of GDP)	17.6	15.9	11.7	13.9	8.4
Mining exports (in percent of GDP)	13.9	15.5	12.6	14.8	10.7
Financing (in millions of U.S. dollars)	-91.3	-28.0	91.7	-30.8	123.5
Change in gross reserves (- = increase)	-91.5	-28.4	85.4	-29.6	118.8
IMF 1/	0.2	0.4	6.3	-1.2	4.7
Gross official reserves (in millions of U.S. dollars)	503.8	532.2	384.0	561.8	265.2
in months of next year's imports	7.9	8.6	5.7	8.7	3.5
Overall fiscal balance (in percent of GDP)	-0.6	1.2	-2.3	0.9	-3.7

Source: IMF staff estimates and projections.

1/ In 2013 and 2014, the baseline scenario envisages disbursements under the low-access ECF arrangement, while the downward scenario reflects disbursements under the ECF arrangement with augmented access.

Authorities' Views

6. **The authorities concurred with staff on the outlook and balance of risks.** They considered the downside risks to the outlook as mainly external and were concerned about the potential impact on Solomon Islands of a deterioration in the global outlook.

II. Program Performance

7. **The one-year SCF arrangement for Solomon Islands was approved on December 6, 2011, replacing an expired SCF arrangement, and program performance with respect to meeting quantitative targets is broadly on track.** Quantitative targets for net credit to the government (NCG), net international reserves (NIR), net domestic assets (NDA) of the central bank, and the cash balance for end-June 2012 were met with comfortable margins (Table 1, MEFP). The cash balance reached SI$391 million—exceeding the program target of SI$342 million. The level of the government's consolidated account at the central bank was SI$140 million at the end of June, in line with program commitments. The indicative targets for end-September were also met comfortably, although the cash balance target was missed by about SI$35 million.

8. **The authorities are making good progress in meeting the program's structural benchmarks, albeit with some delay.** Since last Board meeting in June, the cabinet approved the amendments to the Central Bank Act (end-March 2012 benchmark) and the drafting instructions for the National Provident Fund Act (end-June 2012 benchmark). Moreover, the draft legislation and the discussion papers of the new Public Finance Act were finalized, published on the treasury website (http://www.mof.gov.sb/ReportsNew/Legislation/PFAActReview.aspx) and presented in a public workshop (end-September 2012 benchmark). Tax reforms have taken longer than expected, despite strong political will, owing mainly to resource constraints and the need for a wider consultation among stakeholders to build consensus and increase ownership.

Authorities' Views

9. **The authorities stressed the importance of the SCF arrangement in preserving macro and financial stability and catalyzing donor support.** They also noted that the

program was instrumental in building consensus among all stakeholders (i.e., civil society and development partners) on important reforms, but they recognized that deeper institutional weaknesses will need to be addressed over an extended period of time.

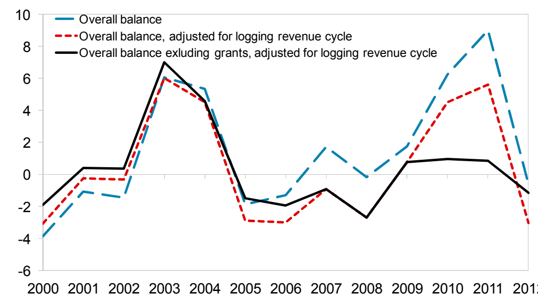
III. Policy Discussions: Rebuilding Policy Buffers and Fostering Broad-based Growth

A. Fiscal Policy

Background

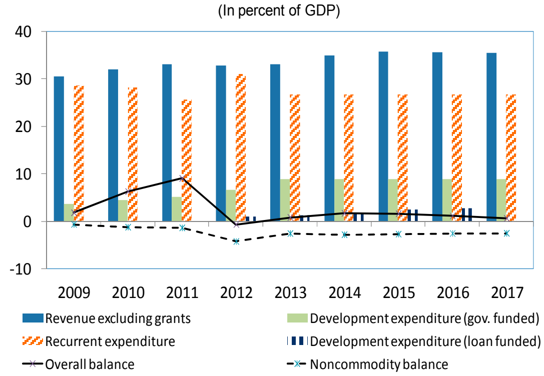
10. **The Solomon Islands' fiscal position has weakened in 2012, owing mainly to higher spending** (Table 3). To be sure, 2011 was an exceptional year in terms of fiscal consolidation, although an analysis of the fiscal stance using structural balances to account for the logging revenue cycle suggests that the improvement in the underlying fiscal position was overstated when the overall balance was used.[1] Data through September indicate that while revenues increased by 1 percentage point of GDP over the same period in 2011, thanks to continued improvements in revenue administration and compliance, recurrent and development spending increased in total by 4 percentage points of GDP relative to the year-earlier period. This rise in spending reflected one-off spending related to the Pacific Arts Festival (of about 2½ percent of GDP), investment in tertiary education abroad, and increased government-funded development spending allocated as "constituency funds." These funds are spent by constituencies, as opposed to provincial and central governments, for the purpose of funding development projects in rural areas. In the 2012 budget, constituency funds increased to 4 percent of GDP from 2 percent in 2010–11. As a result of these developments, the cash balance fell to SI$337 million in September from SI$391 million in June.[2] The supplementary budget submitted to parliament in September envisages a deficit of about 3 percent of GDP.

Solomon Islands: Overall and Structural Fiscal Balances, 2000-12
(In percent of GDP)



Sources: Country authorities; and IMF staff estimates.

Solomon Islands: Fiscal balance, 2009-17
(In percent of GDP)



Sources: Country authorities; and IMF staff estimates.

[1] "Assessing the Fiscal Stance in Solomon Islands: The Role of the Structural Balance," Box 1, Country Report No.12/156.

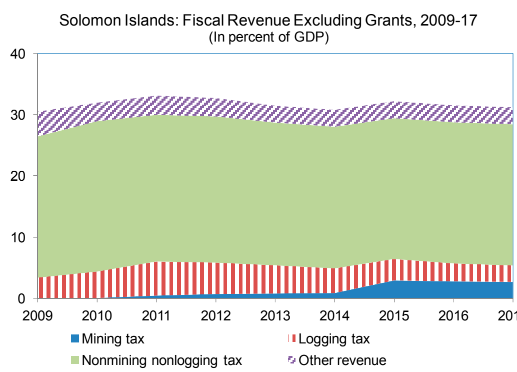
[2] While the revenue outturn is significantly lower than the 2012 budget, the program targets were set according to more realistic revenue projections. Hence, the deterioration of the cash balance target in September 2012 reflects mainly expenditure increases.

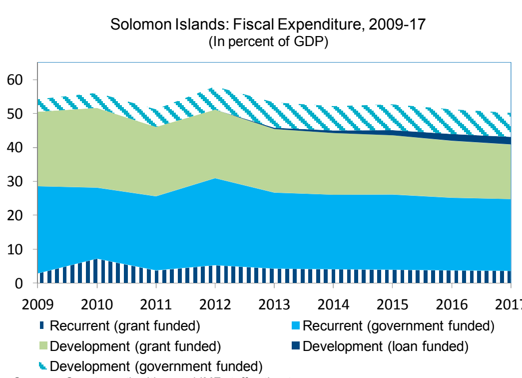
11. **The 2013 budget will be unveiled at the end of November.** Discussions with the authorities suggest that fiscal consolidation, relative to 2012, is in the cards despite the planned increase in nominal basic public wages.

Staff Views

12. **The mission emphasized that given the weakening global outlook but still favorable growth prospects, the key goal should be to continue building fiscal buffers in the near term, to save for rainy days, while fostering inclusive growth over the medium term**. The mission expressed concern about the worsening of the cash balance in September and urged the authorities to re-establish fiscal discipline by adopting a more conservative fiscal stance in the 2013 budget. Given the expected decline in logging revenue over the medium term (Table 4)—as logging stocks are projected to be exhausted and logging prices are forecast to be lower than in the past—and given gold production is now assumed to be at a much lower level, public spending should be kept at a more sustainable level. This could be achieved by containing growth of non-essential recurrent spending, including by streamlining spending on public sector allowances and benefits. The mission conveyed the following key messages.

- *Preserve the cash balance*. Staff stressed that using the cash balance as a fiscal anchor has helped the authorities strengthen their fiscal position and enhance the credibility of budget plans. Staff strongly recommended a substantial tightening of the fiscal stance during the last two months of 2012 in order to maintain the cash balance at just above two months of recurrent spending. This will require a slower rate of implementation of spending with respect to the supplementary budget. In discussing the upcoming 2013 budget, staff called for more realistic revenue projections relative to the 2012 budget and for containing spending, including for constituency funds, to reach a cash balance target equivalent to two and a half months of recurrent spending.





- *Contain public expenditure and improve the quality of public spending*. The mission expressed concerns over the large increase in recurrent spending so far in 2012 and urged the authorities to contain expenditure for the remainder of the year and in 2013. Staff was sympathetic with the increase in nominal wages in the pipeline in 2013, given that basic wages have declined in real terms over the last twenty years. But, it also stressed that this measure should be accompanied by streamlining public-sector allowances and benefits—including overtime—since the share of these benefits within the wage bill has increased at the expense of basic salaries.

This will enhance the transparency of the remuneration system and contain the increase in recurrent spending. The mission was also concerned about the doubling of constituency funds in 2012. While such funds, which are part of development spending, are meant to increase the effectiveness of public service delivery in rural areas where 80 percent of the population lives, the mission cited the lack of accountability to date in the use of such funds and the potential for abuse. Staff welcomed the upcoming internal audits coordinated by the office of the Auditor General to enhance accountability on how constituency funds were spent, but stressed the importance of evaluating *ex ante*, in addition to *ex post*, the projects in the pipeline, in order to enhance transparency in the use of public resources. In the same vein, the mission emphasized that the pace of development spending should be aligned more closely with the absorptive capacity of the economy, in recognition of capacity constraints and to avoid waste. Improving the composition of public spending will foster inclusive growth. On the composition of public spending, positive steps since the beginning of this year include the introduction of an indicative target for spending on health and education (at no less than 32 percent of government-funded recurrent spending), and the establishment of a mechanism to track government-funded spending on health and education. The end-June and September indicative targets on health and education were met comfortably. Furthermore, the mission underlined the importance of striking the right balance between investing on tertiary education and primary education, given the large increase in scholarship for colleges abroad.

- *Strengthen domestic revenue mobilization*. Given the strong prospects for the mining sector, it is critical for the authorities to undertake tax reform in this sector. The new mining legislation will allow the government to receive a fair share of revenue from the mining sector. Delays have occurred in obtaining cabinet's approval of the amendments to tax legislation related to the new resource taxation regime in line with recommendations of the Fiscal Affairs Department (end-September 2012 benchmark). The authorities now plan to seek cabinet's approval of draft amendments to relevant tax legislation by end-December (end-December benchmark). A new comprehensive draft bill on the customs and excise tax is being drafted with the assistance of the Asian Development Bank and co-financed by the AusAID (end-October 2012 benchmark). However, given pressing resource constraints the authorities are now aiming to obtain cabinet's approval to release the draft bill implementing the new customs and excise bills for public consultation by end-December 2012 (end-December 2012 benchmark).
- *Enhance public financial management*. Staff praised the authorities for undertaking commendable public financial management reforms. New charts of accounts will be introduced in the 2013 budget to enhance transparency and accountability in allocating public funds. Despite resource constraints, the authorities still aim to submit to cabinet the draft legislation of the Public Finance Act by mid-November (mid-November 2012 benchmark). The new Act will incorporate fiscal responsibility provisions, and strengthen public financial management and promote budget transparency and accountability.
- *Strengthen the fiscal framework over the medium term.* Efforts to adopt a multi-year budget framework are under way. This will enhance fiscal discipline, ensure fiscal

sustainability, and facilitate coordination between fiscal plans and national development strategy goals. From a political economy point of view, it will also help build consensus on the appropriate sequencing of development projects. Forward estimates of revenue and recurrent expenditure will be presented in the upcoming 2013 budget, and forward estimates of development spending will be released by the end of 2013 ready for the 2014 budget. While staff believes that the cash balance remains the appropriate fiscal anchor, once a complete multi-year budget framework has been developed for the outer years the authorities should start thinking about targeting the non-commodity fiscal balance, rather than the cash balance. This would help bolster the fiscal framework and better anchor fiscal plans by mitigating the pro-cyclicality of fiscal policy which is driven by volatile commodity revenues. It will also ensure a more sustainable use of exhaustible resources, as mining taxes become a large source of government revenue (Box 1).

- *Enhance debt management capacity to ensure prudent concessional borrowings and safeguard external stability.* The new Debt Management Strategy (DMS) provides an appropriate framework for anchoring future borrowing plans. While resuming concessional borrowing is critical for obtaining the resources needed to finance much-needed investments—such as the Tina River Power project and the undersea fiber optic internet cable project in the pipeline which will reduce the cost of doing business and thus foster private sector development—staff emphasized that prudent borrowing is essential for preserving external stability. The results of the joint IMF-World Bank debt sustainability analysis show that the risk of debt distress remains moderate, even after transitioning to concessional loans, assuming borrowing plans of about 1½ percent of GDP annually over the medium and long term. Staff cautioned against increases in contingent liabilities associated with SOE debt and praised the authorities for developing guidelines for SOE borrowing. Staff also urged the authorities to identify outstanding SOE debt and to be extremely cautious in contracting borrowing on behalf of SOEs. Staff pointed to the importance of capacity building in debt management, including establishing and putting in place guidelines and procedures to strengthen project appraisal and evaluation.

Authorities' Views

13. **The authorities remain committed to preserving the cash balance while providing adequate resources for spending critical to promoting higher and more inclusive growth.** They agreed that the 2013 budget will need to be tighter than in 2012 to ensure fiscal sustainability and concurred that realistic fiscal revenues projections are essential for calibrating the expenditure envelope. However, they stressed that political pressure to spend will continue to build given the large development needs and that it is unlikely that the amount of constituency funds will return to their 2010–11 levels given the importance of public sector delivery in rural areas. The authorities concurred that the accountability system being developed is necessary to avoid waste and enhance transparency in the use of public funds. They also noted that the multi-year budget framework will help contain spending pressure by better sequencing the implementation of the development projects. The authorities also indicated that investing in infrastructure remains a key priority.

Box 1. Solomon Islands: Reducing Pro-Cyclical Bias in Fiscal Policy[1]

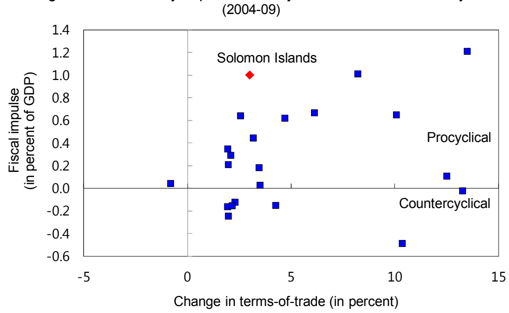
Strengthening the fiscal framework in Solomon Islands is key to addressing its main fiscal challenges: the volatility of fiscal revenue and intergenerational equity in the distribution of earnings from its natural resources.

Fiscal policy in Solomon Islands appears to have been pro-cyclical in recent years, in line with other commodity exporters. The pro-cyclicality of fiscal policy—that is, expansionary during upturns and contractionary during downturns—is the result of the substantial volatility of fiscal revenues. Given Solomon Islands' large share of resource-related revenues (18 percent of total revenue, excluding grants), changes in the terms-of-trade affect revenue directly, and more broadly indirectly because GDP is sensitive to the commodity cycle.

Solomon Islands, as other resource-rich countries, also needs to address the issue of intergenerational distribution of the benefits from its natural resources. While logging is in principle renewable, the rate of the depletion of forest resources has been too fast over the last few years, and logging stocks are now expected to be exhausted by the end of this decade. Going forward, exports of gold could decrease national wealth, unless there is a compensating accumulation of assets, physical or financial, that could increase the welfare of future generations.

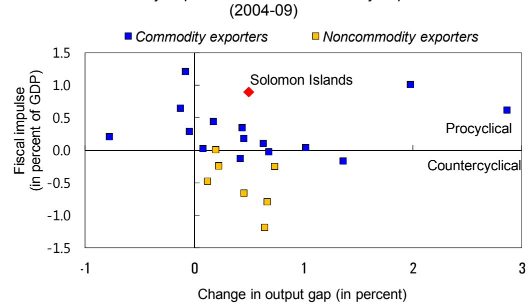
Over the medium term, targeting a non-commodity balance could help address the fiscal risks posed by volatile, unpredictable, and exhaustible commodity revenue. Commodity exporters with a fiscal target responsive to movements in commodity prices—either through a cyclically-adjusted structural balance rule as in Chile or a non-commodity balance target rule as in Norway—do not exhibit a pro-cyclical fiscal policy bias. And real government expenditure has remained broadly stable as a share of GDP over the business cycle, unlike other commodity exporters in the sample, including Solomon Islands. In addition, managing resource-revenue volatility, especially by limiting pro-cyclical policies, is associated with improved macroeconomic outcomes.[2] For resource-rich developing countries where resource exhaustibility is the primary concern, as in Solomon Islands, the key fiscal indicator for assessing the fiscal stance is the non-resource primary balance. For Solomon Islands, staff analysis shows that adjusting for transitory or one-off fluctuations in commodity revenues (from logging and gold) would provide a more accurate measurement of the underlying fiscal position as opposed to using the headline balance.[3] The government should aim for a relatively smooth path of spending to avoid potentially abrupt adjustments when resource revenues decline. Revenue volatility and intergenerational equity can also be achieved by establishing "stabilization" funds that smooth gover nment expenditure, or by "saving" funds that convert resource wealth into financial wealth.

Figure1: Commodity Exporters: Procyclical Bias in Fiscal Policy
(2004-09)



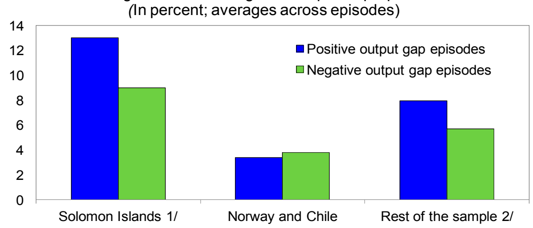
Source: IMF staff estimates.

Figure 2: Pro-cyclical Bias in Fiscal Policy:
Commodity Exporters vs. Non-Commodity Exporters
(2004-09)



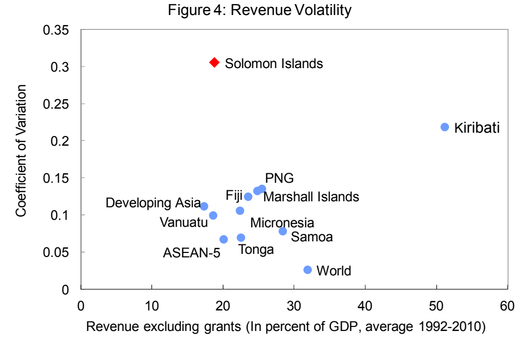
Source: IMF staff estimates.

Figure 3: Commodity Exporters: Real Goverment Expenditure Growth
During Positive and Negative Output Gap Episodes
(In percent; averages across episodes)



Source: IMF staff calculations.
[1] For Solomon Islands, positive (negative) output gap episodes are proxied by postive (negative) change in terms-of-trade episodes.
[2] Algeria, Argentina, Australia, Bahrain, Brazil, Brunei Darusalam, Canada, Colombia, Indonesia, Malaysia, Mexico, New Zealand, Oman, Peru, Qatar, Russia, Saudi Arabia, South Africa, United Arab Emirates, Vietnam, and Zambia.

Figure 4: Revenue Volatility



Source: IMF staff estimates.

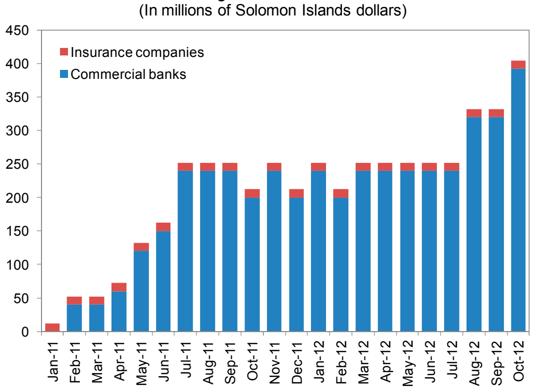
[1] Prepared by Yiqun Wu.
[2] "Macroeconomic Policy Frameworks for Resource-Rich Developing Countries", SM/12/224, IMF.
[3] "Assessing the Fiscal Stance in Solomon Islands: The Role of the Structural Fiscal Balance", IMF Country Report No. 12/156.

B. Monetary and Exchange Rate Policies

Background

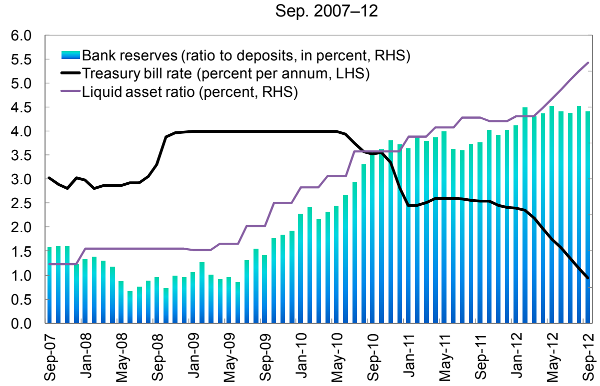
14. **Monetary policy has been broadly appropriate and inflation pressures have eased.** During 2010–11, the rapid buildup of foreign exchange reserves led to fast growth in reserve money (Table 5). The CBSI began to mop up excess liquidity in early 2011 by issuing its short-term *Bokolo bills* and its sterilization capacity has slowly increased. The outstanding stock of such bills nearly doubled from SI$240 million in July to SI$404 million in October. Net international reserves (NIR) reached US$478 million at the end of September 2012, fueled by donor inflows and FDI. Private credit growth moderated from 6½ percent during the first half of 2012 boosted by the Pacific Arts Festival to 2 percent (year-on-year) in August. Sluggish credit growth in recent years, despite the excess liquidity in the banking system, reflects structural impediments to lending, such as problems in using land as collateral. Partly as a result, growth in mining and forestry activities continued to be financed offshore through FDI.

Solomon Islands: Holdings of Bokolo Bills, Jan. 2011-Oct. 2012
(In millions of Solomon Islands dollars)



Source: Central Bank of Solomon Islands.

