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SOLOMON ISLANDS

August 2013

First Review Under the Extended Credit Facility Arrangement—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Solomon Islands.

In the context of the first review under the extended credit facility arrangement and request for waiver of nonobservance of a performance criterion and modification of performance-Criteria, the following documents have been released and are included in this package::

- **Staff Report** for the First Review Under the Extended Credit Facility Arrangement and Request for Waiver of Nonobservance of a Performance Criterion and Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on April 18, 2013, 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 June 12, 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.

- **Press Release** summarizing the views of the Executive Board as expressed during its June 28, 2013 discussion of the staff report that completed the request and/or review.

- **Statement by the Executive Director** for the Solomon Islands.

The documents listed below have been or will be 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
Washington, D.C.

SOLOMON ISLANDS

June 12, 2013

FIRST REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR WAIVER OF NONOBSERVANCE OF A PERFORMANCE CRITERION AND MODIFICATION OF PERFORMANCE CRITERIA

KEY ISSUES

Context: Solomon Islands is a fragile state that is very exposed to natural disasters and commodity shocks, and relies heavily on foreign aid. The successful implementation of two consecutive programs supported by the Standby Credit Facility and the current Extended Credit Facility arrangement has restored macroeconomic and external stability, and policy buffers have been rebuilt. However, several deep challenges lie ahead to enhance external sustainability. Bolstering resilience to shocks, strengthening institutional capacity, and pursuing broad-based and more inclusive growth remain top priorities. Nonetheless, the authorities are making sustained progress to address those challenges.

Program: The three-year arrangement under the Extended Credit Facility (ECF), which was approved on December 7, 2012 in the amount of SDR 1.04 million (10 percent of quota), is on track. All December 2012 and continuous performance criteria (PCs) have been met, except for the cash balance floor, which was temporarily missed by a small amount. The indicative target on health and education for December 2012 was also missed by a very small margin. Preliminary data suggest that all March 2013 indicative targets (ITs) have been met. Structural reforms are advancing, notwithstanding some delays due to capacity constraints; four benchmarks have been met (one with some delay), and two other benchmarks have not been met.

Outlook and Risks: Growth remained robust in 2012, inflation moderated, and external buffers were strengthened. Risks to the outlook have become more balanced. While tail risks from advanced economies have diminished, the potential impact of the trade-related external shocks remains considerable.

Focus of Discussions: Discussions focused on program performance, proposed PCs for end-2013, proposed ITs for September 2013, and for March and June 2014, and proposed structural benchmarks through June 2014. Program commitments seek to preserve macroeconomic and financial stability, and support reforms to improve the economy's resilience to shocks and to promote sustainable and more inclusive growth.

Staff Views: Staff recommends completion of the review and supports the authorities' request for a waiver of the non-observance of the cash balance floor at end-December, and the modification of end-June 2013 performance criteria.

Approved By
Hoe Ee Khor and Masato Miyazaki

Mission team: Discussions took place in Honiara during April 9–18, 2012.The mission comprised Messrs. Breuer (mission chief), Abdel-Rahman (both APD), and Rebei (ICD), and Ms. Svirydzenka, (SPR). The mission met with Prime Minister Gordon Darcy Lilo, Minister of Finance Rick Houenipwela, Governor of the Central Bank Denton Rarawa, Auditor General, other senior officials, donors and private sector representatives.

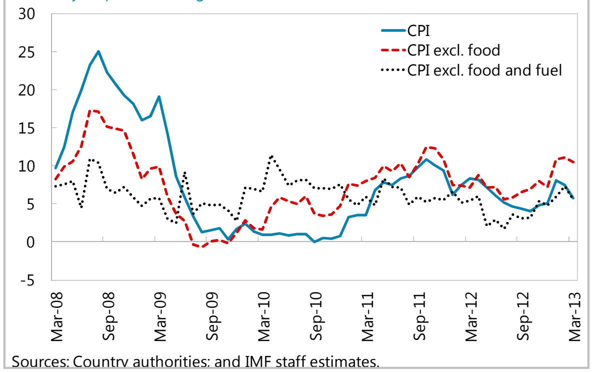
CONTENTS

MACROECONOMIC SETTING AND OUTLOOK

1. **Economic developments have been favorable**. While moderating from the extraordinary expansion in 2011, economic growth in 2012 remained robust at an estimated 4.8 percent, led by mining and activities related to the Festival of Pacific Arts. At end-2012, inflation fell to 5 percent, down from a peak of 11 percent in late 2011; gross international reserves stood at a record US$500 million (8.5 months of imports); and government debt fell to 17.5 percent of GDP.

Solomon Islands: CPI Inflation, Mar. 2008–2013

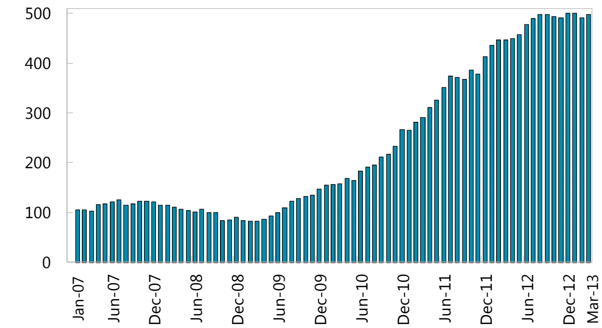
(Year-on-year percent change)



Sources: Country authorities; and IMF staff estimates.

Solomon Islands: Gross International Reserves, Jan. 2007–Mar. 2013

(In millions of U.S. dollars)

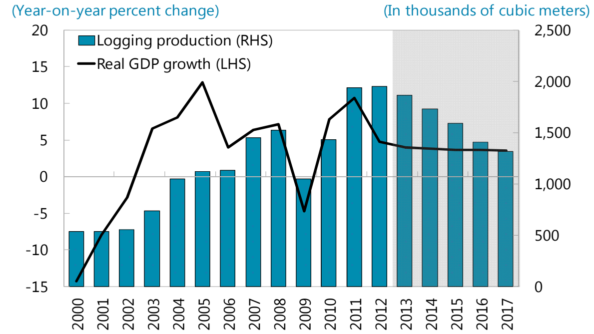


Sources: Central Bank of Solomon Islands; and IMF, IFS.

2. **Growth is expected to moderate, while risks have become more balanced.** Growth is expected to slow down in 2013 and in the medium term—to 3½–4 percent, as forestry (the traditional engine of growth) is expected to be adversely affected by the depletion of logging stocks. The mineral and service sectors are expected to be the main drivers of growth over the medium term. Inflation is projected to remain stable in the near-term at around 6 percent, and to moderate to 4½–5 percent over medium term. Overall risks to the economy have become more balanced in recent months. While tail risks from advanced economies have diminished, the potential impact of external shocks remains considerable, given the limited economic diversification. These shocks include disruptions from natural disasters, food and oil price hikes, or a sharp slowdown in trading partners, in particular China. Sustained efforts to implement reforms in line with program commitment to facilitate broad based and more inclusive growth will be key to mitigate the impact of such shocks over the medium and long term.

Solomon Islands: Logging Production and Real GDP Growth 2000-17

(Year-on-year percent change) (In thousands of cubic meters)



Sources: Country authorities; and IMF staff estimates.

PROGRAM PERFORMANCE

3. **Program performance under the ECF arrangement has been satisfactory.** PCs for December 2012 on net credit to the government (NCG), net international reserves (NIR), and net domestic assets of the central bank (NDA) were all met with large margins. The PC on the cash

balance floor was missed by a small amount due to a brief delay in transferring government deposits already at the central bank to the specific government accounts that comprise the cash balance at the end of 2012. Technically, the timely transfer of these government deposits to the cash balance would have enabled the government to meet this PC with a comfortable margin. The indicative target on health and education for December 2012 was also missed by a small amount (the equivalent of US$1 million). Preliminary data suggest that all March 2013 indicative targets have been met.

4. **Notwithstanding some delays, the authorities are making progress in meeting the structural benchmarks.** The new Central Bank Act (December 2012 benchmark) was submitted to Parliament and approved in November 2012. A multi-year budget framework (December 2012 benchmark) was submitted to Parliament with the 2013 budget. The government released the draft bill on the new Custom and Excise Act for public consultation (December 2012 benchmark) in February 2013, and the workshop on financial inclusion (March 2013 benchmark) took place on February 2013. Cabinet's approval of a draft amendment to legislation on the new mining tax regime (December 2012 benchmark) was not met owing to resource constraints in the Attorney General's office. Similarly, the drafting of borrowing instructions for state-owned enterprises (March 2013 benchmark) has been delayed. In both cases, significant progress has been made and the authorities expect to complete these reforms by end-June 2013.

POLICY DISCUSSIONS AND COMMITMENTS

5. **Discussions focused on policy actions required under the ECF- supported program through June 2014.** These actions seek to preserve external and fiscal buffers, while increasing fiscal space for priority spending, and to support key reforms to improve the economy's resilience to shocks and promote inclusive growth. Reflecting recent developments and the updated outlook—including the need to lock in some of the over-performance in the December 2012 NDA target and to prudently increase priority spending to meet development needs (as discussed below)—modifications are being proposed to the PCs for June 2013 on the cash balance, net credit to the government, and net domestic assets of the CBSI. In addition, new PCs are proposed for December 2013 as well as new ITs for September 2013, and for March and June 2014. In addition, the authorities are requesting that the test dates for benchmarks on the mining tax regime and SOE lending instructions be moved to June 2013, and new benchmarks for the constituency funds and Credit Unions Act be added to their program. A supplement to the previous Memorandum of Economic and Financial Policies (MEFP) sets out program commitments (Appendix 1), extending quantitative targets through end-2013 (MEFP Table 1), and adding new benchmarks through June 2014 (MEFP Table 2).

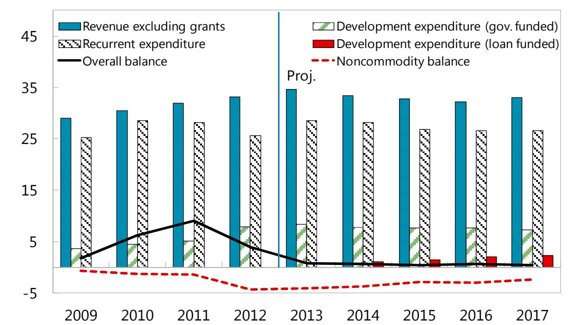
A. Fiscal Policy

Background

6. **The fiscal position in 2012 remained strong.** The authorities achieved commendable consolidation in the last quarter of 2012, which contributed to the overall fiscal surplus of near

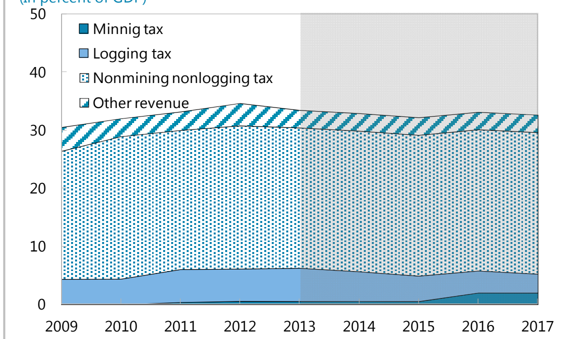
4 percent of GDP. This was achieved through control of recurrent spending and aligning development spending with the implementation capacity of the government and absorptive capacity of the economy. Meanwhile, domestic revenue collection surprised on the upside, particularly in the last months of the year.

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



Sources: Country authorities; and IMF staff estimates.

Solomon Islands: Fiscal Revenue Excluding Grants, 2009-17
(In percent of GDP)



Sources: Country authorities; and IMF staff estimates.

7. The 2013 budget implies a significant increase in public spending.[1] If fully implemented, staff estimates that the budget approved in December would lead to a fiscal deficit of 1.2 percent of GDP, nearly a 5 percent of GDP deterioration in the fiscal balance relative to 2012. On a more positive note, revenue projections in this budget are more prudent and realistic than in the past. The weaker fiscal position mainly reflects significant increases in recurrent expenditure, including utilities, rents, consumption of other goods and services, tertiary scholarships abroad, and payroll. The payroll increase reflects mainly a 6 percent general increase in public wages. At the same time, there are other pressures on the fiscal accounts that are not reflected in the 2013 budget, including a committed additional increase in teachers' salaries (about ½ percent of GDP) and new hiring to fill vacant positions in government agencies (about 0.4 percent of GDP), including the tax office.

Program Commitments

8. The authorities agreed that sound public finances are critical to meet development needs and to maintain adequate buffers. The authorities' program targets are consistent with the objectives of increasing fiscal space for development spending and allowing for a more prudent increase in recurrent spending, while also providing fiscal space for priority spending not included in the budget yet (including teachers' salaries increase and filling some priority vacancies). To achieve this, the authorities committed to tight control and reduction of other recurrent spending items (including those mentioned in paragraph 7 and the public sector allowance component of the public payroll) to offset some of the budgeted increase in spending this year. With these actions, a small fiscal surplus of about 0.8 percent of GDP is projected for 2013. This is slightly lower than staff's previous projection of the surplus (1.2 percent of GDP); thus, the need for a modification of the cash balance target, which, nonetheless, remains at no less than 2 months of recurrent spending. These targets are achievable as the expenditures related to the Festival of Pacific Arts (2.5 percent of GDP)

[1] In recent years, budgets included overly ambitious revenue and spending estimates that were later under executed.

in 2012 will not recur this year. The authorities also agreed that should revenue surprise on the upside, or the development budget is under-executed, they will use the resulting fiscal space to finance priority programs, while also seeking to save for future development programs and to strengthen buffers.

