INTERNATIONAL MONETARY FUND

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SOLOMON ISLANDS

January 2014

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERION

In the context of the 2013 Article IV consultation with Solomon Islands, the following documents have been released and are included in this package:

- The **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF for the Exective Board's consideration on January 8, 2014, following discussions that ended on November 1, 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 December 16, 2013.
- **An Informational Annex** prepared by the IMF.
- **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- **Press Releases** including a statement by the Chair of the Executive Board, and summarizing the views of the Executive Board as expressed during its January 8, 2014 consideration of the staff report on issues related to the Article IV consultation and IMF arrangement.
- A **Statement by the Executive Director** for Solomon Islands.

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

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

*Also included in Staff Report

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

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December 16, 2013

KEY ISSUES

Context: Solomon Islands has achieved considerable gains in development and macroeconomic stability in recent years. However, the country is at an important juncture—with both security and development assistance being scaled down by donors, it needs to become more self-reliant. In addition, new drivers of growth are needed as the depletion of logging stocks in the coming years will adversely affect growth, exports, and public finances. Spending pressures and lower growth give rise to fiscal risks.

Outlook and risks: Growth is recovering gradually after slowing in the first half of 2013 because of unfavorable external conditions and various supply shocks, while the external sector is weakening, in part owing to adverse terms-of-trade developments. Risks are tilted to the downside and include lower export prices, an oil price shock, and a steeper-than-expected withdrawal of foreign aid. Legislative elections scheduled for 2014 introduce uncertainty over the pace of reform.

Program: Program performance has been broadly satisfactory. All performance criteria (PCs) for June 2013 and indicative targets (ITs) for June 2013 and September 2013, as well as continuous PCs, were met. In addition, a critical reform—the Public Finance Management Act (PFMA)—has been approved by Parliament. However, some structural benchmarks scheduled for 2013 were missed because of capacity constraints. The authorities are requesting a modification of the PC on net credit to the government for end-December 2013 and a re-setting of four program benchmarks.

Key policy recommendations:

- Protect policy buffers and fiscal discipline by keeping overall expenditure, including from the supplementary budget, within the original spending envelope.
- Strengthen the quality of public spending by improving the transparency and accountability of programs, including scholarships and constituency funds.
- Strengthen fiscal management by implementing the new PFMA.
- Maintain the monetary policy stance, but stand ready to tighten policy if needed.
- Follow the basket peg more closely, including by widening the operational band and re-centering it periodically.
- Improve capacity to execute macro-critical reform agenda.
- Advance structural reforms to create a more conducive environment for private sector growth. A sound infrastructure investment program within a comprehensive growth and poverty reduction strategy would serve the country well.

Approved by:
Hoe Ee Khor and Masato Miyazaki

Discussions took place in Honiara during October 21–November 1, 2013. The staff comprised Messrs. Breuer (head), Klyuev, and Wu (all APD), and Ms. Svirydzenka (SPR). Ms. Plater (OED) participated in key policy meetings. The mission met with Prime Minister Gordon Darcy Lilo, Minister of Finance and Treasury Rick Houenipwela, Governor of the Central Bank Denton Rarawa, other senior officials, donors, and private sector representatives.

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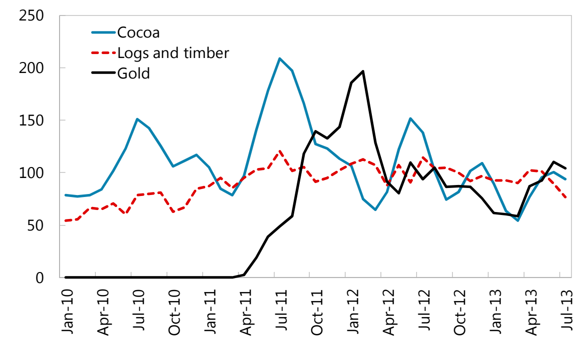
APPENDIXES

BACKGROUND AND OUTLOOK

1. **Economic performance weakened in the first half of 2013**.

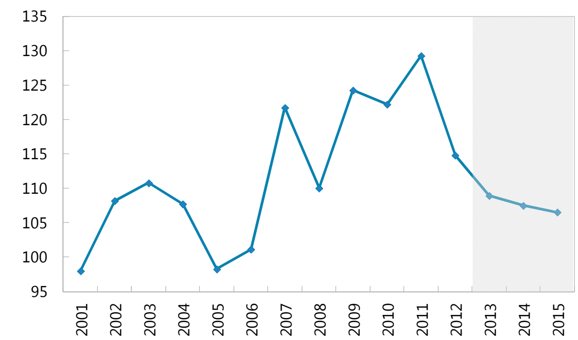
- Growth has slowed. In the first half of the year, output of most agricultural commodities declined owing to unfavorable weather conditions and lower export prices, while gold production fell due to refurbishment of the gold mine. Logging activity was volatile, but on average lower than last year.
- Inflation accelerated earlier in the year but has stabilized at around 6 percent (year-on-year) since mid-2013. The increase was driven primarily by domestic food prices while imported inflation was low on account of tame global commodity prices.
- A current account deficit of 2 percent of annual GDP emerged due to adverse terms-of-trade developments (lower prices of logs and gold) as well as gold mine reconstruction. However, net international reserves (NIR) held up due to sizeable foreign direct investment (FDI).

Production of Selected Commodities
(Index 2012 average = 100; 3-month moving average)



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

Terms of Trade
(Index 2000=100; Export deflator / Import deflator)



Source: IMF staff estimates.

2. **The outlook is subdued, while risks are tilted to the downside.** Some rebound is under way in the second half of the year, partly due to the recovery of gold output, which will carry over to the next year. Real GDP is projected to expand by 2.9 percent for 2013 as a whole and by 4 percent in 2014—down from 4.9 percent in 2012.[1] In the medium term, growth is expected to be moderate at 3½–4 percent, with gold output increasing marginally and logging production declining due to stock depletion. In this context, the current account is expected to go down from near balance in 2012 to a deficit of 4.2 percent in 2013 and weaken further going forward. In addition to the factors mentioned above, the decline is driven by diminishing donor support, return of the gold mine to profitability, and several investment projects with large import content. The outlook is subject to a variety of downside external risks (Appendix I), including a slowdown in emerging or advanced economies leading to lower external demand or prices of exports; an oil price shock; and a sharper-than-expected curtailment of foreign grants. On the other hand, the decline in logging output may

[1] Prior to the mission, the National Statistical Office released a new set of national accounts, which implied downward revisions to earlier growth estimates in 2011 and 2012 (from 10.7 percent and 4.9 percent to 6.4 percent and 2.6 percent, respectively). This report presents numbers based on the earlier estimates since they formed the basis for discussions and their use did not have a material impact on the analysis which is largely forward-looking.

not materialize as fast as envisaged. The authorities broadly agreed with the outlook and the characterization of risks.

PROGRAM PERFORMANCE

3. **Program performance has been satisfactory overall, with all continuous and end-June 2013 PCs met and a key reform accomplished ahead of time, but some reforms experienced significant delays**.

- *PCs and ITs were met*. The June 2013 PCs on net credit to the government (NCG), net domestic assets of the central bank (NDA), the cash balance of the central government (CBCG), and the NIR were all met, the first three with large margins; moreover, the indicative targets for these for September 2013 were also met, as were the IT on health and education spending and the continuous PCs on external debt. The authorities are on track to meet the end-December PCs, except for NCG, where lower-than-programmed revenue (reflecting slower growth in early 2013 and the weaker terms-of-trade) is expected to lead to a small drawdown of government deposits. The authorities have requested a modification of this PC, and staff supports it on account that it is small and would accommodate automatic stabilizers to lower revenues.
- *Mixed progress with structural agenda*. A key pillar in the design of stronger fiscal institutions, the Public Finance Management Act (PFMA), was sent to Parliament (October 2013 benchmark) and approved in October 2013.[2] In addition, the instructions for state enterprise borrowing have been submitted to the Cabinet (June 2013 benchmark) and a new tax exemption regime was approved (originally a component of the new Customs and Excise Law benchmark). However, a number of other reforms experienced delays, and thus the related program benchmarks were not met. These include obtaining the Cabinet's approval to changes in the tax system to allow for a mining regime (June 2013 benchmark) and then submitting the changes to Parliament (November 2013 benchmark); submitting to Parliament a revised National Provident Fund (NPF) Act (October 2013 benchmark); and the publication of the Auditor General's audits of 2012 constituency funds (November 2013 benchmark).
- *Revised reform agenda*. The main reason behind the delays in reforms is capacity constraint, which was recently exacerbated by the heavy workload required to get the PFMA approved. A key bottleneck is the office in charge of vetting and drafting legislation, the Attorney General's Chambers, which is insufficiently staffed in view of the heavy legislative agenda. Staff held discussions on a revised timetable with all parties involved and additional donor support was obtained to address the bottleneck. As a result of these discussions, and in view of the authorities' commitment to these reforms, staff supports the authorities' request in the attached Letter of Intent for revised test dates for the missed structural benchmarks.

[2] "Public Finance Management Act" is the title of the "Public Finance Act" referred to in the structural benchmark.

POLICY DISCUSSIONS

A. Fiscal Policy—Protecting Buffers and Improving Quality of Spending

Background

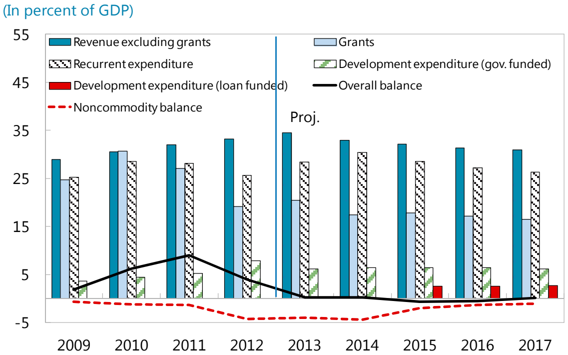
4. **The under-execution of development spending led to a significant budget surplus.** In the first six months of 2013, compared with the same period in 2012, total revenue fell by 1.2 percentage points of GDP (tax and non-tax revenue fell by 0.4 and 0.8 percent of GDP, respectively), reflecting the economic slowdown and the adverse terms-of-trade shocks, in particular a decline in logging output and prices (logging tax revenue fell by 0.3 percent of GDP). In addition, grants from development partners fell by 0.3 percent of GDP. At the same time, the development budget was under-executed, in part because of the introduction of a new chart of accounts, which led to delays in the implementation of development projects. The under-execution of development programs, together with slower implementation of recurrent budget, more than offset the reduction in revenues and grants. Consequently, the fiscal balance rose to 5 percent of annual GDP in the first half of 2013 (compared to a surplus of 4.3 percent in the same period in 2012).

5. **Nonetheless, weak commitment controls and rising spending pressures on selected programs led to the approval of a supplementary budget in October 2013**. In net terms, the supplementary budget authorizes an unfunded spending increase amounting to over 2 percent of GDP, a large portion of which is allocated to the education sector, mostly at the tertiary level. A matter of concern is the fact that the budget ceilings for scholarships were breached by a large margin and arrears emerged in the payment of scholarships for students, including those studying abroad. The decentralized system of approving scholarships led to a rapid increase in spending in this area.

6. **Spending pressures are expected to be very high in the rest of 2013.** The authorities expect development expenditures to recover in the last months of 2013 as the improvements in the information systems and training on the new chart of accounts begin to materialize. At the same time, total revenues for 2013 are expected to be 0.5 percent of GDP lower than envisaged during the first review. These challenges could result in a fiscal deficit for the year, unless decisive actions are taken. However, the authorities have committed to implementing the supplementary budget within the original expenditure envelope. In this context, staff projects the overall fiscal surplus to be 0.3 percent of GDP in 2013, one half of a percentage point lower than in the program and down from 4 percent of GDP in 2012.

Solomon Islands: Fiscal Balance, 2009-17

(In percent of GDP)



Sources: Country authorities; and IMF staff estimates and projections.

7. **The Cabinet approved a prudent draft budget for 2014.** The authorities have indicated their intent to submit to Parliament a balanced *cash* budget, or a small surplus when amortization is excluded. Tax collections are forecast to decline by 0.6 percent of GDP, mostly owing to lower logging revenue. Recurrent donor support is expected to decline by 1.2 percent of GDP. Both

recurrent and development expenditure are lower as shares of GDP in line with the the projections for total revenue and grants. Health and education will be the largest components of recurrent expenditure. The budgeted development expenditure would allow infrastructure maintenance, new capital expenditure, and ongoing funding of development projects carried over from previous years. The authorities' estimates imply a fiscal surplus of about 1 percent of GDP in 2014 under the GFSM definition. Staff projects somewhat lower donor support, which is expected to lead to a smaller fiscal surplus in 2014, in the order of 0.3 percent of GDP.

8. **Fiscal reforms are advancing, even though some have experienced delays.** The recent approval of the PFMA by Parliament is an important achievement of the authorities. In addition, the government has strengthened the tax exemptions regime. However, as noted above, while there has been progress with other structural reforms, there have also been some significant delays owing to the priority given to the PFMA as well as capacity constraints. The government is committed to reducing the burden of public debt guided by the principles established under the Honiara Club Agreement and the Debt Management Strategy. It will continue reforms aimed at strengthening the debt management framework.

Staff Views

9. **The Solomon Islands faces a moderate risk of debt distress**. The Joint IMF/World Bank Debt Sustainability Analysis (DSA) Update indicates that under the baseline scenario all external public and publicly-guaranteed (PPG) debt will remain below policy-relevant thresholds. However, the thresholds may be breached in case of shocks to net non-debt-creating flows and financing terms. This underscores the importance of maintaining fiscal buffers to confine the risk of debt distress.

10. **Maintaining policy buffers requires a sustained push for fiscal discipline and careful management of the budget**. Unfunded recurrent expenditures in the supplementary budget will put pressure on the execution of other programs. The overcommitment in spending in the supplementary budget is largely a result of weak fiscal management, especially the lack of financial and policy oversight over tertiary education, which threatens to erode confidence in economic policies. The unfunded expenditures, if not addressed appropriately, would jeopardize program targets. Staff urged the authorities to reduce the planned level of new spending and other expenditures in the supplementary budget to fit within the orginal spending envelope agreed in the program. The mission also encouraged the authorities to commit to a prudent budget in 2014, consistent with program objectives, while protecting spending on health and primary education.

11. **The quality of public expenditure needs to be safeguarded to make sure priority spending is not crowded out**. The timely implementation of the PFMA is critical for achieveing this objective, including with the issuance of relevant implementing regulations. In addition, two areas require particular attention:

- *Constituency development funds*. The authorities should review the merits of channeling an increasingly large share of public resources through the funds controlled directly by Parliamentarians. In addition, there is a need to improve transparency and accountability in the use of these funds. Adequate implementing regulations for the Constituency Development

Funds Act (CDFA) are needed to ensure continued confidence in economic policies, including by development partners. The audit of 2012 constituency fund spending, which is very advanced, should be finished and published in a timely manner.

- *Tertiary scholarships*. Significant challenges have emerged with the management of tertiary scholarships for students both in the country and abroad. Inadequate record keeping and the approval of scholarships outside established channels have led to the rapid increase in these expenditures and the emergence of arrears in the payment of university fees and stipends. Tertiary scholarship expenditures are now crowding out other priority spending, including on primary education. Staff stressed the need to strengthen the eligibility criteria for tertiary scholarships, apply international best practices of public finance in this program, and find an appropriate balance between various levels of education.

12. **The mission urged the authorities to redouble efforts to implement their fiscal reform agenda in the coming months, before the electoral cycle reduces the reform momentum.** Staff and the authorities discussed ways in which the IMF can support these efforts, including by providing technical advice on the implementing regulations of the CDFA.

Authorities' Views

13. **The authorities, who have a track record of fiscal discipline, committed to addressing fiscal slippages**. They said that they will implement the 2013 supplementary budget within the original spending envelope, by scaling back new spending and reallocating other spending. The authorities also noted their efforts to strengthen tax compliance, including with the recent addition of staff to the Internal Revenue Division and the Customs Office. In the 2014 budget, the authorities stressed that they are targeting a cash balance , and recognized the challenge of achieving the right balance between recurrent and development expenditures. To this effect, they noted that the budget will protect spending on primary education and health, which will remain at least at the same level as in 2013. The authorities also stressed that they will continue to exercise prudence in borrowing, while tapping concessional loans to finance high-priority development projects.

14. **The authorities are taking steps to improve the transparency and accountability of constituency funds and tertiary scholarship awards.** They are working on the implementing regulations for the CDFA, in consultation with development partners and other stakeholders, and expect to put them in place before the end of 2013 (December 2013 benchmark). The authorities plan to publish the Auditor General's audit of 2012 constituency fund spending when it is completed (proposed benchmark for March 2014). The government will seek Cabinet's approval of revamped policies for tertiary scholarships (proposed benchmark for end-January 2014), including better commmitment controls and improved accountability and transparence, so that they can be in place and effective for the next school year. The authorities will also review education policies, in consultation with development partners and other stakeholders, including to ensure an adequate balance of spending between primary and tertiary education (proposed benchmark for March 2014).

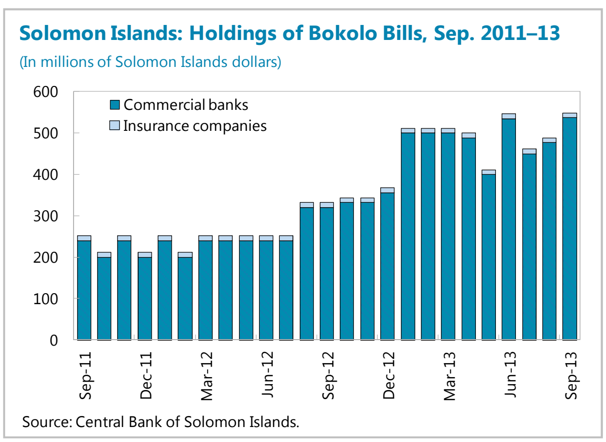
15. **The authorities reaffirmed their commitment to fiscal reforms.** They noted that getting approval of the PFMA absorbed a considerable amount of scarce resources and emphasized that delays in other legislation were due to capacity constraints. The authorities are working with development partners to alleviate critical bottlenecks and have proposed a well-thought out revised

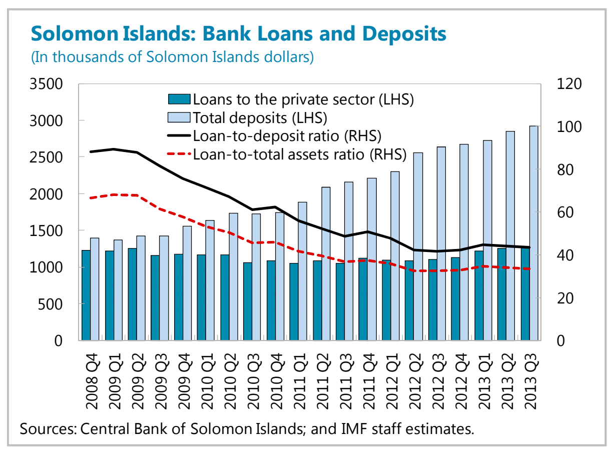
timetable for key legislation. Draft changes to the tax system to allow for a mining regime are currently being vetted by the Attorney General's Chambers. The authorities will obtain Cabinet's approval of this legislation by end-January 2014 (proposed benchmark) and submit it to Parliament by end-March 2014 (proposed benchmark). The draft Customs and Excise law is currently being updated to reflect the recently adopted and strengthened exemptions policy, and will be submitted to Parliament by end-June 2014 (proposed benchmark). In addition, the PFMA contains fiscal responsibility provisions that require the publication of a series of new fiscal documents, starting in 2014. As a first step, the authorities will produce a Final Budget Outcome Report by end-April 2014 (proposed benchmark). To improve public debt management, the authorities will submit to Cabinet the onlending and guarantees instructions by end-February 2014 (proposed benchmark).

B. Monetary and Exchange Rate Policies—Providing a Stable Nominal Anchor

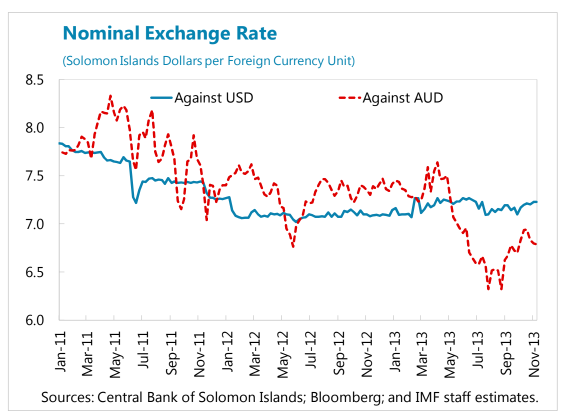
Background

16. **Bank credit continues to recover after the sluggish pace recorded in the last few years**. The expansion is particularly rapid in loans to households as well as to the retail, wholesale, and telecommunication sectors. Reflecting stronger credit growth, an increase in outstanding sterilization bills of the Central Bank of Solomon Island's (*Bokolo* bills), and slower growth in deposits, excess reserves in the banking system have declined from last year's level but remain substantial.





17. **The Solomon Islands dollar was broadly stable against the U.S. dollar.** The exchange rate vis-à-vis the U.S. dollar appreciated gradually over the first nine months of 2013, and then bounced close to the beginning-of-year parity. Fluctuations against the Australian dollar were considerably more pronounced, with the Solomon Islands dollar appreciating by as much as 15 percent by end-August and then reversing its course and unwinding about half of the appreciation by mid-November.



18. **The central bank is gaining experience with the transition to a basket peg.** The CBSI announced a move from a U.S. dollar peg to an invoice-based basket peg in October 2012. The idea of the peg is to set the bilateral SI$/USD exchange rate in such a way as to maintain the value of the basket constant. However, in practice, to avoid excessive fluctuations, the bilateral rate is not allowed to deviate by more than one percent in either direction from a pre-set "base" rate. If following the basket requires a larger shift against the U.S. dollar, the Solomon Islands dollar remains at the floor or at the ceiling of the band until the movements in the basket reverse their course or until the base rate is adjusted, as happened in June 2013. As a result, the range of fluctuations in the bilateral exchange rate against the U.S. dollar has been small.

Staff Views

19. **Excess liquidity does not appear to be feeding inflationary pressures at the moment, but credit growth has picked up and the authorities should remain vigilant**. The monetary transmission mechanism remains weak (Appendix II). The stock of outstanding central bank (*Bokolo*) bills is less than half of the banks' free reserves, and a major expansion might be costly. While the exchange rate peg plays an important anchoring role, the central bank should be open to using all instruments at its disposal, including the cash reserve requirement, to mop up liquidity and tighten monetary policy should credit growth become excessive and inflation pick up.

20. **The Solomon Islands dollar appears moderately overvalued**. While estimating real exchange rate norms is inherently challenging, all three CGER methods suggest varying degrees of overvaluation (Appendix III). This reflects the considerable appreciation of the Solomon Islands dollar in real terms over the last two years and the projected deterioration in the current account balance over the medium term. At the same time, a large portion of the current account deficits is expected to be covered by FDI. An adequate reserve cushion (see Appendix IV) and the expected availability of near-term financing afford time to correct overvaluation by developing new sources of exports and by increasing productivity through stronger business environment, better infrastructure, and higher educational attainment.

21. **The central bank should follow the currency basket more closely by gradually widening the operational band and re-centering the band to the ceiling or floor periodically.** Staff and the authorities reviewed the operational implementation of the basket peg regime and discussed ways of improving it. While the narrow band to which the authorities had restricted movements in the SI$/USD exchange rate has played a useful role while the CBSI gains experience with the new regime, over time the band should be broadened and adjusted to allow the benefits of a basket peg (including greater stability vis-à-vis the Australian dollar) to be enjoyed more fully, and to help economic agents get accustomed to greater variability in the SI$/USD exchange rate.

Authorities Views

22. **The authorities broadly agreed with staff analysis**. They highlighted the role of the currency peg in keeping imported inflation low and noted that high overall inflation was caused mainly by domestic supply shocks. At the same time, they expressed their concern with inflation being persistently higher than in most other Pacific Island countries. The authorities emphasized that *Bokolo* bills remain their most flexible tool of monetary policy, and they continue to develop this instrument including by introducing new maturities—which they also view as important for financial

market development. At the same time, raising the cash reserve requirement is an option if monetary conditions need to be tightened sharply. They agreed that the real exchange rate is stronger than historical averages, which suggests some degree of overvaluation. However, given that most consumer goods and many inputs into production are imported, the authorities would not view a weaker currency favorably.

C. Financial Sector—Promoting Financial Stability and Access to Finance

Background

23. **The financial system is sound, although financial depth is limited**. Banks are adequately capitalized, highly liquid, and profitable. After declining for several years, nonperforming loans as a share of total loans have stayed between 3.5 and 4 percent since end-2012. At the same time, the ratio of credit to GDP rose to 17 percent by mid-2013, which is still only about half of the average for Pacific Island countries. Impediments to credit expansion include weak investor protection, an unclear property rights regime, and a shortage of investable projects. Under pressure from environmentalists, a foreign bank has announced that it will no longer provide banking services to logging firms. The authorities are concerned about the impact of that move on the logging industry. To facilitate the introduction of alternative sources of financing and banking services, Parliament has approved a law authorizing the central bank to issue interim banking licenses. One such license has already been granted, but the CBSI has prohibited the applicant from carrying out traditional banking operations until the full license is given.

24. **Financial sector reforms are advancing**. Consultations with stakeholders on a new NPF Act have been completed, and the law is about to be drafted with the goal of submitting it to Parliament by June 2014. The CBSI is advancing in the preparation of a new Credit Unions Act (CUA). The authorities are also working on a revised Financial Institutions Act (FIA) that would promote financial sector stability and development and have proposed a structural benchmark on Cabinet approval of drafting instructions for the Act by June 2014.

Solomon Islands: Core Financial Soundness Indicators 1/

	2010	2011	2012				2013		
			Mar	Jun	Sep	Dec	Mar	Jun	Sep
Capital adequacy									
Regulated capital to risk-weighted assets	27.9	30.9	31.3	33.2	35.8	33.1	33.0	32.2	33.3
Nonperforming loans, net of provisions to capital	15.0	6.7	6.0	9.1	7.1	4.3	4.7	4.1	4.3
Asset quality									
Nonperforming loans to total gross loans	7.9	5.9	5.9	6.8	5.4	3.7	4.0	3.6	3.5
Earnings and profitability									
Return on average assets	4.9	3.2	2.8	3.4	3.5	3.2	2.6	2.5	2.4
Return on average equity	26.3	16.8	14.7	18.3	19.4	18.1	15.4	15.1	14.4
Net interest income to gross income	43.9	45.7	48.3	45.0	45.2	46.0	51.7	50.6	52.0
Noninterest expenses to gross income	42.0	48.2	51.8	46.7	47.8	50.6	52.4	53.4	53.6
Liquidity									
Liquid assets to total assets (liquid asset ratio)	48.0	57.1	58.9	60.9	62.7	60.9	59.1	59.9	60.5
Liquid assets to short-term liabilities	65.2	69.4	68.8	69.5	65.4	60.3	48.8	54.4	56.8

Sources: Central Bank of Solomon Islands; and IMF staff estimates.
1/ Commercial banks only, at end-period.

Staff Views

25. **The authorities should continue pressing ahead with financial sector development.** It is essential to revise the NPF Act promptly in order to strengthen the NPF's investment regime, improve its governance, and safeguard retirement savings. Regarding the interim banking license, CBSI has appropriately limited the new entity's activities to setting up shop rather than conducting banking operations until they have completed the due dilligence of the firm. A comprehensive revision of the FIA will help improve banking sector stability and facilitate its development.

Authorities Views

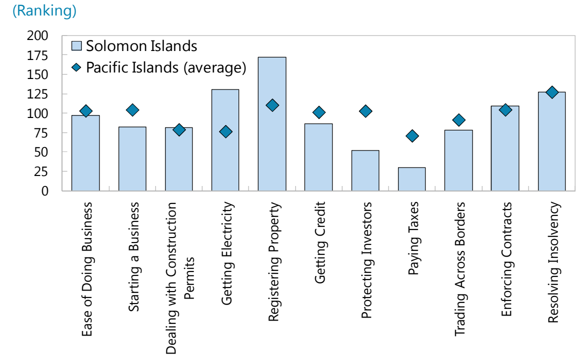
26. **The authorities highlighted progress made in advancing financial legislation despite capacity constraints**. The direction of changes to the NPF Act has been approved by the Cabinet and discussed with stakeholders. Delays relative to the program schedule were caused by capacity constraints in the drafting of legislation, and the authorities have proposed to move the benchmark on submitting the Act to Parliament to June 2014. Work on the CUA, FIA, and a new payments system law is ongoing. With respect to the interim banking license, the authorities pointed out that the period provided by the current law for considering a full license application is insufficient for reviewing new entities. Hence, the interim license gives the central bank more time to examine the applicant, while not allowing the firms to carry out banking operations until the review is completed safeguards financial stability.