Solomon Islands: Bank Reserves and Interest Rate, Sep. 2007–12



Sources: Country authorities; and IMF staff estimates.

15. **To enhance exchange rate flexibility, the authorities modified their exchange rate regime in October**. They moved from a de facto peg to the U.S. dollar in effect since 2002 to a basket peg using as weights the shares of the main currencies of the external payments. This change was in line with recent IMF technical assistance recommendations on promoting greater exchange rate flexibility and foreign exchange market development.

Staff Views

16. **Monetary policy stance is appropriate, but the authorities should be prepared to tighten if domestic inflation pressures re-emerge.** Inflation is expected to pick up slightly toward end of the year reflecting the pass through of temporary higher international food and fuel prices. The banking system is flushed with liquidity because of the sluggishness in credit growth and notwithstanding relatively robust economic growth. The central bank should stand ready to tighten monetary policy if risks of second-round effects from higher oil prices become high or domestic price pressures re-emerge. If downward risks materialize, the exchange rate should also be managed flexibly to provide a buffer against external shocks.

The CBSI draft bill (end-March 2012 benchmark) endorsed by the cabinet in early July will strengthen the operational autonomy and transparency of the central bank; this should help increase the effectiveness of the monetary transmission mechanism.

Authorities' Views

17. **The authorities agreed with staff's assessment on monetary policy.** The Governor of the CBSI emphasized that monetary and exchange rate policies will continue to be geared toward maintaining price and external stability. He noted that the adoption of the new exchange rate currency basket could also help buffer external shocks.

C. Safeguarding Financial Sector Stability

Background

18. **Banks remain sound and profitable, but challenges persist.** Banks are well capitalized, with the capital-to-risk-weighted-asset ratio (CAR) at more than 25 percent at the end of September—well above the required minimum of 15 percent. The ratio of nonperforming loans (NPLs) declined from 6.8 percent in June to 5½ percent in September, well below the end-2010 ratio. Moreover, banks remain highly liquid and profitable. The liquid asset ratio continues to rise and exceeded 60 percent at the end of September. The return-on-asset ratio was 3½ percent and the return-on-equity-ratio was 19½ percent in September. Because credit growth remains subdued, non-interest income, attributable mainly to foreign exchange activities and other charges and fees, plays a key role as a source of bank profitability. Moreover, the interest rate spread between deposit and lending rates of the commercial banks is above the Pacific Islands average. The private sector has regularly complained about high charges and fees. This represents a constrain to private sector development.

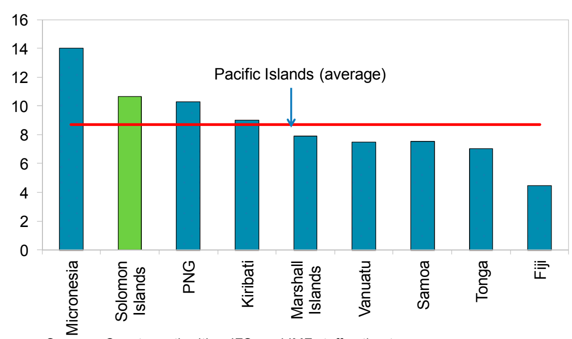
Solomon Islands: Core Financial Soundness Indicators 1/

	2009	2010	2011	2012		
				Mar	Jun	Sep
Capital adequacy						
Regulated capital to risk-weighted assets	22.1	22.7	24.6	28.5	22.0	25.1
Tier 1 capital to risk-weighted assets	15.7	22.7	24.6	28.5	22.0	25.1
Nonperforming loans, net of provisions to capital	9.3	15.0	6.7	6.0	9.1	7.1
Asset quality						
Nonperforming loans to total gross loans	3.8	7.9	5.9	5.9	6.8	5.4
Earnings and profitability						
Return on average assets	6.0	4.9	3.2	2.8	3.4	3.5
Return on average equity	31.6	26.3	16.8	14.7	18.3	19.4
Net interest income to gross income	52.6	43.9	45.7	48.3	45.0	45.2
Noninterest expenses to gross income	37.5	41.4	48.2	51.8	46.7	47.8
Liquidity						
Liquid assets to total assets (liquid asset ratio)	33.4	47.7	56.0	57.4	59.9	61.6
Liquid assets to short-term liabilities	67.4	72.8	85.9	85.9	84.2	84.4

Sources: Central Bank of Solomon Islands; and IMF staff estimates.

1/ Commercial banks only, at end-period.

Pacific Island Countries: Interest Rate Spreads of Commercial Banks



Sources: Country authorities; IFS; and IMF staff estimates.
Note: Kiribati, Marshall Islands, and Vanuatu, 2011; Fiji, Micronesia, PNG, Samoa, Solomon Islands, and Tonga, 2012.

Staff Views

19. **Efforts to strengthen the financial-sector supervisory and regulatory framework should continue in line with program commitments**. The drafting instructions for the NPF Act, endorsed by the cabinet in July (end-June 2012 benchmark), together with the planned amendments to the Financial Institution Act should also help strengthen the regulatory framework of the financial sector. The authorities have already requested IMF technical assistance to help revise the financial institution act; this assistance will be delivered early next year. Furthermore, the CBSI will need to continue strengthening its supervisory capacity

to conduct both on-site examinations and off-site monitoring to identify risks and vulnerabilities in the financial system, and to enforce corrective actions if needed.

Authorities' Views

20. **The authorities expressed particular concern over the high spread between the lending and deposit rates of commercial banks.** They noted that limited access to credit by the private sector was an impediment to inclusive growth. They are planning to request technical assistance to better understand why the spread is higher than in many other Pacific islands and what is the cause behind it.

IV. PROGRAM DISCUSSIONS, MONITORING, AND OTHER ISSUES

21. **Current arrangement.** The authorities have remained committed to complying with program quantitative targets and have made meaningful progress in implementing structural benchmarks. Their commitment to consultations with all stakeholders has strengthened program ownership and built a consensus for reforms.

22. **Successor arrangement.** Staff agreed with the authorities that a three-year low-access Extended Credit Facility (ECF) arrangement—equivalent to 10 percent of quota or SDR 1.04 million—is the most appropriate modality of engagement given the current challenges and the need to continue focusing on structural reforms—now that pressing short-term macro imbalances have been addressed. After 2½ years under the SCF-supported program, it is clear that Solomon Islands needs significantly more time to tackle institutional weaknesses, including capacity-building needs.[1] Moreover, building on the success of the SCF arrangement, the ECF-supported program will be instrumental in anchoring fiscal plans and strengthening fiscal discipline. It will also be key in pushing the structural reform agenda forward and in building institutions. Substantial structural reform and capacity building needs, exhibited by a persistently high level of aid dependency, indicate the presence of a protracted balance of payments problem in Solomon Islands and thus argue for support under an ECF arrangement. And the ECF arrangement is seen by the authorities as critical for supporting Solomon Islands, which remains vulnerable to external shocks associated with its undiversified export base, strong dependence on aid, and frequent natural disasters. While the authorities have been successful in reducing poverty, the overall poverty level is still high, and some Millennium Development Goals remains out of reach by 2015.

23. **A low-access ECF arrangement is seen as critical for consolidating macroeconomic stability**. It will also facilitate further steps toward strengthening economic institutions, and signaling to donors and foreign investors that policy implementation will remain on track—especially in light of increasing risks. Moreover, Solomon Islands' narrow export base and heavy reliance on aid suggest that Fund resources would be needed even in the absence of a major exogenous shock. Should downward risks materialize, the authorities could request the augmentation of access under the ECF arrangement to fill the financing

[1] Under current IMF policies, successive use of the SCF arrangement is normally limited to 2½ out of any 5-year period assessed on a rolling basis.

gap. The ECF-supported program, described in the Memorandum of Economic and Financial Policies (MEFP), would be monitored through semi-annual reviews (Tables 6 and 7), quantitative targets (Table 1, MEFP), and structural benchmarks (Table 2, MEFP).

24. **Objectives and conditionality under the ECF-supported program**. The new program will: (i) support the completion of politically difficult tax reforms, which are essential for broadening the tax base, enhancing the transparency of tax collection and promoting broad-based growth—including by allowing the government to receive a fair share of revenue from the mining sector; (ii) push public financial management reforms further to promote fiscal transparency and strengthen institutional capacity; and (iii) support private sector development by promoting financial inclusion to address weakness in access to financial services, especially in the rural areas by providing, among other measures, financial literacy training and financial education in schools. The authorities' macroeconomic and reform program contained in the attached MEFP is aligned with the development strategy (matrix) under the Core Economic Working Group (CEWG)—a government-donor partnership.

25. **On the financing side, disbursements from most development partners depend on the satisfactory implementation of the IMF-supported program**. Large donor financing is expected from: (i) Australia and New Zealand–about US$50 million in budget support for health and education in 2012 and US$40 million in 2013; (ii) the Asian Development Bank–more than US$38 million is projected during 2013–16 to finance infrastructure projects in transport and information and communication technology, in the form of both budget support and concessionary loans. Of this US$38 million, US$18 million—US$7½ million in grants and US$10½ million in loans—is expected to be disbursed in 2013–14 to finance the undersea fiber optic cable, and about US$5 million in budget support is being negotiated for 2013 under the Economic and Financial Reform Program; (iii) the World Bank–US$2 million in budget support was approved in April 2012, and an additional US$2 million Development Policy Grant is in the pipeline for 2013; and (iv) the European Union–so far US$1½ million has been disbursed in budget support in 2012 and a further US$1¾ million is expected to be disbursed in 2013.

26. **The main risks to the ECF-supported program are political uncertainty, the resource constraints in implementing structural benchmarks, and the inability to submit timely data for program monitoring.** The political situation remains fluid and political instability could weaken program ownership. However, the success of the previous and current program provides a good indication that program ownership in Solomon Islands is strong and bipartisan. Limited institutional capacity remains a challenge, and capacity constraints have increased since the advent of the phased withdrawal of the Regional Assistance Mission to Solomon Islands (RAMSI)—including technical advisors.[2] But Fund

[2] RAMSI technical assistance started in 2003, after the civil war, as a partnership between the government of Solomon Islands and 15 countries of the Pacific. RAMSI assistance focuses on security, justice, law, and economic growth.

technical assistance has been effective in helping the authorities implement the current program.

27. **Other issues.** The authorities will submit to the IMF a revised National Development Strategy, relative to the version launched in September 2011, at the time of the second review of the prospective ECF arrangement, together with the sector strategies developed by the ministry of planning and key development partners. They are also committed to completing the Safeguards Assessment update by the time of the first review under the successor ECF arrangement. The CBSI will provide Fund staff with all the necessary information for the update. In this regard, staff has begun the process to initiate the update safeguards assessment.

V. Staff Appraisal

28. **The macroeconomic situation has improved over the last two years and growth, although moderating, remains relatively strong**. The economy has benefited from the implementation of the government's economic reform program supported by the SCF arrangement, owing to strong political commitment to rebuilding policy buffers and sound macroeconomic management.

29. **Nonetheless, several challenges lie ahead.** The economy is vulnerable to external shocks, and logging stocks—historically the main engine of growth—are expected to be exhausted during this decade. Since this year, the mineral sector has become the main driver of growth together with the service sector, but several reforms need to be implemented to ensure that the country as a whole benefits from its mineral wealth.

30. **Fiscal discipline needs to be strengthened in the 2013 budget, given the still relatively positive growth outlook**. The deterioration of the cash balance in September is a concern which needs to be addressed. Maintaining the cash balance at about two and a half months of recurrent spending will provide a more comfortable buffer for rainy days, should the global and regional outlook deteriorate further. Building these fiscal buffers will help enhance resilience to shocks and ensure debt sustainability.

31. **Containing public spending and improving its composition are also important.** Given the expected decline in logging revenue over the medium term, public spending in 2013 should be kept at a more sustainable level than in 2012. Improving the composition of public spending will foster inclusive growth. The pace of development spending should be aligned more closely with the absorptive capacity of the economy, in light of capacity constraints and to avoid waste. A mechanism should be set up to make spending under constituency funds accountable to enhance transparency in the use of public resources.

32. **We commend the authorities' efforts in reforming the public financial management system and developing the medium-term fiscal framework**. In particular, the forthcoming introduction of the new charts of account in the 2013 budget presentation, as well as forward estimates of revenues and current expenditure (end-December 2012 benchmark), and together with the publication of the discussion papers on the draft

legislation of the PFM, are key steps in promoting public transparency and enhancing the credibility of fiscal policy and of the budget process. The multi-year budget framework will also help build consensus on the appropriate sequencing of development projects.

33. **To foster inclusive growth, the reform momentum should continue.** The agenda includes reforming mining legislation to broaden the tax base, implementing a new resource taxation regime to promote fiscal transparency, and enhancing the efficiency of tax collection. The authorities have undertaken significant reforms in these areas and their efforts should continue.

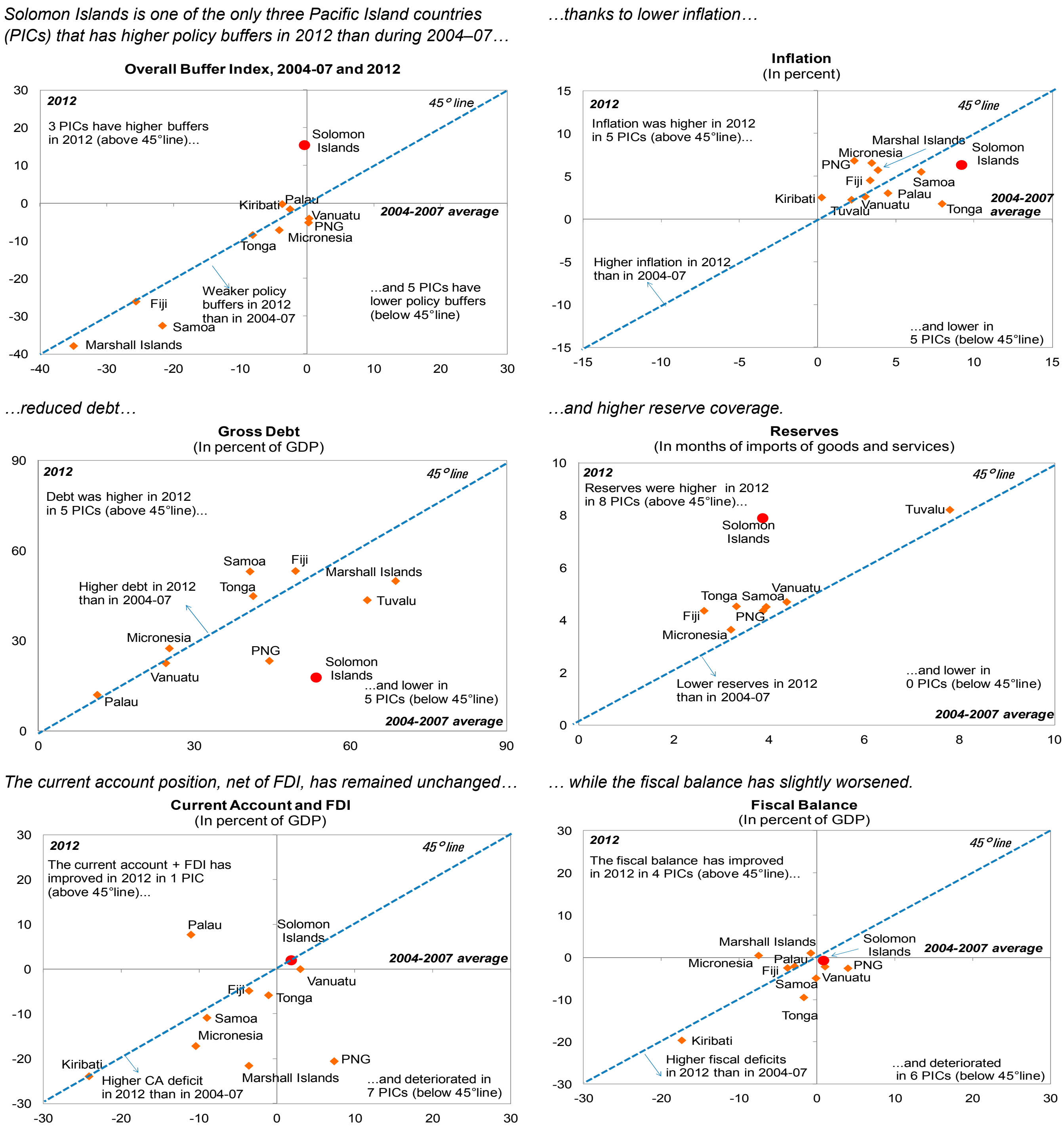
34. **The debt management strategy developed by the authorities is important for resuming external borrowing while safeguarding external stability**. While resuming concessional borrowing is critical for obtaining the resources needed to finance much-needed investments, prudent borrowing is paramount to maintain debt sustainability and minimize external and fiscal risks. A conservative borrowing limit should be introduced to keep debt distress at a moderate level. Capacity building in debt management, including establishing and putting in place guidelines and procedures to strengthen project appraisal and evaluation is also essential going forward.

35. **Monetary and exchange rate policies are appropriate.** If growth remains strong and domestic inflation pressures re-emerge, monetary policy should be tightened. The recent move toward a currency basket, away from a de facto peg with the U.S. dollar, should also help buffer external shocks in the future, should downside risks materialize.

36. **The financial system is sound, but the supervisory and regulatory frameworks need strengthening.** The drafting instructions for the NPF Act endorsed by the cabinet in July, together with the planned amendments to the Financial Institution Act, should help strengthen the financial sector's regulatory framework. The initiatives to increase access to financial services, especially in rural areas are welcome and represent an important step toward supporting private sector development.

37. **Based on Solomon Islands' program performance, staff recommends the completion of the second and last review under the SCF-supported program**. The authorities' reform program going forward will help secure the progress achieved with respect to macro stability under the two consecutive SCF arrangements, provide fiscal discipline, and help the authorities implement their ambitious reform agenda. Therefore, staff recommends the approval of the authorities' request for a successor arrangement in the form of a three-year low-access Extended Credit Facility (SDR 1.04 million). The current SCF will expire on December 5. Because a member cannot have two arrangements effective at the same time under the PRGT Instrument, a proposed decision approving the ECF arrangement (as set in this Staff Report) will be circulated to the Board for adoption on a lapse-of-time basis, for effectiveness after the current SCF arrangement expires.

Figure 1. Solomon Islands: From Crisis to Recovery—Rebuilding Policy Buffers

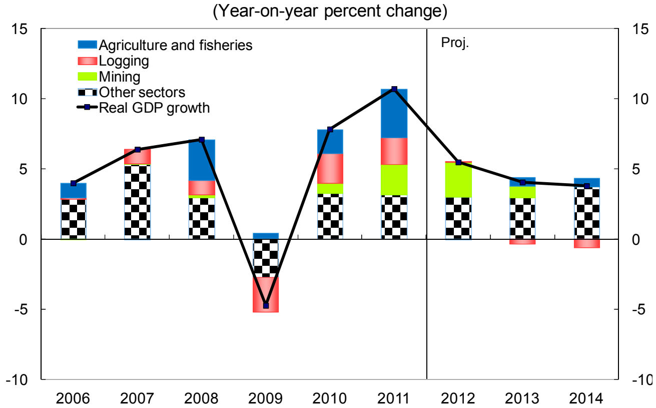


Sources: Country authorities; and IMF staff calculations.

Figure 2. Solomon Islands: Macroeconomic Developments and Outlook

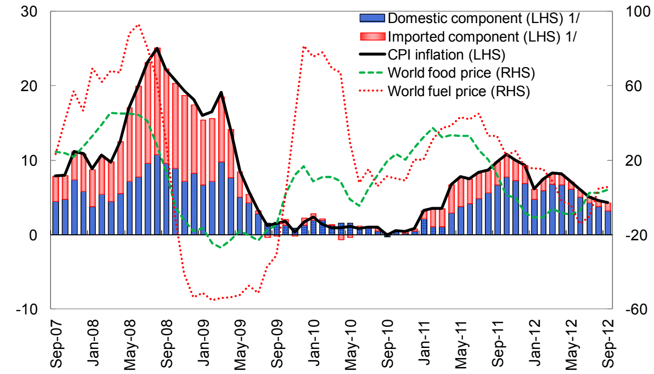
The economic recovery has been driven by booming resource sectors, especially logging and gold mining. Logging is expected to decline over the medium term.

Sources of Growth, 2006–14
(Year-on-year percent change)



Inflation has been moderating in the third quarter because of lower domestic pressure and slow pass-through form world food and oil prices.

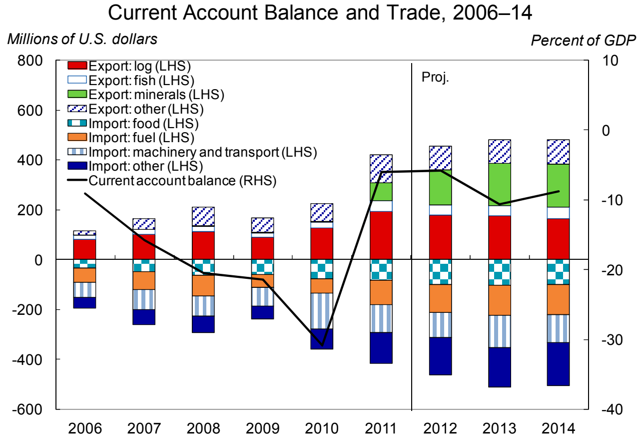
Contribution to CPI Inflation, Sep. 2007–12
(Year-on-year percent change, end of period)



1/ Contribution to CPI inflation (in percentage points).

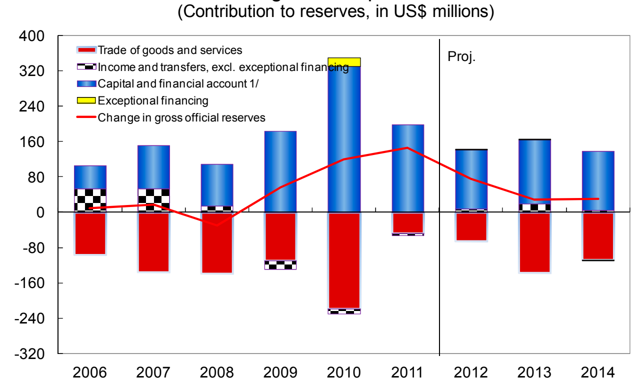
The current account balance improved in 2011, supported by record-high logging and palm oil exports, and recommencement of gold exports but the commodity-led export boom seems to be subsiding.

Current Account Balance and Trade, 2006–14



Reserve buffers have been rebuilt, thanks to donor grants and FDI.