9. The authorities' fiscal reform agenda is being strengthened. There was agreement between staff and the authorities on key priorities for the rest of 2013, in particular, the new public finance management regime that consists of a revised public finance act and stronger regulations for the use of constituency funds (CFs). Funds assigned to CFs have risen rapidly in the past two years, going from 2 percent of GDP in 2011 to 3.5 percent of GDP in 2012. The authorities have taken some initial steps to improve the transparency and accountability of CFs—Parliament recently approved the Constituency Development Funds Act that links spending to national priorities, introduces audits, and expands local support offices. While the Act can be strengthened, including on coverage, it represents a first step in the right direction. The authorities are preparing implementing regulations for the CF Act (proposed December 2013 structural benchmark), in consultation with other stakeholders and development partners. These regulations will provide guidelines for the selection of projects, and establish procedures to improve reporting, control, audit, and evaluation. Equally important is that the planned new Public Finance Act (PFA) (October 2013 benchmark) will apply to all public spending. The authorities also intend to publish the Auditor General's report on the use of CFs (proposed November 2013 structural benchmark). Finally, the authorities also agreed that spending on tertiary scholarship abroad, which has also increased rapidly over the last two years, will be streamlined and linked to the country's development needs.

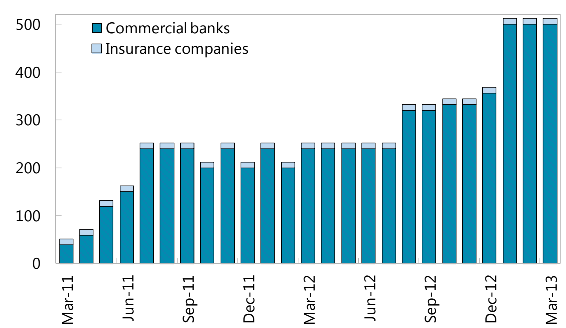
B. Monetary and Exchange Rate Policies

Background

10. Credit growth is resuming after a period of credit contraction. Credit growth accelerated to 12.6 percent in March 2013 (year-on-year), from 4 percent in December (y. o. y.) and negative growth in the period 2009–10. Banks' excess liquidity has remained high, in part due to capital inflows and the buildup of foreign reserves at the Central Bank. The CBSI has continued to mop up liquidity through short-term *Bokolo bills*.

Solomon Islands: Holdings of Bokolo Bills, Mar. 2011–13

(In millions of Solomon Islands dollars)



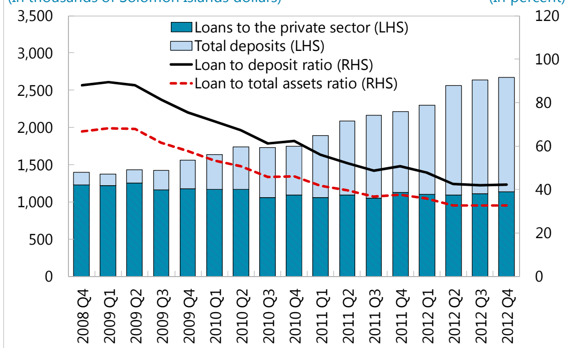
Source: Central Bank of Solomon Islands.

Program Commitments

11. Monetary and exchange rate policies are geared to maintaining price and external stability. While inflation is projected to remain broadly stable, the CBSI is committed to stepping up monetary operations, if needed. In October 2012, the authorities moved from an exchange rate peg to the U.S. dollar to a basket exchange rate peg using as weights the shares of the currencies used in invoicing the country's external payments, where the US dollar and the Australian dollar are the principal components. The new peg seems to be working well and represents an initial step towards more exchange rate flexibility and, thus, enhanced resilience to external shocks.

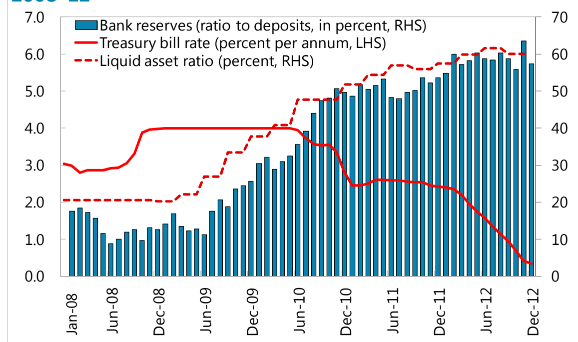
Solomon Islands: Bank Loans and Deposits

(In thousands of Solomon Islands dollars) (In percent)



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

Solomon Islands: Bank Reserves and Interest Rate, 2008–12



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

C. Financial Sector Stability

Background

12. The financial system is sound, but financial depth remains constrained by structural impediments. Banks are adequately capitalized, highly liquid, and very profitable. The ratio of nonperforming loans to total loans declined to 3.7 percent at the end of 2012. However, access to credit by the private sector remains limited, which represents an impediment to inclusive growth. Credit to the private sector as a percent of GDP was about 15 percent in 2012, lower than the average for Pacific Island countries (35 percent) and it has declined since the global crisis. Key barriers limiting credit supply include weak investor protection and property rights regimes. Non-interest income, mainly related to foreign exchange activities, plays a key role in bank profitability. Regarding nonbank financial institutions, the National Provident Fund (NPF) is a systemically important financial institution, which faces gaps and weaknesses in its supervision and investment strategy.

Solomon Islands: Core Financial Soundness Indicators 1/

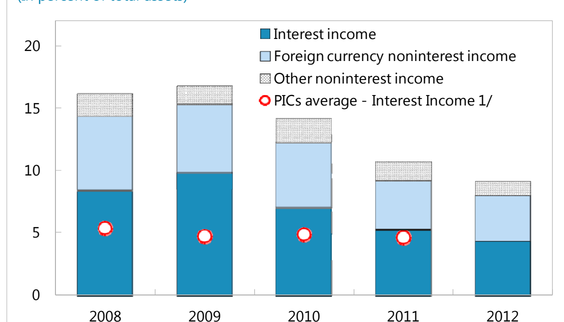
	2008	2009	2010	2011	2012				2013
					Mar	Jun	Sep	Dec	Mar
Capital adequacy									
Regulated capital to risk-weighted assets	22.5	22.1	22.7	24.6	28.5	22.0	24.9	26.9	33.0
Nonperforming loans, net of provisions to capital	7.4	9.3	15.0	6.7	6.0	9.1	7.1	4.3	4.7
Asset quality									
Nonperforming loans to total gross loans	2.7	3.8	7.9	5.9	5.9	6.8	5.4	3.7	4.0
Earnings and profitability									
Return on average assets	6.7	6.0	4.9	3.2	2.8	3.4	3.5	3.2	2.5
Return on average equity	40.5	31.6	26.3	16.8	14.7	18.3	19.4	18.1	14.6
Net interest income to gross income	50.2	52.6	43.9	45.7	48.3	45.0	45.2	46.0	51.7
Noninterest expenses to gross income	34.3	37.5	41.4	48.2	51.8	46.7	47.8	50.6	52.4
Liquidity									
Liquid assets to total assets (liquid asset ratio)	20.6	33.4	47.7	56.0	57.4	59.9	61.6	60.1	58.3
Liquid assets to short-term liabilities	26.7	54.8	65.2	69.4	68.8	69.5	65.4	60.3	48.8

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

1/ Commercial banks only, at end-period.

Solomon Islands: Interest and Noninterest Income

(In percent of total assets)



1/ Includes Fiji, Marshall Islands, Papua New Guinea, Samoa, Tonga and Vanuatu.

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

Program Commitments

13. The authorities are pursuing critical financial reforms to strengthen financial stability and improve access to financial services. The new National Provident Fund (NPF) Act, which will be submitted to Parliament later in the year (October 2013 benchmark), would help reduce NPF's financial risks— such as high share of short term fixed interest instruments, elevated allocation to high risk investments in domestic unlisted companies, and moderate allocation towards offshore assets—and improve its governance. In addition, the authorities intend to amend the Financial Institutions Act to strengthen both banking supervision and protection of depositors. To improve access to financial services for a broader segment of the population, the authorities are preparing a new Credit Unions Act (CUA) with assistance from the AsDB. The authorities are planning to submit to Cabinet the draft CUA by end-March 2014 (proposed new structural benchmark) and to Parliament by end-June 2014 (proposed new structural benchmark). The authorities are also working towards strengthening the payment system's legal framework with support from the World Bank.

OTHER PROGRAM ISSUES

14. Disbursements from development partners are linked to successful implementation of the ECF arrangement. Main donor financing is expected from: (i) Australia and New Zealand–around US$50 million in 2013; (ii) the AsDB—about US$38 million in 2013–16 for infrastructure projects and information and communication technology, both as budget support and concessionary loans; (iii) the World Bank–US$2 million Development Policy Grant in 2013; and (iv) the European Union–US$1¾ million is expected to be disbursed in 2013.

15. The main risks to the program are political fragility and capacity constraints. The political situation remains fluid, and Solomon Islands has a history of fragile governing coalition. While political instability could weaken program ownership, the success of the previous arrangements suggests that program ownership in Solomon Islands is strong and cuts across the different parties. However, capacity constraints remain a challenge. The authorities are devoting more resources to key pressure points, including the drafting of legislation.

16. Other program commitments and issues. These include:

- **The update to the safeguards assessment,** which is substantially completed, confirms that the CBSI continues with its well-established good practices in financial transparency and accountability. A new law for the CBSI, enacted in 2012, provides adequate financial and legal autonomy. Improvements are needed in oversight by the Audit Committee with the inclusion of a financial expert. Strengthening staff capacity in the internal audit function will facilitate the development of a risk-based audit function. The update assessment also recommended that the CBSI should publish the audit opinion of the international audit firm along with the audited financial statements for financial year 2012. The recommendations arising from the safeguards update assessment do not require action in the context of the first review, and will be monitored under the program.
- The authorities will submit **the National Development Strategy**, launched in September 2011, as an Interim Poverty Reduction Strategy Paper (I-PRSP) to the Board by the end of 2013, which is a requirement for completing the second review of the ECF arrangement. The full PRSP will be developed in the following year.

STAFF APPRAISAL

17. Macroeconomic developments have been positive. Growth, while moderating, remains robust. The successful implementation of economic programs has helped consolidate macroeconomic and financial stability and facilitated donor support.

18. However, several challenges remain. The economy is vulnerable to external shocks and natural disasters, and logging stocks—historically the main engine of growth—are expected to be exhausted during this decade. Moreover, several reforms need to be implemented to fulfill the mining sector potential and to ensure that the country as a whole benefits from its mineral wealth.

19. The key priorities for macroeconomic policies in the Solomon Islands are to improve the economy's resilience to shocks and to promote sustainable and inclusive growth. Solomon Islands is exposed to a variety of shocks, including natural disasters. Improving the economy's resilience will require sustained efforts to implement prudent policies that rebuild and protect policy buffers, and structural reforms to strengthen key public institutions and facilitate private sector development. The authorities are making progress with their ambitious and broad reform agenda, notwithstanding some delays in program commitments.

20. Sustaining fiscal discipline and improving the quality of spending are critical to meeting developmental goals. With logging revenues expected to decline and mining revenue still uncertain, careful control of spending is critical to maintaining sound public finances. In addition, this will require decisive implementation of the authorities' plans to improve the quality of public spending, including by enhancing the transparency and accountability in the use of constituency funds and upgrading the public finance act.

21. Monetary and exchange rate policies should continue to be geared to maintaining price and external stability. While inflation is projected to remain broadly stable in 2013, the central bank should be ready to step up monetary operations, if needed. The new FX peg to a currency basket is working well and has introduced some flexibility, which could help buffer external shocks in the future.

22. The financial system is sound, but efforts to strengthen supervisory and regulatory frameworks should continue. The new NPF act, together with the planned amendments to the Financial Institutions 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.

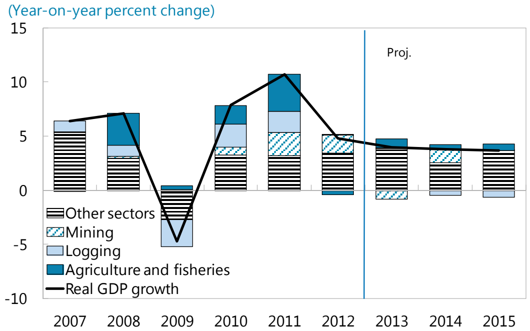
23. Based on Solomon Islands' strong program performance, staff recommends the completion of the first review under the ECF-supported program and supports the authorities request for the waiver of nonobservance of cash balance target at end of December 2012, as the nonobservance was minor and temporary. Staff also supports authorities request for the modification of June 2013 performance criteria, and the request for new test dates for structural benchmarks.

Figure 1. Solomon Islands: Macroeconomic Developments and Outlook

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

Sources of Growth, 2007–15

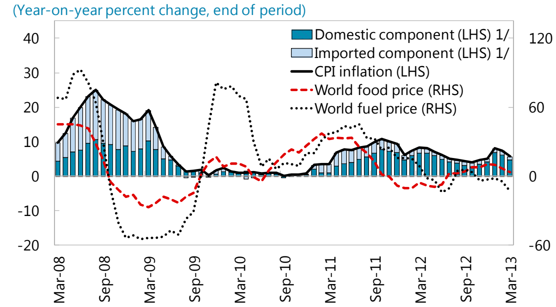
(Year-on-year percent change)



Inflation has been moderating due to lower food and fuel prices.