D. Structural Policies—Developing Infrastructure and Fostering Inclusive Growth

Background

27. **The Solomon Islands continues to face development challenges**. In addition to issues common to many Pacific Islands—including geographic dispersion of the population and young institutions—Solomon Islands is still affected by the memory of violence in the early 2000s. Infrastructure needs are large, particularly with regard to energy supply, transportation, and telecommunications (Box 1). Funds to address these challenges depend on tax revenue from a few natural-resource-based industries and donor support, both of which are likely to diminish. In the meantime, considerable nickel deposits remain untapped pending resolution of a license dispute between two foreign firms and clarity on the mining tax and land access regimes. The plans for an underwater telecommunication cable have suffered delays. In addition, the authorities are reviewing the National Transport Fund (NTF) established in 2010, which has not met expectations of boosting public investment because of weak implementation capacity. Solomon Islands has achieved significant improvements in the business climate, but it still ranks considerably lower than its peers in

Doing Business 2012
(Ranking)



Source: World Bank, 2014 Doing Business Report.

access to electricity and ease of registering property.[3] Progress toward meeting Millennium Development Goals has been limited in recent years.

28. **In response to these challenges, the government has formulated a wide-ranging National Development Strategy (NDS) for 2011-20.** Launched in 2011 with the overarching focus on building better lives for all Solomon Islanders, the NDS has eight objectives: alleviating poverty; supporting the vulnerable; ensuring universal access to quality health care; ensuring universal access to quality education; increasing economic growth, employment, and incomes; developing physical infrastructure and utilities; responding to climate change and managing the environment; and improving governance and order. A 2013 NDS *Performance Report* indicates that while progress has been made toward achieving these objectives, it has been uneven across categories and generally slower than desired. The authorities have submitted the NDS and the 2013 Performance Report to the IMF Executive Board as an Interim Poverty Reduction Strategy Paper (I-PRSP).

Solomon Islands: Millennium Development Goals (MDGs) Progress

	Assessment 2011	Assessment 2013
MDG 1. Eradicate extreme poverty and hunger. Halve between 1990 and 2015 the proportion of people whose income is less than US$1 per day.	**Mixed**	**Mixed**
MDG 2. Achieve universal primary education.	**Mixed**	**Mixed**
MDG 3. Promote gender equality and empowerment. Eliminate gender disparities in primary and secondary education.	**Off track**	**Off track**
MDG 4. Reduce child (under 5-year) mortality by two thirds.	**Off track**	**Mixed**
MDG 5. Improve maternal health. Reduce maternal mortality by three quarters.	**Off track**	**Mixed**
MDG 6. Reverse the spread of HIV/AIDS, malaria and TB.	**Mixed**	**Mixed**
MDG 7. Ensure environmental sustainability. Integrate principles of sustainable development into country policies.	**Off track**	**Off track**

Notes: The Pacific Islands Forum Secretariat assesses progress toward MDGs based on the following classification: (1) "Off Track" indicates insufficient progress; (2) "Mixed" indicates uneven and/or inconsistent progress; and (3) "On track" indicates good progress.

Source: 2011 and 2013 MDG Tracking Reports, Pacific Islands Forum Secretariat.

[3] These indicators should be used with caution, however, given their subjective interpretation, limited coverage of business constraints, and relatively small number of informants as noted in a World Bank evaluation.

Box 1. Infrastructure Needs in the Solomon Islands

Infrastructure needs are large in Solomon Islands. Given the remoteness of the country and the dispersion of its population, adequate transportation and communication are indispensable. However, the main airport struggles to meet International Civil Aviation Organization (ICAO) standards, limiting its commercial viability and the Solomon Islands' connectivity with the rest of the world. Domestic aviation uses small, inefficient planes, as larger ones cannot be handled by provincial airstrips. Internal shipping service relies on a small fleet of 20 to 50 year old ships. Maritime infrastructure is often damaged or defunct. Roads are in poor condition. Information and communication technology infrastructure as well as penetration are among the poorest in the region. Electricity provision is limited, and most rural communities rely on traditional fuels, such as wood. The supply of water and sanitation are also key challenges, with no access to piped water for 75 percent of rural households. On top of that, the Solomon Islands would need significant investments to mitigate the risk of natural disasters and consequences of climate change.

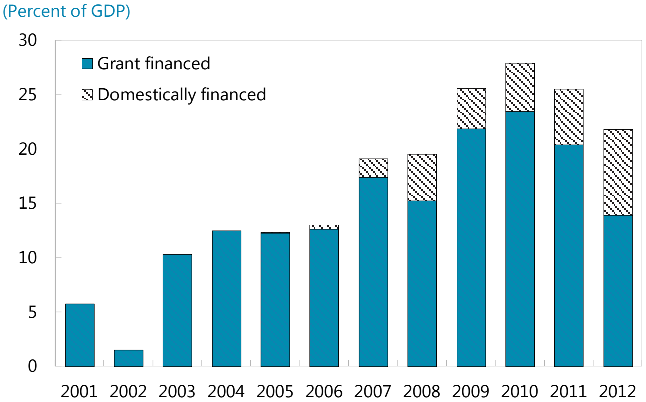
Infrastructure Indicators

	Paved roads (% of network) 2005	Electricity generation (KWh per capita) 2010	Electricity generation capacity (KW per capita) 2010	Improved water source (% of population with access) 2009	Telephone lines (per 100 people) 2010	Mobile cellular subscriptions (per 100 people) 2010	Internet users (per 100 people) 2010
Solomon Islands	3	147	64	71	2	28	5
PICs (Median)	…	465	140	85	12	48	11
Others small states (Median)	98	1,767	525	95	21	119	33
LICs (Median)	19	94	25	65	1	41	4
Emerging markets (Median)	56	2,118	578	93	16	100	31

Sources: World Bank, WDI; U.S. Energy Information Agency; National Statistics Office of Solomon Islands; and IMF staff estimates.

Funding for infrastructure projects is not assured. Development expenditure has been fairly high in recent years, but it is shrinking as donor support is phased down. Domestically funded expenditures may not be able to offset fully the decline in grants. Moreover, the quality of government-funded development expenditure can improve.

Solomon Islands: Development Expenditure
(Percent of GDP)



Sources: Country authorities; and IMF staff estimates.

Staff Views

29. **The authorities should focus on key areas of infrastructure development and diversifying the sources of growth.** Particular emphasis should be put on reliable access to power, telecommunications, and transportation. The key to building much needed infrastructure is stronger implementation capacity, reliable funding, and clear procedures for determining the use of communal land. The governance and implementation capacity of the National Transport Fund should be improved. Resolving the licensing dispute, clarifying land use rights, and establishing a transparent mineral taxation regime would open the door for the exploitation of Solomon Islands' massive nickel resources. Infrastructure development would spur tourism, fishing, and manufacturing. Clearer land use rights and measures to promote financial sector development would improve access to finance, which is key for private sector development and financial inclusion.

30. **The Solomon Islands would benefit from a well-articulated development plan in the context of a comprehensive Poverty Reduction Strategy.** The objectives stated in the NDS are well aligned with the country's needs and aspirations. Achieving these goals requires a detailed implementation plan. The preparation of a Poverty Reduction Strategy (PRS) would help channel efforts towards more inclusive growth.

Authorities Views

31. **The authorities stressed that infrastructure development is a key focus area for them.** A comprehensive Medium-Term Development Plan is being formulated. Several major projects are under consideration. An alternative route for the underwater cable is being sought to overcome the delay. After the review, steps will be taken to improve the operation of the NTF. The authorities viewed broad development as key for poverty reduction since poverty is widespread and reflects mostly the generally low level of income in the country rather than problems specific to certain population groups. Nonetheless, they expressed concern about the effort needed to produce a PRS, given capacity constraints, and suggested that, to address poverty, the PRS would largely be built on existing inputs, such as the National Development Strategy, Medium-Term Development Plan, and the Household Income and Expenditure Survey.

OTHER PROGRAM ISSUES

32. **Disbursements from most development partners depend on the satisfactory implementation of the IMF-supported program**. Large donor financing is expected from: (i) Australia and New Zealand—about US$45 million in budget support for health and education in 2013; (ii) the Asian Development Bank—more than US$38 million is projected during 2013–16 to finance infrastructure projects in transportation and information and communication technology, in the form of budget support, project grants and concessional loans;[4] (iii) the World Bank—US$2 million Development Policy Grant is in the pipeline for 2013; and (iv) the European Union—US$1¾ million in budget support is expected to be disbursed in 2013.

[4] Of this US$38 million, US$18 million—US$7½ million in grants and US$10½ million in loans—is expected to be disbursed once discussions on the undersea fiber optic cable are finalized, and US$5 million in budget support was disbursed in 2013 under the Economic and Financial Reform Program.

33. **The main risks to the ECF-supported program are political and limited institutional capacity**. The political situation remains fluid. Looking ahead, pressures on the budget may increase, in particular in the run-up to the parliamentary elections due in the second half of 2014. While political instability could undermine program ownership, the track record so far suggests that ownership is durable and cuts across party lines. Progress in strengthening public institutions continues. Nonetheless, capacity constraints remain a formidable challenge, which may be exacerbated by the phased reduction in foreign assistance. Technical assistance by the Fund and other development partners is aimed at mitigating capacity constraints.

34. **Progress under the program will continue to be monitored through performance criteria, indicative targets, structural benchmarks, and other necessary measures in order to complete semi-annual program reviews**. Quantitative performance criteria and indicative targets for December 2013, March 2014, and June 2014 are set out in Table 1 and structural benchmarks are set out in Table 2 of the Memorandum of Economic and Financial Policies. They are guided by the Technical Memorandum of Understanding. The third and fourth reviews are expected to take place on or after June 15, 2014 and November 15, 2014, respectively. The authorities highlighted their commitment to keeping the reform momentum going, even in the forthcoming period ahead of elections scheduled for 2014, while they recognized the challenges posed by the ambitious agenda for the next six months.

STAFF APPRAISAL

35. **After slowing early in 2013, economic growth is recovering.** Adverse terms-of-trade and weather shocks, as well as the temporary fall in gold production, led to a slowdown in activity, acceleration in inflation, and deterioration in the current account balance. Conditions improved in the second half of 2013, and a return of gold production to capacity contributed to a rebound, which is expected to continue into 2014. The risks to the outlook are mainly external and are biased to the downside.

36. **The Solomon Islands faces significant long-term growth and development challenges.** Addressing them requires a comprehensive strategy involving both the public and the private sector. With logging activity expected to decline and gold output likely close to capacity, developing new sources of growth is critical. This is likely to entail significant infrastructure investment and creating conditions conducive to private sector growth, including a transparent tax regime, clear land use rights, and better access to finance. The authorities' I-PRSP identifies main developmental challenges and sets out broad strategic objectives. In the next step, a focused poverty reduction strategy could provide a roadmap towards achieving those objectives, and help channel scarce human and financial resources to enhancing inclusive growth.

37. **Decisive actions are needed to protect fiscal discipline and improve the quality of public spending**. Lower revenues and unfunded spending in the supplementary budget have increased fiscal risks. There is a need for timely actions to prioritize spending and to improve the use of public resources, in particular with constituency development funds and tertiary education scholarships. An adequate balance should be sought between spending on primary and tertiary education.

38. **The authorities should sustain their efforts to implement reforms to build sound fiscal institutions**. The approval of the PFMA constitutes a milestone in the modernization of public financial management in Solomon Islands—the challenge now will be its implementation. Other important ongoing reforms include revising the Customs and Excise law to promote fiscal transparency and enhance the efficiency of revenue collections; implementing a new resource taxation regime to broaden the tax base and increase revenue transparency; and strengthening public debt management. The next few months are critical for the success of these reforms, as the parliamentary elections in the second half of 2014 may slow down the reform momentum.

39. **The stance of monetary policy is appropriate, but the authorities should remain vigilant.** While inflation is high relative to the rest of the region, it has been on a downward trend, and recent fluctuations appear to be driven by supply shocks. However, in case of a further acceleration in credit growth and a sustained increase in inflationary pressures, the Central Bank of Solomon Islands should stand ready to tighten monetary policy using all instruments at its disposal.

40. **The currency basket should be followed more closely**. The basket peg is an appropriate exchange rate regime for Solomon Islands. To benefit from its advantages more fully, the range in which the bilateral exchange rate of the Solomon Islands dollar against the U.S. dollar is allowed to move should be widened over time and the center of the band adjusted when either the ceiling or floor is reached for a sustained amount of time.

41. **The Solomon Islands dollar appears moderately overvalued.** While donor financing and FDI are expected to cover projected current account deficits and ample international reserves afford a cushion, new sources of exports and faster productivity growth are key to realigning the exchange rate with fundamentals over time. Maintaining the currency peg and keeping inflation under control should limit further real appreciation.

42. **The financial system is sound, but efforts to strengthen supervisory and regulatory frameworks should continue.** Planned revisions to the NPF Act, the Financial Institutions Act, and the Credit Unions Act will contribute to enhancing financial stability and financial inclusion.

43. **Based on the Solomon Islands' overall satisfactory program performance, staff recommends the completion of the second review under the ECF-supported program**. All performance criteria for June 2013 have been met. While there have been some delays in the structural reform agenda because of capacity constraints, the authorities deserve credit for the progress they have achieved, most importantly with the PFMA. With measures in place to address critical reform bottlenecks, a timetable to put the reform effort back on track, and a high-level commitment to ensure adherence to the program, staff supports the authorities' request for new test dates for several structural benchmarks, the introduction of additional benchmarks, and the modification of the PC on net credit to the government.

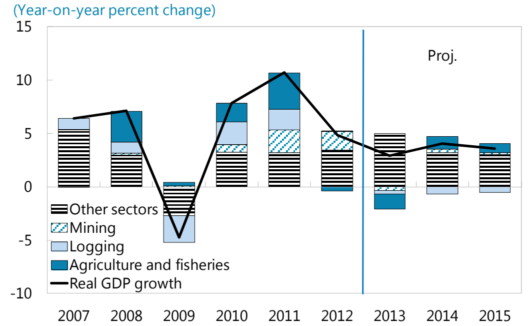
44. It is proposed that the next Article IV consultation take place on a 24-month cycle.

Figure 1. Solomon Islands: Macroeconomic Developments and Outlook

Declining contribution from resource sectors has resulted in growth moderation.

Sources of Growth, 2007–15

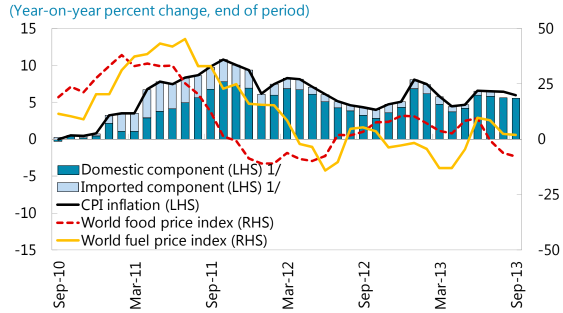
(Year-on-year percent change)



In recent months, inflation has been driven mostly by domestic food prices.

Contribution to CPI Inflation, Sep. 2010–13

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

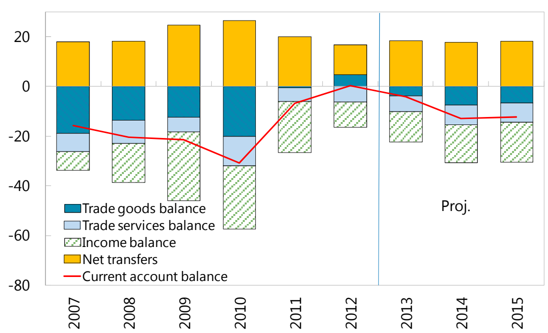


1/ Contribution to CPI inflation (in percentage points).

The current account is projected to deteriorate because of a lower trade balance…

Current Account Balance

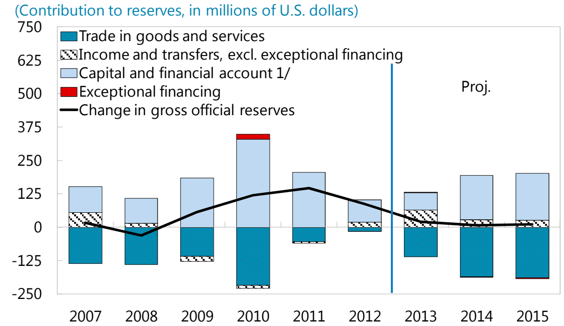
(In percent of GDP)



…but sufficient financing is expected to be available.

Reserve Change Decomposition, 2007–15

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

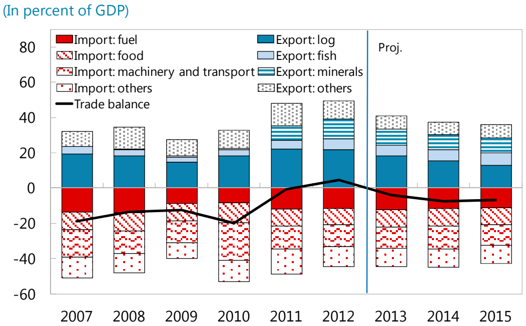


1/ Including errors and omissions.

Log exports are expected to fall, while mining exports have likely reached their peak.

Merchandise Trade, 2007–15

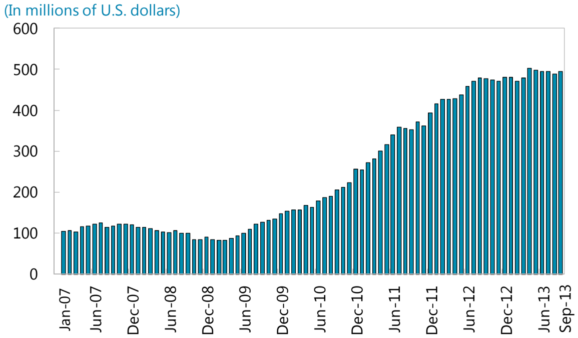
(In percent of GDP)



Reserves have stabilized.

Solomon Islands: Net International Reserves, Jan. 2007–Sep. 2013

(In millions of U.S. dollars)

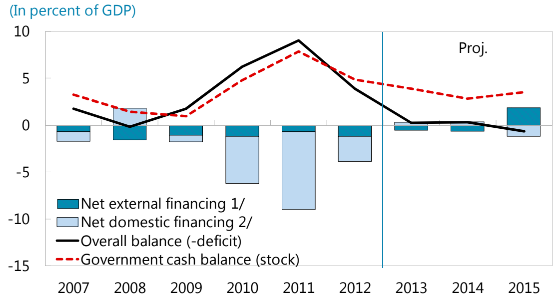


Sources: Country authorities; and IMF staff estimates and projections.

Figure 2. Solomon Islands: Fiscal and Monetary Developments

The fiscal balances are expected to decrease.

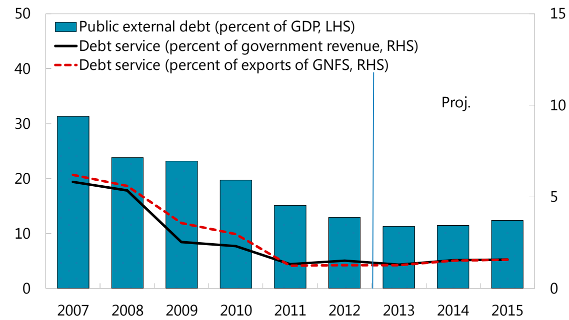
Fiscal Balance and Financing, 2007–15
(In percent of GDP)



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

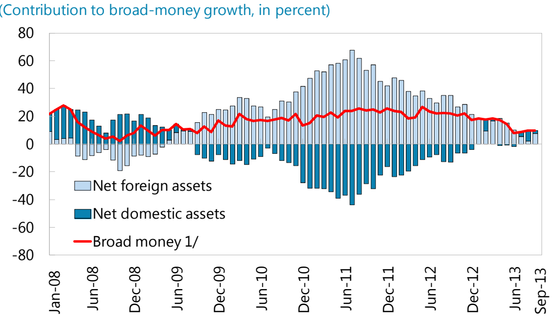
Public external debt has declined.

Public External Debt, 2007–15



Money supply growth has slowed somewhat…

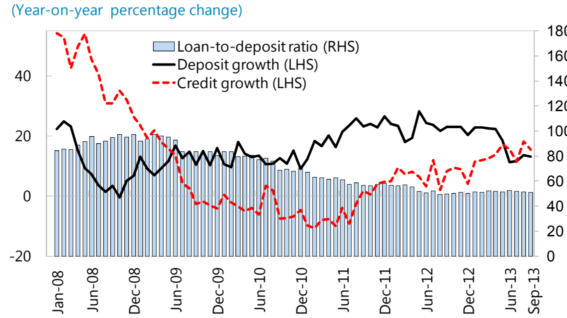
Monetary Developments, Jan. 2008–Sep. 2013
(Contribution to broad-money growth, in percent)



1/ Year-on-year percentage change.

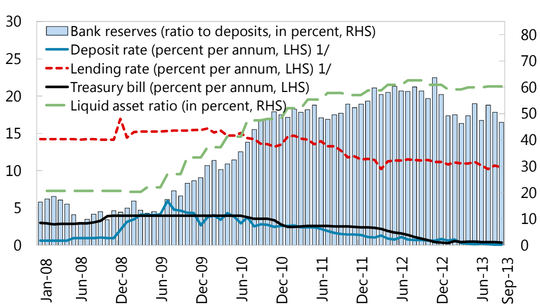
…while credit growth has picked up.

Deposit and Credit Growth, Jan. 2008–Sep. 2013
(Year-on-year percentage change)



Bank reserves have declined, but remain substantial.

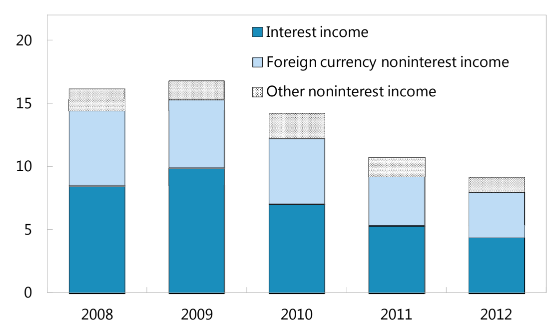
Interest Rates and Bank Reserves, Jan. 2008– Sep. 2013



1/ Weighted average rate of commercial banks.

Noninterest income related to foreign exchange activities supports bank profitability.

Solomon Islands: Interest and Noninterest Income
(In percent of total assets)

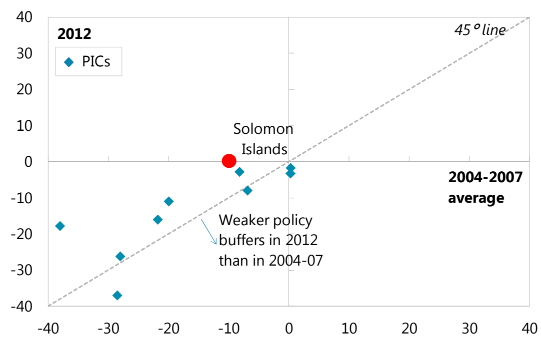


Sources: Country authorities; and IMF staff estimates and projections.

Figure 3. Solomon Islands: Rebuilding Policy Buffers

The Solomon Islands is one of few Pacific Islands countries that have higher policy buffers than during 2004-07…

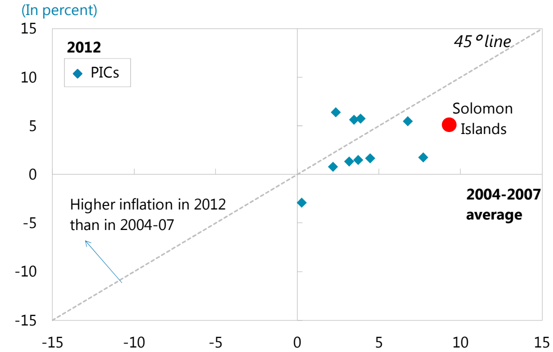
Overall Buffer Index, 2004-07 and 2012



…owing to lower inflation…

Inflation

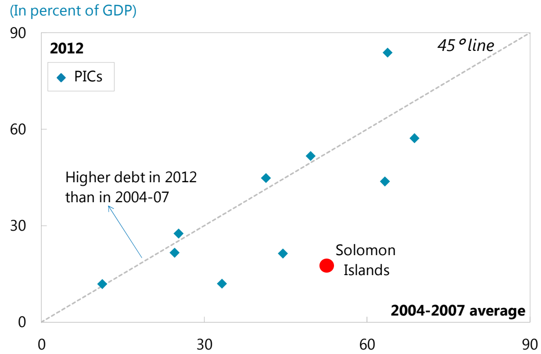
(In percent)



… reduced debt…

Gross Debt

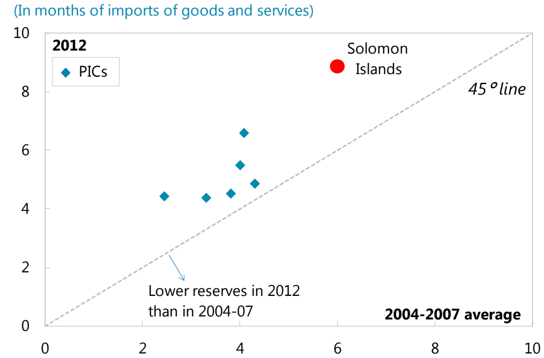
(In percent of GDP)



… and higher reserve coverage.

Reserves

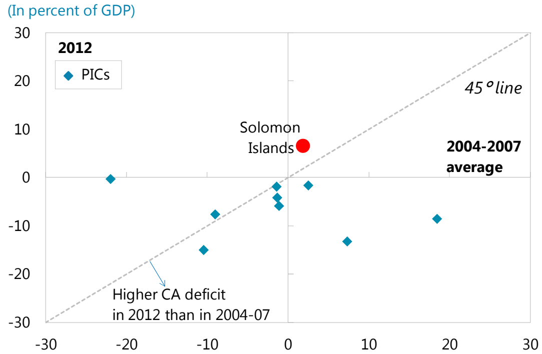
(In months of imports of goods and services)



The current account position has improved…

Current Account plus FDI

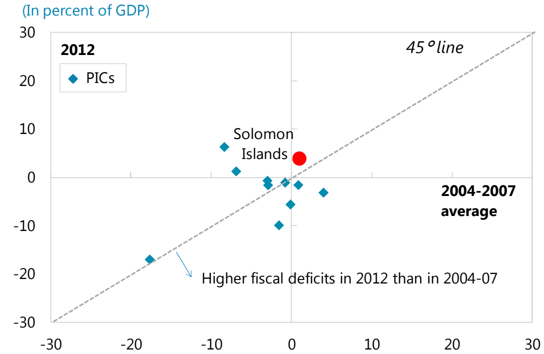
(In percent of GDP)



…as well as the fiscal balance.

Fiscal Balance

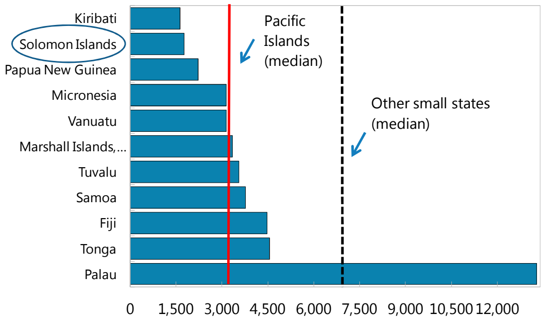
(In percent of GDP)



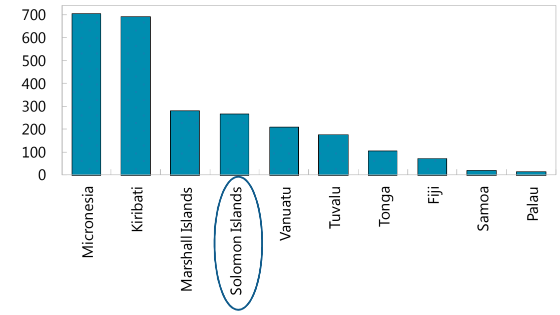
Sources: Country authorities; and IMF staff estimates.