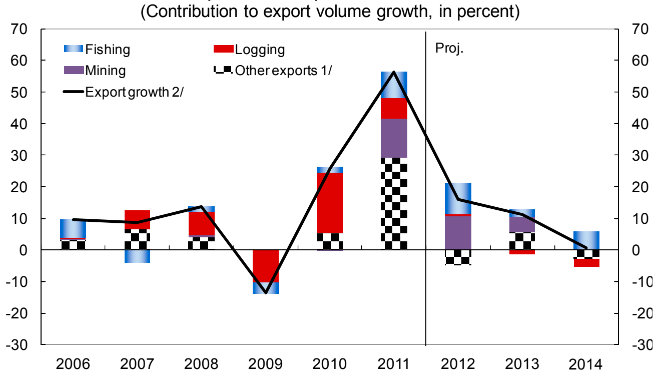
Reserve Change Decomposition, 2006–14
(Contribution to reserves, in US$ millions)



1/ Including errors and omissions.

Export volume has been strong driven by log and mineral exports, although log exports started to decline in 2012 due to weaker export demand and overexploitation.

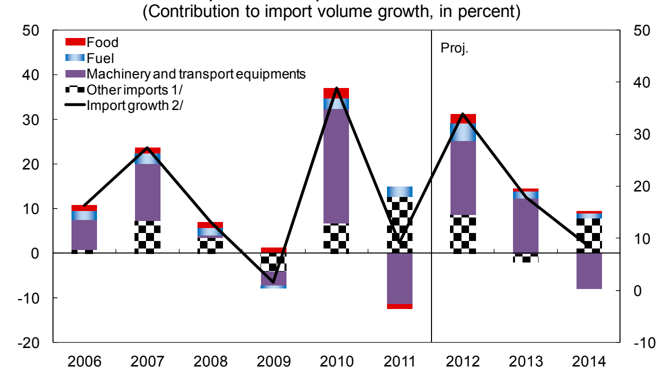
Export Developments, 2006–14
(Contribution to export volume growth, in percent)



1/ Residual.
2/ Year-on-year percent change.

Import volume has picked up recently driven by large imports of machinery and transport equipments associated to the Pacific Festival of Arts.

Import Developments, 2006–14
(Contribution to import volume growth, in percent)



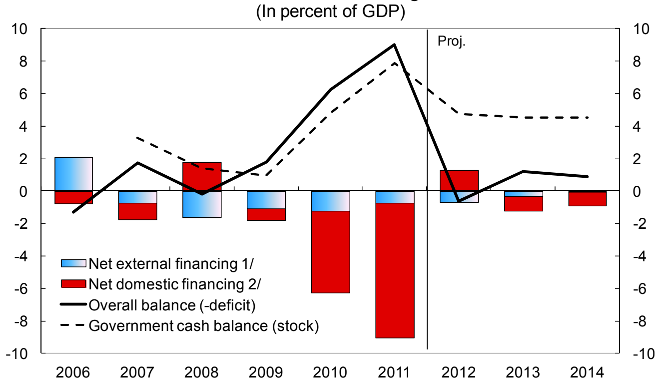
1/ Residual.
2/ Year-on-year percent change.

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

Figure 2. Solomon Islands: Macroeconomic Developments and Outlook (concluded)

The fiscal position has weakened in 2012, causing a decline in the cash balance.

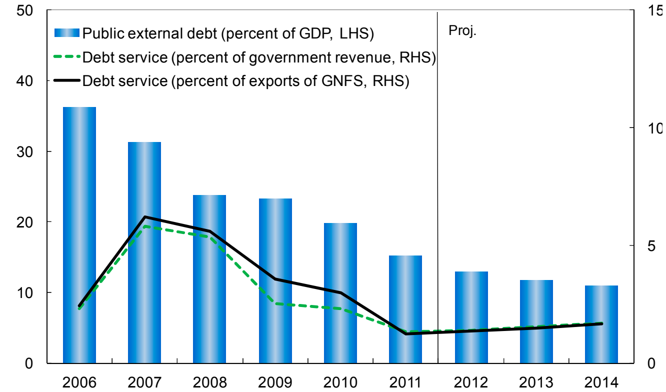
Fiscal Balance and Financing, 2006–14
(In percent of GDP)



1/ Between 2005–07, includes debt forgiveness.
2/ Includes privatization receipts.

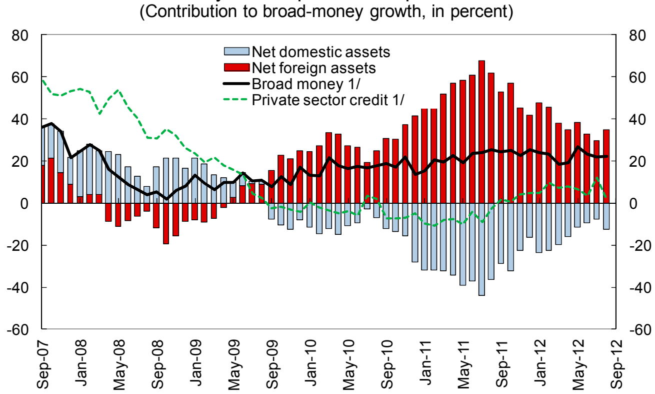
Public external debt continues to decline to sustainable levels.

Public External Debt, 2006–14



Rapid increase in reserve position has contributed to strong money growth.

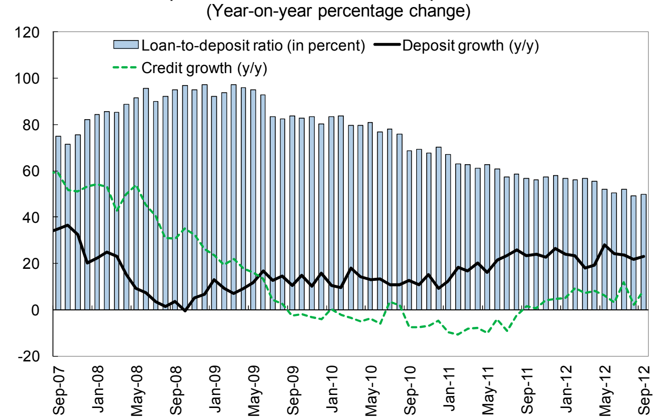
Monetary Developments, Sep. 2007–12
(Contribution to broad-money growth, in percent)



1/ Year-on-year percentage change.

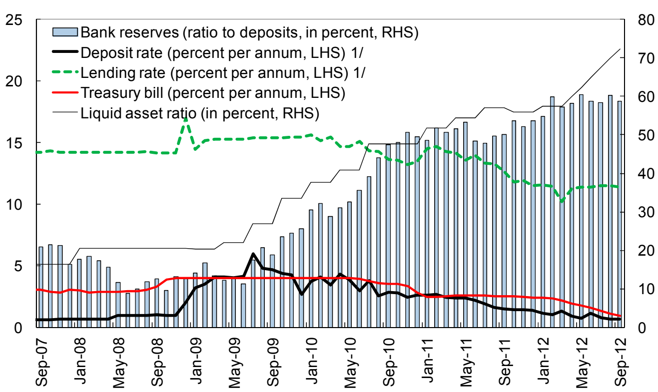
But private sector credit growth remains sluggish…

Deposit and Credit Growth, Sep. 2007–12
(Year-on-year percentage change)



…even with lower lending rates and ample liquidity of the banking sector.

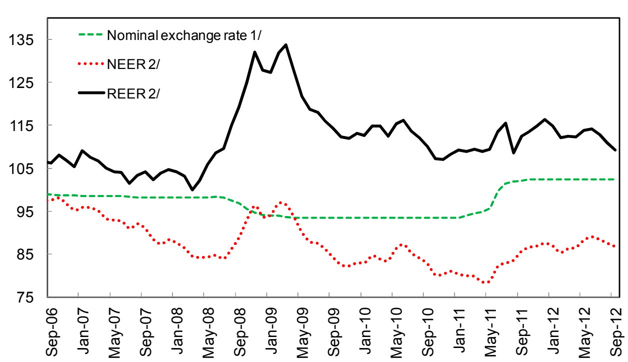
Interest Rates and Bank Reserves, Sep. 2007–12



1/ Weighted average rate of commercial banks.

The real effective exchange rate appreciated by 2 percent since October 2010.

Nominal and Effective Exchange Rates, Sep. 2006–12



1/ Based on U.S. dollar exchange rate.
2/ Index, 2005=100.

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

Table 1. Solomon Islands: Selected Economic Indicators, 2009–13

Per capita GDP (2011): US$1,578 (estimate) | Quota: SDR 10.4 million
Population (2011): 552,000 | Main products and exports: logs and gold
Poverty rate (2006): 23 percent | Main export markets: emerging Asia

	2009	2010	2011	2012		2013
				Prog. (CR/12/156)	Rev. Proj.	Proj.
Growth and prices (percentage change)						
Real GDP 1/	-4.7	7.8	10.7	7.4	5.5	4.0
Of which : nontimber nonmining	-2.6	5.4	7.3	4.2	3.4	4.2
CPI (period average)	7.1	0.9	7.4	4.3	5.1	5.4
CPI (end of period)	1.7	0.8	9.4	4.6	6.2	4.7
GDP deflator	7.3	5.9	9.1	5.0	6.0	6.1
Nominal GDP (in SI$ millions)	4,815	5,498	6,640	7,492	7,426	8,194
Of which : nonmining nominal GDP (in SI$ millions)	4,779	5,393	6,279	6,579	6,732	7,351
Per capita GDP (in US$)	1,159	1,267	1,573	1,843	1,786	1,899
Per capita GNI (in US$)	838	945	1,251	1,368	1,393	1,525
Central government operations (percent of GDP)						
Total revenue and grants	55.2	62.6	60.2	57.0	57.3	54.4
Revenue	30.5	32.0	33.1	32.5	32.7	31.5
Grants	24.7	30.6	27.1	24.5	24.5	23.0
Total expenditure	53.4	56.4	51.2	56.2	57.9	53.2
Recurrent expenditure	28.6	28.2	25.6	28.0	31.0	26.7
Development expenditure	25.6	27.9	25.5	28.2	26.9	26.5
Unrecorded expenditure 2/	-0.7	0.3	0.1	0.0	0.0	0.0
Overall balance	1.8	6.2	9.0	0.9	-0.6	1.2
Foreign financing (net)	-1.1	-1.2	-0.7	-0.6	-0.7	-0.3
Domestic financing (net)	-1.6	-5.1	-8.4	-0.3	1.3	-0.9
Privatization receipts	0.9	0.0	0.1	0.0	0.0	0.0
Central government debt (percent of GDP, unless otherwise indicated) 3/	33.9	28.5	22.2	14.5	18.2	15.4
Domestic debt	10.6	8.7	7.0	3.0	5.3	3.7
External debt	23.2	19.8	15.2	11.5	12.9	11.7
(In US$ millions, end of period)	138.7	134.7	137.0	121.9	130.4	126.8
Monetary and credit (percentage change, end-year data)						
Credit to private sector	-4.1	-4.7	4.7	4.8	6.7	5.0
Broad money	17.0	13.5	25.5	17.0	31.1	3.8
Reserve money	62.5	75.3	32.8	15.0	37.2	3.8
Interest rate - deposit (percent per annum) 4/	2.7	2.6	1.4	...	0.7	...
Interest rate - lending (percent per annum) 4/	15.4	13.5	11.5	...	11.4	...
Balance of payments (in US$ millions, unless otherwise indicated)						
Current account balance	-128.2	-210.1	-52.2	-81.2	-58.3	-116.2
(Percent of GDP)	-21.4	-30.8	-6.0	-7.8	-5.8	-10.6
(excluding mining-related capital imports, in percent of GDP)	…	-12.6	6.3	1.8	2.8	-2.0
Exports of goods and nonfactor services (GNFS)	234.9	330.2	556.6	679.6	601.4	624.4
(Percentage change)	-12.9	40.6	68.5	21.7	8.1	3.8
Logging exports	88.1	124.7	191.4	168.8	177.9	174.2
Imports of GNFS	344.2	547.8	604.0	725.9	667.3	760.9
(Percentage change)	-15.8	59.2	10.3	18.6	10.5	14.0
Foreign direct investment	116.8	235.6	258.0	88.7	116.4	93.4
(Percent of GDP)	19.5	34.6	29.7	8.5	11.5	8.5
Overall balance	56.4	119.8	146.4	41.7	91.3	28.0
Gross official reserves (in US$ millions, end of period) 5/	146.0	265.8	412.3	462.0	503.8	532.2
(In months of next year's imports of GNFS)	3.2	5.3	7.4	7.1	7.9	8.6
(In months of next year's nonmining-related imports of GNFS)	4.1	6.4	8.5	8.2	9.1	9.9
Exchange rate (SI$/US$, end of period) 4/	8.1	8.1	7.4	...	7.4	...
Real effective exchange rate (period average, 2005 = 100) 4/	120.5	112.0	111.7	...	112.5	...
Nominal effective exchange rate (period average, 2005 = 100) 4/	88.7	83.5	82.7	...	87.3	...

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

1/ Incorporates the 2009 revised GDP estimates published by the National Statistics Office in June 2011.
2/ Includes changes in the stock of unpaid payment orders and unpresented checks and the statistical discrepancy.
3/ Includes disbursement under an IMF-supported arrangement.
4/ Latest available for 2012.
5/ Includes SDR allocations made by the IMF to the Solomon Islands in 2009 and actual and prospective disbursements under the IMF-supported arrangements.

Table 2. Solomon Islands: Balance of Payments, 2010–17 1/

	2010	2011	2012 Proj. (CR/12/156)	2012 Rev. Proj.	2013	2014	2015	2016	2017
							Proj.		
				(In millions of U.S. dollars)					
Current account balance	-210.1	-52.2	-81.2	-58.3	-116.2	-101.9	-117.2	-126.7	-131.8
Trade balance for goods	-136.6	0.6	29.1	-9.0	-30.3	-24.6	-42.2	-72.2	-92.4
Exports	223.7	418.2	514.1	453.0	480.5	480.3	479.0	478.1	489.5
Imports	-360.3	-417.7	-485.0	-462.0	-510.8	-504.9	-521.2	-550.3	-581.9
Trade balance for services	-81.0	-48.0	-75.5	-56.9	-106.1	-83.0	-94.2	-105.5	-116.7
Exports	106.5	138.4	165.4	148.4	144.0	154.9	161.6	169.6	178.1
Imports	-187.5	-186.3	-240.9	-205.2	-250.1	-238.0	-255.8	-275.1	-294.8
Income balance	-173.3	-178.1	-267.8	-222.1	-216.4	-239.1	-229.6	-202.2	-180.3
Current transfers balance 2/	180.8	173.3	232.9	229.7	236.6	244.8	248.8	253.2	257.6
Of which : Official transfers, net	168.5	164.3	222.0	219.2	214.9	220.9	222.5	224.4	226.1
Capital and financial account balance	341.4	244.6	122.9	149.6	144.2	132.8	146.9	151.2	163.4
Capital account balance	49.8	71.2	36.3	35.3	37.3	38.4	38.7	39.0	39.3
Credits	50.3	71.2	35.2	35.3	37.3	38.4	38.7	39.0	39.3
Debits	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance	291.6	173.4	114.2	114.3	106.9	94.3	108.2	112.2	124.1
Direct investment balance	235.6	258.0	88.7	116.4	93.4	91.2	95.7	92.7	98.7
Outwards	-2.3	-3.6	-15.9	-0.6	-5.2	-6.6	-8.1	-9.4	-8.2
Inwards	237.9	261.6	104.6	117.0	98.6	97.8	103.8	102.1	106.9
Portfolio investment balance	-2.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment balance 3/	58.6	32.5	-2.1	-2.1	13.6	3.1	12.4	19.5	25.3
Errors and omissions	-11.4	-46.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	119.8	146.4	41.7	91.3	28.0	30.8	29.6	24.6	31.6
Financing	-110.3	-136.8	-41.7	-91.3	-28.0	-30.8	-29.6	-24.6	-31.6
Change in gross reserves (- = increase)	-119.8	-146.4	-49.7	-91.5	-28.4	-29.6	-26.9	-20.3	-27.4
IMF	9.6	9.6	8.0	0.2	0.4	-1.2	-2.8	-4.3	-4.2
				(In percent of GDP, unless otherwise indicated)					
Current account	-30.8	-6.0	-7.8	-5.8	-10.6	-8.7	-9.6	-9.8	-9.8
(excluding mining-related exports and imports of goods and services)	-12.6	6.3	-16.5	-11.3	-17.4	-15.3	-15.9	-16.0	-15.8
(excluding mining-related imports of goods and services)	-12.6	6.3	1.8	2.8	-2.0	-0.6	-1.8	-2.4	-2.6
(excluding net official transfers)	-55.5	-24.9	-29.2	-27.5	-30.1	-27.6	-27.7	-27.3	-26.5
Trade balance for goods	-20.0	0.1	2.8	-0.9	-2.8	-2.1	-3.4	-5.6	-6.8
Exports (in percent of GDP)	32.8	48.1	49.5	44.9	43.7	41.1	39.1	37.1	36.2
Of which: Logs	18.3	22.0	16.2	17.6	15.9	13.9	12.0	10.1	9.2
Of which: Fish	3.6	5.2	4.3	4.1	3.6	3.9	4.1	4.4	4.7
Of which: Minerals	0.5	8.0	18.2	13.9	15.5	14.8	14.4	14.0	13.6
Imports	52.8	48.1	46.7	45.8	46.5	43.2	42.5	42.8	43.1
Of which: Food	11.5	9.8	9.1	9.9	9.3	8.6	8.2	8.3	8.5
Of which: Fuel	8.3	11.1	12.6	11.3	11.1	10.5	10.0	10.1	10.2
Of which: Machinery and transportation equipment	21.0	13.0	10.4	9.9	11.8	9.4	9.2	9.0	8.8
Mining imports	11.4	6.9	5.8	4.6	4.9	4.7	4.5	4.3	4.2
Nonmining imports	41.5	41.1	40.9	41.2	41.6	38.6	38.0	38.4	38.9
Excluding mining capital imports and reinvested earnings	4.0	18.4	9.7	10.3	2.9	6.0	4.4	1.4	-0.3
Trade balance for services	-11.9	-5.5	-7.3	-5.6	-9.7	-7.1	-7.7	-8.2	-8.6
Income balance	-25.4	-20.5	-25.8	-22.0	-19.7	-20.5	-18.7	-15.7	-13.3
Current transfers balance	26.5	19.9	22.4	22.7	21.5	21.0	20.3	19.7	19.1
Of which: Official transfers net	24.7	18.9	21.4	21.7	19.6	18.9	18.2	17.4	16.7
Capital account balance	7.3	8.2	3.5	3.5	3.4	3.3	3.2	3.0	2.9
Direct investment balance	34.6	29.7	8.5	11.5	8.5	7.8	7.8	7.2	7.3
Of which: Inward FDI	34.9	30.1	10.1	11.6	9.0	8.4	8.5	7.9	7.9
Other investment balance	8.6	3.7	-0.2	-0.2	1.2	0.3	1.0	1.5	1.9
Errors and omissions	-1.7	-5.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net international reserves (in US$ million) 3/	256.2	393.1	434.8	484.4	512.4	543.2	572.9	597.4	629.0
Gross official foreign reserves (in US$ million)3/ 4/	265.8	412.3	462.0	503.8	532.2	561.8	588.7	609.0	636.3
In months of next year's imports of GNFS	5.3	7.4	7.1	7.9	8.6	8.7	8.6	8.3	8.3
In months of nonmining-related imports of GNFS	6.4	8.5	8.2	9.1	9.9	9.9	9.7	9.4	8.8
Gross external public debt	19.8	15.2	11.5	12.9	11.7	11.0	11.2	11.9	13.0
Disbursement of consessional borrowing (in US$ millions)	0.0	0.0	1.1	0.0	4.2	8.8	18.4	25.7	30.4
External public debt service (in percent of exports of GNFS)	3.0	1.2	1.3	1.3	1.5	1.7	1.7	1.8	1.6
Gross external debt (percent of GDP)	31.9	25.1	20.1	21.7	21.3	20.0	19.7	19.9	20.5
Private sector	12.2	9.9	8.6	8.8	9.6	9.0	8.5	8.0	7.5
Public sector	19.8	15.2	11.5	12.9	11.7	11.0	11.2	11.9	13.0
External debt service (percent of GDP)	2.3	1.6	1.6	1.5	1.5	1.8	1.9	1.9	1.7
Principal	1.6	1.0	1.0	1.0	1.0	1.3	1.4	1.4	1.2
Interest	0.7	0.7	0.6	0.6	0.5	0.6	0.5	0.5	0.5
Nominal GDP (in US$ million)	681.8	869.0	…	…	…	…	…	…	…

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

1/ Incorporates the authorities' revision of historical data, including new formula for f.o.b/c.i.f conversion, new estimates of reinvested earnings and donor grants, and reclassification of current and cap

2/ For 2010-11, includes additional donor support expected under the IMF-supported arrangement.

3/ Includes the SDR allocations made by the IMF in 2009, and private loans from International Finance Corporation in 2010.

4/ Includes actual and prospective disbursements under the IMF-supported arrangement.