Contribution to CPI Inflation, Mar. 2008–13

(Year-on-year percent change, end of period)

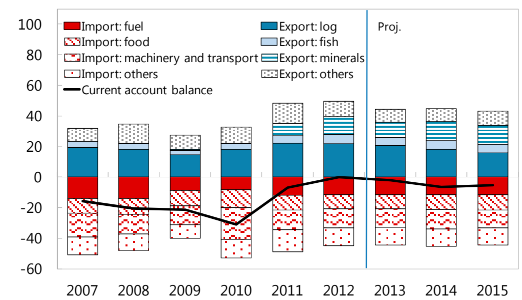


1/ Contribution to CPI inflation (in percentage points).

The current account balance improved in 2012, supported by strong commodity exports and lower imports…

Current Account Balance and Trade, 2007–15

(In percent of GDP)

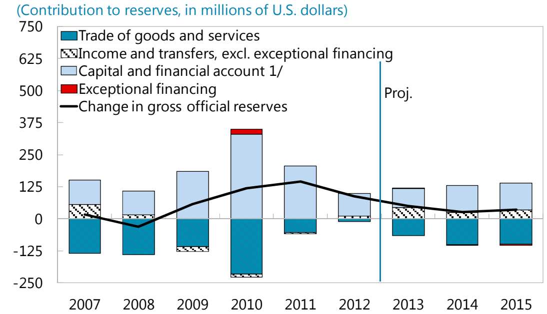


Sources: Country authorities; and IMF staff estimates.

…and reserve buffers have been rebuilt. .

Reserve Change Decomposition, 2007–15

(Contribution to reserves, in millions of U.S. dollars)

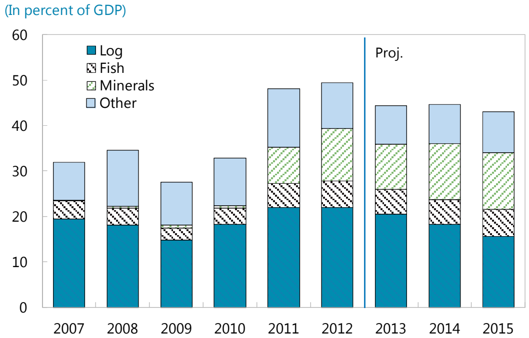


1/ Including errors and omissions.

Log exports have leveled off in 2012, while mining exports have increased…

Exports Goods, 2007–15

(In percent of GDP)

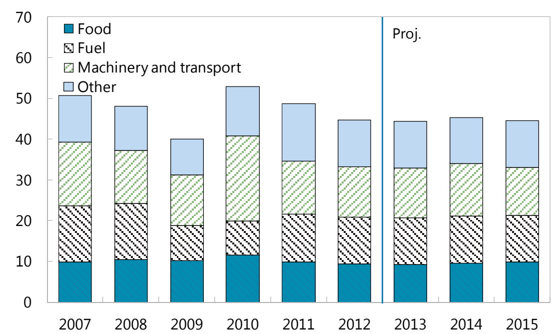


1/ Contribution to CPI inflation (in percentage points).

…and imports have declined in 2012 as the re-furbishing of the gold Ridge mine was completed.

Imports Goods, 2007–15

(In percent to GDP)

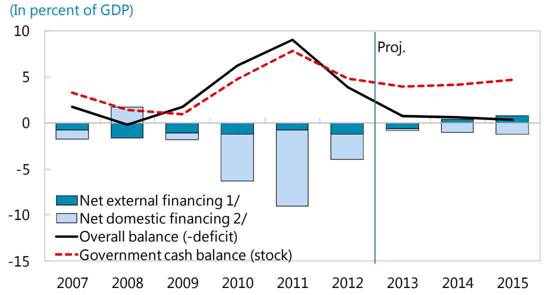


Sources: Country authorities; and IMF staff estimates.

Figure 1. Solomon Islands: Macroeconomic Developments and Outlook (concluded)

The fiscal balance in 2012 posted a surplus of almost 4 percent of GDP.

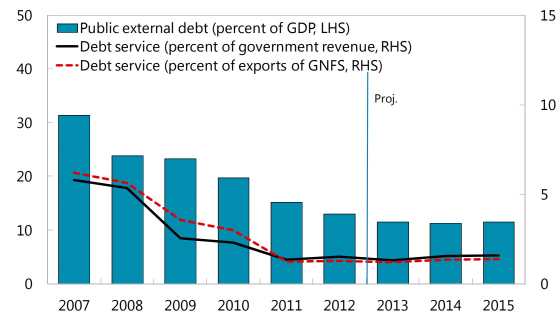
Fiscal Balance and Financing, 2007–15
(In percent of GDP)



1/ In 2007, includes debt forgiveness.
2/ Includes privatization receipts.

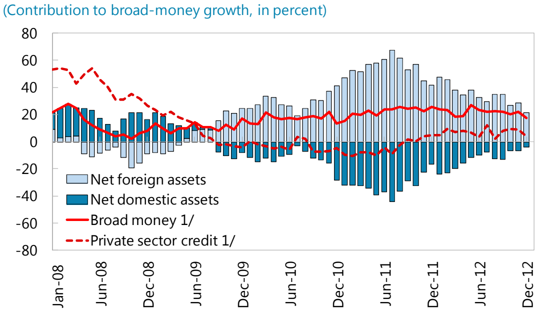
Public external debt continues to decline to sustainable levels.

Public External Debt, 2007–15



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

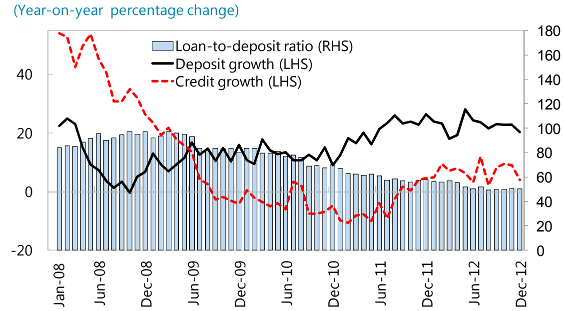
Monetary Developments, 2008–2012
(Contribution to broad-money growth, in percent)



1/ Year-on-year percentage change.

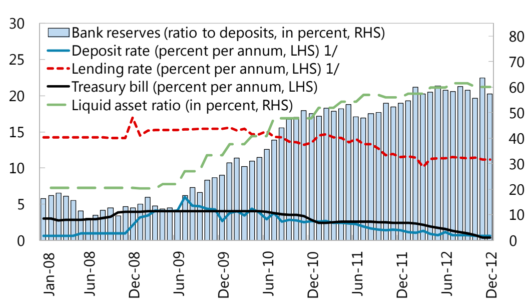
...but credit growth has been weak...

Deposit and Credit Growth, 2008–2012
(Year-on-year percentage change)



...despite lower lending rates and ample liquidity of the banking sector.

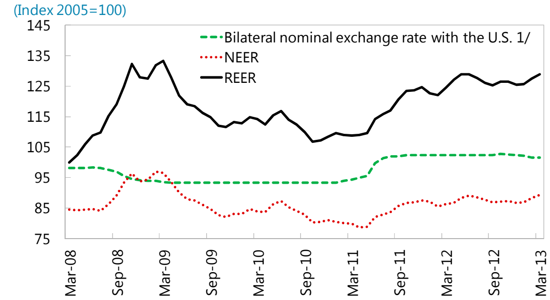
Interest Rates and Bank Reserves, 2008–2012



1/ Weighted average rate of commercial banks.

The real effective exchange rate appreciated by 2.5 percent in Q1 2013.

Nominal and Effective Exchange Rates, Mar.2008–13
(Index 2005=100)



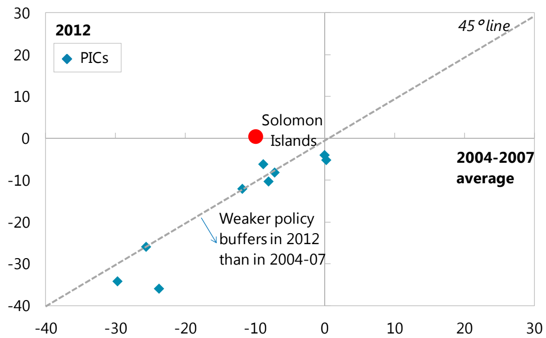
1/ Based on U.S. dollars per Solomon Islands dollar exchange rate.

Sources: Country authorities; and IMF staff estimates.

Figure 2. Solomon Islands: Rebuilding Policy Buffers

Solomon Islands is one of the only two Pacific Island countries (PICs) that has higher policy buffers in 2012 than during 2004–07 ....

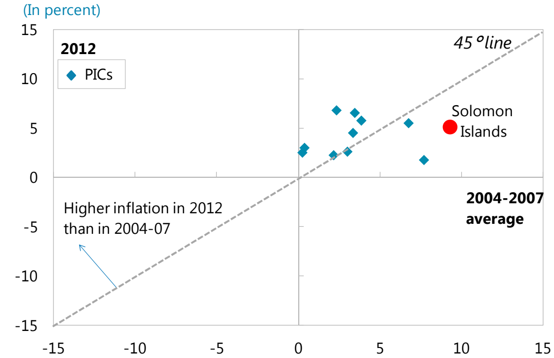
Overall Buffer Index, 2004-07 and 2012



...thanks to lower inflation...

Inflation

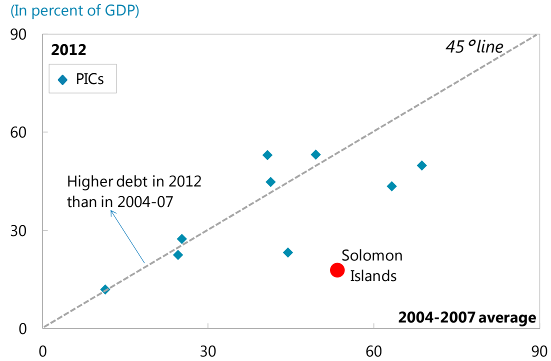
(In percent)



...reduced debt...

Gross Debt

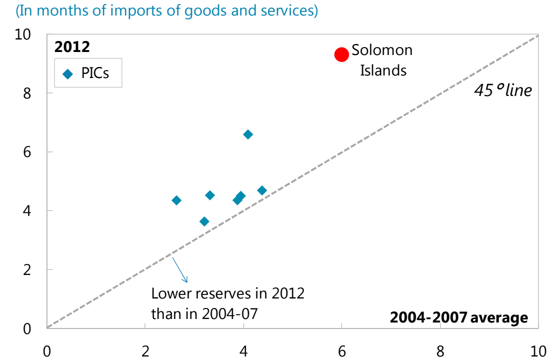
(In percent of GDP)



...and higher reserve coverage.

Reserves

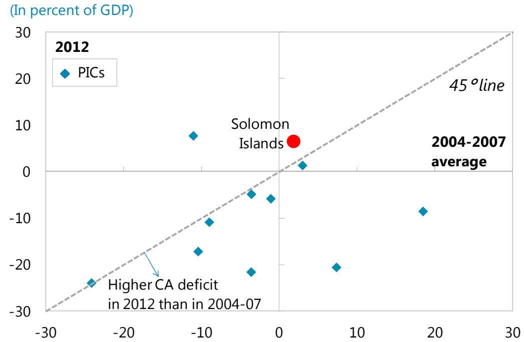
(In months of imports of goods and services)



The current account position has improved...

Current Account and FDI

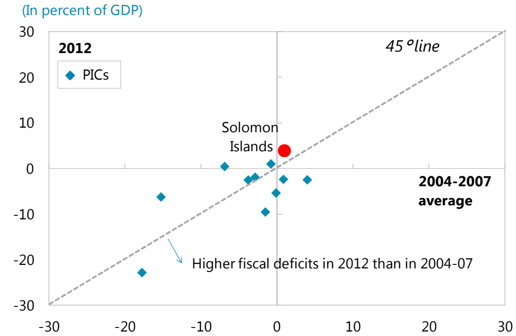
(In percent of GDP)



...as well as the fiscal balance.

Fiscal Balance

(In percent of GDP)

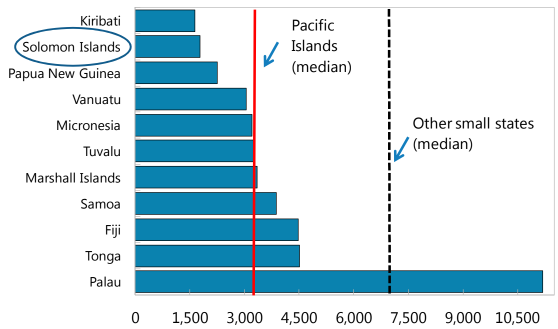


Sources: Country authorities; and IMF staff estimates.