Figure 4. Solomon Islands: Cross-Country Context

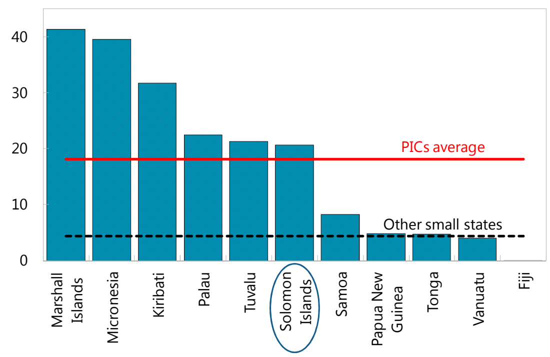
GDP per Capita, 2012
(In U.S. dollars)



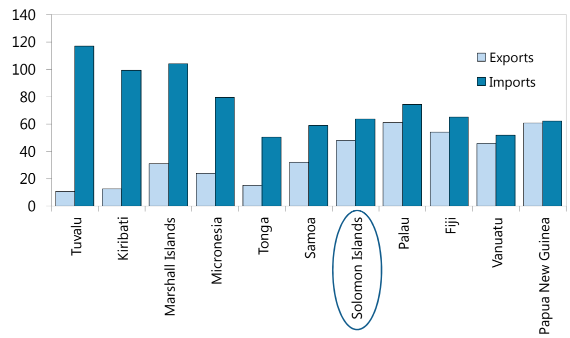
Geographical Dispersion: Average Sea Distance Between Two Inhabitants of the Same Country
(In kilometers)



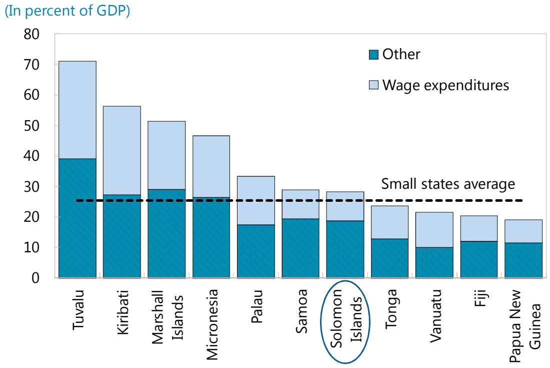
External Grants, 2005-12
(In percent of GDP)



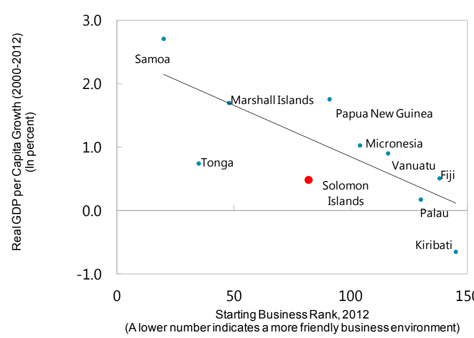
Trade Goods and Services, 2005-12
(In percent of GDP)



Current Government Expenditure, 2012
(In percent of GDP)



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$1,819 (estimate)
Population (2012): 550,000
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
			Est.	Prog. (EBS/13/81)	Rev. Proj.	Proj.
Growth and prices (percentage change)						
Real GDP	7.8	10.7	4.9	4.0	2.9	4.0
Of which : nontimber, nonmining	5.4	7.3	3.5	5.5	4.1	5.0
CPI (period average)	0.9	7.4	5.9	6.0	6.1	5.9
GDP deflator	5.9	9.1	5.7	6.3	5.8	5.6
Nominal GDP (in SI$ millions)	5,497	6,637	7,355	8,099	8,006	8,800
Of which : nonmining nominal GDP (in SI$ millions)	5,392	6,277	6,752	7,599	7,517	8,296
Per capita GDP (in US$)	1,295	1,614	1,819	1,901	1,950	2,096
Per capita GNI (in US$)	965	1,283	1,633	1,689	1,709	1,776
Central government operations (percent of GDP)						
Total revenue and grants	62.6	60.3	53.7	53.3	53.5	49.6
Revenue	32.0	33.1	34.5	33.5	32.9	32.1
Grants	30.7	27.1	19.2	19.9	20.5	17.4
Total expenditure	56.4	51.2	49.8	52.6	53.2	49.3
Recurrent expenditure	28.2	25.6	28.4	28.2	30.4	28.5
Development expenditure	27.9	25.5	21.3	24.4	22.7	20.8
Unrecorded expenditure 1/	0.3	0.1	0.0	0.0	0.0	0.0
Overall balance	6.2	9.0	3.9	0.8	0.3	0.3
Foreign financing (net)	-1.2	-0.7	-1.2	-0.6	-0.6	1.1
Domestic financing (net)	-5.1	-8.4	-2.7	-0.2	0.3	-1.4
Privatization receipts	0.0	0.1	0.0	0.0	0.0	0.0
Central government debt (percent of GDP, unless otherwise indicated) 2/	27.8	21.6	17.5	14.6	14.6	14.1
Domestic debt	8.1	6.4	4.5	3.1	3.2	2.5
External debt	19.8	15.2	13.0	11.5	11.4	11.5
(In US$ millions, end of period)	134.7	137.0	130.4	124.7	124.7	138.7
Monetary and credit (percentage change, end-year data)						
Credit to private sector	-4.7	4.7	4.1	8.2	16.0	16.0
Broad money	13.5	25.5	17.3	15.2	14.5	7.4
Reserve money	75.3	32.8	22.0	14.5	2.8	6.7
Interest rate - deposit (percent per annum)	2.6	1.4	0.9	...	...	...
Interest rate - lending (percent per annum)	13.5	11.5	11.2	...	...	...
Balance of payments (in US$ millions, unless otherwise indicated)						
Current account balance	-210.1	-58.5	2.2	-21.8	-46.2	-156.8
(Percent of GDP)	-30.8	-6.7	0.2	-2.0	-4.2	-13.0
(excluding mining-related capital imports, in percent of GDP)	-12.6	0.8	4.3	1.8	-0.5	-9.9
Exports of goods and nonfactor services (GNFS)	330.2	556.6	635.2	641.8	598.0	614.0
(Percentage change)	40.6	68.5	14.1	0.4	-5.8	2.7
Logging exports	124.7	191.4	219.2	225.9	199.9	183.9
Imports of GNFS	547.8	610.0	650.8	707.7	708.2	799.3
(Percentage change)	59.2	11.4	6.7	8.9	8.8	12.9
Foreign direct investment	235.6	140.8	65.7	27.3	49.0	112.4
(Percent of GDP)	34.6	16.2	6.6	2.5	4.5	9.3
Overall balance	119.8	146.4	87.3	51.0	20.0	8.9
Gross official reserves (in US$ millions, end of period) 3/	265.8	412.3	499.6	551.1	520.0	527.8
(In months of next year's imports of GNFS)	5.2	7.6	8.5	8.4	7.8	7.6
(In months of next year's nonmining-related imports of GNFS)	5.9	8.1	9.0	8.9	8.2	8.0
Exchange rate (SI$/US$, end of period)	8.1	7.4	7.3	...	...	...
Real effective exchange rate (end of period, 2005 = 100)	108.6	125.0	127.6	...	...	...
Nominal effective exchange rate (end of period, 2005 = 100)	81.1	87.6	86.7	...	...	...

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

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

2/ Includes disbursements under an IMF-supported arrangement.

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

Table 2. Solomon Islands: Balance of Payments, 2010–18 1/

	2010	2011	2012	2013		2014	2015	2016	2017	2018
			Est.	EBS/13/81	Rev. Proj.			Proj.		
	(In millions of U.S. dollars)									
Current account balance	-210.1	-58.5	2.2	-21.8	-46.2	-156.8	-162.6	-170.2	-166.2	-175.3
Trade balance for goods	-136.6	-4.8	46.7	0.3	-43.0	-90.7	-89.1	-101.5	-110.9	-116.1
Exports	223.7	418.2	492.8	488.7	446.8	451.3	474.2	495.9	520.0	536.8
Imports	-360.3	-423.0	-446.1	-488.4	-489.8	-542.0	-563.3	-597.4	-630.9	-652.9
Trade balance for services	-81.0	-48.6	-62.3	-66.2	-67.1	-94.6	-100.2	-88.3	-90.3	-93.5
Exports	106.5	138.4	142.4	153.1	151.2	162.7	172.3	183.8	196.2	209.7
Imports	-187.5	-187.0	-204.7	-219.3	-218.4	-257.3	-272.4	-272.0	-286.5	-303.2
Income balance	-173.3	-178.4	-102.4	-122.7	-135.9	-184.2	-212.0	-230.8	-227.7	-241.3
Current transfers balance 2/	180.8	173.3	120.3	166.9	199.9	212.6	238.6	250.4	262.7	275.7
Of which : Official transfers, net	168.5	164.3	104.9	138.6	171.5	182.0	205.5	214.6	224.0	233.9
Capital and financial account balance	341.4	244.5	108.2	72.9	66.2	165.7	175.6	181.5	179.5	185.3
Capital account balance	49.8	71.2	96.6	57.4	50.7	26.0	27.3	28.5	29.8	31.1
Direct investment balance	235.6	140.8	65.7	27.3	49.0	112.4	120.0	120.8	111.9	110.3
Outwards	-2.3	-3.7	-2.5	-5.0	-5.0	-6.0	-6.4	-6.9	-7.2	-7.7
Inwards	237.9	144.5	68.3	32.3	54.0	118.4	126.4	127.7	119.2	118.0
Portfolio investment balance	-2.6	0.0	-5.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment balance 3/	58.6	32.5	-48.6	-11.9	-33.6	27.2	28.3	32.2	37.8	43.8
Errors and omissions	-11.4	-39.6	-23.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	119.8	146.4	87.3	51.0	20.0	8.9	13.0	11.3	13.3	10.0
Financing	-110.3	-136.8	-87.1	-51.0	-20.0	-8.9	-13.0	-11.3	-13.3	-10.0
Change in gross reserves (- = increase)	-119.8	-146.4	-87.3	-51.5	-20.5	-7.7	-10.1	-6.9	-8.9	-10.0
IMF	9.6	9.6	0.2	0.5	0.5	-1.1	-2.8	-4.4	-4.4	0.0
	(In percent of GDP, unless otherwise indicated)									
Current account	-30.8	-6.7	0.2	-2.0	-4.2	-13.0	-12.4	-11.9	-10.7	-10.4
(excluding mining-related exports and imports of goods and services)	-12.6	-6.3	-7.1	-7.0	-9.7	-18.6	-18.0	-18.1	-17.7	-17.5
(excluding mining-related imports of goods and services)	-12.6	0.8	4.3	1.8	-0.5	-9.9	-9.3	-9.1	-8.0	-7.9
(excluding net official transfers)	-55.5	-25.6	-10.3	-14.6	-19.9	-28.1	-28.0	-26.9	-25.1	0.0
Trade balance for goods	-20.0	-0.6	4.7	0.0	-3.9	-7.5	-6.8	-7.1	-7.1	-6.9
Exports (in percent of GDP)	32.8	48.2	49.3	44.5	40.7	37.4	36.0	34.6	33.4	31.7
Of which: Logs	18.3	22.0	21.9	20.6	18.2	15.3	12.8	10.9	9.3	8.0
Of which: Fish	3.6	5.2	5.8	5.4	6.2	6.4	7.2	7.6	7.6	7.6
Of which: Minerals	0.5	8.0	11.6	9.9	9.0	8.6	8.6	9.1	9.8	9.8
Imports	52.9	48.7	44.6	44.4	44.7	45.0	42.8	41.7	40.5	38.6
Of which: Food	11.5	9.8	9.3	9.3	9.8	9.7	9.7	9.8	9.7	9.2
Of which: Fuel	8.3	11.8	11.5	11.4	12.2	11.7	11.1	10.7	10.5	9.6
Of which: Machinery and transportation equipment	21.0	13.0	12.4	12.3	12.1	13.4	11.8	11.2	10.3	9.9
Mining imports	11.4	7.0	4.0	3.8	3.7	3.1	3.0	2.8	2.7	2.5
Nonmining imports	41.5	41.7	40.6	40.6	41.0	41.8	39.8	38.9	37.8	36.1
Trade balance for services	-11.9	-5.6	-6.2	-6.0	-6.1	-7.8	-7.6	-6.2	-5.8	-5.5
Income balance	-25.4	-20.5	-10.2	-11.2	-12.4	-15.3	-16.1	-16.1	-14.6	-14.3
Current transfers balance	26.5	20.0	12.0	15.2	18.2	17.6	18.1	17.5	16.9	16.3
Of which: Official transfers net	24.7	18.9	10.5	12.6	15.6	15.1	15.6	15.0	14.4	13.8
Capital account balance	7.3	8.2	9.7	5.2	4.6	2.2	2.1	2.0	1.9	1.8
Direct investment balance	34.6	16.2	6.6	2.5	4.5	9.3	9.1	8.4	7.2	6.5
Of which: Inward FDI	34.9	16.6	6.8	2.9	4.9	9.8	9.6	8.9	7.7	7.0
Other investment balance	8.6	3.7	-4.9	-1.1	-3.1	2.3	2.1	2.2	2.4	2.6
Errors and omissions	-1.7	-4.6	-2.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net international reserves (in US$ million) 3/	256.2	393.1	480.1	531.2	500.2	509.0	522.0	533.3	546.6	556.6
Gross official foreign reserves (in US$ million) 3/ 4/	265.8	412.3	499.6	551.1	520.0	527.8	537.9	544.8	553.7	563.7
In months of next year's imports of GNFS	5.2	7.6	8.5	8.4	7.8	7.6	7.4	7.1	7.0	6.7
Gross external public debt	19.8	15.2	13.0	11.5	11.4	11.5	12.4	13.4	14.5	15.7
Disbursement of consessional borrowing (in US$ millions)	9.6	9.6	0.2	0.5	0.5	22.0	33.4	37.2	42.0	47.3
External public debt service (in percent of exports of GNFS)	3.0	1.2	1.3	1.2	1.3	1.5	1.6	1.6	1.4	1.3
Gross external debt (percent of GDP)	31.9	25.1	21.9	20.8	20.6	23.0	24.1	25.2	26.3	27.6
Private sector	12.2	9.9	8.9	9.3	9.2	11.5	11.7	11.8	11.8	11.9
Public sector	19.8	15.2	13.0	11.5	11.4	11.5	12.4	13.4	14.5	15.7
External debt service (percent of GDP)	2.3	1.6	1.5	1.4	1.4	1.4	1.7	1.6	1.5	1.4
Principal	1.6	1.0	1.0	0.9	0.8	0.9	1.0	1.0	0.8	0.7
Interest	0.7	0.7	0.6	0.5	0.5	0.5	0.6	0.7	0.7	0.7
Nominal GDP (in US$ million)	682	869	1,000	1,099	1,097	1,205	1,317	1,432	1,557	1,693

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

1/ Incorporates the authorities' revision of historical data, including a 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 under the IMF-supported arrangement.

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

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

Table 3. Solomon Islands: Summary of Fiscal Accounts, 2009–14

	2009	2010	2011	2012	2013		2014	
	Act.	Act.	Act.	Act.	Prog. (EBS/13/81)	Staff Proj.	Budget	Staff Proj.
				(In millions of Solomon Islands dollars)				
Total revenue and grants	2,659	3,442	4,000	3,947	4,320	4,280	4,449	4,361
Total revenue	1,467	1,757	2,199	2,535	2,710	2,636	2,839	2,829
Tax revenue	1,272	1,589	1,989	2,254	2,467	2,410	2,584	2,580
Income and profits	540	638	669	785	870	868	962	944
Goods and services	423	569	752	824	913	903	960	1,000
International trade and transactions	309	382	568	645	684	640	662	636
Of which: Tax on logging	162	241	373	407	462	408	389	387
Other revenue	196	168	210	281	243	226	255	248
Grants	1,192	1,685	1,801	1,411	1,609	1,643	1,610	1,532
Development grants	1,054	1,289	1,553	1,088	1,196	1,235	1,267	1,267
Recurrent budget grants	138	396	248	323	413	408	343	265
Expenditure	2,574	3,099	3,400	3,660	4,258	4,258	4,360	4,335
Recurrent expenditure	1,376	1,548	1,701	2,090	2,286	2,438	2,532	2,507
Compensation of employees	511	588	623	695	806	735	830	830
Interest payments	45	23	24	18	21	15	15	15
Other recurrent expenditure 1/	820	937	1,054	1,376	1,459	1,688	1,687	1,662
Development expenditure	1,231	1,533	1,695	1,570	1,972	1,820	1,828	1,828
Government funded	178	243	342	577	681	490	561	561
Grant funded	1,054	1,289	1,354	993	1,291	1,330	1,267	1,267
Unidentified expenditure 2/	-33	18	4	0	0	0	0	0
Current balance	230	605	745	769	838	607	650	587
Overall balance	85	343	599	286	62	22	88	26
Total financing	-85	-343	-599	-286	-62	-22	-88	-26
Foreign (net)	-53	-65	-49	-90	-48	-45	99	99
Disbursements	0	0	0	0	0	0	157	157
Amortization	-53	-65	-49	-90	-48	-45	-58	-58
Debt forgiveness	0	0	0	0	0	0	0	0
Domestic (net)	-78	-279	-561	-196	-14	23	-187	-125
Banking system	-64	-282	-558	-177	0	37	-159	46
Central bank	-25	-284	-477	-108	39	57	-143	62
Of which: cash balance (- = increase)	…	…	-463	166.6	-56	-114	-143	62
Extra deposits	…	…	0	-253.4	95	175	0	0
Commercial banks	-39	2	-81	-69	-39	-20	-16	-16
Nonbank	-13	2	-3	-19	-14	-14	-28	-171
Others	45	1	10	0	0	0	0	0
				(In percent of GDP)				
Total revenue and grants	55.2	62.6	60.3	53.7	53.3	53.5	50.6	49.6
Total revenue	30.5	32.0	33.1	34.5	33.5	32.9	32.3	32.1
Tax revenue	26.4	28.9	30.0	30.6	30.5	30.1	29.4	29.3
Income and profits	11.2	11.6	10.1	10.7	10.74	10.8	10.9	10.7
Goods and services	8.8	10.4	11.3	11.2	11.27	11.3	10.9	11.4
International trade and transactions	6.4	6.9	8.6	8.8	8.4	8.0	7.5	7.2
Of which: Tax on logging	3.4	4.4	5.6	5.5	5.7	5.1	4.4	4.4
Other revenue	4.1	3.1	3.2	3.8	3.0	2.8	2.9	2.8
Grants	24.7	30.7	27.1	19.2	19.9	20.5	18.3	17.4
Development grants	21.9	23.5	23.4	14.8	14.8	15.4	14.4	14.4
Recurrent budget grants	2.9	7.2	3.7	4.4	5.1	5.1	3.9	3.0
Expenditure	53.4	56.4	51.2	49.8	52.6	53.2	49.5	49.3
Recurrent expenditure	28.6	28.2	25.6	28.4	28.2	30.4	28.8	28.5
Compensation of employees	10.6	10.7	9.4	9.5	10.0	9.2	9.4	9.4
Interest payments	0.9	0.4	0.4	0.2	0.3	0.2	0.2	0.2
Other recurrent expenditure 1/	17.0	17.1	15.9	18.7	18.0	21.1	19.2	18.9
Of which : Government funded	14.2	13.4	13.9	15.4	12.9	16.0	15.4	15.9
Development expenditure	25.6	27.9	25.5	21.3	24.4	22.7	20.8	20.8
Government funded	3.7	4.4	5.2	7.8	8.4	6.1	6.4	6.4
Current balance	4.8	11.0	11.2	10.5	10.3	7.6	7.4	6.7
Overall balance	1.8	6.2	9.0	3.9	0.8	0.3	1.0	0.3
(excluding unidentified expenditure)	1.1	6.6	9.1	3.9	0.8	0.3	1.0	0.3
Total financing	-1.8	-6.2	-9.0	-3.9	-0.8	-0.3	-1.0	-0.3
Foreign (net)	-1.1	-1.2	-0.7	-1.2	-0.6	-0.6	1.1	1.1
Domestic (net)	-1.6	-5.1	-8.4	-2.7	-0.2	0.3	-2.1	-1.4
Others	0.9	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Nominal GDP (in SI$ millions)	4,815	5,497	6,637	7,355	8,099	8,006	8,800	8,800
Target of program cash balance (in SI$ millions) 3/	47	263	522	355	411	411	…	407
in months of recurrent spending	0.4	2.0	3.7	2.0	2.2	2.0	…	1.9
Mineral revenue (percent of GDP)	0.0	0.0	0.4	0.6	0.5	0.6	…	0.4
Nonmineral primary balance (percent of GDP) 4/	2.7	3.1	4.2	1.2	1.7	1.1	…	0.0
Noncommodity primary balance (percent of GDP) 5/	-0.7	-1.3	-1.4	-4.3	-4.0	-4.0	…	-4.4
Noncommodity primary balance, excluding development expenditures (percent of GDP) 6/	3.0	3.2	3.7	3.5	4.4	2.1	…	2.0

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 payment orders and unpresented checks.

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

5/ Defined as nonmineral nonlogging revenue (excludes grants) minus domestically funded recurrent and development spending excluding interest payments.

6/ Defined as nonmineral nonlogging revenue (excludes grants) minus domestically funded recurrent spending excluding interest payments.

Table 4. Solomon Islands: Medium-Term Baseline Scenario, 2010–18

	2010	2011	2012	2013	2014	2015	2016	2017	2018
			Est.	Projections					
Growth and prices (percentage change)									
Real GDP	7.8	10.7	4.9	2.9	4.0	3.6	3.4	3.5	3.6
Of which : nontimber and nonmining	5.4	7.3	3.5	4.1	5.0	4.4	4.2	4.2	4.3
CPI (period average)	0.9	7.4	5.9	6.1	5.9	5.6	5.3	5.1	5.0
GDP deflator	5.9	9.1	5.7	5.8	5.6	5.4	5.2	5.0	5.0
Nominal GDP (in SI$ millions)	5,497	6,637	7,355	8,006	8,800	9,611	10,454	11,367	12,362
Per capita GDP (in US$)	1,295	1,614	1,819	1,950	2,096	2,240	2,384	2,536	2,699
Per capita GNI (in US$)	965	1,283	1,633	1,709	1,776	1,879	2,000	2,165	2,314
Central government operations (percent of GDP)									
Total revenue and grants	62.6	60.3	53.7	53.5	49.6	49.2	48.0	47.8	46.5
Revenue	32.0	33.1	34.5	32.9	32.1	31.4	30.9	31.4	30.7
Tax revenue	28.9	30.0	30.6	30.1	29.3	28.5	28.1	28.6	27.9
Income and profits	11.6	10.1	10.7	10.8	10.7	10.7	10.8	11.8	11.7
Goods and services	10.4	11.3	11.2	11.3	11.4	11.4	11.3	11.3	11.3
International trade and transactions	6.9	8.6	8.8	8.0	7.2	6.5	5.9	5.4	4.9
Of which: Tax on logging	4.4	5.6	5.5	5.1	4.4	3.7	3.1	2.7	2.3
Other revenue	3.1	3.2	3.8	2.8	2.8	2.8	2.8	2.8	2.8
Grants	30.7	27.1	19.2	20.5	17.4	17.8	17.1	16.4	15.8
Total expenditure	56.4	51.2	49.8	53.2	49.3	49.9	48.5	47.6	46.4
Recurrent expenditure	28.2	25.6	28.4	30.4	28.5	27.2	26.3	26.1	25.5
Development expenditure	27.9	25.5	21.3	22.7	20.8	22.7	22.2	21.5	20.9
Unidentified expenditure 1/	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	6.2	9.0	3.9	0.3	0.3	-0.7	-0.5	0.2	0.1
Non-mineral primary balance 2/	3.1	4.2	1.2	1.1	0.0	1.6	1.8	1.6	1.7
Non-commodity primary balance 3/	-1.3	-1.4	-4.3	-4.0	-4.4	-2.1	-1.4	-1.1	-0.6
Central government debt (percent of GDP) 4/	27.8	21.6	17.5	14.6	14.1	14.5	15.2	16.1	17.3
Balance of payments (in US$ millions)									
Current account balance (- deficit)	-210.1	-58.5	2.2	-46.2	-156.8	-162.6	-170.2	-166.2	-175.3
(In percent of GDP)	-30.8	-6.7	0.2	-4.2	-13.0	-12.4	-11.9	-10.7	-10.4
(Excluding mining-related capital imports, in percent of GDP)	-12.6	0.8	4.3	-0.5	-9.9	-9.3	-9.1	-8.0	-7.9
Overall balance	119.8	146.4	87.3	20.0	8.9	13.0	11.3	13.3	10.0
Gross official reserves (in US$ million; end of period) 5/	265.8	412.3	499.6	520.0	527.8	537.9	544.8	553.7	563.7
(In months of next year's imports of GNFS)	5.2	7.6	8.5	7.8	7.6	7.4	7.1	7.0	6.7
(In months of next year's nonmining-related imports of GNFS)	5.9	8.1	9.0	8.2	8.0	7.8	7.5	7.3	7.0

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

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

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

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

4/ Includes disbursements under an IMF-supported arrangement.