Table 3. Solomon Islands: Summary of Fiscal Accounts, 2010–13

	2010	2011		2012				2013
		Budget	Act.	Budget	Suppl. Budget	Proj. (CR/12/156)	Rev. Proj.	Proj.
				(In millions of Solomon Islands dollars)				
Total revenue and grants	3,442	3,635	4,000	4,384	4,299	4,272	4,253	4,461
Total revenue	1,757	1,959	2,199	2,625	2,485	2,434	2,430	2,578
Tax revenue	1,589	1,760	1,989	2,377	2,237	2,202	2,205	2,350
Income and profits	638	741	669	893	753	780	767	831
Goods and services	569	641	752	930	930	841	834	902
International trade and transactions	382	378	568	555	555	581	604	617
Of which: Tax on logging	241	199	373	369	369	357	384	381
Other revenue	168	199	210	248	248	232	225	228
Grants	1,685	1,676	1,801	1,759	1,814	1,838	1,823	1,883
Development grants	1,289	1,469	1,553	1,432	1,432	1,444	1,432	1,533
Recurrent budget grants	396	207	248	327	382	394	391	351
Expenditure	3,099	3,529	3,400	4,365	4,524	4,207	4,299	4,360
Recurrent expenditure	1,548	1,616	1,701	2,058	2,270	2,097	2,300	2,187
Compensation of employees	588	588	623	655	655	685	690	721
Interest payments	23	29	24	25	25	23	21	21
Other recurrent expenditure 1/	937	1,000	1,054	1,377	1,589	1,389	1,589	1,445
Development expenditure	1,533	1,914	1,695	2,307	2,255	2,109	2,000	2,173
Government funded	243	444	342	813	760	602	505	641
Domestic	243	444	342	813	760	595	505	609
External loan	0	0	0	…	…	8	0	31
Grant funded	1,289	1,469	1,354	1,495	1,495	1,507	1,495	1,533
Unidentified expenditure 2/	18	0	4	0	0	0	0	0
Current balance	605	550	745	895	598	731	522	741
Overall balance	343	106	599	20	-225	66	-46	101
Total financing	-343	-106	-599	-20	225	-66	46	-101
Foreign (net)	-65	-58	-49	-50	-50	-44	-49	-28
Domestic (net)	-279	-58	-561	31	275	-22	95	-73
Banking system	-282	-49	-558	45	289	-8	109	-59
Central bank	-284	-24	-477	206	350	153	170	-20
Commercial banks	2	-25	-81	-161	-61	-161	-61	-39
Nonbank	2	-9	-3	-14	-14	-14	-15	-14
Others	1	10	10	0	0	0	0	0
				(In percent of GDP)				
Total revenue and grants	62.6	56.8	60.2	59.0	57.9	57.0	57.3	54.4
Total revenue	32.0	30.6	33.1	35.4	33.5	32.5	32.7	31.5
Tax revenue	28.9	27.5	30.0	32.0	30.1	29.4	29.7	28.7
Income and profits	11.6	11.6	10.1	12.0	10.1	10.4	10.3	10.1
Goods and services	10.4	10.0	11.3	12.5	12.5	11.2	11.2	11.0
International trade and transactions	6.9	5.9	8.6	7.5	7.5	7.8	8.1	7.5
Of which: Tax on logging	4.4	3.1	5.6	…	…	4.8	5.2	4.7
Other revenue	3.1	3.1	3.2	3.3	3.3	3.1	3.0	2.8
Grants	30.6	26.2	27.1	23.7	24.4	24.5	24.5	23.0
Development grants	23.4	22.9	23.4	19.3	19.3	19.3	19.3	18.7
Recurrent budget grants	7.2	3.2	3.7	4.4	5.1	5.3	5.3	4.3
Expenditure	56.4	55.1	51.2	58.8	60.9	56.2	57.9	53.2
Recurrent expenditure	28.2	25.2	25.6	27.7	30.6	28.0	31.0	26.7
Compensation of employees	10.7	9.2	9.4	8.8	8.8	9.1	9.3	8.8
Interest payments	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Other recurrent expenditure 1/	17.0	15.6	15.9	18.5	21.4	18.5	21.4	17.6
Of which : Government funded	13.4	12.4	13.9	14.1	16.3	13.3	16.1	13.4
Development expenditure	27.9	29.9	25.5	31.1	30.4	28.2	26.9	26.5
Government funded	4.4	6.9	5.1	10.9	10.2	8.0	6.8	7.8
Domestic	4.4	6.9	5.1	10.9	10.2	7.9	6.8	7.4
External loan	0.0	0.0	0.0	…	…	0.1	0.0	0.4
Grant funded	23.4	22.9	20.4	20.1	20.1	20.1	20.1	18.7
Unidentified expenditure 2/	0.3	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Current balance	11.0	8.6	11.2	12.1	8.1	9.8	7.0	9.0
Overall balance	6.2	1.7	9.0	0.3	-3.0	0.9	-0.6	1.2
(excluding unidentified expenditure)	6.6	1.7	9.1	0.3	-3.0	0.9	-0.6	1.2
Total financing	-6.2	-1.7	-9.0	-0.3	3.0	-0.9	0.6	-1.2
Foreign (net)	-1.2	-0.9	-0.7	-0.7	-0.7	-0.6	-0.7	-0.3
Domestic (net)	-5.1	-0.9	-8.4	0.4	3.7	-0.3	1.3	-0.9
Others	0.0	0.2	0.1	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Nominal GDP (in SI$ millions)	5,498	6,404	6,640	7,426	7,426	7,492	7,426	8,194
Gross cash balance (in SI$ millions)	326	351	561	451	307	481	464	484
Target of program cash balance (in SI$ millions) 3/	263	287	522	…	…	442	425	445
in months of recurrent spending	2.0	2.1	3.7	…	…	2.5	2.2	2.4
Mineral revenue (percent of GDP)	0.0	0.0	0.4	…	…	0.9	0.7	0.7
Non-mineral primary balance (percent of GDP) 4/	3.1	2.0	4.2	…	…	1.2	-0.2	1.1
Non-commodity primary balance (percent of GDP) 5/	-1.3	-1.1	-1.4	…	…	-3.5	-5.3	-3.5
Non-commodity primary balance, excluding development expenditures (percent of GDP) 6/	3.2	5.9	3.7	…	…	4.4	1.5	3.9

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

1/ Includes spending financed by recurrent grants.

2/ Includes changes in the stock of unpaid payment orders and unpresented checks (+ = reduction) and the statistical discrepancy.

3/ Defined as the sum of government deposits in the cash balance accounts minus unpaid payments orders and unpresented checks.

4/ Defined as non-mineral revenue (excludes grants) minus domestically funded recurrent and development spending excluding interest payments.

5/ Defined as non-mineral non-logging revenue (excludes grants) minus domestically funded recurrent and development spending excluding interest payments.

6/ Defined as non-mineral non-logging revenue (excludes grants) minus domestically funded recurrent spending excluding interest payments.

Table 4. Solomon Islands: Medium-Term Baseline Scenario, 2009–17

				Project					
	2009	2010	2011	2012	2013	2014	2015	2016	2017
Growth and prices (percentage change) 1/									
Real GDP	-4.7	7.8	10.7	5.5	4.0	3.8	3.7	3.6	3.6
Of which : nontimber and nonmining	-2.6	5.4	7.3	3.4	4.2	5.1	4.9	4.9	4.4
CPI (period average)	7.1	0.9	7.4	5.1	5.4	4.4	4.2	4.3	4.4
CPI (end of period)	1.7	0.8	9.4	6.2	4.7	4.1	4.2	4.3	4.5
GDP deflator	7.3	5.9	9.1	6.0	6.1	5.5	4.2	4.5	4.4
Nominal GDP (in SI$ millions)	4,815	5,498	6,640	7,426	8,194	8,974	9,699	10,493	11,343
Per capita GDP (in US$)	1,159	1,267	1,573	1,786	1,899	1,974	2,027	2,083	2,139
Per capita GNI (in US$)	838	945	1,251	1,393	1,525	1,570	1,647	1,756	1,854
Central government operations (percent of GDP)									
Total revenue and grants	55.2	62.6	60.2	57.3	54.4	53.0	53.5	52.0	50.9
Revenue	30.5	32.0	33.1	32.7	31.5	30.8	32.2	31.5	31.2
Tax revenue	26.4	28.9	30.0	29.7	28.7	28.0	29.4	28.7	28.4
Income and profits	11.2	11.6	10.1	10.3	10.1	10.2	12.3	12.2	12.1
Goods and services	8.8	10.4	11.3	11.2	11.0	11.0	11.0	11.0	11.0
International trade and transactions	6.4	6.9	8.6	8.1	7.5	6.8	6.1	5.5	5.3
Of which: Tax on logging	3.4	4.4	5.6	5.2	4.7	4.1	3.5	3.0	2.7
Other revenue	4.1	3.1	3.2	3.0	2.8	2.8	2.8	2.8	2.8
Grants	24.7	30.6	27.1	24.5	23.0	22.2	21.3	20.5	19.7
Total expenditure	53.4	56.4	51.2	57.9	53.2	52.1	52.6	51.2	50.1
Recurrent expenditure	28.6	28.2	25.6	31.0	26.7	26.1	26.1	25.2	24.8
Development expenditure	25.6	27.9	25.5	26.9	26.5	26.0	26.5	26.0	25.4
Unidentified expenditure 2/	-0.7	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.8	6.2	9.0	-0.6	1.2	0.9	0.9	0.8	0.7
Non-mineral primary balance 3/	2.7	3.1	4.2	-0.2	1.1	1.1	-0.3	0.2	0.5
Non-commodity primary balance 4/	-0.7	-1.3	-1.4	-5.3	-3.5	-3.0	-3.8	-2.7	-2.2
Central government debt (percent of GDP) 5/	33.9	28.5	22.2	18.2	15.4	13.9	13.5	13.9	14.9
Balance of payments (in US$ millions)									
Current account balance (- deficit)	-128.2	-210.1	-52.2	-58.3	-116.2	-101.9	-117.2	-126.7	-131.8
(In percent of GDP)	-21.4	-30.8	-6.0	-5.8	-10.6	-8.7	-9.6	-9.8	-9.8
(Excluding mining-related capital imports, in percent of GDP)	…	-12.6	6.3	2.8	-2.0	-0.6	-1.8	-2.4	-2.6
Overall balance	56.4	119.8	146.4	91.3	28.0	30.8	29.6	24.6	31.6
Gross official reserves (end of period) 6/	146.0	265.8	412.3	503.8	532.2	561.8	588.7	609.0	636.3
(In months of next year's imports of GNFS)	3.2	5.3	7.4	7.9	8.6	8.7	8.6	8.3	8.3
(In months of next year's nonmining-related imports of GNFS)	4.1	6.4	8.5	9.1	9.9	9.9	9.7	9.4	8.8

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

1/ Incorporates the 2009 revised GDP estimates published by the National Statistics Office in June 2011.

2/ Includes changes in the stock of unpaid payment orders and unpresented checks and the statistical discrepancy.

3/ Nonmineral balance is defined as nonmineral revenue minus government-funded recurrent and development spending excluding interest payments.

4/ Noncommodity balance is defined as nonlogging nonmineral revenue minus government-funded recurrent and development spending excluding interest payments.

5/ Includes disbursement under an IMF-supported arrangement.

6/ Includes SDR allocations made by the IMF to the Solomon Islands in 2009 and actual and prospective disbursements under the IMF-supported arrangements.

Table 5. Solomon Islands: Summary Accounts of the Banking System, December 2010–March 2013 1/

	2010	2011	2012						2013
	Dec	Dec	Mar	Jun		Sep		Dec	Mar
				Prog. (CR/12/156)	Act.	Prog. (CR/12/156)	Act.	Proj.	Proj.
	(In millions of Solomon Islands dollars, end of period)								
Central Bank of Solomon Islands (CBSI)									
Net foreign assets (NFA)	1,942	2,803	3,052	2,964	3,287	3,043	3,437	3,485	3,488
Net international reserves (NIR)	2,066	2,918	3,167	3,083	3,400	3,170	3,550	3,598	3,600
Other NFA	-124	-115	-115	-119	-113	-126	-113	-113	-112
Net domestic assets (NDA) 2/	-673	-1,118	-1,290	-1,253	-1,309	-1,256	-1,425	-1,173	-1,122
Net claims on central government	-361	-838	-925	-794	-1,001	-754	-1,007	-667	-650
Claims	117	103	101	103	91	103	84	103	103
Deposits	479	941	1,026	898	1,092	857	1,091	771	754
Other items (net)	-312	-280	-365	-459	-308	-502	-418	-506	-471
Reserve money	1,269	1,685	1,762	1,711	1,978	1,788	2,011	2,312	2,366
Currency in circulation	436	526	515	540	543	535	537	591	579
Bank deposits	822	1,126	1,213	1,139	1,398	1,221	1,443	1,688	1,754
Other deposits	11	33	33	32	37	32	31	33	33
Other depository corporations									
NFA of commercial banks	51	88	65	89	103	122	91	85	80
Assets	141	169	166	192	218	226	192	187	180
Liabilities	89	80	100	103	116	104	101	101	100
NDA of commercial banks	760	838	804	991	843	945	876	1,026	1,058
Net claims on central government	53	-28	-86	-93	-128	-128	-105	-89	-97
Claims	121	101	96	76	84	21	68	40	33
Deposits	68	129	182	169	212	149	172	129	129
Claims on the private sector	1,163	1,216	1,204	1,225	1,204	1,226	1,225	1,298	1,282
Other items (net)	-456	-351	-314	-142	-233	-153	-244	-184	-128
Reserves and vault cash	847	1,171	1,248	1,179	1,438	1,262	1,491	1,739	1,793
Deposits	1,658	2,097	2,118	2,259	2,383	2,329	2,458	2,850	2,930
Depository corporations survey									
NFA of the banking system	1,994	2,891	3,117	3,053	3,390	3,165	3,527	3,570	3,567
Central bank	1,942	2,803	3,052	2,964	3,287	3,043	3,437	3,485	3,488
Other depository corporations	51	88	65	89	103	122	91	85	80
NDA of the banking system	87	-280	-486	-262	-466	-310	-549	-148	-64
Net claims on central government	-308	-866	-1,011	-887	-1,129	-882	-1,112	-756	-747
Claims on the private sector 3/	1,166	1,221	1,209	1,230	1,209	1,231	1,230	1,304	1,288
Other items (net)	-772	-636	-684	-605	-546	-659	-668	-696	-605
Broad money (M3)	2,080	2,611	2,631	2,790	2,924	2,855	2,978	3,423	3,503
M1	1,310	1,874	1,909	2,003	2,227	2,049	2,300	2,456	2,514
Currency outside banks	412	481	480	500	503	494	489	540	540
Demand deposits	898	1,393	1,428	1,503	1,723	1,555	1,811	1,916	1,974
Savings and time deposits	771	737	723	788	697	806	678	966	989
	(Annual percentage change, unless otherwise indicated)								
Reserve money	75.3	32.8	29.0	21.0	39.9	20.9	36.1	37.2	34.3
Credit to the private sector	-4.7	4.7	7.2	5.0	3.3	8.3	8.2	6.7	6.5
Broad money	13.5	25.5	18.4	17.8	23.4	17.2	22.2	31.1	33.1
NFA of the banking system 4/	41.5	43.2	38.0	10.7	24.9	11.6	26.5	26.0	17.1
NDA of the banking system 4/	-28.0	-17.7	-19.6	7.1	-1.5	5.6	-4.3	5.1	16.0
Memorandum items:									
Money multiplier	1.6	1.5	1.5	1.6	1.5	1.6	1.5	1.5	1.5
Reserve money	75.3	32.8	29.0	21.0	39.9	20.9	36.1	37.2	34.3
Loan to deposit ratio (in percent)	70.1	58.0	56.8	54.2	50.5	52.7	49.8	45.6	43.8
Interest rates (percent per annum)									
Deposit rate 5/	2.6	1.4	1.3	…	1.1	…	0.7	…	…
Lending rate 5/	13.5	11.5	10.2	…	11.4	…	11.4	…	…
NCG of financial corporations	-205	-765	-914	-793	-1,031	-792	-1,015	-671	-665
91-Day Treasury Bill Rate	2.8	2.4	2.2	…	1.6	…	0.9	…	…
Program targets									
NIR of CBSI (in US$ millions)	256	393	427	421	458	428	478	470	475
NDA of CBSI (in SI$ millions)	-673	-1,118	-1,290	-1,253	-1,309	-1,256	-1,425	-1,173	-1,122

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

1/ Based on the program exchange rate of SI$7.42 per US$.

2/ The end-2009 estimates and 2010-11 revised program projections incorporate the changes in the measurement of reserve money following the recommendations of the IMF Safeguards Assessment.

3/ Includes claims of the CBSI on other (nonbank) financial corporations.

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

5/ Weighted average of different maturities.

Table 6. Solomon Islands: Reviews and Disbursements Under the Fund Arrangements 1/

Date	Amount of Disbursement		Condition
	In percent of quota	In SDR	
Reviews and Disbursement Under the Current Standby Credit Facility			
December 6, 2011	17	1,733,333	Approved Fund arrangement
June 25, 2012	17	1,733,333	Completion of the first review and observance of end-December 2011 performance criteria
November 15, 2012	17	1,733,334	Completion of the second review and observance of end-June 2012 performance criteria
Total	50	5,200,000	
Reviews and Disbursement Under the Successor Extended Credit Facility			
December 7, 2012	1.4	148,571	Approved Fund arrangement
June 15, 2013	1.4	148,571	Completion of the first review and observance of end-December 2012 performance criteria
November 15, 2013	1.4	148,571	Completion of the second review and observance of end-June 2013 performance criteria
June 15, 2014	1.4	148,571	Completion of the third review and observance of end-December 2013 performance criteria
November 15, 2014	1.4	148,571	Completion of the fourth review and observance of end-June 2014 performance criteria
June 15, 2015	1.4	148,571	Completion of the fifth review and observance of end-December 2014 performance criteria
November 15, 2015	1.4	148,574	Completion of the sixth review and observance of end-June 2015 performance criteria
Total	10	1,040,000	

Source: IMF.

1/ There has been no drawings under the current SCF, which was precautionary in nature.
The ECF drawings are expected to be completed.

Table 7. Solomon Islands: Indicators of Capacity to Repay the Fund, 2011–22

		Project										
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Fund obligations based on existing credit (in SDR millions)												
Principal	0.0	0.0	0.0	1.0	2.1	2.8	2.8	2.4	1.4	0.0	0.0	0.0
Charges and interest	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fund obligations based on existing and prospective credit (in SDR millions) 1/												
Principal	0.0	0.0	0.0	1.0	2.1	2.8	2.8	2.5	1.5	0.2	0.2	0.2
Charges and interest	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations based on existing and prospective credit												
In millions of SDRs	0.0	0.0	0.0	1.1	2.1	2.8	2.8	2.5	1.5	0.2	0.2	0.2
In millions of US$	0.0	0.0	0.0	1.7	3.2	4.2	4.2	3.8	2.3	0.2	0.3	0.3
In percent of gross international reserves	0.0	0.0	0.0	0.3	0.5	0.7	0.7	0.6	0.3	0.0	0.0	0.0
In percent of exports of goods and services	0.0	0.0	0.0	0.3	0.5	0.7	0.6	0.5	0.3	0.0	0.0	0.0
In percent of debt service 2/	0.0	0.0	0.3	7.7	13.5	17.5	18.1	16.6	11.7	1.3	1.7	1.7
In percent of GDP	0.0	0.0	0.0	0.1	0.3	0.3	0.3	0.3	0.1	0.0	0.0	0.0
In percent of quota	0.0	0.0	0.3	10.6	20.6	27.0	26.9	23.9	14.4	1.5	2.0	2.0
Outstanding Fund credit												
In millions of SDRs	12.5	12.6	12.9	12.2	10.4	7.6	4.9	2.4	0.9	0.7	0.5	0.3
In millions of US$	19.3	19.1	19.5	18.4	15.7	11.5	7.3	3.6	1.3	1.1	0.8	0.5
In percent of gross international reserves	4.7	3.8	3.7	3.3	2.7	1.9	1.1	0.6	0.2	0.2	0.1	0.1
In percent of exports of goods and services	3.5	3.2	3.1	2.9	2.4	1.8	1.1	0.5	0.2	0.1	0.1	0.1
In percent of debt service 2/	136.9	124.0	117.5	85.5	65.8	47.6	31.4	15.9	6.9	5.8	4.2	2.5
In percent of GDP	2.2	1.9	1.8	1.6	1.3	0.9	0.5	0.2	0.1	0.1	0.0	0.0
In percent of quota	120.0	121.4	124.3	117.1	100.0	73.4	46.6	22.9	8.6	7.0	5.0	3.0
Net use of Fund credit (in SDR millions)												
Disbursements	6.2	0.1	0.3	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	0.0	0.0	0.0	1.1	2.1	2.8	2.8	2.5	1.5	0.2	0.2	0.2
Memorandum items:												
Nominal GDP (in US$ millions)	869.0	1009.7	1098.3	1167.7	1225.3	1287.0	1350.8	1449.2	1562.1	1685.3	1775.3	1882.3
Exports of goods and services (in US$ millions)	556.6	601.4	624.4	635.2	640.6	647.7	667.6	689.2	718.3	750.1	711.2	684.7
Gross international reserves (in US$ millions)	412.3	503.8	532.2	561.8	588.7	609.0	636.3	647.3	669.8	692.6	696.4	687.2
Debt service (in US$ millions) 2/	14.1	15.4	16.6	21.5	23.9	24.1	23.3	22.6	19.4	19.0	18.8	18.8
Quota (in SDR millions)	10.4	10.4	10.4	10.4	10.4	10.4	10.4	10.4	10.4	10.4	10.4	10.4

Source: IMF staff estimates and projections.

1/ Prospective credit includes the 10 percent of quota (SDR 1.04 million) available under the Extended Credit Facility. No drawings are expected under the current Standby Credit Facility, which was precautionary in nature.

2/ Total public debt service, including IMF repayments.

APPENDIX I–LETTER OF INTENT

November 13, 2012

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Lagarde,

Solomon Islands has greatly benefited from the partnership with the IMF in the implementation of the Government's economic reform program supported by a precautionary Standby Credit Facility (SCF) arrangement approved in December 2011. Economic activity, although moderating, has remained strong; short-term macroeconomic imbalances have been addressed; and donor's support has been catalyzed. Given the observance of all end-June 2012 quantitative targets by a large margin and the progress in implementing structural benchmarks, we request the completion of the second and final review under the SCF arrangement. Given the arrangement was intended to be precautionary, we are not requesting the release of the outstanding disbursement of SDR5.2 million.

Looking ahead, growth momentum has eased and downside risks to global growth have increased. Solomon Islands continues to remain vulnerable to shocks associated with its undiversified production and export base, strong dependency on aid, and frequent natural disasters. Despite our situation, we remain committed to reforms aimed at strengthening our economic resilience and promoting strong, sustainable, and inclusive growth beyond the commodity sector to help reduce poverty. To move toward achieving these goals and preserve the reform momentum, we are requesting a successor arrangement in the form of a low-access three-year Extended Credit Facility (ECF) in the amount equivalent to 10 percent of our quota (SDR 1.04 million or about US$1.6 million). Should external downside risks materialize prompting large balance of payment needs, we would request a corresponding augmentation of access under the ECF arrangement.