Figure 3. Solomon Islands: The Cross-Country Context

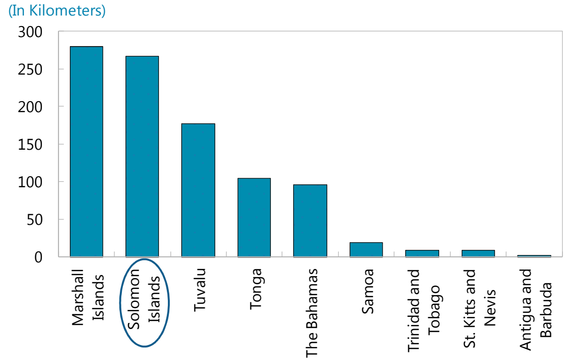
Solomon islands is one of the poorest countries in the Pacific and it faces several challenges…

GDP per Capita, 2012
(In U.S. dollars)



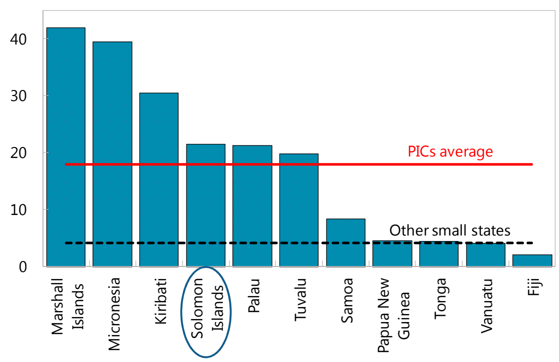
…including geographical dispersion…

Geographical Dispersion: Average Sea Distance Between Two Inhabitants of the Same Country
(In Kilometers)



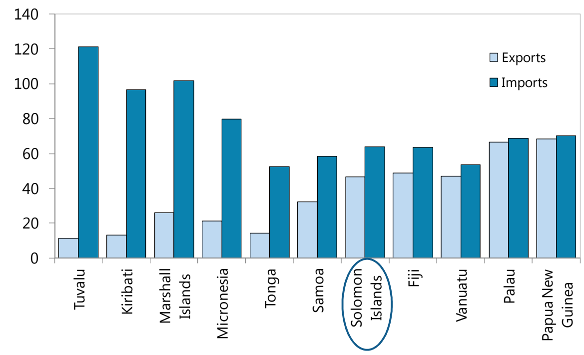
…and the dependence on external support…

External Grants, 2005-12
(In percent of GDP)



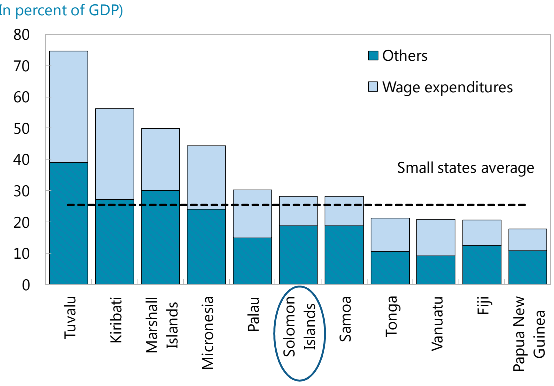
…to finance its trade deficit and large development needs.

Trade Balance Goods and Services, 2005-12
(In percent of GDP)



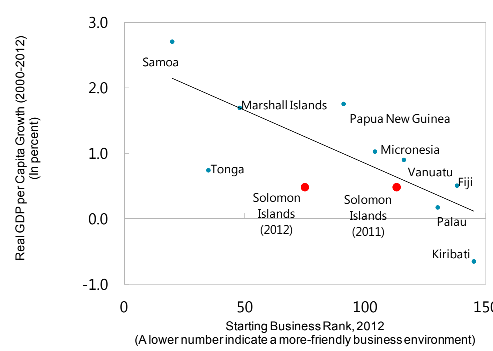
The economy is dominated by the public sector due to its narrow production base…

Current Government Expenditure, 2012
(In percent of GDP)



…and constraints to private sector development, despite recent improvements.

Business Environment and Real GDP per Capita Growth



Sources: Country authorities; and IMF staff estimates.

Table 1. Solomon Islands: Selected Economic Indicators, 2010–14

Per capita GDP (2012): US$1,763 (estimate)
Population (2011): 552,000
Poverty rate (2006): 23 percent

Quota: SDR 10.4 million
Main products and exports: logs and gold
Main export markets: emerging Asia

	2010	2011	2012		2013		2014
			Prog. (EBS/12/145)	Est.	Prog. (EBS/12/145)	Rev. Proj.	Proj.
Growth and prices (percentage change)							
Real GDP 1/	7.8	10.7	5.5	4.8	4.0	4.0	3.8
Of which : nontimber nonmining	5.4	7.3	3.4	3.5	4.2	5.5	3.5
CPI (period average)	0.9	7.4	5.1	5.9	5.4	6.0	4.9
CPI (end of period)	0.8	9.4	6.2	5.1	4.7	5.3	5.0
GDP deflator	5.9	9.1	6.0	5.4	6.1	6.3	5.7
Nominal GDP (in SI$ millions)	5,496	6,637	7,426	7,331	8,194	8,099	8,883
Of which : nonmining nominal GDP (in SI$ millions)	5,391	6,276	6,732	6,737	7,351	7,599	8,192
Per capita GDP (in US$)	1,266	1,573	1,786	1,763	1,899	1,901	1,989
Per capita GNI (in US$)	944	1,250	1,393	1,568	1,525	1,689	1,735
Central government operations (percent of GDP)							
Total revenue and grants	62.6	60.3	57.3	54.2	54.4	53.3	50.9
Revenue	32.0	33.1	32.7	34.6	31.5	33.5	33.0
Grants	30.7	27.1	24.5	19.6	23.0	19.9	17.9
Total expenditure	56.4	51.2	57.9	50.3	53.2	52.6	50.3
Recurrent expenditure	28.2	25.6	31.0	28.5	26.7	28.2	26.9
Development expenditure	27.9	25.5	26.9	21.8	26.5	24.4	23.4
Unrecorded expenditure 2/	0.3	0.1	0.0	0.0	0.0	0.0	0.0
Overall balance	6.2	9.0	-0.6	3.9	1.2	0.8	0.6
Foreign financing (net)	-1.2	-0.7	-0.7	-1.2	-0.3	-0.6	0.4
Domestic financing (net)	-5.1	-8.4	1.3	-2.7	-0.9	-0.2	-1.0
Privatization receipts	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Central government debt (percent of GDP, unless otherwise indicated) 3/	27.8	21.6	18.2	17.5	15.4	14.6	13.6
Domestic debt	8.1	6.4	5.3	4.5	3.7	3.1	2.3
External debt	19.8	15.2	12.9	13.0	11.7	11.5	11.2
(In US$ millions, end of period)	134.7	137.0	130.4	130.7	126.8	124.7	130.3
Monetary and credit (percentage change, end-year data)							
Credit to private sector	-4.7	4.7	6.7	4.1	5.0	8.2	10.7
Broad money	13.5	25.5	31.1	17.3	3.8	15.2	8.4
Reserve money	75.3	32.8	37.2	22.0	3.8	14.5	8.4
Interest rate - deposit (percent per annum)	2.6	1.4	0.7	0.9	...	...	...
Interest rate - lending (percent per annum)	13.5	11.5	11.4	11.2	...	...	...
Balance of payments (in US$ millions, unless otherwise indicated)							
Current account balance	-210.1	-58.5	-58.3	-1.3	-116.2	-21.8	-76.7
(Percent of GDP)	-30.8	-6.7	-5.8	-0.1	-10.6	-2.0	-6.5
(excluding mining-related capital imports, in percent of GDP)	-12.6	0.7	2.8	3.9	-2.0	1.8	-2.7
Exports of goods and nonfactor services (GNFS)	330.2	556.6	601.4	639.2	624.4	641.8	688.5
(Percentage change)	40.6	68.5	8.1	14.8	3.8	0.4	7.3
Logging exports	124.7	191.4	177.9	219.2	174.2	225.9	215.5
Imports of GNFS	547.8	610.0	667.3	650.0	760.9	707.7	790.2
(Percentage change)	59.2	11.4	10.5	6.6	14.0	8.9	11.7
Foreign direct investment	235.6	140.8	116.4	66.8	93.4	27.3	34.0
(Percent of GDP)	34.6	16.2	11.5	6.7	8.5	2.5	2.9
Overall balance	119.8	146.4	91.3	87.3	28.0	51.0	27.0
Gross official reserves (in US$ millions, end of period) 4/	265.8	412.3	503.8	499.6	532.2	551.1	576.9
(In months of next year's imports of GNFS)	5.2	7.6	7.9	8.5	8.6	8.4	8.6
(In months of next year's nonmining-related imports of GNFS)	5.9	8.1	9.1	9.0	9.9	8.9	9.1
Exchange rate (SI$/US$, end of period)	8.1	7.4	7.4	7.3	...	...	...
Real effective exchange rate (end of period, 2005 = 100)	108.4	124.6	112.5	125.5	...	...	...
Nominal effective exchange rate (end of period, 2005 = 100)	81.1	87.6	87.3	86.7	...	...	...

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/ 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		2013	2014	2015	2016	2017
			Prog. (EBS/12/145)	Est.			Proj.		
	(In millions of U.S. dollars)								
Current account balance	-210.1	-58.5	-58.3	-1.3	-21.8	-76.7	-66.3	-99.0	-115.8
Trade balance for goods	-136.6	-4.8	-9.0	47.1	0.3	-7.0	-18.1	-38.4	-61.5
Exports	223.7	418.2	453.0	493.2	488.7	526.1	536.1	545.5	557.9
Imports	-360.3	-423.0	-462.0	-446.1	-488.4	-533.1	-554.2	-583.8	-619.3
Trade balance for services	-81.0	-48.6	-56.9	-57.8	-66.2	-94.7	-82.6	-92.6	-97.8
Exports	106.5	138.4	148.4	146.1	153.1	162.4	170.3	179.4	188.6
Imports	-187.5	-187.0	-205.2	-203.9	-219.3	-257.0	-252.9	-272.0	-286.4
Income balance	-173.3	-178.4	-222.1	-110.5	-122.7	-149.9	-153.7	-152.5	-137.4
Current transfers balance 2/	180.8	173.3	229.7	120.0	166.9	174.9	188.1	184.5	180.9
Of which : Official transfers, net	168.5	164.3	219.2	104.9	138.6	144.1	154.6	148.1	141.4
Capital and financial account balance	341.4	244.5	149.6	96.9	72.9	103.7	104.9	103.4	116.4
Capital account balance	49.8	71.2	35.3	92.1	57.4	60.2	55.0	43.3	43.7
Direct investment balance	235.6	140.8	116.4	66.8	27.3	34.0	35.9	39.0	45.8
Outwards	-2.3	-3.7	-0.6	-2.5	-5.0	-7.6	-8.8	-8.5	-8.5
Inwards	237.9	144.5	117.0	69.3	32.3	41.6	44.8	47.4	54.2
Portfolio investment balance	-2.6	0.0	0.0	-3.7	0.0	0.0	0.0	0.0	0.0
Other investment balance 3/	58.6	32.5	-2.1	-58.4	-11.9	9.4	13.9	21.2	26.9
Errors and omissions	-11.4	-39.6	0.0	-8.3	0.0	0.0	0.0	0.0	0.0
Overall balance	119.8	146.4	91.3	87.3	51.0	27.0	38.6	4.4	0.6
Financing	-110.3	-136.8	-91.3	-87.1	-51.0	-27.0	-38.6	-4.4	-0.6
Change in gross reserves (- = increase)	-119.8	-146.4	-91.5	-87.3	-51.5	-25.9	-35.8	-0.1	3.6
IMF	9.6	9.6	0.2	0.2	0.5	-1.1	-2.8	-4.3	-4.3
	(In percent of GDP, unless otherwise indicated)								
Current account	-30.8	-6.7	-5.8	-0.1	-2.0	-6.5	-5.3	-7.6	-8.4
(excluding mining-related exports and imports of goods and services)	-12.6	-6.3	-11.3	-7.3	-7.0	-13.9	-12.7	-15.5	-17.3
(excluding mining-related imports of goods and services)	-12.6	0.7	2.8	3.9	1.8	-2.7	-1.5	-4.0	-4.9
(excluding net official transfers)	-55.6	-25.6	-27.5	-10.7	-14.6	-18.8	-17.8	-18.9	-18.7
Trade balance for goods	-20.0	-0.6	-0.9	4.7	0.0	-0.6	-1.5	-2.9	-4.5
Exports (in percent of GDP)	32.8	48.2	44.9	49.5	44.5	44.7	43.1	41.6	40.5
Of which: Logs	18.3	22.0	17.6	22.0	20.6	18.3	15.7	13.6	11.6
Of which: Fish	3.6	5.2	4.1	5.8	5.4	5.4	5.9	6.4	6.6
Of which: Minerals	0.5	8.0	13.9	11.7	9.9	12.4	12.5	13.1	13.9
Imports	52.9	48.7	45.8	44.8	44.4	45.3	44.5	44.6	44.9
Of which: Food	11.5	9.8	9.9	9.3	9.3	9.5	9.8	10.0	10.2
Of which: Fuel	8.3	11.8	11.3	11.5	11.4	11.6	11.6	11.7	11.8
Of which: Machinery and transportation equipment	21.0	13.0	9.9	12.5	12.3	12.9	11.7	11.2	11.1
Mining imports	11.4	6.9	4.6	4.0	3.8	3.8	3.8	3.6	3.5
Nonmining imports	41.5	41.8	41.2	40.7	40.6	41.5	40.8	41.0	41.4
Trade balance for services	-11.9	-5.6	-5.6	-5.8	-6.0	-8.0	-6.6	-7.1	-7.1
Income balance	-25.4	-20.5	-22.0	-11.1	-11.2	-12.7	-12.4	-11.6	-10.0
Current transfers balance	26.5	20.0	22.7	12.0	15.2	14.9	15.1	14.1	13.1
Of which: Official transfers net	24.7	18.9	21.7	10.5	12.6	12.3	12.4	11.3	10.3
Capital account balance	7.3	8.2	3.5	9.2	5.2	5.1	4.4	3.3	3.2
Direct investment balance	34.6	16.2	11.5	6.7	2.5	2.9	2.9	3.0	3.3
Of which: Inward FDI	34.9	16.6	11.6	7.0	2.9	3.5	3.6	3.6	3.9
Other investment balance	8.6	3.7	-0.2	-5.9	-1.1	0.8	1.1	1.6	2.0
Errors and omissions	-1.7	-4.6	0.0	-0.8	0.0	0.0	0.0	0.0	0.0
Net international reserves (in US$ million) 3/	256.2	393.1	484.4	480.1	531.2	558.2	596.8	601.2	601.9
Gross official foreign reserves (in US$ million) 3/ 4/	265.8	412.3	503.8	499.6	551.1	576.9	612.7	612.8	609.2
In months of next year's imports of GNFS	5.2	7.6	7.9	8.5	8.4	8.6	8.6	8.1	7.7
Gross external public debt	19.8	15.2	12.9	13.0	11.5	11.2	11.5	12.3	13.4
Disbursement of consessional borrowing (in US$ millions)	9.6	9.6	0.0	0.2	0.5	13.5	19.1	26.2	31.0
External public debt service (in percent of exports of GNFS)	3.0	1.2	1.3	1.3	1.2	1.3	1.4	1.4	1.3
Gross external debt (percent of GDP)	31.9	25.1	21.7	21.9	20.8	22.3	23.1	24.5	26.0
Private sector	12.2	9.9	8.8	8.9	9.3	11.0	11.6	12.2	12.6
Public sector	19.8	15.2	12.9	13.0	11.5	11.2	11.5	12.3	13.4
External debt service (percent of GDP)	2.3	1.6	1.5	1.5	1.4	1.6	1.9	1.9	1.8
Principal	1.6	1.0	1.0	1.0	0.9	1.1	1.2	1.2	1.1
Interest	0.7	0.7	0.6	0.6	0.5	0.5	0.6	0.7	0.7
Nominal GDP (in US$ million)	681.5	868.5	…	996.7	…	…	…	…	…