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

Table 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.	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	3,421	3,418	3,528	3,553	3,567	3,581	3,593
Net international reserves (NIR)	2,893	3,138	3,368	3,516	3,534	3,529	3,639	3,667	3,682	3,696	3,711
Other NFA	-114	-114	-112	-112	-113	-111	-111	-114	-116	-116	-117
Net domestic assets (NDA)	-1,094	-1,263	-1,279	-1,392	-1,366	-1,656	-1,718	-1,713	-1,453	-1,498	-1,556
Net claims on central government	-838	-925	-1,001	-1,007	-946	-1,080	-1,267	-1,197	-888	-908	-941
Claims	103	101	91	84	82	80	79	78	78	78	78
Deposits	941	1,026	1,092	1,091	1,028	1,161	1,346	1,275	967	986	1,019
Other items (net)	-256	-338	-277	-385	-420	-575	-451	-517	-565	-590	-615
Reserve money	1,685	1,762	1,978	2,011	2,055	1,763	1,810	1,839	2,114	2,083	2,037
Currency in circulation	526	515	543	537	599	553	540	529	605	586	583
Bank deposits	1,126	1,213	1,398	1,443	1,446	1,203	1,259	1,299	1,497	1,486	1,443
Other deposits	33	33	37	31	9	7	11	11	11	11	11
Other depository corporations											
NFA of commercial banks	87	65	102	90	12	124	158	196	196	196	196
Assets	167	164	216	190	122	221	246	294	294	294	294
Liabilities	80	99	115	101	110	98	89	98	98	98	98
NDA of commercial banks	838	805	844	877	997	1,228	1,189	1,231	1,199	1,179	1,148
Net claims on central government	-28	-86	-128	-106	-97	-77	-155	-120	-125	-129	-133
Claims	101	96	84	67	65	60	52	55	50	46	42
Deposits	129	182	212	172	163	137	207	175	175	175	175
Claims on the private sector	1,216	1,204	1,204	1,225	1,266	1,356	1,392	1,414	1,442	1,464	1,493
Other items (net)	-350	-313	-232	-242	-172	-51	-48	-63	-118	-156	-212
Reserves and vault cash	1,171	1,248	1,438	1,491	1,513	1,245	1,305	1,354	1,564	1,551	1,507
Deposits	2,097	2,118	2,383	2,458	2,522	2,596	2,652	2,781	2,959	2,926	2,852
Depository corporations survey											
NFA of the banking system	2,867	3,089	3,358	3,493	3,433	3,542	3,686	3,749	3,763	3,777	3,790
Central bank	2,779	3,025	3,257	3,404	3,421	3,418	3,528	3,553	3,567	3,581	3,593
Other depository corporations	87	65	102	90	12	124	158	196	196	196	196
NDA of the banking system	-256	-458	-435	-515	-369	-428	-529	-483	-254	-319	-408
Net claims on central government	-866	-1,011	-1,129	-1,113	-1,043	-1,157	-1,422	-1,317	-1,013	-1,037	-1,074
Claims on the private sector 2/	1,221	1,209	1,209	1,230	1,271	1,361	1,398	1,420	1,475	1,579	1,622
Other items (net)	-611	-656	-515	-633	-598	-632	-505	-586	-715	-861	-955
Broad money (M3)	2,611	2,631	2,924	2,978	3,064	3,114	3,157	3,266	3,508	3,458	3,382
M1	1,874	1,909	2,227	2,300	2,396	2,453	2,414	2,540	2,744	2,705	2,645
Currency outside banks	481	480	503	489	533	511	493	474	538	521	519
Demand deposits	1,393	1,428	1,723	1,811	1,863	1,942	1,920	2,066	2,206	2,183	2,126
Savings and time deposits	737	723	697	678	668	661	743	726	765	754	737
	(Annual percentage change, unless otherwise indicated)										
Reserve money	32.8	29.0	39.9	36.1	22.0	0.0	-8.5	-8.5	2.8	18.2	12.6
Credit to the private sector	4.7	7.2	3.3	8.2	4.1	12.6	15.6	15.5	16.0	16.0	16.0
Broad money	25.5	18.4	23.4	22.2	17.3	18.3	8.0	9.7	14.5	11.1	7.1
NFA of the banking system 3/	42.0	36.7	23.6	25.1	21.7	17.2	11.2	8.6	10.8	7.6	3.3
NDA of the banking system 3/	-16.5	-18.3	-0.2	-2.9	-4.4	1.1	-3.2	1.1	3.7	3.5	3.8
Memorandum items:											
Money multiplier (level)	1.5	1.5	1.5	1.5	1.5	1.8	1.7	1.8	1.7	1.7	1.7
Reserve money	32.8	29.0	39.9	36.1	22.0	0.0	-8.5	-8.5	2.8	18.2	12.6
Loan-to-deposit ratio (in percent)	58.0	56.8	50.5	49.8	50.2	52.2	52.5	50.8	48.7	50.0	52.4
Interest rates (percent per annum)											
Deposit rate 4/	1.4	1.3	1.1	0.7	0.9	0.3	0.2	0.2	…	…	…
Lending rate 4/	11.5	10.2	11.4	11.4	11.2	11.0	10.7	10.2	…	…	…
NCG of financial corporations	-765	-914	-1,031	-1,029	-962	-1,076	-1,337	-1,239	-939	-966	-1,007
91-day treasury bill rate	2.4	2.2	1.6	0.9	0.3	0.4	0.5	0.4	…	…	…
Program targets											
NIR of CBSI (in US$ millions)	393	426	458	478	479	477	494	495	490	470	470
NDA of CBSI (in SI$ millions)	-737	-835	-1,272	-1,259	-1,123	-1,094	-1,358	-1,219	-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 SDRs	
December 7, 2012	1.4	148,571	Approved Fund arrangement
June 28, 2013	1.4	148,571	Completion of the first review and observance of continous and end-December 2012 performance criteria
January 8, 2014	1.4	148,571	Completion of the second review and observance of continous and end-June 2013 performance criteria
June 15, 2014	1.4	148,571	Completion of the third review and observance of continous and end-December 2013 performance criteria
November 15, 2014	1.4	148,571	Completion of the fourth review and observance of continous and end-June 2014 performance criteria
June 15, 2015	1.4	148,571	Completion of the fifth review and observance of continous and end-December 2014 performance criteria
November 15, 2015	1.4	148,574	Completion of the sixth review and observance of continous and end-June 2015 performance criteria
Total	10.0	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
	Act.	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	1.5	0.1	0.1	0.1	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	4.4	4.4	3.9	2.3	0.2	0.3	0.3	0.3
In percent of gross international reserves	0.0	0.0	0.3	0.6	0.8	0.8	0.7	0.4	0.0	0.1	0.1	0.0
In percent of exports of goods and services	0.0	0.0	0.3	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	9.2	14.9	18.5	18.4	16.1	9.5	1.0	1.3	1.3	1.1
In percent of GDP	0.0	0.0	0.1	0.3	0.3	0.3	0.2	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	23.8	14.4	1.5	2.0	2.0	1.6
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	19.7	18.7	16.0	11.8	7.6	3.7	1.4	1.2	0.8	0.5	0.2
In percent of gross international reserves	3.9	3.8	3.5	3.0	2.2	1.4	0.7	0.3	0.2	0.1	0.1	0.0
In percent of exports of goods and services	3.1	3.3	3.0	2.5	1.7	1.1	0.5	0.2	0.1	0.1	0.1	0.0
In percent of debt service 2/	126.2	131.2	107.6	72.6	50.3	31.9	15.6	5.8	4.7	3.3	2.1	0.9
In percent of GDP	1.9	1.8	1.5	1.2	0.8	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	23.1	8.8	7.1	5.1	3.2	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)	1000.0	1096.5	1205.5	1316.5	1432.1	1557.1	1693.4	1850.3	2070.5	2239.3	2442.1	2676.3
Exports of goods and services (in US$ millions)	635.2	598.0	614.0	646.5	679.6	716.3	746.4	737.2	773.8	754.8	755.4	750.0
Gross international reserves (in US$ millions)	499.6	520.0	527.8	537.9	544.8	553.7	563.7	555.3	556.4	562.3	559.3	562.8
Debt service (in US$ millions) 2/	15.4	15.0	17.4	22.1	23.6	23.8	24.0	24.7	24.7	24.9	25.1	26.4
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 7.1 percent of quota (SDR 0.74 million) available under the Extended Credit Facility.
2/ Total public debt service, including IMF repayments.

Table 8. Solomon Islands: Millennium Development Goals

	1990	1995	2000	2005	2010	2011	2012
Goal 1: Eradicate extreme poverty and hunger							
Employment to population ratio, 15+, total (%)	67	67	66	65	64	65	...
Employment to population ratio, ages 15-24, total (%)	44	45	45	46	45	45	...
GDP per person employed (constant 1990 PPP US$)	...	...	...	...	...	...	...
Income share held by lowest 20%	...	...	...	...	...	...	...
Malnutrition prevalence, weight for age (% of children under 5)	16	...	...	12	...	...	...
Poverty gap at US$1.25 a day (PPP) (%)	...	...	...	...	...	...	...
Poverty headcount ratio at US$1.25 a day (PPP) (% of population)	...	...	...	...	...	...	...
Vulnerable employment, total (% of total employment)	...	...	...	...	...	...	...
Goal 2: Achieve universal primary education							
Literacy rate, youth female (% of females ages 15-24)	...	...	80	...	88	...	...
Literacy rate, youth male (% of males ages 15-24)	...	...	90	...	91	...	...
Persistence to last grade of primary, total (% of cohort)	61	55	...	...	...	...	...
Primary completion rate, total (% of relevant age group)	60	73	...	...	...	...	...
Total enrollment, primary (% net)	...	...	...	77	87	...	87
Goal 3: Promote gender equality and empower women							
Proportion of seats held by women in national parliament (%)	0	2	2	0	0	0	2
Ratio of female to male primary enrollment (%)	87	88	93	96	99	...	...
Ratio of female to male secondary enrollment (%)	63	66	79	84	88	...	...
Ratio of female to male tertiary enrollment (%)	...	...	...	...	...	...	...
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	...	...	30.8	...	...	...	...
Goal 4: Reduce child mortality							
Immunization, measles (% of children ages 12-23 months)	70	68	85	70	68	73	...
Mortality rate, infant (per 1,000 live births)	34	29	25	22	19	18	...
Mortality rate, under-5 (per 1,000)	42	36	31	26	22	22	...
Goal 5: Improve maternal health							
Adolescent fertility rate (births per 1,000 women ages 15-19)	...	71	71	70	67	66	...
Births attended by skilled health staff (% of total)	...	85	85	86	...	...	...
Contraceptive prevalence (% of women ages 15-49)	...	11	7	35	...	...	...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	150	120	120	110	93	...	...
Pregnant women receiving prenatal care (%)	...	...	...	74	...	...	...
Unmet need for contraception (% of married women ages 15-49)	...	...	...	11	...	...	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases							
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	...	...	...	19	...	...	...
Condom use, population ages 15-24, female (% of females ages 15-24)	...	...	...	...	...	...	...
Condom use, population ages 15-24, male (% of males ages 15-24)	...	...	...	...	...	...	...
Incidence of tuberculosis (per 100,000 people)	312	240	185	142	108	103	...
Prevalence of HIV, female (% ages 15-24)	...	...	...	...	...	...	...
Prevalence of HIV, male (% ages 15-24)	...	...	...	...	...	...	...
Prevalence of HIV, total (% of population ages 15-49)	...	...	...	...	...	...	...
Tuberculosis case detection rate (%, all forms)	40	41	40	60	58	70	...
Goal 7: Ensure environmental sustainability							
CO2 emissions (kg per PPP US$ of GDP)	0	0	0	0	0	...	...
CO2 emissions (metric tons per capita)	1	0	0	0	0	...	...
Forest area (% of land area)	83	...	81	80	79	79	...
Improved sanitation facilities (% of population with access)	...	30	26	27	28	29	...
Improved water source (% of population with access)	...	69	79	79	79	79	...
Marine protected areas (% of territorial waters)	0.0	0.1	0.1	0.1	0.1	...	...
Net ODA received per capita (current US$)	146	133	166	423	647	620	...
Goal 8: Develop a global partnership for development							
Debt service (PPG and IMF only, % of exports, excluding workers' remittances)	11	1	3	5	3	1	...
Internet users (per 100 people)	0.0	0.0	0.5	0.8	5.0	6.0	7.0
Mobile cellular subscriptions (per 100 people)	0	0	0	1	21	50	53
Telephone lines (per 100 people)	2	2	2	2	2	2	1
Fertility rate, total (births per woman)	6	5	5	5	4	4	...
Other							
GNI per capita, Atlas method (current US$)	790	900	1,010	900	1,050	1,120	1,130
GNI, Atlas method (current US$) (billions)	0.3	0.3	0.4	0.4	0.6	0.6	0.6
Gross capital formation (% of GDP)	20	8	7	14	...	...	...
Life expectancy at birth, total (years)	57	60	63	65	67	68	...
Literacy rate, adult total (% of people ages 15 and above)	...	...	77	...	84	...	...
Population, total (million)	0.3	0.4	0.4	0.5	0.5	0.5	0.5
Trade (% of GDP)	94.7	94.8	62.7	88.7	92.6	72.9	69.1

Source: World Bank, World Development Indicators.

Appendix I. Solomon Islands—Risk Assessment Matrix

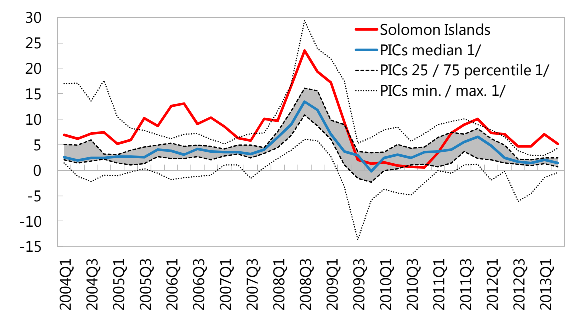
Shock	Likelihood	Impact	Policy Response
Deeper-than-expected slowdown in emerging markets, reflecting (i) the impact of prospective exit from QE; (ii) lower than anticipated growth potential; or (iii) sharp slowdown in China	Depending on the trigger **(i) High** **(ii) Medium** **(iii) Medium**	**High** Lower demand for commodities would worsen the Solomon Islands' terms of trade and have a significant impact on the economy.	Use policy buffers, including countercyclical fiscal policy and international reserves, to cushion the impact. In case of a large and persistent terms-of-trade deterioration the exchange rate may need to be adjusted. Over time, diversify sources of growth.
Slowdown in advanced economies due to a (i) reintensification of the euro area crisis; (ii) bond market stress in Japan; or (iii) a fiscal policy shock in the United States	Depending on the trigger **(i) Medium** **(ii) Medium** **(iii) Low**	**Low** The direct impact of financial turmoil would be small given the relatively closed capital account. However, lower global demand would affect commodity prices and may lead to a reduction in agricultural output.	Use policy buffers, including countercyclical fiscal policy and international reserves, to cushion the impact. Over time, diversify sources of growth.
Global oil shock triggered by geopolitical events	**Low**	**Medium** A substantial and prolonged increase in oil prices would increase production cost, reduce purchasing power of households, and exert pressure on fiscal accounts and on the balance of payments.	In the event of second-round effects on inflation, communicate the intention to tighten monetary policy.
Sharp decline in foreign assistance	**Medium**	**High** Given the high reliance on foreign aid, a significant scaling down of aid would undermine both fiscal and external positions and damage both short-term and long-term growth prospects.	Reduce spending to reflect a tighter budgetary envelope, and accelerate putting in place a new regime for mineral taxation. Use policy cushions to avoid abrupt adjustment.

Appendix II. Determinants of Inflation in Solomon Islands[1]

Consumer price inflation in Solomon Islands is among the highest in the region. The monetary transmission mechanism is weak, while global commodity prices, exchange rate movements, and domestic economic activity have expected impact on inflation. Supply shocks play a big role, but likely affect inflation volatility more than its trend. Large international presence in Honiara in recent years may have contributed to elevated levels of inflation.

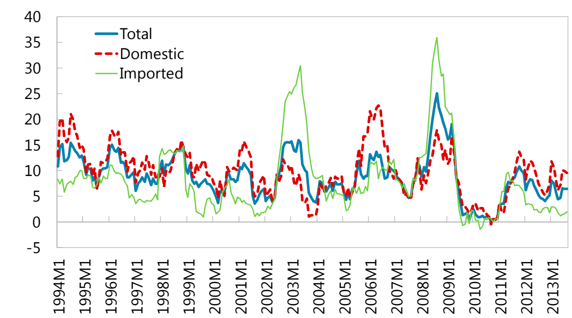
Consumer price inflation in the Solomon Islands has been on a broad downward trend over the last two decades. Still, it remains high relative to the rest of the region and fairly volatile. The prices of both domestically-produced and imported goods have contributed to volatility.

Year-on-year Inflation Rate
(In percent)



1/ Excludes Solomon Islands.
Sources: Country authorities; and IMF staff estimates.

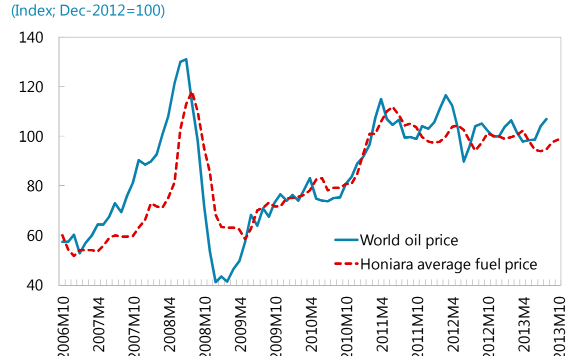
Year-on-year Inflation Rate
(In percent)



Sources: Country authorities.

Regression results show that external shocks and domestic activity have expected impact on inflation (Table 1). With a pegged exchange rate and few price controls, shocks to international commodity prices pass through into domestic prices quickly and nearly fully. For example, global oil prices affect Honiara fuel prices with a short lag and almost one-for-one. The link with international food prices is somewhat less tight. Depreciation of the Solomon Islands dollar against the Australian dollar raises the prices of goods imported from Australia—the main source of non-commodity imports—and feeds into general inflation. The coefficient on the U.S. dollar—the currency in which most imports into Solomon Islands are invoiced—is as large as that on the Australian dollar, but is not statistically significant. This likely reflects the fact that the Solomon Islands dollar has been effectively pegged to the U.S. dollar for a large part of the estimation period, reducing the variance of that regressor and thus increasing the

Fuel Prices
(Index; Dec-2012=100)



Sources: Country authorities; and IMF staff estimates.

[1] The Appendix uses results from ongoing work in the Pacific Island Countries Unit.

standard error of the coefficient.[2] Interestingly, inflation does not appear to be very inertial in Solomon Islands, with coefficient on the lagged dependent variable fairly low and statistically insignificant. In line with economic theory, higher level of domestic economic activity relative to capacity—as measured by the output gap—leads to an acceleration in inflation.[3] On the other hand, regional economic activity—proxied by the average of real GDP growth rates in Australia, New Zealand and Emerging Asia—does not have a discernible effect on inflation in Solomon Islands.

Table 1. Dependent Variable: CPI Inflation (In percent; quarter-to-quarter)

Sample: 1993Q1 2013Q1

Variable	Coefficient	Std. Error	t-Statistic
Constant	0.018***	0.007	2.70
Inflation (t-1)	0.055	0.112	0.49
World food price inflation in SI$	0.065**	0.034	1.95
Nominal exchange rate SI$/AUD depreciation (t-1)	0.065*	0.036	1.77
Oil price growth rate (t-4)	0.023*	0.014	1.67
Nominal exchange rate SI$/USD depreciation	0.063	0.066	0.95
Nominal exchange rate SI$/USD depreciation (t-1)	0.065	0.066	0.99
Output gap	0.001**	0.000	2.04
Asia-Pacific real GDP growth	-0.001	0.002	-0.43
R-squared	0.224		
Durbin-Watson stat	2.035		

*** 1 percent statistical significance.

** 5 percent statistical significance.

* 10 percent statistical significance.

The link between inflation and monetary aggregates is tenuous. Private sector credit and broad money do appear to have a statistically significant impact on inflation or its domestic component in certain specifications (e.g., Table 2), but the results are not very robust.[4] This suggests a weakness in the monetary transmission mechanism noted in earlier work for the Solomon Islands[5] and for other Pacific Island Countries[6] as well as low-income countries more generally.[7] Liquidity, measured as excess reserves in the banking system, does not appear to have a direct impact on inflation. On the

[2] The impact of the U.S. dollar exchange rate is partially absorbed in the coefficients on global oil and food prices, because those prices are converted into Solomon Islands dollars before entering the regression.

[3] Solomon Islands has only annual national accounts data, and quarterly GDP series was generated by interpolation. The output gap was obtained via the HP filter. Given that this activity indicator is not measured directly but rather derived using statistical techniques, one should view the results involving that variable with a bit of caution.

[4] Monetary data are only available on a consistent basis since 2002, resulting in a shorter sample for these regressions.

[5] Peiris, Shanaka J., 2011, "Monetary Transmission Mechanisms and Inflation Dynamics in Solomon Islands," Chapter 2 of the *Selected Issues Paper* for the 2011 Article IV Consultation with Solomon Islands.

[6] Yang, Yongzheng, Matt Davies, Shengzu Wang, Jonathan Dunn, and Yiqun Wu, 2011, "Monetary Policy Transmission Mechanisms in Pacific Island Countries," IMF Working Paper No. 11/96.

[7] Mishra, Prachi, Peter J. Montiel, and Antonio Spilimbergo, 2012, "Monetary Transmission in Low-Income Countries: Effectiveness and Policy Implications," *IMF Economic Review* Vol. 60, No, 2, pp. 270-302.

one hand, this suggests that the currently high level of liquidity does not present an immediate inflationary threat. On the other hand, the weakness of the monetary transmission mechanism makes it difficult for the central bank to control inflation and to bring it further down.

Table 2. Dependent Variable: CPI Inflation

(In percent; quarter-to-quarter) Sample: 2003Q2 2013Q1

Variable	Coefficient	Std. Error	t-Statistic
Constant	0.020*	0.011	1.894
Inflation (t-1)	-0.105	0.164	-0.640
World food price inflation in SI$	0.078*	0.040	1.934
Nominal exchange rate SI$/AUD depreciation (t-1)	0.081*	0.044	1.849
Oil price growth rate (t-4)	0.024	0.016	1.534
Nominal exchange rate SI$/USD depreciation	-0.281	0.295	-0.954
Nominal exchange rate SI$/USD depreciation (t-1)	0.533*	0.287	1.856
M3 growth rate (t-4)	0.250**	0.096	2.600
Output gap	0.001	0.001	1.435
Asia-Pacific real GDP growth	-0.005*	0.003	-1.917
R-squared	0.486		
Durbin-Watson stat	2.276		

*** 1 percent statistical significance.

** 5 percent statistical significance.

* 10 percent statistical significance.

Supply shocks have a considerable impact on inflation. The fit of the regressions—indicated by the R-squared—is fairly low, suggesting that some important drivers of inflation are not captured by the model. In particular, supply shocks likely play a big role in a small, remote, spread-out, undiversified economy such as that of Solomon Islands, with food items constituting a large share of the consumer basket. Lately domestic inflation has been running considerably higher than imported inflation, and the authorities attribute the pick-up in domestic inflation largely to supply disruptions, primarily weather-related.

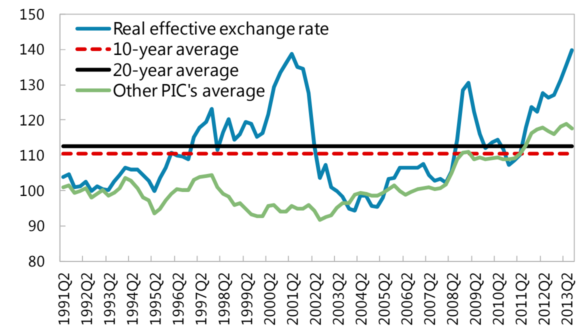
Other factors may be at work as well. While supply shocks surely contribute to volatility, given their transient nature they can hardly account for the persistently elevated level of inflation in the Solomon Islands relative to the rest of the region. It is possible that the large flow of foreign assistance and significant expatriate presence since the end of the "tensions" have been driving up the prices by bringing an influx of purchasing power that the central bank finds difficult to sterilize. The impact of this phenomenon on measured inflation would be exacerbated by the fact that the Solomon Islands consumer price index only covers the capital city of Honiara, which is home to just 12.5 percent of the country's population, but that is where the expatriate community is concentrated. Ongoing cross-country research on the determinants of inflation in Pacific Island countries will likely shed further light on the issue.

Appendix III. Solomon Islands: Exchange Rate Assessment

Long-term averages and model-based estimates suggest that the Solomon Islands dollar has become moderately overvalued since the time of the last assessment.

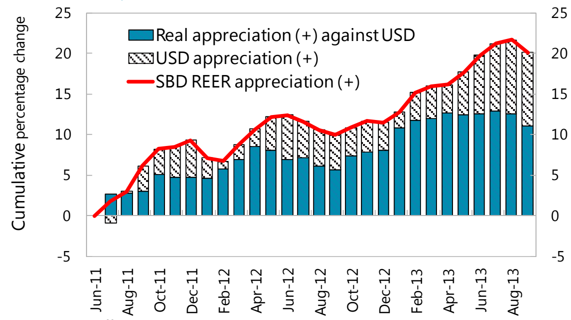
Recent developments in the real effective exchange rate (REER) point to overvaluation. At the time of the last Article IV consultation in 2011, the Solomon Islands' exchange rate was judged as broadly in line with medium-term fundamentals. After that assessment, the REER appreciated by 23 percent between June 2011 and July 2013. It is now 24 percent above its 20-year average and 27 percent above its 10-year average. The appreciation reflects the Solomon Islands dollar real appreciation vis-à-vis the U.S. dollar of around 13 percent and the U.S. dollar appreciation of around 10 percent in real terms against the other currencies in the REER basket.

Solomon Islands: Real Effective Exchange Rate (REER)
(Index, 2005=100)



Sources: INS; and IMF staff estimates.

(June 2011– September 2013) 1/



Source: IMF staff estimates.
1/ Real appreciation of the Solomon Islands dollar against the U.S. dollar, and real appreciation of the U.S. dollar against other currencies in the basket.

Quantitative analysis, drawing on the IMF's CGER[1] methodology, suggests a real effective exchange rate overvaluation of between 5 to 20 percent (Table 1). There is considerable uncertainty over point estimates and sizable variation in estimates across the methodologies.

Table 1. Exchange Rate Assessment: Results
(In percent)

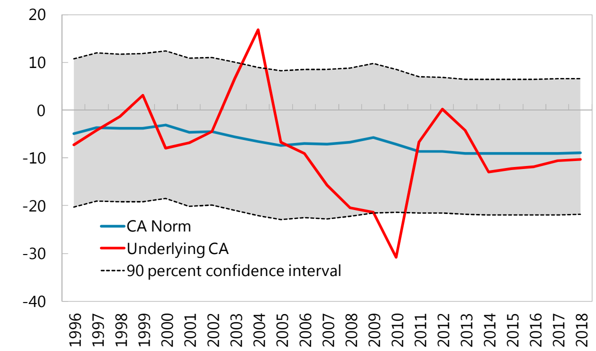
	Current Account/GDP		REER	2011 Art. IV
	Norm	Underlying 1/	Overvaluation	Overvaluation
Macroeconomic balance 2/	-8.9	-10.3	5.1	-2.0
Equilibrium real exchange rate 3/	...	...	20.3	2.7
External sustainability 2/ 4/	-5.1	-10.3	19.4	...

Source: IMF staff estimates.
1/ Staff projection over the medium-term (last year of WEO projections), which is 2018.
2/ Based on semi-elasticity of CA/GDP with respect to the REER of -0.26.
3/ Overvaluation is assessed with respect to medium-term REER, which is held constant at the current level in 2013 Q2.
4/ CA norm stabilizing NFA at -94 percent of GDP (current level according to IFS data), assuming a real GDP growth rate of 3.6 percent and U.S. inflation at 2.2 percent.

[1] The IMF's Consultative Group on Exchange Rate issues. Lee, Jaewoo, Milesi-Ferretti, Gian Maria, Ostry, Jonathan David, Prati, Alessandro, and Luca Antonio Ricci, 2008, "Exchange Rate Assessments: CGER Methodologies," Occasional Paper, No. 261, International Monetary Fund. Vitek, Francis, 2013. "Exchange Rate Assessment Tools for Advanced, Emerging, and Developing Economies." IMF memo.

The Macroeconomic Balance (MB) approach shows an overvaluation of 5 percent, suggesting that the real effective exchange rate needs to depreciate by this much to bring the underlying current account (CA) to the equilibrium. The MB model constructs the equilibrium current account (CA norm) as a function of oil balance, aid inflows, initial net foreign asset position (NFA), and relative[2] values for the fiscal balance, old age dependency, population and output growth, and income. Misalignment is defined as the change in the REER that is needed to bring the underlying CA in the medium term[3] to the equilibrium level, using a country-specific elasticity. The equilibrium CA deficit over the medium term is estimated at 9 percent of GDP, while the projected medium-term CA deficit is about 10 percent[4]. Export and import elasticities of 0.71 and 0.92 are taken from Isard and Faruquee (1998)[5] and translate to a Solomon Islands specific CA elasticity of -0.26 based on the ratios of exports and imports of goods and services to GDP in the medium term. It should be noted that the CA norm estimates are subject to considerable uncertainty, as shown by the wide confidence intervals. Furthermore, the underlying CA over the medium term could worsen even more if the current rate of REER appreciation were to continue.

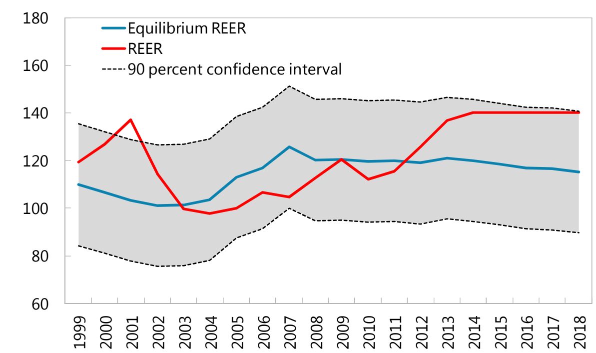
Figure 2. Macroeconomic Balance Approach Results
(In percent of GDP)



Sources: IMF, staff estimates.

The Equilibrium Real Exchange Rate (ERER) approach indicates an overvaluation of 20 percent. It models the ERER as a function of relative productivity, government consumption, terms of trade, and remittances. Misalignment is defined as the difference between the medium term estimate of ERER and the most recently observed value of the REER. Estimated overvaluation reflects the recent REER appreciation.

Figure 3. Equilibrium Real Exchange Rate Results
(Index 2005=100)



Sources: IMF, staff estimates.

The External Sustainability (ES) approach results in an overvaluation of 19½ percent, indicating that some REER depreciation would be necessary to sustain the current level of NFA. The ES approach estimates the CA norm as the CA that stabilizes a country's NFA at a

[2] Measured in deviation from trade partners' average.