We believe that this successor arrangement will help us secure the progress achieved with respect to macroeconomic stability under the two consecutive SCF arrangements (since June 2010) and will complement ongoing Government's reforms under the Core Economic Working Group policy dialogue. Our recent experience demonstrates how a virtuous cycle of strong commitment to reforms, rebuilding of policy buffers, and strengthening the macro framework can quickly boost business confidence and spur growth. The new ECF arrangement will also be instrumental in helping the Government implement its ambitious medium-term structural reform agenda and tackle persistent institutional weaknesses. The requested ECF arrangement will also help strengthen our fiscal framework, preserve external stability and debt sustainability, maintain stable monetary conditions, and strengthen our financial sector. The Memorandum of Economic and Financial Policies (MEFP), which describes the Government's reform policies during 2013–15, is attached. We also request the release of the first disbursement equivalent to SDR 0.149 million upon the Executive Board's approval of this arrangement. The program will be monitored through quantitative performance criteria and indicative targets, structural benchmarks, and semi-annual reviews

(MEFP Tables 1 and 2). The first review under the ECF arrangement is expected to take place on or after June 15, 2013, and the second review is expected to take place on or after November 15, 2013.

Solomon Islands believes that the policies set forth in the attached Memorandum of Economic and Financial Policies (MEFP) are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Solomon Islands will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. Furthermore, we will provide the Fund with any information it may request on policy implementation, as necessary, to achieve program objectives. We also authorize the publication of this Letter of Intent and the attached MEFP.

Sincerely yours,

/s/	/s/
Hon. Rick Houenipwela, MP	**Denton Rarawa**
Minister of Finance and Treasury	Governor
Ministry of Finance and Treasury	Central Bank of Solomon Islands

Attachments: MEFP and Technical Memorandum of Understanding

APPENDIX I—ATTACHMENT I

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. RECENT DEVELOPMENTS AND OUTLOOK

1. **Macroeconomic conditions have improved.** The implementation of IMF-supported programs over the last two and half years, together with strong political commitment, has helped preserve macroeconomic and financial stability as well as trigger donor support. After contracting by 5 percent in 2009, economic activity rebounded to 6¾ percent in 2010 and exceeded 10 percent in 2011. External and fiscal buffers have been rebuilt, with gross international reserves increasing to US$ 496 million (about ten months of this year's imports of goods and services) as of September 2012, relative to US$412 million at end-2011. Reserves levelled off in September, however, compared to August.

2. **Growth is slowing to around 5 percent in 2012 including in the commodity sector—and private sector activity remains subdued**. Growth is being driven by mining and service sectors. Logging has surprised on the upside so far in 2012, but contribution to growth has been much smaller than in previous years. Inflation has eased to 4.7 percent (year-on-year) in August, despite the rise in international food prices as the global food price spike did not affect rice—the main food component in the CPI basket.

3. **Growth will moderate further in 2013 and beyond, with mainly external downside risks.** Logging production is expected to decline in 2013 and beyond, but gold production together with services are expected to continue to support growth of almost 4 percent in the medium term. Headline inflation is likely to be in the 4-6 percent range over the medium term as commodity prices stabilize. But our economy will remain heavily dependent on aid that is essential to finance the structural trade deficit. Moreover, risks of a serious global slowdown have heightened considerably. If the downside risks to the global outlook materialize, Solomon Islands will be affected mainly through weaker growth in emerging Asia. The main channels of contagion would be a worsening the terms of trade, contraction in demand for logging from Asia—especially China, our main trading partner—and lower foreign direct investment. However, given the uncertainty surrounding logging production, GDP growth could be higher over the medium term, should logging activity be larger than expected.

4. **The program under the Standby Credit Facility (SCF) arrangement is broadly on track**. The program performance criteria for end-June 2012 were met with comfortable margins. Government cash balances reached SI$391 million at end-June, covering two months of recurrent spending, and net international reserves stood at US$454 million. The targets for net credit to the Government and the central bank's net domestic assets were also met with comfortable margins. However, we missed the indicative target for September on the cash balance by SI$35 million, owing to shortfalls in revenues relative to the 2012 Budget and higher recurrent spending related to hosting the recent Festival of Pacific Arts, and increased spending on tertiary education. Moreover, development spending has been higher than in previous years. This reflects much larger allocations in the 2012 Budget (4 percent of GDP compared to 2 percent in 2010 and 2011) to be spent through the Rural Constituency Development Livelihoods Fund (RCDL). We have also implemented most of the benchmarks committed under the program (Tables 1 and 2). Despite a strong commitment, we continue to face capacity constraints which have slowed the pace of

implementation of some structural benchmarks. Moreover, building a consensus in favor of reforms requires a wider consultation process among shareholders and civil society to ensure that these reforms are benefitting the entire population. That said, substantial progress has been made in achieving the structural reforms agreed under the current IMF-backed program.

5. **Looking ahead, further reforms are needed to ensure that Solomon Islands reduces its vulnerability to external shocks and remains on a sustainable growth path.** Building on the success of the current program, we are formulating a set of policies that can be supported by a successor medium-term arrangement with the Fund.

II. Program Policies

6. **Our policies aim at enhancing resilience to shocks and implementing growth-enhancing structural reforms that will benefit all Solomon Islanders.** By doing so we aim to boost investor confidence and ensure sustainable and inclusive growth. Our program will focus on strengthening the fiscal framework, improving monetary operations, maintaining a strong foreign exchange position and ensuring debt sustainability, and containing financial risks. We will also focus on reforms aimed at tackling our institutional and structural weaknesses, such as public financial management and tax reform. Furthermore, we will continue to support private sector development by promoting financial inclusion that enhances access to financial services by the private sector, especially in the rural areas.

A. Fiscal Policies

7. **We remain committed to preserving a strong fiscal position while providing adequate resources for critical social spending.** The fiscal position strengthened considerably in 2011, and continued to be relatively robust during the first half of 2012, as a result of buoyant revenues and sound fiscal management. However, the shortfall in revenues relative to the 2012 Budget estimates owed partly to the doubling of the threshold for personal income tax as well as higher-than-budgeted expenditure that resulted in a deterioration of the fiscal position during the third quarter of 2012. We realize that logging revenue will continue to remain volatile in the near term, and that it will decline over the medium term as logging stocks are exhausted over this decade. While we expect that increased revenue from mining will offset some of the losses from logging over the medium and long term, this is likely to slow. The implementation of the mining tax regime will help ensure better return for Solomon Islanders on the extraction of our natural resources. Thus, we will use much more conservative revenue projections and will contain expenditure to rebuild policy buffers. At the same time, we will refocus on ensuring a higher quality of public spending to lift long-term growth potential. To achieve these near- and medium-term goals, we will ensure that fiscal policy for the remainder of 2012—as well as in the 2013 budget and over the medium term—is consistent with the following:

- We are firmly committed to continuing to use the cash balance as our fiscal anchor and to preserve its level according to the quantitative targets and performance criteria reported on Table 1. Going forward this will imply a tighter fiscal policy relative to 2012 and strengthening our fiscal position in the 2013 Budget. We believe that a prudent fiscal stance is further warranted given the deterioration in the global outlook. Should commodity revenue surprise on the upside, or under-spending of the development budget materialize owing to capacity constraints, we will save this windfall for future development spending or increase fiscal space to buffer future shocks.

- We will contain public expenditure and enhance the quality of public spending. Given the expected decline in logging revenue over the medium term, we will keep public spending at a more sustainable level in line with the expected slower growth in revenue receipts. However, the basic public sector wage has declined in real terms over the last ten years. Thus, we are planning an increase in basic public sector wages in 2013. The size of the increase will be prudent and determined in the ongoing 2013 Budget process. At the same time we will aim at consolidating the number and magnitude of public-sector allowances and benefits into the remuneration base and control the use of other allowances, such as overtime. In so doing we will also increase the transparency of remuneration levels, which provides a more definitive base for making future projections of public service payroll Going forward, a comprehensive reform of the payroll system is necessary to be able to attract and retain high-qualified staff in key areas in the public service sector and improve the composition of the overall payroll. Should revenue surprise on the upside, resources should be spent on high-priority areas as education, health, and infrastructure, which in turn will help us make progress toward our goal of achieving inclusive growth and alleviating poverty. We will continue to make large contributions to the National Transport Fund to finance transportation infrastructure that would trigger positive growth spillovers to all sectors and encourage private sector development. We will maintain spending on education and health at no less than 32 percent of the Government-funded recurrent spending, in line with our economic reform program and consistent with the Core Economic Working Group's recommendations; we will also continue to track government-funded spending on education and health. We will also strike a balance between financing tertiary education abroad and investing in primary education, given the low enrolment rate in basic education by regional standard.

- We will contain the use of constituency funds. The use of constituency funds is meant to increase the effectiveness of public service delivery in the rural areas. We are in the process of enhancing the accountability on how these funds are spent. Internal audits are underway and we look forward to the upcoming assessment by the Office of the Auditor General (OAG) to provide advice to the Government on how to standardize procedures to evaluate and prioritize ex ante our development projects. Thus, to enhance transparency in the use of public funds, we are introducing an accountability system in which the OAG reports back to the Cabinet and Parliament on actual spending and project achievements.

- To strengthen public financial management and better monitor priority spending, we will continue to make progress toward improving our budget presentation. We took an important step in the 2012 Budget by revising our budget presentation to include output line items, thus attaining a program benchmark (end-September 2012 benchmark) ahead of schedule. We also improved the transparency of the budget process through deeper consultations with non-governmental organizations and ministries as well as with provincial governments for the first time. In 2012, a new chart of accounts has been put in place to better capture Government expenditure according to natural account codes

This will improve the transparency and accountability in the allocation of spending in the 2013 Budget. We will also continue to seek assistance from development partners to advance current work being done to strengthen procurement, financial management information systems and internal audit processes in order to reduce leakages affecting public service delivery.

- To strengthen our medium-term fiscal position, we are currently implementing a multi-year budget framework. We have developed a framework that includes forward estimates of revenues and current expenditure that will be included in the 2013 recurrent Budget (end-December 2012 benchmark). We will complete this process next year by including forward estimates for the 2014 Development Budget. Casting budget decisions in a multi-year perspective will help us design realistic fiscal plans in line with the objectives laid down in the National Development Strategy (NDS). The multi-year budget framework will also help build consensus on the appropriate sequencing of development projects.
- We are strongly committed to strengthening the fiscal framework and public management by continuing to reform the Public Finance Act (PFA). The new PFA will incorporate provisions on fiscal responsibility, management and use of public funds, and management of public debt. We have drafted four discussion papers (and posted them on the Ministry of Finance and Treasury web site) which we presented in a public workshop in August at the presence of the Government, development partners, private-sector representatives, and civil society (end-September 2012 benchmark). Despite substantial resource constraints, we are aiming to submit to Cabinet the draft legislation on the PFA by mid-November (mid-November 2012 benchmark). We will also submit to parliament the draft of the PFA by end-October 2013 (end-October 2013 benchmark). Consequently, we will be revising the Financial Instructions and accompanying finance manuals and guidelines during the course of 2013. These are subsidiary instruments to the new PFA, which will not come into effect until January 1, 2014. Training will be an integral component in embedding these reforms.
- We will continue to boost domestic revenue by strengthening compliance and streamlining exemptions. In order to achieve this, a new comprehensive bill on customs and excise taxes (end-October 2012 benchmark) is being drafted with the assistance of the Asian Development Bank and co-financed by the AusAID. However, given recent resource constraints in finalizing the draft legislation, the elements on exemptions may need to be considered by Cabinet ahead of the rest of the legislation. This will also include changes to the exemption processes relating to income taxes, stamp duties, and goods and sales tax acts which are in other legislation. We are planning on obtaining Cabinet approval to release the draft bill implementing the new Customs and Excise Act for public consultation, including the clauses related to exemptions and the draft amendments to other revenue acts (income tax, stamp duties, goods and sales tax acts) by end-December 2012 (end-December 2012 benchmark) and to Parliament by November 2013 (end-November 2013 benchmark). Looking forward, we are currently considering further tax reforms aimed at strengthening and broadening the narrow tax base.
- Implementing a new resource taxation regime will be critical for Solomon Islands to benefit from its natural resource wealth. We are aiming at seeking Cabinet approval of

draft amendments to income tax legislation, custom and excise taxes, and goods tax legislations to implement a new mining taxation regime, in line with IMF technical assistance recommendations, originally set by end-September 2012 (end-September 2012 benchmark), by mid-December 2012 (end-December 2012 benchmark) and to submit it to Parliament by November 2013 (end-November 2013 benchmarks). The reform on mining legislation has taken longer than expected to allow for a wider consultation process with different stakeholders—including extractive companies, civil society, and landowners—and also because of further and unexpected resource constraints at the drafting stage. A consultation meeting with all stakeholders was held in July. Until this new tax regime is in place, we will refrain from approving new mining leases. At the same time, we will adopt measures to enhance revenue administration in the area of mining taxation to ensure that the government receives its share of mining revenue. Finally, we will continue to apply, as we have done since January 2012, the full market price for log exports with an automatic quarterly adjustment, to support revenue-mobilization efforts.

- We will exercise caution in resuming concessional borrowing to preserve domestic and external stability while tapping resources to finance much needed investment projects. These projects include the Submarine Cable System Project and the Tina River Power Project, which will reduce the cost of doing business and encourage private sector investment. The internet submarine connection is expected to be fully operational by the middle of 2014. This project will reduce communication costs significantly, enhance efficiency and create new information and communication industries. It will also ease the business registration process. The Tina River Project will reduce significantly the cost of energy. The Debt Management Strategy (DMS), endorsed in May by the Cabinet, builds on the results of the IMF-World Bank Debt Sustainability Analysis, provides the appropriate framework to anchor borrowing plans going forward. The DMS has been incorporated in the Honiara Club Agreement (HCA) review (end-April 2012 benchmark). We are setting a yearly borrowing limit in the 2013 Budget which will include domestic, external and SOE borrowing and guarantees, to preserve debt sustainability. This limit will be revised on a yearly basis depending on the debt outlook and our investment needs, but we will continue to maintain a conservative approach. The next steps include: developing instructions for SOE borrowing (end-March 2013 benchmark) and including it in the DMS; identifying the outstanding debt of SOEs; developing an on-lending policy framework; and designing a framework to estimate the cost of guarantees.

B. Monetary, Exchange Rate, and Financial Sector Policies

8. **Monetary and exchange rate policies will continue to be geared to maintaining price and external stability**. We have contained inflationary pressures by issuing short-term *Bokolo bills*. The monetary transmission mechanism has also improved over the last couple of years, but remains weak. Given the clouds surrounding the global outlook, we will continue to closely monitor credit, liquidity and real sector developments in conducting monetary policy for the rest of the year and will scale up the issuance of *Bokolo bills*, if needed. Given our vulnerability to external shocks, we also recently modified our exchange rate regime. While the previous regime (a de facto peg to the U.S. dollar), in place since 2002, has provided a strong nominal anchor, in October we moved toward a basket peg

using as weights the currency denominations of the largest shares of our external payments. This was in line with recent IMF technical assistance recommendations on promoting greater exchange rate flexibility and foreign exchange market development. We believe this arrangement will provide more flexibility, with a view to maintaining external stability and absorbing external shocks. To reinforce the effectiveness of the CBSI in conducting monetary policy and its supervisory activities, we have drafted a new CBSI Act. The Cabinet approved the draft in July (end-March 2012 benchmark) and we plan to be ready to submit the final Act to Parliament by December 2012 (end-December 2012 benchmark).

9. **We will continue our efforts to strengthen the financial supervisory and regulatory frameworks, and improve access to credit.** Reforming the National Provident Fund (NPF) to improve its governance and investment framework are critical for providing retirement income and maintaining financial stability. The drafting instructions for the NPF Act endorsed by Cabinet in July (end-June 2012 benchmark) will strengthen the NPF's governance structure and investment framework, reduce political influence on investment decisions, and maximize returns to its members. We are planning to be ready to submit the revised NPF Act to Parliament by October 2013 (end-October 2013 benchmark). We would like to request IMF technical assistance in strengthening on-site supervision of the NPF and insurance companies as well as in formulating prudential regulations and reports for the NPF. The planned amendments to the Financial Institution Act should also help strengthen the financial sector's regulatory framework. An IMF TA mission will arrive shortly to assist us in reviewing the Financial Institution Act to reflect international best practices. We will also request the IMF to follow up with TA on banking supervision to capitalize on the recent assistance received from PFTAC as well as on continued capacity building efforts in financial markets supervision. To address the continuing weakness in access financial services, especially in the rural areas, we will advance our current work on financial inclusion, including by providing financial literacy training and financial education in schools. We will also prepare to present our work developed by the financial inclusion taskforce in a public workshop by March 2013 (end-March 2013 benchmark).

C. Other Structural Reforms to Support the Private Sector and Other Issues

10. **It is the intention of our government to continuously improve the business climate by enacting appropriate business friendly policies and laws.** We believe that reforms to support private sector development are critical for inclusive growth. The conditionality under the successor arrangement will continue to be aligned with the development strategy (economic and financial reform matrix) developed under the Core Economic Working Group (CEWG)—a government-donor partnership. We are planning to submit to the IMF a revised National Development Strategy at the time of the second review of the prospective ECF, together with the sector strategies developed by the Ministry of Planning and Aid Coordination (MDPAC) and key development partners that will serve as the Poverty Reduction Strategy Paper.

11. **Safeguards assessment.** We agree to ensure the completion of the Safeguards Assessment update by the time of the first review under the successor ECF arrangement. The CBSI will provide Fund staff with all the necessary information for the update.

12. **Statistics**. Progress has been made in strengthening the quality of national accounts and related economic statistics and fiscal and monetary data for program purposes, but there

have been some delays in the timely release of national accounts and fiscal data. Delays in the provision of national accounts data have been, in part, attributable to the implementation of the Household Income and Expenditure Survey (HIES) 2012/13. The HIES will provide relevant data for policy and decision-making, in particular, in updating the weights of the current CPI, providing estimates for GDP, poverty and MDG indicators. However, we have recently filled two key positions within the Ministry of Finance and this should help us provide timely data to monitor our program with the IMF. We will continue to improve the quality of macroeconomic data by devoting more resources to the National Statistics Office through the hiring of additional permanent staff if resources become available. The CBSI would like to request a follow-up TA to support the ongoing Monetary and Financial Statistics Project.

Appendix I. Table 1 —Solomon Islands: Quantitative Performance Criteria (PC) and Indicative Targets (IT)

	12/31/2011		3/31/2012		6/30/2012			9/30/2012			12/31/2012	3/31/2013	6/30/2013	9/30/2013
	PC with adjustors	Act.	IT with adjustors	Act.	PC (CR/12/156)	PC with adjustors	Act.	IT (CR/12/156)	IT with adjustors	Act.	PC	IT	PC	IT
Performance criteria 1/														
Net international reserves (NIR) of the Central Bank of Solomon Islands (CBSI) (floor, end-of-period stock, in millions of U.S. dollars (US$)) 2/	341	390	346	423	421	424	454	428	428	473	470	475	480	485
Net domestic asset (NDA) of the CBSI (ceiling, end-of-period stock, in millions of Solomon Islands dollars (SI$)) 3/	-737	-1,118	-835	-1,290	-1,253	-1272	-1,309	-1,256	-1258	-1,425	-1,173	-1,122	-1,120	-1,102
Net credit to central government (NCG) (ceiling, cumulative change from the beginning of the year, in millions of SI$) 4/	-27	-561	62	-149	-28	-28	-266	-26	-26	-250	95	6	-33	-60
New nonconcessional external debt maturing in more than one year, contracted or guaranteed by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of US$) 5/	0	0	0	0	0	0	0	0	0	0	0	0	0	0
New nonconcessional external debt maturing in one year or less, contracted or guaranteed by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of US$) 5/	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Accumulation of new external payment arrears by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of SI$) 5/	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Central government program cash balance (floor, end-of-period stock, in million of SI$) 4/	254	522	232	402	342	321	391	392	372	337	425	440	420	383
Indicative Targets (cumulative)														
Government funded recurrent spending on health and education 6/	…	…	…	…	273	…	294	409	…	418	611	147	294	441
Memorandum items:														
32 percent of actual government funded recurrent spending	…	…	…	…	…	…	240	…	…	372	…	…	…	…
Budget support from bilateral and multilateral donors other than IMF (cumulative change from the beginning of the year, in millions of US$), program level.	…	46	…	9	38	…	40.6	47	…	47	61	11	26	44
Outstanding stock of Solomon Islands government (SIG) treasury bills, excluding restructured government bonds (end-of-period stock, in millions of SI$), program level.	…	38	…	40	60	…	39	60	…	40	40	40	40	40
Balance of SIG Consolidated Deposits Account, millions of SI$ 7/	…	60	…	140	140	…	140	140	…	140	140	140	140	140

1/ Evaluated at the program exchange rate.

2/ The adjustors are specified in the Technical Memorandum of Understanding (TMU) and include: the floor on NIR will be adjusted upward (downward) by the amount of budget support from bilateral and multilateral donors (excluding IMF) in excess (short) of the program level.

3/ The adjustors are specified in the TMU and include: the ceilings on NDA will be adjusted downward (upward) by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in excess (short) of the program level. Following the recommendations of the IMF Safeguards Assessment, the program targets starting from end-December 2010 incorporate the recommended changes in the measurement of reserve money. Such changes, however, are not applied in measuring the September 2010 NDA outcome to make it consistent with the September 2010 IT, which was set before the changes were made.

4/ The adjustors are specified in the TMU and include: the floor on central government program cash balance will be adjusted downward and the ceiling on NCG will be adjusted upward by the stock amount of budget support from bilateral and multilateral donors (excluding the IMF) short of the program level; the floor on the program cash balance will be adjusted upward (downward) by the stock of government treasury bills, excluding restructured government bonds, in excess (short) of the program level; the floor on the program cash balance will be adjusted upward by the balance in the SIG Consolidated Deposits Account short of the program level (this adjustor applies to end-June PC and end-September IT).

5/ These performance criteria are applicable on a continuous basis.

6/ An indicative target for spending on health and education at no less than 32 percent of government-funded recurrent spending.

7/ The SIG Consolidated Deposits Account functions like a contingency fund for the government and transfers to and from this account can affect the program cash balance. Negative deviations from the projected balance in this account will therefore be used to adjust the program cash balance targets upward. The balance in this account for end-2011 and end-March 2012 are reported for reference since the balance in this account has not been monitored previously as part of the program.