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 capital transfers.

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, 2010–14

	2010	2011		2012			2013			2014
		Budget	Act.	Suppl. Budget	Prog. (EBS/12/145)	Act.	Budget	Prog. (EBS/12/145)	Rev. Proj.	Proj.
				(In millions of Solomon Islands dollars)						
Total revenue and grants	3,442	3,635	4,000	3,984	4,253	3,975	4,350	4,461	4,320	4,522
Total revenue	1,757	1,959	2,199	2,485	2,430	2,535	2,683	2,578	2,710	2,931
Tax revenue	1,589	1,760	1,989	2,237	2,205	2,254	2,441	2,350	2,467	2,664
Income and profits	638	741	669	753	767	785	872	831	870	950
Goods and services	569	641	752	930	834	824	925	902	913	1,010
International trade and transactions	382	378	568	555	604	645	644	617	684	704
Of which: Tax on logging	241	199	373	369	384	407	…	381	462	452
Other revenue	168	199	210	248	225	281	242	228	243	267
Grants	1,685	1,676	1,801	1,499	1,823	1,440	1,667	1,883	1,609	1,591
Development grants	1,289	1,469	1,553	1,116	1,432	1,116	1,196	1,533	1,196	1,286
Recurrent budget grants	396	207	248	382	391	323	471	351	413	305
Expenditure	3,099	3,529	3,400	4,209	4,299	3,689	4,451	4,360	4,258	4,468
Recurrent expenditure	1,548	1,616	1,701	2,270	2,300	2,090	2,473	2,187	2,286	2,394
Compensation of employees	588	588	623	655	690	695	731	721	806	884
Interest payments	23	29	24	25	21	18	21	21	21	19
Other recurrent expenditure 1/	937	1,000	1,054	1,589	1,589	1,376	1,722	1,445	1,459	1,490
Of which: Government funded	737	793	924	1,207	1,207	1,053	1,246	1,094	1,046	1,185
Development expenditure	1,533	1,914	1,695	1,939	2,000	1,598	1,978	2,173	1,972	2,075
Government funded	243	444	342	760	505	577	686	641	681	789
Domestic	243	444	342	760	505	577	686	609	681	691
External loan	0	0	0	…	0	0	0	31	0	98
Grant funded	1,289	1,469	1,354	1,179	1,495	1,021	1,291	1,533	1,291	1,286
Unidentified expenditure 2/	18	0	4	0	0	0	0	0	0	0
Current balance	605	550	745	598	522	769	681	741	838	842
Overall balance	343	106	599	-225	-46	286	-101	101	62	54
Total financing	-343	-106	-599	225	46	-286	101	-101	-62	-54
Foreign (net)	-65	-58	-49	-50	-49	-90	-48	-28	-48	37
Domestic (net)	-279	-58	-561	275	95	-196	148	-73	-14	-91
Banking system	-282	-49	-558	289	109	-177	162	-59	0	-77
Nonbank	2	-9	-3	-14	-15	-19	-14	-14	-14	-14
Others	1	10	10	0	0	0	0	0	0	0
				(In percent of GDP)						
Total revenue and grants	62.6	54.8	60.3	54.3	57.3	54.2	53.7	54.4	53.3	50.9
Total revenue	32.0	29.5	33.1	33.9	32.7	34.6	33.1	31.5	33.5	33.0
Tax revenue	28.9	26.5	30.0	30.5	29.7	30.7	30.1	28.7	30.5	30.0
Income and profits	11.6	11.2	10.1	10.3	10.3	10.7	10.8	10.1	10.7	10.7
Goods and services	10.4	9.7	11.3	12.7	11.2	11.2	11.4	11.0	11.3	11.4
International trade and transactions	6.9	5.7	8.6	7.6	8.1	8.8	8.0	7.5	8.4	7.9
Of which: Tax on logging	4.4	3.0	5.6	5.0	5.2	5.5	…	4.7	5.7	5.1
Other revenue	3.1	3.0	3.2	3.4	3.0	3.8	3.0	2.8	3.0	3.0
Grants	30.7	25.3	27.1	20.4	24.5	19.6	20.6	23.0	19.9	17.9
Development grants	23.5	22.1	23.4	15.2	19.3	15.2	14.8	18.7	14.8	14.5
Recurrent budget grants	7.2	3.1	3.7	5.2	5.3	4.4	5.8	4.3	5.1	3.4
Expenditure	56.4	53.2	51.2	57.4	57.9	50.3	55.0	53.2	52.6	50.3
Recurrent expenditure	28.2	24.3	25.6	31.0	31.0	28.5	30.5	26.7	28.2	26.9
Compensation of employees	10.7	8.9	9.4	8.9	9.3	9.5	9.0	8.8	10.0	10.0
Interest payments	0.4	0.4	0.4	0.3	0.3	0.2	0.3	0.3	0.3	0.2
Other recurrent expenditure 1/	17.1	15.1	15.9	21.7	21.4	18.8	21.3	17.6	18.0	16.8
Of which : Government funded	13.4	11.9	13.9	16.5	16.1	14.4	15.4	13.4	12.9	13.3
Development expenditure	27.9	28.8	25.5	26.5	26.9	21.8	24.4	26.5	24.4	23.4
Government funded	4.4	6.7	5.2	10.4	6.8	7.9	8.5	7.8	8.4	8.9
Domestic	4.4	6.7	5.2	10.4	6.8	7.9	8.5	7.4	8.4	7.8
External loan	0.0	0.0	0.0	…	0.0	0.0	0.0	0.4	0.0	1.1
Grant funded	23.5	22.1	20.4	16.1	20.1	13.9	15.9	18.7	15.9	14.5
Unidentified expenditure 2/	0.3	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current balance	11.0	8.3	11.2	8.2	7.0	10.5	8.4	9.0	10.3	9.5
Overall balance	6.2	1.6	9.0	-3.1	-0.6	3.9	-1.2	1.2	0.8	0.6
(excluding unidentified expenditure)	6.6	1.6	9.1	-3.1	-0.6	3.9	-1.2	1.2	0.8	0.6
Total financing	-6.2	-1.6	-9.0	3.1	0.6	-3.9	1.2	-1.2	-0.8	-0.6
Foreign (net)	-1.2	-0.9	-0.7	-0.7	-0.7	-1.2	-0.6	-0.3	-0.6	0.4
Domestic (net)	-5.1	-0.9	-8.4	3.8	1.3	-2.7	1.8	-0.9	-0.2	-1.0
Memorandum items:										
Nominal GDP (in SI$ millions)	5,496	6,637	6,637	7,331	7,426	7,331	8,099	8,194	8,099	8,883
Target of program cash balance (in SI$ millions) 3/	263	287	522	…	425	355	…	445	411	461
in months of recurrent spending	2.0	2.1	3.7	…	2.2	2.0	…	2.4	2.2	2.3
Mineral revenue (percent of GDP)	0.0	0.0	0.4	…	0.7	0.6	…	0.7	0.5	0.6
Non-mineral primary balance (percent of GDP) 4/	3.1	2.0	4.2	…	-0.2	1.2	…	1.1	1.7	1.4
Non-commodity primary balance (percent of GDP) 5/	-1.3	-1.0	-1.4	…	-5.3	-4.3	…	-3.5	-4.0	-3.7
Non-commodity primary balance, excluding development expenditures (percent of GDP) 6/	3.2	5.7	3.7	…	1.5	3.6	…	3.9	4.4	4.1

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, 2010–17

	2010	2011	2012	2013	2014	2015	2016	2017
			Est.	Projections				
Growth and prices (percentage change) 1/								
Real GDP	7.8	10.7	4.8	4.0	3.8	3.7	3.6	3.6
Of which : nontimber and nonmining	5.4	7.3	3.5	5.5	3.5	4.9	4.8	4.6
CPI (period average)	0.9	7.4	5.9	6.0	4.9	4.7	4.5	4.5
CPI (end of period)	0.8	9.4	5.1	5.3	5.0	4.7	4.5	4.5
GDP deflator	5.9	9.1	5.4	6.3	5.7	5.1	4.7	4.7
Nominal GDP (in SI$ millions)	5,496	6,637	7,331	8,099	8,883	9,676	10,493	11,377
Per capita GDP (in US$)	1,266	1,573	1,763	1,901	1,989	2,058	2,120	2,183
Per capita GNI (in US$)	944	1,250	1,568	1,689	1,735	1,803	1,873	1,966
Central government operations (percent of GDP)								
Total revenue and grants	62.6	60.3	54.2	53.3	50.9	50.2	50.4	49.2
Revenue	32.0	33.1	34.6	33.5	33.0	32.3	33.2	32.7
Tax revenue	28.9	30.0	30.7	30.5	30.0	29.3	30.2	29.7
Income and profits	11.6	10.1	10.7	10.7	10.7	10.7	12.2	12.2
Goods and services	10.4	11.3	11.2	11.3	11.4	11.4	11.4	11.4
International trade and transactions	6.9	8.6	8.8	8.4	7.9	7.2	6.7	6.2
Of which: Tax on logging	4.4	5.6	5.5	5.7	5.1	4.4	3.8	3.2
Other revenue	3.1	3.2	3.8	3.0	3.0	3.0	3.0	3.0
Grants	30.7	27.1	19.6	19.9	17.9	17.9	17.1	16.5
Total expenditure	56.4	51.2	50.3	52.6	50.3	49.8	49.7	48.8
Recurrent expenditure	28.2	25.6	28.5	28.2	26.9	26.7	26.7	26.4
Development expenditure	27.9	25.5	21.8	24.4	23.4	23.1	23.0	22.4
Unidentified expenditure 2/	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	6.2	9.0	3.9	0.8	0.6	0.4	0.7	0.4
Non-mineral primary balance 3/	3.1	4.2	1.2	1.7	1.4	1.5	0.8	0.8
Non-commodity primary balance 4/	-1.3	-1.4	-4.3	-4.0	-3.7	-2.8	-2.9	-2.4
Central government debt (percent of GDP) 5/	27.8	21.6	17.5	14.6	13.6	13.3	13.8	14.7
Balance of payments (in US$ millions)								
Current account balance (- deficit)	-210.1	-58.5	-1.3	-21.8	-76.7	-66.3	-99.0	-115.8
(In percent of GDP)	-30.8	-6.7	-0.1	-2.0	-6.5	-5.3	-7.6	-8.4
(Excluding mining-related capital imports, in percent of GDP)	-12.6	0.7	3.9	1.8	-2.7	-1.5	-4.0	-4.9
Overall balance	119.8	146.4	87.3	51.0	27.0	38.6	4.4	0.6
Gross official reserves (end of period) 6/	265.8	412.3	499.6	551.1	576.9	612.7	612.8	609.2
(In months of next year's imports of GNFS)	5.2	7.6	8.5	8.4	8.6	8.6	8.1	7.7
(In months of next year's nonmining-related imports of GNFS)	5.9	8.1	9.0	8.9	9.1	9.1	8.6	8.1