[3] Defined as a horizon over which domestic and partner-country output gaps are closed and the lagged effects of past exchange rate changes are fully realized. The methodology takes this to be the last year of the WEO projections (2018).

[4] Stripping out temporary surges in FDI and transfers.

[5] Isard, Peter, and Hamid Faruqee, 1998, "Exchange Rate Assessment: Extensions of the Macroeconomic Balance Approach," Occasional Paper, No. 167, International Monetary Fund.

particular benchmark level, given real growth and U.S. inflation rate assumptions. Misalignment is derived similarly to the MB approach. The results hinge on the assumption on the steady state level of NFA. As a benchmark, we take the NFA in 2011 of 94 percent of GDP as reported by the IFS. While admittedly at a high level, the NFA position reflects net FDI liabilities of 96 percent of GDP due to the Gold Ridge mine. The steady state level could even be higher, as the mining industry develops and attracts further FDI inflows over the medium term. However, the prospects are uncertain at this point. Sensitivity tests suggest that a higher level of the steady state NFA position would imply a lower degree of overvaluation (Table 2).

Table 2. Sensitivity: ES Misalignment Estimates

Steady-state NFA ratio	Steady-state nominal GDP growth	Implied CA norm	Underlying CA	Gap = Underlying - CA norm	Overvaluation
-70	5.8	-3.8	-10.3	-6.4	24.3
-80	5.8	-4.4	-10.3	-5.9	22.2
-90	5.8	-4.9	-10.3	-5.3	20.2
-94	**5.8**	**-5.1**	**-10.3**	**-5.1**	**19.4**
-100	5.8	-5.5	-10.3	-4.8	18.1
-110	5.8	-6.0	-10.3	-4.2	16.0

Appendix IV. Solomon Islands: Assessing Reserve Adequacy

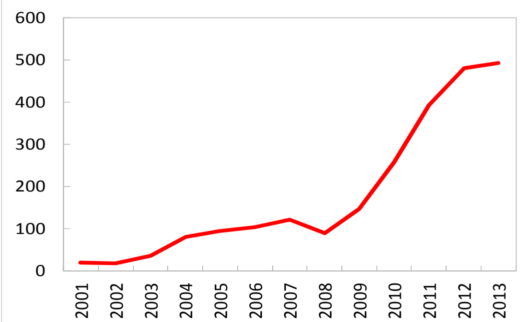
Cross-country comparisons and both traditional and new metrics of reserve adequacy suggest that the net international reserves (NIR) held by the Central Bank of Solomon Islands (CBSI) are fully adequate in the current volatile global environment. However, the current level of reserves may decline as the government draws down the cash balances at the CBSI accumulated from previous grant disbursements and uses them for earmarked capital projects, which tend to have high import content.

International reserves are an important source of self-insurance against external shocks. Solomon Islands is vulnerable to a variety of exogenous shocks, such as sharp swings in terms of trade, given the weakly diversified exports, reliance on international trade to import large quantities of essential goods, and a fixed exchange rate.

The Solomon Islands accumulated impressive reserve buffers over the past five years. The NIR increased more than five times, reaching USD 495 million (7.4 months of prospective imports) at the end of September 2013 (Figure 1). The current USD levels are well over the USD 90 million low at the end of 2008.

Figure 1. Solomon Islands: Net International Reserves

(U.S. dollar million)

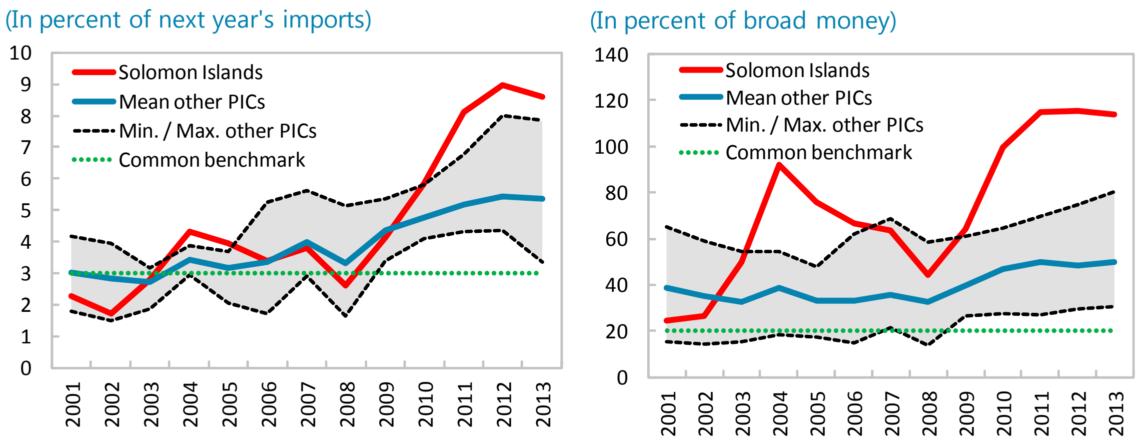


Sources: IMF, APD-LISC.

Traditional rules of thumb suggest that the Solomon Islands' reserve position is more than adequate. Traditional metrics include: (i) import cover, which measures the number of months of imports that could be sustained should all inflows stop; and (ii) percentage of broad money (M2), intended to capture the risk of capital flight, when capital account crisis is accompanied by outflows of deposits of domestic residents.[1] On both measures, Solomon Islands is above the traditional rules of thumb: 3 months of imports and 20 percent of M2 (Figure 2). The reserve cover is also above the traditional indicators for the other PICs. However, these traditional measures are too simple to capture the diversity of shocks and vulnerabilities that Solomon Islands faces.

[1] While the exact number is not available, the ratio of reserves to short-term external debt by remaining maturity is several hundred percent, thus exceeding the third traditional benchmark of 100 percent by a very wide margin.

Figure 2. Net International Reserves: Comparison on traditional reserve metrics



Sources: IMF, APD-LISC.

Recently, Dabla-Norris et al. (2011)[2] and IMF (2011)[3] proposed a new methodology to assess reserve adequacy in a way specific to low-income countries. In this framework, a crisis is defined as a sharp drop in absorption, and the optimal level of reserves is determined when the crisis prevention and mitigation benefits of reserves are balanced against the net financial cost of reserves. An important feature of the model is that optimal reserve holdings depend on the country characteristics and policy fundamentals. However, the methodology is particularly sensitive to the assumption on the opportunity cost of reserves, which ranges between two and six percent. The opportunity cost of holding reserves proxies for the cost of foregone investment opportunities. It is based on existing estimates of the marginal product of capital and the differential between domestic and foreign real interest rates.

The model is calibrated for the Solomon Islands as follows (Table 1). Fundamentals, which include the World Bank Country Policy and Institutional Assessment (CPIA) rating and the fiscal balance, are set at their five year averages (2008-2012). Shock variables for the terms of trade, external demand, FDI to GDP ratio, and aid to GDP ratio are set at the bottom 10 percentile of the country specific distribution over the past sixteen years (1997-2012). The model then estimates a range of optimal reserves for the given policy and shock specification. Two alternative policy scenarios are also considered, subject to the same shocks. In one alternative scenario, optimal reserves are estimated under less favorable fiscal projections, assuming the 2013 supplementary budget is fully implemented without offsets, leading to a 3.4 percent deficit. The second scenario gauges the

Table 1. Model Parameters

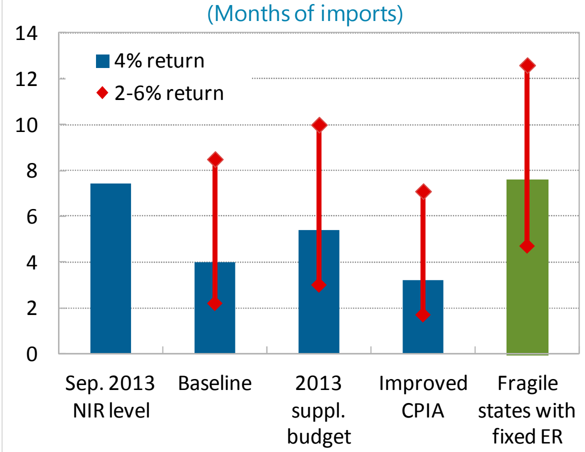
Variables	
Government balance, percent of GDP	4.2
CPIA	2.8
External demand growth, percent	0.9
Terms of trade growth, percent	-12.6
Change in FDI to GDP	-7.2
Change in aid to GDP	-5.7

[2] Era Dabla-Norris & Jun Il Kim & Kazuko Shirono, 2011. "Optimal Precautionary Reserves for Low-Income Countries: A Cost-Benefit Analysis," IMF Working Paper 11/249, International Monetary Fund.

[3] IMF, 2011. "Assessing Reserve Adequacy," IMF Board Paper 11/31, International Monetary Fund.

benefits of improving institutional strength in the Solomon Islands to the median CPIA score of 3.4 for other PICs.

Figure 3. Optimal Reserves
(Months of imports)



The reserve cover as of end-September 2013 of 7.4 months of imports is in the upper range, but does not exceed the optimal reserves coverage estimates under both baseline and alternative scenarios (Figure 3). Under baseline assumptions, the optimal level of reserves varies from 2 to 8.5 months of imports, depending on the opportunity cost of holding reserves. A weaker fiscal stance increases the range of optimal reserves to between 3 and 10 months of imports by increasing the probability of a crisis. A higher CPIA score lowers the optimal reserve range to between 1.7 and 7.1 months of imports because stronger institutions lower the probability of a crisis.

The reserve cover is also in line with the optimal reserve estimates for other low-income countries. Dabla-Norris et al. (2011) suggest a range of 4.7 to 12.6 months of imports as optimal reserve cover for fragile states with fixed exchange rate regimes.

While adequate at their current levels, reserves may decline as the government draws down cash balances at the CBSI. Some of these balances were accumulated from previous grant disbursements earmarked for capital projects, and certain donors insist on government executing those allocations before new disbursements are made. Given the high import content of capital projects, their implementation will have a negative impact on the current account and on international reserves.

Appendix V. Solomon Islands Authorities' Response to Fund Policy Advice

Fund Recommendation	Policy Actions
Fiscal Policy	
Promote fiscal transparency and enhance the efficiency of revenue collections.	Cabinet approved in February 2013 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. Parliament passed in September 2013 the new Public Finance Management Act which covers fiscal responsibility provisions, management and use of public funds, and management of public debt.
Develop a multi-year budget framework to provide more fiscal discipline.	The country is currently implementing a multi-year budget framework.
Resume concessional borrowing after completing the Honiara Club Agreement (HCA) review.	Cabinet endorsed the Debt Management Strategy in May 2012, providing a framework to anchor borrowing plans going forward. The HCA was amended in July 2012 to allow external borrowing to resume.
Monetary and Financial Sector Policy	
Strengthen supervisory and regulatory framework for the financial system.	The CBSI Act was passed by Parliament in November 2012 to strengthen the monetary policy and supervisory framework.
Improve operations and financial performance of the National Provident Fund (NPF).	Cabinet approved in July 2012 draft instructions to revise the NPF Act to strengthen its governance structure and investment framework.
Exchange rate policy	
The exchange rate should continue to be managed in a flexible manner in order to provide a buffer against external shocks.	In line with IMF TA recommendations, the country moved in October 2012 toward a basket peg based on the currency composition of external payments.
Structural policy	
Support private sector development.	Complicated land tenure system remains hindrance to credit growth. The National Development Strategy would benefit from a more detailed implementation plan.

Appendix VI. Letter of Intent

December 16, 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. Strengthened fundamentals helped the economy deal with a variety of adverse shocks in the first half of 2013, including a significant terms-of-trade deterioration and poor weather conditions. Despite the unfavorable environment, growth has continued, albeit at a slower pace than anticipated earlier; net international reserves rose to US$495 million in September from US$480 million at the end of 2012; and public debt remains low. We expect new investments to drive robust growth going forward even though agricultural commodity prices remain subdued, our logging industry is entering a period of secular decline, and donor aid is expected to fall in the coming years.

Our overall performance under the Extended Credit Facility (ECF) arrangement has been satisfactory. We met all of the June 2013 performance criteria (PCs), indicative targets, and continuous PCs. The PCs on net credit to the government, net domestic assets of the central bank, and the cash balance of the central government were all met with large margins.

In addition, a critical reform—the Public Finance Management Act (PFMA)—was approved by Parliament in September, ahead of schedule. However, while there has been progress with other structural reforms, there have also been delays in the completion, owing to the priority given to the PFMA as well as capacity constraints. In particular, delays were experienced in the submission to Parliament of (i) the changes to the tax system to allow for a mining regime (November 2013 benchmark);[1] (ii) the revised National Provident Fund (NPF) Act (October 2013 benchmark); and (iii) the new Customs and Excise Law (November 2013 benchmark. The publication of the Office of Auditor General's (OAG) report on 2012 constituency funds (November 2013 benchmark) has also been delayed. We are fully committed to carrying out these reforms. Moreover, upon a careful examination of the requirements of these reforms, we are proposing a revised schedule to complete them and have secured additional resources from the development partners to address the bottlenecks in the drafting and vetting of legislation that contributed to these delays. In particular, we are requesting that the test dates for obtaining Cabinet's approval of changes to the tax system to allow for a mining regime and submitting then to Parliament be modified to end-January 2014 and end-March 2014, respectively; that the submission to Parliament of a revised NPF Act and of a new Customs and Excise

[1] The benchmark on obtaining Cabinet's approval for these changes, rescheduled from December 2012 to June 2013, has also been missed.

Law be moved to end-June 2014; and that the publication of the OAG report on constituency development funds be moved to end March 2014.

This year, our fiscal position has been challenged by a rapid increase in tertiary scholarships and constituency development funds, combined with the impact of unfavorable economic developments on the revenue. The government is committed to maintaining fiscal discipline and improving the quality of public spending. To this effect, we intend to implement the supplementary budget approved in October within the spending envelope for 2013 agreed during the first review of the ECF, and we will target a balanced budget position in 2013 and 2014. However, our fiscal surplus this year is likely to be lower than envisaged earlier because revenues have been affected by unfavorable external conditions. In view of that, we request a small modification of the PC on net credit to the government because we may need to draw down our deposits to finance the amortization of external debt.

In addition, to improve the quality of spending, we will revamp policies for tertiary scholarship, including by strengthening commitment controls and ensuring enhanced transparency (proposed January 2014 benchmark). Moreover, in consultation with the Core Economic Working Group, we will review policies on education, and ensure an adequate balance of spending between primary and tertiary education (proposed March 2014 benchmark).

We are also working on reforms to improve the quality of spending. In particular, we are going to issue implementing regulations to strengthen the accountability and transparency of constituency development funds (end-December 2013 program benchmark) and of tertiary scholarships (proposed program benchmarks for end-January 2014 and end-March 2014). In addition, in consultation with the Fund, we have designed a strategy to implement financial instructions for the PFMA, including proposed program benchmarks for budget reports (end-April 2014) and public debt management (end-February 2014).

We are continuing with our reforms of the financial sector. Substantial progress is being achieved in the preparation of the Credit Unions Act, and we are on track to meet related program benchmarks next year. In order to promote financial sector stability and development, we are working on a revised Financial Institutions Act and will seek Cabinet's approval of drafting instructions for the Act (proposed program benchmark for end-June 2014). Our work on a new National Provident Fund Act has fallen somewhat behind schedule, and we request moving the benchmark on submitting the Act to Parliament to June 2014.

The attached Memorandum of Economic and Financial Policies (MEFP), which supplements the previous one dated June 10, 2013, provides an update on achievements under our program so far, and sets out our PCs, indicative targets and structural benchmarks through June 2014. 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 Solomon Islands is requesting completion of the second review under the ECF arrangement. We consent to publication of the staff report and the Letter of Intent and attachments.

Sincerely yours,

/s/	/s/
Hon. Rick Houenipwela	Denton Rarawa
Minister of Finance and Treasury	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

Recent Economic Developments and Outlook

1. **Economic performance weakened somewhat in the first half of 2013.** Growth slowed as the output of most agricultural commodities and logging declined owing to unfavorable weather conditions and lower export prices, while gold production temporarily fell as the gold mine was being refurbished. Inflation accelerated earlier in the year, driven by domestic food prices, but stabilized at around 6 percent in mid-2013 (year-on-year). The current account deteriorated due to adverse terms-of-trade developments as well as gold mine reconstruction, which temporarily reduced exports while pushing up imports. However, net international reserves increased slightly owing to higher foreign direct investment.

2. **Macroeconomic Outlook and Risks**. The economy, in particular agriculture and gold production, has begun to rebound in recent months, which is expected to continue in 2014. Real GDP is projected to expand by about 3 percent for 2013 as a whole and further by 4 percent in 2014. Gold output is expected to remain close to capacity, but logging production is projected to fall due to the gradual depletion of stocks. In the medium term, annual growth is expected to be around 3.5 percent. Boosting growth will require raising investment in infrastructure, fisheries, agriculture and mining. The outlook is subject to a variety of downside external risks, including lower external demand or prices of exports, an oil price shock, and a sharper-than-expected curtailment of foreign grants. On the upside, the expected decline in logging output may not materialize as fast as envisaged.

3. **Program Performance.** Program performance has been broadly satisfactory**.** All performance criteria (PCs) and indicative targets for end-June, as well as continuous PCs, were met. In addition, a critical reform—the Public Finance Management Act (PFMA)—was approved by Parliament in September, ahead of schedule. However, while there has been progress with other structural reforms, there have also been some significant delays owing to the priority given to the PFMA as well as capacity constraints, including in the Attorney General's Chambers, combined with the departure of selected external advisors. In particular, delays were experienced in the submission to Parliament of (i) the changes to the tax system to allow for a mining regime (November 2013 benchmark);[1] (ii) the revised National Provident Fund Act (October 2013 benchmark); and (iii) the new Customs and Excise Law (November 2013 benchmark). The publication of the Office of Auditor General's (OAG) report on 2012 constituency funds (November 2013 benchmark) has also been delayed. Upon a careful examination of the requirements for these reforms, we are proposing a revised schedule to complete them and have secured additional resources from the development partners to address the bottlenecks in the drafting and vetting of legislation that contributed to these delays. The government remains firmly committed to these reforms and will complete them in the timeframe described below.

[1] The benchmark on obtaining Cabinet's approval for these changes, rescheduled from December 2012 to June 2013, has also been missed.

Program Policies

4. **Our policies aim at preserving macroeconomic and financial stability through prudent policies and building stronger institutions**, while carrying out reforms to improve the economy's resilience to shocks and to promote sustainable and inclusive growth.

A. Fiscal Policy

5. **We are committed to maintaining fiscal discipline and policy buffers, while providing resources for critical development spending**. The fiscal position remained strong during the first half of 2013, with the overall fiscal surplus up to 5 percent of GDP (from 4.3 percent in the first half of 2012) due to the under-execution of spending (in particular, development spending). However, since then, significant fiscal challenges have emerged that pose risks to our fiscal objectives. These challenges as well as our policies to deal with them include:

- *Supplementary budget*. Unavoidable spending, including clearing of arrears on tertiary scholarships and other expenditures, led to the approval of a supplementary budget in September 2013, with an unfunded net increase of spending amounting to over 2 percent of GDP. We will implement the priorities contained in the supplementary budget within the spending envelop approved during the first review of the Extended Credit Facility (ECF) arrangement in June 2013, by reducing the level of new spending and reallocating other spending. We believe that this is feasible because of the lower-than-anticipated spending level in the first half of the year and the expanded fiscal space approved at the time of first review of the ECF arrangement, even if the latter was intended for development spending.
- *Revenue performance*. Unfavorable terms of trade and slower economic growth have adversely impacted government revenues, which are projected to be lower by around 0.5 percent of GDP in 2013 as a whole, compared to first review projections. Lower revenues are projected because of lower growth, as well as on excises on tobacco and alcohol. We are strengthening tax compliance, including with the recent incorporation of additional staff to the Internal Revenue Division and the Customs Office. In addition, nontax revenues, including fishing licenses, are below earlier projections.
- *Development spending*. The development budget was under-executed, in part because of lower capital expenditures, which were adversely affected by capacity constraints and transitional challenges related to the introduction of a new chart of accounts. We have made significant effort to train staff and expect these expenditures to gradually increase in line with absorptive capacity and within the overall spending envelope of our financial program.
- *Constituency development funds*. After increasing rapidly in the last few years, the growth of these expenditures, managed by Members of Parliament, slowed somewhat in the first nine months of 2013. Cabinet has created a committee chaired by the Minister of Finance to prepare the implementing regulations of the Constituency Development Funds Act, which are expected to be put in place before end-year (December 2013 benchmark). The regulations are expected to provide guidance on consultations with various stakeholders—especially constituency members—on plans for use of funds, linking them to the National and Provincial Development Plans, and will

introduce norms for developing costing of projects, managing fund accounts, procurement, and reporting on use of funds. The OAG's audit of 2012 constituency fund spending has advanced with some delays, and the review of 38 out of 50 constituencies has been completed, with the remaining audits to be completed by the end of the year. We expect the summary findings to be published by end-2013 and the audits of each constituency by end-March 2014, after each Member of Parliament has had a chance to react to the findings of the audits. Consequently, we request that the structural benchmark for the publication of the audit be extended from November 2013 to end-March 2014.

- *Tertiary scholarships*. Significant challenges have emerged with the management of tertiary scholarships for students both in the Solomon Islands and abroad. Inadequate record keeping and the approval of scholarships outside established channels have led to the rapid increase in these expenditures and the emergence of arrears in the payment of university fees and stipends, including for students abroad. Tertiary scholarship expenditures are now crowding out other priority spending, including on primary education. The government is committed to correcting this situation and has created a committee chaired by the Ministry of Education to revamp the practices and policies related to tertiary scholarships. We propose to strengthen our policies in a number of ways, including:
    - We will seek Cabinet's approval of a decision to revamp the policies for tertiary scholarships (proposed benchmark for end-January 2014), in place and effective for the next school year, in order to ensure that best practices in public finance are applied to this priority program of the government. Some of the criteria to be included in the Cabinet decision are spelled out in the attached TMU. A joint group of officials from the Ministry of Finance and Treasury (MOFT) and Ministry of Education will be specifically assigned to the Ministry of Education to regularly monitor and report on the Ministry of Education's administration of scholarships. The group will advise on the business processes and information required to enable the government's financial management information system (FMIS) to better capture accurate and timely information. This should lead to better commitment control, prevent arrears in payments to students and universities, and maintain documentation of student applications in the FMIS.
    - In coordination with the development partners, the government will review the policies on tertiary education, including selection criteria, budget allocation, and accountability and transparency in the use of funds, and make the necessary changes to ensure that an adequate balance of spending between primary and tertiary education is achieved (proposed benchmark for end-March 2014) and that spending in this area follows international best practices on public financial management.

6. **The approval of the Public Finance Management Act constitutes an important benchmark in the modernization of public financial management in the Solomon Islands**. The law contains many of the elements of a modern PFM law, including sound principles on fiscal responsibility, and transparency and accountability in the use of public funds. Going forward, initially we will work on revising and updating the financial instructions in order to effect the policy and operational intentions of the new PFMA in the areas of budget preparation, expenditure control, accounting, and financial reporting. This will also include updating the financial instructions to clarify

the role of the Internal Audit Office in the implementation of OAG recommendations by the government's ministries and agencies, and its technical supporting role to the Audit Committee under the new Act. We are also working, in collaboration with PIFTAC, on a strategy for the implementation of the new PFMA. These will entail the accomplishment of key milestones of our PFM reform program such as:

(i) strengthening the FMIS in its inter-operability with other financial application programs in the MOFT and the supporting business processes;

(ii) implementing new procurement rules and requirements at operational level;

(iii) embedding the new Chart of Accounts as the structure for recording financial information and to build standard reporting templates to meet PFMA requirements;

(iv) updating the accounting framework and financial policies. This will entail the development of a new set of financial regulations that will consolidate all the rules, processes and information that will be required (as binding regulations) in the administration of the new PFMA, including special funds, targeted balances, budget strategy, procurement, public debt management, public stores, public accounts, public funds, gifts and donations.

(v) developing and implementing a training and capacity building strategy;

(vi) entrenching PFM-driven changes as an integral part of the Solomon Islands Government's wider public sector and governance reform agenda.

In addition, the PFMA contains fiscal responsibility provisions that require the publication of a series of new fiscal documents, starting in 2014, which will greatly increase fiscal openness, transparency and planning. In this context, we will produce a Final Budget Outcome Report (proposed benchmark by end April 2014); a Mid-Year Budget Review (by end July 2014); the Budget Strategy Paper (by end July 2014); Fiscal and Debt Management Strategies (by end September 2014); and the Medium Term Development Plan (by end September 2014).

7. **Public Debt Management**. We will continue to exercise prudence in resuming concessional borrowing to preserve domestic and external stability, while tapping resources to finance high-priority development projects. The Debt Management Strategy (DMS) provides the framework to anchor our borrowing plans going forward. We have identified the outstanding debt of state owned enterprises (SOEs) and submitted to Cabinet instructions for SOE borrowing (June 2013 benchmark). We are developing the framework for the evaluation, provision, and setting of terms for onlending and guarantees that are sought from government. We will submit the onlending and guarantees instructions to Cabinet by end-February 2014 (proposed benchmark) and conduct the final review of the Honiara Club Agreement. In accordance with the DMS, the 2014 budget will set a limit on new borrowing based on the debt sustainability analysis of the Debt Management Unit. The debt limit will be revised on a yearly basis depending on the debt outlook and our investment needs and will cover all external government borrowing, external and domestic SOE borrowing, and government guarantees. The Debt Management Advisory Committee (DMAC) will assess all borrowing and

guarantees proposals to make sure that projects increase government revenue and GDP, or fund essential infrastructure that can benefit all citizens.

8. **Other fiscal reforms.** Notwithstanding some delays, progress has been achieved with other reforms, including changes to the tax system to allow for a mining regime (June 2013 and November 2013 benchmarks) and the new Customs and Excise Law (November 2013 benchmark). Regarding the former, the draft legislation is currently being vetted by the Attorney General's Chambers and will be sent to Parliament by end-March 2014. We therefore request that the test dates for obtaining Cabinet's approval of changes to the tax system to allow for a mining regime and submitting then to Parliament be modified to end-January 2014 and end-March 2014, respectively. Regarding the draft Customs and Excise law, including the exemptions regime, we have recently adopted and strengthened exemptions policy that includes the establishment of a revenue and customs committee to review requests for exemptions and make recommendations to the Minister of Finance, who cannot overrule these recommendations. In addition, all exemptions will be published semiannually. The new Customs and Excise Law is currently being updated to reflect this policy, and will be submitted to Parliament by end-June 2014. We therefore request that the test date for this reform be modified to end-June 2014.

9. **We are preparing the 2014 budget proposal for Parliament.** While we are still at the early stages of the process, we commit to maintaining a prudent budget consistent with the program objectives. In particular, we will target an overall balanced budget position, with an adequate balance between recurrent and development expenditures. In addition, we will protect spending on primary education and health, and commit to maintaining at least the same level as in 2013.

B. Monetary Policy and Exchange Rate Polices

10. **Strengthening monetary and exchange rate policy management.** Monetary and exchange rate policies will continue to be geared to maintaining price and external stability. The Central Bank of Solomon Islands (CBSI) will continue to strengthen monetary instruments, including by deepening the market for Bokolo bills through the issuance of additional maturities, and stands ready to take any actions needed to mop up liquidity if inflationary pressures rise. To this effect, the central bank will review all its monetary policy instruments, including the cash reserve requirement. The CBSI will adjust the formula used to implement the exchange rate peg to a basket of currencies, with the aim of following the basket peg more closely. The CBSI will review the merits of widening the current band of ±1 percent around the base parity of the bilateral SI$/US$ exchange rate, to benefit more fully from the advantages of a basket peg. To make sure that the currency peg does not lead to real exchange rate misalignment in the presence of inflation differentials with our trading partners, we will take further steps to boost productivity growth as described in Section C.