Appendix I. Table 2—Solomon Islands: Structural Benchmarks

Actions	Macroeconomic criticality	Date	Status
Current Standby Credit Facility Arrangement			
Obtain Cabinet's approval of draft amendment to the CBSI Act to strengthen the monetary policy and supervisory framework.	To strengthen the effectiveness of monetary policy.	March 31, 2012	Met in July. The CBSI draft bill 2012 was submitted to Cabinet on June 11 and was approved to be taken to Parliament at the next sitting
Complete the Honiara Club Agreement (HCA) review and reach agreements on amendments to the HCA.	To strengthen debt management and maintain public debt sustainability.	April 30, 2012	Met. The Debt Management Strategy (DMS), endorsed by Cabinet on May 10, supersedes the Honiara Club Agreement (HCA) review. The review is being completed by presenting the DMS bilaterally to HCA signatories and observers.
Obtain Cabinet's approval of the drafting instructions to revise the NPF Act incorporating the reform plan approved by the Cabinet to strengthen its governance structure and investment framework.	To improve the long-term financial viability of the NPF and reduce fiscal risks.	June 30, 2012	Met in July. The Drafting instructions for the NPF Act Review was submitted to Cabinet and was endorsed. The next step is to do consultation with key stakeholders which is expected to start no later than September 2012.
Revise the budget presentation from input line items to functional/output line items.	To strengthen the quality and monitoring of government spending.	September 30, 2012	Met. The revised presentation has been provided in the 2012 Budget approved in February 2012.
Discussion papers and draft legislation of the new Public Finance Act to be presented at a public workshop.	To strengthen budget management and ensure fiscal sustainability.	September 30, 2012	Met in August. The MoFT completed publishing all four PFA Act Review discussion papers on their website. On August 22, the discussion papers were presented at a public workshop.
Obtain Cabinet's approval of a draft amendment to income tax, customs and excise tax, and goods tax legislations related to the new mining tax regime in line with IMF TA recommendations.	To broaden the tax base and increase revenue transparency.	September 30, 2012	Not met, but in progress. This reform is taking longer than expected to allow a wider consultation process with different stakeholders and because of resource constraints at the legal drafting stage. The authorities plan to seek Cabinet approval of draft amendments to relevant tax legislation by end December 2012 (see below).
Submit to Cabinet the new Customs and Excise bill, including the clauses related to exemptions and the draft amendments to other revenue acts (income tax, stamp duties, goods and sales tax acts).	To promote fiscal transparency and enhance the efficiency of revenue collections.	October 31, 2012	Not met, but in progress. Given pressing resource constraints in the legal drafting, the authorities are now aiming to send to Cabinet the draft on the exemption bill by late November and submit to the cabinet the rest of legislation by December 2012 (see below).
Submit to Cabinet the draft of new Public Finance Act that covers fiscal responsibility provisions, management and use of public funds, and management of public debt.	To strengthen budget management and ensure fiscal sustainability.	November 15, 2012	On track. The authorities aim to submit to cabinet the draft legislation by mid-November.
Successor Arrangement			
Obtain Cabinet's approval of a draft amendment to income tax, customs and excise tax, and goods tax legislations related to the new mining tax regime in line with IMF TA recommendations.	To broaden the tax base and increase revenue transparency.	December 31, 2012	
Obtain Cabinet's approval to release the draft bill implementing the new Custom and Excise Act for public consultation including the clauses related to the exemptions and the draft amendments to the other revenue acts (income tax, stamp duties, goods and sales tax acts).	To promote fiscal transparency and enhance the efficiency of revenue collections.	December 31, 2012	
Submit to Parliament the final CBSI Act to strengthen the monetary policy and supervisory framework.	To strengthen the effectiveness of monetary policy.	December 31, 2012	
Submit to Parliament the multi-year budget framework on revenues and recurrent spending	To strengthen the quality and monitoring of government spending.	December 31, 2012	
Submit to Cabinet the instructions for SOE borrowing.	To strengthen debt management and maintain public debt sustainability.	March 31, 2013	
Workshop organized by the National Financial Inclusion taskforce taking stock of progress to date to better access financial services in rural areas.	Increase access to financial services ensure inclusive growth	March 31, 2013	
Submit to Parliament the revised NPF Act that strengthens its governance structure and investment framework.	To improve the long-term financial viability of the NPF and reduce fiscal risks.	October 31, 2013	
Submit to Parliament the draft of new Public Finance Act covers fiscal responsibility provisions, management and use of public funds, and management of public debt.	To promote fiscal transparency and enhance the efficiency of revenue collections.	October 31, 2013	
Submit to Parliament the new Customs and Excise bill, including the clauses related to exemptions and the draft amendments to other revenue acts (income tax, stamp duties, goods and sales tax acts).	To promote fiscal transparency and enhance the efficiency of revenue collections.	November 30, 2013	
Submit to Parliament draft amendment to income tax, customs and excise tax, and goods tax legislations related to the new mining tax regime in line with IMF TA recommendations.	To broaden the tax base and increase revenue transparency.	November 30, 2013	

APPENDIX I—ATTACHMENT II

SOLOMON ISLANDS: TECHNICAL MEMORANDUM OF UNDERSTANDING

1. The program will be monitored through quantitative performance criteria, indicative targets, structural benchmarks, and reviews. This memorandum sets out the definitions for quantitative performance criteria and indicative targets under which performance under the program will be assessed. Monitoring procedures and reporting requirements are also specified.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

2. Performance criteria for end-December 2012 and end-June 2013 and indicative targets for end-March 2013 have been established with respect to:

- Floors on the level of net international reserves (NIR) of the Central Bank of Solomon Islands (CBSI);
- Ceilings on the level of net domestic assets (NDA) of the CBSI;
- Ceilings on the level of net credit to the central government (NCG); and
- Floors on the central government cash balance.
- An indicative target (cumulative) for spending on health and education at no less than 32 percent of government-funded recurrent spending.

3. Performance criteria applicable on a continuous basis have been established with respect to:

- Ceilings on the contracting and guaranteeing by the public sector of new medium- and long-term nonconcessional external debt;
- Ceilings on the contracting and guaranteeing by the public sector of new short-term nonconcessional external debt; and
- Ceilings on accumulation of new external payment arrears by the public sector.

II. INSTITUTIONAL DEFINITIONS

4. The central government includes all units of budgetary central government and extra budgetary funds.

5. Depository corporations (DCs) include the CBSI and other depository corporations (ODCs). ODCs include commercial banks, the Credit Corporation of Solomon Islands, and credit unions. Financial corporations include DCs and other financial corporations (OFCs). OFCs are the National Provident Fund (NPF), the Development Bank of Solomon Islands, and the Investment Corporation of Solomon Islands.

III. MONETARY AGGREGATES

6. **Valuation.** Foreign currency-denominated accounts will be valued in Solomon Islands dollar (SI$) at the program exchange rate of SI$7.36 per U.S. dollar, as of end-June 2012. Foreign currency accounts denominated in currencies other than the U.S. dollar and monetary gold will first be valued in U.S. dollars at actual exchange rates and gold prices used by the CBSI, respectively, before they are converted to Solomon Islands dollars.

A. Reserve Money

7. Reserve money consists of currency issued by the CBSI (excluding CBSI holdings of currency) and all transferable deposits held at the CBSI.

B. Net International Reserves of the CBSI

8. A floor applies to the level of NIR of the CBSI. The floor on NIR will be adjusted upward (downward) by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in excess (short) of the programmed level.

9. NIR will be calculated as gross international reserves (GIR) less international reserve liabilities. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the CBSI, as reported in Solomon Islands dollars, shall be valued at program exchange rate in U.S. dollars, as described on paragraph 6.

10. GIR of the CBSI are defined as the sum of:

- Foreign currency assets in convertible currencies held abroad and as vault cash that are under the direct and effective control of the CBSI and readily available for intervention in the foreign exchange market or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution.
- The reserve position of the Solomon Islands in the IMF;
- Holding of SDRs; and
- Monetary gold.

Excluded from the definition of GIR are:

- Foreign currency deposits of ODCs and OFCs held at the CBSI;
- Any foreign currency claims on residents, capital subscriptions in international institutions, and foreign currency assets in nonconvertible currencies, and;
- GIR that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities.

11. International reserve liabilities of the CBSI are defined as the sum of:

- All outstanding liabilities of the Solomon Islands to the IMF, excluding IMF SDR allocations; and

- Foreign currency liabilities in convertible currencies to nonresidents with an original maturity of up to and including one year.

C. Net Domestic Assets of the CBSI

12. A ceiling applies to the level of NDA of the CBSI. The ceiling on NDA will be adjusted downward (upward) by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in excess (short) of the programmed level.

13. NDA of the CBSI will be calculated as the difference between reserve money and the sum of NIR of the CBSI and other NFA of the CBSI. Any revisions to the historical stock of reserve money based on changes to the accounting treatment of the profit/loss account of the CBSI will be notified to the Fund immediately and used to adjust monetary aggregates by an equivalent amount, as deemed appropriate. Other NFA of the CBSI includes:

- Foreign assets related to holdings of foreign currency deposits, and securities not included in NIR of the CBSI, and loans, shares, financial derivatives, or accounts receivable with nonresidents; and other foreign assets that are not included in NIR of the CBSI, as defined in Section III. B; and

- Foreign liabilities related to IMF SDR allocations; deposits, securities, loans, financial derivatives, and other accounts payable with nonresidents; and other foreign liabilities that are not included in NIR of the CBSI, as defined in Section III. B.

D. Net Credit to the Central Government

14. A ceiling applies to the NCG measured cumulatively from the beginning of the year. The ceiling on NCG will be adjusted upward by the amount of budget support from bilateral and multilateral donors (excluding the IMF) short of the programmed level.

15. NCG is defined as the sum of net claims of: (i) the CBSI, (ii) commercial banks and other ODCs, (iii) OFCs, (iv) insurance companies, (v) and government treasury bills held by the general public.

IV. Fiscal Aggregates

D. Cash Balance of the Central Government

16. A floor applies to the program cash balance of the central government. The floor on the program cash balance will be adjusted downward by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in short of the programmed level. The

floor on the program cash balance will also be adjusted upward (downward) by the stock of government treasury bills, excluding restructured government bonds, in excess (short) of the program level of SI$40 million. The floor on the program cash balance will be adjusted upward by the difference between SI$140 million (hereafter known as program level) in the SIG Consolidated Deposits Account and its actual balance, should the actual balance in the SIG Consolidated Deposits Account be lower than SI$140 million.

17. The program cash balance of the central government is defined as the gross cash balance minus the total amount of unpaid payment orders and unpresented checks.

18. The gross cash balance is defined as the sum of government deposits, which are not in any way encumbered or pledged as collateral or used as a guarantee against government incurred liabilities, in the following accounts:

- In CBSI: Solomon Islands Government (SIG) Revenue Account, SIG Funded Development Account, SIG Debt Servicing Account;
- In Australia New Zealand Bank: SIG Creditors Account; Payroll Imprest Account, and Airport Service Fees Account;
- In Bank of South Pacific: Provincial Revenue Holding Account, SIG Inland Revenue Account, Sub Treasury Gizo Account, and Sub Treasury Auki Account; and
- Donor funded budget support accounts that are created by and under control of the government.

V. External Debt

A. Medium- and Long-Term External Debt

19. A ceiling applies to the contracting and guaranteeing by the public sector of new nonconcessional borrowing with nonresidents with original maturities of more than one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitutes a contingent liability of the public sector. The public sector comprises the central government, the CBSI, nonfinancial public enterprises (i.e., enterprises in which the government owns more than 50 percent of the shares), and other official entities.

20. The definition of debt, for the purposes of the program, is set out in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangement Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009 (see Annex I).

21. Excluded from the ceiling are (i) the use of Fund resources; (ii) lending from the World Bank and the Asian Development Bank; (iii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than

the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt; (iv) concessional debts; (v) any SI$-denominated treasury bill and bond holdings and Bokolo bonds held by nonresidents.

22. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the central government, the CBSI, nonfinancial public enterprises, or other official entities on behalf of the central government or the CBSI to service debt in the event of nonpayment by the main obligor (involving payments in cash or in kind).

23. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The NPV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the Organization for Economic Cooperation Development (OECD). For debt with a maturity of at least 15 years, the 10-year-average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the 6-month average CIRR will be used. To both the 10-year and 6-month averages, the same margins for differing repayment periods as those used by the OECD would continue to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

B. Short-Term External Debt

24. A ceiling applies to the contracting and guaranteeing by the public sector of new nonconcessional borrowing with nonresidents with original maturities of up to and including one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector. The public sector comprises the central government, the CBSI, nonfinancial public enterprises (i.e., enterprises in which the government owns more than 50 percent of the shares), and other official entities.

25. For program purposes, the definition of debt is set out in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangement approved by the Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009 (see Annex I).

26. Excluded from the ceiling are (i) debts classified as international reserve liabilities of the CBSI; (ii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt; (iii) SI$-denominated treasury bills and bonds and CBSI and Bokolo bills held by nonresidents; (iv) concessional debts; and (v) normal import financing. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

VI. External Payment Arrears

27. A continuous performance criterion applies to the non-accumulation of external payments arrears by the public sector, comprising the central government, the CBSI, nonfinancial public enterprises, and other official entities. External payments arrears consist of external debt-service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreement, subject to any applicable grace period.

VII. Data Provision

28. The data listed below will be provided for monitoring performance under the program based on data templates agreed with Fund staff. Under each section, reporting responsibilities are indicated in parentheses. Weekly data are requested for submission to Fund staff by the end of the following week. Monthly and quarterly data are requested for submission within six weeks of the end of the observation period. The authorities have committed to using the best available data, so that any subsequent data revisions will not lead to a breach of quantitative performance criteria or benchmarks. All revisions to data will be promptly reported to Fund staff.

A. Monetary Data (CBSI)

On a weekly basis:

- Daily exchange rates, both buying and selling rates, of the Solomon Islands dollar against the U.S. dollar, including the official, interbank, and parallel market exchange rates;
- Stock of NIR and sales and purchases by the CBSI in the foreign exchange markets;
- Stock of reserve money and its components; and
- Treasury bill auction reports.

On a monthly basis:

- Financial corporations' survey, including the balance sheet of CBSI, the consolidated balance sheet of ODCs, and the consolidated balance sheet of OFCs;
- Liquid asset ratios and/or reserves requirement of the commercial banks;
- Interest rates, including average interbank rate, bank deposit rates, and bank lending rates;
- A detailed breakdown of NCG from the CBSI, commercial banks and other ODCs, and OFCs;
- Foreign exchange cash-flow of the CBSI, including donor disbursements; and
- Balances of each central government account specified in Section IV. A., as recorded or collected by the CBSI.

B. Fiscal Data (Ministry of Finance and Treasury (MoFT)

On a monthly basis:

- Consolidated accounts of the central government, including detailed data on:
    - Revenue, including tax and nontax revenues, and recurrent and development grants included in the consolidated budget;
    - Recurrent expenditure, including payroll, goods and services, and other recurrent outlays, including those funded by donor support;
    - Other recurrent charges of the Ministry of Education and Ministry of Health, separating spending funded by donor support;

- o Debt service payments, classified into amortization and interest payments on (i) domestic debt, (i) external debt, (iii) domestic arrears, and (iv) external arrears; and

- o Development expenditure funded by (i) central government of the Solomon Islands, and (ii) foreign grants and loans included in the consolidated budget.

- Detailed financing components of central government's accounts, classified into foreign and domestic sources.

  - o Foreign financing includes (i) disbursement and amortization of project and program loans, and (ii) changes in external debt arrears, classified into principal and interest arrears.

  - o Domestic financing includes (i) borrowing from and repayment to the CBSI, commercial banks and other ODCs, and OFCs; (ii) changes in deposits at the CBSI, commercial banks and other ODCs, and OFCs; and (iii) privatization receipts and changes in domestic debt arrears, classified into principal and interest arrears.

- Stock of domestic debt, including the outstanding balance of government securities, treasury bills, cash advances, and other debt instruments.

- Balances of each central government account specified in Section IV. A., as recorded by the MoFT.

- Stock of unpaid government payment orders and unpresented checks.

C. External Sector Data (CBSI and MoFT)

On a quarterly basis:

- New external debt obligations contracted and/or guaranteed by the government of the Solomon Islands, CBSI, and other official entities, including details on the amounts, terms, and conditions of each obligation.

- Stock of outstanding external debt at end-month and disbursement, amortization, and interest payments for short-term external obligations contracted or guaranteed by the government or the CBSI by creditor in original currency and U.S. dollars.

- Stock of external debt at end-month and disbursement, amortization, and interest payments for medium- and long-term external obligations contracted or guaranteed by the government or the CBSI by creditor in original currency and U.S. dollars.

- Stock of arrears on the external debt contracted or guaranteed by the government or the CBSI by creditor in original currency and in U.S. dollars at end-month.

On a quarterly basis:

- Balance of payment data, including detailed components of current accounts and capital and financial accounts.

D. Real Sector Data (MoFT, National Statistical Office)

On a monthly basis:

- The monthly consumer price index and a detailed breakdown by major categories of goods and services included in the consumer basket.

ANNEX I. GUIDELINES ON PERFORMANCE CRITERIA WITH RESPECT TO FOREIGN DEBT

Excerpt from Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009

9. (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

Joint IMF/World Bank Debt Sustainability Analysis[1]

Prepared by Staffs of the International Monetary Fund and World Bank
Approved by Hoe Ee Khor and Masato Miyazaki (IMF)
and Jeffrey D. Lewis and Sudhir Shetty (World Bank)

November 14, 2012

Solomon Islands continues to face a moderate risk of external debt distress according to this debt sustainability analysis. The debt profile is sensitive to adverse shocks to non-debt-creating flows and financing terms. Containing the risk of debt distress will require continued efforts to rebuild fiscal buffers, strengthen the budgetary process to improve fiscal discipline and the quality of spending, and implement structural reforms that are essential for promoting broad-based growth. Debt management will need to be strengthened in light of the resumption of external borrowing.

I. BACKGROUND

1. **Solomon Islands is a small commodity exporter heavily reliant on imports, foreign aid, and foreign direct investment–and vulnerable to external shocks.** The country's export and production bases are narrow and include mainly logs, more recently gold, and a few agricultural products. The country is thus vulnerable to both external demand and commodity price volatility. It also relies heavily on foreign aid and FDI to finance its structural trade deficit and large development needs.

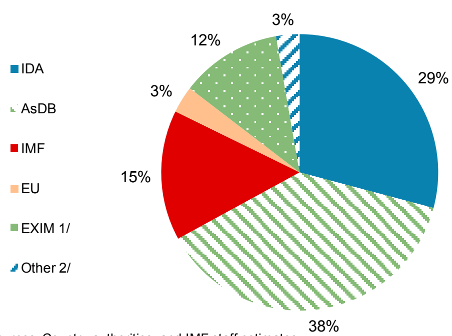
2. **Macroeconomic conditions have improved over the last two years but the fiscal position has weakened recently.** After rebounding from the 2009 recession, economic growth in Solomon Islands has moderated from the rapid pace of 2010–11. Logging has surprised on the upside so far in 2012, but gold production is somewhat lower than initially projected. The fiscal position has weakened in the first three quarters of 2012 relative to the

[1] This DSA was produced in consultation with the Asian Development Bank (AsDB). It is based on the common standard LIC DSA framework. Under the Country Policy and Institutional Assessment (CPIA), Solomon Islands is rated a weak performer, and the DSA uses the indicative threshold indicators on the external public debt for countries in this category: 30 percent for the present value (PV) of the debt-to-GDP ratio; 100 percent for the PV of the debt-to-export ratio; 200 percent for the PV of the debt-to-revenue ratio; 15 percent for the debt-service-to-exports ratio; and 18 percent for the debt-service-to-revenue ratio. In Solomon Islands, the fiscal year begins on January 1. This DSA covers central government debt, and includes a discussion of contingent liabilities associated with debts of state-owned enterprises.

strengthening in 2011. The weakening fiscal position reflects revenue shortfalls relative to the 2012 budget and higher recurrent spending associated with the recent Festival of Pacific Arts, as well as higher spending on tertiary education and utility bills.

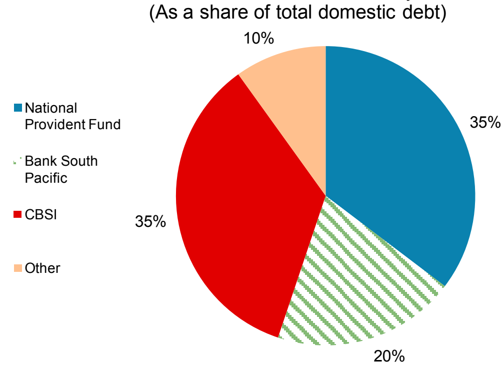
3. **Nonetheless, fiscal buffers have been rebuilt.** Total public debt fell to about 22 percent of GDP at the end of 2011 from some 60 percent in 2005 under the framework of the Honiara Club Agreement (HCA).[2,3] At the end of 2011, domestic public debt, including the contingent liabilities associated with the debt of state-owned enterprises (SOEs)—which amounted to 1½ percent of GDP—was about 6¾ percent of GDP, approximately one third of total public debt; it was owed mainly to the banking sector (including the Central Bank of Solomon Islands) and the National Provident Fund. Total external debt has declined to about 25 percent of GDP as of end-2011 from some 50 percent of GDP in 2005, with public and publicly-guaranteed (PPG) external debt accounting for about 15 percent of GDP. The composition of the external PPG debt and of the domestic debt by creditor is reported in the text charts.

Solomon Islands: External Public and Publicly Guaranteed (PPG) Debt by Creditor (as a share of total external PPG debt)



Sources: Country authorities; and IMF staff estimates.
1/ Taiwan Province of China.
2/ Includes Kuwait, IFAD, and International Cooperation Development Fund-Tawain Province of China.

Solomon Islands: Domestic Debt by Creditor (As a share of total domestic debt)



Sources: Country authorities; and IMF staff estimates.

4. **The cabinet endorsed the Debt Management Strategy (DMS) in May, providing a framework to anchor borrowing plans going forward**. The HCA was amended in July to allow external borrowing to resume. Under the DMS, the government will set a yearly borrowing limit[4] once the results of the DSA exercise prepared by the Debt Unit at the Ministry of Finance and Treasury (MOFT) become available. Setting the debt limit will be part of the budgetary process. The debt limit will cover external borrowing by the

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[2] At the central government level only.

[3] External borrowing has been restricted since 2005 under the Honiara Club Agreement (HCA) signed by the government and its major creditors. Under this agreement, Solomon Islands could not borrow from official external lenders until it received a "green light" rating from the World Bank's International Development Association.

[4] For 2012, the limit was set at SI$150 million (2 percent of GDP). This is broadly in line with staff assumptions. So far in 2012, only one SOE (Solomon Airlines) contracted domestic debt of SI$32 million. No additional borrowing is expected until the end of this year.

government and all forms of SOE borrowing and guarantees (both domestic and external). The government is expected to resume access to external concessional financing in 2013 (Box 1).