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 2011–June 2014 1/

	2011	2012					2013				2014	
	Dec	Mar	Jun	Sep	Dec		Mar	Jun	Sep	Dec.	Mar	Jun
			Act.		Prog. (EBS/12/145)	Act.	Act.			Projections		
	(In millions of Solomon Islands dollars, end of period)											
Central Bank of Solomon Islands (CBSI)												
Net foreign assets (NFA)	2,779	3,025	3,257	3,404	3,485	3,421	3,418	3,429	3,467	3,504	3,541	3,577
Net international reserves (NIR)	2,893	3,138	3,368	3,516	3,598	3,534	3,529	3,540	3,577	3,616	3,653	3,691
Other NFA	-114	-114	-112	-112	-113	-113	-111	-111	-111	-112	-112	-114
Net domestic assets (NDA)	-1,094	-1,263	-1,279	-1,392	-1,173	-1,366	-1,655	-1,279	-1,202	-1,150	-1,268	-1,159
Net claims on central government	-838	-925	-1,001	-1,007	-667	-946	-1,080	-1,069	-1,035	-996	-1,010	-1,004
Claims	103	101	91	84	103	82	80	80	80	80	80	80
Deposits	941	1,026	1,092	1,091	771	1,028	1,161	1,149	1,116	1,077	1,091	1,084
Other items (net)	-256	-338	-277	-385	-506	-420	-574	-210	-167	-154	-258	-155
Reserve money	1,685	1,762	1,978	2,011	2,312	2,055	1,764	2,150	2,265	2,353	2,273	2,419
Currency in circulation	526	515	543	537	591	599	553	608	669	669	669	669
Bank deposits	1,126	1,213	1,398	1,443	1,688	1,446	1,204	1,521	1,579	1,671	1,589	1,733
Other deposits	33	33	37	31	33	9	7	21	17	13	15	17
Other depository corporations												
NFA of commercial banks	87	65	102	90	85	12	124	82	102	97	82	82
Assets	167	164	216	190	187	122	221	179	198	193	178	178
Liabilities	80	99	115	101	101	110	98	96	96	96	96	96
NDA of commercial banks	838	805	844	877	1,026	997	1,226	992	1,031	1,080	1,054	1,127
Net claims on central government	-28	-86	-128	-106	-89	-97	-77	-96	-125	-164	-171	-184
Claims	101	96	84	67	40	65	60	41	12	-27	-34	-47
Deposits	129	182	212	172	129	163	137	137	137	137	137	137
Claims on the private sector	1,216	1,204	1,204	1,225	1,298	1,266	1,356	1,342	1,358	1,399	1,414	1,395
Other items (net)	-350	-313	-232	-242	-184	-172	-53	-254	-203	-155	-189	-84
Reserves and vault cash	1,171	1,248	1,438	1,491	1,739	1,513	1,246	1,480	1,534	1,626	1,544	1,688
Deposits	2,097	2,118	2,383	2,458	2,850	2,522	2,596	2,555	2,667	2,803	2,680	2,898
Depository corporations survey												
NFA of the banking system	2,867	3,089	3,358	3,493	3,570	3,433	3,542	3,511	3,569	3,601	3,623	3,660
Central bank	2,779	3,025	3,257	3,404	3,485	3,421	3,418	3,429	3,467	3,504	3,541	3,577
Other depository corporations	87	65	102	90	85	12	124	82	102	97	82	82
NDA of the banking system	-256	-458	-435	-515	-148	-369	-428	-287	-171	-71	-214	-32
Net claims on central government	-866	-1,011	-1,129	-1,113	-756	-1,043	-1,157	-1,165	-1,160	-1,160	-1,181	-1,188
Claims on the private sector 2/	1,221	1,209	1,209	1,230	1,304	1,271	1,361	1,345	1,360	1,376	1,417	1,422
Other items (net)	-611	-656	-515	-633	-696	-598	-632	-467	-371	-286	-450	-266
Broad money (M3)	2,611	2,631	2,924	2,978	3,423	3,064	3,114	3,225	3,397	3,530	3,409	3,628
M1	1,874	1,909	2,227	2,300	2,456	2,396	2,453	2,522	2,657	2,761	2,666	2,837
Currency outside banks	481	480	503	489	540	533	511	649	714	714	714	714
Demand deposits	1,393	1,428	1,723	1,811	1,916	1,863	1,942	1,873	1,943	2,047	1,952	2,123
Savings and time deposits	737	723	697	678	966	668	661	703	741	769	743	791
	(Annual percentage change, unless otherwise indicated)											
Reserve money	32.8	29.0	39.9	36.1	37.2	22.0	0.1	8.7	12.6	14.5	28.8	12.5
Credit to the private sector	4.7	7.2	3.3	8.2	6.7	4.1	12.6	11.2	10.6	8.2	4.1	5.7
Broad money	25.5	18.4	23.4	22.2	31.1	17.3	18.3	10.3	14.1	15.2	9.5	12.5
NFA of the banking system 3/	42.0	36.7	23.6	25.1	26.0	21.7	17.2	5.2	2.5	5.5	2.6	4.6
NDA of the banking system 3/	-16.5	-18.3	-0.2	-2.9	5.1	-4.4	1.1	5.1	11.5	9.7	6.9	7.9
Memorandum items:												
Money multiplier	1.5	1.5	1.5	1.5	1.5	1.5	1.8	1.5	1.5	1.5	1.5	1.5
Reserve money	32.8	29.0	39.9	36.1	37.2	22.0	0.1	8.7	12.6	14.5	28.8	12.5
Loan to deposit ratio (in percent)	58.0	56.8	50.5	49.8	45.6	50.2	52.2	52.5	50.9	49.9	52.7	48.1
Interest rates (percent per annum)												
Deposit rate 4/	1.4	1.3	1.1	0.7	…	0.9	0.3	…	…	…	…	…
Lending rate 4/	11.5	10.2	11.4	11.4	…	11.2	11.0	…	…	…	…	…
NCG of financial corporations	-765	-914	-1,031	-1,029	-671	-962	-1,077	-1,092	-1,098	-1,111	-1,136	-1,150
91-Day Treasury Bill Rate	2.4	2.2	1.6	0.9	…	0.3	0.4	…	…	…	…	…
Program targets												
NIR of CBSI (in US$ millions)	393	426	458	478	470	479	477	480	485	490	495	500
NDA of CBSI (in SI$ millions)	-1,094	-1,263	-1,279	-1,392	-1,173	-1,366	-1,655	-1,279	-1,202	-1,150	-1,268	-1,159

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

1/ Based on the new program exchange rate of SI$7.36 per US$.
2/ Includes claims of the CBSI on other (nonbank) financial corporations.
3/ Contribution to year-on-year broad money growth, in percentage points.
4/ Weighted average of different maturities.

Table 6. Solomon Islands: Reviews and Disbursements Under the Extended Credit Facility

Date	Amount of Disbursement		Condition
	In percent of quota	In SDR	
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.

Table 7. Solomon Islands: Indicators of Capacity to Repay the Fund, 2012–23

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
		Projections										
Fund obligations based on existing credit (in SDR millions)												
Principal	0.0	0.0	1.0	2.1	2.8	2.8	2.5	1.4	0.0	0.0	0.0	0.0
Charges and interest	0.0	0.0	0.0	0.1	0.0	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	1.0	2.1	2.8	2.8	2.5	1.5	0.2	0.2	0.2	0.2
Charges and interest	0.0	0.0	0.0	0.1	0.0	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	1.0	2.1	2.8	2.8	2.5	1.5	0.2	0.2	0.2	0.2
In millions of US$	0.0	0.0	1.6	3.3	4.3	4.3	3.8	2.3	0.2	0.3	0.3	0.2
In percent of gross international reserves	0.0	0.0	0.3	0.5	0.7	0.7	0.7	0.4	0.0	0.1	0.1	0.1
In percent of exports of goods and services	0.0	0.0	0.2	0.5	0.6	0.6	0.5	0.3	0.0	0.0	0.0	0.0
In percent of debt service 2/	0.0	0.0	8.2	14.1	17.5	17.4	15.3	10.2	1.1	1.4	1.4	1.1
In percent of GDP	0.0	0.0	0.1	0.3	0.3	0.3	0.3	0.1	0.0	0.0	0.0	0.0
In percent of quota	0.0	0.0	10.0	20.6	27.0	26.9	23.9	14.4	1.5	2.0	2.0	1.4
Outstanding Fund credit												
In millions of SDRs	12.6	12.9	12.2	10.4	7.6	4.9	2.4	0.9	0.7	0.5	0.3	0.2
In millions of US$	19.4	19.8	18.6	15.9	11.6	7.4	3.6	1.4	1.1	0.8	0.5	0.2
In percent of gross international reserves	3.9	3.6	3.2	2.6	1.9	1.2	0.7	0.3	0.2	0.2	0.1	0.1
In percent of exports of goods and services	3.0	3.1	2.7	2.2	1.6	1.0	0.5	0.2	0.1	0.1	0.1	0.0
In percent of debt service 2/	126.2	130.6	96.3	68.3	47.6	30.1	14.6	6.0	5.0	3.6	2.1	1.0
In percent of GDP	1.9	1.8	1.6	1.3	0.9	0.5	0.2	0.1	0.1	0.0	0.0	0.0
In percent of quota	121.4	124.3	117.1	100.0	73.4	46.6	22.9	8.6	7.0	5.0	3.0	1.3
Net use of Fund credit (in SDR millions)												
Disbursements	0.1	0.3	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	0.0	0.0	1.0	2.1	2.8	2.8	2.5	1.5	0.2	0.2	0.2	0.2
Memorandum items:												
Nominal GDP (in US$ millions)	996.7	1099.3	1176.4	1244.0	1309.7	1378.8	1457.3	1540.6	1634.1	1691.4	1776.4	1893.6
Exports of goods and services (in US$ millions)	639.2	641.8	688.5	706.4	724.9	746.4	717.8	746.7	778.4	746.6	737.0	719.1
Gross international reserves (in US$ millions)	499.6	551.1	576.9	612.7	612.8	609.2	547.0	538.3	523.8	470.2	386.6	292.4
Debt service (in US$ millions) 2/	15.4	15.2	19.4	23.3	24.4	24.5	24.7	22.4	22.2	22.1	22.1	22.6
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	11.4

Source: IMF staff estimates and projections.

1/ Prospective credit includes the 8.6 percent of quota (SDR 0.89 million) available under the Extended Credit Facility.
2/ Total public debt service, including IMF repayments.

Appendix I—Letter of Intent

June 10, 2013

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

Dear Ms. Lagarde:

The successful implementation of sound economic programs supported by the IMF has helped consolidate macroeconomic and financial stability in Solomon Islands, and facilitated donor support. In 2012, real GDP expanded by 4.8 percent, albeit slower than the record level of 2011, inflation fell to 5 percent in December (down from the peak of 11 percent in late 2011), and, by end-year, gross international reserves stood at a record US$500 million (above eight months of imports), while the external public sector debt fell to 13 percent of GDP.

Good overall performance under the Extended Credit Facility arrangement (ECF) has been achieved. We met all of the end-December 2012 performance criteria (PCs) with one exception; the PCs on net credit to the government, net international reserves, and net domestic assets of the central bank were all met with large margins. However, despite a better than anticipated fiscal outcome for 2012, the PC on the cash balance was missed by a very small amount (less than 5 per cent of the target) due to a brief delay in transferring government deposits already at the central bank to the specific government accounts that comprise the cash balance. Accordingly, we are requesting a waiver of nonobservance for this performance criterion based on the fact that the deviation from the performance criterion was minor and temporary. Finally, we also request the modification of the end-June 2013 performance criteria on the cash balance, net credit to the government, and net domestic assets of the CBSI in order to reflect recent developments and the updated outlook, including the need to lock in some of the over-performance in the net domestic assets of the CBSl relative to the December target and to use some of the fiscal space earned in 2012 to fund high priority spending and development needs in 2013.

We are also making sustained progress in meeting program benchmarks, notwithstanding a heavy workload. We have successfully met the end-December 2012 benchmarks on the multi-year budget framework, customs and excises act (*albeit* with some delay), Central Bank of Solomon Islands Act and the end-March 2013 benchmark on the workshop on financial inclusion. However, Cabinet's approval on changes to the tax system related to the new mining tax regime (end-December 2012 benchmark) has been delayed due to capacity constraints, in particular in the area of drafting legislation. Work is ongoing on the submission to Cabinet of instructions for state-owned enterprise borrowing (end-March 2013 benchmark). Both of these reforms are at an advanced stage, and we are confident that they will be implemented in the coming months. We request that the test date for both of these reforms be modestly extended by a few months to end-June 2013.

The attached Memorandum of Economic and Financial Policies (MEFP), which supplements the previous one dated November 13,2012, provides an update on achievements under our program so far, and sets out our PCs to end-2013 and indicative targets for March and June 2014, and a structural agenda for the first half of2014. We believe that the policies set forth in the MEFP are adequate to achieve the objectives of our program. However, if necessary, we stand ready to take further measures, in consultation with the IMF. We 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. In this context, the Government of the Solomon Islands is requesting completion of the first review under the ECF arrangement. We consent to publication of the staff report and the Letter of Intent and attachments.

Sincerely yours,

/s/
Hon. Gordon Darcy Lilo, MP
Prime Minister
Acting Minister of Finance and Treasury

/s/
Denton Rarawa
Governor
Central Bank of Solomon Islands

Attachments:
- Memorandum on Economic and Financial Policies;
- Technical Memorandum of Understanding.