11. **Strengthening the financial supervisory and regulatory frameworks and improving access to financial services.** Despite some temporary delays, progress continues with the preparation of the revised National Provident Fund legislation aimed at improving its governance and investment framework. We are currently incorporating comments received from the recently concluded consultation phase, and expect to begin the drafting of the legislation shortly. Upon the approval of

Cabinet, we plan to submit the draft legislation to Parliament before end-June 2014 (proposed program benchmark). Progress is also being made in the preparation of the Credit Unions Act (CUA), which aims at establishing a sound regulatory and supervisory framework under the management of the central bank. We will submit to Cabinet the draft CUA by end-March 2014 (program benchmark) and to Parliament by end-June 2014 (program benchmark). The central bank will also continue with the preparations of a new payment system law, with support from development partners. Finally, we are preparing a new Financial Institutions Act, in line with IMF technical assistance recommendations, and intend to obtain Cabinet's approval of drafting instructions by end-June 2014 (proposed program benchmark). We remain committed to maintaining financial stability, including by conducting full due diligence before any institution can commence banking operations in the Solomon Islands.

C. Policies to Promote Inclusive Growth and Other Issues

12. **The government recognizes the importance of creating conditions conducive to private-sector-led growth over the medium and long term.** We have submitted our National Development Strategy as an Interim Poverty Reduction Strategy Paper. We will finalize shortly the medium-term development plan that specifies infrastructure projects consistent with our national priorities. Structural reforms outlined above will facilitate private sector growth by clarifying the tax regime and improving access to finance. We are currently engaged in a process of defining reform priorities for inclusive growth and shared prosperity. With the support of the World Bank, we will prepare an assessment of hardship and vulnerability, which is expected to be completed by the end of 2014. This will provided the basis for the preparation of a Poverty Reduction Strategy, which would help focus policy reforms and investment priorities more clearly on the objectives of reducing hardship and fostering broadly based improvements in living standards in an actionable plan.

13. **We will continue to improve the quality of our economic statistics**. Our National Statistics Office has just compiled national accounts for the period 2007-12, with a breakdown both on production and on expenditure side. We are working on improving the compilation of price statistics and we are preparing the introduction of core CPI. We are also getting ready to disseminate the Census report. We have completed data collection for the Household Income and Expenditure Survey, which will be an important input for the Poverty Reduction Strategy.

D. Program Monitoring

14. **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 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 third and fourth reviews are expected to take place on or after June 15, 2014 and November 15, 2014, respectively.

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

	3/31/2013				6/30/2013			
	IT (EBS/12/145)	IT with adjustors	Act.	Status	PC (EBS/13/81)	PC with adjustors	Act.	Status
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$)) 2/	475	471	477	Met	480	491	494	Met
Net domestic assets (NDA) of the CBSI (ceiling, end-of-period stock, in millions of Solomon Islands dollars (SI$)) 3/	-1,122	-1094	-1,656	Met	-1,279	-1358	-1,718	Met
Net credit to central government (NCG) (ceiling, cumulative change from the beginning of the year, in millions of SI$) 4/	6	34	-114	Met	-15	-15	-375	Met
New nonconcessional external debt maturing in more than one year, contracted or guaranteed by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of US$) 5/	0	0	0	Met	0	0	0	Met
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$) 5/	0	0	0	Met	0	0	0	Met
Accumulation of new external payment arrears by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of SI$) 5/	0	0	0	Met	0	0	0	Met
Central government program cash balance (floor, end-of-period stock, in millions of SI$) 4/	440	411	444	Met	399	399	518	Met
Indicative Targets (cumulative)								
Government funded recurrent spending on health and education (cumulative from the beginning of the year, in millions of SI$) 6/	147	...	180	Met	300	...	346	Met
Memorandum items:								
The threshold of indicative target on health and education (actual 32 percent of government funded recurrent spending)	...	...	153	...	...	...	...	...
Budget support from bilateral and multilateral donors other than IMF (cumulative change from the beginning of the year, in millions of US$), program level.	11	...	7	...	27	...	38	...
Outstanding stock of Solomon Islands government (SIG) treasury bills, excluding restructured government bonds (end-of-period stock, in millions of SI$), program level.	40	...	40	...	40	...	40	...
Balance of SIG Consolidated Deposits Account, millions of SI$ 7/	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 the 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 the 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.

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

	9/30/2013				12/31/2013		3/31/2014		6/30/2014	
	IT (EBS/13/81)	IT with adjustors	Act.	Status	PC (EBS/13/81)	PC	IT (EBS/13/81)	IT	IT (EBS/13/81)	PC
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$)) 2/	485	487	495	Met	490	490	495	470	500	470
Net domestic assets (NDA) of the CBSI (ceiling, end-of-period stock, in millions of Solomon Islands dollars (SI$)) 3/	-1,202	-1219	-1,713	Met	-1,150	-1,150	-1,268	-1,268	-1,159	-1,159
Net credit to central government (NCG) (ceiling, cumulative change from the beginning of the year, in millions of SI$) 4/	-6	-6	-277	Met	-14	35	-24	-24	-14	-50
New nonconcessional external debt maturing in more than one year, contracted or guaranteed by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of US$) 5/	0	0	0	Met	0	0	0	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$) 5/	0	0	0	Met	0	0	0	0	0	0
Accumulation of new external payment arrears by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of SI$) 5/	0	0	0	Met	0	0	0	0	0	0
Central government program cash balance (floor, end-of-period stock, in millions of SI$) 4/	390	390	546	Met	411	411	429	429	409	440
Indicative Targets (cumulative)										
Government funded recurrent spending on health and education (cumulative from the beginning of the year, in millions of SI$) 6/	449	...	517	Met	599	599	167	179	334	359
Memorandum items:										
The threshold of indicative target on health and education (actual 32 percent of government funded recurrent spending)	...	...	...	...	...	...	...	...	...	...
Budget support from bilateral and multilateral donors other than IMF (cumulative change from the beginning of the year, in millions of US$), program level.	48	...	50	...	67	67	9	11	22	26
Outstanding stock of Solomon Islands government (SIG) treasury bills, excluding restructured government bonds (end-of-period stock, in millions of SI$), program level.	40	...	40	...	40	40	40	40	40	40
Balance of SIG Consolidated Deposits Account, millions of SI$ 7/	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 the 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 the 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.

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 legislation 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.
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 the release of the draft bill for public consultation on February 15, 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 toward better access to financial services in rural areas.	Increase access to financial services to ensure inclusive growth.	March 31, 2013	Met in February.
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	Not met. The benchmark was rescheduled to end-December 2013.
Submit to Cabinet the instructions for SOE borrowing.	To strengthen debt management and maintain public debt sustainability.	June 30, 2013	Met in June.
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	Not met. The benchmark was rescheduled to June 30, 2014.
Submit to Parliament the draft of the new Public Finance Act that 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	Met in July. The Act was passed into law in September.

Table 2–Solomon Islands: Structural Benchmarks (Concluded)

Actions	Macroeconomic criticality	Date	Status
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	Not met. The benchmark was rescheduled to June 30, 2014.
Submit to Parliament draft amendment to income tax, customs and excise tax, and goods tax legislation 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	Not met. The benchmark was rescheduled to March 30, 2014.
Release to public the results of the audits conducted by the office of the Auditor General on spending of constituency funds by the 50 constituencies, and project achievements in 2012.	To promote the transparency and accountability in the use of public funds.	November 30, 2013	Not met. The benchmark was rescheduled to March 30, 2014.
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	
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.	January 31, 2014	
Obtain Cabinet's approval of revamped policies for tertiary scholarships as specified in TMU.	To promote the transparency and accountability in the use of public funds.	January 31, 2014	
Submit to Cabinet the onlending and guarantees instructions under the framework of the Debt Management Strategy.	To promote public debt management.	February 28, 2014	
Release to public the results of the audits conducted by the office of the Auditor General on spending of constituency funds by the 50 constituencies, and project achievements in 2012.	To promote the transparency and accountability in the use of public funds.	March 30, 2014	
Review the policies on tertiary education and ensure an adequate balance of spending between primary and tertiary education	To promote the transparency and accountability in the use of public funds.	March 30, 2014	
Submit to Parliament draft amendment to income tax, customs and excise tax, and goods tax legislation related to the new mining tax regime in line with IMF TA recommendations.	To broaden the tax base and increase revenue transparency.	March 30, 2014	
Produce a Final Budget Outcome Report.	To increase fiscal openness, transparency and planning.	April 30, 2014	
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.	June 30, 2014	
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.	June 30, 2014	
Obtain Cabinet's approval of drafting instructions of a new Financial Institutions Act.	To promote financial sector stability and 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.

I. Quantitative Performance Criteria and Indicative Targets

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

II. Institutional Definitions

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

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

III. Monetary Aggregates

A. Reserve Money

6. 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

7. 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.

8. NIR will be calculated as gross international reserves (GIR) less international reserve liabilities. For NIR program monitoring purposes, the stock of foreign assets and foreign liabilities of the CBSI will be reported in U.S. dollars and be valued at the program exchange rates, as specified in Table 1.

TMU Table 1. Solomon Islands: Program Exchange Rates

Solomon Islands (Program) Exchange Rates for the ECF Arrangment

(Rates as of September 30, 2013)

Currency	Solomon Islands Dollar per currency unit	U.S. Dollars per currency unit
Australian dollar	6.831	0.932
British pound	11.820	1.612
Euro	9.901	1.350
Japanese yen 1/	13.352	97.890
New Zealand dollar	6.068	0.827
SDR	11.236	1.533
Singapore dollar	5.838	0.796
U.S. dollar	7.331	1.000

1/ Currency unit per U.S. dollar and Solomon Islands dollar.

9. 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.

10. Excluded from the definition of GIR are:

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

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

- All outstanding liabilities of the Solomon Islands to the IMF, excluding IMF SDR allocations; and
- Foreign currency liabilities in convertible currencies to nonresidents with an original maturity of up to and including one year.

C. Net Domestic Assets of the CBSI

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

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

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

D. Net Credit to the Central Government

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

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

IV. Fiscal Aggregates

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.

V. External Debt

A. Medium- and Long-Term External Debt

19. A ceiling applies to the contracting and guaranteeing by the public sector of new nonconcessional borrowing with nonresidents with original maturities of more than one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended

and which, therefore, constitutes a contingent liability of the public sector. The public sector comprises the central government, the CBSI, nonfinancial public enterprises (i.e., enterprises in which the government owns more than 50 percent of the shares), and other official entities.

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

21. Excluded from the ceiling are (i) the use of Fund resources; (ii) lending from the World Bank and the Asian Development Bank; (iii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt; (iv) concessional debts; (v) any SI$-denominated treasury bill and bond holdings and Bokolo bonds held by nonresidents.

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

23. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The NPV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rate used for this purpose is five percent.

B. Short-Term External Debt

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

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

26. Excluded from the ceiling are (i) debts classified as international reserve liabilities of the CBSI; (ii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the

actually restructured/refinanced/prepaid debt; (iii) SI$-denominated treasury bills and bonds and CBSI and Bokolo bills held by nonresidents; (iv) concessional debts; and (v) normal import financing. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

VI. External Payment Arrears

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

VII. Tertiary Education

28. Approval will be sought from Cabinet to strengthen the policy of the granting of tertiary scholarships, which will contain at least the following elements:

- *Commitment controls.* The Ministry of Finance will certify the availability of budget allocation before any new award letters can be granted, in order to ensure that the budget ceilings are abided by and no new arrears are incurred. Commitment information will be entered into the Ministry of Finance's Financial Management Information System to record commitments made for each individual scholarship awardee. The Ministry of Education will ensure that the documentation relating to identification and eligibility, expected length of studies, as well as due dates for tuition and stipend payments is provided to the Ministry of Finance in a timely manner.
- *Queuing system.* If there are more candidates for scholarships than resources available in a fiscal year, a queuing policy for eligible applicants based on the timing of their application will be established.
- *Arrears.* All arrears will be cleared and no new arrears allowed.
- *Documentation.* In consultation with the Ministry of Finance, the Ministry of Education will establish the standards for eligibility documentation and documentation retention for each application. The required and retained documentation should include at least the application form, high school transcript, receipt for the payment of the application fee, copy of Ministry award letter, signed declaration letter, transcripts of results in each semester from tertiary institutions and qualifications attained by the scholarship holders.
- *Monitoring and dissemination.* The Ministry of Education will produce regular reports on total number of applicants for scholarships, number granted scholarships, current number of students classified by gender and educational institutions, and number of terminations or fails in the last 12 months. The Ministry of Education will publish the guidelines for obtaining scholarships and publish their periodic reports.

- *Tuition and Fee Rates.* The Ministry of Education will sign a memoranda of understanding the USP and other tertiary institutions, including to establish the basis of the financial commitment of the Solomon Islands Government.
- *Allowances.* The Ministry of Education, in consultation with the Ministry of Finance, will recommend an allowances policy with specific allowance amounts that vary for students depending on the institutions where they study, the course that they are undertaking, employment status, travel requirements, whether studies are full-time or part-time, the length of the program in which they are enrolled and the number of years they have received the grant.

VIII. Data Provision

29. 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 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

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

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

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

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

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

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

December 16, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERION—INFORMATIONAL ANNEX

Prepared By | Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of October 31, 2013)

Membership Status: Joined September 22, 1978; Article VIII

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	10.40	100.00
Fund holdings of currency	9.85	94.73
Reserve position in the Fund	0.55	5.29

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	9.91	100.00
Holdings	9.26	93.43

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
ECF Arrangements	0.30	2.86
SCF Arrangement	12.48	120.00

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Mission)	Amount Drawn (SDR Million)
ECF	12/7/2012	12/6/2015	1.04	0.30
SCF	12/6/2011	12/5/2012	5.20	0.00
SCF	6/2/2010	12/1/2011	12.48	12.48

Projected Payments to Fund[1]:
(SDR Million; based on existing use of resources and present holdings of SDRs):

		Forthcoming			
	2013	**2014**	**2015**	**2016**	**2017**
Principal		**1.04**	**2.08**	**2.77**	**2.77**
Charges/Interest	**0.00**	**0.00**	**0.06**	**0.04**	**0.03**
Total	**0.00**	**1.04**	**2.14**	**2.82**	**2.80**

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative: Not applicable.

Implementation of MDRI Assistance: Not applicable.

Implementation of PCDR: Not applicable

Exchange Rate Arrangements:

The exchange rate arrangement is a conventional peg. The Solomon Islands dollar is pegged to an invoice-based basket of currencies consisting of the U.S. dollar (with the weight of 58 percent), the Australian dollar (32 percent), the New Zealand dollar (5 percent), the Japanese yen (3 percent), and the British pound (2 percent). The Central Bank of Solomon Islands sets the exchange rate vis-à-vis the U.S. dollar in such a way as to maintain the value of the basket constant in Solomon Islands dollars given the movements of currencies in the basket relative to each other. However, the exchange rate of the Solomon Islands dollar against the U.S. dollar is not allowed to deviate from the "base" rate by more than one percent in either direction. This regime was introduced in October 2012, replacing a peg to the U.S. dollar. The initial base rate equaled SBD7.36 per USD, which was the parity under the U.S. dollar peg, but in June 2013 the base rate was adjusted to SBD7.28 per USD. Solomon Islands maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

Last Article IV Consultation:

The 2011 Article IV Consultation discussions were held in Honiara during September 29–October 12, 2011. The staff report (IMF Country Report No. 11/359) was considered by the Executive Board and the consultation concluded on November 23, 2011.

Technical Assistance:

Date	Department	Purpose
January 2005	PFTAC	Financial reporting system
February 2005	PFTAC	Financial supervision of insurance
April 2005	PFTAC	Financial supervision
May, August, and October 2005; and February 2006	MFD	Financial supervision of insurance
May 2005	PFTAC	Tax policy and administration
August 2005	MFD	Reserve management
August 2005, February and April 2006	PFTAC	Statistics
September 2005 and February 2006	PFTAC	AML/CFT
October 2005	LEG	AML/CFT
November 2005 and July 2005	STA	Monetary and Financial Statistics
January 2006	PFTAC and LEG	Tax policy
April and June 2006	MFD	Central Bank Accounting
May, August, and October 2006 and January 2007	PFTAC	Public Financial Management and Accounting
October 2006	MCM	TA program monitoring
October 2006	MCM	Financial sector supervision
October 2006	MCM	Reserve Management
December 2006	PFTAC	Business Revenue Reform
February 2007	PFTAC	Balance of Payments Statistics
February and November 2007 and May 2008	PFTAC	National Income Accounts

March 2007 and March 2008	MCM	Accounting
February 2008-February 2009	STA	Peripatetic Export and Import Price Index Statistics
February-March 2008	PFTAC and FAD	Tax Policy
April 2008, February 2009	PFTAC	Balance of Payments Statistics
June 2008	LEG	Review of Central Bank Act
April 2008-April 2009	MCM	Peripatetic Advisor to CBSI
June 2008, September 2008, June 2009	MCM	Monetary Operations and Liquidity Management
July 2008	STA	Money and Banking Statistics
January 2009, April 2010, April 2011	STA	Monetary and Financial Statistics
April 2009	MCM	Insurance Supervision
June 2009	LEG	Insurance Sector Law
June 2009	MCM	Central Bank Law
April 2010	PFTAC	Balance of Payment Statistics
April 2010, May 2011	PFTAC	National Account Statistics
September 2010	PFTAC	Government Finance Statistics
June 2010, October 2010, March 2011	PFTAC	Financial Supervision
October 2010, March 2011	FAD, PFTAC	Natural Resource Tax Policy
October 2010, June 2011	MCM	Monetary Operation and Liquidity Management
July 2010, October 2010, January 2011	PFTAC	Public Financial Management
April 2011	FAD	Budget Law
April 2011	PFTAC	Macroeconomic Advisor Visit
April 2011	STA	GDDS Metadata Development
July 2011	PFTAC	Customs Administration
September 2011	LEG	Tax Legislations
November 2011	MCM	Exchange Rate Flexibility and Foreign Exchange Market Development
February 2012	STA	Consumer Price Index
June 2012	FAD	Public Finance and Audit Act
September 2012	STA	Monetary and Financial Statistics
January 2013	LEG	Financial Institutions Act
March 2013, September 2013	STA	External Sector Statistics
May 2012, May 2013	MCM	National Provident Fund
February 2013, August 2013	PFTAC	National Accounts
November 2013	PFTAC	PFM law and the Constituency Development Fund Law

Resident Representative: The resident representative office in the Pacific Islands was opened in September 2010 in Suva, Fiji. Mr. Yongzheng Yang is the Resident Representative.

SUPPORT FROM THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTER[1]

Solomon Islands: PFTAC Country Strategy 2013–15

Background

The Solomon Islands has recovered well from a precarious position during the global economic crisis. Growth has accelerated rapidly and international and fiscal reserves increased, on the back of increased logging and mining, but also due to better fiscal management and increased international assistance. The medium-term reform agenda under the Core Economic Working Group emphasizes, amongst other things, strengthening of public financial management in particular with regard to the management of natural resource revenues.

Solomon Islands has been a moderate user of PFTAC TA. Despite the large international presence, mainly through RAMSI which caters for much of the technical assistance needs in the government, PFTAC has made specific technical contributions in particular with regard to the fiscal regime for natural resources. In the PFM area, PFTAC has reviewed and provided suggestions on a draft PFM law and provided follow up support to a revision of accounting standards. Significant amounts of support have been provided to CBSI in formulating and implementing new prudential regulations for banks and also in developing a more robust inflation forecasting regime.

Strategy 2013-2015

PFTAC's TA strategy is guided by the APD regional strategy note and is planned within the Results-Based Management (RBM) framework for the current PFTAC funding cycle.[2] The main focus of PFTAC TA will be on strengthening fiscal management, particularly with regard to natural resource management and solidifying the financial sector. In the Government area inputs will either be at the strategic/policy level or dealing with niche requirements where IMF/PFTAC has a comparative advantage. Support for implementation is expected to continue to come from other donors, in the context of RAMSI or its successor.

In the **Public Financial Management** area, following on the results from the 2012 PEFA, the main focus is expected to be assisting the authorities to develop a revised PFM Roadmap in the context of

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

[2] See PFTAC program document, available at: www.pftac.org. The specific result in the framework that activities target is identified in italics in the section, for example cash management is referred to as (*1.6*), where 1.6 is the code in the result framework in the program document.

the Core Economic Working Group. The process will guide the need for any PFTAC support to implementation, but priorities are likely to be follow-up on accounting reform, developing implementing instructions for a PFM law approved in 2013, and development of systems to appropriately manage natural resource revenues (including fiscal responsibility provisions). The authorities have also requested assistance with training on Cash Basis IPSAS for provincial governments.

In the **revenue** area, the Solomon Islands receives significant revenue administration support from New Zealand Inland Revenue Department (NZID) under RAMSI TA and this assistance is expected to continue to be in place for some time. PFTAC has supported the development of natural resources administrative skills through a recent "international tax" regional workshop and is developing a more detailed program that will be carried out in 2014. It is anticipated that Solomon Islands would figure strongly in that program. The 2013 Pacific Islands Tax Administrators Association (PITAA) was held in Solomon Islands in September 2013 and a general review of Solomon Islands TA needs was carried out at that time. The authorities indicated that the development of a new revenue administration regime was under consideration and PFTAC confirmed that it would provide TA to support for this initiative. The authorities were also reminded of an existing PFTAC recommendation to implement a VAT and PFTAC re-affirmed its commitment to support Solomon Islands should it decide to adopt the recommendation.

In **financial sector supervision**, making use of PFTAC support, the CBSI has made great strides in improving its on-site supervision. As a result of extensive assistance over the past year, supervisors now have the skills and processes to effectively carry out on-site examinations of banking institutions with a lower level of technical assistance-probably with one visit a year from the PFTAC advisor for onsite examination. Additionally support has been provided in September 2013 to the CBSI as they act as the pilot for the implementation of the Reserve Bank of New Zealand's information technology system to enhance supervision. Technical advisory assistance will also be provided in strengthening the oversight of credit unions.

In **statistics**, PFTAC has recently assisted the NSO enhance national accounts by incorporating historical business survey results back to 2003 and improving the methodology for the compilation of GDP estimates by production and by expenditures. The main focus of follow-up TA will be to complement inputs by the resident statistics advisor funded by donors, with a particular focus on expanding the range of aggregates available in the national accounts and on future rebase of GDP estimates by production and by expenditures. Methodological improvements and support to further develop external sector statistics and government finance statistics are supported by HQ TA. PFTAC also supported the implementation of the recommendations made by an IMF HQ mission in 2012 to improve the methodology and data sources for the CPI.

In the **macroeconomic** area, work in previous years has focused on building macroeconomic modeling and analysis capacity in CBSI with the aim of having better inflation and external forecasts to feed into monetary policy making. In 2012, this was complemented by development of a financial programming framework involving staffs from both the Ministry of Finance and CBSI, based on the macroeconomic framework. Going forward, the task is to provide training in the effective use of this framework as well as deepen skills in macroeconomic analysis and forecasting.

RELATIONS WITH THE WORLD BANK GROUP

(As of December 2013)

1. The Bank and the Fund teams led by Mr. Robert Utz (Lead Economist, World Bank Sydney Office) and Mr. Luis Breuer (IMF Mission Chief for Solomon Islands) maintain a regular dialogue on macroeconomic and structural issues. In recent years, collaborative efforts have focused on the joint Bank-Fund Debt Sustainability Analysis and regular discussions during missions and at headquarters. Visiting IMF missions regularly meet Bank staff in their Honiara office, led by Ms. Anne Tully (World Bank Country Representative), and at headquarters.

2. The teams agree that the key priorities for Solomon Islands include consolidating the recent improvement in the country's macro-fiscal framework in the face of ongoing volatility in external conditions, improving the quality of public spending to ensure public resources support the access to basic social services, improvements in the investment climate to support business development, and ensuring state-owned enterprises can sustainably provide public services.

3. The risks to the economy, from slippages in domestic policy decisions or a deterioration in external conditions remain considerable. Ongoing efforts to strengthen Solomon Islands' economic management and reinforce protective buffers are to be supported, as are efforts to improve the quality of spending.

4. The Bank and Fund teams agree that the focus has shifted to the medium-term reform agenda. Priority issues include developing a more coordinated and prioritized approach to weaknesses in public financial management systems and ensuring that the reforms achieved to date are sustained and become regular practice, identifying policy reform priorities for fostering inclusive growth and reducing hardship, ensuring budget allocations are better achieve the priority of improving delivery of social services, and of strengthening the climate for investments and including mining regulation. Between the Bank and the Fund, the Bank takes the lead in public expenditure management framework and structural reform issues, and the Fund will continue to take the lead on macro issues.

5. The Banks and Fund teams agree to continue close collaboration, mainly with regular contact through the Bank's Honiara and Sydney offices, the IMF regional resident representative office in Suva, and at headquarters. The Fund will also continue to collaborate with the government-donor Core Economic Working Group convened regularly in Honiara by the Ministry of Finance and Treasury with World Bank support. Appendix I provides a list of planned activities in the coming year.

Appendix 1. Solomon Islands: Bank and Fund Planned Activities, November 2013–October 2014

	Activities	Expected Delivery Date
World Bank	• Line Ministry Public Expenditure Analyses (analytic and TA) • Support for review and revision of mining sector regulatory and institutional framework (TA) • Advisory and analytical support to the Solomon Islands Statistics Office for the 2013 HIES • Supporting Solomon Islands EITI candidature (TA) • Urban land management (TA) • Health sector public financial management support (Analytic and TA) • Core Economic Working Group policy dialogue, supporting the ongoing series of Development Policy Operations • Pacific Tuna Advisory project IFC TA • Pacific Credit Bureau Phase 2 IFC TA • Pacific Investment Climate Rapid Response IFC TA • BSP Solomon Rural Banking IFC TA	FY 14 (ongoing) FY14 (ongoing) FY 14 (ongoing) FY 14 (ongoing) FY 14 (concluded) FY 14 (ongoing) FY 14 (ongoing) FY 14 (pipeline) FY 14 (ongoing) FY 14 (pipeline) FY 14 (pipeline)
IMF	• Technical assistance on new resource tax regime and relevant tax legislations • Technical assistance on public finance management, including fiscal responsibility provisions • Technical assistance on financial programming framework • Technical assistance on national accounts, price, balance of payment statistics, and government finance statistics. • 2013 Article IV Consultation, Second Review of the ECF-supported program • Third Review of the ECF-supported program • Fourth Review of the ECF-supported program	2014 2014 2014 2014 October-November 2013 April 2014 October 2014

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of November 2013)

Since joining the Asian Development Bank (AsDB) in 1973, Solomon Islands has received 17 loans amounting to US$89.81 million, 9 Asian Development Fund grants amounting to US$68.80 million, and 66 technical assistance (TA) projects amounting to US$23.50 million.

The AsDB's Country Partnership Strategy (2012–16) was endorsed in March 2012. The strategy seeks to reduce poverty in line with the government's national development strategy, 2011–20, by promoting equitable private sector-led economic growth through assistance in three core areas: transport, and information and communication technology; public sector management; and energy. Private sector development, capacity development, and the promotion of good governance are thematic priorities.[1]

In line with the improvements in its public debt situation, Solomon Islands' borrowing status was changed by the AsDB from grant-only to a 50:50 mix of grants and concessionary loans, as of 1 January 2011.

Transport, and information and communication technology. Building on AsDB's Transport Sector Development Project, AsDB will continue to support a sector-wide approach to management and development of a multimodal transport system. A proposed Phase 2 of the Transport Sector Development Project will support maintenance and improvement of the national integrated transport network including land (roads and bridges), marine (wharves and ports), and aviation (airport runways and airports) in line with the implementation framework of the national transport plan. Complementary to the transport initiatives, the ongoing Solomon Islands Broadband for Development Project approved in September 2012 also helps improve rural connectivity. The submarine cable system, which will be financed by both sovereign and nonsovereign investments, will deliver good-quality, high-speed internet services at affordable prices to Solomon Islanders in both urban and rural areas.

Public sector management. Fiscal stability and a competitive business environment are essential to fostering private sector-led growth and development. In coordination with development partners and operating through the Core Economic Working Group, AsDB will continue supporting the government-led public sector management reforms with policy-based programs. The main goal of AsDB's assistance in public sector management is to improve the enabling environment for private-sector led, inclusive growth and development. In line with the Core Economic Working Group medium-term economic and financial reform program, a fourth policy-based program grant has

[1] The Country Partnership Strategy 2012–16 can be found at <http://www.adb.org/documents/solomon-islands-country-partnership-strategy-2012-2016>, and the Country Operations Business Plan 2014–16 at <http://www.adb.org/documents/solomon-islands-country-operations-business-plan-2014-2016>.

been programed for 2015. This follows AsDB's program grants approved in 2010, 2011, and 2013. AsDB will continue to provide TA to support public sector management reforms, including commercial legal reform, state-owned enterprise reform, improving access to finance, and implementation of the national development strategy, and support to the government audit functions.