5. **The assumptions and results behind the current DSA are broadly in line with the 2011 DSA (Box 1)**. While the 2011 outturn and the 2012 projections are more favorable than envisioned in November 2011, growth projections for the medium and long term have been reduced given the uncertain global outlook (for the medium term from an average of 5.1 percent to 4 percent; for long term from 3.6 percent to 3 percent). While logging production is expected to decline at a lower rate in the medium term than the one assumed in the 2011 DSA (7 percent decline relative to 20 percent decline each year), gold production is forecast to be some 20 percent lower than in 2011 DSA. Aid flows have been lowered by1 percent in medium and long term, and FDI inflows are two percent lower. This is compensated by a more favorable path of the current account and primary balances. In 2011, the current account deficit and the primary government surplus surprised on the upside, owing to higher-than-expected commodity prices and revisions in historical data on service imports. Over the medium term, the current account is expected to improve relative to the 2011 DSA by 2-3 percentage points, mainly reflecting higher-than-expected logging estimates attributable to a slower rate of depletion of forest stocks. Primary surplus has been revised down by 1 percent for the medium term, while the long-term deficit improved by 0.8 percentage point. Debt levels are expected to decline over the medium term under the baseline scenario, despite the resumption of external borrowing, owing to lower-than-expected new borrowing during 2012-14. This DSA envisages a more conservative borrowing path (1½ percent of GDP annually) over the next five year, consistent with the prudent borrowing policy, relative to the 2 ½ percent of GDP annually in the 2011 DSA. As a result, the debt rating remains unchanged.

6. **Looking forward, Solomon Islands will need to maintain fiscal buffers, exercise caution in borrowing, and diversify the sources of growth.** Despite the projected decline of log production over the medium term and the weakening global outlook, the country has relatively favorable medium- and long-term prospects. Similar to the DSA issued in November 2011, this DSA also envisages a still favorable outlook. The favorable prospects depend on a healthy fiscal balance and strong aid inflows from donors; cautious external borrowing to finance much-needed infrastructure; and the expectation that the Gold Ridge mine will contribute an average of about 35 percent of export earnings over the next decade.

II. External and Public Debt Sustainability Analysis

A. External Debt Sustainability Analysis

7. **The external DSA indicates that Solomon Islands faces a moderate risk of debt distress.** Under the baseline scenario (Table 1a), total external debt is projected to decline to about 22 percent of GDP in 2012, and further next year, with foreign aid and FDI expected to finance most of the trade and services deficit. Further declines in 2013–15 would result from scheduled repayment of external debt more than offsetting new external borrowing. Total

Box 1. Macroeconomic Assumptions under the Baseline Scenario

- **GDP growth.** After rebounding from the 2009 recession to achieve 8 percent growth in 2010, and nearly 11 percent in 2011, growth is expected to slow to a still-strong 5½ percent this year. Growth is projected to moderate to 4 percent over the near and medium term, with gold production, together with services, remaining the main driver of expansion and logging activity declining over the medium term—consistent with the projections of the Ministry of Finance and Treasury (MOFT). Over the longer term, growth is expected to fall further to 3 percent, reflecting the impact of the closing of the Gold Ridge mine more than offsetting the positive impact of expanding service sectors. Population is projected to grow by 2.2 percent annually over the medium to long term.
- **Logging and mining.** After peaking in 2011, log production is expected to decline by about 7 percent each year until 2018 after which it will remain stable. Consistent with MOFT projections, gold output is projected at 80,000 ounces in 2012 and 95,000 ounces during 2013–20. It will then gradually wind down by 2023.
- **Aid flows and FDI**. Aid flows continued to be strong in 2012, led by large grant disbursements catalyzed by the SCF-supported program. After peaking in 2010 at 25 percent of GDP, aid flows are expected to average about 20 percent over the medium term and to decline gradually to their historic average of about 12 percent by 2031. This reflects the gradual scaling-down of the operations of the Regional Assistance Mission to Solomon Islands (RAMSI), and the economy becoming less reliant on aid. As the Gold Ridge mine is now operational, FDI is projected to decrease from its peak of 35 percent of GDP in 2010 to about 8 percent over the medium term. It will then stabilize at about 5 percent over the longer term, with the resumption in external borrowing making up the difference in financing the current account deficit.
- **External borrowing.** With the revision in the Honiara Club Agreement (HCA), the government is expected to resume access to external concessional financing. New loan disbursements are expected to begin in 2013, with an initial disbursement from the AsDB of US$4.2 million in 2013 and a second disbursement of US$7.3 million in 2014—to finance the undersea fiber optic cable. The private sector is expected to borrow an additional US$13 million in 2013 from the Private Sector Operations Department of the AsDB to finance the cable. Concessional borrowing is projected to average about 1½ percent of GDP annually over the next five years and about 2½ percent over the longer term.
- **Fiscal outlook.** The primary balance is expected to generate a surplus averaging about 1 percent of GDP over the medium term, driven by mining and log revenues. Over the longer term, however, the balance is expected to shift into a deficit of about ½ percent of GDP. This shift is attributable to the projected fall in grants, and logging and mining revenues while additional external borrowing will partially replace grant-funded development expenditure. Revenue (excluding grants) is forecast at about 30 percent of GDP over the longer term, reflecting continued efforts to increase the non-commodity tax base and to strengthen tax administration and enforcement.
- **The non-interest current account deficit** is projected to be about 5 percent of GDP in 2012, and to widen to about 9 percent in the next two years, owing mainly to the drop in log exports more than offsetting the rise in gold exports. The shortfall is likely to stay at this level over the medium and long term, because reduced repatriation of gold mine profits (in the income balance) and fuel imports (a major input of gold production), together with a more diversified exports base would roughly offset the decline in gold exports.

external debt is projected to gradually increase starting in 2016, reaching just over 30 percent of GDP over the longer term. Similarly, PPG external debt is projected to fall to 13 percent in 2012 and to rise moderately to about 26 percent of GDP over the longer term. Other key indicators of sustainability—the present value (PV) of PPG external debt, the ratio of PPG debt service to exports and the ratio of PPG debt service to revenue—all remain well below the indicative thresholds (Figure 1).[5]

8. **Sensitivity analysis suggests that Solomon Islands' debt path is vulnerable to several shocks, in particular, a shock to net non-debt-creating flows (Table 1b, and Figure 1).** A shock to non-debt-creating flows is defined as a lower share of net current transfers and net FDI of GDP in 2013–14 at one standard deviation less than the historical average.[6] Such a shock would keep the PV of PPG external-debt-to-GDP ratio above the threshold for 19 years before it begins to decline. The PV of PPG external debt to exports would also breach the threshold during the years approximating the scheduled closure of the Gold Ridge mine. Debt-service-to-revenue/exports ratios would jump around 2022–23 as the grace period of new borrowing is 8 years.

9. **A permanent shock to financing terms would also lead to a breach of thresholds (Table 1b).** A permanent shock to financing terms is defined as an interest rate that is 2 percentage points higher during 2012–32 than in the baseline scenario. Such a shock would keep the PV of PPG external-debt-to-export ratio above the threshold starting from 2032. A shock to nominal export growth no longer causes a breach of thresholds, as it did in the 2011 DSA. The change in the historical reference period results in the historical (10-year) average of growth of exports of 24.5 percent and the standard deviation of the growth of exports of 22.3 percent, implying a growth rate of 2 percent in 2013–14 under the stress test, compared with a contraction of 10 percent in the 2011 DSA.

B. Public Debt Sustainability Analysis

10. **Public debt analysis paints a similar picture.** In addition to PPG external debt, public debt includes the central government's contingent liabilities of 1½ percent of GDP, of which 1 percent of GDP represents guaranteed loans for SOEs as of end-2011. Under the baseline scenario (Table 2a), the PV of total public debt will decline further to about 12 percent of GDP over the medium term. Over the longer term, it is projected to increase to about 22 percent, driven by external borrowing after the completion of the HCA review.

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[5] The negative residuals in Table 1a reflect the fact that part of the current account deficit is being financed through the aid in kind for capital projects from donors. These inflows are reflected in capital account but are not captured in the identified net debt-creating flows, which only correct for FDI inflows. The positive residuals in Table 2a reflect the assumption that the large mineral revenue expected in coming years will be saved in a special fund to support health, education, and infrastructure.

[6] The historical (10-year) averages of foreign aid and FDI are 13½ percent GDP and 12 percent of GDP, respectively, while the standard deviations of these flows are 9.9 percent GDP and 12.6 percent of GDP, respectively. The template does not capture the decline in imports that the shock may induce.

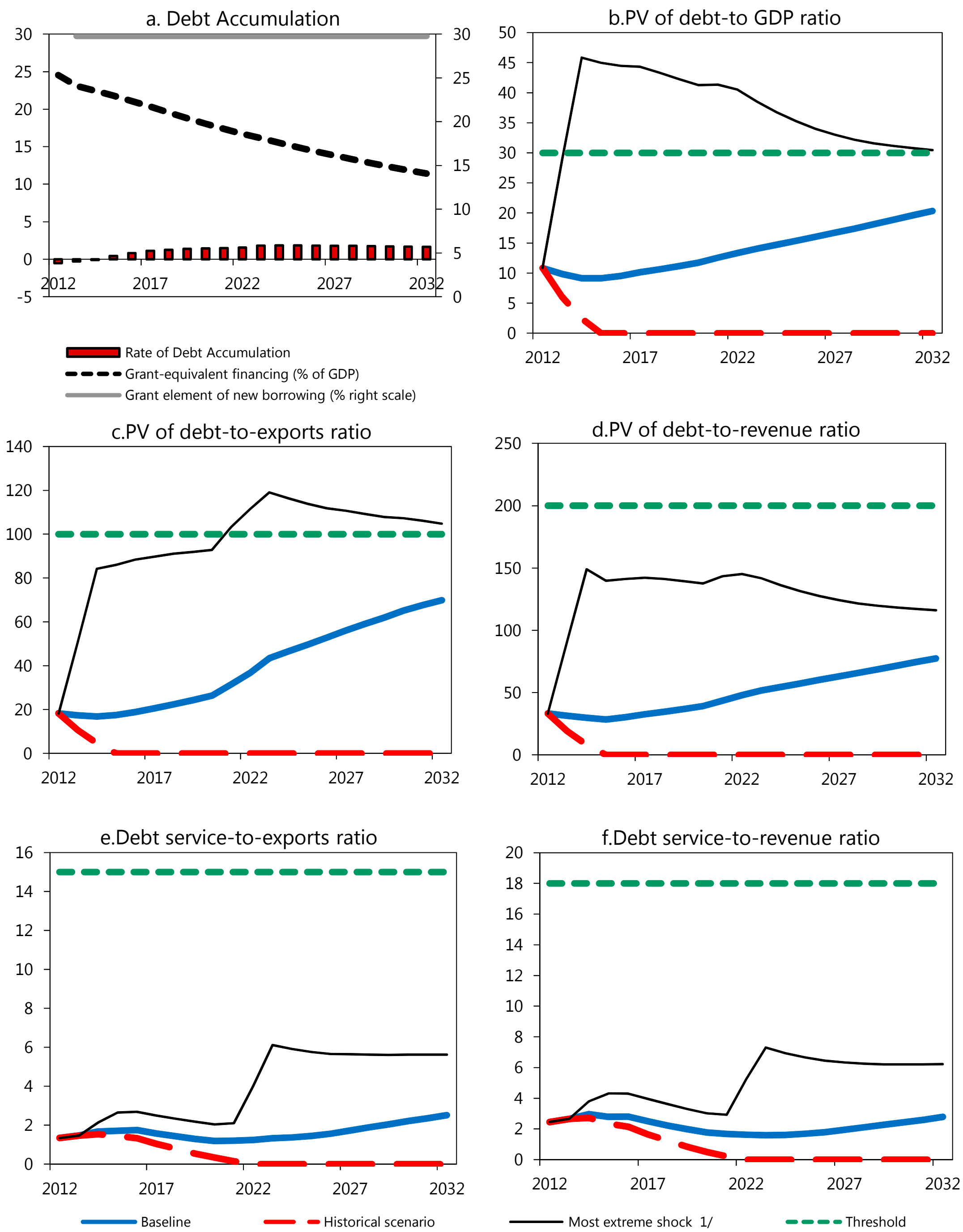
Public debt sustainability is vulnerable to shocks as well. Under the most extreme stress test scenario—permanently lower real GDP growth—the PV of debt reaches about 30 percent of GDP by 2022 and surges to more than 70 percent of GDP by 2032 (Table 2b and Figure 2).

III. POLICY IMPLICATIONS AND CONCLUSIONS

11. **With Solomon Islands facing moderate risk of debt distress, it must maintain public and external debt at sustainable levels with actions on multiple fronts**. First, efforts to rebuild fiscal buffers and create fiscal space will need to continue, especially in light of the uncertainties surrounding the external environment. Second, an acceleration of structural reforms (such as a new resource tax regime and new mining legislation) will help maximize the spillovers from the commodity sectors to non-commodity sectors, boost investors' confidence, and promote sustainable growth. These reforms would also help strengthen the outlook for exports, thereby reducing the vulnerability to external shocks. Third, strengthening and deepening ongoing reforms in both budget formulation and execution, including greater attention to the medium-term fiscal consequences of current policy choices will improve fiscal discipline and the quality of spending. And, finally caution would need to be exercised in contracting new borrowing, especially by the SOEs.

12. **The authorities have broadly agreed with this assessment**. They are fully committed to strengthening the fiscal framework and public management by continuing to reform the Public Finance Act (PFA) and implementing a multi-year budget framework. Supported by the low-access ECF, they will also implement a new resource taxation regime to ensure that the government receives its fair share of mining revenue and will reform the mining legislation to provide a predictable investment regime to attract foreign investment. The authorities will strengthen debt management capacity by developing instructions for SOE borrowing and by including them in the DMS; identifying the outstanding debt of SOEs; developing an on-lending policy framework; and designing a framework to estimate the cost of guarantees.

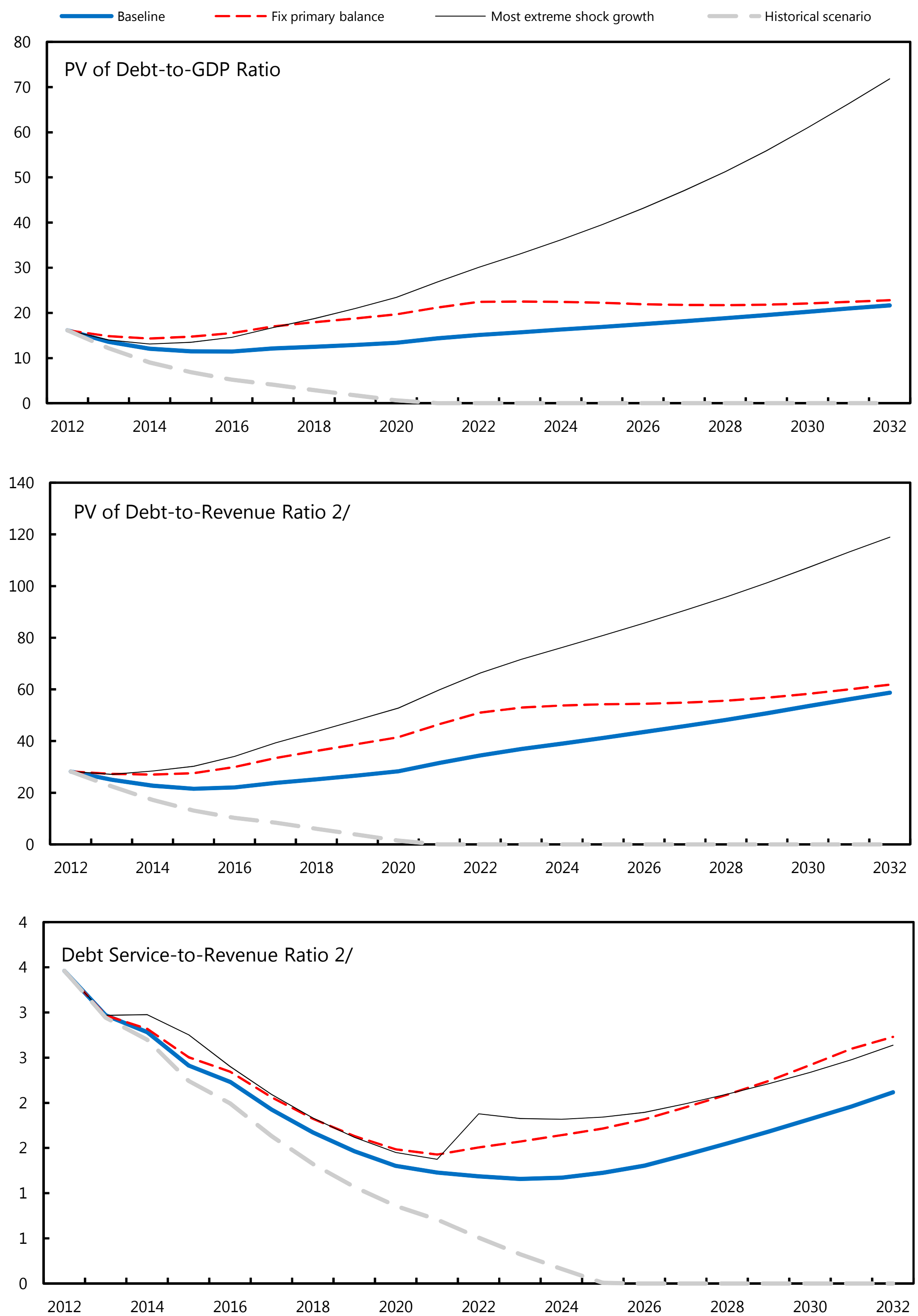
Figure 1. Solomon Islands: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2012-32 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022. In all figures, it corresponds to a non-debt flows shock.

Figure 2. Solomon Islands: Indicators of Public Debt Under Alternative Scenarios, 2012-32 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022.

2/ Revenues are defined inclusive of grants.

Table 1a.: External Debt Sustainability Framework, Baseline Scenario, 2009-2032 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-2017 Average	2022	2032	2018-2032 Average
External debt (nominal) 1/	**32.4**	**31.9**	**25.1**			**21.7**	**21.3**	**20.0**	**19.7**	**19.9**	**20.5**		**23.3**	**30.2**	
of which: public and publicly guaranteed (PPG)	23.2	19.8	15.2			12.9	11.7	11.0	11.2	11.9	13.0		17.7	26.5	
private	9.2	12.2	9.9			8.8	9.6	9.0	8.5	8.0	7.5		5.7	3.7	
Change in external debt	0.3	-0.5	-6.8			-3.4	-0.4	-1.3	-0.3	0.2	0.6		0.8	0.7	
Identified net debt-creating flows	2.5	-7.7	-30.6			-7.0	1.3	0.2	1.0	2.0	1.8		4.6	3.4	
Non-interest current account deficit	**20.7**	**30.2**	**5.4**	**8.2**	**14.1**	**5.2**	**10.0**	**8.2**	**9.0**	**9.3**	**9.3**		**9.3**	**9.3**	8.8
Deficit in balance of goods and services	18.3	31.9	5.5			6.5	12.4	9.2	11.1	13.8	15.5		19.2	18.9	
Exports	39.3	48.4	64.1			59.6	56.9	54.4	52.3	50.3	49.4		36.4	29.1	
Imports	57.6	80.3	69.5			66.1	69.3	63.6	63.4	64.1	64.9		55.6	48.0	
Net current transfers (negative = inflow)	-24.5	-26.5	-19.9	-13.5	9.9	-22.7	-21.5	-21.0	-20.3	-19.7	-19.1		-16.3	-12.2	-15.0
of which: official	-20.3	-24.8	-18.9			-21.7	-19.6	-18.9	-18.2	-17.5	-16.8		-13.7	-9.1	
Other current account flows (negative = net inflow)	27.0	24.8	19.8			21.4	19.2	19.9	18.2	15.2	12.8		6.4	2.5	
Net FDI (negative = inflow)	**-19.5**	**-34.6**	**-29.7**	**-11.9**	**12.6**	**-11.5**	**-8.5**	**-7.8**	**-7.8**	**-7.2**	**-7.3**		**-4.6**	**-5.4**	-5.4
Endogenous debt dynamics 2/	**1.3**	**-3.3**	**-6.2**			**-0.6**	**-0.3**	**-0.2**	**-0.2**	**-0.1**	**-0.2**		**0.0**	**-0.4**	
Contribution from nominal interest rate	0.8	0.7	0.7			0.6	0.5	0.6	0.5	0.5	0.5		0.4	0.4	
Contribution from real GDP growth	1.5	-2.2	-2.7			-1.2	-0.8	-0.8	-0.7	-0.7	-0.7		-0.4	-0.9	
Contribution from price and exchange rate changes	-1.0	-1.8	-4.2			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-2.2**	**7.2**	**23.7**			**3.6**	**-1.7**	**-1.4**	**-1.4**	**-1.8**	**-1.2**		**-3.8**	**-2.7**	
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/	...	...	22.6			19.7	19.4	18.2	17.6	17.5	17.6		19.0	24.0	
In percent of exports	...	...	35.2			33.0	34.2	33.5	33.8	34.7	35.7		52.3	82.5	
PV of PPG external debt	**...**	**...**	**12.7**			**10.9**	**9.9**	**9.2**	**9.2**	**9.5**	**10.1**		**13.4**	**20.3**	
In percent of exports	**...**	**...**	**19.8**			**18.2**	**17.4**	**16.9**	**17.5**	**18.9**	**20.5**		**36.7**	**69.9**	
In percent of government revenues	**...**	**...**	**38.3**			**33.2**	**31.4**	**29.8**	**28.4**	**30.2**	**32.5**		**47.9**	**77.4**	
Debt service-to-exports ratio (in percent)	**5.9**	**4.7**	**2.5**			**2.6**	**2.7**	**3.4**	**3.7**	**3.7**	**3.5**		**2.7**	**3.7**	
PPG debt service-to-exports ratio (in percent)	**3.6**	**3.0**	**1.2**			**1.3**	**1.5**	**1.7**	**1.7**	**1.8**	**1.6**		**1.2**	**2.5**	
PPG debt service-to-revenue ratio (in percent)	**4.6**	**4.5**	**2.4**			**2.5**	**2.7**	**3.0**	**2.8**	**2.8**	**2.5**		**1.6**	**2.8**	
Total gross financing need (Billions of U.S. dollars)	0.0	0.0	-0.2			0.0	0.0	0.0	0.0	0.1	0.0		0.1	0.2	
Non-interest current account deficit that stabilizes debt ratio	20.4	30.7	12.2			8.6	10.5	9.4	9.4	9.1	8.7		8.5	8.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	-4.7	7.8	10.7	5.6	5.5	5.5	4.0	3.8	3.7	3.6	3.6	4.0	2.0	3.1	3.0
GDP deflator in US dollar terms (change in percent)	3.2	5.8	15.1	3.3	8.2	10.2	4.5	2.4	1.2	1.4	1.3	3.5	4.0	1.8	3.5
Effective interest rate (percent) 5/	2.3	2.3	2.6	2.3	0.5	2.6	2.7	2.8	2.9	2.8	2.7	2.7	2.1	1.6	1.9
Growth of exports of G&S (US dollar terms, in percent)	-12.9	40.6	68.5	24.5	22.3	8.1	3.8	1.7	0.8	1.1	3.1	3.1	-3.7	5.1	3.0
Growth of imports of G&S (US dollar terms, in percent)	-15.8	59.2	10.3	22.0	30.8	10.5	14.0	-2.4	4.6	6.2	6.2	6.5	2.5	6.0	4.5
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	0.0	29.8	29.8	29.8	29.8	29.8	24.8	29.8	29.8	29.8
Government revenues (excluding grants, in percent of GDP)	30.5	32.0	33.1			32.7	31.5	30.8	32.2	31.5	31.2		27.9	26.2	27.6
Aid flows (in Billions of US dollars) 7/	0.3	0.3	0.4			0.2	0.3	0.3	0.3	0.3	0.3		0.3	0.4	
of which: Grants	0.1	0.2	0.2			0.2	0.3	0.3	0.3	0.3	0.3		0.3	0.4	
of which: Concessional loans	0.1	0.1	0.1			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			24.5	23.1	22.5	21.8	21.1	20.3		16.7	11.4	15.1
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			100.0	98.9	97.7	95.4	93.8	92.8		91.4	86.7	89.6
Memorandum items:															
Nominal GDP (Billions of US dollars)	0.6	0.7	0.9			1.0	1.1	1.2	1.2	1.3	1.4		1.9	3.6	
Nominal dollar GDP growth	-1.7	14.1	27.4			16.2	8.8	6.3	4.9	5.0	5.0	7.7	6.0	4.9	6.7
PV of PPG external debt (in Billions of US dollars)			0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.2	0.7	
(PVt-PVt-1)/GDPt-1 (in percent)						-0.5	-0.3	-0.1	0.4	0.8	1.1	0.2	1.6	1.7	1.7
Gross workers' remittances (Billions of US dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	12.7			10.9	9.9	9.2	9.2	9.5	10.1		13.4	20.3	
PV of PPG external debt (in percent of exports + remittances)	...	...	19.8			18.2	17.4	16.9	17.5	18.9	20.5		36.7	69.9	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	1.2			1.3	1.5	1.7	1.7	1.8	1.6		1.2	2.5	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

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 generally derived over the past 10 years, subject to data availability.