Attachment I. Memorandum of Economic and Financial Policies

June 2013

Recent Developments and Outlook

1. **Recent macroeconomic performance.** The successful implementation of IMF-supported programs has helped consolidate macroeconomic and financial stability and facilitated donor support. While slowing down from the extraordinary level in the previous year (over 10 percent), in 2012 real GDP expanded by 4.8 percent, inflation moderated, and external buffers were rebuilt. At end-2012, inflation fell to 5 percent, down from a peak of 11 percent in late 2011; gross international reserves stood at a record US$500 million; and public external sector debt fell to 13 percent of GDP.

2. **Macroeconomic outlook and risks.** Growth is expected to moderate further in the near and medium term—to 3½–4 percent—as forestry, the traditional engine of growth, is expected to be adversely affected by the depletion of logging stocks well within a decade. In the medium-term, service sector is expected to drive growth. Despite some delays, planned investments in fiber-optic infrastructure and hydroelectric energy are expected to provide a boost to the economy over the medium-term, particularly to the telecommunications and energy sectors, and improve business opportunities by delivering low-cost, high-quality internet service and reliable energy. With inflation rising in early 2013 due to weather-related supply disruptions, it is projected to remain around 6 percent in the medium-term. Overall risks to the economy have become more balanced, even as near-term uncertainty remains elevated. On the upside, global and regional prospects have improved somewhat, assisting the outlook for Solomon Islands' external demand and foreign direct investment. Mining activity and the impact on growth of improved connectivity could be greater than anticipated. On the downside, the road to recovery for the global economy may remain bumpy, affecting Solomon Islands' prospects.

3. **Program performance.** Good overall performance under the Extended Credit Facility (ECF) arrangement has been achieved for most benchmarks. Performance criteria (PCs) for end-December 2012 on net credit to the government, net international reserves, and net domestic assets of the central bank were all met with large margins. However, the PC on the cash balance was missed by a small amount (SI$20 million, or less than 5 per cent of the target). This was due to the brief delay in transfer of government deposits already at the central bank to the specific government accounts that comprise the cash balance at the end of the 2012 financial year. Technically, the timely transfer of these end-of-year government deposits to the cash balance would have enabled Government to meet this PC. In addition, we are making sustained progress with our structural reform agenda, notwithstanding the heavy workload. We have successfully met the end-December 2012 benchmarks on the multi-year budget framework, customs and excises act, Central Bank of Solomon Island (CBSI) Act (*albeit* with some delay), and the end-March 2013 benchmark on the workshop on financial inclusion. However, Cabinet's approval of changes to the tax system related to the new mining tax regime (end-December 2012

benchmark) have been delayed due to capacity constraints, especially in the drafting of legal documents. At the same time, work is ongoing on the submission to Cabinet of instructions for state-owned enterprise borrowing (end-March 2013 benchmark). Both of these reforms are at an advanced stage and we request a modification in their test dates, to end-June 2013 for both of them.

Program Policies

4. **Our policies aim at enhancing the economy's resilience to shocks and promoting sustainable and inclusive growth through sound policies and reforms**. We will focus on strengthening the fiscal framework, improving monetary operations, maintaining a strong foreign exchange position, ensuring debt sustainability, and containing financial risks. We will also focus on reforms improving institutions to strengthen macroeconomic management and facilitate private sector development.

A. Fiscal Policies

5. **We are committed to preserving sound public finances while providing adequate resources for critical development spending.** The fiscal position remained strong in 2012, despite overly-optimistic revenue forecasts that were not achieved. This was due to careful control of spending, including bringing recurrent and development spending to levels consistent with economic fundamentals and the economy's absorptive capacity. We expect logging revenues to hold up in the near term and decline over the medium-term, while the expected mining revenues are still very uncertain. Therefore, our budgets will incorporate prudent revenue estimates, while careful control over expenditures will protect our policy buffers. At the same time, we will intensify our efforts to improve the quality of public spending to lift the economy's growth potential. To achieve these goals, we will ensure that fiscal policy for the near and medium-term is consistent with the following:

- **The cash balance.** We are committed to using the cash balance as a fiscal anchor at its current level (at least two months of recurrent spending), which requires careful financial planning of the budget's implementation. We believe that a prudent fiscal stance is further warranted given the uncertainty surrounding the global economy. Should revenue surprise on the upside, or the budget be under-spent due to capacity constraints, we will finance some unavoidable and high priority spending pressures, while also seeking to save for future development spending or to strengthen buffers.
- **Public expenditure.** We will strengthen control over public expenditure and enhance its quality, while meeting priority and developmental needs. One near-term priority is to address the erosion of real public wages—public sector wages have increased much slower than inflation in the past decade. We intend to increase basic wages for the public sector by a cumulative of 6 percent in 2013, and, in addition, strengthen teachers pay for length of service and qualification. At the same time, we will work towards consolidating the number

and magnitude of public-sector allowances and benefits into the base remuneration and review stricter controls in the use of other allowances, such as overtime.

- **Constituency funds and tertiary scholarships.** We are improving the transparency and accountability in the use of constituency funds in order to enhance the effectiveness of public service delivery in the rural areas. To this effect, Parliament just approved the Constituency Development Fund Act that introduces a legal framework to enhance control over the use of these public funds. As a complement, we intend to issue implementing regulations by end-December 2013 (end-December 2013 program benchmark) that would establish the effectiveness date of the approved legislation, provide guidelines for the selection and prioritization of projects, and spell out the mechanisms to improve transparency and reporting, control, audit, and evaluation of constituency development funds spending, which will be line with the new Public Finance Management Act (PFMA). In addition, we intend to publish the Auditor General's report on constituency spending by end-November 2013 (end-November 2013 program benchmark). We will apply these same public financial procedures to spending on tertiary educational scholarships, which have risen significantly. Moreover, in light of the challenges of decreasing levels of per capita spending on basic education, we will strengthen the eligibility criteria for tertiary scholarships abroad, linking it to our development needs, and striking a balance between financing tertiary education abroad and investing in primary education.
- **Domestic revenue mobilization.** To improve compliance and operational effectiveness, a new comprehensive bill on customs and excise taxes is being drafted with the assistance of the Asian Development Bank and AusAID. In February 2013, Cabinet approved the release of the draft for public consultation. We plan to submit the bill to Parliament by November 2013 (end-November 2013 benchmark). Moreover, implementing a natural resource taxation regime is critical for Solomon Islands to benefit from its natural resource wealth. To this effect we will seek Cabinet approval of draft amendments to income, custom, excise, and goods tax legislations to implement such a regime. These amendments have benefited from IMF technical assistance and are in line with IMF recommendations. The amendments will be submitted to Cabinet by end-June 2013 (program benchmark) and submitted to Parliament by November 2013 (program benchmark). This reform has taken longer than anticipated in light of a broader consultation process with stakeholders and also due to resource constraints at the drafting stage. Until the new mining tax regime is in place, we will refrain from approving new mining licenses. At the same time, we will adopt measures to enhance tax administration in the area of mining to ensure that the government receives its share of revenue. Also, 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. Looking forward, we are considering additional tax reforms aimed at strengthening and broadening the tax base.
- **The fiscal framework and public financial management**. We will strengthen the fiscal framework and public financial management by upgrading the current Public Finance Act (PFA). The new Public Financial Management Act (PFMA) will incorporate provisions on fiscal

responsibility, management and use of public funds, and management of public debt. We have drafted and published four discussion papers and presented them in a public workshop. We will also submit to parliament the draft PFM Bill by end-October 2013 (end-October 2013 benchmark). In addition, we will be revising the Financial Instructions and accompanying finance regulations, manuals and guidelines during the course of 2013. These are subsidiary instruments to the new PFMA, which will come into effect in January 1, 2014. Training will be an integral component in embedding these reforms. To better monitor priority spending, we will continue to improve our budget presentation, even as we already have taken some important steps during the preparation of the 2012 Budget: (i) the budget presentation was revised to include output line items; (ii) we extended the consultation process with stakeholders; and (iii) a new chart of accounts has been put in place to better capture public expenditure and improve transparency and accountability. Moreover, we will continue to seek assistance from development partners to further advance ongoing efforts to strengthen procurement, financial management information systems and internal audit processes in order to reduce leakages affecting public service delivery.

- **Medium-term budget.** We are currently implementing a multi-year budget framework, with forward estimates of revenues and recurrent expenditure already included in this year's budget (end-December 2012 benchmark). We will expand this process next year by including forward estimates for the 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.
- **Public debt management.** We will continue to follow prudence in resuming concessional borrowing to preserve domestic and external stability, while tapping resources to finance high-priority development projects. These projects include the Submarine Cable System Project and potentially the Tina River Power Project, which will reduce the cost of doing business, encourage private sector investment, and improve growth prospects. The cable project will reduce communication costs significantly, enhance efficiency, create new information and communication industries, and ease the business registration process. Another potential project is the Tina River Project, which would significantly reduce the cost of energy. The Debt Management Strategy (DMS), endorsed by the Cabinet in May 2012, builds on the Honiara Club Agreement (HCA) and provides the appropriate framework to anchor borrowing plans going forward. The DMS has been incorporated in the HCA, which was reviewed in July 2012. We have set a limit for new borrowing in the 2013 Budget which includes domestic, external and SOE borrowing and guarantees. This limit is based on the analysis of the Debt Management Unit and will be revised on a yearly basis. The limit depends on the macroeconomic outlook and takes a conservative approach, allowing for economic shocks. Our next actions include implementing instructions for SOE borrowing (proposed end-June 2013 benchmark); 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

6. **Strengthening monetary and exchange rate policy management.** Monetary and exchange rate policies will continue to be geared to maintaining price and external stability. The CBSI has continued to mop up excess liquidity by issuing its short-term Bokolo bills, the stock of which have risen to SI$512 million at end-January 2013 from SI$368 million at end-2012. While the previous de facto exchange rate peg to the U.S. dollar in place since 2002 had provided a strong nominal anchor, in October 2012, we moved to a basket exchange rate peg using as weights the currency denominations of the largest shares of our external payments. This action is intended to promote greater exchange rate flexibility and foreign exchange market development, and followed technical assistance from the IMF. To reinforce the effectiveness of the CBSI in conducting monetary policy and its supervisory activities, a new CBSI Act was approved by Parliament in November 2012 (end-December 2012 benchmark).

7. **Strengthening the financial supervisory and regulatory frameworks and improving access to financial services.** Reforming the National Provident Fund (NPF) to improve its governance and investment framework is important to strengthening financial stability and ensuring the soundness of pension savings. To this effect, Cabinet endorsed drafting instructions for the NPF Act. We will submit the revised NPF Act to Parliament by October 2013 (end-October 2013 benchmark). To address the challenges we face on financial access to a broader segment of the population, especially in rural areas, we intend to provide financial literacy training and education in schools. We also presented our work developed by the financial inclusion taskforce in a public workshop in February 2013 (end-March 2013 benchmark). Credit unions play an important role in providing financial services outside of Honiara, offering credit to a broader segment of the population. In this regard, we are working on a new Credit Unions Act (CUA) with assistance from the ADB to promote the performance of the sector. We will seek Cabinet approval of the draft CUA by end-March 2014 (program benchmark) and will submit it to Parliament by end-June 2014 (program benchmark). Finally, our efforts to improve financial services include bringing the payment system up to best international practices. With assistance from the World Bank, we are preparing a new Payment System Act, which will enhance the reliability of the payment system, and increase the certainty of operations.

C. Structural Policies to Promote Private Sector Growth and Other Issues

8. **Facilitating private sector-led growth over the medium and long term.** We plan to continuously improve the business climate by enacting appropriate business friendly policies and laws. The conditionality under the ECF arrangement will continue to be aligned with the SIG-donor program of economic and financial reforms (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 ECF arrangement, 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.

9. **Update on Safeguards assessment.** The Central Bank of Solomon Islands will take the necessary steps to implement the recommendations of the safeguards assessment update.

10. **Statistics**. Progress is being made in strengthening the quality of economic statistics and fiscal and monetary data for program purposes, and to address some delays in the timely release of national accounts data. The Solomon Islands National Statistics Office (NSO) will complete the business survey data analysis in May 2013, which will form a key source of data input in the compilation of the national accounts statistics by July 2013. To address the weaknesses of CPI data collection and compilation, the SISO will ensure the timely implementation of the CPI Action Plan, which has benefited from PFTAC technical assistance recommendations.

D. Program Monitoring

11. **Program monitoring.** Progress under our program will continue to be monitored through performance criteria and indicative targets, structural benchmarks, and other necessary measures in order to complete semi-annual program reviews. Quantitative performance criteria and indicative targets for June 2013, September 2013, December 2013, March 2014, and June 2014 are set out in Table 1 and structural benchmarks are set out in Table 2. They are guided by the Technical Memorandum of Understanding. The second and third reviews are expected to take place on or after November 15, 2013 and June 15, 2014, respectively.