Energy. Access to clean and affordable power is needed to allow producers of commodities and other goods on the outer islands to diversify production and improve livelihoods. AsDB support will complement the efforts of other partners in energy sector reform through sustainable off-grid power services. A pilot project to build small hydropower generators and increase access to modern energy services in selected growth centers is planned for 2014. A power sector development project is planned for 2016, with a preparatory TA project in 2015.

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

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance.
National Accounts: Recent technical assistance (TA) from the Pacific Financial Technical Assistance Center has led to improvements in national accounts at constant and current prices. GDP estimates through 2012 on the production side and the expenditure side were released in October 2013. While limited data on employment can be obtained from the National Provident Fund, wage data are not compiled.
Price statistics: A monthly consumer price index (CPI) is produced with a short lag (about a month), but covers only the capital Honiara. The weights of this index were revised in 2007, based on the results of the 2005–06 Household Income and Expenditure Survey. The authorities plan to compile a nationwide CPI, and have already compiled a list of goods to be contained in the basket. However, the timing of actual compilation is unclear due to lack of funds. TA has been provided on the development of an import price index but, due to resource constraints, there has been little progress in implementation. A PFTAC mission reviewed CPI in January 2012, and the recommendations still need to be implemented. The development of a core inflation index has been largely completed and estimates should be released soon.
Government finance statistics: Monthly fiscal data for the central government are published by the Ministry of Finance and Treasury (MOFT). The authorities have started collecting disbursement information on donors' grants, including those nonappropriated in the budget. Monthly public debt data are published, and the quality debt data has improved through better coordination between the MOFT and the Central Bank of Solomon Islands (CBSI).
Monetary and financial statistics: The CBSI publishes monthly monetary and financial statistics (MFS) in summary form and reports data for the central bank, other depository corporations and other financial corporations to the IMF's Statistics Department using the standardized report forms (SRFs). An integrated monetary database meeting the monetary data needs of the CBSI, APD and STA is in operation. Financial soundness indicators are reported quarterly.
External Sector Statistics: The CBSI has been compiling quarterly balance of payment statistics (BPS) using its own survey since 2006. Compared to the previous method, which was based on foreign exchange transactions reported through the banking system, the newly compiled BPS has improved both coverage and data accuracy. However, these quarterly data have not yet been reported to the IMF's Statistics Department. Solomon Islands has been one of the beneficiaries of the Japan Administered Account (JSA) Project on the improvement of external sector statistics. A TA mission under this project was conducted in 2013, with more missions planned.

II. Data Standards and Quality	
Solomon Islands has participated in the General Data Dissemination System (GDDS) starting in 2011.	No data ROSC available.

III. Reporting to STA (Optional)
No data are currently reported to STA for publication in the *Government Finance Statistics.*

TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of November, 2013)

	Date of latest observation	Date received	Frequency of Data/7	Frequency of Reporting/7	Frequency of Publication/7
Exchange Rates	Oct-13	Nov-13	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities/1	Oct-13	Nov-13	M	M	M
Reserve/Base Money	Sep-13	Nov-13	M	M	M
Broad Money	Sep-13	Nov-13	M	M	M
Central Bank Balance Sheet	Sep-13	Nov-13	M	M	M
Consolidated Balance Sheet of the Banking System	Sep-13	Nov-13	M	M	M
Interest Rates/2	Sep-13	Nov-13	M	M	M
Consumer Price Index	Sep-13	Nov-13	M	M	M
Revenue, Expenditure, Balance and Composition of Financing/3 – General Government/4	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing/3– Central Government	Sep-13	Nov-13	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt/5	Aug-13	Sep-13	M	M	M
External Current Account Balance	Jun-13	Aug-13	Q	Q	Q
Exports and Imports of Goods and Services	Jun-13	Aug-13	Q	Q	Q
GDP/GNP (GDP production)	2009 (Production 2011)	2010 (Production 2012)	A	A	A
Gross External Debt	Dec-12	Apr-13	Q	Q	Q
International Investment Position/6	NA	NA	NA	NA	NA

1/ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

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

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

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

5/ Including currency and maturity composition.

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

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

MAIN WEBSITES OF DATA

Central Bank of Solomon Islands (www.cbsi.com.sb)

Central bank survey
Depository corporation survey
Financial corporation survey
Monetary aggregates
Treasury bills and Bokolo bills
Exchange rates
Interest rates
Balance of payments
Government budget accounts
Public domestic and external debt
Export and imports

National Statistics Office (www.spc.int/prism/country/sb/stats/Index.htm) and Ministry of Finance (www.mof.gov.sb)

Budget documents
Medium-term fiscal strategy
Central government revenue and expenditure
Central government cash balance
National accounts
Consumer price statistics
Exports and imports

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

December 16, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERION—DEBT SUSTAINABILITY ANALYSIS[1]

Approved By
Asia and Pacific Department, IMF

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

The Solomon Islands continues to face a moderate risk of external debt distress owing to possible shocks to non-debt-creating flows and financing terms. Containing the risk of debt distress will require continued efforts to maintain fiscal buffers, strengthen the budget process to improve fiscal discipline and the quality of spending, and implement structural reforms that are essential for promoting broad-based growth.

[1] This DSA update was prepared in the context of the second review of the ECF arrangements that took place in October 2013. It updates the last full joint Bank-Fund DSA conducted in November 2012 (SM/12/333). A post-mortem of the November 2012 DSA is not included given that the medium and long term assumptions and conclusions remain broadly unchanged. The DSA update is based on the common standard LIC DSA framework. Under the Country Policy and Institutional Assessment (CPIA), the Solomon Islands is rated a weak performer, and the DSA uses the indicative threshold indicators on the external public debt for countries in this category: 30 percent for the present value (PV) of debt-to-GDP ratio; 100 percent for the PV of the debt-to-export ratio; 200 percent for the PV of the debt-to-revenue ratio; 15 percent for the debt-service-to-exports ratio; and 18 percent for the debt-service-to-revenue ratio. The Solomon Islands' fiscal year begins on January 1.

ASSUMPTIONS AND RECENT DEBT DEVELOPMENTS

1. **Context.** As described in the 2012 DSA, fiscal buffers have been rebuilt in the Solomon Islands in recent years. Total public debt fell to about 17½ percent of GDP at the end of 2012 from some 60 percent in 2005 under the framework of the Honiara Club Agreement (HCA). The Debt Management Strategy (DMS) endorsed by Cabinet in 2012 provides a framework to anchor borrowing plans going forward.

2. **Assumptions.** Key macroeconomic assumptions were revised in the context of the second review of the Solomon Islands' ECF, taking into account developments through mid-2013. The scaling-down of the operations of the Regional Assistance Mission to Solomon Islands (RAMSI) at the end of 2012 and the revision in the Gold Ridge gold mine capacity result in a further deterioration in the trade and current account balance in the medium term. The discount rate used to calculate the net present value (NPV) of the external debt was changed from three to five percent (SM/13/271).[2] Box 1 summarizes the key assumptions.

Box 1. Macroeconomic Assumptions under the Baseline Scenario

- **GDP growth and inflation.** After rebounding to nearly 11 percent in 2011, growth has slowed and is projected to moderate to 3½ percent over the medium and long term. GDP deflator growth is likely to decline from recent rates but remain near historical levels at 5½ percent.
- **Logging and mining.** Log production is expected to decline by about 7 percent each year until 2025 after which it will remain stable. With the transfer of Gold Ridge ownership, gold production has been revised downwards to 64,000 ounces in 2013 and maximum capacity to 76,000 ounces.
- **Aid flows and FDI**. Aid flows declined in 2012 with the scaling-down of the operations of the Regional Assistance Mission to Solomon Islands (RAMSI).There was also a number of major capital projects completed by donors in 2012, skewing the allocation between current and capital account donor transfers. The ratio is projected to return to historical norm going forward. As a result, aid flows are expected to average about 15 percent over the medium term and 9 percent over the long term. FDI is projected at about 8 percent over the medium term and 6 percent over the longer term, with resumption in external borrowing making up the difference in financing the current account deficit.
- **External borrowing.** New loan disbursements are expected to begin in 2014 to finance the undersea fiber optic cable. Concessional borrowing is projected to average about 2½ percent of GDP annually over the next five years and 3½ percent over the longer term.
- **Fiscal outlook.** The primary balance is expected to generate a deficit of about 1 percent of GDP in the

[2] IMF Staff Paper on 'Unification of Discount Rates Used In External Debt Analysis for Low-Income Countries', 4 October, 2013. The system of discount rates was complex, with different discount rates applying to different currencies, linked to market interest rates in different ways and updated with varying frequencies. Further, the methodology for determining the discount rate produced an unwarranted tightening of assessed borrowing space available to LICs in recent years, especially following the easing in monetary conditions since 2009. The discount rate fell by 2 percentage points between 2009 and 2013, to 3 percent, pushing up the estimated present value of LIC debt and reducing the assessed borrowing space available to LICs. A uniform discount rate, used for both present value and grant element calculations in the Debt Sustainability Analysis addresses the unnecessary complexity and is consistent with the convergence of long-term interest rates across major economies. Resetting the discount rate set to 5 percent broadly aligns it with the discount rate currently used for calculating the grant element of long-term U.S. dollar-denominated loans.

medium and long term. This shift is attributable to the projected fall in grants, and logging and mining revenues while additional external borrowing would only partially substitute for previously grant-funded development expenditure. Revenue (excluding grants) is forecast at about 27 percent of GDP over the longer term.

- **The non-interest current account deficit** is projected to increase to about 12½ percent in the next two years reflecting a number of import intensive projects in the pipeline (the undersea cable, Soltuna and USP campus expansions). The higher deficit over the medium term reflects the major downward revision in gold mine capacity.

External debt. Despite the amendment of the Honiara Club Agreement (HCA) to allow for external borrowing to resume, the Solomon Islands government has not contracted new external debt in 2013 due to delays in the start of the undersea cable project. The gross external public and publicly guaranteed (PPG) debt is expected to decline to 11.3 percent of GDP by the end of 2013. Total public sector debt is expected to decline to 14½ percent.

EXTERNAL AND PUBLIC DEBT SUSTAINABILITY ANALYSIS

A. External Debt Sustainability Analysis

3. **Under the baseline scenario all external PPG debt indicators remain below the policy-relevant thresholds.** Total external debt is projected to gradually increase starting in 2014, reaching 38 percent of GDP over the longer term. Similarly, PPG external debt is projected to rise to 34½ percent of GDP. In present value (PV) terms all key indicators of sustainability – the GDP, revenue, and export ratios of PPG external debt and PPG external debt service – remain well below the indicative thresholds (Figure 1).[3]

4. **Sensitivity analysis suggests that the Solomon Islands' debt path is vulnerable to shocks to net non-debt-creating flows and financing terms (Table 1b, and Figure 1).** A shock to non-debt-creating flows lowers the net current transfers and net FDI 2014-15 to one standard deviation below the historical average.[4] Such a shock would lead the PV of PPG external debt to exports to breach the threshold during 2028-2033. A permanent shock to financing terms is defined as an interest rate that is 2 percentage points higher during 2013–33 than in the baseline. Such a shock would keep the PV of PPG external-debt-to-GDP ratio above the threshold starting in 2032 and the PV of PPG external-debt-to-exports ratio starting 2028.

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

[4] The historical (10-year) averages of foreign aid and FDI are 15 percent and 11¼ percent of GDP, respectively, while the standard deviations of these flows are 8½ percent and 10½ percent of GDP, respectively. The template does not capture the decline in imports that the shock may induce.

B. Public Debt Sustainability Analysis

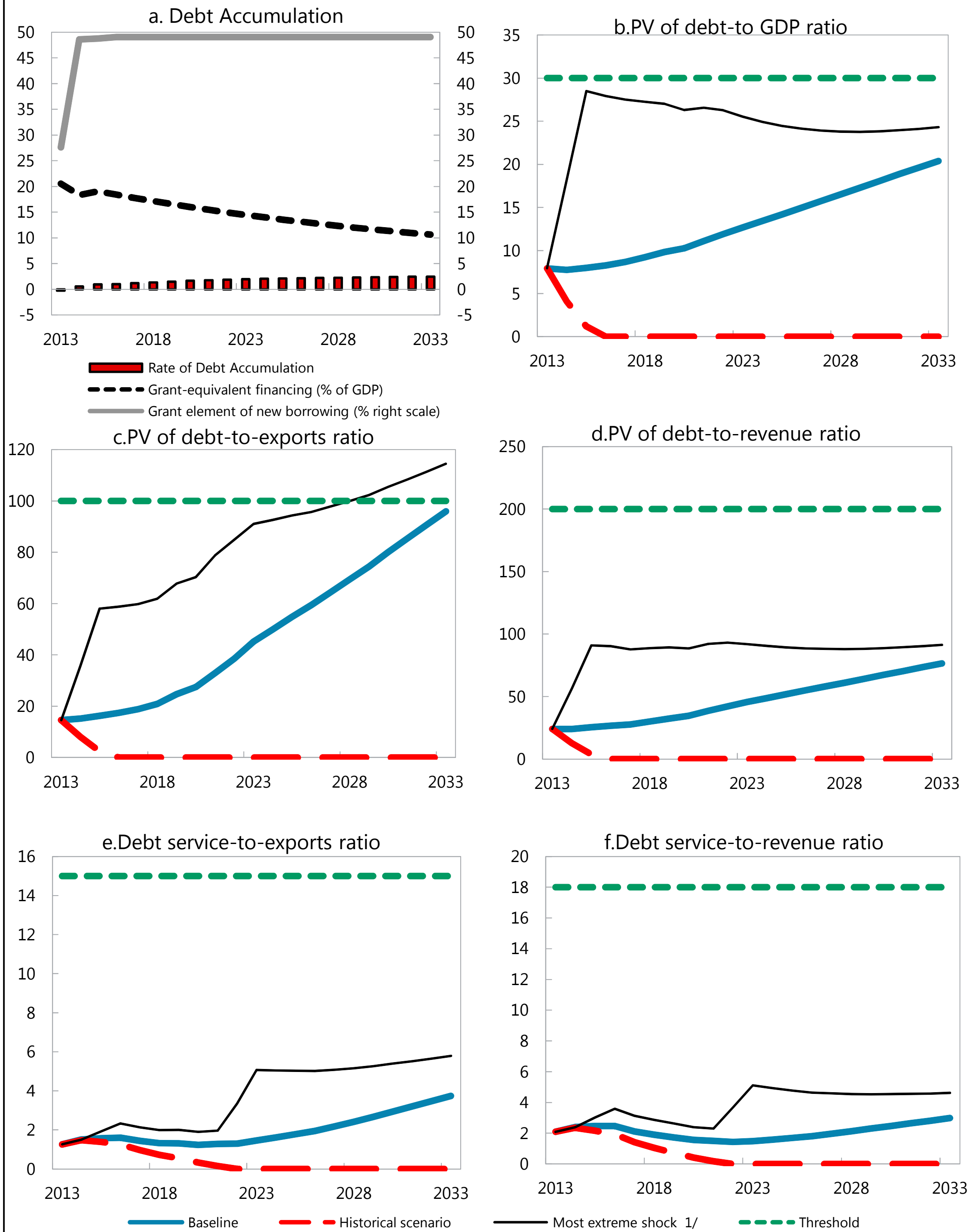
5. **Public debt analysis paints a similar picture.** Under the baseline scenario (Table 2a), the PV of total public debt will decline further to about 11 percent of GDP over the medium term. Over the longer term, it is projected to increase to about 22 percent, driven by new external borrowing after the completion of the HCA review. Public debt sustainability is vulnerable to shocks as well. Under the most extreme stress test scenario—permanently lower GDP growth—the PV of debt reaches about 30 percent of GDP by 2026 and 50 percent of GDP by 2033 (Table 2b and Figure 2).

CONCLUSIONS

6. **The Solomon Islands continues to face a moderate risk of debt distress, in line with the conclusion of the 2012 DSA**. The baseline scenario does not indicate a breach of thresholds. However, alternative scenarios and stress tests result in a significant rise in debt indicators over the projection period, nearing thresholds on PV of PPG external debt in percent of GDP and breaching the thresholds on PV of PPG external debt in percent of exports. The shock scenarios underscore the importance of caution in external borrowing and of structural reform measures to broaden the export base in a country that is heavily reliant on imports, foreign aid, and foreign direct investment.

7. **The authorities have broadly agreed with this assessment**. They are fully committed to strengthening their public finance management framework by developing the implementing regulations for the Public Finance Act (PFA). A new resource taxation regime that the authorities are working on is expected to help attract foreign investment. The authorities will further strengthen the debt management capacity by developing on-lending and guarantees instructions.

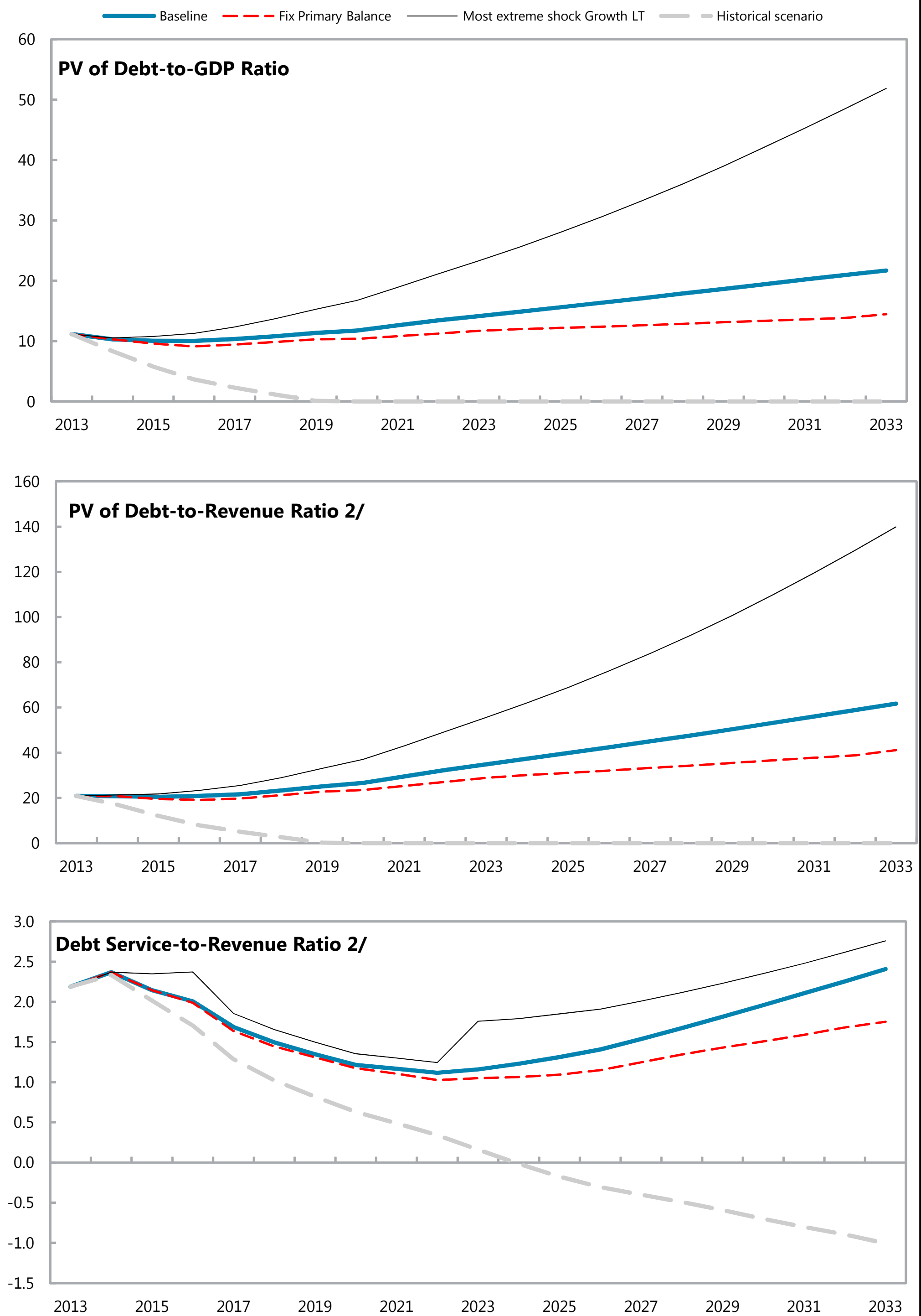
Figure 1. Solomon Islands: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2013-33 1/



Sources: Country authorities; and staff estimates and projections.

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

Figure 2. Solomon Islands: Indicators of Public Debt Under Alternative Scenarios, 2013-33 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2023.
2/ Revenues are defined inclusive of grants.

Table 1a.: External Debt Sustainability Framework, Baseline Scenario, 2010-2033 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2010	2011	2012			2013	2014	2015	2016	2017	2018	2013-2018 Average	2023	2033	2019-2033 Average
External debt (nominal) 1/	**31.9**	**25.1**	**21.9**			**20.6**	**23.0**	**24.1**	**25.2**	**26.3**	**27.6**		**29.7**	**38.1**	
of which: public and publicly guaranteed (PPG)	19.8	15.2	13.0			11.4	11.5	12.4	13.4	14.5	15.7		21.9	34.4	
Change in external debt	-0.5	-6.8	-3.2			-1.3	2.4	1.1	1.1	1.1	1.3		0.6	0.9	
Identified net debt-creating flows	-7.7	-16.4	-10.1			-0.8	2.9	2.5	2.7	2.7	3.0		3.6	3.3	
Non-interest current account deficit	**30.2**	**6.1**	**-0.8**	**7.9**	**14.3**	**3.7**	**12.5**	**11.7**	**11.2**	**10.0**	**9.7**		**10.4**	**9.7**	9.8
Deficit in balance of goods and services	31.9	6.2	1.6			10.0	15.4	14.4	13.3	12.9	12.4		16.2	12.2	
Exports	48.4	64.1	63.5			54.5	50.9	49.1	47.5	46.0	44.1		28.0	21.3	
Imports	80.4	70.2	65.1			64.6	66.3	63.5	60.7	58.9	56.5		44.3	33.5	
Net current transfers (negative = inflow)	-26.5	-20.0	-12.0	-14.9	8.4	-18.2	-17.6	-18.1	-17.5	-16.9	-16.3		-13.7	-9.7	-12.5
of which: official	-24.8	-18.9	-11.1			-15.9	-15.3	-15.8	-15.1	-14.5	-13.9		-11.4	-7.6	
Other current account flows (negative = net inflow)	24.8	19.9	9.7			11.9	14.7	15.5	15.5	13.9	13.6		7.9	7.1	
Net FDI (negative = inflow)	**-34.6**	**-16.2**	**-6.6**	**-11.3**	**10.4**	**-4.5**	**-9.3**	**-9.1**	**-8.4**	**-7.2**	**-6.5**		**-6.4**	**-5.6**	-5.7
Endogenous debt dynamics 2/	**-3.3**	**-6.2**	**-2.7**			**-0.1**	**-0.2**	**-0.1**	**-0.1**	**-0.1**	**-0.2**		**-0.4**	**-0.7**	
Contribution from nominal interest rate	0.7	0.7	0.6			0.5	0.5	0.6	0.7	0.7	0.7		0.6	0.5	
Contribution from real GDP growth	-2.2	-2.7	-1.1			-0.6	-0.8	-0.8	-0.8	-0.8	-0.9		-1.0	-1.2	
Contribution from price and exchange rate changes	-1.8	-4.2	-2.2			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**7.2**	**9.5**	**6.9**			**-0.5**	**-0.5**	**-1.4**	**-1.6**	**-1.6**	**-1.7**		**-3.0**	**-2.4**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	17.9			17.2	19.2	19.6	20.1	20.5	21.1		20.5	24.1	
In percent of exports	...	...	28.1			31.5	37.8	40.0	42.3	44.5	47.9		73.1	113.3	
PV of PPG external debt	**...**	**...**	**9.0**			**7.9**	**7.7**	**8.0**	**8.3**	**8.7**	**9.2**		**12.7**	**20.4**	
In percent of exports	**...**	**...**	**14.1**			**14.6**	**15.2**	**16.2**	**17.4**	**18.9**	**20.9**		**45.2**	**95.9**	
In percent of government revenues	**...**	**...**	**26.0**			**24.1**	**24.1**	**25.4**	**26.7**	**27.7**	**30.0**		**45.7**	**76.5**	
Debt service-to-exports ratio (in percent)	**4.7**	**2.5**	**2.4**			**2.5**	**2.8**	**3.4**	**3.5**	**3.3**	**3.2**		**3.5**	**5.1**	
PPG debt service-to-exports ratio (in percent)	**3.0**	**1.2**	**1.3**			**1.3**	**1.5**	**1.6**	**1.6**	**1.4**	**1.3**		**1.5**	**3.7**	
PPG debt service-to-revenue ratio (in percent)	**4.5**	**2.4**	**2.4**			**2.1**	**2.4**	**2.5**	**2.5**	**2.1**	**1.9**		**1.5**	**3.0**	
Total gross financing need (Billions of U.S. dollars)	0.0	-0.1	-0.1			0.0	0.1	0.1	0.1	0.1	0.1		0.1	0.3	
Non-interest current account deficit that stabilizes debt ratio	30.7	12.9	2.4			5.0	10.1	10.6	10.1	8.9	8.4		9.8	8.7	
Key macroeconomic assumptions															
Real GDP growth (in percent)	7.8	10.7	4.9	6.4	4.7	2.9	4.0	3.6	3.4	3.5	3.6	3.5	3.6	3.6	3.4
GDP deflator in US dollar terms (change in percent)	5.7	15.1	9.8	5.5	6.2	6.5	5.7	5.4	5.2	5.0	5.0	5.5	5.8	4.6	5.5
Effective interest rate (percent) 5/	2.3	2.6	2.6	2.4	0.5	2.7	2.8	3.1	3.0	2.9	2.9	2.9	2.2	1.5	2.0
Growth of exports of G&S (US dollar terms, in percent)	40.6	68.5	14.1	25.6	21.4	-5.8	2.7	5.3	5.1	5.4	4.2	2.8	-0.7	6.4	4.0
Growth of imports of G&S (US dollar terms, in percent)	59.2	11.4	6.7	25.6	26.2	8.8	12.9	4.6	4.0	5.5	4.2	6.7	4.6	6.3	5.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	27.6	48.6	48.8	49.1	49.1	49.1	45.4	49.1	49.1	49.1
Government revenues (excluding grants, in percent of GDP)	32.0	33.1	34.5			32.9	32.1	31.4	30.9	31.4	30.7		27.7	26.6	27.7
Aid flows (in Billions of US dollars) 7/	0.3	0.4	0.2			0.2	0.2	0.3	0.3	0.3	0.3		0.4	0.8	
of which: Grants	0.2	0.2	0.2			0.2	0.2	0.2	0.2	0.3	0.3		0.3	0.5	
of which: Concessional loans	0.1	0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.1	0.3	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			20.5	18.3	19.1	18.4	17.8	17.1		14.5	10.6	13.3
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			99.9	95.1	93.6	93.3	92.8	92.3		89.7	83.1	87.7
Memorandum items:															
Nominal GDP (Billions of US dollars)	0.7	0.9	1.0			1.1	1.2	1.3	1.4	1.6	1.7		2.7	6.3	
Nominal dollar GDP growth	14.0	27.4	15.1			9.7	9.9	9.2	8.8	8.7	8.8	9.2	9.6	8.4	9.1
PV of PPG external debt (in Billions of US dollars)			0.1			0.1	0.1	0.1	0.1	0.1	0.2		0.3	1.3	
(PVt-PVt-1)/GDPt-1 (in percent)						-0.3	0.6	1.0	1.0	1.2	1.3	0.8	2.0	2.5	2.1
Gross workers' remittances (Billions of US dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	9.0			7.9	7.7	8.0	8.3	8.7	9.2		12.7	20.4	
PV of PPG external debt (in percent of exports + remittances)	...	...	14.1			14.6	15.2	16.2	17.4	18.9	20.9		45.2	95.9	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	1.3			1.3	1.5	1.6	1.6	1.4	1.3		1.5	3.7	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that PV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 1b.Solomon Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013-33

(In percent)