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

8/ 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, 2012-2032
(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	**2022**	2032
PV of debt-to GDP ratio								
Baseline	11	10	9	9	10	10	**13**	20
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	11	6	2	0	0	0	**0**	0
A2. New public sector loans on less favorable terms in 2012-2032 2/	11	10	9	10	11	12	**18**	30
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	11	10	10	10	10	11	**14**	22
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	11	10	10	10	10	11	**14**	20
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	11	11	11	11	11	12	**16**	24
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	11	29	46	45	45	44	**41**	30
B5. Combination of B1-B4 using one-half standard deviation shocks	11	19	22	22	22	22	**24**	26
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	11	14	13	13	13	14	**18**	28
PV of debt-to-exports ratio								
Baseline	18	17	17	18	19	21	**37**	70
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	18	11	5	0	0	0	**0**	0
A2. New public sector loans on less favorable terms in 2012-2032 2/	18	17	17	18	21	24	**49**	103
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	18	17	17	17	19	20	**36**	69
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	18	18	19	19	21	22	**39**	70
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	18	17	17	17	19	20	**36**	69
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	18	51	84	86	88	90	**111**	105
B5. Combination of B1-B4 using one-half standard deviation shocks	18	29	30	31	32	33	**48**	65
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	18	17	17	17	19	20	**36**	69
PV of debt-to-revenue ratio								
Baseline	33	31	30	28	30	33	**48**	77
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	33	19	8	0	0	0	**0**	0
A2. New public sector loans on less favorable terms in 2012-2032 2/	33	31	30	30	34	38	**64**	114
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	33	32	32	30	32	35	**51**	82
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	33	33	33	31	33	35	**50**	77
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	33	34	35	33	35	38	**56**	90
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	33	92	149	140	141	142	**145**	116
B5. Combination of B1-B4 using one-half standard deviation shocks	33	61	72	68	70	72	**84**	98
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	33	43	41	39	42	45	**66**	107

Table 1b.Solomon Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012-2032 (continued)

(In percent)

Debt service-to-exports ratio

Baseline	1	1	2	2	2	2	**1**	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	1	1	2	1	1	1	**0**	0
A2. New public sector loans on less favorable terms in 2012-2032 2/	1	1	2	2	2	2	**2**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	1	1	2	2	2	2	**1**	3
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	1	1	2	2	2	2	**1**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	1	1	2	2	2	2	**1**	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	1	1	2	3	3	3	**4**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	1	1	2	2	2	2	**2**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	1	1	2	2	2	2	**1**	3

Debt service-to-revenue ratio

Baseline	2	3	3	3	3	3	**2**	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	2	3	3	2	2	2	**0**	0
A2. New public sector loans on less favorable terms in 2012-2032 2/	2	3	3	3	3	3	**3**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	2	3	3	3	3	3	**2**	3
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	2	3	3	3	3	3	**2**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	2	3	4	3	3	3	**2**	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	2	3	4	4	4	4	**5**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	2	3	4	4	4	3	**3**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	2	4	4	4	4	4	**2**	4
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	30	30	30	30	30	30	**30**	30

Sources: Country authorities; and staff estimates and projections.

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.
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/ 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 a an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ 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 Framework, Baseline Scenario, 2009-2032

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2009	2010	2011	Average 5/	Standard Deviation 5/	2012	2013	2014	2015	2016	2017	2012-17 Average	2022	2032	2018-32 Average
Public sector debt 1/	33.9	28.5	22.2			18.2	15.4	13.9	13.5	13.9	14.9		19.4	27.9	
of which: foreign-currency denominated	23.2	19.8	15.2			12.9	11.7	11.0	11.2	11.9	13.0		17.7	26.5	
Change in public sector debt	-1.6	-5.4	-6.3			-3.9	-2.8	-1.6	-0.3	0.3	1.1		1.0	0.8	
Identified debt-creating flows	-3.3	-10.5	-15.5			-1.7	-2.6	-1.9	-1.6	-1.5	-1.4		-1.5	-0.4	
Primary deficit	-2.3	-6.7	-9.3	-3.2	3.8	0.3	-1.5	-1.1	-1.1	-1.0	-0.9	-0.9	-0.6	0.6	0.4
Revenue and grants	55.2	62.6	60.2			57.3	54.4	53.0	53.5	52.0	50.9		43.9	36.9	
of which: grants	24.7	30.6	27.1			24.5	23.0	22.2	21.3	20.5	19.7		16.0	10.7	
Primary (noninterest) expenditure	52.9	55.9	50.9			57.6	53.0	51.9	52.4	51.0	50.0		43.3	37.6	
Automatic debt dynamics	0.0	-3.8	-6.1			-2.1	-1.1	-0.8	-0.5	-0.5	-0.5		-0.9	-1.0	
Contribution from interest rate/growth differential	1.3	-2.8	-3.3			-1.4	-0.9	-0.7	-0.6	-0.6	-0.6		-0.5	-1.0	
of which: contribution from average real interest rate	-0.5	-0.3	-0.5			-0.3	-0.2	-0.1	-0.1	-0.1	-0.1		-0.1	-0.1	
of which: contribution from real GDP growth	1.8	-2.5	-2.8			-1.2	-0.7	-0.6	-0.5	-0.5	-0.5		-0.4	-0.8	
Contribution from real exchange rate depreciation	-1.3	-1.0	-2.8			-0.6	-0.2	-0.1	0.1	0.0	0.0		...	...	
Other identified debt-creating flows	-0.9	0.0	-0.1			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.9	0.0	-0.1			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	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)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	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	1.6	5.1	9.2			-2.2	-0.2	0.3	1.3	1.8	2.5		2.5	1.2	
Other Sustainability Indicators															
PV of public sector debt	...	...	19.7			16.2	13.6	12.1	11.5	11.5	12.1		15.1	21.7	
of which: foreign-currency denominated	...	...	12.7			10.9	9.9	9.2	9.2	9.5	10.1		13.4	20.3	
of which: external	...	...	12.7			10.9	9.9	9.2	9.2	9.5	10.1		13.4	20.3	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	0.2	-4.1	-7.3			2.8	0.9	1.0	0.8	0.8	0.6		0.4	1.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	32.6			28.2	25.0	22.7	21.5	22.0	23.8		34.4	58.8	
PV of public sector debt-to-revenue ratio (in percent)	...	...	59.4			49.4	43.2	39.2	35.8	36.4	38.9		54.2	82.6	
of which: external 3/	...	...	38.3			33.2	31.4	29.8	28.4	30.2	32.5		47.9	77.4	
Debt service-to-revenue and grants ratio (in percent) 4/	3.8	3.2	2.4			3.5	3.0	2.8	2.4	2.2	1.9		1.2	2.1	
Debt service-to-revenue ratio (in percent) 4/	6.9	6.3	4.3			6.1	5.1	4.8	4.0	3.7	3.1		1.9	3.0	
Primary deficit that stabilizes the debt-to-GDP ratio	-0.7	-1.3	-3.0			4.3	1.3	0.5	-0.8	-1.3	-1.9		-1.7	-0.2	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	-4.7	7.8	10.7	5.6	5.5	5.5	4.0	3.8	3.7	3.6	3.6	4.0	2.0	3.1	3.0
Average nominal interest rate on forex debt (in percent)	1.3	1.2	1.1	1.4	0.6	1.1	1.1	1.0	1.1	1.1	1.1	1.1	1.1	1.0	1.1
Average real interest rate on domestic debt (in percent)	-5.0	-3.9	-6.9	-4.1	2.6	-3.7	-3.1	-2.3	-1.2	-1.6	-1.7	-2.3	-4.1	-0.9	-3.2
Real exchange rate depreciation (in percent, + indicates depreciation)	-5.2	-4.7	-15.4	-1.4	9.3	-4.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	7.3	5.9	9.1	6.9	3.3	6.0	6.1	5.5	4.2	4.5	4.4	5.1	7.1	4.8	6.6
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.1	0.0	0.2	0.2	0.2	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)	...	...	...	...	...	0.0	29.8	29.8	29.8	29.8	29.8	24.8	29.8	29.8	...

Sources: Country authorities; and staff estimates and projections.

1/ Gross debt of central government and SOEs.

2/ 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.

3/ Revenues excluding grants.

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

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2b.Solomon Islands: Sensitivity Analysis for Key Indicators of Public Debt 2012-2032

	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
PV of Debt-to-GDP Ratio								
Baseline	16	14	12	12	11	12	15	22
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	16	12	9	7	5	4	0	0
A2. Primary balance is unchanged from 2012	16	15	14	15	16	17	22	23
A3. Permanently lower GDP growth 1/	16	14	13	13	15	17	30	72
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	16	15	16	17	18	21	30	45
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	16	15	15	14	14	15	17	23
B3. Combination of B1-B2 using one half standard deviation shocks	16	14	12	12	13	14	19	28
B4. One-time 30 percent real depreciation in 2013	16	18	16	15	15	15	17	23
B5. 10 percent of GDP increase in other debt-creating flows in 2013	16	21	19	18	18	18	20	25
PV of Debt-to-Revenue Ratio 2/								
Baseline	28	25	23	21	22	24	34	59
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	28	22	17	13	10	8	0	0
A2. Primary balance is unchanged from 2012	28	27	27	28	30	33	51	62
A3. Permanently lower GDP growth 1/	28	26	24	25	28	32	66	181
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	28	27	28	30	34	39	66	119
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	28	28	28	26	27	29	39	62
B3. Combination of B1-B2 using one half standard deviation shocks	28	25	23	23	24	27	42	74
B4. One-time 30 percent real depreciation in 2013	28	33	31	29	29	30	39	63
B5. 10 percent of GDP increase in other debt-creating flows in 2013	28	38	36	34	35	36	46	67
Debt Service-to-Revenue Ratio 2/								
Baseline	3	3	3	2	2	2	1	2
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	3	3	3	2	2	2	1	0
A2. Primary balance is unchanged from 2012	3	3	3	3	2	2	2	3
A3. Permanently lower GDP growth 1/	3	3	3	2	2	2	2	5
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	3	3	3	3	2	2	2	4
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	3	3	3	3	2	2	1	2
B3. Combination of B1-B2 using one half standard deviation shocks	3	3	3	2	2	2	1	3
B4. One-time 30 percent real depreciation in 2013	3	3	4	3	3	3	2	3
B5. 10 percent of GDP increase in other debt-creating flows in 2013	3	3	3	3	2	2	2	3

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 12/464
FOR IMMEDIATE RELEASE
November 29, 2012

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes the Second Review Under the Standby Credit Facility Arrangement with Solomon Islands

On November 28, 2012, the Executive Board of the International Monetary Fund (IMF) completed the second and final review of Solomon Islands' economic performance under a program supported by a Standby Credit Facility arrangement (see Press Release No. 11/448).

Following the Executive Board's discussion on Solomon Islands, Mr. Min Zhu, Deputy Managing Director and Acting Chair, stated:

"Firm program implementation under the Standby Credit Facility arrangement as well as some progress in structural reforms have succeeded in restoring macroeconomic and financial stability. However, the economy remains vulnerable because of lack of diversification, a strong dependence on aid, and frequent natural disasters. Bolstering resilience to shocks, strengthening institutional capacity, and pursuing more inclusive growth remain top priorities.

"The authorities have formulated a reform program to be supported by a successor Fund arrangement. The program aims at consolidating recent macroeconomic progress. To this end, the authorities intend to enhance the efficiency of tax collection through a new resource taxation regime, implement public financial management reforms, and promote access to financial services, especially in rural areas.

"The near-term priority for fiscal policy is to safeguard the accumulated cash balances while improving the efficiency, transparency, and composition of public spending. Looking ahead, it will also be important to preserve debt sustainability while tapping resources to finance much needed investment projects. Strengthening the policy framework by targeting the non-commodity budget balance would also increase the effectiveness of fiscal policy.

"Monetary and exchange rate policies have helped moderate inflation. The authorities indicate their readiness to tighten monetary policy if domestic inflation pressures re-emerge. The recent shift to a currency basket regime for exchange rate management should also help buffer external shocks.

"The banking system remains profitable and adequately capitalized. Efforts by the central bank should continue to focus on strengthening the financial supervision and regulation as well as promoting access to financial services."

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 12/479
FOR IMMEDIATE RELEASE
December 10, 2012

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves a Three-Year Arrangement Under the Extended Credit Facility (ECF) for Solomon Islands and US$ 0.228 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) approved on December 7, 2012 a three-year arrangement under the Extended Credit Facility (ECF)[1] for Solomon Islands, in an amount equivalent to SDR 1.04 million (about US$ 1.59 million), or 10 percent of the country's quota.

The Board's decision, which was taken on a lapse of time basis,[2] enables the immediate disbursement of an amount equivalent to SDR 0.149 million (US$ 0.228 million).

Building on the success of the program supported by a Standby Credit Facility arrangement, which expired on December 5, 2012, the ECF-supported program will be instrumental in tackling deep institutional and structural issues and is seen by the authorities as critical for supporting Solomon Islands, which remains vulnerable to external shocks associated with its undiversified export base, strong dependence on aid, and frequent natural disasters.

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[1] The Extended Credit Facility (ECF) has replaced the Poverty Reduction and Growth Facility (PRGF) as the Fund's main tool for medium-term financial support to low-income countries by providing a higher level of access to financing, concessional terms, enhanced flexibility in program design features, and more focused streamlined conditionality. Financing under the ECF carries a zero interest rate, with a grace period of 5½ years, and a final maturity of 10 years (http://www.imf.org/external/np/exr/facts/ecf.htm). The Fund reviews the level of interest rates for all concessional facilities every two years.

[2] The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

Statement by Mr. Davidoff, Alternate Executive Director for Solomon Islands and Ms. Hunter, Senior Advisor to the Executive Director
November 23, 2011

The Solomon Islands' SCF arrangements have provided a crucial policy anchor for the authorities, as they have progressed a structural reform agenda that lays the foundations for inclusive growth and poverty reduction. The first SCF commenced following spillover from the global financial crisis that combined with pressures from the decline of the logging industry. The economy rebounded in 2010/11, and while remaining relatively strong, growth has slowed in 2012. As noted in staff's report, the mining and services sectors are expected to support future growth in the range of 4 percent, and inflation is expected to ease to around 4 percent over the medium term.

The growth outlook is largely underpinned by the development of the mining sector, with substantial international interest expressed in Solomon Islands' mining potential. The return to full production at the Goldridge mine (following its closure in 2002 due to civil unrest) accounted for a significant share of growth in 2011, alongside a surprisingly strong (but not sustainable) logging performance. While prospects for further mining development are favorable, controversy surrounding mine development can cause delay, as has been the case for a large nickel mine on Isabel Island. Other agricultural commodities (fishing, palm oil, copra) performed well in 2011 and early 2012, contributing to a significantly reduced trade deficit in 2011. However, agricultural production can be highly price sensitive, and some weakening in prices of key commodities has been observed since the start of 2012.

The authorities have continued to demonstrate strong program ownership under the second SCF. Most of the structural benchmarks were met, and the remainder are being steadily progressed. Many of the structural benchmarks contribute to a comprehensive and far-reaching fiscal reform agenda. Work towards a new Public Finance Act (PFA) will strengthen the fiscal framework, and the authorities are conscious that deriving benefit from the new act will depend on the implementation of its legislative requirements. Improvements in revenue collection have been made, with strong focus now being applied to reducing tax exemptions, including through work on the new Customs and Excise Tax Act. A critical new mining tax regime is being developed, though progress has been delayed due to insufficient drafting capacity – a problem that has also slowed progress in other areas. Minimum levels have been set on education and health spending, in line with ensuring quality public spending. Improvements to budget processes have included the new chart of accounts and enhanced consultation, and a planned shift to multi-year budgeting.

The authorities have also developed a new debt management strategy, which has been incorporated into the Honiara Club Agreement. The new strategy, which includes an annual borrowing limit, provides for the measured and careful resumption of external borrowing by government to finance key infrastructure investment. In particular, the new debt management strategy will facilitate two projects that will be crucial to encouraging private sector investment: the Submarine Cable System Project to improve internet connectivity, and the Tina River Power Project. However, tests of the new strategy will quickly appear and in order to provide further guidance a description of how the Debt Management Strategy will apply to SOE borrowing will soon be released. Progress is being made on solvency and debt issues surrounding key state-owned utilities, although work remains to clarify the outstanding debt of troubled SOEs. As described in the DSA, the economy continues to face moderate risk of debt distress.

In addition to steady progress on structural benchmarks, most of the program performance criteria for end-June 2012 were met comfortably, with the exception of the cash balance indicative target. This target was met in June, but missed in September due to revenue expectations that proved overly optimistic, alongside higher development spending on rural constituency development funds ("constituency funds"), higher tertiary education expenditure, and one-off expenditure related to hosting of the Festival of Pacific Arts. The additional spending reflects the practical challenge of preserving fiscal buffers in the face of strong development needs. Capacity constraints have meant that the authorities have frequently struggled to execute development spending, with disbursement regularly below budget allocations. In response, the authorities have increased budget allocation to the constituency funds, which have typically had a higher disbursement rate. However, the authorities recognize the need to contain and ensure proper governance of the constituency funds, and have called on the Office of the Auditor General to audit twenty of the fifty funds.

With regard to revenue forecasts, the authorities agree that these forecasts must be appropriately conservative going forward, particularly given uncertainties in the external outlook. Over-spending on the Festival of Pacific Arts highlighted poor procurement processes, that must also be addressed. However on a more positive note, Solomon Islands' successful hosting of the Festival generated an intangible but real confidence boost, as well as increased economic activity.

While agreeing that spending must be contained in order to preserve fiscal buffers, the authorities plan to raise public sector wages in the 2013 budget, as described in staff's report. The increase is intended to reduce the extent of decline in the real wage that is occurring through inflation, and is considered necessary in light of the deterioration that has already taken place in the real wage over the last two decades. A review of the remuneration structure is also planned, and has the potential to streamline non-wage benefits and reduce administrative costs.

Efforts to improve fiscal management are taking place with the assistance of development partners, with coordination facilitated by the Core Economic Working Group. The CEWG is highly supportive of government's goals to strengthen budget preparation and planning systems, and to improve the quality of budget execution and reporting, as well as the goal to improve the environment for private sector investment, as set out in government's Economic and Financial Reform Program.

Turning to the financial sector, banks are stable, profitable, and well capitalized. Credit growth remains weak, with banks attributing this to a dearth of lending opportunities. The authorities, however, remain concerned at the high spread between deposit and lending rates in Solomon Islands, and would be appreciative of technical assistance to help them better understand this. Staff has noted several areas of legislative reform that are underway to strengthen the financial sector framework, including the new CBSI Act, the National Provident Fund Act and the Financial Institution Act. Monetary policy continues to focus on price and external stability. Following IMF technical assistance, the de facto peg to the US dollar has been replaced by a basket peg, with weights based on the largest shares of Solomon Islands external payments. The central bank continues to actively promote financial inclusion, including through the expansion of mobile phone banking, though access to financial services in Solomon Islands' many remote regions remains limited.

In order to build on progress made under the previous SCF arrangements, the authorities have requested an ECF arrangement with an access level of 10 percent of quota. The proposed ECF fits well with government's structural reform agenda, and is based on continued vulnerabilities inherent in the commodity-dependent economy. Engagement with the Fund has been especially important as the country transitions through the phased withdrawal of the Regional Assistance Mission for the Solomon Islands (RAMSI). The ECF would catalyze donor support, as the two SCFs have successfully done, and we note that aid flows have been an important explanatory factor behind the reserves position. In terms of other program options, we note that the 2.5 year limit on precautionary SCF usage has been reached, and the country is not yet considered ready for a PSI.