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

	12/31/2012				3/31/2013				6/30/2013		9/30/2013		12/31/2013	3/31/2014	6/30/2014
	PC (EBS/12/145)	PC with adjustors	Act.	Status	IT (EBS/12/145)	IT with adjustors	Act.	Status	PC (EBS/12/145)	PC	IT (EBS/12/145)	IT	PC	IT	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$)) 2/	470	463	479	Met	475	473	477	Met	480	480	485	485	490	495	500
Net domestic asset (NDA) of the CBSI (ceiling, end-of-period stock, in millions of Solomon Islands dollars (SI$)) 3/	-1,173	-1123	-1,366	Met	-1,122	-1104	-1,655	Met	-1,120	-1,279	-1,102	-1,202	-1,150	-1,268	-1,159
Net credit to central government (NCG) (ceiling, cumulative change from the beginning of the year, in millions of SI$) 4/	95	145	-196	Met	6	24	-115	Met	-33	-15	-60	-6	-14	-24	-14
New nonconcessional external debt maturing in more than one year, contracted or guaranteed by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of US$) 5/	0	0	0	Met	0	0	0	Met	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$) 5/	0	0	0	Met	0	0	0	Met	0	0	0	0	0	0	0
Accumulation of new external payment arrears by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of SI$) 5/	0	0	0	Met	0	0	0	Met	0	0	0	0	0	0	0
Central government program cash balance (floor, end-of-period stock, in million of SI$) 4/	425	375	355	Not met	440	422	474	Met	420	399	383	390	411	429	409
Indicative Targets (cumulative)															
Government funded recurrent spending on health and education (cumulative from the beginning of the year, in millions of SI$) 6/	611	...	558	Not met	147	...	179	Met	294	300	441	449	599	167	334
Memorandum items:															
The threshold of indicative target on health and education (actual 32 percent of government funded recurrent spending)	...	...	565	...	...	...	153	...	...	...	...	...	...	...	...
Budget support from bilateral and multilateral donors other than IMF (cumulative change from the beginning of the year, in millions of US$), program level.	61	...	54	...	11	...	9	...	26	27	44	48	67	9	22
Outstanding stock of Solomon Islands government (SIG) treasury bills, excluding restructured government bonds (end-of-period stock, in millions of SI$), program level.	40	...	40	...	40	...	40	...	40	40	40	40	40	40	40
Balance of SIG Consolidated Deposits Account, millions of SI$ 7/	140	...	140	...	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.

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.

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.

Appendix 1. Table 2–Solomon Islands: Structural Benchmarks

Actions	Macroeconomic criticality	Date	Status
Extended Credit Facility 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	Not met. The benchmark was rescheduled to end-June 2013 due to limited resources in the Attorney General's Chambers (see below).
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, and sales tax acts).	To promote fiscal transparency and enhance the efficiency of revenue collections.	December 31, 2012	Met in February. Cabinet approved to release the draft bill for public consultation on 15 February, 2013.
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	Met in November. The new Central Bank Act was submitted to Parliament and passed in November 2012, one month ahead of schedule.
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	Met in December in the context of the 2013 budget.
Submit to Cabinet the instructions for SOE borrowing.	To strengthen debt management and maintain public debt sustainability.	March 31, 2013	Not Met. The benchmark was rescheduled to end-June 2013 (see below).
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	Met in February.
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 financial 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	
Revised and Proposed new benchmarks			
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.	June 30, 2013	
Submit to Cabinet the instructions for SOE borrowing.	To strengthen debt management and maintain public debt sustainability.	June 30, 2013	
Release to public the results of the audits conducted by the office of the Auditor General on spending of constituency funds by the fifty constituencies, and project achievements in 2012.	To promote the transparency and accountability in the use of public funds.	November 30, 2013	
Submit to Cabinet the implementing regulations for the Constituency Development Funds Act that provide guidelines for the selection and prioritization of projects, and spell out the mechanisms to promote transparency and reporting, control, audit, and evaluate constituency funds spending in line with the new Public Finance Act.	To promote the transparency and accountability in the use of constituency funds.	December 31, 2013	
Submit to Cabinet the draft Credit Unions Act.	To promote financial sector development.	March 30, 2014	
Submit to Parliament the draft Credit Unions Act.	To promote financial sector development.	June 30, 2014	

Attachment II. 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.

Quantitative Performance Criteria and Indicative Targets

2. Performance criteria for end-June 2013 and end-December 2013 and indicative targets for end-September 2013 and end-March and end-June 2014 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.

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.

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.

Fiscal Aggregates

A. 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.

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.

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.

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

Press Release No. 13/240
FOR IMMEDIATE RELEASE
June 28, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review Under the Extended Credit Facility Arrangement for Solomon Islands, and Approves US$ 0.22 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the first review of Solomon Islands' economic performance under the Extended Credit Facility (ECF) arrangement. The Executive Board also approved the waiver of nonobservance of the performance criterion on the floor on the central government program cash balance.

Completion of the first review enables Solomon Islands to draw an amount equivalent to SDR 0.149 million (about US$ 0.22 million) immediately, bringing total disbursements under the arrangement to an amount equivalent to SDR 0.297 million (about US$ 0.45 million).

On December 7, 2012, the Executive Board approved the three-year ECF arrangement for Solomon Islands in the amount of SDR 1.04 million (about US$1.59 million), or 10 percent of the country's quota (see Press Release No. 12/479).

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

"Solomon Island's economic developments in 2012 were favorable. Economic growth remained robust at an estimated 4.8 percent. As of end-2012, inflation fell to 5 percent, gross international reserves stood at a record US$500 million, and government debt fell to 17.5 percent of GDP.

"Performance under the ECF-supported program has been satisfactory with sound macroeconomic policies leading to the rebuilding of policy buffers. All assessment criteria for end-2012 were met, except for a small and temporary shortfall in the cash balance of the central government. Structural reforms are advancing, notwithstanding some delays due to capacity constraints.

"Sustaining fiscal discipline and improving the quality of public spending remain critical to meeting program objectives. With tax revenues from logging activities expected to decline, and mining revenue still uncertain, careful control of spending is essential to maintaining sound public finances. In addition, this will require decisive implementation of the authorities' plans to improve the quality of public spending, including by strengthening the transparency and accountability in the use of constituency funds and upgrading the public finance act.

"Monetary and exchange rate policies have contributed to maintaining price and external stability. While inflation is expected to remain broadly stable, the authorities have indicated their readiness to step up monetary operations, if needed. The new exchange rate peg to a basket of currencies has worked well and could help buffer external shocks in the future.

"Looking ahead, several challenges remain, including bolstering resilience to shocks, strengthening institutional capacity, and deepening broad-based and more inclusive growth. The authorities are commended for their successful implementation of the ECF-supported program and their commitment to preserving macroeconomic stability and maintaining efforts to implement their comprehensive reform agenda."

Statement by Mr. Jong-won Yoon, Executive Director and Ms. Leni Hunter, Advisor June 28, 2013

The Solomon Island's programs with the IMF have been seen by the authorities and other development partners as providing critical support to Solomon Islands' macro-economic reform efforts. The 3-year program under the ECF is assisting the authorities to address deep institutional and structural issues that are central to broader efforts to improve living standards and alleviate poverty, and is highly complementary to the work of other development partners.

The authorities remain strongly committed to the program, and have welcomed the constructive engagement with the Fund mission teams. As noted by staff, performance criteria have been met with large margins, with the exception of the brief delay in meeting the performance criteria on the cash balance target. The authorities continued to make progress on structural benchmarks, albeit with some delays. However, achievements such as the new Central Bank of Solomon Islands (CBSI) Act are the result of the persistent effort under severe capacity constraints. Lack of institutional capacity has been a key cause of delay in the structural benchmark on the mining tax regime, but with strong prioritization the authorities hope to increase resources in this area, and will not agree to any new licenses until the new mining tax regime is in place.

Solomon Islands shares many challenges common to other small Pacific Island states, including vulnerability to external shocks due to a narrow export base, aid dependence, and frequent natural disasters. The authorities welcomed staff's judgment that tail risks arising from advanced economies have diminished, though agreed that these remain considerable. Exposure to natural disasters was again demonstrated by the tsunami that in February this year claimed the lives of ten people on Santa Cruz island, and injured fifteen others. Damage to housing, water systems and other infrastructure have affected the lives of 4,509 people, or 37 percent of the Santa Cruz population. Although recovery progress has been good, limited resource is available to address the extensive damage. In addition to these issues, the need to build on and maintain relative stability in the years following the period of civil conflict known as the "tensions" that occurred from 1998 to 2003, has remained a primary concern. Improved stability has enabled the Regional Assistance Mission to Solomon Islands (RAMSI) to undertake a transition, with the military component of RAMSI to withdraw from July 2013, while a RAMSI police presence is maintained until 2017. RAMSI's remaining aid development work will transfer to bilateral and multilateral aid programs.

Growth and Development

While the economy rebounded in 2011, growth conditions slowed in 2012 reflecting stabilization in logging and mining activity, as well as weaker commodity prices. The reopening of the Goldridge mine, after ten years of closure, provided a significant boost to growth that appears to have stabilized. Likewise, growth in logging export volumes stabilized in 2012, despite remaining at very high levels. With logging having comprised nearly 20 percent of GDP in 2011, the anticipated decline in the industry will weigh on future growth. At the same time, rural farm incomes have been affected price volatility and lower production for agricultural commodities such as copra, cocoa, and palm oil. More positively, upside risks to growth and employment exist from the development of proposals for new fish canning operations. In addition, and as noted at the time of the last review, significant investments have been proposed in nickel mining, pending clarity on the mining tax and land access regimes.

Growth continues to be held back by poor infrastructure. Lack of a reliable and affordable power supply continues to pose challenges to private sector investment and improved living standards. Although electricity supply in Honiara could be greatly improved through the Tina River Hydro project in Guadalcanal (which would be Solomon Islands' first hydro power scheme) the project has been subject to lengthy delays. Unfortunately, the submarine fiber optic cable project has run into some difficulties, due to higher project costs associated with the original proposal which have increased risks. Given the potential to boost economic development opportunities and education in rural areas, significant Government effort has been expended on project development. The authorities and the Solomons Oceanic Cable Company are examining all options, and the ADB is working with the authorities to resolve the issues.

The authorities agree that improvements in public financial management will assist with achieving development goals. The move to a multi-year budgeting framework will assist the authorities' communication and sequencing of development spending goals over the medium term. These goals are set out in the authorities' National Development Strategy (NDS), with the high-level goals including: increasing social and economic opportunities; securing sustainable growth; and maintaining stability and peace. A revised version of the NDS will serve as the basis for the PRSP at the time of the second review, along with sector strategies from the Ministry of Development Planning and Aid Coordination and key development partners.

Fiscal Performance

While the strong fiscal performance in 2012 represented efforts to maintain fiscal buffers, development under-spending has been cause for concern. The authorities are still aiming to achieve a balanced budget in 2013, although they acknowledge the factors underlying staff's projection of a 1.2 percent deficit. Reaching a balanced budget will be tough in the 2013 fiscal year, due in part to spending pressures, as well as concerted efforts to improve cross-department coordination and address chronic development budgetary under-spending. Spending pressures include additional spending on domestic and overseas university student scholarships, as well as increases to public sector wages, following a long period of significant real public sector wage decline. There has also been strong demand for Rural Constituency Development Funds (‘Constituency funds’). While the role of Constituency funds in rural development can help to bring about broad-based inclusive growth, governance structures around the funds have been a concern. In this regard, regulatory guidelines for Constituency funds will be of primary importance, and as noted in the MEFP, these will be in accordance with the new Public Financial Management Act.

Declines in Government debt over the last few years allowed the Honiara Club Agreement (HCA) to be revised in 2012. As discussed at the time of the previous review, Cabinet has endorsed a new Debt Management Strategy (DMS). The DMS allows the Government to undertake prudent concessional borrowing, with the Government to set a yearly borrowing limit as part of the annual budget, based on a debt sustainability assessment. The debt limit covers external borrowing by the Government and all forms of SOE borrowing and guarantees (both domestic and external). The Government approved its first loan under the revised HCA late in 2012, for ADB financing of the planned submarine fiber optic cable, discussed above.

New borrowing guidelines for State Owned Enterprises were recently endorsed by Cabinet. In endorsing the guidelines, Cabinet agreed to amend the DMS to allow commercial borrowing by SOEs under certain circumstances. The new SOE Borrowing Policy intends to provide a balance between allowing SOEs to operate as a profitable and efficient business, with managing total debt levels. Safeguards have been put in place to ensure that SOE borrowing is fit for purpose and does not pose unacceptable risks to Government. SOE borrowing will count towards the Government’s annual limit on new borrowing.

Financial Sector

Despite the recent uptick in credit growth, bank-intermediated credit has generally been weak, with the banks relying on non-interest income as noted by staff. However, the year to March 2013 saw an increase in lending from several sources, including a large loan taken by Solomon Airlines. In recognition of the important role played by credit unions in providing credit and financial services, particularly outside of Honiara, the authorities are working on a new Credit Unions Act with assistance from the ADB, to promote the performance of the sector. The authorities also continue to work towards structural benchmarks for the National Provident Fund Act and the Financial Institutions Act.

The Central Bank of Solomon Islands continues its work towards improving financial inclusion, which has been made part of the central bank’s mandate in the new Act. The authorities have ambitious goals to increase access to financial services in the relatively near term, and are also focusing on financial education, both of which will support inclusive growth. With low financial literacy, the central bank has recently highlighted the need to address customer empowerment and protection, and is investigating potential demand for a micro-insurance industry. The banks have undertaken increased investment towards branchless and mobile phone banking, and steps have been taken to facilitate access to financial services, particularly in rural areas. For example, these have included methods to assist with customer identification and verification, and the introduction of “pay as you go” accounts by commercial banks, where customers do not pay monthly account keeping fees, but pay only when they transact.