	Projections											
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	**2023**	2033
PV of debt-to GDP ratio												
Baseline	8	8	8	8	9	9	10	10	11	12	**13**	20
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2013-2033 1/	8	4	1	0	0	0	0	0	0	0	0	0
A2. New public sector loans on less favorable terms in 2013-2033 2	8	8	9	10	11	12	13	14	16	17	**18**	31
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	8	8	8	9	9	10	10	11	12	12	**13**	21
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	8	7	8	8	8	9	9	10	11	12	**12**	20
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	8	8	9	9	10	10	11	12	13	13	**14**	23
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	8	18	29	28	28	27	27	26	27	26	**26**	24
B5. Combination of B1-B4 using one-half standard deviation shocks	8	11	11	11	12	12	13	13	14	15	**15**	22
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	8	11	11	12	12	13	14	14	16	17	**18**	28
PV of debt-to-exports ratio												
Baseline	15	15	16	17	19	21	25	27	33	39	**45**	96
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2013-2033 1/	15	8	2	0	0	0	0	0	0	0	0	0
A2. New public sector loans on less favorable terms in 2013-2033 2	15	16	19	21	24	28	34	38	47	55	**65**	148
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	15	15	16	17	19	21	25	27	33	39	**45**	96
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	15	14	15	16	18	20	24	26	32	37	**44**	95
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	15	15	16	17	19	21	25	27	33	39	**45**	96
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	15	36	58	59	60	62	68	70	79	85	**91**	114
B5. Combination of B1-B4 using one-half standard deviation shocks	15	18	18	19	20	22	25	27	32	36	**42**	81
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	15	15	16	17	19	21	25	27	33	39	**45**	96
PV of debt-to-revenue ratio												
Baseline	24	24	25	27	28	30	32	35	39	42	**46**	77
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2013-2033 1/	24	13	4	0	0	0	0	0	0	0	0	0
A2. New public sector loans on less favorable terms in 2013-2033 2	24	26	29	33	36	40	44	48	54	60	**66**	118
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	24	25	27	28	29	31	34	36	40	44	**48**	80
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	24	23	24	25	26	29	31	33	37	41	**45**	76
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	24	26	29	30	31	34	37	39	44	48	**52**	87
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	24	57	91	90	88	89	89	89	92	93	**92**	91
B5. Combination of B1-B4 using one-half standard deviation shocks	24	33	36	37	38	40	42	44	48	52	**55**	83
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	24	34	36	37	39	42	45	48	54	59	**64**	107

Table 1b.Solomon Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013-33 (concluded)

(In percent)

Debt service-to-exports ratio

Baseline	1	2	2	2	1	1	1	1	1	1	**1**	4
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2013-2033 1/	1	1	1	1	1	1	1	0	0	0	0	0
A2. New public sector loans on less favorable terms in 2013-2033 2	1	2	2	2	2	2	2	2	3	3	**4**	8
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	1	2	2	2	1	1	1	1	1	1	**1**	4
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	1	1	2	2	1	1	1	1	1	1	**1**	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	1	2	2	2	1	1	1	1	1	1	**1**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	1	2	2	2	2	2	2	2	2	3	**5**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	1	1	1	1	1	1	1	1	1	1	**2**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	1	2	2	2	1	1	1	1	1	1	**1**	4

Debt service-to-revenue ratio

Baseline	2	2	2	2	2	2	2	2	1	1	**1**	3
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2013-2033 1/	2	2	2	2	1	1	1	0	0	0	0	0
A2. New public sector loans on less favorable terms in 2013-2033 2	2	2	3	3	2	2	3	3	3	3	**4**	6
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	2	2	3	3	2	2	2	2	2	1	**2**	3
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	2	2	2	2	2	2	2	2	1	1	**1**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	2	3	3	3	2	2	2	2	2	2	**2**	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	2	2	3	4	3	3	3	2	2	4	**5**	5
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	3	3	2	2	2	2	2	2	**2**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	2	3	3	3	3	3	2	2	2	2	**2**	4
Memorandum item:												
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	47	47	47	47	47	47	47	47	47	47	**47**	47

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 2a.Solomon Islands: Public Sector Debt Sustainability Framework, Baseline Scenario, 2010-33

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2010	2011	2012	Average 5/	Standard Deviation 5/	2013	2014	2015	2016	2017	2018	2013-18 Average	2023	2033	2019-33 Average
Public sector debt 1/	27.8	21.6	17.5			14.6	14.1	14.5	15.2	16.1	17.3		23.4	35.7	
of which: foreign-currency denominated	19.8	15.2	13.0			11.4	11.5	12.4	13.4	14.5	15.7		21.9	34.4	
Change in public sector debt	-5.4	-6.2	-4.1			-2.9	-0.6	0.5	0.6	1.0	1.1		1.2	1.2	
Identified debt-creating flows	-10.4	-15.4	-6.0			-1.8	-1.6	-0.5	-0.7	-1.4	-1.4		-1.4	-1.9	
Primary deficit	-6.7	-9.3	-4.2	-3.7	3.5	-0.5	-0.5	0.5	0.3	-0.3	-0.3	-0.1	0.3	0.4	0.7
Revenue and grants	62.6	60.3	53.7			53.5	49.6	49.2	48.0	47.8	46.5		40.6	35.2	
of which: grants	30.7	27.1	19.2			20.5	17.4	17.8	17.1	16.4	15.8		12.9	8.6	
Primary (noninterest) expenditure	56.0	51.0	49.5			53.0	49.1	49.7	48.4	47.5	46.2		40.9	35.6	
Automatic debt dynamics	-3.7	-5.9	-1.9			-1.3	-1.1	-1.0	-1.0	-1.0	-1.1		-1.7	-2.3	
Contribution from interest rate/growth differential	-2.7	-3.2	-1.3			-0.7	-0.7	-0.6	-0.6	-0.6	-0.7		-0.9	-1.4	
of which: contribution from average real interest rate	-0.3	-0.5	-0.3			-0.2	-0.1	-0.1	-0.1	-0.1	-0.1		-0.1	-0.2	
of which: contribution from real GDP growth	-2.4	-2.7	-1.0			-0.5	-0.6	-0.5	-0.5	-0.5	-0.6		-0.8	-1.2	
Contribution from real exchange rate depreciation	-1.0	-2.8	-0.6			-0.6	-0.4	-0.4	-0.4	-0.4	-0.5		...	...	
Other identified debt-creating flows	0.0	-0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	-0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	5.0	9.2	1.9			-1.1	1.1	1.0	1.3	2.4	2.5		2.6	3.1	
Other Sustainability Indicators															
PV of public sector debt	...	...	13.5			11.2	10.3	10.1	10.0	10.4	10.8		14.2	21.7	
of which: foreign-currency denominated	...	...	9.0			7.9	7.7	8.0	8.3	8.7	9.2		12.7	20.4	
of which: external	...	...	9.0			7.9	7.7	8.0	8.3	8.7	9.2		12.7	20.4	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	-4.1	-7.3	-1.8			1.2	1.2	2.0	1.9	1.0	1.1		1.3	1.5	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	25.1			20.9	20.8	20.5	20.9	21.7	23.3		34.9	61.7	
PV of public sector debt-to-revenue ratio (in percent)	...	...	39.0			33.9	32.0	32.1	32.5	33.0	35.2		51.0	81.5	
of which: external 3/	...	...	26.0			24.1	24.1	25.4	26.7	27.7	30.0		45.7	76.5	
Debt service-to-revenue and grants ratio (in percent) 4/	3.2	2.4	3.4			2.2	2.4	2.1	2.0	1.7	1.5		1.2	2.4	
Debt service-to-revenue ratio (in percent) 4/	6.3	4.3	5.3			3.6	3.7	3.4	3.1	2.6	2.3		1.7	3.2	
Primary deficit that stabilizes the debt-to-GDP ratio	-1.2	-3.1	-0.1			2.4	0.1	0.0	-0.3	-1.3	-1.4		-1.0	-0.8	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	7.8	10.7	4.9	6.4	4.7	2.9	4.0	3.6	3.4	3.5	3.6	3.5	3.6	3.6	3.4
Average nominal interest rate on forex debt (in percent)	1.2	1.1	1.1	1.4	0.5	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Average real interest rate on domestic debt (in percent)	-3.8	-6.8	-3.6	-4.0	2.4	-4.1	-3.4	-3.2	-2.9	-2.8	-2.6	-3.2	-2.2	-0.3	-1.7
Real exchange rate depreciation (in percent, + indicates depreciation)	-4.6	-15.4	-4.3	-4.0	4.6	-4.8	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	5.9	9.1	5.7	6.3	2.8	5.8	5.6	5.4	5.2	5.0	5.0	5.3	5.8	4.6	5.5
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.0	0.0	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	27.6	48.6	48.8	49.1	49.1	49.1	45.4	49.1	49.1	...

Sources: Country authorities; and staff estimates and projections.

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

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

3/ Revenues excluding grants.

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

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

Table 2b.Solomon Islands: Sensitivity Analysis for Key Indicators of Public Debt 2013-33

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
PV of Debt-to-GDP Ratio								
Baseline	11	10	10	10	10	11	14	22
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	11	8	6	4	2	1	0	0
A2. Primary balance is unchanged from 2013	11	10	10	9	9	10	12	14
A3. Permanently lower GDP growth 1/	11	11	11	11	12	14	23	52
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	11	11	12	12	13	14	20	30
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	11	10	10	10	10	11	14	22
B3. Combination of B1-B2 using one half standard deviation shocks	11	10	8	8	8	9	12	20
B4. One-time 30 percent real depreciation in 2014	11	13	12	11	11	11	12	17
B5. 10 percent of GDP increase in other debt-creating flows in 2014	11	16	15	15	15	15	17	23
PV of Debt-to-Revenue Ratio 2/								
Baseline	21	21	20	21	22	23	35	62
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	21	17	12	8	5	3	0	0
A2. Primary balance is unchanged from 2013	21	21	19	19	20	21	29	41
A3. Permanently lower GDP growth 1/	21	21	22	23	25	29	56	140
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	21	22	23	25	27	30	48	85
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	21	21	20	20	21	23	34	61
B3. Combination of B1-B2 using one half standard deviation shocks	21	19	16	17	17	19	30	58
B4. One-time 30 percent real depreciation in 2014	21	26	25	24	23	24	30	47
B5. 10 percent of GDP increase in other debt-creating flows in 2014	21	31	31	31	31	33	43	66
Debt Service-to-Revenue Ratio 2/								
Baseline	2	2	2	2	2	1	1	2
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	2	2	2	2	1	1	0	-1
A2. Primary balance is unchanged from 2013	2	2	2	2	2	1	1	2
A3. Permanently lower GDP growth 1/	2	2	2	2	2	2	2	5
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	2	2	2	2	2	2	1	3
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	2	2	2	2	2	1	1	2
B3. Combination of B1-B2 using one half standard deviation shocks	2	2	2	2	2	1	1	2
B4. One-time 30 percent real depreciation in 2014	2	3	3	3	2	2	2	4
B5. 10 percent of GDP increase in other debt-creating flows in 2014	2	2	2	2	2	2	2	3

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Press Release No. 14/19
FOR IMMEDIATE RELEASE
January 21, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with Solomon Islands

On January 8, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the 2013 Article IV Consultation with Solomon Islands.[1] On the same day, the Executive Board also completed the second review under the Extended Credit Facility (ECF) arrangement with Solomon Islands, and approved US$0.23 million disbursement (Press Release No. 14/06).

Economic growth in Solomon Islands is slowly rebounding from the slowdown of the first half of 2013, when agriculture, logging, and gold production fell, owing mainly to unfavorable weather developments, lower terms of trade, and one-off factors. Real GDP growth is projected at 2.9 percent for 2013 and 4 percent for 2014. Risks are tilted to the downside, including from lower external demand and grants. Inflation has stabilized at around 6.5 percent and is expected to fall gradually as agricultural prices react to the recovery of production.

The under-execution of development spending led to a significant budget surplus in the first six months of 2013, but fiscal risks have risen. Government revenues for the year are somewhat lower than expected owing to slower economic growth and weather shocks. Spending overruns on selected program, including on tertiary scholarships, combined with the increase in constituency development spending, are putting significant pressure on the budget.

The financial system is sound, although deepening financial markets remains an important development challenge. Banks are adequately capitalized, highly liquid, and profitable. Bank credit continues to recover after the sluggish pace recorded over the last few years. Excess reserves in the banking system have declined from last year's level but remain substantial.

The current account balance is expected to deteriorate this year, due to lower exports and higher imports—the latter on account of higher foreign direct investment—although net

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

international reserves are expected to hold up at close to current levels. The Solomon Islands dollar was broadly stable against the U.S. dollar during the year, but fluctuations against the Australian dollar were considerably more pronounced. The central bank is gaining experience with the transition to a basket peg.

The country continues to face development challenges. Infrastructure needs are large, particularly with regard to energy supply, transportation, and telecommunications. The country has achieved significant improvements in the business climate, but still ranks lower than its regional peers in some areas, such as access to electricity and ease of registering property.

Executive Board Assessment[2]

Executive Directors commended the authorities' broadly satisfactory implementation of their ECF-supported program. Economic growth is gradually recovering and inflation has stabilized since the second half of 2013. Nonetheless, the country faces significant growth and development challenges, including from diminishing donor assistance. This will require continued efforts to strengthen public finances, enhance monetary and exchange rate policies, safeguard financial stability, and address constraints to broad-based, inclusive growth.

Directors encouraged the authorities to protect policy buffers by keeping overall expenditure, including from the supplementary budget, within the original spending envelope, while addressing priority social and development needs. They stressed the importance of strengthening the quality and efficiency of public spending and the transparency and accountability of constituency funds and tertiary scholarship awards. Directors commended the approval of the Public Finance Management Act. They looked forward to its implementation, and further efforts to enact remaining tax reforms and to improve debt management.

Directors endorsed the current monetary policy stance. They welcomed the central bank's efforts to strengthen monetary policy instruments and readiness to mop up liquidity if inflationary pressures arise. Directors agreed that the basket peg remains appropriate. They saw merit in widening the operational band against the U.S. dollar to track the currency basket more closely. They also highlighted the importance of boosting productivity to prevent real exchange rate misalignment.

Directors noted that the financial sector is sound. They supported the authorities' pursuit of financial sector reform, including plans to strengthen the legal and oversight frameworks of the financial sector and improve access to financial services.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors underscored the need for new sources of growth as logging activities decline, and the importance of fostering private sector growth. They urged the authorities to prioritize investments to ensure reliable access to power, telecommunications, and transportation, and to promote a transparent tax regime and clear land-use rights. They noted that the right balance of spending on all levels of education will help meet the economy’s skills needs.

Solomon Islands: Selected Economic Indicators, 2010–14

	2010	2011	2012	2013		2014
			Est.	Prog. (EBS/13/81)	Rev. Proj.	Proj.
Growth and prices (percentage change)						
Real GDP	7.8	10.7	4.9	4.0	2.9	4.0
Of which: nontimber, nonmining	5.4	7.3	3.5	5.5	4.1	5.0
CPI (period average)	0.9	7.4	5.9	6.0	6.1	5.9
GDP deflator	5.9	9.1	5.7	6.3	5.8	5.6
Nominal GDP (in SI$ millions)	5,497	6,637	7,355	8,099	8,006	8,800
Of which: nonmining nominal GDP (in SI$ millions)	5,392	6,277	6,752	7,599	7,517	8,296
Per capita GDP (in US$)	1,295	1,614	1,819	1,901	1,950	2,096
Per capita GNI (in US$)	965	1,283	1,633	1,689	1,709	1,776
Central government operations (percent of GDP)						
Total revenue and grants	62.6	60.3	53.7	53.3	53.5	49.6
Revenue	32.0	33.1	34.5	33.5	32.9	32.1
Grants	30.7	27.1	19.2	19.9	20.5	17.4
Total expenditure	56.4	51.2	49.8	52.6	53.2	49.3
Recurrent expenditure	28.2	25.6	28.4	28.2	30.4	28.5
Development expenditure	27.9	25.5	21.3	24.4	22.7	20.8
Unrecorded expenditure 1/	0.3	0.1	0.0	0.0	0.0	0.0
Overall balance	6.2	9.0	3.9	0.8	0.3	0.3
Foreign financing (net)	-1.2	-0.7	-1.2	-0.6	-0.6	1.1
Domestic financing (net)	-5.1	-8.4	-2.7	-0.2	0.3	-1.4
Privatization receipts	0.0	0.1	0.0	0.0	0.0	0.0
Central government debt (percent of GDP, unless otherwise indicated) 2/	27.8	21.6	17.5	14.6	14.6	14.1
Domestic debt	8.1	6.4	4.5	3.1	3.2	2.5
External debt	19.8	15.2	13.0	11.5	11.4	11.5
(In US$ millions, end of period)	134.7	137.0	130.4	124.7	124.7	138.7
Monetary and credit (percentage change, end-year data)						
Credit to private sector	-4.7	4.7	4.1	8.2	16.0	16.0
Broad money	13.5	25.5	17.3	15.2	14.5	7.4
Reserve money	75.3	32.8	22.0	14.5	2.8	6.7
Interest rate - deposit (percent per annum)	2.6	1.4	0.9	...	...	...
Interest rate - lending (percent per annum)	13.5	11.5	11.2	...	...	...
Balance of payments (in US$ millions, unless otherwise indicated)						
Current account balance	-210.1	-58.5	2.2	-21.8	-46.2	-156.8
(Percent of GDP)	-30.8	-6.7	0.2	-2.0	-4.2	-13.0
(excluding mining-related capital imports, in percent of GDP)	-12.6	0.8	4.3	1.8	-0.5	-9.9
Exports of goods and nonfactor services (GNFS)	330.2	556.6	635.2	641.8	598.0	614.0
(Percentage change)	40.6	68.5	14.1	0.4	-5.8	2.7
Logging exports	124.7	191.4	219.2	225.9	199.9	183.9
Imports of GNFS	547.8	610.0	650.8	707.7	708.2	799.3
(Percentage change)	59.2	11.4	6.7	8.9	8.8	12.9
Foreign direct investment	235.6	140.8	65.7	27.3	49.0	112.4
(Percent of GDP)	34.6	16.2	6.6	2.5	4.5	9.3
Overall balance	119.8	146.4	87.3	51.0	20.0	8.9
Gross official reserves (in US$ millions, end of period) 3/	265.8	412.3	499.6	551.1	520.0	527.8
(In months of next year's imports of GNFS)	5.2	7.6	8.5	8.4	7.8	7.6
(In months of next year's nonmining-related imports of GNFS)	5.9	8.1	9.0	8.9	8.2	8.0
Exchange rate (SI$/US$, end of period)	8.1	7.4	7.3	...	...	...
Real effective exchange rate (end of period, 2005 = 100)	108.6	125.0	127.6	...	...	...
Nominal effective exchange rate (end of period, 2005 = 100)	81.1	87.6	86.7	...	...	...

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

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

2/ Includes disbursements under an IMF-supported arrangement.

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

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 14/06
FOR IMMEDIATE RELEASE
January 8, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review Under the Extended Credit Facility Arrangement for Solomon Islands

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Solomon Islands' economic performance under the Extended Credit Facility (ECF) arrangement. The Executive Board also approved a request for modification of the end-December 2013 performance criterion on net credit to the government.

Completion of the second review enables Solomon Islands to draw an amount equivalent to SDR 0.149 million (about US$0.23 million) immediately, bringing total disbursements under the arrangement to an amount equivalent to SDR 0.446 million (about US$ 0.68 million).

The three-year ECF arrangement was approved on December 7, 2012, in an amount equivalent to 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:

"The Solomon Islands authorities are to be commended for the broadly satisfactory implementation of their economic and financial program supported under the ECF.. Sound policies helped the economy deal with adverse shocks in the first half of 2013. However, the scaling down of development assistance by donors and downside external risks pose significant challenges. It will be important to strengthen public finances, enhance monetary and exchange rate policy, safeguard financial stability, and bolster the sources of growth."

"Policy buffers should be protected by keeping overall public expenditure, including from the supplementary budget, within the original spending envelope. The quality of public spending should be improved through greater transparency and accountability and by implementing the newly-approved Public Finance Management Act. Remaining fiscal reforms should be completed, including adoption of a new mining tax regime and a new customs and excise law."

"The central bank should continue to strengthen its monetary policy instruments and stand ready to mop up liquidity should inflationary pressures arise. The basket peg remains appropriate. Widening the operational band against the U.S. dollar would help reap the full benefit of the peg."

"Banks remain adequately capitalized and profitable. The authorities' efforts to strengthen the legal and oversight frameworks of the financial system should be continued."

"Diversification will be crucial for sustained and inclusive growth. Critical infrastructure bottlenecks in power, telecommunications, and transportation should be addressed. A clear and transparent tax regime and improved access to finance will also facilitate private sector growth."

Statement by Mr. Jong-won Yoon, Executive Director and Ms. Vicki Plater, Advisor
January 8, 2014

The Solomon Islands authorities consider the ECF is valuable to promote continued macroeconomic and financial stability and build momentum for reform, and they remain firmly committed to this three-year program. The program is helping to strengthen the institutional framework to ensure enduring improvements to macroeconomic and public financial management, and to address structural issues that hold back improvements in living standards for Solomon Islanders. The ECF (and predecessor SCF arrangements) have helped strengthen donor support and the ongoing success of the program will help to build confidence with development partners.

The key challenges facing Solomon Islands (and other small Pacific Island states) – small size, remoteness, and a dispersed population; a narrow economic base; and vulnerability to natural disasters and external shocks – cannot be easily overcome. The past six months has, however, seen the significant milestone of the withdrawal of the military component of the Regional Assistance Mission to Solomon Islands (RAMSI), part of the Solomon Islands' landscape for a decade following the period of civil conflict known as the "ethnic tensions" (1998 to 2003). RAMSI has partnered with Solomon Islands to lay the foundations for stability, security and prosperity. RAMSI's police presence will be maintained until 2017 and its remaining development work and assistance is transferring to bilateral and multilateral aid programs. The outlook more generally is that donor assistance in the future will be at lower levels than currently.

Progress under the ECF has been steady. All of the June 2013 performance criteria (PCs), indicative targets, and continuous PCs were met. There has been progress with structural reforms. Significantly, the Public Finance Management Act (PFMA) was approved by Parliament ahead of schedule in September. This critical reform provides Solomon Islands with a modern financial and legislative framework that will encourage fiscal responsibility (through a focus on sustainable levels of Government expenditure, revenue and public debt) and promote greater transparency and accountability. This will support the more efficient, effective and ethical use of public resources. Nevertheless, other structural reforms have not progressed as quickly as hoped due to capacity constraints and the attention given to advancing the PFMA. In particular, weakened staff resources in the Attorney-General's Chambers have delayed legislative reform in respect of the tax changes for mining; the revised National Provident Fund Act; and the new Customs and Excise law. The authorities are actively addressing this constraint with support from the Asian Development Bank to supplement capacity, and are giving priority to ECF program-related legislation.

Economic Developments

The economy faced several adverse shocks in the first half of 2013, including a significant terms of trade deterioration, poor weather conditions affecting agricultural production, and more subdued gold production due to the refurbishment of the Gold Ridge mine. The economy is expected to grow by 2.9 percent this year, down from around 5 percent in 2012, and lift to 4 percent growth in 2014 boosted by recovering agriculture and gold production. Inflation has stabilized in recent months and was 5.5 percent in October (3 month moving average).

As noted by staff, key short-term risks are to the downside: weaker demand from offshore markets; lower commodity prices for Solomon Island exports; higher oil prices; and the risk of lower foreign grant financing. In conjunction with the updated Debt Sustainability Analysis which shows Solomon Islands continues to face a moderate risk of external debt distress owing to possible shocks, these risks highlight the importance of continuing to strengthen economic and fiscal buffers to ward against any shocks.

Fiscal Policy

Government revenues are now projected to be around 0.5 percent of GDP lower than was projected at the time of the first review, reflecting lower growth, reduced revenue from excises on tobacco and alcohol, and weaker revenues from fishing licenses. In light of this, the authorities have requested a small modification of the PC on net credit to the government.

Several challenges have also emerged on the expenditure side, with authorizations for sizeable increases in expenditure in certain areas – most particularly tertiary scholarships.

The Solomon Islands authorities consider tertiary scholarships are vital to support the country's future development prospects and to provide opportunities for the youth. Nevertheless, the rapid increase in tertiary scholarship expenditure and emergence of arrears revealed weaknesses. The authorities are determined to ensure spending on tertiary scholarships is responsible, managed within a budget, and applies best practices in public financial management. As such, corrective action is underway with the Ministry of Education and the Ministry of Finance and Treasury working closely to improve the policies and processes related to tertiary scholarships. Revised policies will go to Cabinet for approval by the end of January so that they may come into effect for the coming school year. Recognizing the importance that basic education is not unduly crowded out, the government will also review tertiary policies in coordination with development partners to ensure an appropriate balance of spending between primary and tertiary education.

The government is committed to maintaining fiscal discipline and improving the quality of spending. The authorities have committed to manage total expenditure in 2013, including that authorized in the supplementary budget approved by Parliament in September, within the overall spending envelope approved during the first review of the ECF and thus achieve a balanced budget. The authorities are doing this through reallocating other spending and utilizing under-spends in the first half of 2013 (including in the development budget). The 2014 Budget recently passed by Parliament also targets a balanced cash budget, while protecting spending on primary education and health.

Steps are well advanced to bring greater rigor to the management of Constituency Development Funds. Implementing regulations that will give effect to the Constituency Development Funds Act have been drafted by a bipartisan committee and are being consulted widely. The regulations will introduce requirements on the management, use and reporting of funds to deliver greater accountability and transparency.

A key priority for the coming months will be to bring the new PFMA into effect. The authorities recognize that solid implementation is vital if the new fiscal framework is to truly deliver responsible fiscal management and improved quality of spending over time. A number of new program benchmarks have been established to begin to bring into effect the new requirements under the Act, including new reporting, and updating of the financial instructions.

Strengthening the debt management framework remains a priority. The authorities are committed to a prudent approach to borrowing in line with the Debt Management Strategy. With the completion of the Debt Management Strategy, the Government continues to put in place a comprehensive debt management policy framework over the last 18 months. This includes the endorsement by Cabinet of annual borrowing limits in line with the debt sustainability analysis; completion of the State Owned Enterprises Debt Policy; the incorporation of key aspects of the new Debt Management Strategy into the new Public Financial Management Act 2013; the establishment and excellent running of the Debt Management Advisory Committee; and the recent approval by Cabinet of the Guarantee and On-Lending Policy, ahead of the new ECF benchmark.

Monetary Policy and Financial Sector

The authorities are committed to efforts to further deepen financial markets and strengthen monetary policy instruments. In this context the Central Bank of Solomon Islands (CBSI) will review all its monetary policy instruments and is continuing to deepen the market for Bokolo bills through issuing additional maturities. The CBSI is alert to inflationary risks in the light of stronger credit growth, and stands ready to take action if needed to reduce liquidity.

Access to financial services remains of critical importance. The decision of the banks currently operating in Solomon Islands to no longer provide banking services to logging firms from 2014 – reflecting pressure from environmental groups in their home countries – is a concern. Nevertheless, CBSI has responded to this cautiously in order to safeguard financial stability. While two 'interim' banking licenses have now been issued (to a Malaysian and a Sri Lankan bank), these entities are not permitted to carry out banking operations until due diligence is complete and a full banking license has been issued.

Strengthening the financial supervisory and regulatory frameworks remains vital and the authorities are continuing work to revise the National Provident Fund legislation; prepare the Credit Unions Act; and to prepare a new Financial Institutions Act.

Structural Reforms

The authorities agree with staff on the need to develop new sources of growth – and thus secure employment opportunities, government revenue and foreign exchange earnings - given the long-term decline of the logging industry. Sectors that have been identified as offering potential are agriculture, tourism, fisheries and mining, with new fisheries and mining investments currently being explored.

Investment in critical infrastructure, particularly energy and transport, will remain vital to secure improved growth prospects. The authorities are currently finalizing a new medium-term development plan that will set out development goals for Solomon Islands and priority actions to achieve these. Furthermore, the authorities are motivated to see the functioning of the National Transport Fund (NTF) improved so that it can better support transport infrastructure development in Solomon Islands.

Conclusion

The Solomon Island authorities would like to thank IMF staff for their constructive engagement and valued technical assistance, including that provided from Headquarters and the Pacific Financial Technical Assistance Centre (PFTAC). This is playing an important role supporting Solomon Islands to strengthen its economic resilience and growth prospects, in order to deliver a higher standard of living for all Solomon Islanders.